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Free Volume Profiling education

Free Volume Profiling education

<u>Getting started with Volume Profile Analysis</u>

Introduction

My method uses a combination of Volume Profiling and Order flow analysis. I trade FUTURES only; this is because of the nature of the centralized exchanges and accurate data regarding prices and volume. Spreads are one tick and most of the markets I trade are thick enough to avoid and slippage even on news spikes. I stay away from thinner markets such as gold and crude oil.

I use 3 main charts for each market I watch: A 5-minute, a 120-minute, and a Daily. However the timeframe is <u>completely</u> irrelevant to the way I trade. I do not care about chart patterns, candlestick patterns or 'hourly closes above x level" etc.

I use no oscillators or indicators apart from 'cumulative delta', which will be covered.

1) Intraday Chart

This is a 5minute chart that I use to view the intraday action. The screenshot posted is a 'stripped down' version showing nothing but the price and a volume profile for each session. 3 sessions are included in this picture. Monday, Tuesday and Wednesday of the week starting 6th January 2014. The product is the EMini S&P 500 contract with March14 expiry.
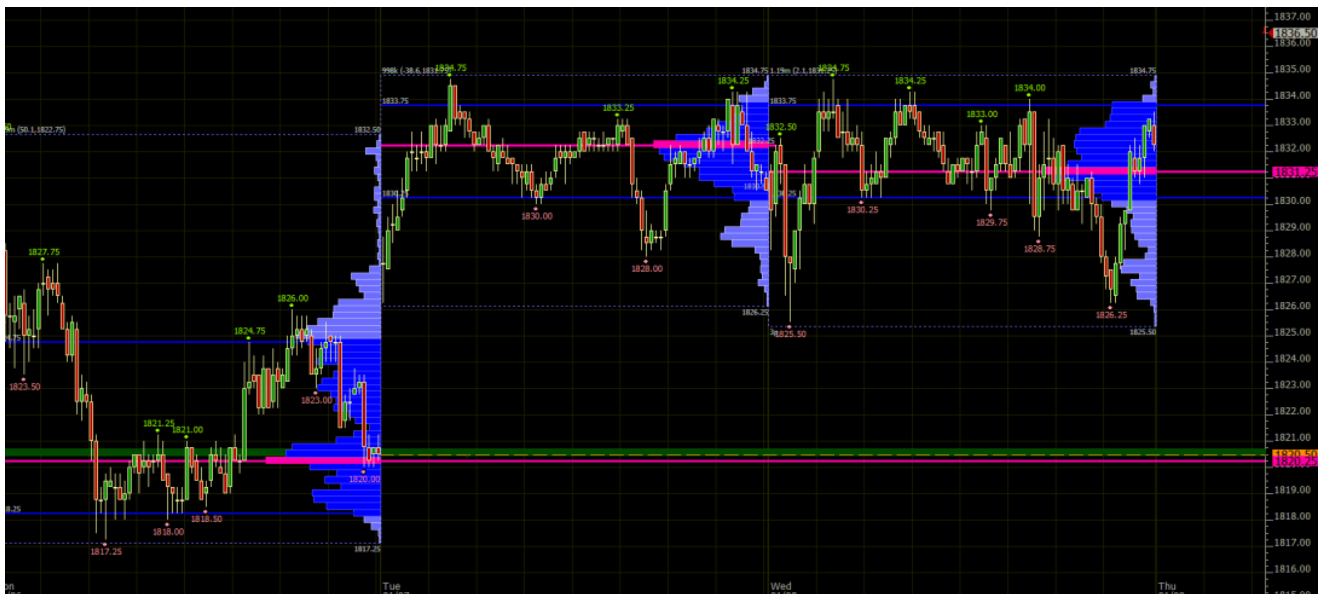
This is a good time to explain what a volume profile actually is.

Each time a trade is made between a buyer and a seller, the size of the trade gets added to the total quantity for the day. For example if I buy a 5 lot from you, the total quantity or 'TQ" increases by 5. On an average day, the TQ for the day in the S&P 500 is around 1.5 million contracts (That's a lot of commission for the CME at $2.28 per contract!).

This total volume is of course, divided up amongst every price level that traded that day. On an average, the S&P 500 trades over about 50 prices, from the high to the low of the day. However it is never the case that each price trades an equal amount of volume. There are always some prices where a lot of trading occurs (high volume prices) and some prices that trade very little volume occurs (low volume prices).

The volume profile is simply a visual representation of this. Going back to the screenshot, for each of the 3 days, you can see my charting software has drawn a profile indicating these high and low volume prices. When the profile becomes very fat/wide, it is indicated that a lot of trading occurred on those prices. Conversely the troughs in the profile represent low volume prices where very little trading occurred.

These 'nodes' in the profile that are derived by trading activity often become highly significant prices, and if's very common to see some kind of reaction when they are revisited.

The pink lines are simply highlighting the 'Volume Point of Control' or VPOC for each day. This the single price for each day where the most trading occurred (a very significant piece of information)
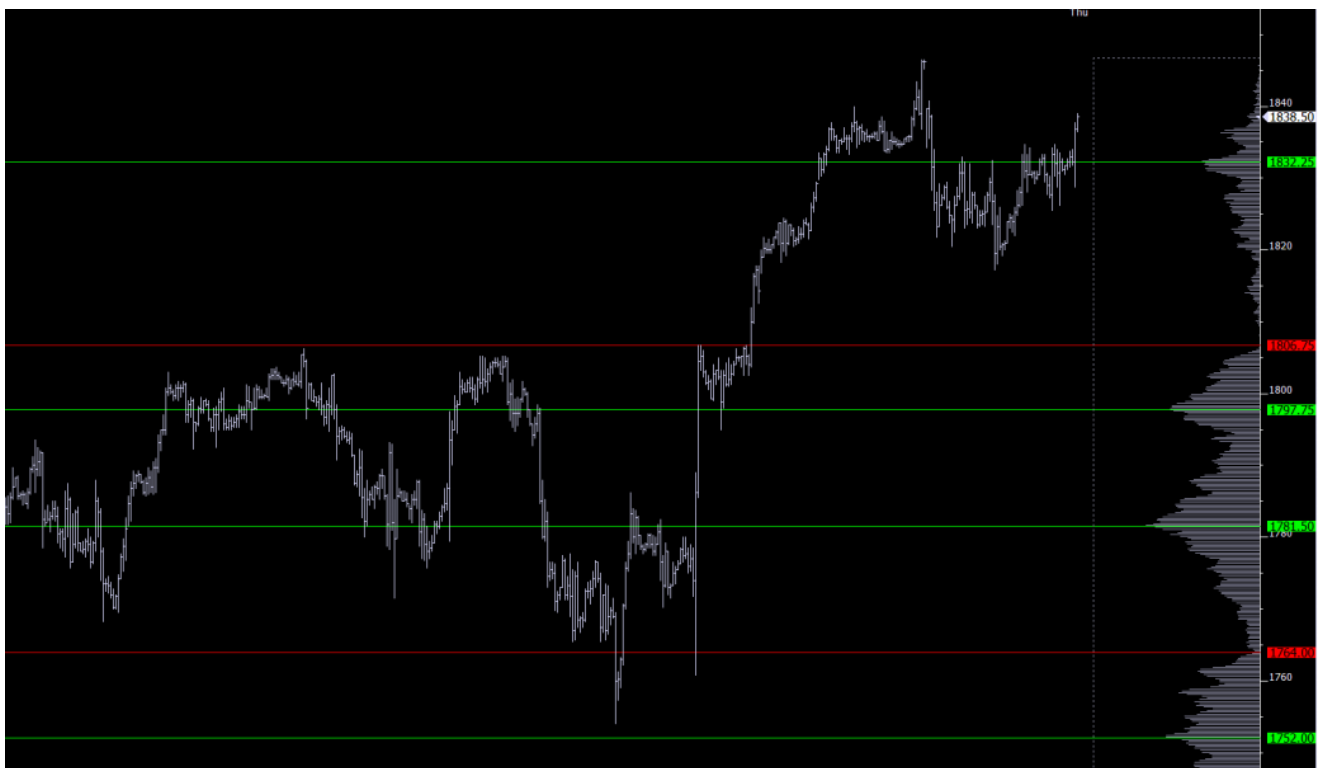
Rolling chart

The rolling chart consists of 120 minute bars. It includes only the last 120 days of data. Data from 121 days ago gets 'chopped off' every time a new day starts.

It is a very simple chart showing me a slightly more 'zoomed out' view of the market. It does not take into account individual sessions, but aggregates them all to form one big 120 day rolling session. Once again you'll see a volume profile. This time to the right of the screen.

The chart is collecting ALL the volume data from the past 120 days, and aggregating it to form one big profile. This allows me to see more longterm areas of high and low volume. The green lines are drawn on High volume nodes (HVNs) and the red lines are drawn on low volume nodes (LVNs)

Screenshot showing the rolling chart applied to the same E-Mini S&P500 contract:

Daily chart (composite)

Finally I use the composite chart. This is very similar to the Rolling chart, however in this case; each candle represents one day or session. And the data is not limited to 120 days. In fact the profile on the right hand side, is grabbing all the volume data going back to 2007. This chart highlights for me the major levels in the market. I am always aware of them and have this chart up continually. If one of these major levels aligns with something I am looking at intraday, it can be a VERY high probability trade

Once again, Green lines are showing High volume nodes where much trading has occurred, Red lines are showing Low volume Nodes where very little trading has occurred.

High Volume nodes (HVNs)

High volume nodes are created when there is a high activity of trading over a narrow range of prices, this is showing that these prices are being accepted by traders, Buyers are happy to buy, sellers are happy to sell, both are equally aggressive resulting in stable prices. We can call this an area of acceptance. You can sometimes see this in a candlestick chart as a consolidation area or 'boxing'.

Eventually something will change, This can either be a fundamental piece of news, or something as simple as one side (buyers for example) running out of bullets. If sellers continue to sell at the same pace, while buying dries up, we are going to see a shift in prices.

Imagine the Euro is trading at 1.3000 and we have created a balance zone/high volume node. There has been lots of participation at 1.3000, buyers buying from sellers, sellers selling to buyers, over and over, doing more and more volume at 1.3000.
Then imagine the buying starts to dry up, maybe a hedge fund or central bank has done all the business they need to do and go for lunch. The sellers remain aggressive. However now they find themselves in a situation where there are less bids to absorb their aggressive selling. In fact, they may hit all the bids at 1.3000 and clear out the price completely, meaning if they want to continue selling, they must start hitting the bids at 1.2999, if they are truly aggressive, they will do exactly that, then the same at 1.2998, 1.2997 and so on. We now have a situation where value is being shifted; we are leaving the 1.3000 High volume node behind.
Now imagine all the participants who were buying 1.3000 earlier, they are now offside, their team is loosing. Some of the shorter-term traders will realize this and want to get out of their longs., their efforts, along with the already aggressive sellers, means that price will start to accelerate away from 1.3000 very quickly. Prices may move sharply to 1.2980, where buyers become motivated once again by a cheaper price, and the whole balancing process starts over.

Once a clear High Volume node has been created, and price moves away. It is very likely that the node will cause a reaction in price when it is revisited.

Take this example in the GBP futures contract on the 120 minute rolling chart.
We have a period of consolidation in late December 2013, A lot of trading occurs over a small number of prices generating a high volume node at 1.6347. Sellers weaken and 'puke' their positions as buyers regain control and we see a rally up to 1.6560. We

drift lower and test the previous high volume node, and price bounces aggressively.
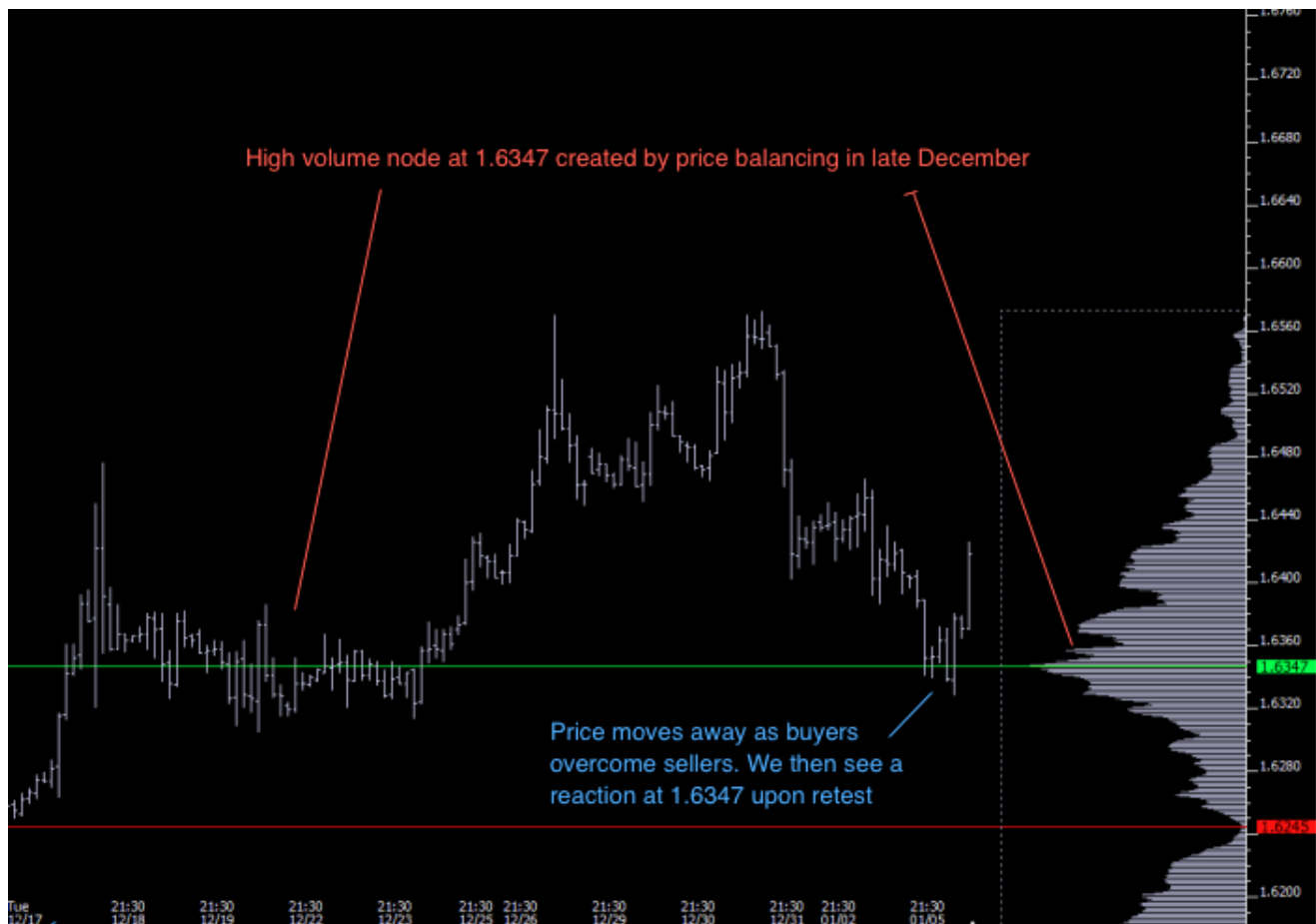
Low Volume Nodes

Low volume nodes have very different characteristics. They are generally created when participants see prices as 'unfair'. Either too expensive or too cheap. This creates a bit of a vacuum effect. Low volume nodes are often the result of a stop run or a breakout from balance.

Upon the revisit, price usually slices right through the zone, or bounces very aggressively; this makes them harder to play. However when there is a bounce, it is usually very quick and clean, allowing you to keep a tight stop and hopefully getting paid very quickly.

Take this intraday example in the German 10 year bund future this week. On Wednesday we had an interesting profile, with a clear Low Volume Node left behind at 139.83, towards the top of the profile, before price sold off to close near the lows.

On Thursday, we opened up and eventually started to drift higher again towards the Node at 139.83. The price tagged it and immediately got rejected, price sold off over 40 ticks, without going one tick against you.

With that kind of risk/reward ratio, It doesn't matter if you loose on 50% of your entries, or even 75%! You'll easily come out ahead, given a large enough sample size of trades.
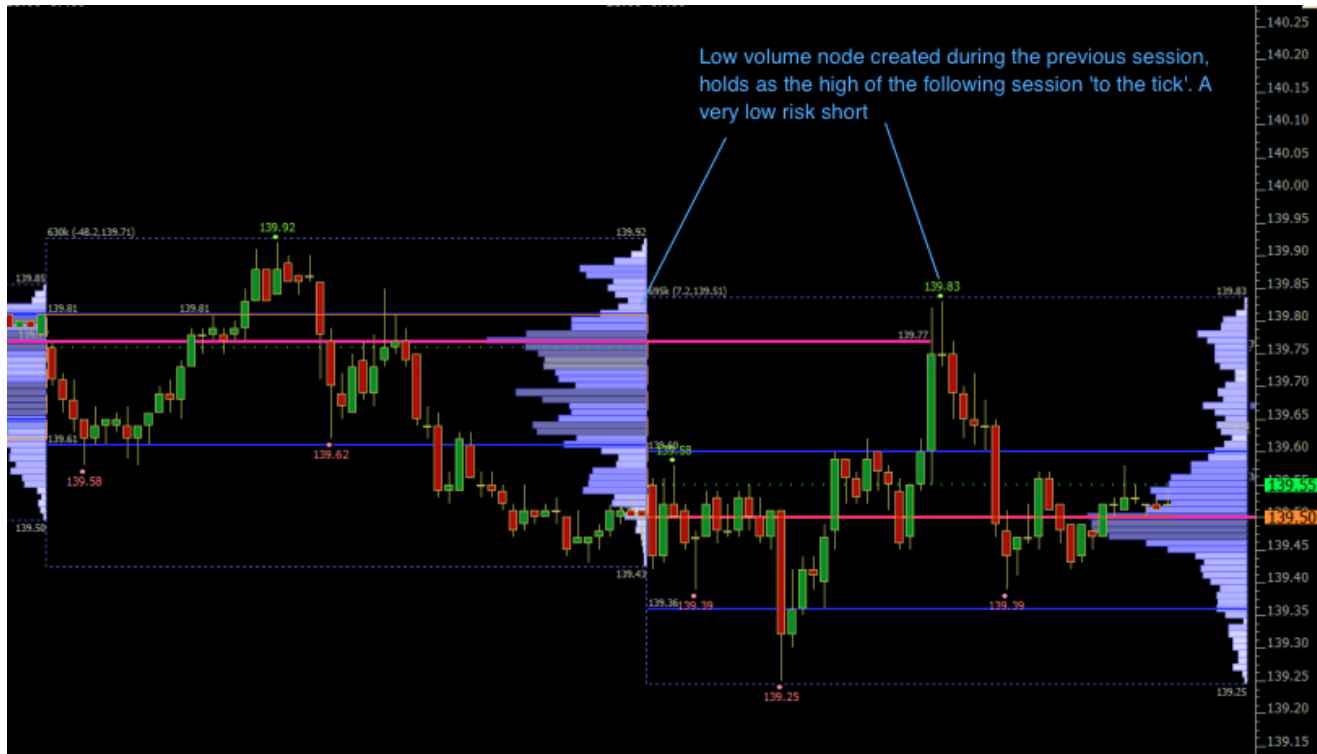
Gravitational pull of High Volume Nodes

High volume nodes tend to be magnetic to price. Price likes them and often gravitates from one to another.

Take the US 10year Note for example, rolling chart.

Price has been stuck for some time around the 123'055 level, it has tried several times to break away, both up and down, however the gravitational pull of the HVN at 123'055 has been too strong and we have always drifted back towards it.

After todays Non Farm Payrolls release however (Much weaker than expected -> positive for treasuries) There has been a sudden shift in the perception of where value is. We have clearly broken higher and left the old HVN behind.

Looking above we see another large HVN at 124'160. I feel it is very likely that we now get pulled towards that HVN, rejecting it initially, then finding ourselves stuck there until the next piece of information becomes apparent and value shifts once more.
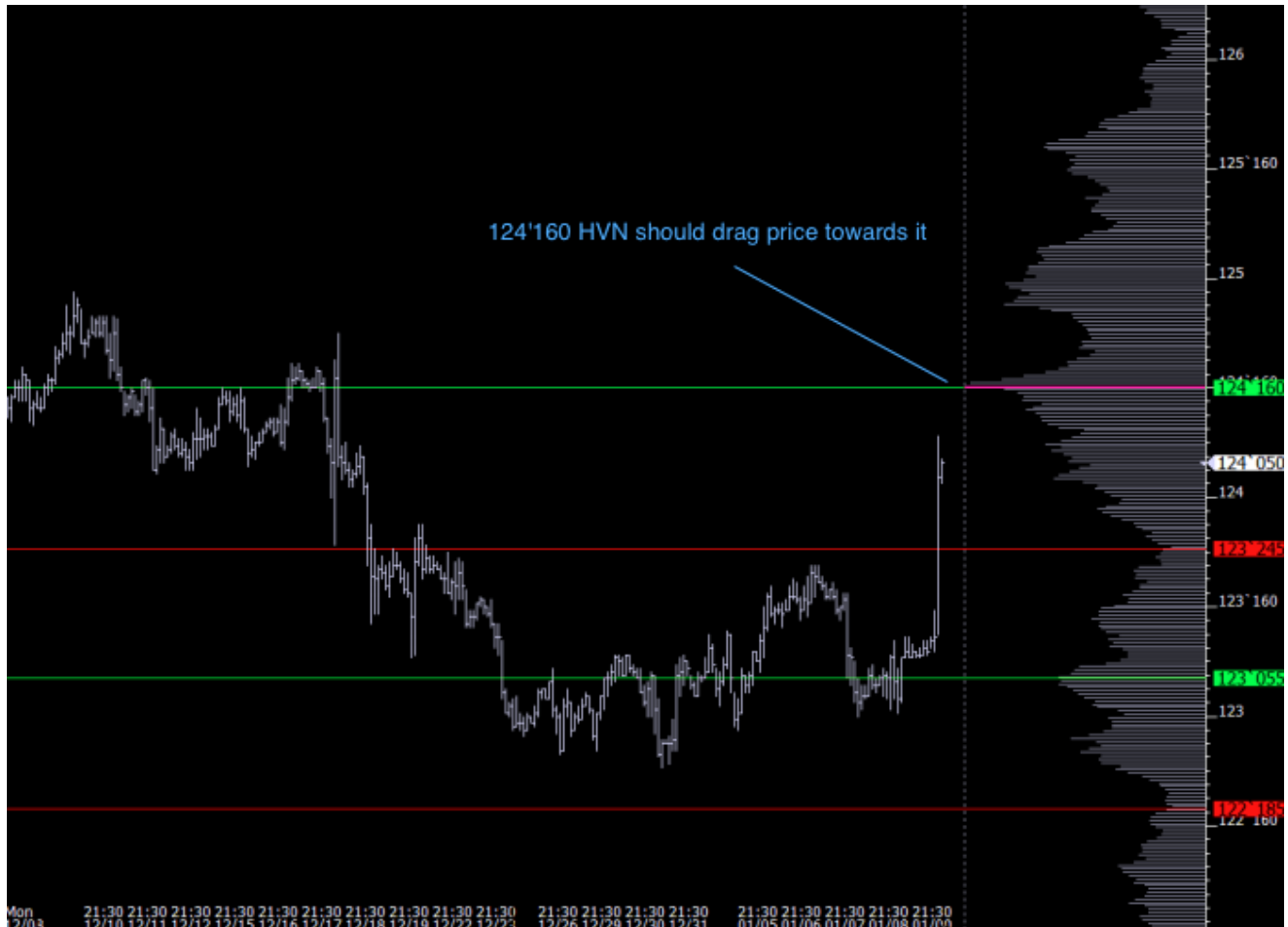
Follow up 3 days later -We did get pulled towards the 124'160 level, rejecting it initially (visible on the lower timeframes) and now chopping around that previous high volume area.

120 minute Rolling chart;
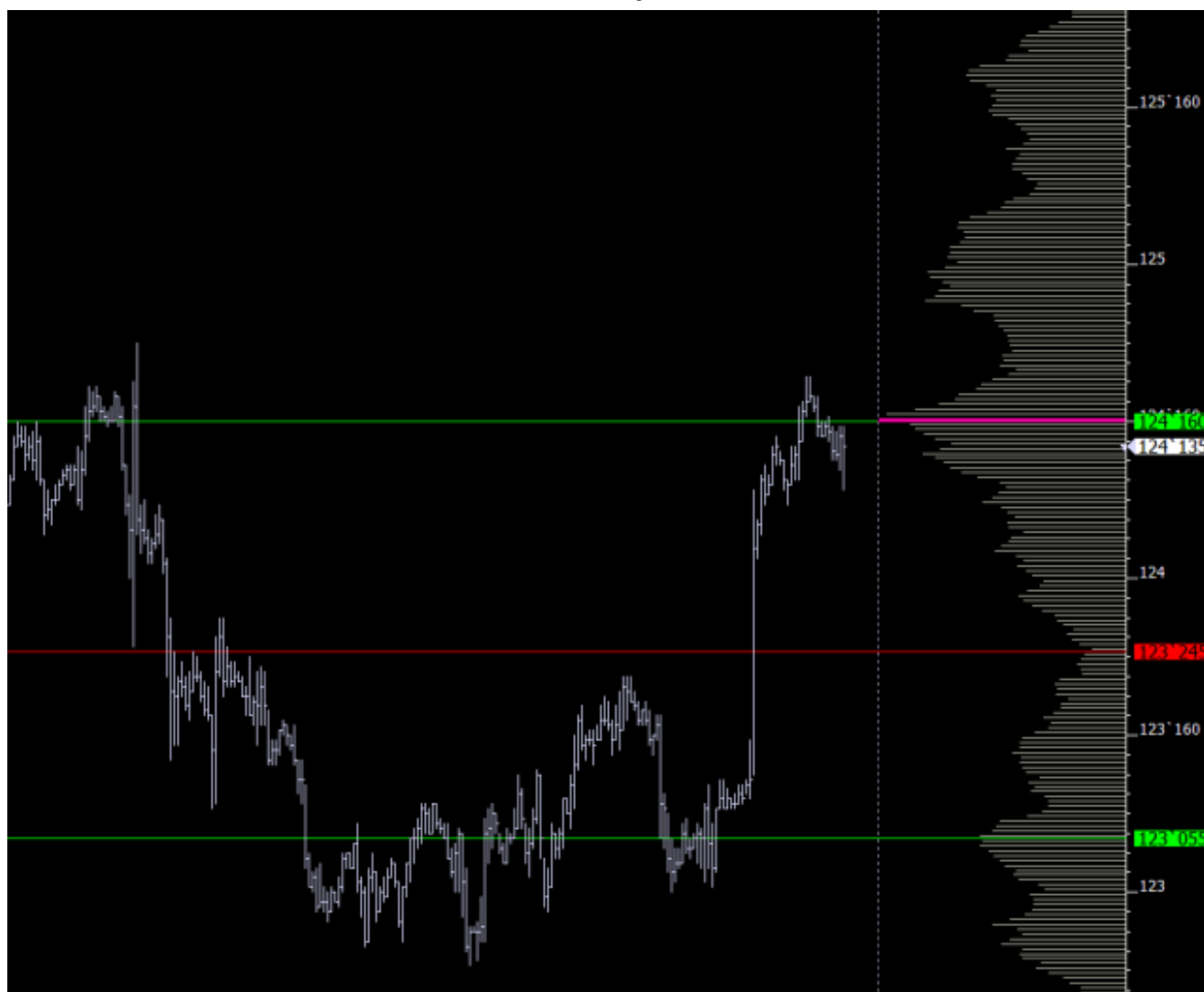
VPOCs

One of the key metrics that develops through a trading session is the Volume Point of Control, or "VPOC" This is simply the single price where the most trading has occurred, i.e. where the most contracts have changed hands. It can be identified visually as the 'fattest' part of the profile; my charting software automatically draws a pink line at VPOC.

These VPOC often provide a bounce or reaction upon revisit *especially* if there have been several days in between the formation and the revisit. Un-tested VPOCs are known at 'Naked VPOCs'. They can remain naked for months, and become very strong areas of support/resistance, when price finally finds it's way back to them.

Here's an example in the German Bund. 15-minute chart.

The VPOC forms at 141.45, and is immediately retested the next day, holding as good support to the tick, providing another low risk opportunity.

Opens, closes and gaps

Most Futures markets have a very well defined open and closing time. Any product traded on the Eurex exchange opens at 7AM GMT and closes at 9PM GMT. Between 9PM and 7AM no trading occurs. If there is a shift in value while the market is closed, the market will open the following day with a gap. The opening/closing price is a very valuable piece of information regarding the overall auction.

You have probably heard the notion that "Gaps always fill". Whilst not entirely true, there is a certain amount of logic to this. A gap represents an un-auctioned range of

prices, i.e. a range of prices where no trading occurred. If there's one thing that markets hate, it's missing information. When a gap occurs, participants have no idea what orders lie within the gap (size, quantity, level of aggression and so on), It's very common for markets to want to determine this information before any significant progress can be made in the direction of the gap. Thus, when markets open outside of the previous days range, it's a common observation to see markets auction this missing prices before continuing.

An even better piece of information is when the gap _fails_ to fill. If a market opens with a gap higher and the gap attempts to fill but fails, it can be very telling to the underlying strength of the market. In that situation you'd want to be trading far more aggressively to the long side than the short side.

Here's an example in the S&P. The 23rd of December 2013 was a Monday and the market opened higher due to some weekend news flow. We then sold off sharply in order to retest Fridays high, before continuing to push higher
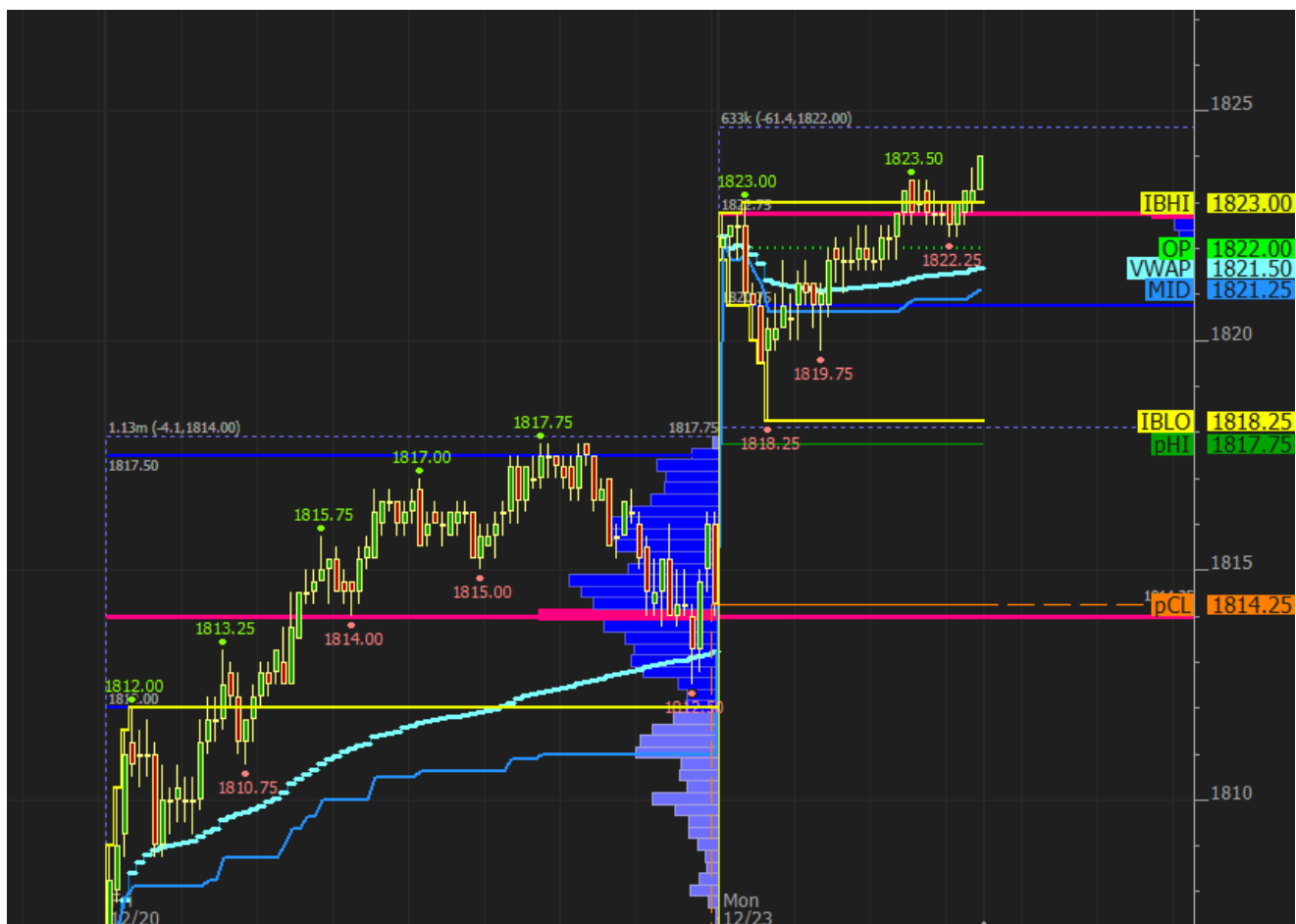
Initial Balance

Another metric traders use is the Initial Balance or "IB". The IB is the range established within the first 60 minutes of trading.There are many implications of various forms of Initial Balance, but for now I'll stick to one basic concept. Once the IB has been put in for the day, it often becomes a major support/resistance line for the remainer of the day.There is a clear example in the S&P 500 from just a few days ago, 2nd Jan 2014. The session opens and the market puts in an Initial Balance of 1828.25 to 1838.00. Eventually the IB low breaks. The session continues, price tries to rally back up into the IB, but is rejected by the IB low of 1828.25 5 times in total

Value Area

Personally I do not use the Value Area much when analyzing the market, but it is an important component of Auction Market Theory so I'm going to post about it anyway.The VA can be seen on most Volume Profile graphics. It is showing an estimation of the sessions 'acceptance region' or where prices are finding value that day. Mathematically it is the range of prices that contain 68% of the days trading

volume.The Value Area is being calculated continually as a session unfolds, it can shift up and down, expand and contract. This is the *developing* value area. Once a session has ceased trading, the VA is fixed, and we have permanent values for the VA high and low. These values are known to be significant for the market as potential support and resistance points.

Again, I don't use the VA much for my own trading, but I to take note. If a potential level I am watching lines up with an old VAH or VAL, I will treat it as confluence and have more confidence in that trade.One thing I do watch is to see if the current days value area is forming above or below the previous days. This gives me a clearer indication of the trend.This screen shot shows some examples in Crude Oil, Pit session only. The value areas are highlighted in blue
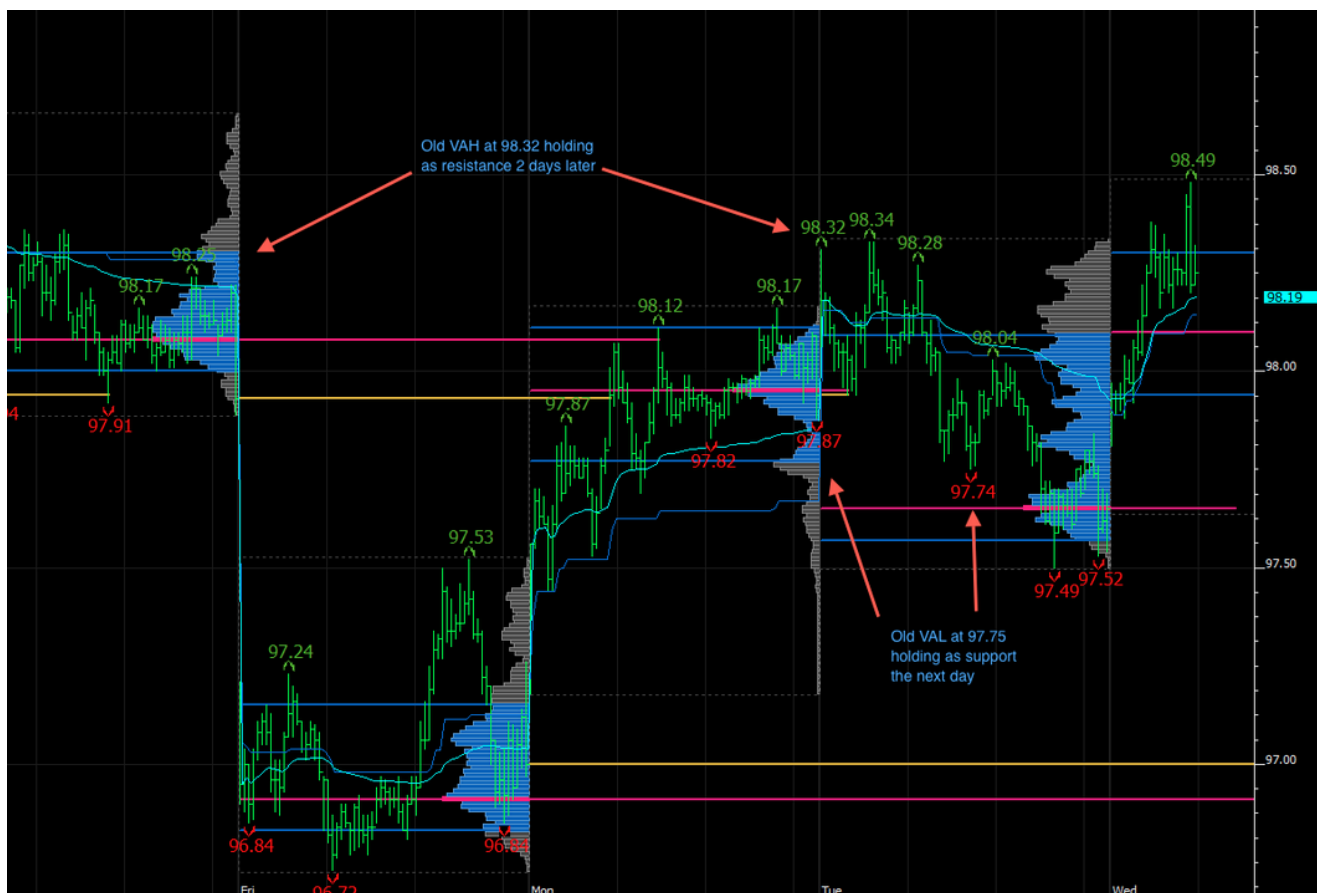
VWAP and Midpoint

There are two more tools I use in my trading:

Midpoint:

This one is self explanatory. Since the markets I watch have a defined open and close, they also have a defined high and low, and therefore midpoint. It's widely looked at,

and has become a self fulfilling support/resistance line and orders collect around it. Here's an example in todays Crude oil session. The midpoint is marked in Blue (it updates automatically and the highs/lows are extended during the session)

VWAP:

This one is a little less well known. But a very valuable tool for me. VWAP stands for "volume weighted average price" In simple terms is like a midpoint of volume and price, The line is drawn on the chart where there is a weighted amount of volume above and below it. VERY often you see price react at VWAP, even if it's just for a few ticks retracement. There are various reasons for this. Sell side traders are often judged on how they executed their block trades relative to VWAP, but that doesn't matter for us, we just have to be aware of it. I have found VWAP to be particularly effective on trend days, as price makes small countertrend moves.This is example is from Wednesday of this week in the German Bund. You can see how Price respected VWAP all session (The light blue line)

Market Depth / DOM

Back in 2011 when I was trading for my Proprietary trading firm, many of the traders on the floor did not use charts; they filled up all their trading screens with DOMS. Dom stands for "Depth of Market" This was all they needed to make their trading decisions. Not only is the Dom used to enter orders into the market, but it can be a valuable tool for reading the order flow and analyzing the strength of buyers and sellers.The DOM essentially displays 3 main metrics.1) Last traded price

2) Volume trading at that price

3) Bids resting below the market price, Offers resting above the market priceThe DOM can look very complicated and overwhelming for those who have never seen one before, especially in a fast moving market, the numbers move very quickly. I'm posting a static screenshot here first to highlight the key features:
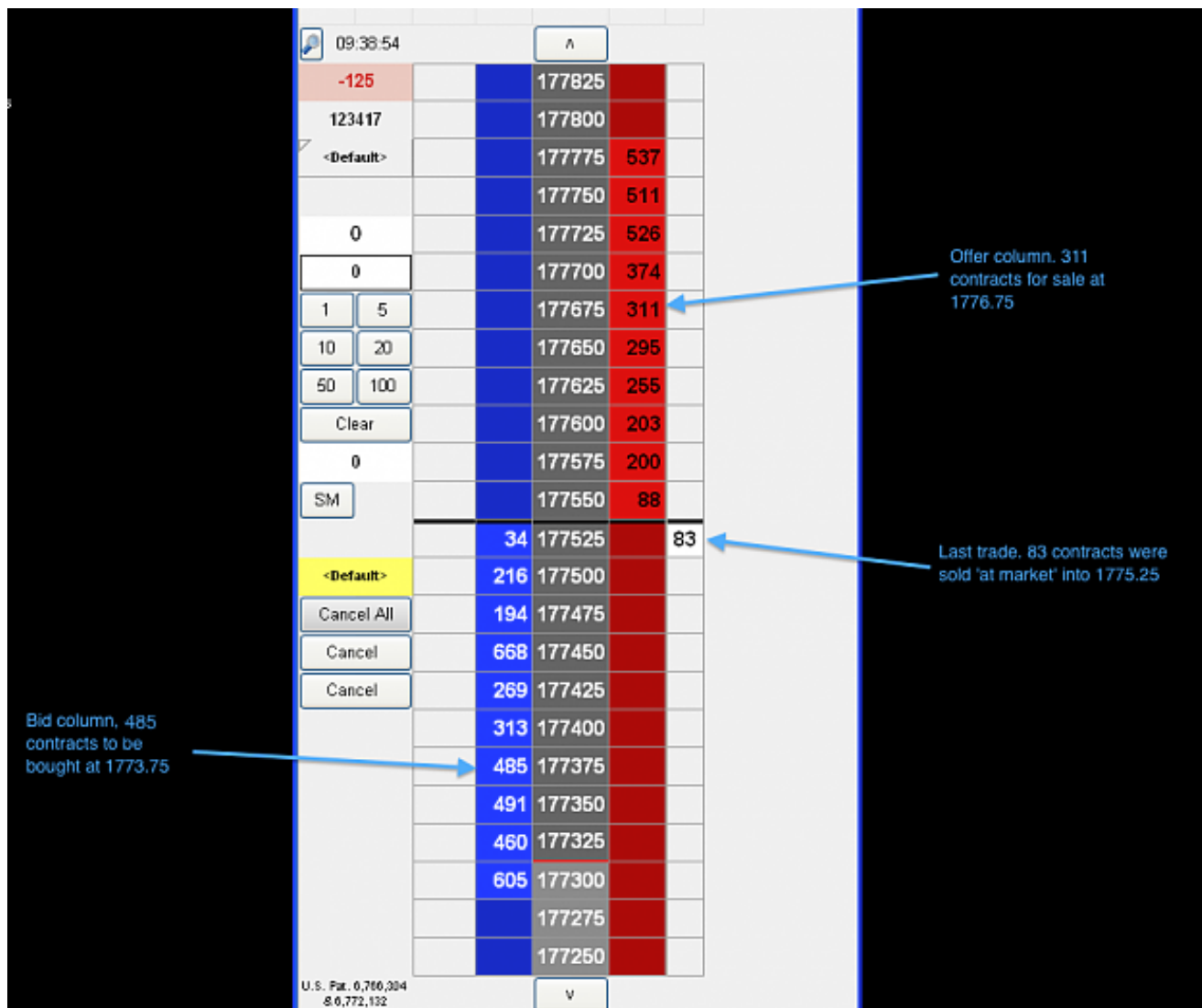
In the futures market there are no 'spreads' in the traditional sense like you would find with a retail spot FX broker. There are two ways to enter a trade. You either use a 'limit order' or a 'market order'Market Orders – To trade 'at market' means you get you in or out of a trade immediately at any cost. For Long trades you must buy from someone who is offering contracts for sale at the nearest ask price.

Pros – you get filled instantly meaning you will never miss a trade

Cons – you have to pay the bid or ask price, which essentially means giving up a tickLimit Orders – Limit Orders come in two forms, bids and offers. If you want to enter a long trade, you will 'work a bid' order at the price you want to be filled at, this can be anything from the last traded price or lower. To enter a short trade you must 'work an offer' at or above the last traded price. Placing the order will not get you into the market on it's own. When you place the order you join the back of the queue of limit orders that are already on your price, and you will only be filled when another trader buys or sells from you buy hitting the market price.

Pros – you will only be filled at the price you pre-select, no better no worse

Cons – you risk not being filled and missing the trade if there is no one to buy or sell

from you.Limit orders <u>provide</u> liquidity

Market orders <u>use</u> liquidityWhich order type to use depends on what kind of trade you're making, clearly the aggressive trade is to hit the market price and not worry about the cost. Most stop loss orders are market orders, meaning when you've reached the maximum pain on a trade, you just want to be out of the position, you don't want to wait for a better price and risk not being filled.Here's what a trade looks like:

A limit order is used for my target, I am offering 5 lots at 1777.50. If I am at the back of the queue, 323 lots need to be bought at this price for me to get filled

Last traded price is 1776.25. 1 lot just bought at market into this price

My long entry at 1773.75 is highlighted in blue

09:38:54			^		
-125			177825		
123417			177800		
<Default>			177775	537	
			177750	511	
0			177725	526	
0			177700	374	
1	5		177675	311	← Offer column. 311 contracts for sale at 1776.75
10	20		177650	295	
50	100		177625	255	
Clear			177600	203	
0			177575	200	
SM			177550	88	
		34	177525		83 ← Last trade. 83 contracts were sold 'at market' into 1775.25
<Default>		216	177500		
Cancel All		194	177475		
Cancel		668	177450		
Cancel		269	177425		
		313	177400		
		485	177375		← Bid column, 458 contracts to be bought at 1773.75
		491	177350		
		460	177325		
		605	177300		
			177275		
			177250		
U.S. Pat. 6,766,304 & 6,772,132			v		

TPO Profiles

When Market Profiling was introduced in the 1980s, Volume data was not used; instead, traders in the pit used a time-based profile, known as a TPO profile.Each session was split up into 30 minute periods, (similar to using 30 minute candles). However each 'candle' was assigned a letter, alternating for each period. This screenshot shows what I'm talking about. The first period is the 7.00am – 7.30am period, and is assigned the letter 'k'. The next period is the 7.30am-8.00am period, and is assigned the letter 'l'. You get the picture. Each letter is called a TPO, or Time Price Opportunity.

```
u                                                            142.95
u                                                            142.94
u                                                            142.93
u                                                            142.92
u                                                            142.91
u                                                            142.90
u                                                            142.89
u                                                            142.88
u                                                            142.87
tu                                                           142.86
tu                                                           142.85
tu                                                           142.84
tuv                                                          142.83
tOv                                                          142.82
tuv                                                          142.81
tuv                                                          142.80
tuv                                                    M     142.79
tuv                                                    M     142.78
tuv                                                    M     142.77
tuv                    A                               M     142.76
tuvw                   A                              LM     142.75
tuvw                   A                              LM     142.74
tuvw                   A        EF                    LM     142.73
tuvO                   A        EF                    LO     142.72
tuvw                   A      DOF                     LM     142.71
r  tuOw                A      DEF                     LM     142.70
rsOuvw                 A      DEF             KL             142.69
qrst vw                A  CDEF  H  JKO                       142.68
qrst vw                A  CDEF  HIJKL                        142.67
qrst    wx  z *        A  CDEF  HOJO                         142.66
qrOt    wO  z          O  CDEOGHIJK                          142.65
qrs     wx  z          A  CDEFGHIJK                          142.64
qrs     wx  z          A  COEFGHIJK                          142.63
qrs     wxyz          ABCD  FOOIJK                           142.62
qrs     wxyz          ABCD  FG  IJ                           142.61
qrs     wxyz          AOCD  FG  IJ                           142.60
qrs     wxyO          ABCD    G  IO                          142.59
qOs     xyz           BOD       I                            142.58
pqrs    xyz           BCD       I                            142.57
pqrs    xyz>          B                                      142.56
pqr     xyz      • B                                         142.55
pqr     xyz           B                                      142.54
pqr     xOz           B                                      142.53
pq      xy            B                                      142.52
pq      xy                                                   142.51
pO      xy                                                   142.50
npq      y                                                   142.49
npq      y                                                   142.48
np       y                                                   142.47
np       y                                                   142.46
np       y                                                   142.45
np       y                                                   142.44
k     nO    y                                                142.43
k     np    y                                                142.42
k     np    y                                                142.41
k     np    y                                                142.40
k     np                                                     142.39
kl    n                                                      142.38
kl    n                                                      142.37
kl    n                                                      142.36
kl    n                                                      142.35
kl    n                                                      142.34
Ol    n                                                      142.33
kl    n      Each 30 minute period is                       142.32
kl    n      assigned it's own bar/letter                   142.31
klmn                                                         142.30
klmO                                                         142.29
klO                                                          142.28
kOm                                                          142.27
klm                                                          142.26
klm                                                          142.25
  m                                                          142.24
  m                                                          142.23
  m                                                          142.22
  m                                                          142.21
                                                             142.20
                                                             142.19
```

To turn this from a regular bar chart into a Market Profile chart, we shift all the bars to toward the left margin. This gives is something that looks similar to our Volume Profile, however the 'fatter' parts of the profile are representing where price has spent the most time, rather than done the most volume.

```
                              142.94
                              142.93
                              142.92
                              142.91
u                             142.90
u                             142.89
u                             142.88
u                             142.87
tu                            142.86
tu                            142.85
tu                            142.84
tuv                           142.83
tuv                           142.82
tuv                           142.81
tuv                           142.80
tuvM*                         142.79
tuvM                          142.78
tuvM                          142.77
tuvAM                         142.76
tuvwALM                       142.75
tuvwALM                       142.74
tuvwAEFLM                     142.73
tuvwAEFLM                     142.72
tuvwADEFLM                    142.71
rtuvwADEFLM                   142.70
rstuvwADEFKL                  142.69
qrstvwACDEFHJKL               142.68
qrstvwACDEFHIJKL              142.67
qrstwxzACDEFHIJK              142.66
qrstwxzACDEFGHIJK             142.65
qrswxzACDEFGHIJK              142.64
qrswxzACDEFGHIJK              142.63
qrswxyzABCDFGHIJK             142.62
qrswxyzABCDFGIJ               142.61
qrswxyzABCDFGIJ               142.60
qrswxyzABCDGIJ                142.59
qrsxyzBCDI                    142.58
pqrsxyzBCDI                   142.57
pqrsxyzB                      142.56
pqrxyzB                       142.55
pqrxyzB                       142.54
pqrxyzB                       142.53
pqxyB                         142.52
pqxy                          142.51
pqxy                          142.50
npqy                          142.49
npqy                          142.48
npy                           142.47
npy                           142.46
npy                           142.45
npy                           142.44
knpy                          142.43
knpy      This is the         142.42
knpy      same session        142.41
knpy      as the              142.40
knp       previous            142.39
kln       picture, but        142.38
kln       with all the        142.37
kln       bars shifted to     142.36
kln       the left            142.35
kln                           142.34
Oln                           142.33
kln                           142.32
kln                           142.31
klmn                          142.30
klmn                          142.29
klm                           142.28
klm                           142.27
klm                           142.26
klm                           142.25
m                             142.24
m                             142.23
m                             142.22
m                             142.21
                              142.20
```

As with the volume profile, we are interested in the extreme fat/thin parts of the profile. In this case, the Point of control comes in at 142.62. This will be a key price going forward.Take these examples in the Bund. For the first two days in the picture, the following day bounced at the previous days POC, and held as the low of the day.

POC holding as Low of the day
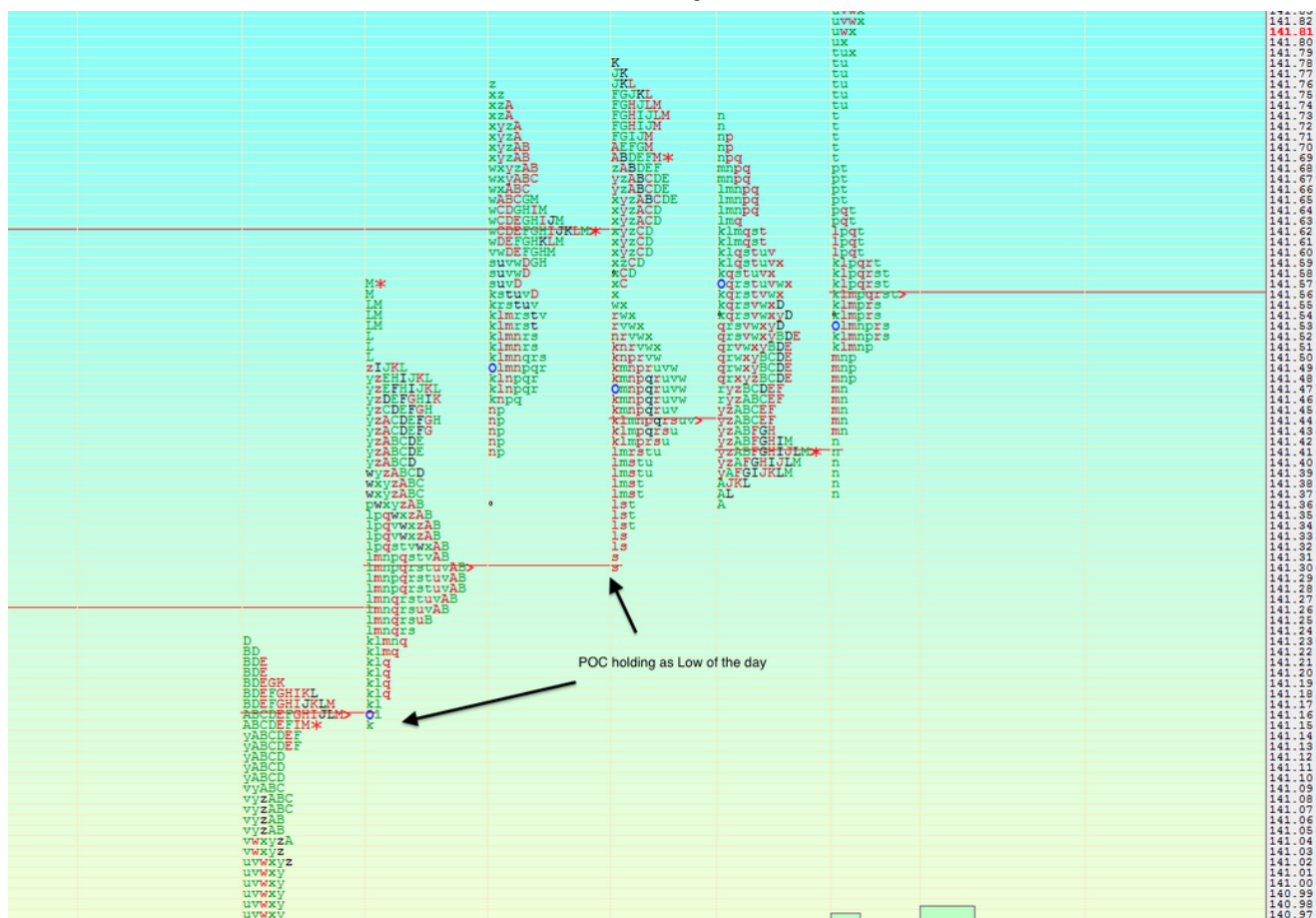
'Low time nodes' are also key. In this example you can see one price in the middle of the profile where only 1 TPO printed, this is know as a 'single print' and is certainly a level to take note of going forward.

Repairing low volume areas

It is interesting to watch how different areas of high and low volume interact with each other. Earlier in the thread I spoke about how previous high volume nodes often become future high volume nodes when price comes back to that area.However it's also common to experience periods where previous low volume areas need to be 'repaired' or 'filled in' by higher volume. This is explained by the nature of the market wanting to ensure all prices have been thoroughly auctioned in order for the prevailing trend to continue. In fact it can often be observed that one session's low volume node, can become the next sessions VPOC.Here's an example in the Yen future, from January 2014On the 6th, we had a strong drive up late in the day, leaving behind a clear Low Volume Node:
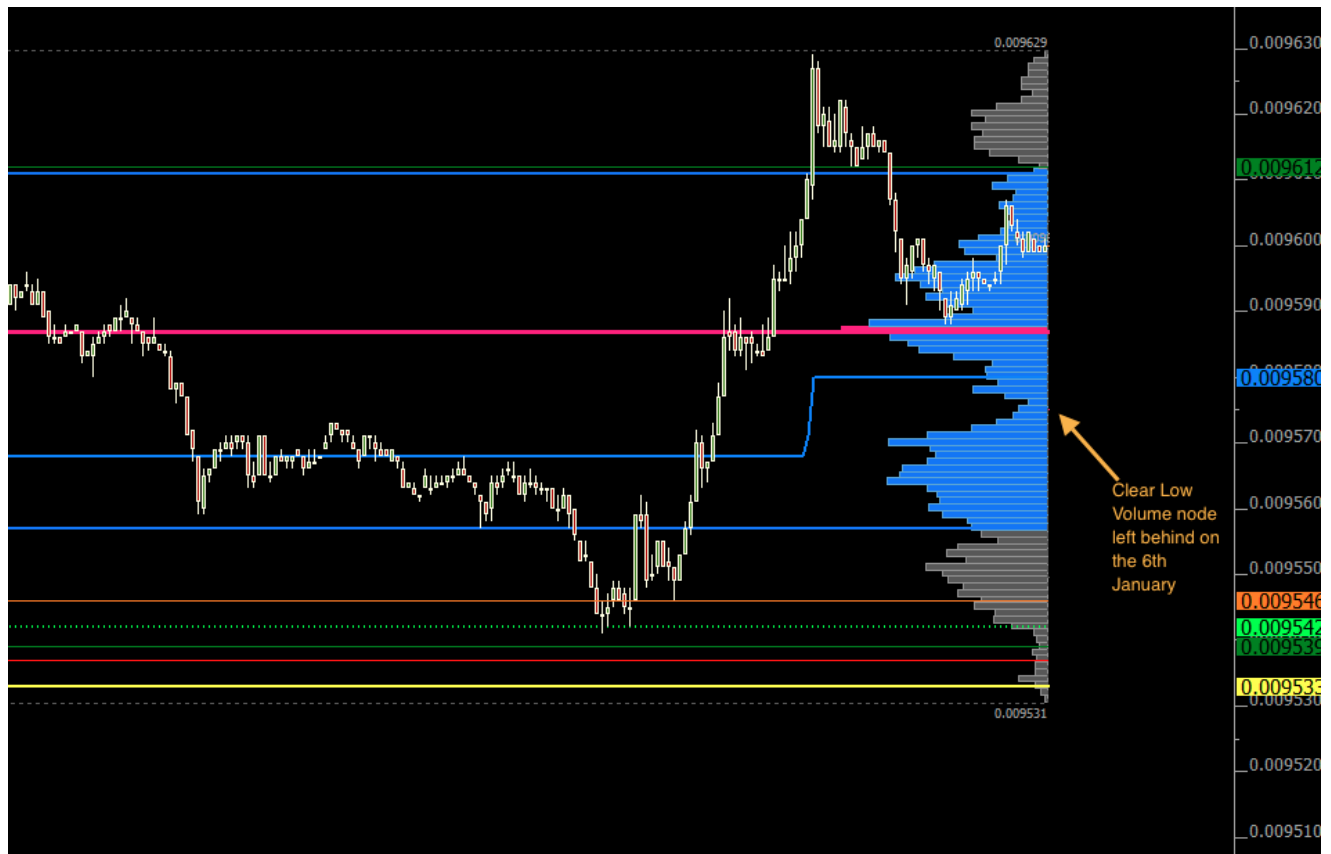
When the 7th of January session opens up, we have an immediate drive down to test the low volume node, and price bounces higher as expected:
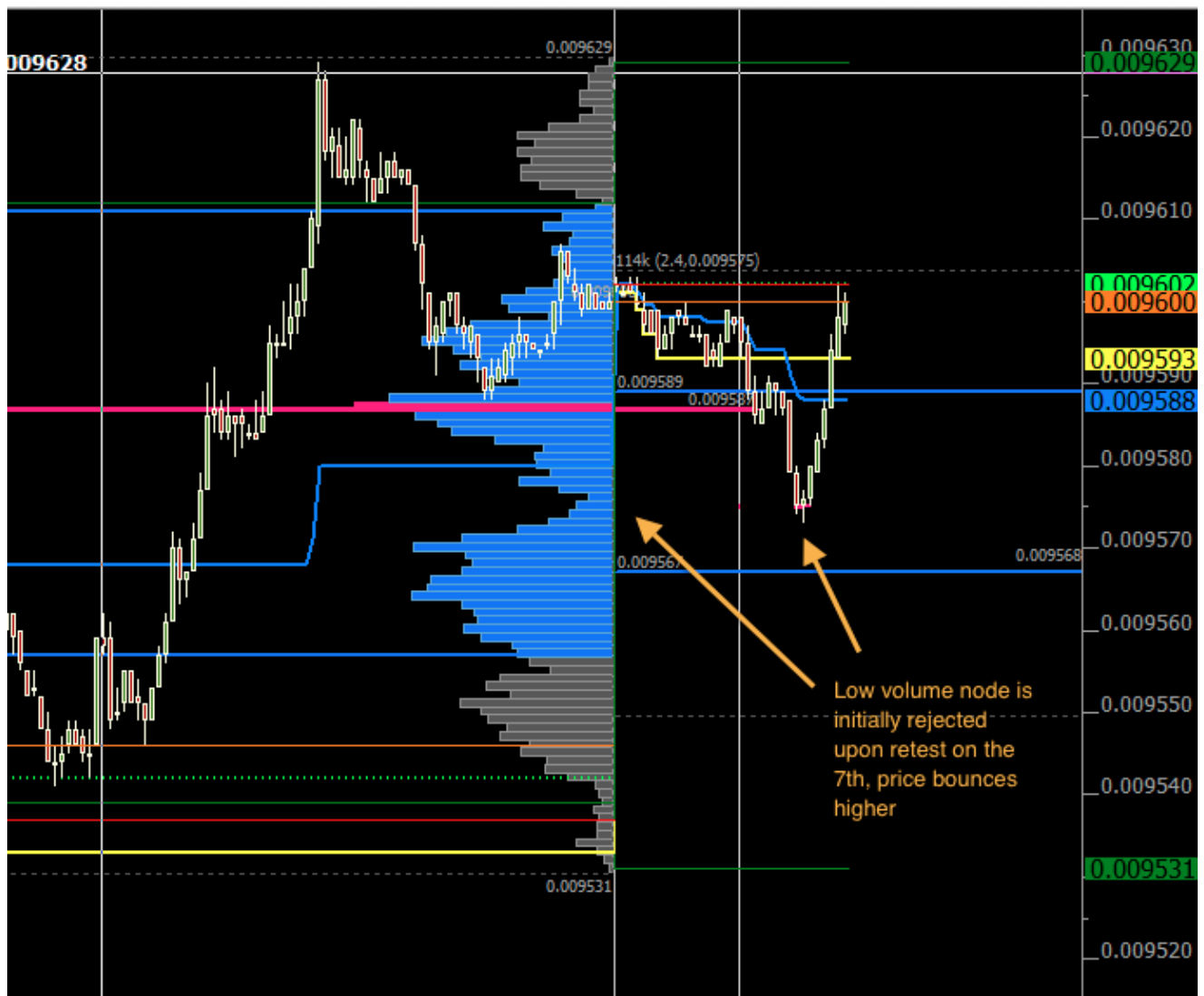
However by the end of the day, we can see that price spent a lot of time chopping around in that area, thoroughly auctioning those prices. In fact, when the 7th January session closed, the most traded price (VPOC) is in line with the low volume node from the 6th:

By the end of the January 7th session, the low volume has
been filled in, and has become the day's VPOC

Weak Highs/Lows

This concept isn't strictly profile (although the profile can help you identify it) but it's
something I use regularly in my analysis.

When the market runs up to a resistance level, and continually retests it over and
over again (see diagram), we form whats known as a weak high. The opposite would
be a strong high, which is when price tags the level, then immediately sells off
aggressively. Strong highs are far more likely to hold as major swing points in the
market. Weak highs/lows are almost always retested eventually, usually sooner
rather than later, and can make great targets for open positions.

WEAK highs, tested multiple
times without breaking or even
making slight higher highs

Would be looking to buy
on lower levels targeting
new highs
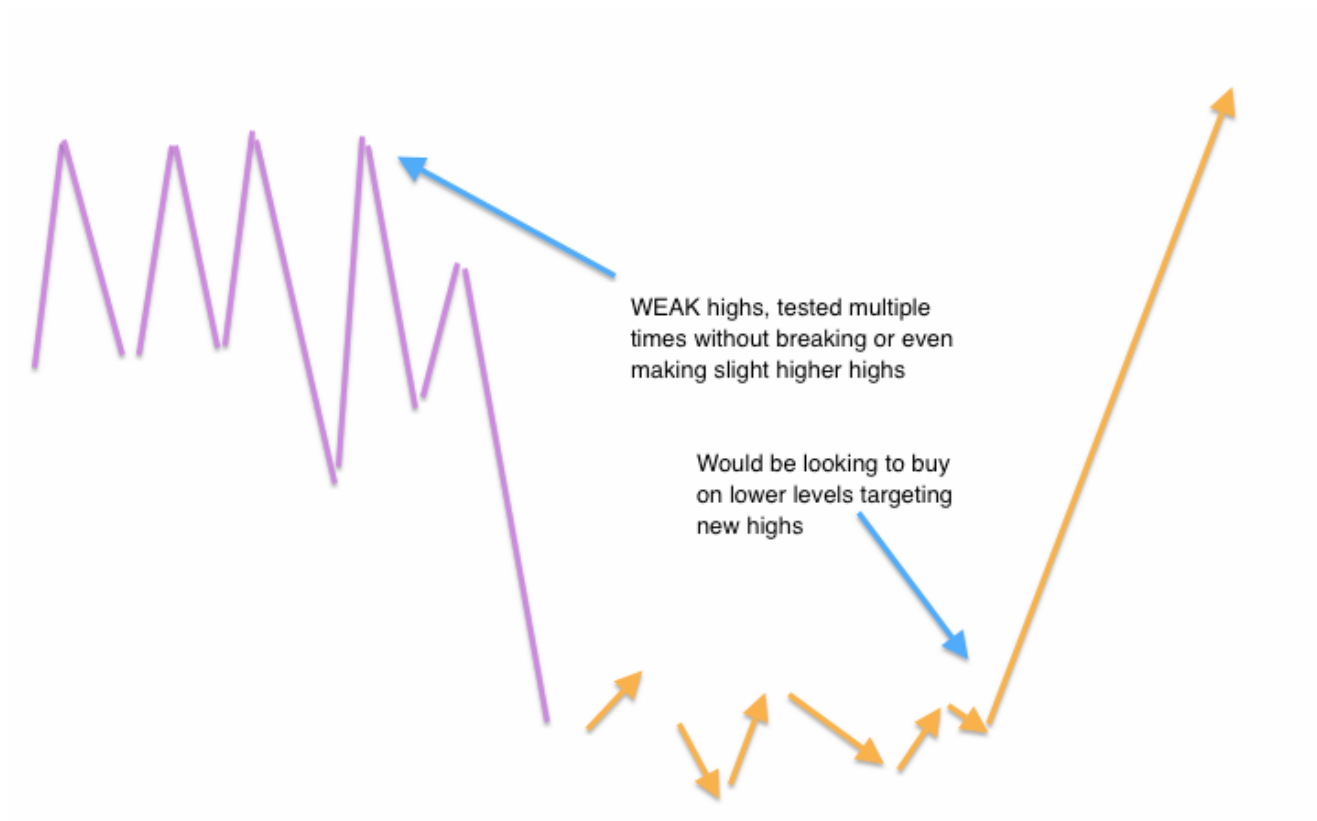
See this example in Crude oil, 120 minute chart:

Weak highs at 97.95 get annihilated
later in the week

Opening and Closing Ranges

Unlike the spot FX market, the futures markets are not open 24 hours a day. They have defined open/close times.

Both the open and close are important periods to take note of, as you have a spike in volume and some unusual activity.

Every time the market opens, you have traders that for whatever reason, need to be

in the market immediately (customer orders, hedging, etc). To to this they place a MOO order or 'market on open' order. These orders are executed by and algorithm that tries to match them as efficiently as possible and give everyone the best fill. On a typical day it takes 1-2 minutes of trading before all the opening orders are executed and more typical trading resumes. These opening orders create an initial swing high/low which we define as the *Opening Range.* This opening range becomes significant to us for the rest of the day, once it has been fully established. Often when the opening range is formed, it holds as support/resistance. Equally if they opening range *fails* to hold, it tells you something about the prevailing strength/direction of the market on that day. This setup is particularly clear and tradable in the S&P 500 future, when they pit opens alongside the cash stock market.

This example is from the E-Mini ES future a few days ago. 1 minute chart:

The opening swing low is
eventually broken, then proceeds
to hold as resistance as the
market trades lower

Market opens with a gap
higher and an opening
range is established,
marked by the 2 blue lines

A similar effect can be seen at the close of the market. MOC (market on close) orders establish a closing range, which can be significant for the market going forward

Fundamentals

The markets in general have been very news driven lately, So I think it's an appropriate moment to talk about news and fundamentals.

First of all, I know many people intentionally ignore effect of news on the markets because they consider them irrelevant. That's absolutely fine. My intention isn't to try to persuade anyone that they are making a mistake by ignoring it. Nor do I wish to preach to anyone how they should be trading. However I started this thread to explain the way I trade and convey an alternative view on the markets. Fundamentals play a major role in my trading so I cannot really leave them out.

I see a lot complaints from people, that markets "don't make sense" They are confused that when a piece of negative news hits the wires the market doesn't react the way the would expect. Their conclusion from this that the markets are corrupt and manipulated, that they move randomly and by their own free will.

They throw their arms up in the air and say "what are these idiots doing!! The eurozone is falling apart and yet they are BUYING the S&P!!!??, what fools!!"

All I can say is, don't be like them. Don't think for one second that markets move randomly and for no reason.
As everything in life does perhaps, the markets have reasons to move the way they do. Markets move because Central Banks, Hedge Funds, Prop traders and individual with ridiculous amounts of money at their disposal, trade them. And they do not trade them because they have flipped a coin and it told them to go long. They very valid and logical reasons to do so.

In my view the market is never wrong. If certain events happen, and you do not see the reaction you were expecting, this gives you some very big clues about the state of the market.

One important thing to accept is that the market has 'moods'

Sometimes the market just wants to go up and up and up. Any excuse is used to fuel a rally. Good economic data will send the market into a huge rally. While negative data might push the market down initially but it is soon discounted and it's not long before we're trading higher again. When you see these kind of reactions you know what mood the market is in, and therefore what direction your bias should be.

Another important thing to learn is the level of severity of certain news/announcements, and how much you would expect it to affect your market. This is something that takes time and comes with experience, but it can present fantastic opportunities when you combine it with natural places you would want to entering the market anyway.

Let me give an example;

You are a Bund trader

1) The market has been trading down all day, and is now 80 ticks below the open

2) You know from your research that 80 ticks is towards the maximum range you would expect out of a normal day, so you are already in 'Buy' Mode.

3) Suddenly Jeffery Lacker from the FOMC comes on the wires, and announces that the Fed should raise interest rates sooner rather than later.

4) The Market spikes down 20 ticks to a support level you have marked on the chart. The range is now 100 ticks and you are trading at an area you know buyers will want to enter. You are seeing more an more reasons to buy this market.

5) From you knowledge base you that Mr Lacker is a very Hawkish member of the FOMC and every time he is interviewed, he mutters something about raising rates.

6) You also know that Mr Lacker is not actually a current voting member of the FOMC, therefore he can think what he likes, he cannot actually influence rates.

7) From this information you have a even more reasons to buy... You are fading an overreaction to 'non' news. you are at a support level AND the market is over extended. You would have to call this trade a No Brainer! It's an ideal opportunity to exploit your edge.

Now lets change the example slightly. Replace Jeffery Lacker with Janet Yellen making exactly the same hawkish comments.

This changes everything. Janet Yellen is traditionally a very dovish member of the FOMC. and she has recently been appointed as Fed chairman. If she suddenly changes her stance and becomes hawkish, this is huge news to the market. The reaction is likely to be far greater, and there is no way I would fade this news.

These are the kind of things I consider when I make trades. I'm not saying it's the right way and I know many people will think I am overcomplicating things. It helps that I find these things quite interesting, so it's not hard work for me to research what makes the markets tick, especially when they make me a better trader.