



JIGSAW TRADING

# Practical Application of Order Flow Part 2 – Tape Reading, Order Book

Peter Davies – Jigsaw Trading



# Reading Order Flow

- Order Flow components
  - INTENT
    - Resting Orders – Market Depth, Depth & Sales
  - ACTUAL
    - Executions – Time & Sales, Reconstructed Tape, Summary Tape, Footprint, Cumulative Delta, Depth & Sales
- Order Flow is subjective, it is more like reading a story than following a rigid set of rules.
  - Changes over time vs Static setups (e.g. SOBI)
- The use of Intuition/feel....
  - Spiritual nonsense?
  - Psychobabble?
  - Every day run of the mill way we do pretty much everything?



# Intuition/Feel

- Driving, golf, tennis, ten pin bowling, telling the time, flying a plane, writing, swimming, playing pool, skiing, surfing etc. etc. are things we do without much conscious effort.
- These things required deliberate, conscious effort during the learning period. Now they are automatic (implicit memory).
- We weren't very good at these things when we first started.
- Our skills improved with repetition.
- Once skilled, if we focus too much on conscious effort our performance will be suffer.
- **Is it not true that most things in life are like this?**



# Use of Order Book in Prop Shops

- Not all prop shops are the same.
- Interns are not allowed to use charts whilst they are trading – AT FIRST.
- They generally use XTrader. Depth, executions, volume profile.
- Order Book traders ARE using the profile, they are looking for good trade location, even though they are scalping the book.
- Internships last 12 weeks at which point some traders go live on 1-2 lots. For people that never even placed a trade before.
- Of course, many traders never go live.
- Take with a pinch of salt the “10,000” hours. “I have enough of the guys telling me I had to quit my job or university just to watch the charts like 9 years and then work with 50 indicators and interpret them right. It sucks. I really wanna do it this way and I’m making progress, I really like that”. –J, Austria





# Order Book Training in Prop Shops

- European Prop Shops like Futex push traders towards Eurex. Eurostoxx is thick & slow, depth in the 1000's. Bund is thinner than the ES with depth in the 100's.
- Prop Drills.
  - Stay in the market all day.
  - Scalp 2 ticks out of the market, not allowing any trade to make more than 2 ticks profit.
  - Enter a trade at random & manage it as long as momentum is with you.
  - Enter a trade when you think a price will stick and see how long you can hold that price
  - Enter trades when you see momentum and exit when momentum stops. Make 70-100 trades per day.
  - Look for the market to make a short term range and scalp either side.
- Propex (Australia/Singapore) -  
<http://www.youtube.com/watch?v=Bqrma-vMxJQ>  
<http://www.youtube.com/user/GuyBower/videos>



# Order Book learning curve

- All order flow tools are variations of a common theme.
- There aren't that many things to look for.
- The skills of ABSORBING the information and USING the information are separate & this is what makes most people give up. They dive straight in, expecting to get something from it in the short term.
- The Jigsaw Tools were created to help with the absorbing of information.
- 60-90 minutes per session
- 1-2 times per day
- Charts OFF, alerts on.
- Focus on the trades first, not all of it.
- Speed, ease of ticks up vs ticks down, levels no-one wants to hit, volume to go through each level.
- You will then be able to look at depth/pulling/trade size.
- And yes – there ARE setups.
- No SIM trading.



# Order Book learning curve

- Stick with one market or at least 1 type
  - Some people will get along better with thin & some with thick
  - It's fine to spend some 'fun' time selecting one that suits you
- Keep your eye on the rear view mirror.
- Use screen recording software to
  - Record the action and then replay key areas
  - Play the day on fast forward (sounds odd – just try it)
  - Record your trades and replay them (Camtaisa/BB Flashback)
- Watch the opens
  - Often a “plain as day” order flow setup in the few minutes
  - Doesn't mean it's going to stick for the whole day!
  - Always look behind you.
- Treasury Scalping eBook/Video
  - [www.nobsdaytrading.com](http://www.nobsdaytrading.com)
  - \$70 – full refund if you don't like it.





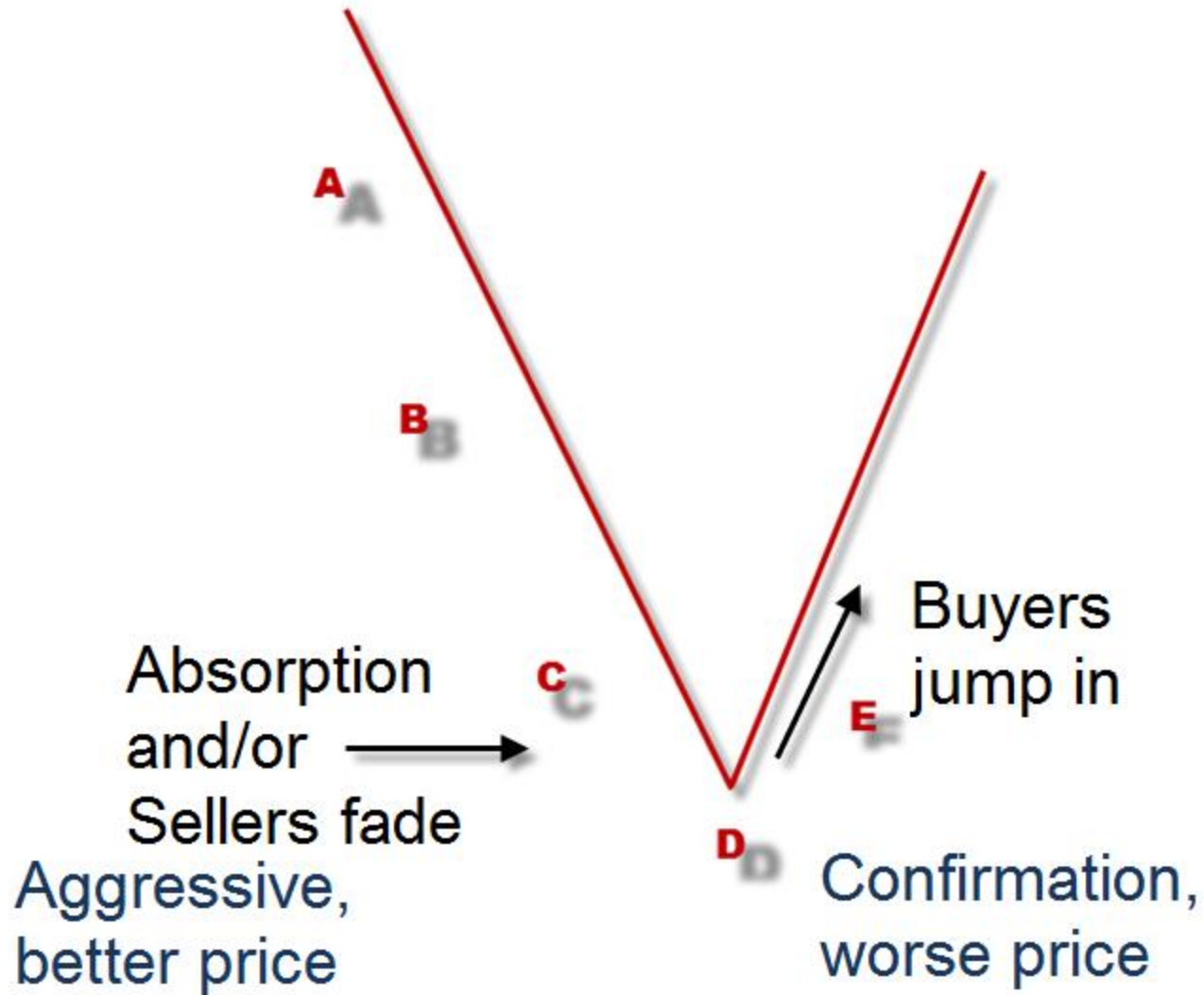
# Reversals - recap

- Basic components of a reversal (long to short)
  1. Absorption. Offers stay firm in the face of continued buying. Often this is with an iceberg, often this absorption/accumulation occurs across many prices. The more they can absorb the better. Delta will continue to increase but price will not. **Easy to spot in the order flow. Aggressive.**
  2. Buyers fade away. Buyers simply stop buying. Quite often they will return to the same spot several times and just not hit it. This is more significant when the offer is small. **Easy to spot in the order flow but the market does pause all the time. Aggressive.**
  3. Sellers come in and start selling. AKA “The Roll” there is not so much a fade in buying as much as the sellers just appear ‘out of nowhere’. **Hard to spot anywhere in a timely manner. Less Aggressive.**

These are not mutually exclusive!



# Reversals - recap



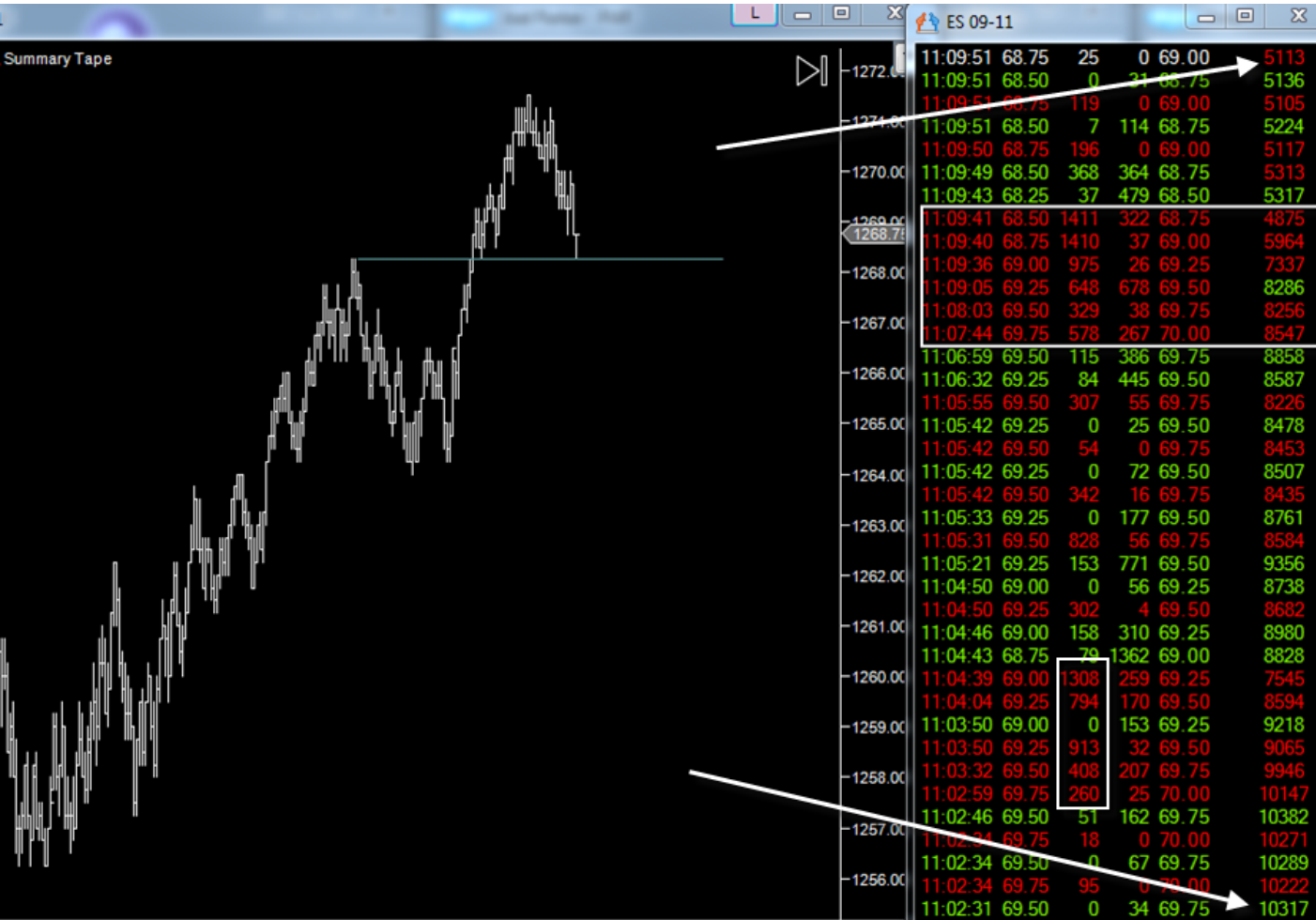


# Reversals

- Do not expect the reversals to occur at a single price
- Changes over time are more important than what occurs at a single price.
- Market can 'thicken up' (absorption) over 3-6 prices on the ES, although it can also be 1 price. Thinner markets will tend to be more 'wiggly'
- **Gaming is common, although this is also just a variation on the three reversal elements**
- A reversal of a major move, at a major level with a lot of people watching it is more prone to gaming. Reversals here will be over more ticks. You will still get 'to the tick' entries'
- A reversal of a pullback/second entry has less people watching it and will be easier to nail in terms of the exact reversal location.



# Absorption over multiple prices



7 Minutes, 20 seconds.

Price down 3 ticks.  
Delta down 5000 contracts

Sellers are there but they  
are not getting anything for  
their efforts.

They are getting trapped.

These plays occur over  
time.

These are not static  
setups.

This change in the order flow is not visible on the chart.



# Momentum

- Everyone wants to trade reversals.
- It makes some sense to focus on action at reversals.
- If you never take time to understand the mechanics of a market moving one way, you might miss out on signals warning that a reversal is risky.
- Momentum/Buying Pressure/Selling Pressure – all amounts to the same thing.
  - 500 print the offer & tick up, 800@offer & tick up, 700 @ offer & tick up, pull back a few ticks on low volume, 650 @ offer & tick up.... This is momentum
  - Then you see 3000 print the offer & no tick up. Momentum?
  - Understand that pauses are quite normal. Don't sell every pause in an up move.
- You don't have to trade momentum but it sure helps to not step in front of it.



# Spoofing – “banana in the tailpipe”

- Common misconception “spoofing makes the order book useless”.
  - Which is why the largest traders still do it ;-)
- The thicker the market, the more spoofing.
  - Thin markets present too much risk of being filled
  - Thick markets like ES – about 75% spoof
- Most levels will contain spoof orders. Actual liquidity is only known after the event.
- Flash spoofs that last a fraction of a second are predatory algos fishing for a reaction from other algos. Don’t pay attention to them.
- There will ALWAYS be an imbalance at the high and low of the day. Offers will be stacked at the high of the day and Bids stacked at the low of the day.
- Price does not ALWAYS move towards or away from size. If it did, I would just trade that. You have to develop a feel for whether the size is real or not...
  - Does a large bid/offer shrink away as price trades towards it?
  - Are other traders backing off as it gets to that large bid/offer?
  - What is occurring on the opposite side of the large bid/offer?
  - Does a large bid BEHIND a move step up as we move higher?
  - Does a series of excessively large bids come in behind us as we move up?



## Spoofering – “banana in the tailpipe”

- Orders are being added and taken away all the time.
- The closer to the inside bid/offer you are the more important this is.
- Remember that when you tick up, the bid has to build, so don't think that adding to the bid after a tick up or adding to the offer after a tick down is significant.
- A build over time or a build as orders hit (iceberg) is what you are looking for.
- Take time to focus on the inside depth + inside snapshot. Play 'which tick next'.
- There is no real benefit in showing your hand if you want to buy/sell a lot of contracts. Always look on the opposite side. Spoofer on offer/iceberg on bid.



# Q&A

Peter Davies – Jigsaw Trading

[peterdavies@jigsawtrading.com](mailto:peterdavies@jigsawtrading.com)

[www.jigsawtrading.com](http://www.jigsawtrading.com)