

Vwap strategy pdf

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You’ve likely heard the term VWAP used by traders and chartists. This refers to a moving average indicator called the volume weight average price (VWAP). This useful indicator is used by retail traders, institutional traders and market makers in several different ways. The VWAP is displayed as a moving average line on a chart. The line is a moving average that tracks the price value traded over the total volume usually on an intraday chart. How is VWAP Calculated? The VWAP is calculated (automatically) by taking the average of the high, low, and close for the time period and then weighting that average price by the total volume traded for that period. As the day goes on, you would need to continue to keep updating the formula for each time period to derive the VWAP line throughout the day. This can be tedious and thus most trading platforms will automatically calculate the VWAP as an indicator throughout the day. Why Is VWAP Used? For intraday traders, the VWAP is often used as a trend indicator. For money managers and institutions, it’s often used as benchmark price value to gauge the quality of executions from their traders or market makers. Hedge funds and algorithms will embed VWAP into their trading systems for various strategies. VWAP is widely followed and that in itself can make it a self-fulfilling factor of importance. What is Anchored VWAP? The VWAP is constantly calculated from the start of the market open to the close. For any number of specific reasons, a trader may want to specify the starting point to start calculating VWAP at a different time other than the open. This is where an anchored VWAP is used. An anchored VWAP starts calculating from a selected starting period by the user. There’s a number of reasons for using an anchored VWAP like trying to normalize a price due to a large price gap up or down. How to Use VWAP Most platforms have the VWAP indicator which is usually displayed as a moving average trend line. It’s important to check for the indicator on your specific brokerage charting platform as part of the ‘how to set-up on your charts’. The typical timeframe will be intraday starting off the opening trade. Keep in mind that VWAP works best when there is plenty of volume. Most charting platforms usually provide the VWAP indicator on the charts. Anchored VWAP vs. VWAP Normally, the regular VWAP is sufficient for intraday trading. The anchored VWAP can be considered if there is a large irregular trade on the time and sales or a large gap up or down. For example, if XYZ is trading at \$24.47 and then a trade comes in at \$36.76 then back to \$24.46, then you might consider an anchored VWAP is you can’t edit out the irregular trade. Typical Timeframes The VWAP is typically used intraday with the default settings. Many VWAP indicators also come with an upper and lower trend line that is similar to a Bollinger Band. The intraday time frame VWAP value can change depending on the time frame of the chart. A 5-minute or 15-minute VWAP is typical when trading intraday to illustrate the trend. Why is VWAP Important? The VWAP indicator is significant for the purposes of its use. It provides a context of the price trend depending on where the stock is trading (above or below) in relation to the VWAP line. A stock trading above the WAP as the line rises indicates an uptrend and vice versa on a downtrend. For example, if stock XYZ has a falling VWAP line, then you may want to wait for the stock price to pierce the VWAP and reverse back up to play with the trend. VWAP provides a visual basis for supply and demand based on its relation to the stock price and the direction of the trend. Popular Indicator Since VWAP is such a popular tool utilized by traders, it can often have characteristics of a self-fulfilling prophecy. If a stock is trading higher but still under the VWAP, traders may anticipate the test of the VWAP and step into a long position targeting the VWAP. As traders jump on board trying to get ahead of the next trader, the stock may naturally rise towards the VWAP. On the flipside, bears that expect a rejection at the VWAP may place their limit orders to short-sell the stock at the VWAP expecting profit takers and more sellers to come in. The VWAP is most useful when combined with other indicators or with a trading methodology. Used by Institutions Institutions and fund managers may use the VWAP to gauge the quality of their order fills. If they are constantly getting filled above the VWAP, it may cause the manager to seek other market makers or traders to carry out the order fills. Institutions may want to get into a position, but the price at which they get in can make a market impact. The VWAP is also used to gauge the liquidity and market impact of institutional orders. If the trader is recklessly filling orders, then it will cause shares to rise triggering a chasing element to the fills and a potential steep drop once the orders are filled. How to Trade With VWAP There are many ways to trade with the VWAP. Again, it works best when combined with other complementary indicators including momentum indicators like MACD or stochastic. Support/Resistance One of the simplest uses of the VWAP is gauging support and/or resistance. It’s a simple line (VWAP) that acts as a support if the stock is trading above it and a resistance if the stock is trading below it. The direction of the VWAP line is the indication of the trend thereby using it as a de facto trend line. Entry and Exit Levels One trader’s support is another trader’s resistance. In other words, a trader who is long a stock can use the VWAP as a target exit if its trading below. Traders looking to take a long position can wait for the stock to breakout through the VWAP for longs or pullback and bounce off VWAP on pullbacks. The VWAP makes for a great entry and exit area. If you also have the accompanying higher and lower envelopes, these can be used for entries back towards the VWAP. Gauge Relative Strength A stock trading over intraday VWAP may be bullish, while a stock trading under may be bearish. A quick glance at the chart immediately provides you a gauge of relative strength or weakness. When you combine the VWAP reading for benchmark indexes and peer stocks, it enables you to compare and gauge whether your stock is exhibiting relative strength or weakness. It also enables you to think through your trade more thoroughly. For example, shorting a stock that is uptrending and trading above its VWAP makes it susceptible to a short-squeeze as you are trading against the trend. Whereas, shorting a stock that is downtrending and trading below the VWAP enables you to trade the relative weakness aligned with the trend. Trade VWAP Price Crosses When the underlying stock price crosses the VWAP up from below, it can represent a breakout. This can be a signal to go long the stock. If a stock falls below the VWAP, it could signal a short-sell trade as it breaks down. The VWAP also makes for a good stop area if the support is broken. For example, you may plan on entering XYZ on a breakout through \$27.10 which is the VWAP and place a trail stop \$0.20 below the VWAP. This enables you to devise a quantifiable game plan for your trade. Remember, the VWAP works best when combined with complementary indicators, especially momentum indicators. The information contained herein is intended as informational only and should not be considered as a recommendation of any sort. Every trader has a different risk tolerance and you should consider your own tolerance and financial situation before engaging in day trading. Day trading can result in a total loss of capital. Short selling and margin trading can significantly increase your risk and even result in debt owed to your broker. Please review our day trading risk disclosure, margin disclosure, and trading fees for more information on the risks and fees associated with trading. Volume-weighted average price (VWAP) is a commonly used benchmark derived from a ratio of the average share price for a stock compared to total volume of shares traded over a particular time frame. This measure helps investors and analysts evaluate the current price of a stock and determine whether it is relatively overpriced or underpriced compared to the average trading price for the day. Often this information is used to facilitate the entry or exit of a position. The VWAP is used as a benchmark to determine the quality of executions in large orders. For example, if a portfolio manager wants to acquire thousands of shares, but also wants to purchase the position below the average price for the day, the VWAP will usually be the price to beat. A trader tasked with acquiring such a large position will be considered successful based on a comparison between the average purchase price and the VWAP at the time the position was accumulated. Volume-weighted average price (VWAP) is a ratio of the cumulative share price to the cumulative volume traded over a given time period. The measure often serves as a benchmark for comparing trade executions. The VWAP uses intraday data. Some traders use the VWAP to indicate the timing of buy and sell signals for intraday trading. VWAP is an intraday price measure that can be used to help investors decide whether to adopt an active or passive approach to position entries. It can also be useful for making decisions on whether to enter or exit a given security. Many traders use the VWAP to help them buy at relatively inexpensive prices, and sell at comparatively higher prices. The VWAP is calculated using the opening price for each day and adjusting in real time right up until the close of the session. Thus, the calculation uses intraday data only. The formula for calculating VWAP is as follows: 
$$VWAP = \frac{\text{Cumulative typical price} \times \text{volume}}{\text{cumulative volume}}$$
 The calculation begins with the Typical Price (TP) price of the first completed bar or candle on the chart which means it is dependent on the time frame of the chart being observed. For example, on a five-minute chart, this would be the Typical Price of the first five-minute bar or candle. This price level is the average of the high price, the low price, and the closing price of the candle. Consider the following example using these pre-selected inputs:  $\{(H+L+C)/3\}$ , if  $H = 44.54$ ,  $L = 43.96$  and  $C = 44.28$ .  $TP = (44.54+43.96+44.28) / 3 = 44.26$  The next step in the VWAP calculation is to multiply TP by the volume (V) in the period being measured to find the Total Price Volume (TPV). If  $V = 35,000$ , then TPV calculates as follows:  $TPV = 44.26 \times 35000 = 1549000$  The VWAP for the first candle ends up being the Typical Price because the volume component cancels out in the first iteration of the calculation. However, things change for the next candle. The formula then calculates cumulative price and volume in the following procedure for the second candle and similarly for each subsequent candle thereafter:  $TPV(\text{Candle } 1) + TPV(\text{Candle } 2) = TPV(\text{Candle } 1) + V(\text{Candle } 2)$  If we suppose that the second candle closed with a typical price of 43.96, and a volume of 32000, the price and volume product for the second candle would be 1,406,720. This amount would be added to the TPV for the first candle. The VWAP keeps the running total of the volume and price information aggregated throughout the day to give the current VWAP in real time. Thus, to continue the example, the VWAP can be calculated by dividing the TPV sum by the cumulative volume amount of 67000 (35,000 from Candle 1 and 32,000 from Candle 2). Therefore, the VWAP after the second candle would be obtained as follows:  $VWAP = 1549000 + 1406720 / 67000 = 44.11$  This indicator is calculated for any time period to show the VWAP for every data point in an intraday stock chart. This is done automatically by charting platform algorithms. Thus, the trader only needs to specify an intraday time frame to see the results of the VWAP calculation. Because it combines price and volume together in its value, most analysts consider the VWAP to be more representative of a true average price of the stock. The calculation of the VWAP is independent from, and does not directly affect, the stock's closing price. Since the VWAP calculation is based on historical data it is still considered a lagging indicator, but that doesn't stop traders from using this measure to establish support and resistance levels suitable for intraday trading. In addition to this, because institutional traders use the VWAP as a benchmark for execution activity, the VWAP price level is considered to be highly influential in intraday price action. For the reasons previously mentioned, most professional traders agree that the VWAP is influential and useful when trading in short-term timeframes. Strategies for intraday trading using the VWAP might be as simple as buying the first closing price above VWAP as an entry, and selling at a predetermined point above it. But more often than not, the strategies for trading hold a bit more complexity than that. The reason for this is the widespread belief among professional and nonprofessional traders that enough institutional traders use the VWAP as a benchmark. Traders often believe that a recognition of this dynamic must be factored into the trading strategy. As a result, a trader might use VWAP as a filter for their activity. They might go long only when the price is below the VWAP and short when the price is above VWAP. This filter would be based on the point of view that benchmark-beating buyers are more likely to create support when the price is below VWAP, than when it is above it. This filter would work well for days with relatively sideways price action. By contrast, other trades might prefer the opposite tactic. They would thus assume entries for buying a stock should only occur when price is above the VWAP and short-selling entries should only be undertaken when the price is below it. This filter would be based on the point of view that benchmark watchers are unable to get the price they want and will be forced to push the stock further into its trend for the day. This filter would work well for days that had a well-defined trend for the day, whether upward or downward. Neither tactic executed over a large number of trades appears to hold a statistical edge. Therefore traders often combine their VWAP approaches with other indications. That helps them to work with a more profitable filter depending on how they perceive the day's price action will play out. For example, a trader can also use the VWAP in conjunction with Bollinger Bands. These are a set of trendlines plotted two standard deviations (positively and negatively) away from a simple moving average (SMA) of a security's price that can be adjusted to user preferences. Traders may enter into a trade based on a VWAP signal and exit the trade based on a Bollinger Band signal, or vice versa. Perhaps the most interesting use of the VWAP trade comes from programmers who have created a standard deviation of price range anchored to the VWAP. This creates price regions above and below the VWAP which make for surprisingly robust, real-time support and resistance measures (see example below). Consider the following hypothetical example of a more sophisticated version of VWAP representation. This chart below depicts a 5-minute time frame during a period of just over two-days duration (click on the graphic for an enlarged chart). The VWAP line shown here (blue line) makes for an excellent intraday strategy filter. Not all days trade like this, but these two days represented a fairly sideways price action, and under such conditions, intraday traders like to have a game plan. A strategy to make trades based on a reversion to the average price for the day would work well here. In this setting, the VWAP indicator becomes very useful. When additional regions are added to the chart that represents statistically significant distances from the VWAP line, they can make excellent guidelines for when to initiate long positions (in support regions) or to initial short-selling positions (in resistance regions). One approach for trading might be to initiate a long entry when the price closes in a support region, with a stop-loss order outside the farthest line of the region, and a profit target at the VWAP line. A similar setup for short-selling at resistance can also be employed. This method will fail quickly on trending days, and make multiple successful trades on sideways days. Note also that the support and resistance regions from previous days can also be significant markets for future days when the price is moving sideways. Example.



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