The Imbalance Course

Module 1: What imbalances are, why they are important and how they are formed.

Disclaimer

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In the days of pit trading it was fascinating to watch the markets open and begin trading for the day. Now that everything is electronic the opening is kind of uneventful.

Seeing the traders and order fillers aggressively buying the offers or selling the bids really gave a trader an insight into the market direction, at least in the near term.

With electronic trading you don’t see when the Paul Tudor Jones’ S&P broker is buying 1500 lots and lifting every offer in sight. It was easy to spot on the trading floor when there was an imbalance in the market.

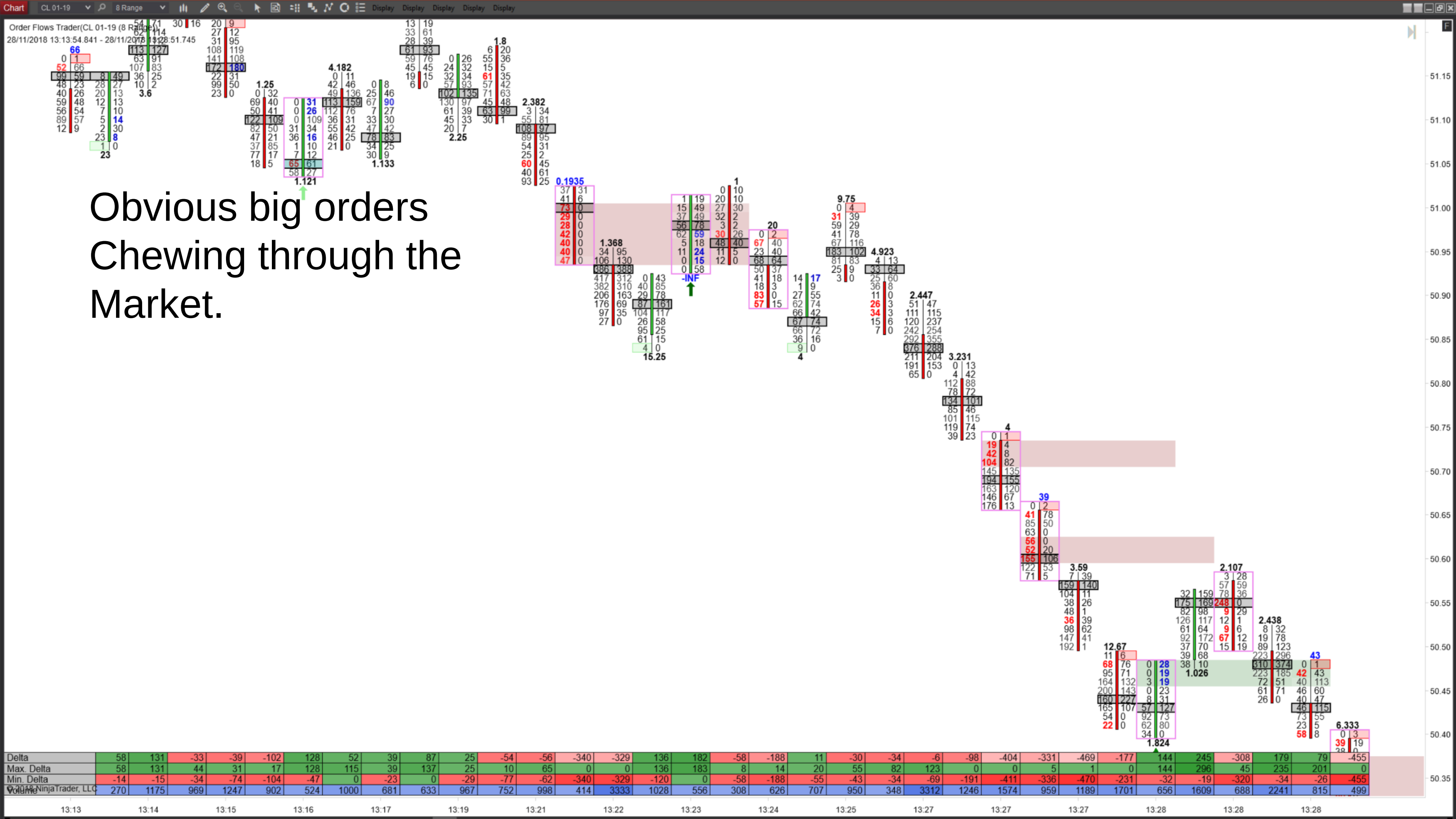
Chart
CL 01-19
8 Range
Order Flows Trader(CL 01-19 (8 Range))
28/11/2018 13:13:54.841 - 28/11/2018 13:28:51.745
Obvious big orders
Chewing through the
Market.
Delta
Max. Delta
Min. Delta
Volume
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One of the misunderstandings of order flow is that you can easily see what the big boys, the institutions are doing in the market.

Actually what you see is big orders going through. You don’t see who the underlying trader or firm.

The way you see it is in order flow imbalances. You are not going to see it by watching each tick go through. There is just too much noise watching time and sales.

Institutional activity shows up in the 2-way auction in the form of imbalances.

Module 1

The whole purpose of putting together this course on order flow imbalance is to teach you the thought process that goes on during the trading day, not to say “buy here” or “sell here.”

Most people new to trading, new to order flow want to be shown where to buy and where to sell instead of learning how to understand and interpret what is happening in the market.

Most traders are familiar with imbalance because of what they learned by studying Market Profile where the market is either balanced or out of balance.

When dealing with order flow imbalance you are looking specifically in a bar and seeing when the market imbalanced at that moment in time.

Market Profile deals with imbalance in a macro sense, while order flow deals with imbalance in a micro sense.

Module 1

Order flow imbalance occurs when there are more aggressive traders than aggressive buyers.

4 types of traders:

Aggressive buyers – traders who buy at the market. They buy the offer and the next offer.

Aggressive sellers – traders who sell at the market. They sell into the bid and the next bid.

Passive buyers – traders who work limit orders on the bid or below the bid. They let the market come to them.

Passive sellers – traders who work limit orders on the offer or above the offer. They let the market come to them.

Module 1

The market trades in a two way auction.
There is a bid and an offer.

	Qty	Price	Price	Qty	
			2711.25	691	Passive Sellers
			2711.00	562	
			2710.75	241	
Passive Buyers	85	2710.50			
	149	2710.25			
	822	2710.00			

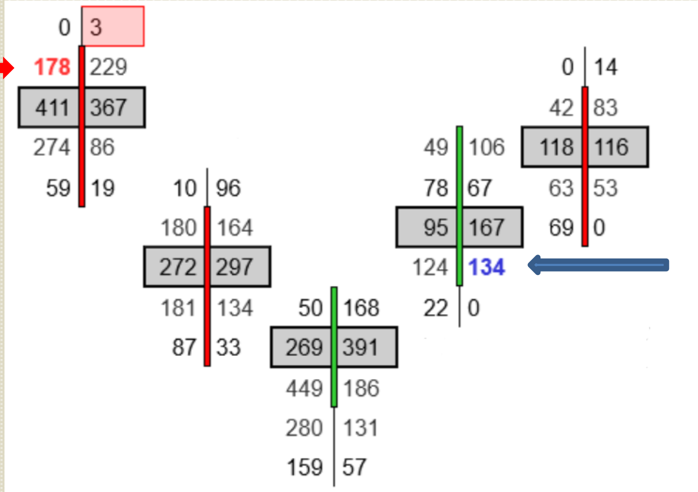
For a trade to happen, a trader has to become aggressive, he either has to change from a passive bidder and become aggressive and buy the offer or change from a passive seller to an aggressive seller and sell the bid.

Module 1

An order flow imbalance occurs when there are more aggressive buyer than aggressive sellers or more aggressive sellers than aggressive buyers based on trades on the bid vs the offer, diagonally. NOT HORIZONTALLY.

On order flow charts buying imbalances are generally blue While selling imbalances are generally red.

Selling
Imbalance
178 vs 3
NOT 178 vs 229



Buying
Imbalance
22 vs 134
NOT 124 vs 134

What causes an imbalance?
A buying imbalance occurs when there are more aggressive buying orders coming into the market.
A selling imbalance occurs when there are more aggressive selling orders coming into the market.

Why they are coming in is not important to an order flow trader, what is important is recognizing and identifying they are coming into the market.

Knowing there is an imbalance occurring can give you an edge over other traders oblivious to the fact there is an abundance of orders in one direction that is moving the market.

Module 1

It takes large orders to move the market. Large orders come from large traders.

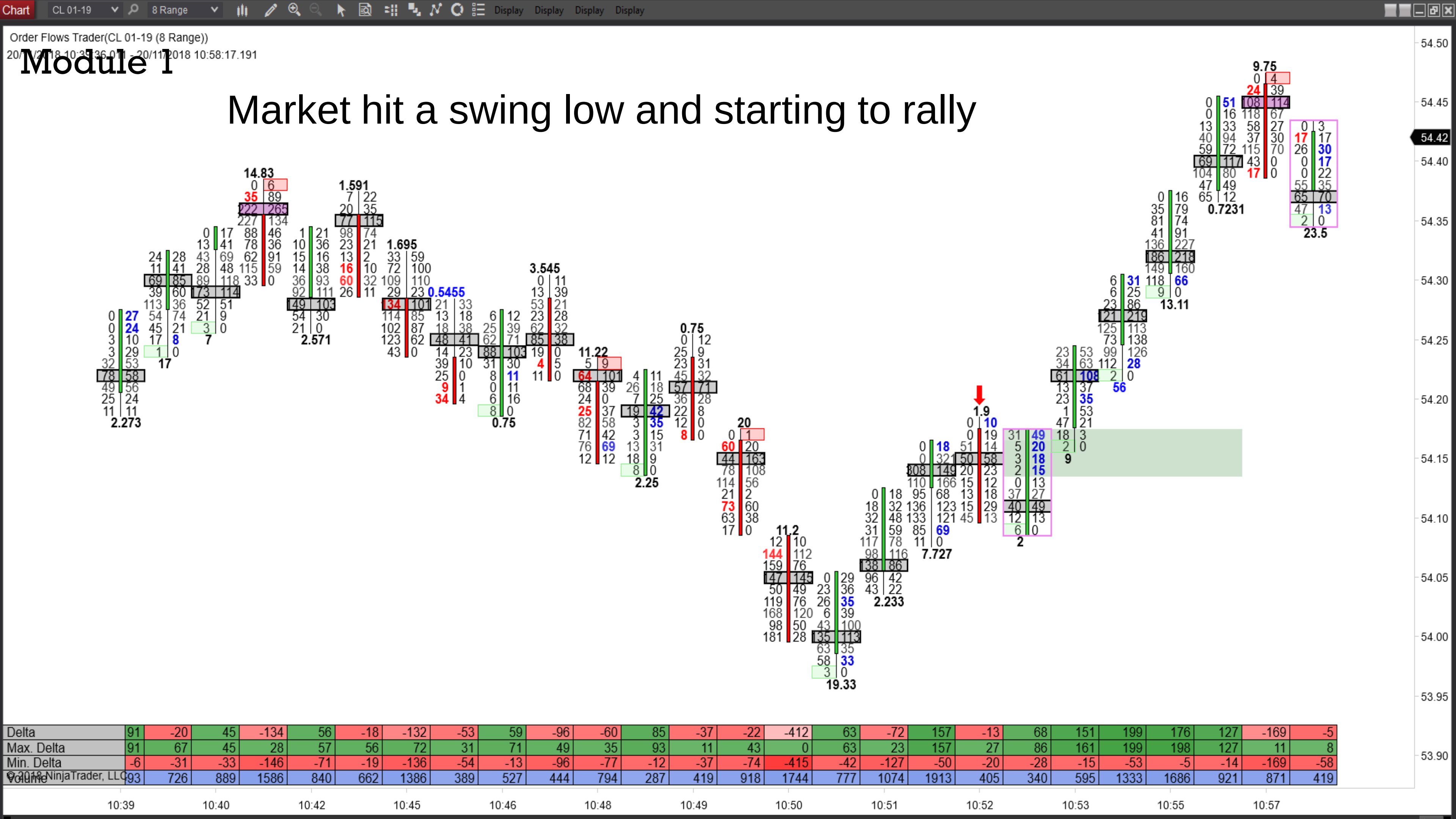
Generally speaking, institutional traders are the money that has conviction and will move the markets.

To get the most out of order flow imbalances you have to think similar to the institutional trader causing the imbalance.

Where is the market currently trading relative to key reference points and more importantly value.

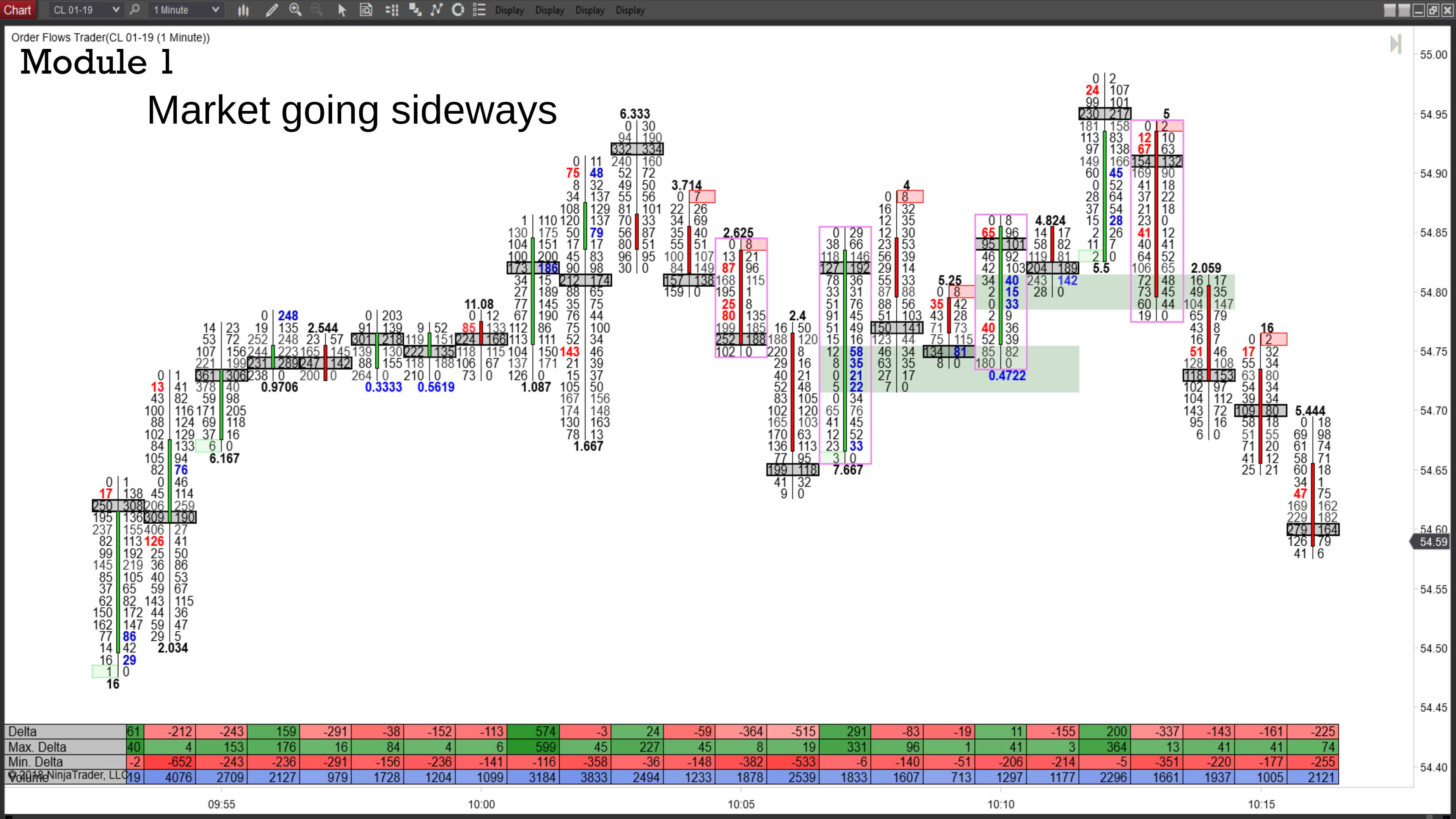
Module 1

Market hit a swing low and starting to rally



Module 1

Market going sideways



Delta	61	-212	-243	159	-291	-38	-152	-113	574	-3	24	-59	-364	-515	291	-83	-19	11	-155	200	-337	-143	-161	-225
Max. Delta	40	4	153	176	16	84	4	6	599	45	227	45	8	19	331	96	1	41	3	364	13	41	41	74
Min. Delta	-2	-652	-243	-236	-291	-156	-236	-141	-116	-358	-36	-148	-382	-533	-6	-140	-51	-206	-214	-5	-351	-220	-177	-255
Volume	19	4076	2709	2127	979	1728	1204	1099	3184	3833	2494	1233	1878	2539	1833	1607	713	1297	1177	2296	1661	1937	1005	2121

The general market consensus is an imbalance is formed if the more aggressive side out numbers the less aggressive side by a ratio of 4 to 1.

But 4 to 1 is not set in stone.

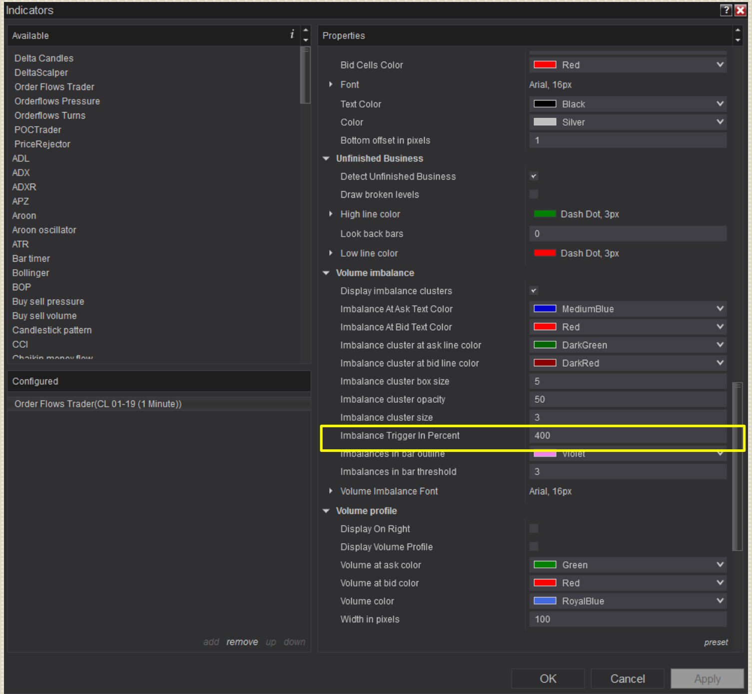
You can use 10 to 1. You can use 5 to 1. You can use 3 to 1. But I really would not venture below 3 to 1.

Remember you want to measure more aggressive trading in certain direction.

Module 1

Your order flow software should allow you adjust your imbalance ratio. You just have to find it.

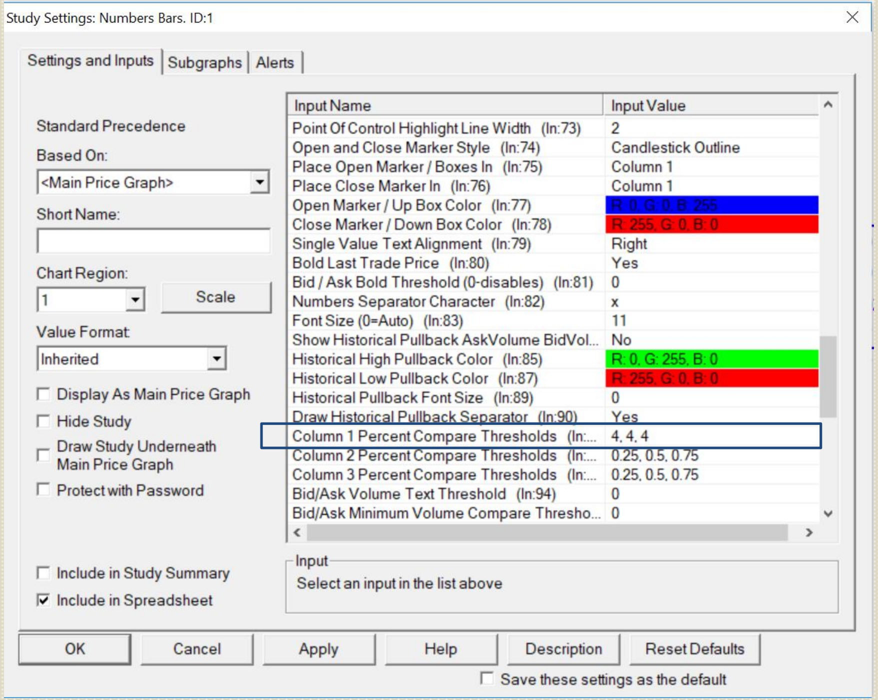
On the Orderflows Trader Software its here:



Module 1

Your order flow software should allow you adjust your imbalance ratio. You just have to find it.

On Sierra Chart Software its here (more complicated):



Module 1

I think it is important to know there is often a time decay of sorts with order flow imbalance. As time goes on, the imbalance loses it importance.

Don’t treat an imbalance as a level to hold all day long, instead I view it as the lighter fluid to get the fire started.

Remember, if a big buyer comes in and the market doesn’t or can’t rotate up that could be a sign in change of bias.

Module 1

What I like about order flow and think its why I gravitated to it was because it was very visual and it allowed me to understand the dynamics of what was occurring in the market at a glance.

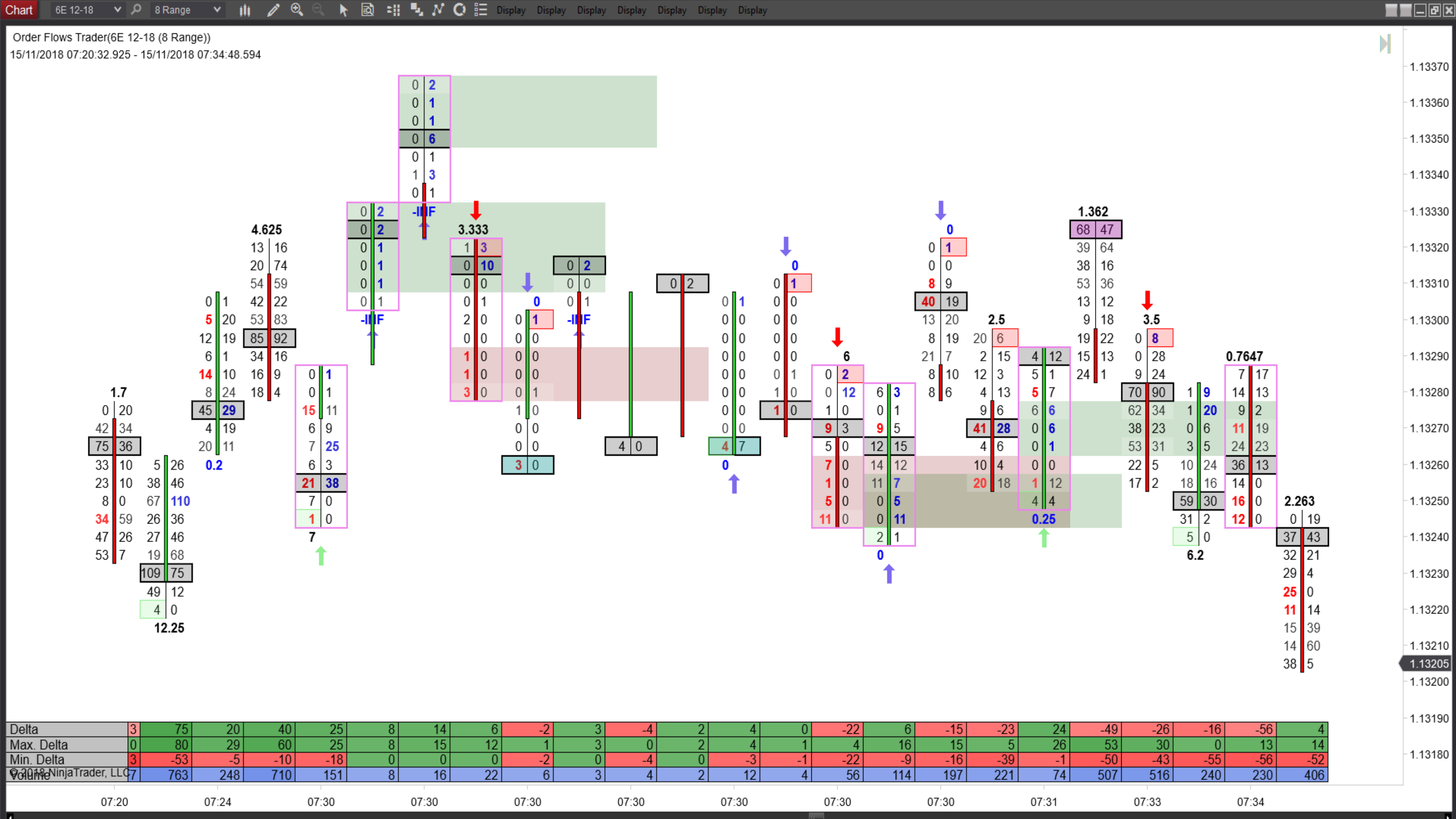
Imbalances, especially in its extended forms or stacked and multiple imbalances was very easy to identify and determine what was happening in the market.

A limitation of imbalances is when the market conditions are considered “fast market” you tend to get an abundance of imbalances everywhere.

This is due to the fact that most data providers cannot keep pace with the data and it looks a mess.

This often happens when there is a big data release like NFP or API numbers in the CL market.

Generally though you most likely won’t be trading through a number.


Order Flows Trader(6E 12-18 (8 Range))
15/11/2018 07:20:32.925 - 15/11/2018 07:34:48.594
Delta 3 75 20 40 25 8 14 6 -2 3 -4 2 4 0 -22 6 -15 -23 24 -49 -26 -16 -56 4
Max. Delta 0 80 29 60 25 8 15 12 1 3 0 2 4 1 4 16 15 5 26 53 30 0 13 14
Min. Delta 3 -53 -5 -10 -18 0 0 0 -2 0 -4 0 -3 -1 -22 -9 -16 -39 -1 -50 -43 -55 -56 -52
Volume 7 763 248 710 151 8 16 22 6 3 4 2 12 4 56 114 197 221 74 507 516 240 230 406
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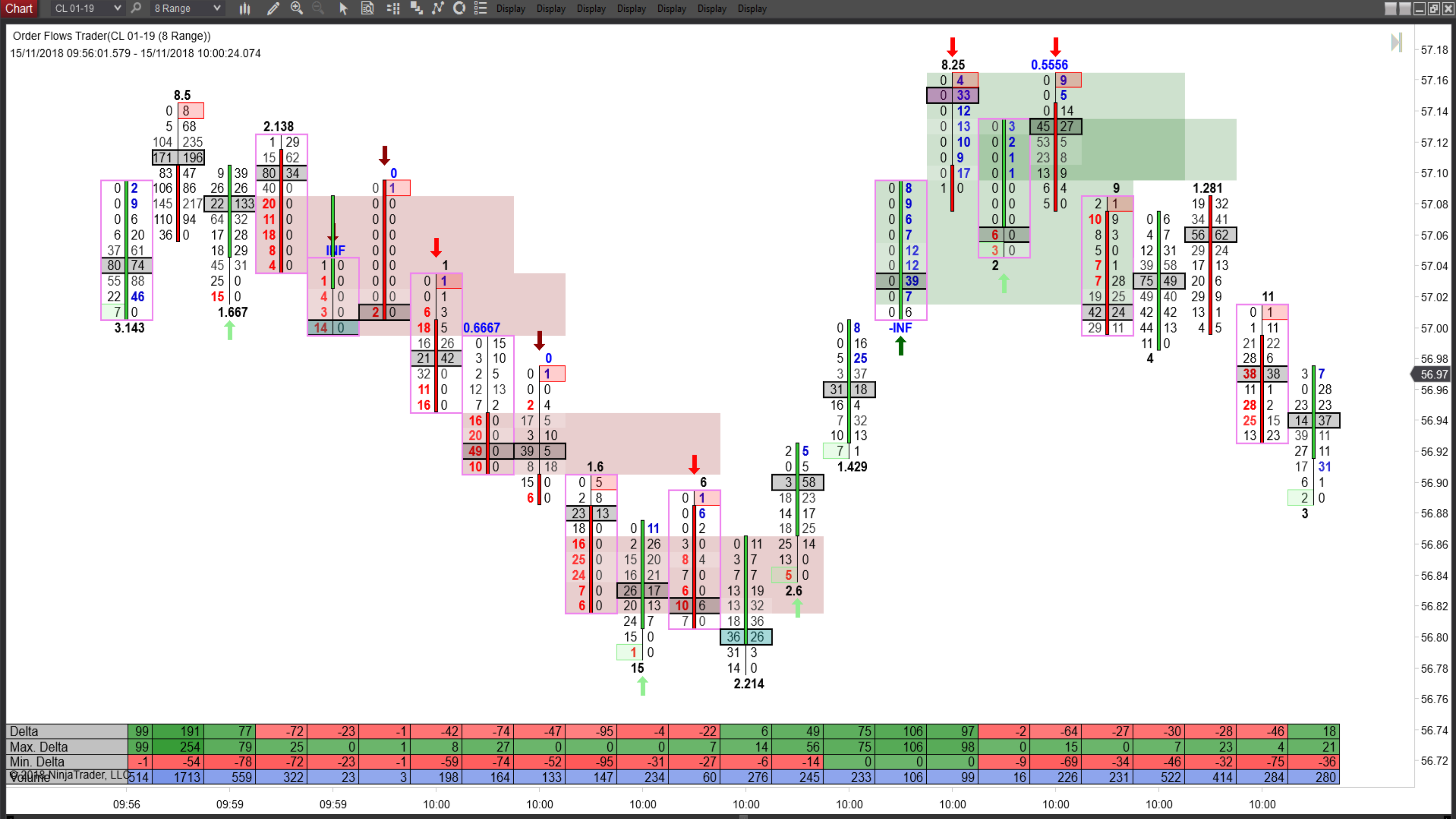
Chart
CL 01-19
8 Range
Display
Order Flows Trader(CL 01-19 (8 Range))
15/11/2018 09:56:01.579 - 15/11/2018 10:00:24.074
Delta 99 191 77 -72 -23 -1 -42 -74 -47 -95 -4 -22 6 49 75 106 97 -2 -64 -27 -30 -28 -46 18
Max. Delta 99 254 79 25 0 1 8 27 0 0 0 7 14 56 75 106 98 0 15 0 7 23 4 21
Min. Delta -1 -54 -78 -72 -23 -1 -59 -74 -52 -95 -31 -27 -6 -14 0 0 0 -9 -69 -34 -46 -32 -75 -36
Volume 514 1713 559 322 23 3 198 164 133 147 234 60 276 245 233 106 99 16 226 231 522 414 284 280
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09:56
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This is the end of module 1.

In module 2 we will discuss Individual, Stacked and Multiple Imbalances.