Presents:

The Lost Art of Tape Reading

by Sang Lucci
The Lost Art of Tape Reading Part 1

We’re bringing back an old series here at Sanglucci.com and taking it to the next level. I’ve gotten numerous requests to start addressing this topic in greater detail.

So that is what I intend to do folks.

First, the basics. If you read this post when I first wrote it a year or so back... read it again.

The term 'tape reading' gets its name from the old method of displaying trades. Information on bids and ask prices were printed on paper by a ticker tape machine. Investors would crowd around these machines and read the tape numbers to try and capitalize on the behavior of the market. The basic premise of tape reading involves evaluating the size of stock orders, the frequency of orders and the price at which orders are taking place (at ask, at bid, between ask and bid) to identify trends in trading behavior by insiders, professionals and the general public. Profiting from understanding these trends is what tape readers seek to do.

Today, everything is done electronically and within fractions of seconds. The tape has evolved to display it’s information through several tools readily available in most broker platforms. These tools are the 'time and sales' and the level 2. These two tools compile all the necessary information for the savvy tape reader. Gimme those two with a simple chart and I’m good to go!

Over the years, tape reading took a back seat to 'Technical Analysis'. Ironically, technical analysis is just a derivation of tape reading and seeks to transform bid and ask prices into charts and categorize specific price action into common chart patterns. This particular analysis also adds in the use of many 'technical indicators' that introduce even more patterns to the game.

Personally, I think the whole concept of technical analysis was designed for the simple purpose to attract more investors. More investors means bigger markets. Bigger markets means more cash money for the market makers. Technical analysis EXPLODED and new ideas were constantly being created. The more people followed the same patterns the more technical analysis became the foremost way to trade the markets. Candlestick charts, bollinger bands, cup and handle formations, inverted hammer sex positions are all examples of terms used by the avid technical analyst (Maybe I exaggerated on that last one, but tell me that doesn't sound like a sex position?)

To tape readers, the only two terms we really need to be concerned about are BID and ASK.

All the technical analysis in the world is just a simple recreation of price action (BID and ASK). Price action will always show you the way before any chart or technical indicator. That is a fact, not an opinion.

Alright Lucci, so how does one read the tape?

Stay tuned for the next part 2 of 'The Lost Art Of Tape Reading'
The Lost Art Of Tape Reading Part 2- The Bid and Ask

Folks, we continue this much anticipated series by bringing back another classic. This post breaks down the fundamentals that set the groundwork for this forgotten trading methodology.

'Bid' and 'Ask' are the two most important terms you'll ever hear a true tape reader talking about. Understanding these two basic tools will allow you to analyze what's happening on that Time & Sales so you will no longer assume it's just random numbers running down your screen.

**So without further ado, let's get crackin'!**

*The 'Bid' is the best price you can sell your shares/contracts at this exact moment. Vice versa for the 'Ask', which is the best price you can buy shares/contracts at this exact moment.*

Starting out at the prop firm, I always got the two confused and it took me a couple months to truly grasp what was going on logistically between the two. Normal rhetoric will describe the 'Bid' as the price that someone is willing to buy a security and that the 'Ask' is the price at which someone is willing to sell a security. Even the actual words themselves imply the action to be taken: 'bidding' suggests you want to buy whereas 'asking' or 'offering' implies you want to make a sale.

While this seems obvious to experienced traders, it added a lot of confusion to me starting out in this game. I remember sitting at my desk, staring at my screens looking at the 'Bid' and 'Ask' prices fluctuating sporadically and continually asking myself the question, "**So is that someone buying or selling?**"

I pride myself on explaining these instances so that all are able to understand and realize that this stuff really isn't as complicated as the books and teachers make it seem.

**So let's paint a picture here to help assist you in understanding these tools of the tape!**

First things first, imagine over a million people all at the computers right now placing orders for where they specifically want to buy or sell BAC. As one might suspect, these orders can range in prices from $10 all the way to $15. Realize though that at EVERY cent, there are buyers and sellers actively exchanging shares with each other. Every transaction holds a buyer and a seller.

**Let's examine this Time and Sales data before delving into 'Bid' and 'Ask'...**
• MMID- Market Maker ID. This shows what exchange the shares are being offered on.
• Bid Price - The price of the BEST bid. ($11.96)
• Bid Size – The number of shares at the BEST bid price. Keep in mind this is often times a collective number of all bids at this price. It's not necessarily one guy sitting at his computer wanting to buy 94,200 shares. (In the Time & Sales and Level 2, bids and offers are displaying omitting two zeros to save space so if you see 942 that means 94,200)
• Ask Price - The price of the BEST offer. ($11.97)
• Ask Size – The number of shares at the BEST offer. (57,600 shares)
• Last Transaction - The last price at which the most recent transaction took place ($11.96)
• Route- the route that was used to place the trade, using abbreviations (P=Arca, T=Knight).
• Size – The number of shares that exchanged hands during the most recent transaction (10,000 shares)
• Time - The time at which the most recent transaction took place (9:56:01:492)

Now, before you go bonkers on me check this out...

The last quote displayed above shows a 'Bid' of $11.96 and an 'Ask' of $11.97. Let's say you want to get active in this stock and buy it. You have two options you can either place an order to buy ('Bid') at $11.96 and WAIT for a seller to sell you their stock OR you can just buy the 'Ask' price at $11.97 and not have to wait. This is why I define the 'Ask' as the BEST price you can buy the stock for RIGHT AT THIS MOMENT. Placing bids is advantageous if you want to make sure you get a better price than just simply buying the 'Ask'.

This works vice versa if you want to sell as well. Let's say you own 400 shares of the stock and would like to sell your position. You can either place an offer 'Ask' at $11.97 and WAIT for a buyer to buy your shares OR you can just sell your stock to best 'Bid' at $11.96 and not have to wait.
The thing to realize here is that your limits may or may not get filled. If you want out of your 400 shares and you place a limit at $12.05 you must wait until the ebb and flow of the stock pushes it higher to your price.

Now that you understand the basics of 'Bid' and 'Ask', we're ready to talk about how to analyze and actually 'read' the constantly changing quotes and transactions in order to develop a theory as to where the stock will move in the future!

Stay tuned for Part 3 of 'The Lost Art Of Tape Reading’
The Lost Art Of Tape Reading Part 3 – Long Trades

Folks we continue this popular series by exploring some of the things you want to see on the tape if you are on the long side of a trade. This is an updated version of my previous post on the subject.

Alright lets get into it. If you find yourself long a stock, make sure you watch out for this stuff on the tape, it may help you out in providing even more conviction for your trade.

- **Look for large bids that step up.**
  - For example, if you are in Apple (AAPL) and see a 100K bid that shows up. Buyers step in front of that bid and you see that bid periodically moving up with the stock. This could mean that buyer is aggressive, wants more stock, and is willing to pay for up it.

- **The majority of transactions are going off on the offer price. (‘Ask’)**
  - You want to see people buying immediately and not waiting for their bids to get filled. You basically want to see them saying, “Screw it, I want to buy and I don’t care what price I get it at.” People buying on the offer are saying they are willing to sacrifice the price difference between bid and ask in exchange for immediately getting into the stock.

- **Level 2 is 'thin' on the offer.**
  - This means that if you took a glance at your Level 2 as far down as you can go, you don’t want to see too much size (resistance) all the way up. For example, you don’t want to see GIANT offers that will possibly hold your stock down. You want your long to go as smooth as possible with the least amount of complications on the way up!

- **Lack of down ticks**
  - Down ticks suggest selling on the bid. That means that sellers are aggressively exiting their positions instead of letting themselves get taken out at the offer price (where they would make more money in their exit). Down ticks create downward pressure on the price of the stock.

- **Futures (SPY) pushing higher**
  - The level of correlation between the S&P 500 (SPY) and large cap stocks has only increased in the last few years. For certain sectors, it can be as high as 90%. That means the SPY will be a very good indicator of where your stock is likely to go. If the SPY starts dropping, you better have some good arguments to stay in the trade. Otherwise, consider dumping that long position.

- **Controlled pullbacks**
  - You need to see buyers holding run-ups. If your stock goes up $.60, you want to see the sellers UNABLE to push the stock lower. During pullbacks, you don’t want to see your stock dropping quickly. You want to see evidence that heavy buying activity is still present. This will most likely result in second or third legs higher.

- **Higher highs**
  - Buyers should be unafraid of new daily highs. A stock that slows down at it’s highs may mean buyers are unsure and it’s time to take your profits.
• **Large Prints**
  
o  If you're seeing big transactions sizes go off on the offer and resulting sweep ups, chances are you've found a buyer that means business. He might be marketing large orders to get in to your stock and it's important to watch for continuation of that similar activity going forward.

*Every situation and every stock is different. These are simple guidelines, however, that you should always keep in mind if you're long a stock!*
The Lost Art of Tape Reading Part 4 - Short Trades

It's been almost a year since I wrote the last part to this series and with the introduction of our educational tape reading/options class, I’ve decided to bring it back for further exploration.

Ironically, price action analysis is starting to resurface from increased scrutiny of algorithmic trading. People are now trying to fully understand the ways that high-frequency trading affects equity prices on a second to second basis. Unfortunately, if you're looking at your charts, the only HFT you visually experience is the news algorithms that cause large spike-ups or spike-downs off of breaking news. Or you may see flash crashes in sporadic names at random when there has been no fresh news issued on that security. HFT goes way beyond what you view on your red/green candlestick charts.

On the tape, you’ll watch HFT's decrease or increase liquidity within fractions of a second by pulling back bids or offers. You’ll watch large orders influence buyers and sellers for a short period of time and then cancel soon after. You’ll see manipulation of equities by order-execution algorithms or large hedge funds needing to achieve certain prices for buy or sell orders.

Of course, if you don't know how to decipher your time and sales, then you won’t be able to follow the footprints of the larger players. Large funds buying or selling is what moves equity prices and if you can understand their digital signatures, you might just find that edge you've been looking for.

Trackers are known in the wild for their unique ability to find and follow trails & correctly read their surroundings. Modern tape readers are, in essence, using similar principles to properly analyze their environment.

So let's continue where we left this series by delving into the short side and what you basically want to watch out for on the tape when you're in a short trade.

• **Look for large offers that step down**
  o A large trader or fund that needs to clear out of a large position will try everything they can to hide their true intentions. But often times you will see a large offer come into the market and then people sell right ahead of that offer, forcing the big seller to get aggressive in order to dump their shares. As a result, you may see that big offer slowly step down. For example, you see a 200K share offer at $550.24 and 20 minutes later that same size offer steps down to $549.40. That’s an aggressive seller that wants out.

• **Transactions are going off on the 'bid'**
  o You’re looking for motivated sellers. You’re looking for people who want to get out of their positions and they don’t care what price they get filled at instead of waiting for their offers to get taken out by potential buyers. Ideally, you're looking for panic.

• **Level 2 is 'thin' on the 'bid'**
When you glance at your Level 2 while short a stock, you don't want any unforeseen obstacles that will block your path to riches. In order for a stock to go down in price, you must have increased supply over the current demand. You're looking for liquidity to dry up on the bid side because buyers are bracing for a pullback. You also don't want to see any large bids standing in the way and keeping the stock up.

**Lack of upticks**
- You don't want to see increased buying activity when you're short a stock. Remember, the daytrading game is all about timing and if you want to have successful trades, you must be able to feel around correctly for the right timing. If you do see upticks, make sure they're few and far between.

**Lower lows**
- You're looking for your stock to continually make fresh lows and hold previous lows on the downside. You don't want to hold a short position on a stock that rallies back through previous support levels. This makes your trade much more difficult to hold.

Again folks, these are just simple things to look for when you're trying to make sense of the time & sales. To most, the transactions that fly down your screen look like the Matrix, a cryptic feed that only certain people can decipher. You’ll find out soon enough though, that market makers, institutions and large traders all have unique footprints which can only be tracked through the tape.

Try these few tricks above to get started and check out our classes beginning on January 14th, 2013. Show us this PDF and you’ll get $500 off the price of your class:

http://bullsonwallstreet.com/options-made-simple/