

Market Line Update for Monday, June 21, 2004

FYI

The Character of the Action

Sometimes Wyckoff students express frustration over the level of detail that the approach seems to involve. It is true that there are a substantial number of observations and considerations that one should make to complete a thorough analysis. It is possible to get lost in the details. That is why a systematic approach to analysis based on Wyckoff's five steps is strongly encouraged. A detailed checklist of observations to make and things to consider helps prevent getting lost in the details. It also helps prevent over emphasizing or under emphasizing particular aspects of the action. Anyone who takes the time to make one of these check lists and then examines it should realize that all the details that are sometimes seen as being frustrating boil down to primary concerns. What is happening and how is it unfolding.

What is happening is the easier of the two concerns to consider. It focuses on the trend and the position in the trend. The direction of the trend indicates what type of trading action should be considered. The position in the trend indicates whether this is a good time to be taking the action that the direction of the trend suggests. Even if the trend is clearly defined and the position in the trend obviously indicates that a particular type of position should be established, there is one more critical consideration that must be made before any action is actually taken. How did the market or the individual issue get to where it is? This is what is defined as the character of the action.

The character of the action is revealed by the price spread, the volume, the intra-day action and the close. In order to arrive at a conclusion about the character of the action, it is necessary to combine all four of the ingredients. Looking at just one or two of the factors will not in most cases reveal enough information to make a conclusion with confidence. Adding a third variable should improve the level of confidence substantially, but the greatest level of confidence comes when all four variables are considered.

Many Wyckoff students do not have access to the intra-day action of individual issues. This obviously diminishes the level of confidence that can be assigned to any conclusion about an individual issue. However, it need not and in the majority of cases is not a fatal flaw in the process. The intra-day break down of the action of the market is available. Much of the time most individual issues follow the intra-day action of the market as a whole. Therefore, conclusions made about the action of the general market based on intra-day movement can frequently be applied to the action of individual issues as well. There are obvious exceptions, however. For example, if the market makes a wide price spread to the up side and an individual issue makes a wide spread to the down side, it is unlikely that there will be anything in the intra-day action of the market that can be applied to the action of that individual issue.

The four factors mentioned above are used when comparing the character of the action on one day to the day before. They are also used when making conclusions about the character of the action during a period of successive days. They are also important when evaluating the test of a prior action to that action. Examples of this include the evaluation of the secondary test to a climax or the test of a spring or up thrust to the spring or up thrust. The character of the action of one week vs. the previous week or one month vs. the previous month can also be made using the four factors mentioned above. However, it should be noted that as the time frame of an individual bar on a vertical line chart is expanded, the importance of the intra-week or intra-month action increases. It is easier to hide important action within a weekly or monthly position than it is to hide something significant in a daily position.

There are other ways to measure the character of the action beyond the four factors mentioned earlier. One that has been helpful on the decline since February has been to study the thrusts and the corrections.

The decline from the up thrust at the February high has had two thrusts and two corrections. The decline from the February high to the March low was larger than the decline from the April high to the May low. This indicates that the character of the action is changing as the market declines. The market is becoming less weak. The decline to the March low made a substantial penetration below the support level defined by the February low. The May low made a penetration below the March low, but the penetration was not as deep. This also indicates a change of character. Again, the market is becoming less weak. The correction of the decline to the March low was stopped at the halfway point. The correction of the decline to the May low has made more than a halfway recovery. This is a third indication of a change in character to a less weak market. Note that in this approach to the character of the action, the emphasis is not on comparing one day to another, but on an entire move vs. another. Both approaches are important. Focusing only on the very short term can lead to confusion over the bigger picture. It is not uncommon for the day to day character of the action to change several times during a larger advance or decline. If there periodic short term shifts do not adversely effect the bigger move, they should be viewed as cautionary but not by themselves reason for dramatic defensive action. For example, the market is declining in widening spreads on increasing volumes leading to poor closes indication supply entering the market. Then, the market reverses and starts rallying in narrower spreads on lower volumes. The character of the action has changes, but the overall indication has not. First, the market was indicating supply entering the picture. Then it was indicating a relative lack of demand. Both indications are negative. Therefore, there was no need to be overly defensive.

The effort vs. result relationship can also signal changes in the character of the action. When the Wyckoff Wave and the O.P. Index are used together, we are able to see what is happening and how it is happening at the same time. On the decline from the March high to the March low, the character of the action of the Wyckoff Wave was on balance negative. When the Wave rallied to the April high and was stopped in the vicinity of the halfway point of the previous decline, the character of the action was still negative. When the Wave declined to the May low and moved into new low ground, the character of the action was still negative.

When the action of the O.P. is added, additional information is revealed, which can emphasize or mute the indications already noted. For example, as the Wave declined from the March high to the March low, the O.P. also declined. With the two indexes moving together, the character of the Waves action was being confirmed. However, there was not perfect harmony. During this period, the Wave made much more progress toward its November low than did the O.P. This observation does not change the fact that the character of the Waves action was negative. However, it does change the emphasis. If the O.P. had been declining as fast as the Wave, the indication would have been much more negative. How the two indexes behaved during this period indicated that the decline more likely corrective than a collapse.

On the move to the April high, the Wave and O.P. were in harmony. Both rallied and both were stopped in the vicinity of the halfway point of the previous decline. This tended to confirm the negative character of the Waves action suggested there was more down side to come. On the decline to the May low, there was harmony between the two indexes in that both lost ground. However, the Wave moved even closer to its November low, but the O.P. did not. The O.P. did not even take out its March low. This second development was not only a change in emphasis, but also a change in character. The Wave was indicating continuing weakness by moving to a new low. However, the O.P. was indicating that the weakness could not be sustained.

A change in the character of the action can be most profitable when it comes as a potential up thrust or spring. These are the points of greatest danger but minimum risk. A character of action at these points that encourages the taking of a position will provide an opportunity for maximum participation in the coming move. However, not every new low is a potential spring worth buying and not every new high is a potential up thrust worth selling.

The action at the February high provides a good study of the character of the action. The Wave had made a strong advance from the November low to the January high and then corrected to the February low. Depending upon how it was drawn, the correcting to the February low either decisively broke or weakened the demand line defined off the November low. This was an early warning that the character of the action was changing. On February 11, the Wave approached the resistance defined by the January high. The price spread widened dramatically as the volume increased lifting the price to a strong close. If the weakening or breaking of the up trend was ignored, the February 11 action could have been seen as the beginning of a jump across the January high. On February 12, the Wave did not follow through to the up side. It traded lower in a narrower spread to a poor close on reduced volume. This was a change of character. It indicated a withdrawal of the demand that was present the day before. A jump was not confirmed. However, the character of the price spread and volume made a somewhat positive statement since supply was not present. Therefore, a jump was still possible. On February 13, the Wave attempted to resume up side progress. It experienced an intra-day failure to the up side followed by a poor close in a wider spread on reduced volume. In this case, the action made a negative statement. There was either a continuing lack of demand as the Wave attempted to continue its jump, or it was met by overwhelming supply. Either way, the character of the action was not consistent with a jump. On February 17, the Wave penetrated the resistance. The spread narrowed and volume increased and the close was well off the high. The character of the action indicated supply was present. In order for a jump to be accomplished, demand needed to be in control. Since it was not, the new high was a potential up thrust and could be sold.

On April 30, the Wyckoff Wave made a slight penetration of the March low. The spread narrowed and the volume decreased indicating a relative lack of supply. The close was poor, however. Therefore, some additional penetration of the support should have been anticipated. Even so, the action was a potential spring. However, notice the character of the action from the high on Tuesday to the low on Thursday. This was a hard move down with two wide spreads, three poor closes and increasing volume. This action indicated weakness and was not consistent with a spring. Therefore, buying was not justified. The character of the action was the decisive factor. How the market was doing the potential spring was more important than what it was doing.

The importance of the character of the action cannot be over emphasized. How the market or an individual issue reaches a particular point in the action is at least as important as the position. This is especially true when the position is a primary trading position and a trade is being considered. If the character of the action is not consistent with the position, leave it alone. Look for a different opportunity or wait for additional information before proceeding with the action under consideration.

