SURFING THE ORDER LINES PART 2
*By Daryl Guppy*

Most of the newsletter case study examples are end of day. The exit signal is based on the closing price and the exit decision is made on the next day. In the newsletter we often talk about stop loss exit discipline and the role this plays in long term trading success. It is a habit I stress in all my books, and this is common with most serious trading books.

But every now and then we override this rule and keep a position open after the exit signal has been given. This is a discretionary decision which is used in real trading. Several readers have asked for an explanation, and it is difficult to write about. This type of decision is based on experience and feel for the market. It relates to the behaviour of the market, and the behaviour of the particular stock being traded. There are many small details that come together to help form an overall picture that contributes to the decision to delay the immediate execution of a stop loss order when the market opens on the next day. Last week we discussed the background. This week we look at understanding order line behaviour.

ORDER LINE CONTINUITY

When we talk of buying pressure or selling pressure we bring together this market volatility behaviour, the velocity of trading and our understanding of liquidity. This combination allows a better analysis of the pressure within the market. We want to decide if this is temporary, or permanent. Specifically we want to know if the low price set yesterday that triggered our stop loss is an isolated and temporary price point, or if it is part of a broader trend. We use the order line structure and the buying or selling pressure to combine yesterday's price activity and the opening minutes of today's price activity to decide if we have a situation that would have been ignored if this were a single day of activity.
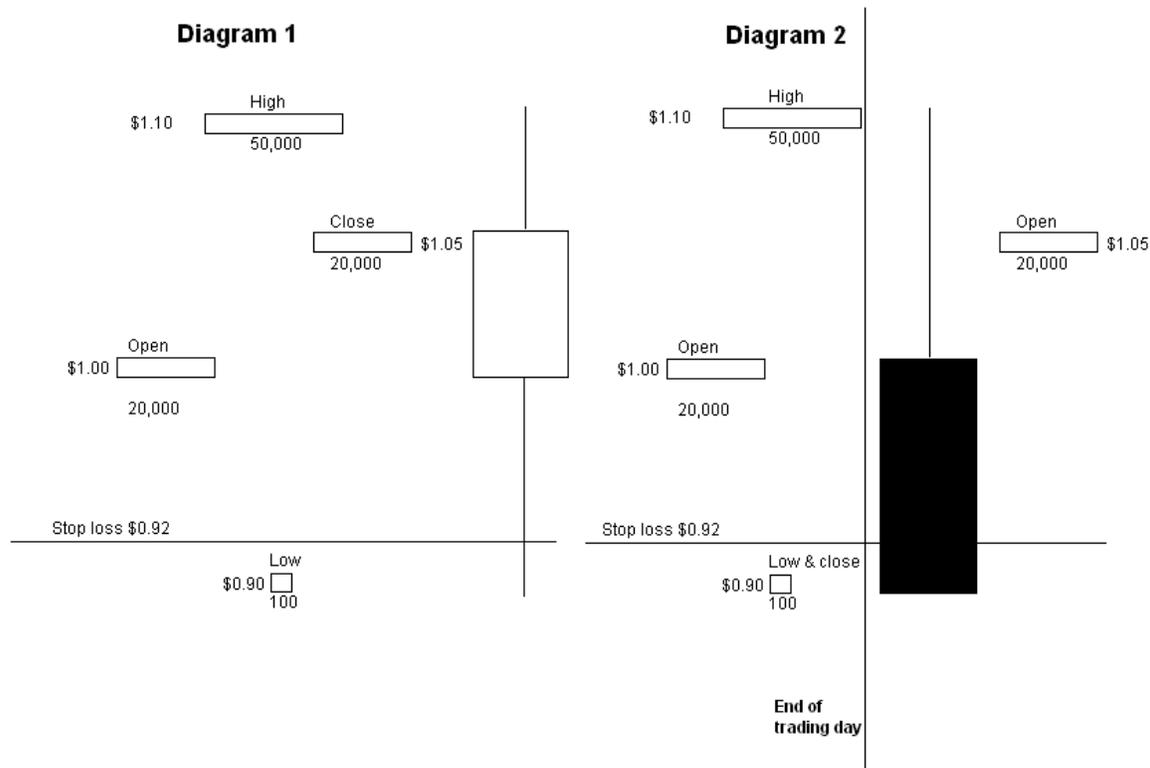
Diagram 1

Diagram 2

The diagram shows the difference. Diagram 1 shows a day with four price levels. Our stop loss is at $0.92. The intraday day low at $0.90 is ignored because the close at $1.05 is much higher. Additionally we know that the intraday low was on a sale of just 50 shares. The trades at the other 3 price points were 20,000 or more. Despite the low volume at $0.90 the tape is 'printed' with this price and it sets the low for the day. The candle for the day is a white candle.

If we were watching the intraday order screens we would see that this $0.90 'print' was an isolated panic trade out of character with the usual order line activity. It was low velocity – an isolated trade. It has no impact on the way trading developed after the single low point trade. In real time this analysis is easier because we can see the line up of buy and sell orders.

Now shift to diagram 2. In this case we end the day at a different time point, immediately after the tape is printed at $0.90. Now the nature of the candle changes, with the low of the day also being the close of the day. This is a black candle. The stop loss exit is triggered so we have to exit on the next day.

We manage the exit on the next day in the same way as we would observe the low $0.90 print on the intraday chart. We use the order line to decide if this is an aberration, or part of a general trend. If it's an aberration, we delay the placement and execution of a stop loss sell order. This is not guesswork, and it is not second guessing the activity on the next day. We base this decision on the continuity of the buying or selling pressure we see in the order line.

This decision is made more difficult because we do not have the immediate order line continuity that we have on an intraday chart. However the principles of decision making, based on the tape reading, remain the same. It is essential that

these principles are applied rationally and that they are not used as an excuse to stay in a losing trade and not take action.
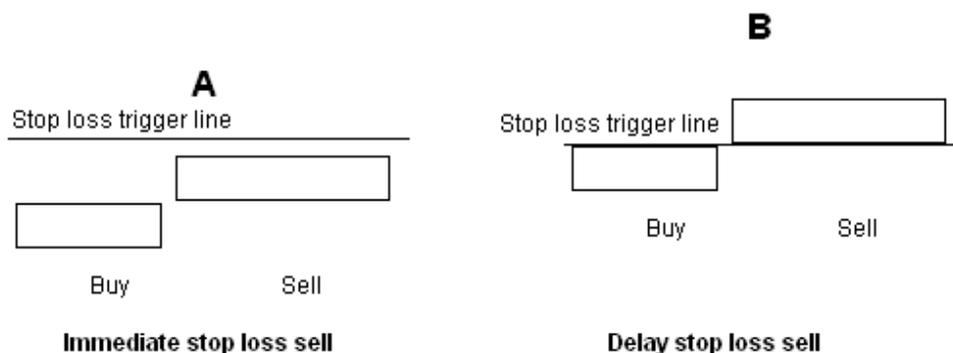
PRESSURE

All of the features mentioned above help us to decide if the stop loss exit signal seen on the end of day chart translates into buying or selling pressure when the market opens on the next day. In our case, if we observe selling pressure then we must join the sellers and exit the trade. If we see an absence of selling pressure, or if we see buying pressure, then we can delay the exit decision and watch how the price activity develops. This ultimately, as in a recent case study example, may defer the stop loss exit decision and leave the trade open.

We are looking for active evidence of buying or selling pressure. We also look for evidence of implied buying or selling pressure.
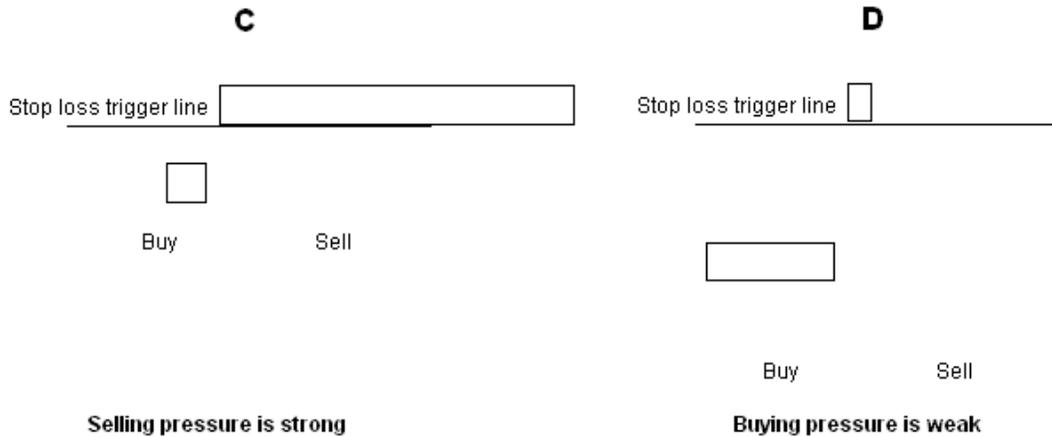
SELLING PRESSURE

The diagram shows the types of selling pressure that would automatically signal the immediate execution of the stop loss order at the most favourable market price. In situation A the sellers are clustered below the stop loss trigger level of $0.90. Buyers are lower again. Immediate stop loss sell.

In situation B the sellers remain above the stop loss level. Adding your sell order would increase the selling pressure and may force a sale at a lower price than would otherwise be the case. Remember, others are watching the order line and making decisions based on the growth and changes in the order lines. Your action in placing an order will influence their decisions. The objective is to follow the market, not the lead the market.

In situation C we see strong selling pressure that is confirmed by the absence of buy orders. The length of the box is used to show the comparative volume. Although the sell order is still at $0.90, there are no nearby buying orders. There is a high probability that one of the sellers will jump the line, and sell at the lower level. The stop loss solution here is to be the first to jump, placing your sell order under the bulk of sell order and above the highest buy order. Your order will fill the gap. The objective is to tease out a buyer so your position can be unwound. In this situation, getting out is more important than getting out at your preferred price. The buyers are simply not interested.
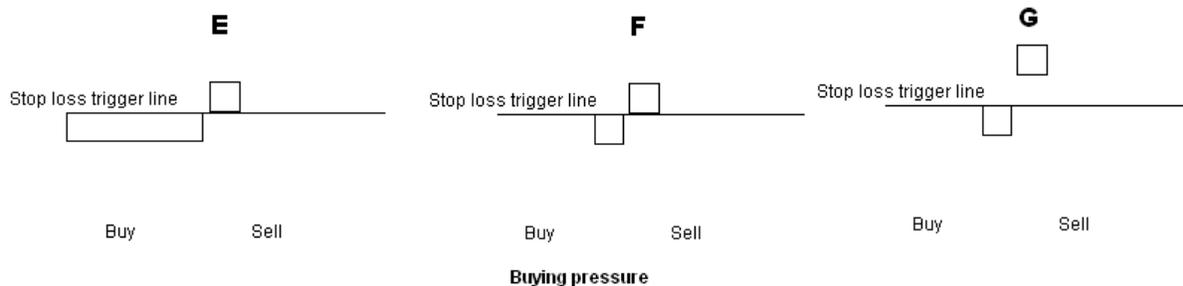
C   **D**

Stop loss trigger line   Stop loss trigger line

Buy   Sell   Buy   Sell

Selling pressure is strong   **Buying pressure is weak**

In situation D we also see strong selling pressure, even though the sell order volume is small. The buy order are clustered much lower, perhaps $0.86. There is a low probability buyers will lift their price. This is market selling pressure because buyers have disappeared. It is not physical selling pressure as in situation C. In situation A, C and D, the trader acts on the stop loss signal from the previous day. His task is to get the best possible exit on the day. He exits because there is a low probability of a price rise.

Only in situation B does the trader delay the execution of his stop loss exit and wait for the order line relationships to confirm the exit.

BUYING PRESSURE

Buying pressure sounds easy, but it is not the exact reverse of selling pressure. Situation E,

E   **F**   **G**

Stop loss trigger line   Stop loss trigger line   Stop loss trigger line

Buy   Sell   Buy   Sell   Buy   Sell
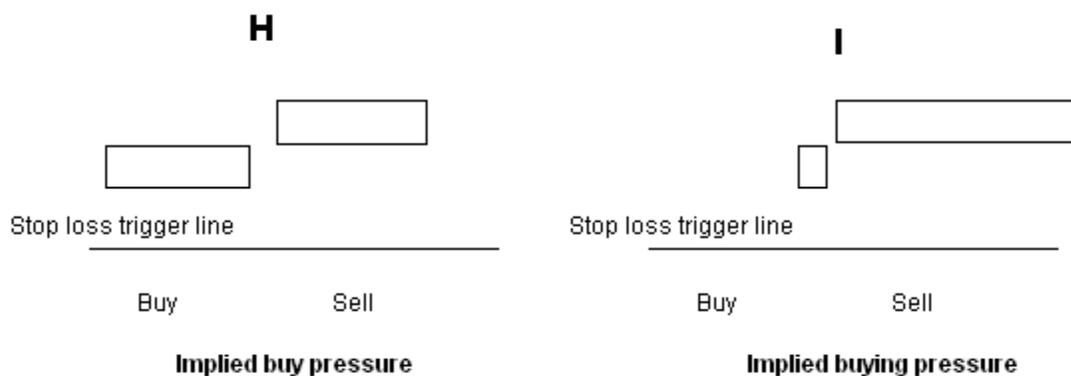
Buying pressure

F and G show buying pressure.

Situation E is the most common understanding of buying pressure. The large buy order is clustered under $0.90 and there are only a few sell orders. There is no need to act on the stop loss exit signal because there is a high probability that price will rebound.

Situation F shows moderate buying pressure. It is a return to the usual buy and sell situation that prevails with this stock. Buy and sell orders are balanced at

the stop loss level. It is similar to situation B. The addition of your sell order can tip the balance. The buying pressure here is confirmed by the absence of selling pressure.

Situation G is also good buying pressure which is created by the absence of selling pressure. Buying order size remains about the same size as normal. However the selling pressure has disappeared. The nearest sell order is well above the stop loss level. There is a low probability that price will drop back to the stop loss level and an even lower probability it will move below the stop loss level. Buying pressure is not decided by the traded price. It is decided by the relationship between the buy and sell orders. It does not depend on strong buying support. It also depends on a lower level of selling.

H   **I**

Stop loss trigger line   Stop loss trigger line

Buy   Sell   Buy   Sell

Implied buy pressure   **Implied buying pressure**

Situations H and I show implied buying pressure – even though no trade may necessarily take place at these levels. In both cases the buy and sell order activity on the day following the stop loss exit signal is above the stop loss level. In situation H the buy and sell orders are about the same size. In situation I the sell orders are larger. However both buyers and sellers are, in principle, prepared to trade at high prices than yesterday's close. This is strong buying pressure, even though a trade might not take place.

Classically a no trade day is taken as evidence of low liquidity and price weakness. Tape reading shows a different relationship. It tells us the selling pressure has receded. It tells us that all participants are prepared to do business at a higher price than yesterday. The fact that they cannot agree – that no trade actually takes place – does not diminish the bullish impact of this prodder line. In

situation H and I, traders do not execute their stop loss order based on the previous day's close.

When an end of day stop loss exit signal is triggered I always use intraday charts to manage the exit on the next day. My objective is to first use tape reading analysis to determine if an exit is required. I look for buying pressure. I also look for absence of selling pressure. If an exit is still required, I use the activity in the order line to try to get the best exit price possible. Tape reading is not a rule based exit method. It is based on experience and judgement. It is essential that this analysis of the order line is not used as an excuse to delay an exit.