Legendary technical trader Richard Wyckoff's work is still relevant from both a long- and short-term perspective, and is particularly valuable at looking at long-term trends in the dollar.

UPTHRUSTS & CLIMAXES: WYCKOFF ANALYSIS & THE DOLLAR INDEX

by Robert Burgess

Richard Wyckoff was a legendary trader in the early 1900s. Wyckoff thought that a trader who applied tape-reading skills (i.e., studies of current price and volume characteristics to weekly and monthly charts) could determine a market's forthcoming price movement ahead of price change. In coming to this realization, Wyckoff concluded that price action was a continuing contest between buyers and sellers, which he called the composite man.

By developing and using an understanding of price and volume characteristics--which are the basic components of his trading technique--Wyckoff theorized that price change often created a sequence of repetitive price actions that were predictive of future price action. Years later, in the 1950s and 60s, Bob Evans, a Wyckoff disciple, refined Wyckoff's concepts with labels like buying and selling climaxes, automatic rallies, retests, springs, jump across the creek (JAC), markup, sign of strength, back up to the creek, last point of support, and many others, as a way to know the current position of prices, and therefore, the next projected step within the sequence of price actions. Wyckoff, and subsequently Evans, thought that by applying Wyckoff's price and volume techniques they could determine whether buyers or sellers were going to win the bullish or bearish contest, and therefore determine the direction of prices.

Traders, looking for long-term trades have always kept an eye on weekly and monthly charts of the Dollar Index. They do it to find trades, but more importantly, they also do it to stay abreast of the always developing and therefore always changing, but interesting, "technical interpretation" of the global economic story.

Price action in this currency is often an excellent long-term indicator of future global economic trends. Of course, the immediate trade and its potential are frequently more important to a trader than the developing long-term economic story. Nonetheless, perhaps ironically, future economic events almost always develop as the price action has indicated to confirm projected price action at critical price points. Therefore, understanding the technical influences within the developing economic story is beneficial to decision making–as long as the trader has the ability to separate when the near-term developing chart story appears to be in conflict with the current long-term economic story.

As background, the Dollar Index peaked in 2001 and started a macro long-term decline (see "Dollar days," page 74). The decline in the Dollar Index bottomed in 2008 as the credit crisis became a global issue. A flight to quality rally in the Dollar Index in 2008 recovered most of the depreciation of the last down leg (selling climax) of the larger decline that had started in 2001.

Technically, the rally from the low in 2008 is called an "automatic rally" by Wyckoff technicians. The automatic rally is usually the prelude to the development of a new long term trading range, which can evolve into either a new long-term bull market rally, or instead, a corrective rally within a much larger macro bear market. Either potential, long-term bullish or longer-term macro bearish, should be preceded by the expected long-term trading range. Afterward, the long-term trading range often ends with the potential for an important long-term rally, even if the expected rally is destined to become a macro corrective rally within a much larger macro trading range (i.e., a trading range within a larger trading range) leading to an eventual decline.

As we see in "Dollar days," the expected trading range lasted until mid-2014. In Wyckoff terms, the long-term trading range had evolved after multiple, friendly "secondary retests" of the initial low in 2008. The friendly retests resulted in a bullish "springboard" position in mid–2014. The indication in May 2014, due to the absence of supply having created a long-term springboard position, had become, prices are ready to rally. They did, taking out numerous resistance levels.

In Wyckoff terms the multi-year trading range had created a cause (point and figure count) for a result (breakout), but would the expected rally become the start of a new long-term bull market or would it become a counter trend rally in a much larger and developing macro bear market?

NEW CYCLE

Starting in July 2014, notice how easily prices started to trade higher (see "Breaking out," page 74). The price action is classic Wyckoff bullish price action. It is the start of "markup." The Wyckoff trader knows that the price action is bullish. Additionally, because of the previous preparation within the multi-year trading range, the Wyckoff trader has every technical reason to conclude that the rally will become an extended and meaningful rally. Nonetheless, it remains possible that eventually the current positive beginning becomes a long-term rally, which peaks as a "retest and lower high," to the existing 2001 high. If so, the rally will risk becoming a rally within a developing macro price action, which is long-term bearish.

Therefore, at a point in July 2014, in spite of all of the future long-term macro unknowns, the Wyckoff trader wants to be long the dollar. He sees bullish near-term and bullish long-term potential; and very importantly, the markup should have only just begun because of the large point and figure counts created within the long-term trading range. Additionally, the upside potential greatly outweighs the risk because of the combination of the existing multi-year point and figure counts where price action in July 2014 is confirmed as bullish.

The "wide price spread" in September 2014 can't be bought on the cheap (Lockout). Prices have surged past the old 2012 and 2013 highs, which is another important step supporting the unfolding bullish price action. Going forward, new participants will have to pay up–increasing their risk of ruin–to trade.

Markup continues to carry prices

WYCKOFF'S WISDOM

The following terms are part of Richard Wyckoff's technical trading method.

BUYING CLIMAXES: End rallies

SELLING CLIMAXES: End sell-offs

AUTOMATIC RALLY: These follow selling climaxes. The Automatic reaction follows a buying climax

RETESTS: Price actions that confirm whether a prior high or low has validity as a turning point

SPRINGS: Very important price action that ends declines. The most common example is a price action that makes a new low below a trading range or other support; but the new low reverses and having trapped short sellers, prices rally

UPTHRUSTS: An Upthrust ends rallies. Prices make a new high above a trading range or other resistance and then reverse and prices decline

ICE: Stong resistance

JUMP ACROSS THE CREEK (JAC): JAC is a price action that clears old highs, usually a trading range, followed by really good appreciation

SIGN OF STRENGTH (SOS): SOS is a strong rally, which almost always has an increase in volume. It is an expression of increased demand

SIGN OF WEAKNESS: This is an easy decline in prices on increased volume. It is an indication that selling has overcome buying

MARKUP: This indicates prices are intentionally being bid up by the Composite Man

THE COMPOSITE MAN: The Composite Man is the market participants in general; usually dominated by a more informed trader or group of traders

BACK UP TO THE CREEK: Back up to the creek is a correction to a rally/jump across a creek

LAST POINT OF SUPPORT: The last point where prices are supported in what is usually a small correction before a strong rally

EFFORT & RESULT: There should be an appropriate price action/result to the quality of the preceding price action/effort. Combinations of volume and price spread are used to decide if the result is appropriate for the effort

SHORTENING OF THE UPWARD OR DOWNWARD THRUSTS: A price action that indicated that the response has been inappropriate for the effort

DOLLAR DAYS

The dollar reversed a seven-year long bear market in 2008, but only has retraced a little more than half the ground lost.

Source: eSignal

BREAKING OUT

The dollar began its breakout with the markup month in July 2014. May 2014 is an important Springboard Position.

Source: eSignal

upward through December 2014, and importantly, prices trade through the previous high of the automatic rally, which is potentially a very bullish long-term price action: A "JAC" and a "sign of strength." Once again, these price actions are classic bullish Wyckoff behavior, and positive indications that the rally should still have had further to run.

Importantly, the monthly price bar for January 2015 continues the JAC with a wide price spread that closes near the monthly high creating an important separation between the January 2015 level of prices and the old trading range. After a narrow monthly price spread in February (consolidation), prices rally again in March 2015. Therefore, after the monthly price action in March 2015, prices have cleared the old trading range by a comfortable margin, accomplishing a successful bullish JAC. Nonetheless, the increased volume and relatively poor monthly close for March 2015 indicates a potential near-term "buying climax," which should cause a near-term correction to the rally that started in May 2014.

NEXT STEP HIGHER

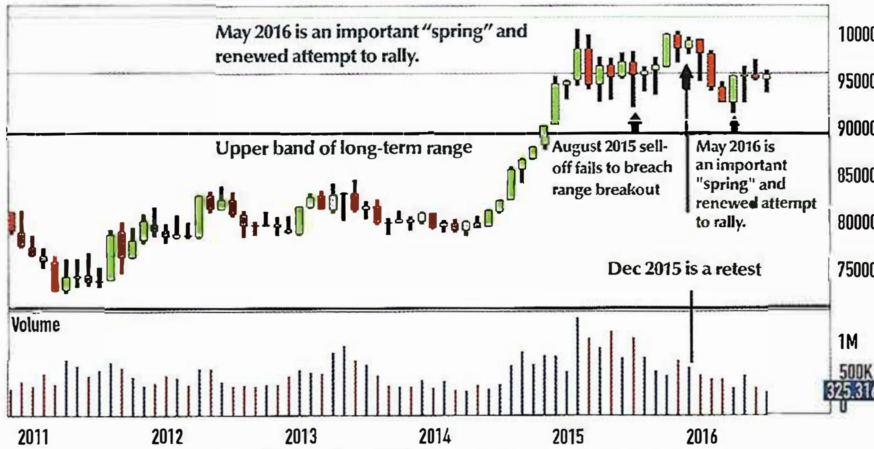
A successful correction, if that becomes the result of forthcoming price action (back up to the creek) would be bullish, creating the potential for the long-term rally to extend upward. Price action, as a back up to the creek, should be expected to hold on top of the older trading range. If that step is accomplished, another important piece to the macro puzzle will have fallen into place. Afterward, at least a short-term rally should develop. The expected short-term rally could break out of a near-term trading range and become positioned to create an extension to the larger rally that began in May 2014. Therefore, short-term price action, the new developing trading range, could become another longer-term bullish step and potentially the catalyst that could substantially extend the larger rally.

Price action in August 2015 is a positive. The five-month-long correction has not led to significant depreciation. Instead, the correction has held on top of the previous multi-year trading range as it should if the market remains bullish (see "A closer look," right). Therefore, the price action contains the bullish potential of a back up to the creek. In August prices are, once again, positioned to rally. The rally has the potential to extend the larger rally that began in May 2014. Whether the expectation will become a reality or not will be defined by "how" the forthcoming price action develops.

A Wyckoff trader appreciates this advantage, which is offered because of the Wyckoff' trader's understanding of the dynamics of price action within trading ranges and trends. Therefore, using his "tape reading skills," the Wyckoff trader can study price action as it develops; gaining information from the developing price action that confirms or rejects his initial

A CLOSER LOOK

Monthly price action during the last year indicates the dollar may be near an important inflection point.



Source: eSignal

analysis. Nonetheless, he must always be very careful not to confuse a short-term indication as a long-term indication.

Having rallied from the August 2015 low, the monthly price bar in December is a warning sign that prices may not currently have the power to break out of the trading range. This tentative indication is confirmed in January 2016 because the month, which is a rally, lacks the price and volume characteristics that are necessary to continue the rally. This indication is followed by initial price weakness in early February.

Although prices close lower for the month, since prices closed in a recovery from the low, the close in February offers an indication of support, but the support may be the last ditch effort by prices to hold on. Subsequently, prices fall easily in March. The downward thrust starts to shorten in April and prices enter a spring position in May (see "Breaking out," left). The recovery and close in May creates a renewed rally potential. Initial price weakness in June is followed by a recovery rally and positive close at month end. Therefore, June has the potential to be an important "positive short-term retest of the spring." The indication has become that prices should rally. The expected upside effort develops in July, but the effort fails to gain a following and create a positive result. Prices close down and well off of the monthly high.

In macro terms, a near-term correction, which may be a bullish back up to the creek, has been in effect since March 2015. As part of the macro analysis, prices entered a spring position in May 2016. The spring created a rally within the near-term trading range, but the response to the spring remains questionable. Additionally, the high in July 2016 failed within the range of the prior monthly price spread for March 2016. The failure of prices to rally in March 2016 was significant, because February had been an important effort to hold prices up following the poor price action in December 2015 and January 2016. The subsequent low in May became a spring, which recovered the macro potential. Nonetheless, the spring was only able to produce a rally, which failed once again, where supply had turned prices downward in March. Price action has failed in December 2015 and again in July 2016. Because of these failures, a potential downtrend - within the trading range - has been drawn.

These price actions are important red flags developing within what had been an unencumbered bullish long-term analysis that indicate the market may be failing to successfully back up to the creek. Remember, it has always been possible for the Dollar Index to rally without breaching the longer-term bear market, which started in 2001. If so, the rally begun in 2008 has been a rally within a larger macro downtrend. Going forward, either a failed or successful back up to the creek will define which choice will have the greater potential to become the real macro trend.

It is clear that prices are headed toward an important inflection point, because within the developing short-term trading range, the recent red flags indicate that the short-term bullish interpretation for price action has become vulnerable. Therefore, a long-term trading opportunity, with macro potential, has become questionable. For the long-term analysis to remain bullish, price action, within the short-term trading range, must have a positive retest of the May spring. Afterward, it must be followed by a good rally. Otherwise the macro back up to the creek will fail. If prices fail to rally, after a friendly retest of the May spring, the failure will indicate that the short-term trading range, which has been charged with the responsibility of creating price action that successfully backed up to the creek, failed. A short-term failure, now, leads to a long-term failure with macro potential. Δ

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