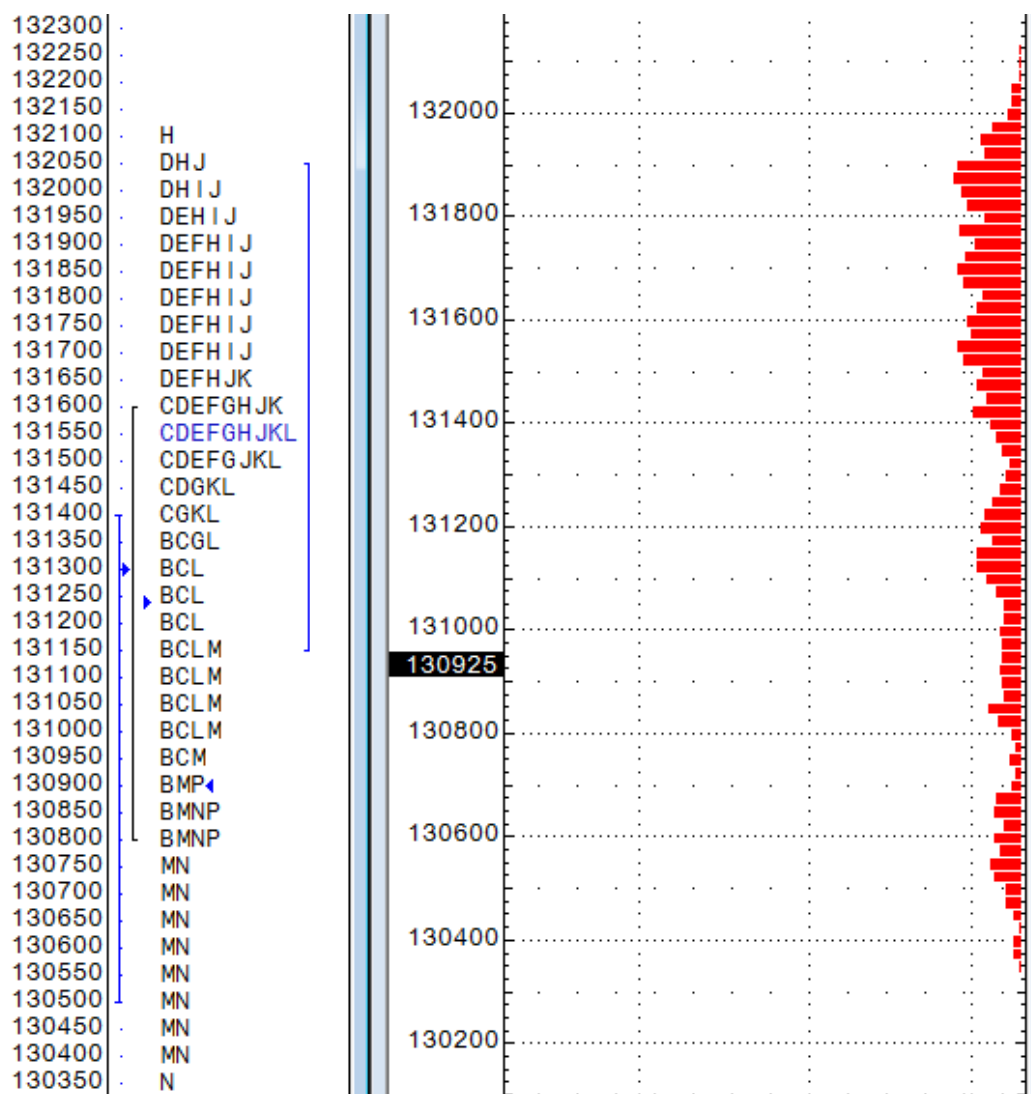


Trading Education Article 59 - TPO VERSUS VOLUME PROFILES

We have a fascination with numbers and exactness; at the same time we abhor ambiguity. Volume Profiles will show you exactly how much volume, as well as relative volume, occurred at each price as well as the exact number of contracts for the entire session. See the example below.



The three main components of the auction process are;

1. Price—advertises all opportunities.
2. Time— regulates all opportunities.
3. Volume—measures the success or failure of the advertised opportunities.

What the volume Profile does not show is far more important to the way I trade. I believe it is the more ambiguous combination of time and volume, rather than volume alone, which provides me with the best information. Clearly volume is important but so is time. A price that is not accepted over time is, in fact, rejected.

The psychological pressure of time—drip, drip, drip, for example—is a feeling known to all traders. Being in a trade that begins to stall can create great psychological doubt; the longer a trade fails to advance, in our favor, the longer we have to imagine what might be going wrong. The late liquidation or short covering rally in the pit session may be more the result of time running out for the day trader rather than a lack of volume; more likely these situations are a combination of both.

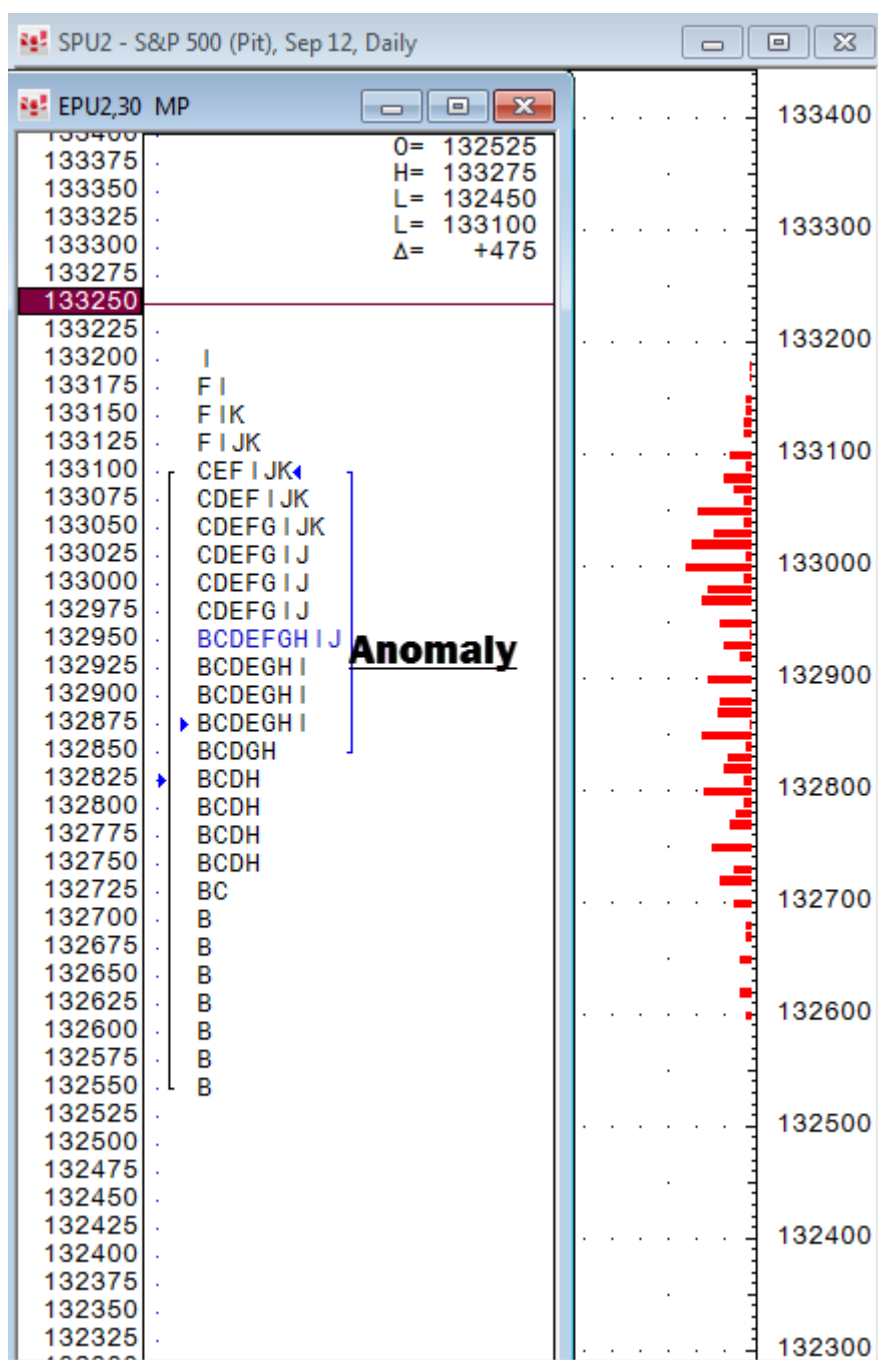
SINGLE PRICE LEVEL DISTORTIONS—It is not uncommon to see much higher volume at or around a single price or level. For example, the previous day's high or low or the overnight high or low are likely to attract above average trade. Additional examples include the opening as well as halfback. When viewed on an absolute volume basis, these levels may appear to be far more prominent or important than they deserve to be; combining both time and volume will more likely smooth these prices or levels allowing us to better maintain a more complete overall perspective.

END OF DAY TOTAL VOLUME VERSUS ONGOING VOLUME THROUGHOUT THE DAY—It is not uncommon for a market to develop a tone or direction for a day; this tone or direction may not be confirmed by volume however the directional auction continues until the close. In many instances the correction, due to lack of volume, is corrected the following day. In other words, there is a delay in the effect low volume may have on a market.

ANOMALIES—An anomaly is a single price or price level that lacks symmetry, it is an unusual structural arrangement in the Market Profile; anomalies represent structural weakness. Anomalies are created through a combination of time and price; they may not show on volume Profiles. Volume Profiles alone are likely to identify many false anomalies, for example, the previous day's high or low as discussed earlier.

These structural weaknesses are often revisited during the current or following trading session. The next graphic will help make this point.

TPO PROFILES NEXT TO VOLUME PROFILES



It is hard to believe that these two Profiles are from the same market on the same day; the difference is combining time and volume; in a conventionally constructed Profile, volume is estimated by multiplying price x time. The greater the number of TPOs reading from left to right, the higher the estimated volume. It isn't perfect however, I believe it is superior to using volume alone.

You can construct volume Profiles in many platforms using letters. The difference being that the POC and the value area are constructed based on volume. Nonetheless this volume Profile does not reflect the time element. The TPO Profile allows me to better understand how volume is being distributed;

1. Is volume being distributed within a rotational market.
2. Is volume being distributed as part of a trend.
3. I start a new Profile anytime I think that a new directional auction is underway; I want to compare the new volume to the old volume.

TOO FOCUSED ON VOLUME—Volume is only one element to consider within a trading day. I have talked with several traders who attempt to rely almost exclusively on volume. Among the other considerations are:

1. Value: where is it developing—higher, lower, overlapping, etc.
2. Rotational trading day.
3. Trend day.
4. What timeframe is in control; this is very important.
5. One-timeframing.
6. Short covering.
7. Long liquidation.

CONCLUSION—Make your own decisions after reviewing both side-by-side on your own platform; no matter what you decide there is never a single, simple answer. After you make your comparisons write down your observations. Both TPO and volume Profiles are helpful; they needn't be pitted against one another. However, I give more emphasis to the TPO Profile because I believe that it provides a more accurate representation of the auction process by its inclusion of time in conjunction with volume. Additionally, it smooths some aberrations when there is high volume at the opening price and other static references such as the prior pit session high and low and the overnight high and low.