The #1 Indicator Of Institutional Traders

Introduction

When you get started trading the markets, it can feel like a casino.

No, I'm not talking about the ability to make and lose vast sums of money...

I'm talking about the bright flashly lights, trying to distract you and keep you entertained while they extract an edge from your play.

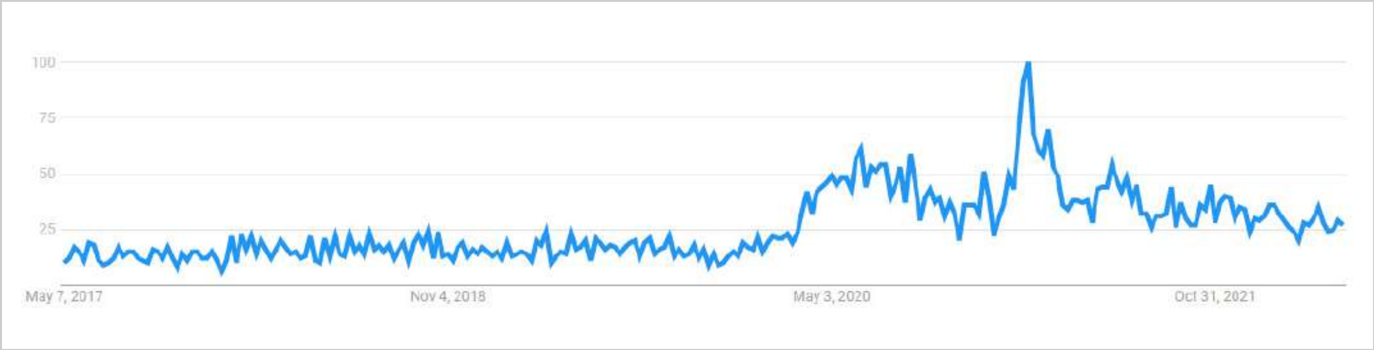
You'll get a trading platform with all sorts of bright and flashy indicators... and so many chase the "holy grail" to try and find the perfect trading system.

Yet underneath the surface is an indicator that, until very recently, was not available to retail traders.

It's an indicator that has been used on the institutional side for decades and holds tremendous power to help identify key turning points in the market.

We're talking about the VWAP.

It's popularity exploded in 2021 as new traders and new technology entered the market:



Just like any trading tool this can be used, or abused. This guide is setup to get you started with the VWAP so you can start using this to gain a massive edge in the markets.

What is the VWAP

VWAP stands for "volume weighted average price."

When I read this it can seem self-explanatory, but I'll try to rephrase it so we can get a better feel for how its calculated.

The VWAP shows us, over a certain timeframe, the average transaction price that market participants traded.

This is powerful information, as it can show you if buyers are underwater and how far they are from their average basis.

It allows you to "get in the head" of market participants to get a feel for if they are confident, or starting to sweat that their positions will start to move against them.

It can also show you the overall demand for a market in the long term.

Let's look at ARKK, a tech growth fund that has had both a boom and bust cycle:

We have a daily anchored vwap (DAVWAP) against the March 2020 lows. All the way through February 2021, the average buyer in this market has been in a profitable trade.

Then in March 2021, ARKK broke this VWAP, and then it traded sideways for a full year.

Then a breakdown happened, and the average buyer from the March 2020 lows is now at a loss.

Can you see how this captures the potential behavior of market participants?

By The Numbers

To calculate the VWAP, you take the average price paid as a function of total trading volume.

Let's look at a theoretical example.

A stock is trading in a range between \$5 and \$6.

You have a buyer who picks up 100 shares at \$5, and then another buyer who buys 100 shares at \$6.

So what's the average price?

Here's the math... let's start by figuring out the total price and volume traded:

> (\$5 x 100) + (\$6 x 100) = 1100

Then we take that number and divide it by the total volume:

> 1100 / 200 = 5.5

This calculation is done over many bars, and the fancy math looks like this:

$$\text{VWAP} = \frac{\sum (\text{Volume x Price})}{\sum \text{Volume}}$$

This can be done on an intraday basis, and is usually calculated for regular trading hours (RTH) for stocks.

Many futures traders will use both a regulart trading hours and extended trading hours VWAP for reference points.

Here's an example of a VWAP on AAPL during a trend down day:

And here is one for AAPL when it is seeing accumulation:

When the market is in a strong trend, sometimes you will not see the intraday VWAP touched. But many times it is used as a reference point for traders and fund managers.

The Edge Over Traditional Indicators

A more traditional trend indicator would be something like a simple moving average.

These can be very valuable tools, yet one drawback is that they can lag the market, especially when we see capitulation or trading excesses.

Let's go back to our ARKK example:

In late 2020, as more traders played the tech momentum theme, you saw more trading volume come into this instrument.

This caused the VWAP to accelerate to the upside. Meanwhile, longer term trend indicators were left in the dust.

Higher trading volumes can often be during turbulent times in the markets, and those volumes will help to "pull" a VWAP down to adjust for higher trading volumes.

How Funds Use the Intraday VWAP

Let's go back to our AAPL example earlier:

With this backdrop, I want you to imagine that you are sitting at a trading desk in Manhattan.

You get a call from your boss and one of your clients wants to buy 100k shares of AAPL before end of day.

Even if AAPL is the most liquid stock on the planet, you're going to move the market when you trade any kind of size.

So these trading firms will try all sorts of tricks to get the best fills they can.

Maybe they'll buy Nasdaq futures, buy AAPL and jam the market higher, then sell the NQ futures at a profit.

Or perhaps they'll flash heavy offers on the ask to drive the price lower so they can sweep up a good amount of shares cheap.

However they do it, one of the metrics they use to measure their performance is the VWAP.

If you are a very good trader, you can help get your buyer in at prices close to VWAP. If you did that, then you did your job.

Because everyone knows about how that plays out, it becomes a self-fulfilling prophecy. This is used by hedge funds, algorithmic traders, option vol specialists, and market makers.

Introducing the DAVWAP

At Precision Volume Alerts, we rigorously use the DAVWAP in our trading.

Unlike the intraday VWAP that resets every trading session, the daily VWAP gets a little tricky because we have to "anchor" it.

This is where it can tricky, because it is more art than science.

You can also end up with "VWAP Spaghetti," which is another form of analysis paralysis.

Yet when you can place them against key levels, you can gain a massive insight into the average participant.

Let's take a look at where some of the best areas are to anchor this indicator.

Pivot Anchors

If the stock has made a key pivot, then you will often see that level act as a great place to manage risk or put on a new trade.

Consider the SPY after the December 2018 lows:

The first retest of that DAVWAP was a massive level. Had you bought the market at that price, you would have seen a 7% rally over the course of about a week.

You can also combine several pivots together to "stack" them into powerful levels.

Gap Anchors

If a stock has a large gap on an event, anchoring against that level can provide key places to play the stock.

Take PYPL, which has been in a nasty bear market since 2021. It had a big earnings gap down in Nov 2021:

After an attempt to rally, the stock got knocked down again, the gap AVWAP was tested several times ento the end of the year. This was most likely institutions using it as a "good enough" place to unload inventory.

The next quarter, PYPL got obltierated, 100 points lower from those AVWAP levels.

By anchoring the October 2020 lows and the all time highs, there was a "last chance" level before the Russell 2000 got crushed.

YTD Anchors

You know you're not supposed to... but if you're like me you'll look at your YTD P/L. If you're doing great, then you feel like a genius, but if you're at a drawdown, you can end up making rash decisions.

The same mechanics play out when we anchor on the beginning of the year. It tells us if the average buyer is in a drawdown or not.

This is a chart of AMD with the YTD VWAP drawn. Any reversal underneath it has led to a combination of profit taking, stop losses, and selling momentum. Any of those were amazing short entries on the stock

How to Trade the VWAP

At Precision Volume Alerts, we use the DAVWAP in conjunction with several other items on our Trading Roadmap.

When they align, it can offer some powerful trading strategies.

The VWAP "Must Hold"

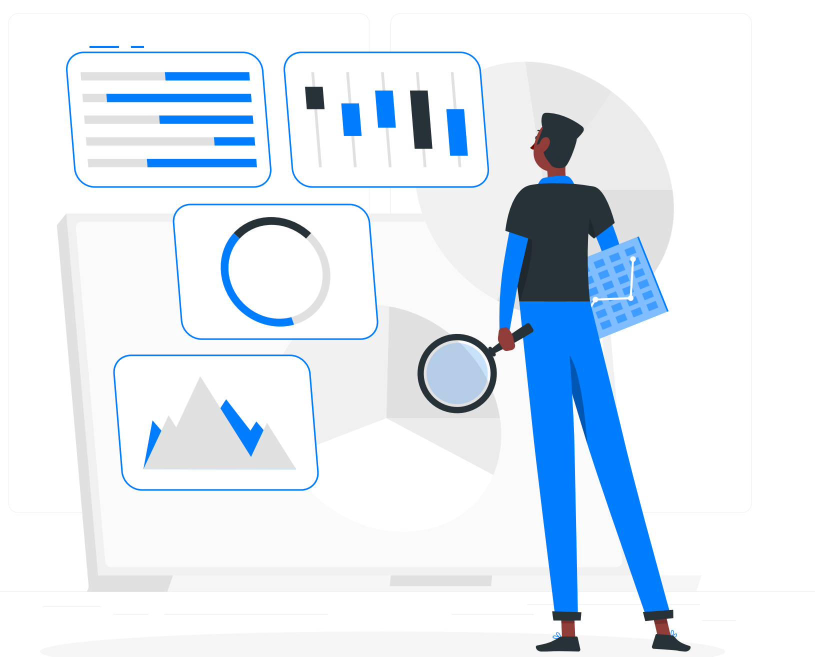
When price comes down into a key DAVWAP, along with a massive volume shelf, that is a level that is a must hold, and is often defended by existing buyers.

This example is in Peabody Energy (BTU).

At the beginning of December, we noticed a key level coming into play on Peabody Energy (BTU). This coal stock had a monster run over th epast year, and finally saw profit taking, with a pullback into a key low volume node (LVN) as well as a major AVWAP just underneath price.

We made the call to pick up the stock at 9.77 and to buy the April 14 call for 1.05

After building up some steam, the stock finally took off, running to our first profit target.low grinding move back to the swing AVWAP and an LVN.



We chose this as our first profit target because it lines up with the swing AVWAP from the recent highs, a key volume shelf, and prior support as potential resistance.

Did we know for 100% certainty that this is where the stock would find sellers? No, but it's where it had the highest odds of a pullback.

The stock then went on a massive run higher:

We were able to close out our final position at a 168% gain on the stock and a 1,104% return on the stock.

VWAP Clearout

After a parabolic spike higher, there's a tendency for an "echo squeeze" once the recent bagholders are cleared out.

n October 2021, we noticed that Lucid Motors (LCID) had tested it's DAVWAP from the beginning of its stock run. It had been consolidating for a few months and was ready to clear out that VWAP and start another run.

We picked up the stock at 28.15 and had a call option for 2.75.

The stock ended up going on a massive run back to the $55 per share level, leaving us with massive profits on this trade.

The VWAP is just one tool that we use for our Trading Roadmap. Keep your eye on your email for additional lessons to come.

Disclaimer

Futures, forex, stock, and options trading are not appropriate for all traders. There is a substantial risk of loss associated with trading these markets. Losses can and will occur. No system or methodology has ever been developed that can ensure returns or against losses. No representation or implication is being made that using any of these methodologies or systems will generate returns or ensure against losses.

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