



DISCORD: INSTITUTIONAL_SCALPER (friend request)

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ABSORPTION IN TRADING

In trading, 'absorption' refers to a phenomenon where large buy or sell orders are executed without significantly impacting the price of a financial instrument. This usually occurs because there is sufficient opposite interest to "absorb" these large orders. Absorption is typically observed when a large volume of buy orders is absorbed by sell orders at a certain price level, or vice versa, which indicates strong support or resistance.

Key Points of Absorption in Trading:

1. Definition:

- Absorption occurs when substantial buying or selling pressure is met with sufficient opposite orders, preventing significant price movement.

2. Indicators of Absorption:

- **Large Volume:** High volume of trades occurring at a specific price level without the price moving significantly.

- **Order Flow:** Continuous flow of orders on one side being matched by orders on the opposite side.

- **Price Stagnation:** Prices remain stable despite large orders being executed, indicating that the market is absorbing these orders.

3. Support and Resistance Levels:

- Absorption is often seen at key support and resistance levels where market participants have placed significant orders.

- For example, at a resistance level, large sell orders absorb buy orders, preventing the price from rising above that level.

4. Market Sentiment:

- Absorption can indicate strong market sentiment and expectations. For instance, if buyers are consistently absorbing sell orders, it may indicate bullish sentiment and expectations of a price rise.

How Absorption Works:

1. Order Book Dynamics:

- The order book shows the depth of market with buy and sell orders at different price levels. When a large buy order is placed, it matches with the existing sell orders in the book. If the sell orders are sufficient to absorb the buy order, the price remains stable.

2. Real-Time Trading:

- During real-time trading, large orders that do not cause significant price changes can indicate absorption. For example, if there is a large buy order and the price does not rise, it means sell orders are absorbing the buy order.

3. Volume Analysis:

- By analyzing volume at different price levels, traders can identify where absorption is occurring. High volume with little price movement suggests absorption.

Example of Absorption:

- Scenario:

- A trader places a large buy order for 10,000 shares at \$50.00.
- The order book shows numerous sell orders at \$50.00.
- The buy order is executed without the price moving above \$50.00 because the sell orders at that price level were sufficient to absorb the buy order.

Importance of Absorption in Trading:

1. Identifying Market Strength:

- Absorption can indicate the strength of a support or resistance level. If a price level is absorbing large orders, it signifies strong market interest at that level.

2. Trade Entries and Exits:

- Traders can use absorption to identify optimal entry and exit points. For instance, entering a buy position where there is strong absorption of sell orders might indicate a good support level.

3. Predicting Breakouts:

- Understanding absorption can help in predicting breakouts. If a resistance level is consistently absorbing buy orders, a subsequent breakout above that level may lead to a significant price movement.

Practical Application:

- Tape Reading:

- Tape reading involves analyzing the order flow and identifying absorption. Traders look for large orders being executed with little price change to spot absorption.

- Volume Profile Analysis:

- Traders use volume profile charts to see the volume traded at different price levels. High volume at a particular level with stable prices indicates absorption.

- Algorithmic Trading:

- Absorption data can be integrated into trading algorithms to improve the precision of trade execution and to avoid placing large orders in thinly traded markets.

In summary, absorption in trading is a critical concept that helps traders understand the underlying dynamics of market liquidity and order flow. By recognizing where and how absorption occurs, traders can make more informed decisions about their trading strategies and positions.