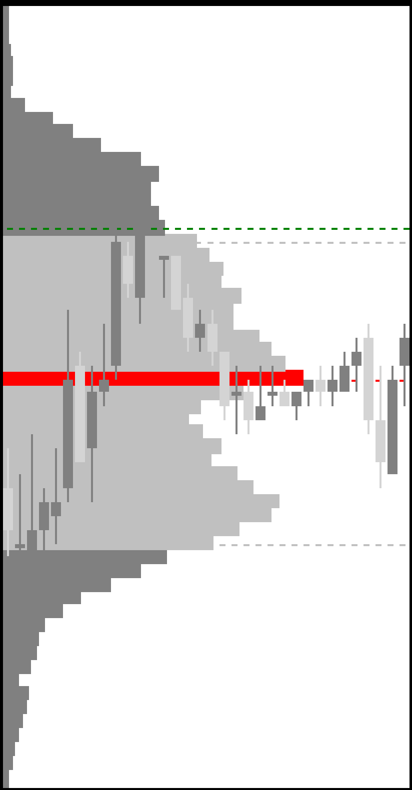
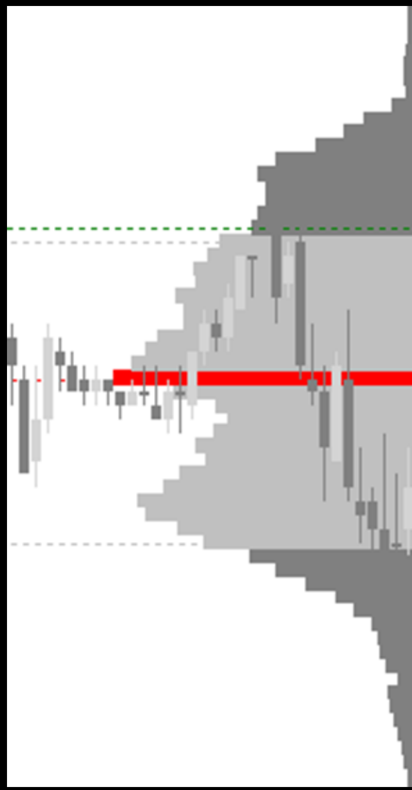


Auction Market Theory



“unfluffed”

By

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Contents

Introduction

The Traders Mindset

Auction Market Theory

The 3 Fundamental Elements of an Auction

The 3 Key Observations:

- Context
- Acceptance
- Rejection

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Introduction

Firstly I would like to thank you for taking interest in reading this book. I truly believe that this will be one of the most influential texts that you read as a part of your trading career. My objective in writing this book is to help break down my understanding, knowledge and wisdom that I have gained as a part of my career as a professional trader over the last 13 years. My goal here is to help explain what builds the foundation of my style of trading. However my mission is to do so in a manner that cuts out all the fluff and simplifies the whole process. Action Market Theory and Market Profile Trading techniques have already been made much more complex that they need to be, so I want to give you what I wish was provided to me when I set off my journey to learn this wonderful way of perceiving the markets.

It is imperative that you firstly understand that my style of trading is not a trading system or a mechanical way of trading. It is a discretionary style of trading which at its core requires a deep understanding of the basics of auction market theory and volume profiling concepts. Although having a brief understanding of traditional market profile concepts may help, the way that I have developed my style of trading around profiling concepts does differ from traditional market profile theory and strategies that are more commonly taught.

I like to believe my success with trading the concepts that I'm about to share with you ultimately comes down to the fact that I see these concepts purely as a foundation which forms a framework for doing business. It is a way of perceiving and thinking about the markets that leads to you having the ability to develop an objective opinion through a projection (Perception becomes a projection!) of what you believe. Ultimately how well you understand the underlying concepts will define how well you may potentially trade with them.

The Traders Mindset

Being a Certified Master NLP Practitioner, I understand the concept of Perception is Projection. So what we see is and how we act is mostly made up of both Conscious awareness and Unconscious Filtering processes.

We filter our perception of the markets and everything else that we see through what we believe, past experiences/memories, values and attitudes. Therefore the story we tell ourselves about the market has an important influence on our behaviours and how we actually trade the markets.

We basically trade what we believe about the market. Therefore what we know and understand will affect the opportunities we see, the Risk to Reward perceptions that we associate with those opportunities as well as how we execute and manage our trades.

In this book my aim is to share some of my beliefs about the market that I have formed through past experiences and an understanding of the Auction market Theory Principals with the hope that these ideas will help expand your awareness of the market its participants and their behaviours.

Auction Market Theory

The main principal behind Auction Market Theory is that it attempts to breakdown the main purpose of the market and how the market participants interact to fulfil that purpose

The purpose of the market is quite simply to "Facilitate Trade". It does this through what is known as the "Dual Auction Process". The market will move up until there is no more buying interest and reverse back down until there is no more selling interest. In essence the market moves up to cut off buying and moves down to cut off selling.

More specifically the market begins (opens), moves directionally and advertises prices for an opposite response to shut off the directional move. If the opposite response is found we reverse, if not we continue. Quite simple really, and it's just like any other auction.

When a market is frequently finding the opposite response after a directional swing, we have two sided trade and we should be auctioning\rotating up and back down. This is when the market is considered most "Efficient" and when we say the market has found BALANCE.

However, when we have an Excess of Supply or Demand in the market and the market continues to move directionally (or what is commonly known as trends) we have "Inefficiency" or what we call Imbalance in Auction Market Theory.

The market will continue negotiating between Market Participants until a new area of Balance can be found and we return to efficiency. For this to happen the market must find an area\prices that the buyers find unfair (known as an unfair high) and sellers find unfair (known as Unfair lows), and where market participants begin to agree on prices to trade, known as acceptance or and area of Value.

Auction Market Theory defines an area where 70% of volume has traded as an area perceived to be of Value.

The market will Ebb and flow from Balanced phases to Imbalanced phases, spending most of its time Balanced because that is when the market is most efficient with the purpose of the market in mind.

The 3 Fundamental Elements to A Market's Auction

Firstly there is PRICE, which is simply the auctions means of advertising opportunity. It is the most Volatile variable and it the fastest moving market element. It can often also be misleading when trying to read the market participants true intentions.

We see price as the ball in a game being played. It gets kicked around the playing field based upon market participant's perceptions of what's too low and what's too high OR whether they believe that price should go higher or go lower.

Then there is TIME, which regulates each price opportunity. It is the constant around which all auction data is organised. Over time we and other market participants can establish how interested Market participants are at specific prices, and speculate on where price may go next.

Lastly we have VOLUME, which Measures the Success OR Failure of each auction higher or lower. Volume is also a variable, but it changes much more gradually than price alone, and it represents the INTERACTION of market participants, and it is the truest reflection of their behaviour and level of interest at prices over time.

Analysing the VOLUME traded at prices is KEY for measuring the success or failure of the price advertisements during the auction process.

The volume defines where the players in the game are interested in playing and not interested in playing. This helps us read their EXPECTED Behaviours with high probability, an objective opinion and in advance.

Price is the result and the advertisement of opportunity.

Time allows for market participants to think and make decisions\choices about what to do next.

Volume defines the behaviour of participants over time and in the moment. Behaviour in terms of what prices are Accepted and which are Rejected.

The 3 Key Observations

The 3 key observations that traders must be making are:

- Understanding which CONTEXT the market is currently within.
- Understanding where **ACCEPTANCE** is and has been. This is knowing through the profile graphic which prices have the majority of market participants proven they are interested in accepting?
- Understanding where **REJECTION** is and has been. This is knowing through the profile graphic which prices have the majority of market participants proven that they are rejecting?

CONTEXT

Understanding the context provides an enhanced understanding of the current markets situation as well as a story for you to work with for building trading ideas. Essentially it helps you form a “Framework for doing business”.

Understanding the context provides a trader with the ability to form a Vision of what the market is attempting to do.

- This therefore allows for a trader to form an objective opinion.
- Things to consider, include:
    - What kind of Market Structure is evident?
    - Are we balanced and trading sideways, or are we Imbalanced and Trending?
    - Then use a top down approach. Start with the bigger picture, as Day Traders we should observe the Daily Charts, then a larger time frame such as 30-60 minute chart for immediate context to trade as day traders. I personally trade 30-60 minute chart setups but confirm them with shorter time frame confluence and Order flow for execution.

ACCEPTANCE

We are interested in knowing where market participants have accepted prices in the past as well as where they are accepting them now. Very frequently we will accept and facilitate trade, where the market has proven to have found efficiently facilitated trade in the past,

This leads to further volume a price building and there for the market spending time in areas of acceptance with a tendency to get stuck, spend a lot of time and what we normally define as chop sideways.

Although this is where the most amount of volume has traded it's the least favourable place for trade location for entries. However it's great for targets! These are fair prices, however not advantageous.

The best deals and opportunities are found in areas that have previously rejected…

REJECTION

Areas of rejection define unfair prices, however advantageous and provide the best deals.

The reason the market spends less time here is because each time these areas are revisited the opportunities are snapped up very quickly. When a good deal is available traders take advantage of this price advertisement quickly.

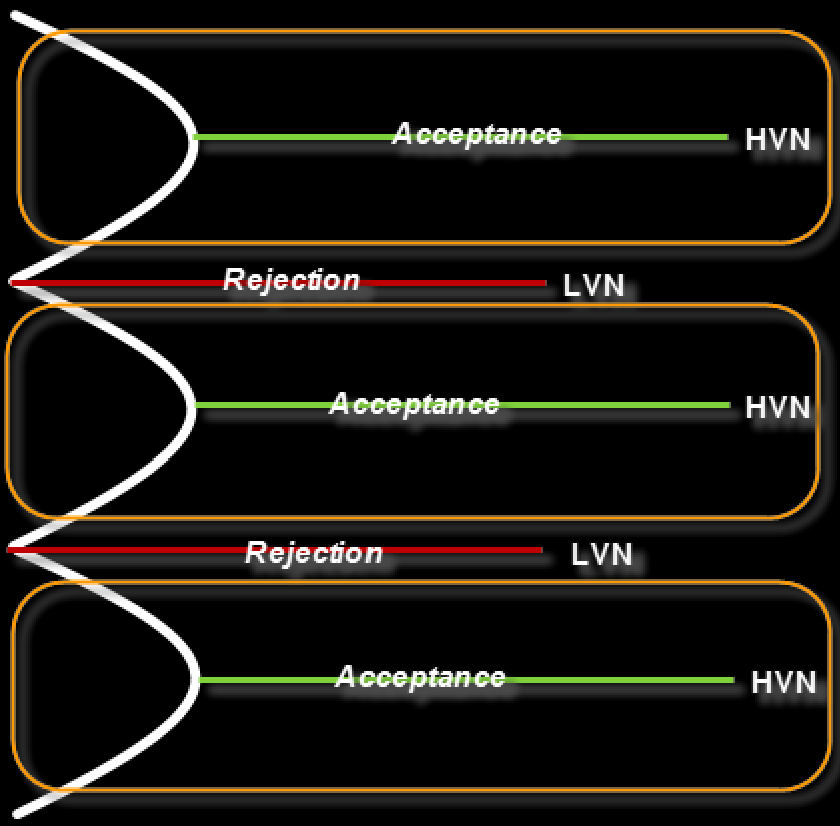
This leads to the market moving away from these areas, and this is what we need to look for as traders for key reversals and great trading opportunities.

As a rule, the best place to look for Support and Resistance is at Low Volume\Rejection areas and target Higher volume areas of acceptance for profit taking.

There are 2 types of Rejection: Rejection Reverse and Pass through Rejection

With Rejection Reverse the Area holds, with pass-through rejection, the prices can still be rejected but trade through very quickly. With Pass through rejection the market doesn't hold the support or resistance and instead it runs straight through it.

FIG 1: Acceptance and Rejection as Low-Volume Nodes and High-Volume Nodes



USING THE CONCEPTS

I believe that the market and its participants have a memory\mindset, the Market Volume Profile represents that memory as the mind of the market. The areas that were previously accepted tend to be accepted again and the those that were rejected to be rejected again. of course, this doesn't happen for ever, but as the market references those areas time and time again, MANY opportunities are presented around these levels. Quite commonly the market will spend more time at areas of high volume that have shown acceptance, and lesser time at low volume areas that define rejection.

As I am looking for the market to move rather than just chop, I use areas of Rejection for potential Entries and Areas of Acceptance as potential targets. Therefore, in both theory and practice I look to trade from Rejection into Acceptance, then back towards another area of rejection. This is the natural flow and rhythm of the market and you will see it repeating time and time again. Just bring up a Composite Profile on any market covering a significant period (i.e. 3 -6 months or even more if required) next to a price chart and you will see how the market constantly moves from low volume areas to high volume areas and back to low volume areas again.

We can see evidence of this playing out around areas of Balance (Sideways Market) as volume dries up and rejects above and below the range of development. As well as when we are getting ready to break outside of the range as further acceptance takes place when volume builds at price outside of the range. Then of course we see further evidence of this when the market begins to trend and further acceptance and rejection areas begin to form and trade around.

FIG 2: A Balanced Market

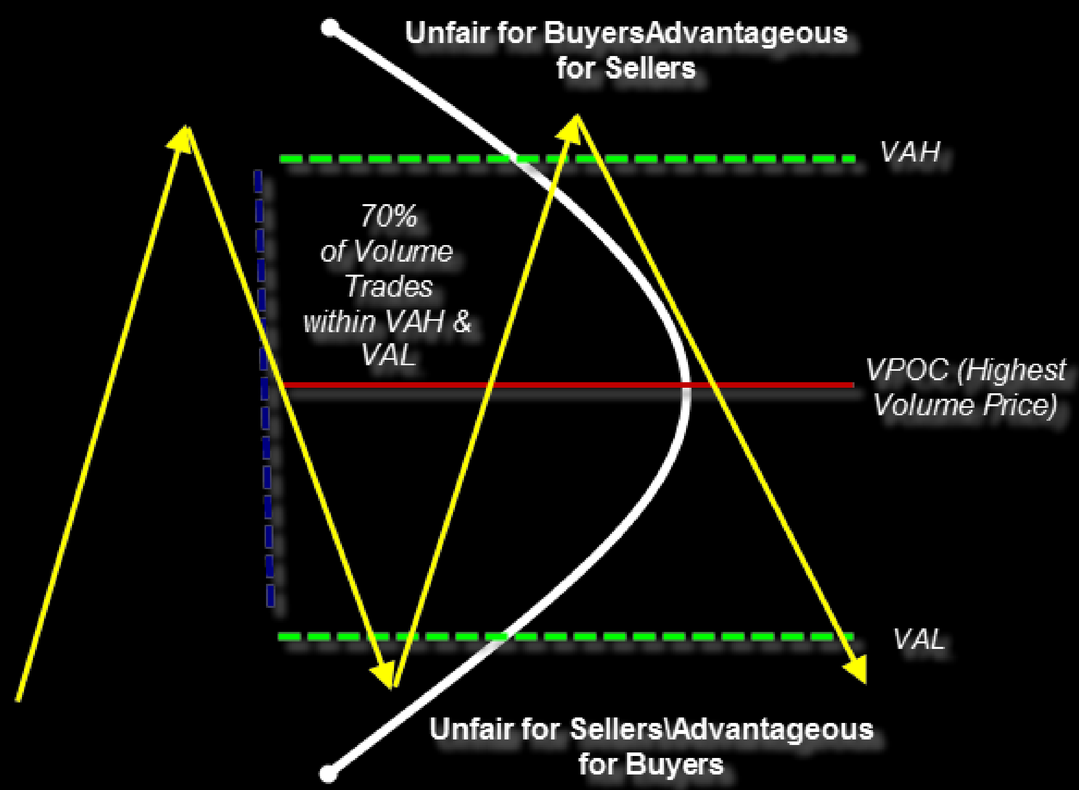


FIG 3: A Balanced Market Shifting to Potentially Imbalanced

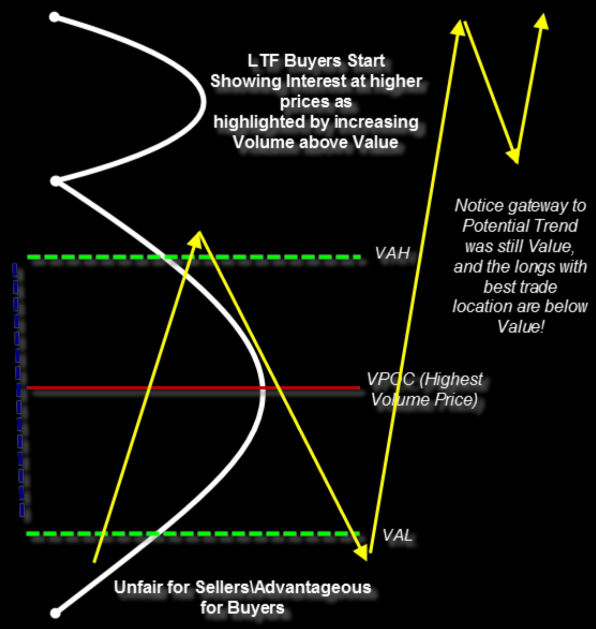


FIG 4: A Market that has now become Imbalanced

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