Value in Time

Better Trading through Effective Volume

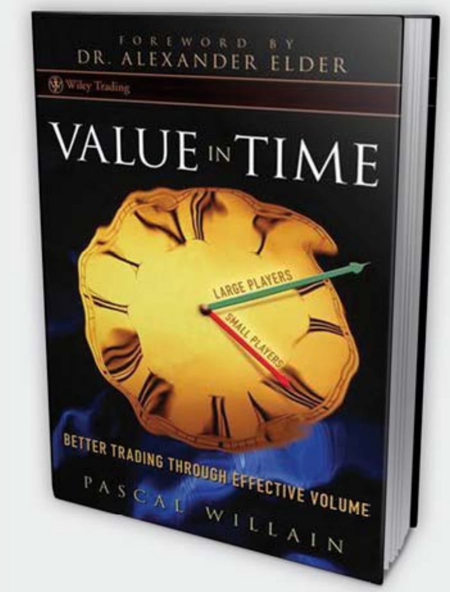
By Pascal Willain

In his book début, Pascal Willain provides breakthrough new technical analysis tools that have a good chance of revolutionising the way we look at financial markets. This unique guide contains insights that will take your trading to the next level as it shows you how to look beneath the surface of financial markets and spot the manipulations they are prone to. How, you might ask?

First there is the idea that large players are mainly responsible for stock price movements, because of the large size of their trades. Therefore, monitoring the movements of large players seems to be the best way to monitor the whole market. To do this we need tools to find out whether and when institutional investors are moving in or out of stocks. Building those tools is what this book is all about.

Secondly, the decimalisation of prices, as of April 9 2001, changed the markets. Before that date, prices were quoted in sixteenths of a dollar, making the spread cost rather high. The difference between placing an order at the ask (the best price offered by sellers) and placing it at the bid (the best price offered by buyers), was one sixteenth or 0.0625 (so for 1000 shares this cost amounted to 62.50). This high spread cost, hence pushed buyers to place their orders at the bid and sellers to place their orders at the ask. Another consequence was that the price did not change much, since it took quite a large volume to move the price up or down one tick (the smallest level of price change possible between the bid and the ask, before decimalisation 6.25 cents). Large funds have the dual advantage of size and power, but this also has limitations. Large players cannot put in their big orders as one lot if they do not want to show their hand to the market. So they need to, can and do, use legitimate price manipulation in order to accumulate or distribute shares during sideways trading ranges, by combining buying and selling both at the bid and the ask, which translates into four combinations. In return they provide liquidity to the markets. Before decimalisation market manipulation was quite costly and easy to spot. Decimalisation, though, lowered the spread cost, and therefore freed large players from disclosing their orders. Typically, these days, you can easily push the price by one tick, at a cost of one cent per share. This is not proving that markets are constantly manipulated. But if a service suddenly costs six times less than it did the day before, you can be sure that this service will be used more often. So decimalisation, which was originally conceptualised to reduce spreads and add to the transparency of price behaviour to the benefit of the retail public, may very well have killed market visibility and encouraged price manipulation.

Finally, in an environment where technical analysis has



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become mainstream and swarms of traders watch most classic indicators like hawks, there is still a lot of 'illusion of control'. Most visual chart patterns and indicators are highly subjective in their definition and/or their interpretation. Most visual patterns do not have a mathematical definition at all, while almost all indicators need parameters that have to be provided for proper usage, which is an open invitation for the 'illusion of control' and curve fitting of a system to the data it has been fed. To make things worse, most of the existing indicators are using interval data instead of transactional data. Transactional data consists of every transaction that passed. It is volume, it is price and it is timestamp, while interval data merely is the compression of that transactional data into the first, last, highest and lowest transaction price measured over the interval as well as the accumulated volume of all transactions in the interval. When we use the classic open, high, low, close and accumulated volume over a certain interval (typically a day for many traders), we are leaving out a whole lot of information for the sake of synthesised analysis. Moreover, a significant part of the retail public does not even have access to transactional data and a lot of software is not yet equipped to define this kind of tools.

The tools the author comes up with, are really next generation tools. They do not need to be fed parameters and are using data at the atomic transactional level.

Pascal Willain's unique view on supply and demand, their equilibrium, accumulation and distribution, what is cheap and what is expensive, why we have trends and how they emerge, all translated into his tools named Effective Volume, Active Boundaries, Divergence Analysis and the Supply Analysis tool. In the first part of the book, all of them are fully explained, in their own chapter, as to their definition, formulas, interpretation, real life usage scenario's and hints drawn from experience.

The second and third part of the book is dedicated to the synergy effect that flows from the combination of this tools and their relation to trading strategies, risk/reward balance, automated trading systems, sector analysis and short selling.

You will see that the different concepts introduced in this book are very simple in nature. The math may look complex at first, but in the end it all comes down to nothing more than addition, subtraction, multiplication and division. In fact you do not need the math to use the tools. But it is important though that you understand what these tools represent, what they measure, and how you can take advantage of what they tell you. After all, technical analysis is not about predicting the future. It is about measuring the present. Just the thermometer will not tell you tomorrows temperature but it remains a useful device. Just as it is not the math doing the trading; it is the trader.