Combining Price and Volume

Understanding the volume is very important to all technical traders out there. Volume is a very important indicator for us as it helps us make sense of the price movement. When people trade, they create volume whether they sell or buy the asset. Reading the volume is a vital piece of information which helps us in our trading decision.

Imagine a situation when we see that there is a huge increment in price of the underlying asset. How do we know that this increment in the price is a real deal or a feint? We will know that this increment in price is real deal if we see that it is accompanied by a huge surge in volume compared to the other trading days. On the other hand, if the volume of trade that happen in the trading day is comparable or lesser than the other trading days, we can know that this increment in price could be due to other factors like share consolidation for instance.

Now that you are reading this article, I assume that you have a basic level of knowledge in Technical Analysis. Most indicators that we learnt about are known as lagging indicator. This means that they cannot reflect the present. Take the example of Moving Averages. 20 days closing Simple Moving Average is formed by taking the average of the closing prices of the past 20 days. This can offer us a glimpse of what is happening in the future (which is now). However, if there is a huge price increment within the day, the Moving Average will be useless in helping us discern between a real deal and a feint.

Hence, volume is said to be one of the leading indicator as it follows in tandem with price changes. At the point of the sudden price movement, the volume will also change and presented live to us. This can help us make on the spot decisions whether or not to buy or short the stock. Reading leading indicators can help us make snap and immediate decisions as it reduces the lag time to wait for say Candlestick Patterns to form, or Moving Averages to show the change at the end of the day. In turn, this can help us earn more profits or it can potentially save us from losing big time.

With that much being said about volume being a leading indicator, it also means that we have to be constantly monitoring for sudden volume changes during the entire trading day. This could be very taxing and a style which not all of us are suitable for.

There are many trading strategies that revolve around using volume to trade. Over here, we shall discuss a few strategies. We can use volume to trade for breakout patterns and also false breakouts, using volume to confirm the trend, using volume to confirm accumulation phases.

1. Volume to trade for Breakout Patterns

Figure 1

Figure 2

Figure 2 here is a zoomed in portion of the red circled part. Notice the large surge in volume that accompanied the long white bullish candlestick and the subsequent rise in the prices.

To read breakout patterns, we need to combine some knowledge of support and resistance. As we can see in Figure 1, there is a resistance level denoted by the blue line. The prices stayed below the blue resistance line until there was a day with a sudden surge in the price. It was accompanied with a surge in volume too. Hence, it was enough to conclude that this is a breakout pattern.

2. Volume to trade for False Breakout Patterns

Figure 3

Figure 4

Figure 4 shows the zoomed in portion of the red circled area. Notice that there was low volume during the breakout period. This depicts a false breakout pattern that subsequently will show the stock prices going down instead.

To read False Breakout Patterns, we need to see the volume. Like what we did for Breakout Pattern, we identified the resistance level. Then, there was a breakout pattern forming in this chart as well. However, there was a lack in the volume to accompany the surge in prices. The volumes of those long white candlesticks are comparable to the other trading days. Hence, we can conclude that this is a False Breakout Pattern.

3. Using Volume to confirm Trend

Figure 5

We can also use volume to confirm the trend. This chart here shows a downward trending stock. Notice the high volume that accompanied the black candlesticks as shown in the red circled area. In the second and the third circles, we can see that the stock breaks the resistance with high volume. In the other circles, we can see a rather long black candlestick together with high volume indicating that the overall trend of the stock is going down. Unlike Breakout Patterns, we cannot confirm the overall trend of the stock using just one volume. We will need the information of the stock for over a period which will allow us to see this overall picture.

4. Volume to confirm Accumulation

Figure 6

Accumulation pattern is another pattern which shows the overall trend of the asset over a period of time. They are generally characterized by having the prices ranging within the support and resistance over a long period of time, having rather low volumes generally during the period, but we can see sudden spikes in volume without much price surges. In Figure 6, under the red circled area, we can see all the characteristics listed above. Accumulation doesn't mean that there is inactivity. In fact, you can think of it as a spring which is getting compressed. Once released, we can see huge surges in prices as what we seen in the chart.

In conclusion, volume as an indicator is vital in helping us validate patterns. There can be many different types of volume that we can use and that can be all customized to whatever you are comfortable with. However, we all can't run away from the need to know volume. When combined with other information like prices, support and resistance, it could be sufficient for us to make swift and decisive trading decisions to make us some money or protect us from suffering losses.