Using Pivots Points Part 1 Market Auction Theory

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Meet the Presenter

Hello and welcome. My name is Thor Young, and I am a moderator with Bear Bull Traders. I have been trading for over 3 years and been consistently profitable for over 2 years. Other than my beautiful family my obsession falls to trying to understand what makes the market tick. As I push forward, it has been my goal to take the complexities of the market and dilute them down to a more tangible view.

I still believe that stock trading is more of an artform than a technical process. It's subjective to the individual interpreting the data. In the way a person can interpret an abstract painting.

Funny enough in the following presentation. I'm going to be tapping into a slightly different skill set. You see, I grew up in the country around cattle and hogs. Going to the county fairs and auctions where our family interacted with the community around us. These Markets were where all our commerce was done. From selling livestock, to buying land. Everything was auctioned off there. Little did I know at the time, but I was actually learning the art of supply and demand. How auctioneers control the mob. And how money is often made at the expense of someone else.

Our Stock market is no different. The theory behind them both is driven by the same principles.

Introduction of Concept

To understand the movement of stock prices. You must first understand why and how they move. The market has a psychology to it that is extremely organic and emotional. The market is made up of traders and you must remember that. Every single order going across the market is made by someone. Even the algos that trade, are programmed by people. Therefore, they carry their emotional bias into the programs themselves.

As we move forward in this webinar. We are going to be discussing the Theory behind how and why the Market Moves. This is popularly known as “Market Auction Theory”.

My goal by the end of this Webinar is to have changed the way you look at the market. No longer seeing bids and asks. But seeing buyers and sellers. Competitors fighting an epic battle. Where the winners get rich, and the losers go broke.

The information here applies to ANY market where supply and demand is in use. In this instance we are going to apply it to the US stock Market. But it could just as easily be a hog auction or the real estate market.

Table of Contents

Market Auction Theory

The Auction Process

As I mentioned before, the Market is nothing more than an Auction. We often attempt to complicate the aspects of the market. However, it's sole purpose is to facilitate trade between buyers and sellers. When they agree on price. We find the value. Plain and simple.

The Price Auctions until it establishes Value and that is where we begin every trading day. The opening 15m or so on each stock is what we call the open auction period, the ultimate period of imbalance. And this is where we begin our phases. In search of Value.

To most easily explain the process, I have created a diagram to the left that is broken into 4 quadrants. Each of the quadrants represent a phase in the stock's movement.

Each Phase leads to the next and continues around the diagram in a clockwise motion. Always repeating the cycle. Once you learn to identify your position in the cycle. You can begin to predict likely changes within that cycle.

Before we get into the fine details of the Theory let's first define our roles in the Market. The market is motivated by buyers along with sellers. Their stops and profit taking are what move the market. In Auction theory we simply consider them participants.

Know your Role!

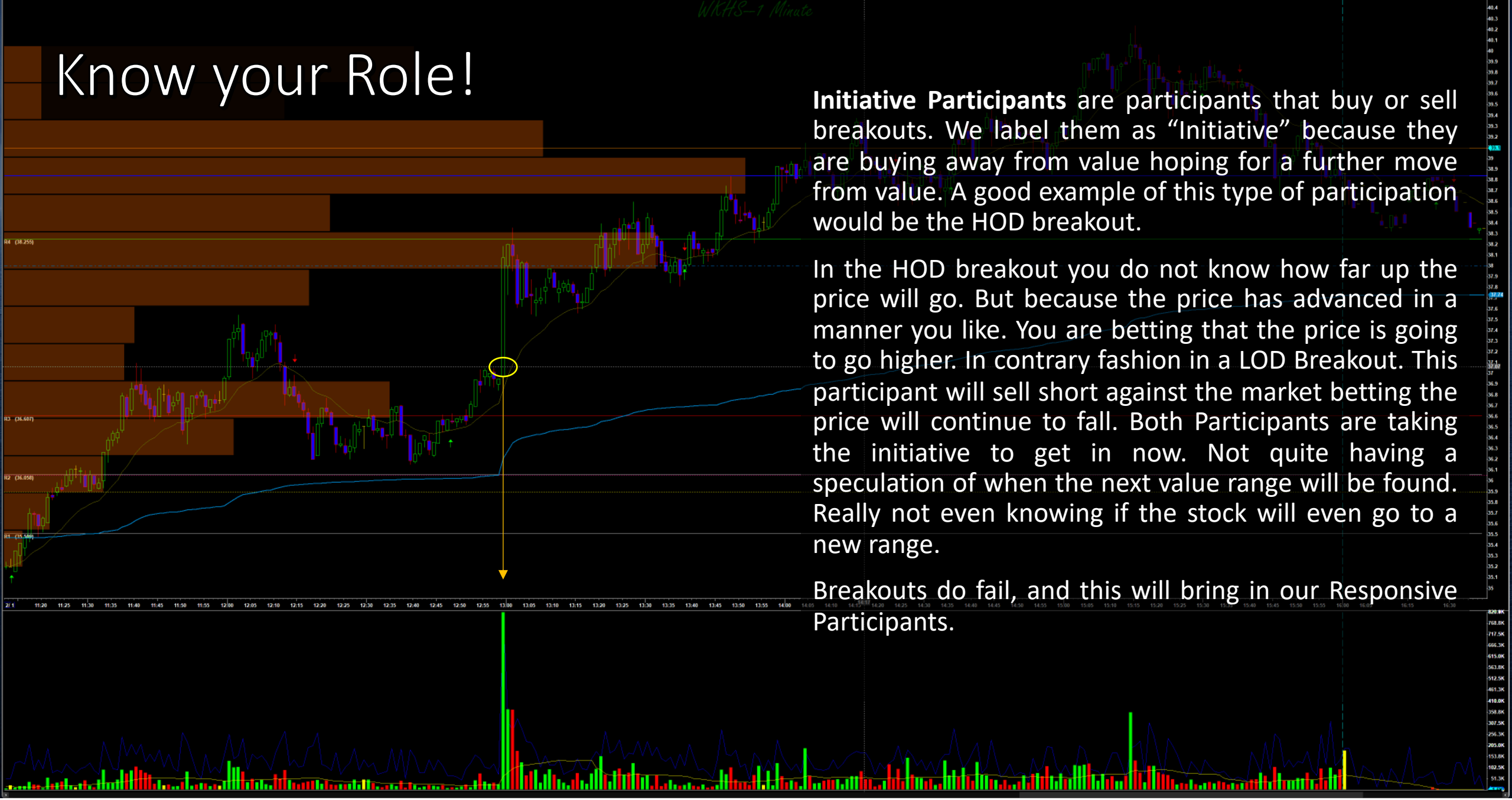
Auction Participants can be split into 3 major groups.

1. Initiative Participants
2. Responsive Participants
3. Larger Time Frame Participants

Each of those groups will be split again into Buyers and Sellers. You **MUST** understand these roles in order to identify what is happening as the stock attempts to auction higher or lower. Have you ever saw the stock start to move higher than expected. You think who is buying a stock when it's this far extended.

Soon you will know the answer to that question. In the Market everyone has their role to play.

Know your Role!



Initiative Participants are participants that buy or sell breakouts. We label them as “Initiative” because they are buying away from value hoping for a further move from value. A good example of this type of participation would be the HOD breakout.

In the HOD breakout you do not know how far up the price will go. But because the price has advanced in a manner you like. You are betting that the price is going to go higher. In contrary fashion in a LOD Breakout. This participant will sell short against the market betting the price will continue to fall. Both Participants are taking the initiative to get in now. Not quite having a speculation of when the next value range will be found. Really not even knowing if the stock will even go to a new range.

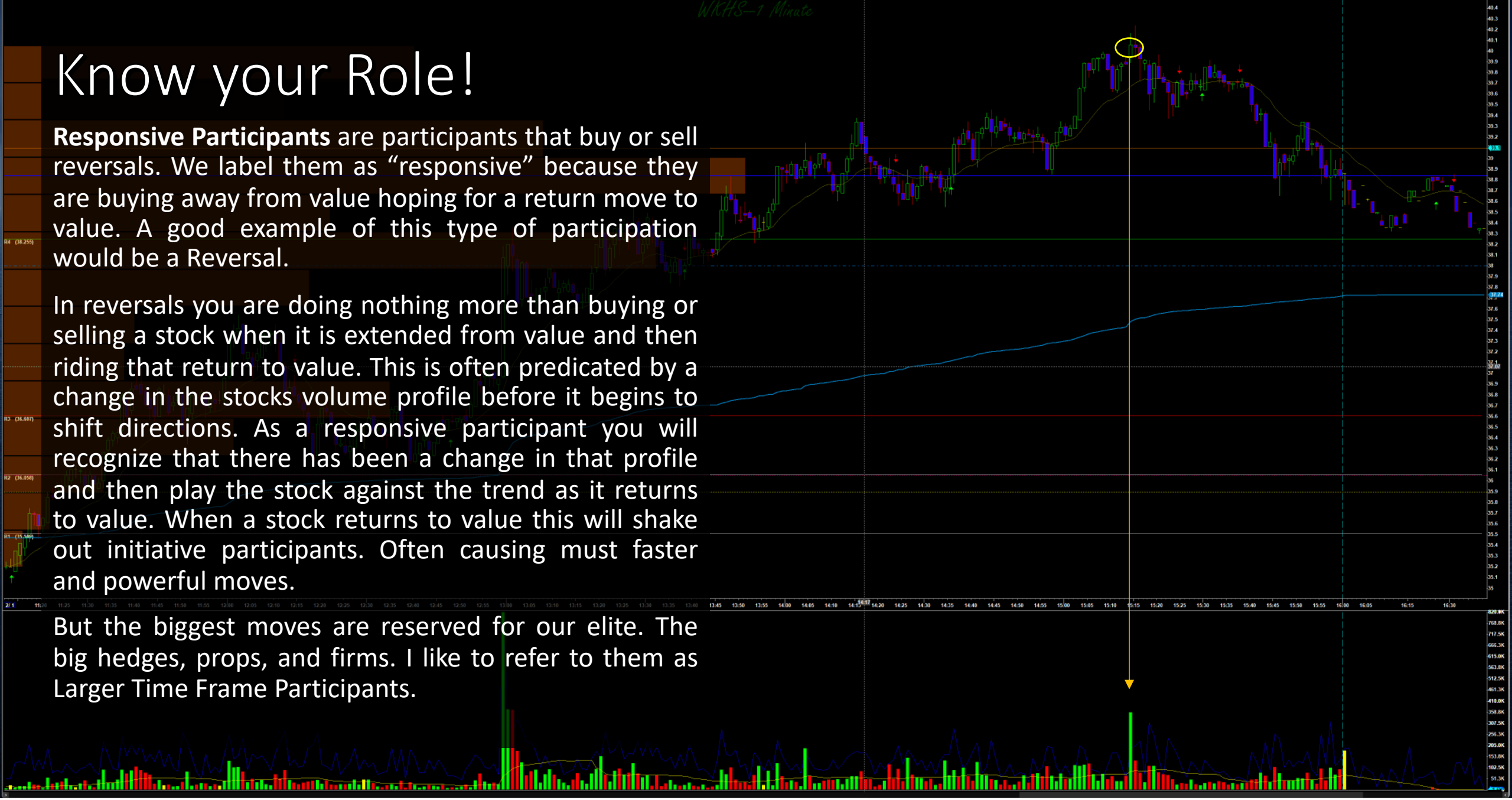
Breakouts do fail, and this will bring in our Responsive Participants.

Know your Role!

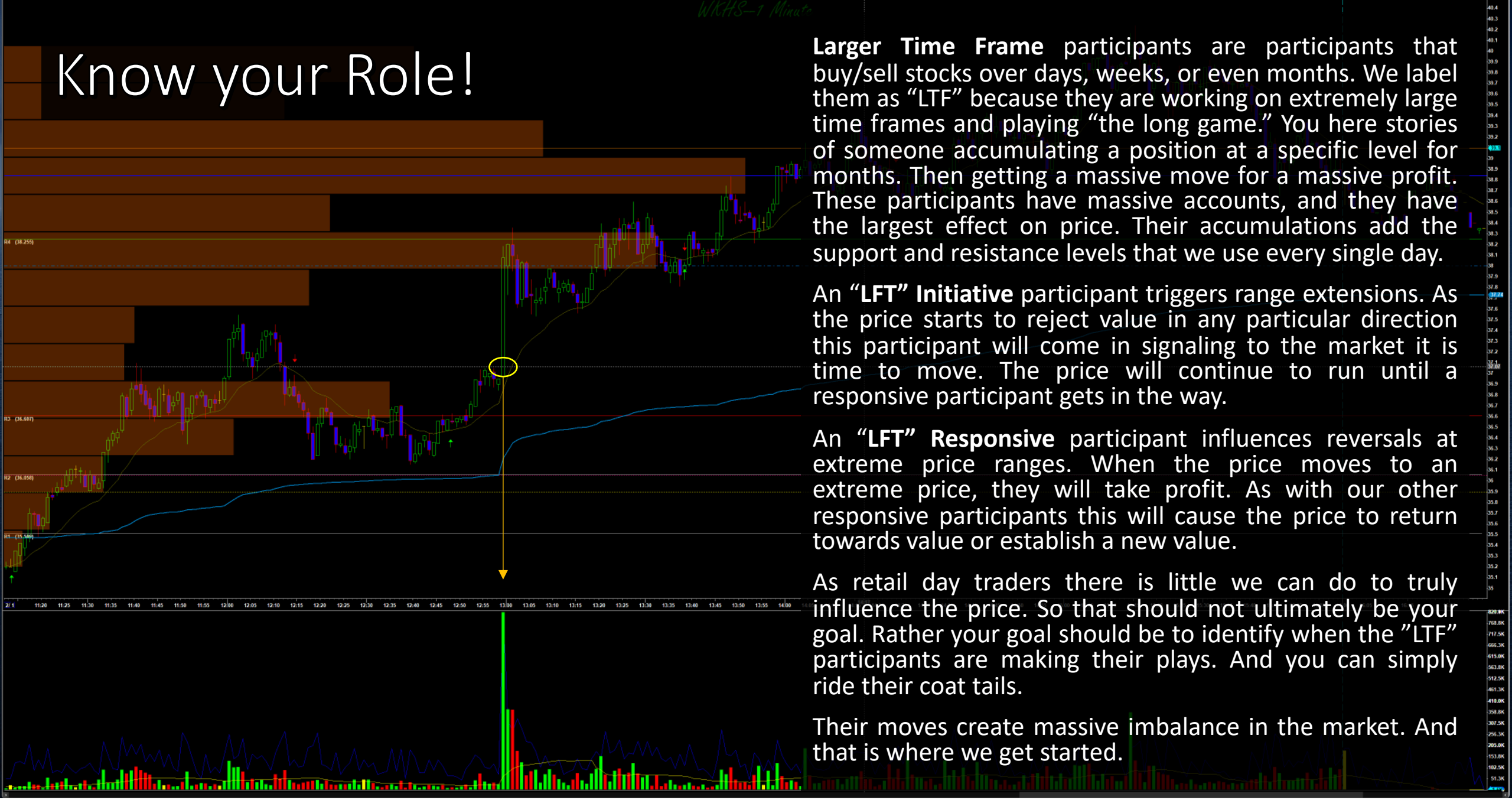
Responsive Participants are participants that buy or sell reversals. We label them as “responsive” because they are buying away from value hoping for a return move to value. A good example of this type of participation would be a Reversal.

In reversals you are doing nothing more than buying or selling a stock when it is extended from value and then riding that return to value. This is often predicated by a change in the stocks volume profile before it begins to shift directions. As a responsive participant you will recognize that there has been a change in that profile and then play the stock against the trend as it returns to value. When a stock returns to value this will shake out initiative participants. Often causing must faster and powerful moves.

But the biggest moves are reserved for our elite. The big hedges, props, and firms. I like to refer to them as Larger Time Frame Participants.



Know your Role!



Larger Time Frame participants are participants that buy/sell stocks over days, weeks, or even months. We label them as “LTF” because they are working on extremely large time frames and playing “the long game.” You here stories of someone accumulating a position at a specific level for months. Then getting a massive move for a massive profit. These participants have massive accounts, and they have the largest effect on price. Their accumulations add the support and resistance levels that we use every single day.

An “**LFT” Initiative** participant triggers range extensions. As the price starts to reject value in any particular direction this participant will come in signaling to the market it is time to move. The price will continue to run until a responsive participant gets in the way.

An “**LFT” Responsive** participant influences reversals at extreme price ranges. When the price moves to an extreme price, they will take profit. As with our other responsive participants this will cause the price to return towards value or establish a new value.

As retail day traders there is little we can do to truly influence the price. So that should not ultimately be your goal. Rather your goal should be to identify when the ”LTF” participants are making their plays. And you can simply ride their coat tails.

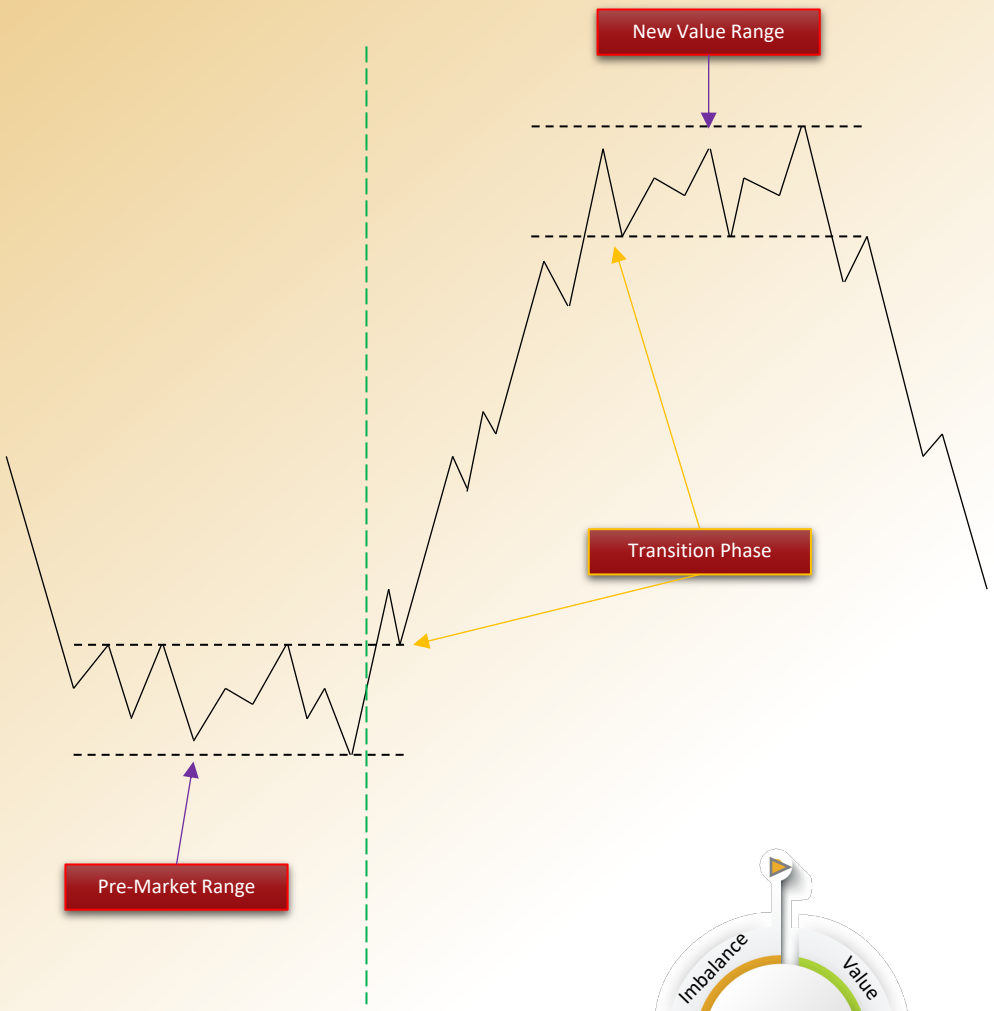
Their moves create massive imbalance in the market. And that is where we get started.

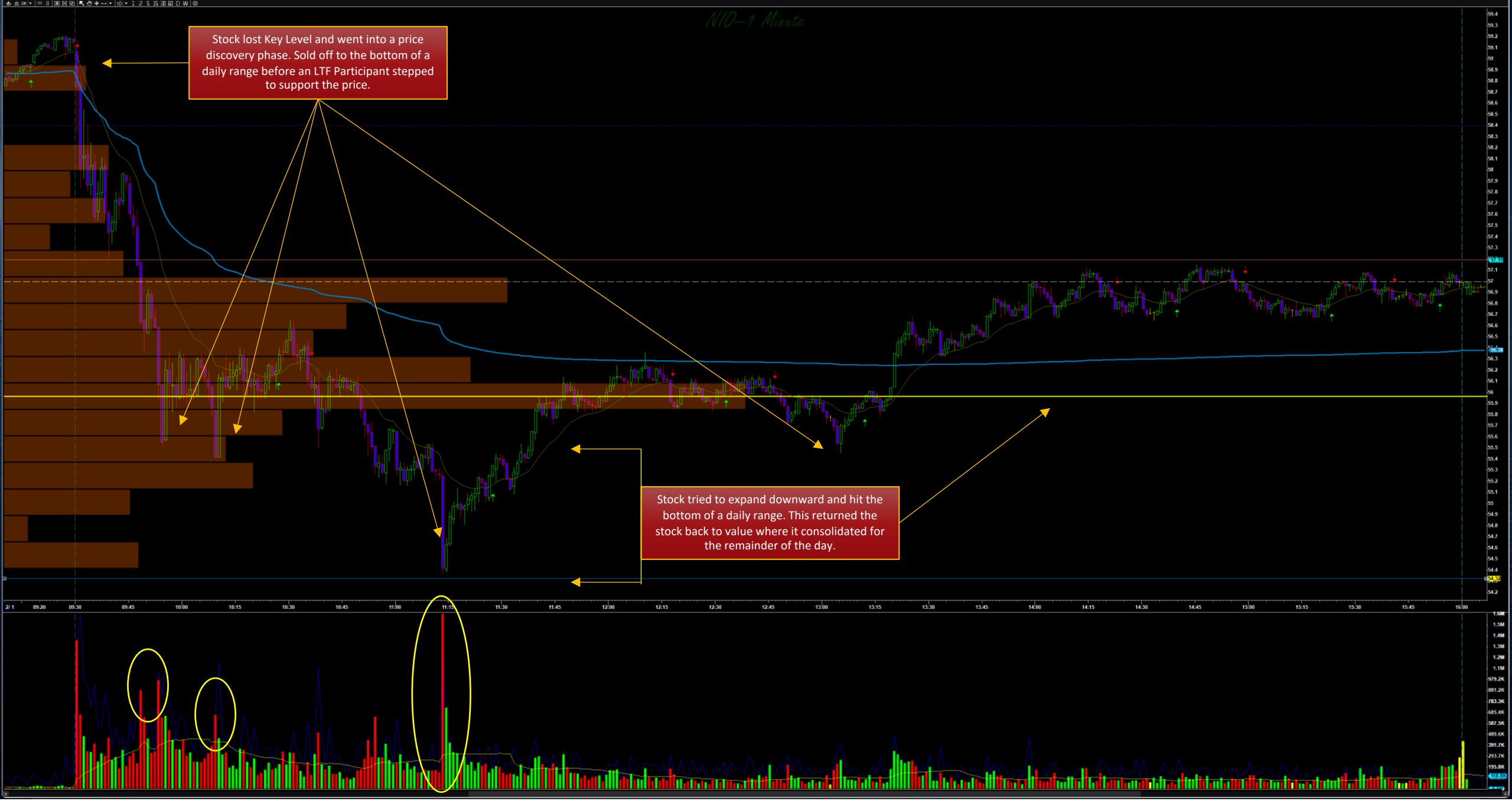
Imbalance

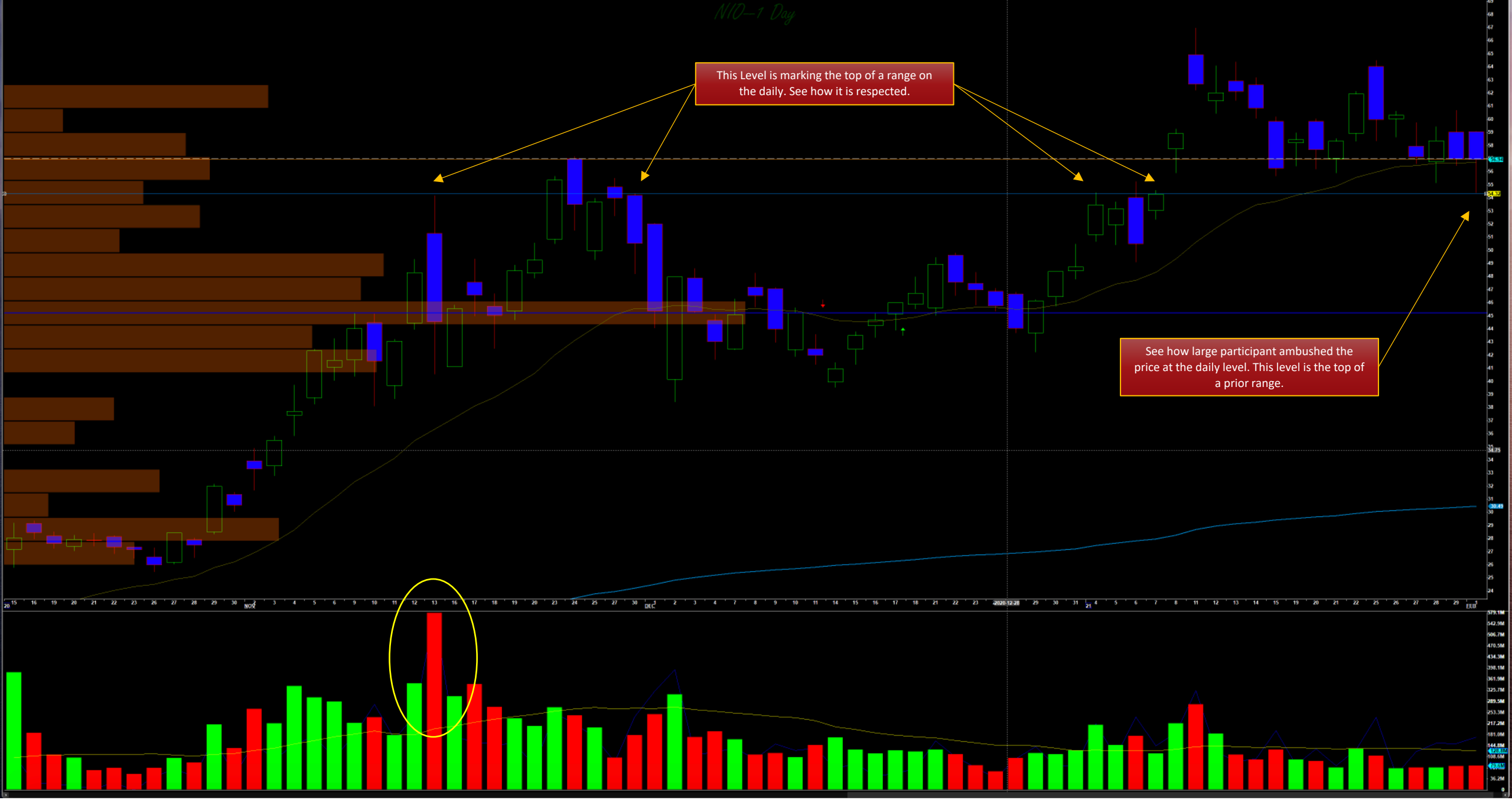
As I reference earlier the best example of Imbalance available is the market open. **Imbalance** occurs when there is an excess of supply or demand. During this opening auction the price frantically moves in search of value. Bouncing up and down it can take from 15 minutes to an hour for the price to find value.

Considered the price discovery or transition phase. It's marked by high average volume. Any trade taken is now based on momentum. We will now be searching for a new value range. Keep that in mind when you take these trades. You truly have no idea how much or little they will move. But this is hands down the best opportunity for a big move. Riding the imbalance as the price transitions to new value is the easiest way to make money with the least amount of shares possible.

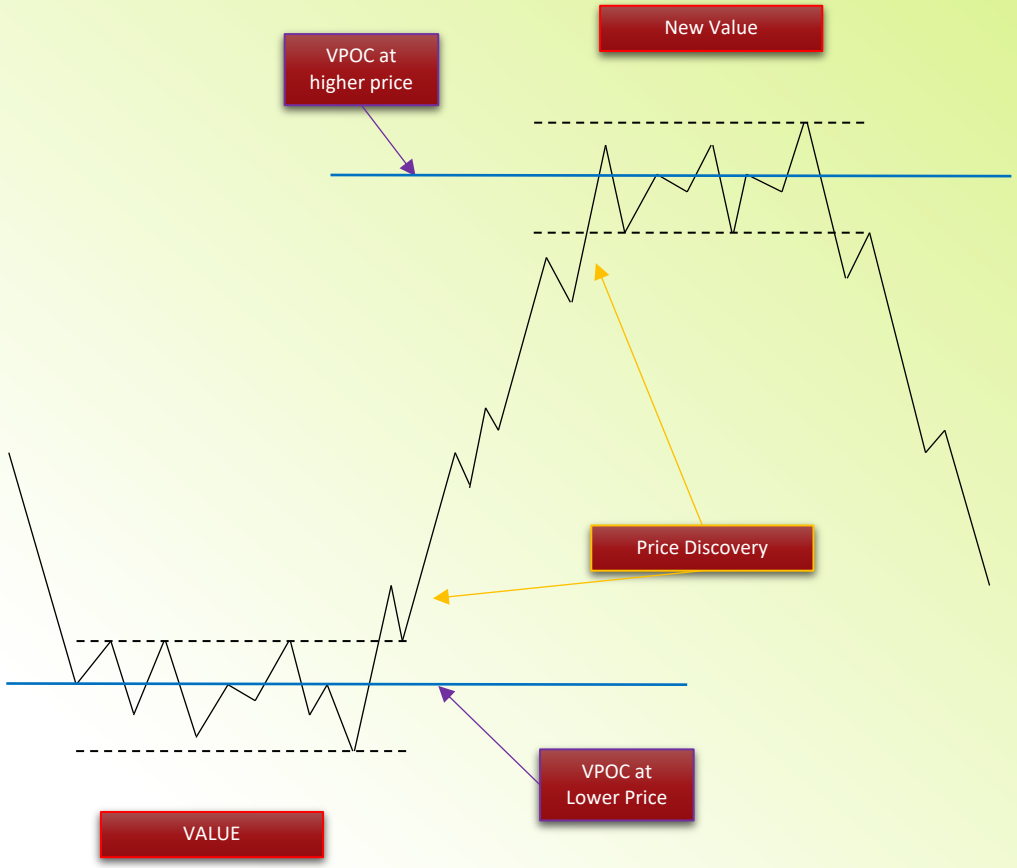
That is after all the entire point. Value is going to be established by LTF participants at some point. Once they start to make their plays we will be able to establish value and a range. You can often see them on the L2 as large bids and asks. Once we encounter those orders value will become easier to see.




NIO–1 Minute
Stock lost Key Level and went into a price discovery phase. Sold off to the bottom of a daily range before an LTF Participant stepped to support the price.
Stock tried to expand downward and hit the bottom of a daily range. This returned the stock back to value where it consolidated for the remainder of the day.


NIO-1 Day
This Level is marking the top of a range on the daily. See how it is respected.
See how large participant ambushed the price at the daily level. This level is the top of a prior range.

VALUE



Value is the principal variable in the market and it is changing constantly. We represent the current value in the current price. The current price is reached when the bid and the ask agree that value has been found. Demand drives this value and that is reflected by the price changing. As the price changes you will then again find value. I like to use the below equation to help me quantify the concept of value.

Price is valued differently in every time frame. This is why tools like VPOC dynamically change as you zoom in and out. The larger the time frame the wider the representation of value as defined by the largest participants. The larger the position you have the more you can influence the supply and demand. Therefor influencing the price.

$$\text{Value} = \frac{\text{Price*Volume}}{\text{Time}}$$

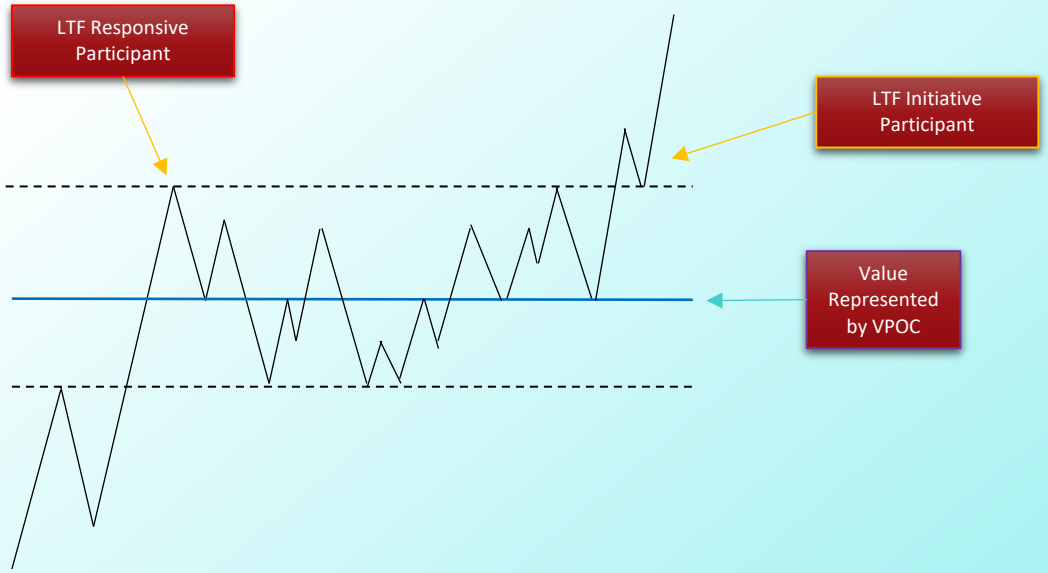
This gives price **Historical Value** as larger time frame participants exist. This gives value in the past the ability to influence value in the future. The Market moves from *rejection* into *acceptance*, and then rejects that acceptance. One way you can think of this is as UNFAIR pricing moving back to FAIR pricing. Once the price can establish value, it can then find balance.


NIO–1 Minute
Stock immediately auctions lower slamming the bid as it searches for value. Value begins to establish before 10am.

Balance

After the price discovery phase locates value, we find **Balance**. Balance is achieved when the stock has established a value range that all participants agree in majority that the price is fair. Demand and Supply are equal for the most part.

This Phase is referenced in many ways. In VPA we call these accumulation and distribution phases. For consistency we will just reference them as Consolidations. This is not to be confused with a "Pull back" or a retracement. In this area the Volume Profile will change as large funds and institutions begin to do business. Despite the lack of volume per minute these are actually the locations where the vast majority of shares are exchanged. Stocks can consolidate for hours in these phases and are market by a characteristic constant low volume.



Over time things will start to change. As the shares are exchange eventually you will start to have an excess of supply or demand which will imbalance the stock and send back in search of value.

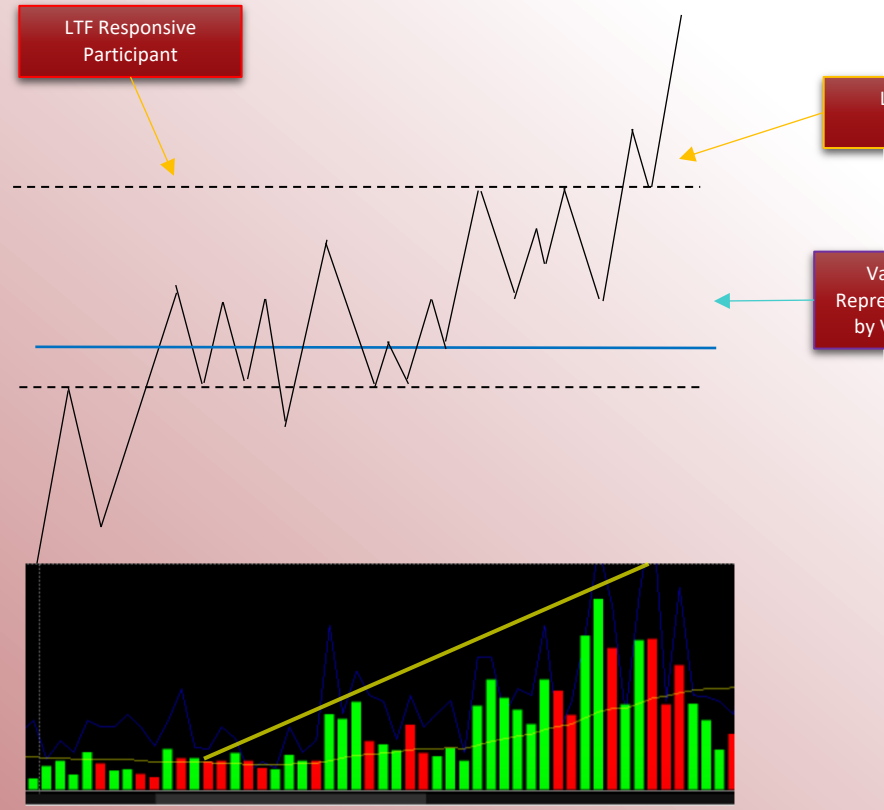
**during this phase it's recommended that you don't take new positions.*


NVAX–1 Minute
R4 (261.835)
R3 (242.173)
Notice the low average volume showing that we are consolidating a little under value. Takes almost 2 hours for this consolidation to finally break back to value.

Excess

After a period of time during a consolidation phase there will become an abundance of either supply or demand. During a distribution for instance. We have a large amount of selling as the stock price is likely well above established Value. As selling continues buyers will lose interest in the current price.

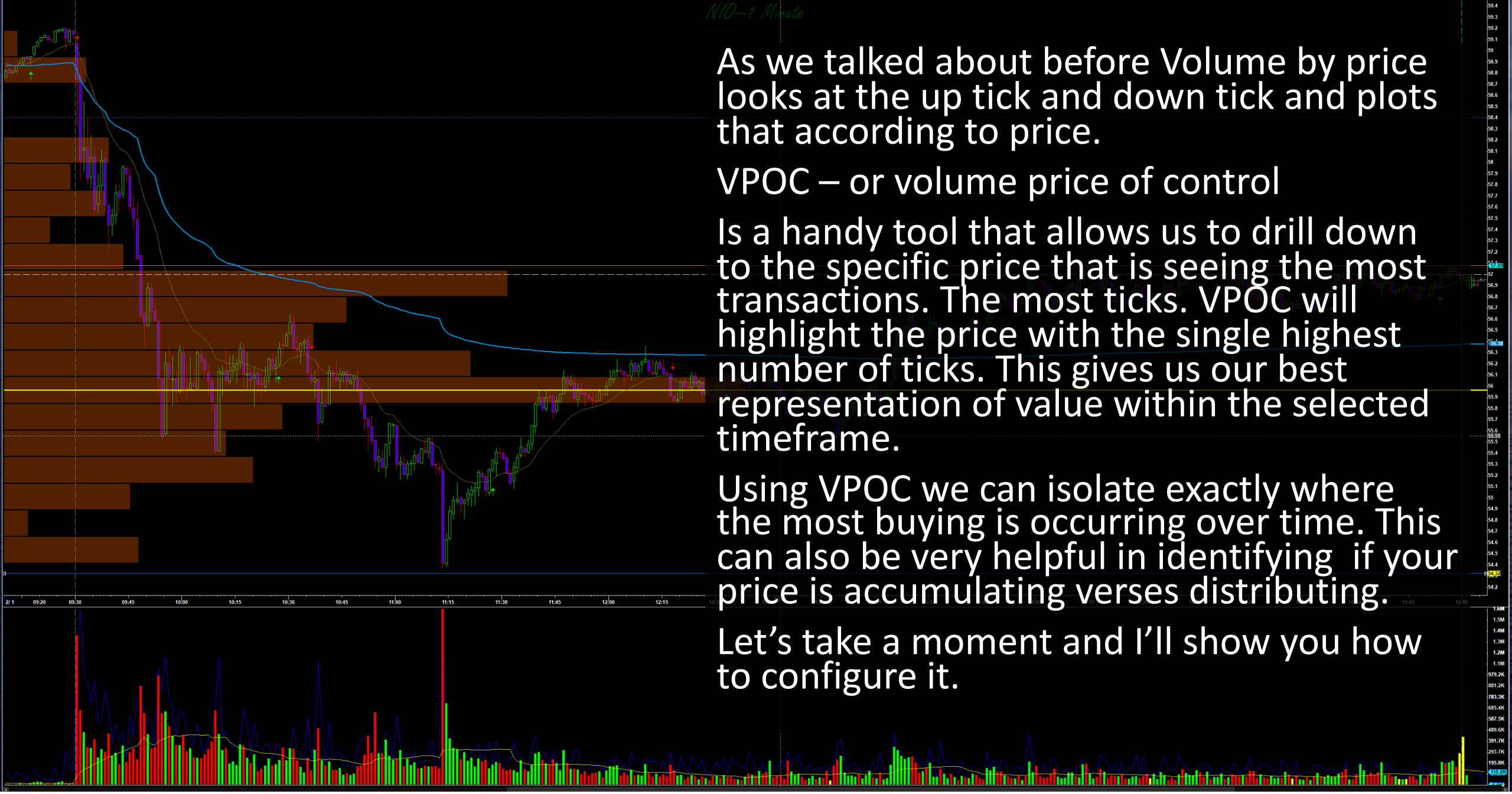
Since there is so much available inventory. Buyers will start to feel that the current price is unfair and overpriced. This will cause sellers to start lowering prices to entice more buyers. Eventually the sellers out of fear will start dumping shares as LTF participants take profit and allow the stock to return lower. Also, LTF participants may begin short positions here if you are close enough to the top of a daily value range.



Excess is marked by a gradually building volume profile near the end of the consolidation. You will start seeing volume spikes as the LTF participants start to make decisions about what is expected to happen next. Soon the stock will go in search of value. This will trigger a new price discovery phase as imbalance returns and the process starts again.

**A fresh catalyst can often shift the balance to excess faster.*


BB--1 Minute
R3 (15.363)
R2 (14.922)
R1 (14.481)
S1 (13.599)
S2 (13.158)
S3 (12.717)
Elevated Volume as we start to breakout from the top of the range shows the Excess Demand for the stock allowing the ask to rise. Once above the PDC volume came in as the stock transitioned back up to a prior range.



As we talked about before Volume by price looks at the up tick and down tick and plots that according to price.

VPOC – or volume price of control

Is a handy tool that allows us to drill down to the specific price that is seeing the most transactions. The most ticks. VPOC will highlight the price with the single highest number of ticks. This gives us our best representation of value within the selected timeframe.

Using VPOC we can isolate exactly where the most buying is occurring over time. This can also be very helpful in identifying if your price is accumulating verses distributing.

Let’s take a moment and I’ll show you how to configure it.


BB—15 Minute
R3 (15.363)
R2 (14.922)
R1 (14.481)
S1 (13.599)
S2 (13.158)
S3 (12.717)
Study Config
Studies
Price
Volume
Moving Average
STO
Momentum
RSI
OBV
VAD
CMF
Envelopes
Bollinger Bands
CCI
Select-->
<--- Remove
<<--- Clear
Studies in Chart
VWAP (0)
Moving Average Pair (Expone@9, Expone@20)
PriceMarker (Y High,Y Open,Y Close,Y Low)
PriceMarker (PreMkt High,PreMkt Low,Open)
Volume By Price ()
PivotPoint (Line,Cam)
Price (Candle)
MoveDown
MoveUp
Config
ConfigEx
Open Study Information Page
Commit
Cancel
Volume By Price Config
Bar Color
Number of Bars (maximum 50)
14
Display down volume
Down Volume Color
Transparency
Low
High
Volume Area Settings
Show Point of Control
Line Style
Color
Width
2
Show Volume Area
70
% (0 - 100)
Volume Area Transparency
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The Conslusion.

Now that we have looked at some examples. I'm hoping you are starting to see how these phases line up and identify themselves. It is true that every single moment of the market is unique. But the theory behind Market Auctions is not. Even if not defined the same way these principles have driven commerce for longer than the written word has existed. And although the market is unique the phases the price will go through will repeat the same way, over and over again.

This is the conclusion of Part 1. Market Auction Theory. In Part 2 we will be talking about Price Based Analysis and Identifying Key Levels. This next webinar will show you how to dissect the price action to figure out where everyone's entries and stops are located. Remember stops drive the market. So, if you know where everyone is going to stop out. Then you know when to get in. MM's and LTF participants thrive with this information. And soon so will you.

Thank you!

Special Mentions

Frank O. Ochoa: https://www.amazon.com/Secrets-Pivot-Boss-Revealing-Profiting/dp/0615391273/ref=asc_df_0615391273/?tag=hyprod-20&linkCode=df0&hvadid=312118059795&hvpos=&hvnetw=g&hvrand=7636419567013366504&hvpone=&hvptwo=&hvqmt=&hvdev=c&hvdvcmdl=&hvlocint=&hvlocphy=901148

ANNA COULING: https://www.barnesandnoble.com/w/a-complete-guide-to-volume-price-analysis-anna-coulling/1116968406?ean=9781491249390

James Dalton: https://www.amazon.com/Markets-Profile-Profiting-Auction-Process/dp/0470039094


That's all Folks!