Pump up the volume

Spikes in market volume can anticipate market trend reversals and, with an adequate database of market volume history and real-time updates to identify spikes and compare them historically, can provide low-risk, high-reward trading strategy. By MarketVolume's Vlad Korzinin

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Market volume of the major equity indices – such as the S&P500, the Nasdaq 100 and Dow Jones indexes – may run in an advancing or declining direction for any period of time; it is, however, when there is a volume surge after such a run- regardless of direction- that indicates the market is a state of being either overbought or oversold.

To analyze these volume surges for their relative intensity, their distance from previous reversal points, and their duration, provides insight into the likelihood of other reversals soon to follow, and this gives traders the advantage of anticipating market activity in a timely way instead of following it.

Depending on thresholds given these criteria (intensity, comparative history and duration of market volume) strategies can be developed for long-term, mid-term and short –term trading, in each case by anticipating market reversals (or determining none is on the horizon) according to market volume in highly liquid markets, such as the US equity indexes.

Gauging the market volume of these indexes- whether daily, hourly or over 60 seconds- is useful in understanding current market sentiment when the "big money" is trading and in which direction (buying or selling) the market is moving in order to participate in this direction at the cusp or the optimum time, instead of getting caught after the direction and its momentum have already been established.

Trading not merely on market volume, but market volume analysis of intensity, history and duration for favorable results is particularly easily applied to large, liquid equity indexes and their derivatives (SPDRS, DIA, QQQQ). However, the same principle can be applied to any liquid market, including currencies, futures, contracts on futures, or a basket of liquid stocks.

Requirements of market volume analysis

For liquid equity indexes, a real-time volume moving average is a key tool, but also a key is oscillation technology to enable quantification of the magnitude and duration of a market volume spike when it appears. Also necessary is a database of previous market volume history against which to compare current activity in order to determine, when a spike appears, whether it is significant enough to indicate a reversal.

Oscillation measures the divergence between two volume-moving averages- a slower and faster. The slower can be in days or a day, and the faster in minutes. By calculating and charting the difference, the extent to which the faster volume-moving average is above or below the slower one can be determined. This provides an indication of the intensity of short-term trading activity (compared to average trading activity over a longer time span).

This oscillation evaluates volume spikes with unbiased, mathematical precision, thus enabling a true gauge of the impact of any given volume spike (whether advancing or declining) on the market, and over different timeframes, this empowering any number of trading strategies.

Oscillation measures the magnitude of a volume spike; and because it is represented as a percentage value, it is amenable to comparisons. With an historical database of market volume and a precise method for identifying current volume spikes as just described, comparisons can be drawn instantaneously to establish critical values at which a market trend reversal is most likely to occur, and in various time frames.

Sample strategies based on market volume analysis

Assume that any market volume that occurs when an index or basket of stocks is moving lower is "supportive volume". Assume also that any market volume that occurs when an index or basket of stocks is moving higher is "resistive volume". The following research was performed on the S&P500 and is most suited for medium-term trading based on daily market volume data, although these principles can be applied to other timeframes and other indexes or baskets.

The most basic trading decision anyone can make based on pre-analyzed market volume data is to sell on resistive volume spikes and to buy on supportive volume spikes. Here are two simple examples:

- Close short positions and open long positions on supportive volume spikes;
- Close long positions and initiate short positions on resistive volume spikes;
- Add a long position on each supportive volume spike;
- Add to a short position on each additional resistive volume spike.

Here is the other strategy:

- Open a long position only on a second or even a third supportive volume spike;
- Close long positions on a first resistive volume spike;
- Open short positions only on a second or even a third resistive volume spike;
- Close short positions on a first supportive volume.

The difference between these two strategies is that the first applies dollar cost averaging whereas the second assumes a trader will only make a single buy/sell decision. Dollar cost averaging is based on the assumption that a trader will never remain in cash, that is, short positions are entered immediately upon the closing of the long positions and vice versa.

Rewards of market volume analysis

Large market volume spikes indicate that a significant number of shares, not have, but are, changing hands, prompting a shift to the prevailing support/demand balance. A wholesale transferring of shares during a mature up-trend (that is, the building of a resistive volume spike) can lead to the exhaustion of the bullish group of investors. The market may become oversold, making it prone to downside reversals. The opposite is true when a large supportive market volume surges appear during mature downtrends.

Market volume oscillation analysis must use a mathematical model to characterize price movements base don critical volume spike levels. The strategy of using elevated oscillation levels to anticipate market reversals, however, remains sensitive to the status of the prevailing long-term trend. Oscillation levels, therefore, should be re-analyzed on a regular basis so that critical oscillation values can be re-calibrated for the prevailing market situation.

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If there is any single indicator upon which market sentiment can be objectively gauged in a contemporaneous way, that is , while the market is moving , it is market volume. It is universal, entirely reliable and, if garnered comprehensively and acted upon properly, provides the key to successful investing with nearly non-existent downside risks. Required for this analysis are tools to measure and coalesce market volume intensity, comparative history, and duration in order to identify genuine spikes that signal a market reversal before it is underway.

The attractiveness of this system is that it generates trading market sentiment indicators in a precise, objective, even mechanical, way, excluding obviously less reliable, subjective or emotional factors from trading decisions, while producing favorable results.

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