



STOCK MARKET INSTITUTE

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GE TECHNOMETER

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How To Select a Stock

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Advances in Market Technology

A guide to picking stocks
with more profit potential and
a report on **new** tools for
better market timing.

How to Select a Stock

The purpose of this volume is to focus on the processes involved in translating a correct analysis and interpretation of general market action into a profitable trade in an individual stock or stocks. The means to this end will include such established concepts as comparative strength and weakness, cause and effect, effort vs. result, the nine buying and selling tests, and selected new concepts that may be an aid toward better timing of trades.

Each investor or trader in stocks, bonds, options, or commodities is called upon to make a wide range of interrelated observations and conclusions. The result is a process that can be seen as being extremely complex. Unfortunately, many investors allow themselves to become so wrapped up in this apparent complexity that they are rendered incapable or unwilling to make the necessary decisions. When this happens, it represents a failure to recognize that what detail is involved, and it is substantial, can be approached in a predetermined step by step manner and that these steps are the building blocks of an investor's most basic objectives.

If an individual is going to reap a profit in a particular market from an individual stock, there are two absolutely critical points that must be considered. One is to determine what it is that is the most important thing to know. The other is to determine what decision is the most important one to make. These are two very separate and distinct operations. The most important thing that any investor or trader should want to know is the trend and position of the general market. Knowing this may not guarantee a profit, but not knowing it greatly increases the prospects of a loss. The most important decision that needs to be made is which, if any, stock should be traded based on the determination of the trend and position of the general market. These two considerations represent the investors most basic objectives being superseded only by the quest to avoid loss.

There are those who try to find profits by focusing solely on one or the other of the above mentioned considerations. Their goal, probably derived from a lack of self confidence, is to simplify the entire process. The idea being that if the procedures are simple enough the chances of making a mistake in applying them are substantially reduced. This is probably true. However, if things are oversimplified, there is a risk that the result will contain basic flaws even if there are no mistakes in application. The individual whose concentration is centered on the general market may find his efforts academically satisfying because he is always or almost always correct on his interpretations.

The problem here is that even with this degree of accuracy it is possible to never realize an especially meaningful profit. Another individual who is concentrating his efforts on developments in individual stocks may be following steps that lead down a dead end path. Monitoring positive events in a stock that exists in a short seller's market or negative events in a stock trading in a buyer's market will generally result in a great deal of wasted effort and very little if any profit. The only investor who truly has the odds for success in his favor is the one who learns to split his concentration so that it is first on the general market and then on the individual stocks that stand to benefit most from the trend and position of the market.

Although it is not the primary mission of this volume, some brief consideration of the trend and position of the general market is in order before moving on to individual stock selection. This is because of its overwhelming impact on the level of success that is achieved and also because it should be the first aspect of all market study.

Since the trend and position of the general market are so critical, more specific tools for their measurement have been developed over the years than are available for making similar measurements for the individual stocks. These are the five SMI indexes, which are used in combination with each other and with the total volume. Their purpose is not to confuse the investor. However, this is often the result when they are not considered in a very logical manner. Rather, the goal is to provide additional ways of monitoring the three basic relationships, which of course are supply and demand, effort vs. result, and cause and effect.

In analyzing the relationships that develop from comparing one index to another, the investor must arrive at answers to three very important questions. 1. What did the market do and how did it do it? 2. What does the action mean? 3. What if anything should be done about it? Unless the investor has the answer to these three questions firmly in mind first, it makes no sense to proceed to stock selection procedures. This is because he does not have a clear understanding of what it is for which he is looking. Since an error here will undermine

everything that follows, it is often desirable to write out impressions of the general market in as much detail as time will allow giving special emphasis to answering the three important questions. Often an appraisal of these written impressions after they have been set down will more readily reveal errors in judgment or logic than will an interspective analysis of ones own thoughts. Once the thoughts are down on paper, they are much more difficult to overlook.

Another reason why it is imperative to have answers to the three important questions before moving on to stock selection has to do with protection against loss. It is purely a matter of common sense that if questions relating to what is going on have not been answered first, it will be virtually impossible to protect oneself in the event that things should start to go wrong.

Consider this hypothetical example. An investor witnesses the market break through a previously established resistance level on widening price spread and increased volume. He then sees it give back approximately half of that gain on decreased volume and find support at the previous resistance level. He now has an impression of what happened and how it happened. His determination of what it means is a jump across the creek followed by a constructive back up. His decision on what to do about it is that buying can be done in stocks similarly positioned or better positioned. In this case a better position would be hard to find because a back up to the edge of a creek is about as good as buying opportunities come.

This hypothetical investor has now answered the three important questions and in the process he has told himself how to protect his funds. He knows that once a successful back up has been completed the bulk of the up move should begin. The stock should be able to move up freely experiencing little if any difficulty in breaking through the resistance created at the top of the jump. Knowing this, he has justification to put his stop below the bottom of the back up by a margin that maintains the minimum profit risk ratio that he has established for his trading. His knowledge also tells him what to do if the resistance at the top of the previous rally stops what should be a freely moving advance. He should take what profit he has at the time and get out. Because he has taken the time in advance to answer the three important questions, the investor has his funds protected to the fullest extent possible. He is not guaranteed a large profit nor is he guaranteed that a loss will be avoided. He is, however, guaranteed a fuller measure of control over his trade, which can often mean the difference between a positive result and a disaster. This presents a tremendous advantage over the investor who depends on nothing more than emotion.

Unless a trader or investor is monitoring the action of just a handful of individual issues, he is likely to find that the answers to his basic questions will reveal a group of stocks that can be considered for a trade. If he has done his general market analysis correctly and follows the action indicated by it in a disciplined and unemotional manner, chances are that he could make a random selection from the group of potential candidates and not do too bad. For some this might be an acceptable return especially if it represents a considerable improvement over prior results. However, it does not fulfill the investors obligation to himself. To do this, he must squarely face an investor's most important decision, which is to select the one, two, or three stocks from the group that his general market analysis has revealed as candidates that present the best opportunity.

The selection of a stock or stocks from a group of potential candidates is where many investors and traders make most of their mistakes. There are two primary reasons for these errors. One is a lack of understanding of the step by step logic involved in the stock selection process. An attempt to help correct this problem will follow shortly. The other problem centers around the position of the investor as he approaches the stock selection phase of his operations. Assuming that the question of what to do about the general market's action has been answered with something other than a decision to do nothing, the pressure to act and to act quickly usually becomes very strong. This represents a lack of discipline, which almost invariably will lead to some type of mistake even though it may not be a fatal one. The unfounded belief that the only trading opportunity that will ever exist is right now and must be acted upon immediately causes people to trade too early, or too much, or without taking the proper protective measures, or to make any one of a number of other dumb mistakes. Discipline problems unfortunately cannot be solved by book learning. A person who does not already possess a good measure of self discipline can condition himself to it through practice. There is no other way. Anyone who seeks to short circuit the practice phase of his learning process will likely end up short circuiting his profits as well.

The step by step logic involved in stock selection is to be found in the nine buying and nine selling tests. If it can be concluded from an investigation of the general market that positions can be justified on the long side, only those stocks which have passed the nine buying tests should be considered. On the other side of the market, only stocks that have passed the nine selling tests should be considered as short sale candidates when such action is justified by general market action.

An investor who has answered the most important questions accurately and who has made the most important decisions based on the buying and selling tests may approach the taking of his position with a high degree of confidence. That does not mean absolute confidence. Due to the nature of the endeavor, that is never possible. Therefore, the investor should be aware of the most important thing to do, which is to provide himself with a measure of protection through the placing of a stop order. Some trading situations will not allow the placing of an actual stop order. In these cases a mental stop may be used. However, this method of operation is only for the person who has demonstrated an ability to maintain discipline over himself. Those who have not, have no business in such a trading situation regardless of its profit potential. The obvious reason is the risk potential that accompanies such opportunities.

As stated, application of the buying and selling tests is at the heart of stock selection. Before investigating just how they should be used, it is important that some warnings be issued. Any time we work with criteria that can be simply stated as a set of steps or items on a list, there is a tendency to use them mechanically. This is only natural because the method of presentation, the use of lists and numbered steps, seems to encourage such usage. The Wyckoff student who gives in to the temptation to behave in this manner is setting himself up for trouble.

In the case of the buying and selling tests, they are presented in a list of nine points only as a convenience. It is true that in many instances the order in which they are usually presented corresponds to the order in which they are passed. However, there are just as many instances where this is not the case and yet these may be some of the best trading opportunities. Often, the perspective of the investor will play an important part in the order in which the tests are passed.

If the tests cannot be used in a mechanical step by step manner, can they be used as a checklist? This is a much better utilization. It is based on the premise that the order in which the tests are passed is very much secondary to the fact that they have indeed been passed. Although this method forms the basis for proper usage, there is still need for a warning. At some point during the development of a trading opportunity all of the tests will have been passed. Using the checklist approach, this point in time could be equated with the moment most desirable for taking a position. This would be an error. If a stock has passed all of its buying or selling tests, it does not automatically become a candidate for an immediate trade. This is because the perception that all the tests have been met may come when the stock is positioned in such a way that the trade indicated would be vulnerable if taken at that moment. Therefore, we must use the tests only as a means of identifying who is a candidate and leave the actual position taking for one of the primary trading opportunities such as a spring, upthrust, back up or rally back.

Waiting for the nine tests to be passed and then waiting for the stock to enter a good trading position requires a great deal of patience. The long term investor for example may have to wait several months following the climax of one move before he can justify taking a position that is intended to profit from the next move. Even the shorter term trader who may only have to wait several days or a couple weeks will likely be forced to exhibit more patience than he would like.

Since patience is a form of self discipline, which may be the most difficult thing for an investor to master, there is often the desire to develop a plan of operation that cuts out much of the need for patience. Are these sound? They are never totally sound, but sometimes and when used by some students they can be made to work. What these amount to are the taking of positions before all nine of the tests have been passed. This increases the amount of risk being taken by the investor. The only logical reason to do this is to benefit from a potentially greater profit.

An investor who strictly adheres to all of the tests will likely find that his trading opportunities are not coming until the back up to the edge of a creek or the rally back to the ice level. It often takes this long for all the tests to be clearly passed and this explains why these two positions are generally considered to be the best trading opportunities. The problem that many individuals have with waiting for these positions to develop in addition to the normal impatience is their distance from the absolute best price. Why give up what is often a meaningful percentage of the overall move just so a list of nine criteria can be met? If a primary trading position develops prior to the passing of all the tests, does it not make sense to take action, especially if the stock happens to be at or near the beginning of the move, which helps to maximize the profits?

If every trade was absolutely guaranteed to produce a profit, the price at which the position is taken would be the only concern. Of course, that is not the way it works. No trade has a guaranteed profit. Therefore, the person who takes a position prior to the time that he can clearly see that all tests have been passed is trading off a

measure of safety for an extra added measure of profit potential. In deciding how much safety to trade off, there is no fixed guideline that can be used. Each test that has not been passed does not represent a fixed percentage of safety that is being given up. Such mechanical usage of any part of Wyckoff philosophy is almost certain to produce more harm than good.

What about a procedure that ranks the tests? The idea here is that if enough of the most important tests have been passed the safety given up by not waiting for the remaining tests is of little consequence. On the surface, this seems to be a reasonable approach. There is one serious problem, however. How does one rank the various tests? Even if it is possible to rank them in order of importance, there is still the problem of weighing them. Consider the following examples and the problems they present.

Suppose we are working with buying tests. We want to buy at the lowest point possible as soon as enough of the most important buying tests have been passed to greatly improve the chances of success. A careful investor would never think of buying a stock unless he had first seen evidence of preliminary support and the selling climax of the previous decline. Certainly this must be the most important buying test and weighed very heavily in the decision of when to take action. It is an important test, but what about those instances where preliminary support and a selling climax occur when there is no indication that the downside objective has been reached? Does the preliminary support and selling climax combination still carry as much weight in these cases? The answer is probably not. The unfulfilled objective creates an unacceptable doubt as to the authenticity of the climax. The paramount question becomes whether or not the stock can survive a confirming test to the climax. If that is true, how about adding to signs of preliminary support and a selling climax an indication of a successful secondary test? This helps in that it confirms the climax and completes the stopping action, but it does not resolve the underlying question created by the unfulfilled downside objective. A stopping action may be only temporary. There is nothing to say that on some later test the support will not be broken and the decline resumed. Therefore, we must conclude that although preliminary support, selling climax, and secondary test represent an important buying test, it only carries with it a high degree of certainty if the downside objective has been reached.

From the line of reasoning just presented, it would appear as though the reaching of the downside objective is actually the most important and most heavily weighted test. This, however, can be immediately faulted for reasons very similar to those used above. Only the order is reversed. Without the stopping action created by the preliminary support, selling climax and secondary test, there can be no certainty that the fulfilled objective represents the end of the move. Particularly heavy downside momentum may carry the price well beyond its indicated objective, or the objective may simply indicate a resting area where further distribution is undertaken and a resumption to the decline insured. Therefore, it cannot be said that the reaching of a downside objective is the most important or the most heavily weighted buying test. It should be apparent already that any attempt to arrive at a short cut to a trading decision is not going to be easy.

The evidence thus far presented suggests that no one test is going to be found to be so all important that it takes precedence over all the rest. In that case, what about combining a couple such as the two just considered. If we do, we can say that a stock that has reached its downside objective and has experienced signs of preliminary support, selling climax, and secondary test has completed the most important tests and those that are the most heavily weighted. It therefore can be bought.

Many would say this, and instances can be found where it is true. In situations where a short position happened to be held with a substantial paper profit such a condition could be used as justification to cover the position, especially if it is not possible to logically place a stop so as to protect a large amount of the profit. Beyond this, however, there are problems.

The combination of tests stated above do represent a rather convincing picture of a stopping action. This may be enough to result in the liquidating of short positions, but it is not reason enough to reverse sides and start buying. The same would be true of a stopping action that stops an up move. It can be used as a reason to close out a profitable long position, but it does not provide justification for automatically switching to the short side.

The reason why a stopping action is only grounds for culminating participation on one side of the market is that it does not represent what might be called an ending action. The stopping of a move in one direction does not mean that it cannot be resumed. To confirm the stopping requires an ending action. This is what the buying and selling tests that tend to come later in the trading range phase are intended to confirm. By such things as indications of bullish or bearish behavior, signs of relative strength or weakness, and the breaking of an upward or downward stride the stopping of a move can be confirmed as an ending action. This suggests that the tests,

which signify an ending action are actually the most important and should be most heavily weighed. The only problem with this is that without giving special emphasis to the development of a stopping action there is no reason to be looking for an ending action.

What seems to be developing from these various reasoning patterns is a vicious circle. If we conclude that one or a small group of tests is of greatest importance, the overlooked tests tend to present an obstacle to that line of reasoning. If we then conclude that the tests that form the obstacle are of greatest importance, the others become the obstacle. The only solution to this dilemma is to accept the idea that all of the tests are of equal importance and must be passed before a position can truly be justified.

Does this mean that primary trading opportunities develop only after all buying or selling tests are passed? Unfortunately, it does not. A trading opportunity refers to a position that a stock can occupy relative to established levels of demand or supply. For example, a spring is a penetration of an established support level. The volume determines whether it represents a buying opportunity. There is nothing about the buying or selling tests that would preclude one of these or some other type of trading opportunity from developing before all the buying or selling tests have been passed.

The early development of a primary trading opportunity creates a conflict for the investor. On the one hand he is faced with a position, which is the trading opportunity, that should result in a very favorable price should a trade be made. On the other hand, he is faced with the uncertainty created by a situation that does not clearly indicate that the prior move has been both stopped and ended and that the preparation for the next move has been put in place. The unexperienced investor or the one who cannot point to a consistent record of profitable trading extending over a prolonged period of time should resolve the conflict by doing nothing. He would do well to make note of the situation giving special attention to the trading opportunity that existed and the tests that had been passed at that point. He should also take note of the eventual result of a trade that might have been made. Over time a pattern of positive results from a given set of conditions may develop. This may be used as a basis for intelligent risk taking. Risks taken in anticipation of profit where there is objective evidence suggesting that a profit is in fact likely to be realized is intelligent risk taking. Anything else is probably greed. It should be noted that in this context the idea of risk taking is intended to mean extra added risk. For many and perhaps most investors the taking of an extra added risk should be considered unacceptable. If given the choice between doing nothing and taking an extra added risk, the decision should usually be to do nothing. Normal trades, those taken under the best of conditions, have enough risk. The profit potential reflected in this degree of risk should be adequate for even the most aggressive trader.

At this point, having been rather thoroughly indoctrinated into some of the general ideas behind stock selection, it is time to move on to more specific matters. To do this, it is necessary to find a good starting point. This should be with the obvious. Although no one of the buying or selling tests can be singled out as being the most important, some are easier to see. This does not mean that if you have seen one you have seen them all, but seeing one should serve as a signal that something of importance may be taking shape.

One of the easiest tests to prove and one where objectivity is also quite easy to attain is the test of an accomplished objective. The objective of a particular move is normally determined very early in that move. This means that the target is set well in advance of the point when it becomes a factor in when to buy or sell. Therefore, its determination should be less subject to the influences of fear or greed and as a result more objective. There is, however, one important potential problem that can develop around the establishing of an objective.

Let's assume that we are watching the action of the stock whose vertical line and figure chart are pictured in Exhibit 1. The stock in this case is McDonnell Douglas. We are monitoring this stock's decline with the idea of establishing a long position at some point. First, however, we need to know that the downside objective has been fulfilled. We see the stock move down to the thirty-five level at "A" and ask ourselves whether the downside objective has been fulfilled. The answer is yes and no. That apparently ambiguous answer is not an attempt to evade the question. It is the truth.

There is a major area of distribution around the forty-four level. As with every such build up, it is advisable to break it down into important segments if possible. At "x", the price made a brief bulge up to the forty-nine level and then immediately returned to the distribution area. This provides a natural break and a good place to break the count on the forty-four level into two phases. The result is two objectives. The midpoint of the more conservative of the two targets is near thirty-five, which just happens to be the level reached at point "A". Therefore at "A", it can be said that a downside objective had been reached and one buying test had been passed.

At the same time, it can be said that reaching point "A" does not constitute the reaching of a downside objective because it is actually in the eighteen to twenty-three area, or at point "B". This lower target is without doubt the downside objective. The reason for believing this can be found in the fact that at point "B" the downside potential has been totally exhausted.

The problem created by this example should be obvious. The investor who saw the objective at "A" as a passing of the buying test concerning the reaching of downside objectives might have taken himself out of any short position that had been established earlier just as the stock was preparing to begin the second phase of the decline. On the other hand, the investor who chose to consider the entire count would likely still be holding his short position as of the end of the chart and perhaps be just starting to consider covering his position. The first investor could have missed half the move while the second investor failed to follow the directive to always consider the most conservative count first. Did either of them act correctly?

The correctness of the action taken by the two traders mentioned above depends a great deal on their individual perspectives. A trader of intermediate moves will generally be looking for a potential of twenty to twenty-five percent. In moving down to the thirty-five level, McDonnell Douglas declined twenty-seven percent. This fulfills his trading objectives. As the stock begins to pass buying tests after point "A", this investor would be justified in taking his profit. He should, however, take note of the fact that a lower objective does exist and that another intermediate opportunity may develop relatively soon. In some situations, similar to this an opportunity to trade on the long side may develop between the two short selling opportunities. This would come on a move to a point "C". These are relatively rare, however. It is more likely that an opportunity to trade on the long side between two short sales in one stock will come in another issue. The reason for this is that in order to have the potential and ability to make an intermediate move on the upside between points "A" and "C" the stock already has to be relatively strong. A stock that has just produced one profit on the short side and is anticipated to produce another such opportunity is probably not going to be strong enough to produce one on the long side in between.

An investor in long term moves is usually looking for a move of about fifty percent or even more. The move down to the twenty-three area represents a decline of forty-eight percent. This investor upon seeing the passing of one buying test after another following point "B" would be justified in taking his profit. He must be aware of the first phase objective and must realize that some type of relatively important correction is likely to follow it. However, as long as that correction is not excessive, there is justification to hold the position. In this case, holding would have made sense. The move up to point "C" is nothing more than a normal halfway correction of the previous decline.

Even in something as objective and obvious as the fulfilling of an objective, perspective is very important. At any one time, there are three games being played in the market simultaneously. It is critical to the overall level of success attained that each player keep clearly in mind whether it is the long term, intermediate term or short term game that he is playing and to never start playing that game with somebody else's rules. It simply will not work.

Another straightforward or obvious test that must be passed is the development of preliminary support or supply and a buying or selling climax. Unless these two events have occurred, there is no indication that the end of the move in progress has even been started. Therefore, it is essential that they be isolated.

Sometimes preliminary support and a selling climax or preliminary supply and a buying climax are not obvious. If so, the stock in question should not be considered for a trade. No matter how many other tests appear to have been passed, the absence of the first step in the stopping process should leave an unacceptable level of doubt as to whether the move has in fact been stopped. What is needed instead are stocks such as the one pictured in Exhibit 2.

Preliminary support is said to be the first attempt to rally after a sustained decline. The move bracketed as "A" is such a move. A decline of this nature indicates that the stock is really serious about its decline. Some stocks just seem to drift aimlessly. They do not appear to be serious about anything and are generally not good candidates for trading.

Once a move such as at "A" is underway they tend to feed on themselves and are very difficult to stop or even interrupt. That is why an action like the one boxed as "B" is significant. They suggest that a change is taking place and serve as a warning to sit up and take notice. If it is preliminary support, the selling climax should follow shortly. In this case it did. After the attempt to rally at "B", the price resumed its precipitous decline, but with one important difference. There was an unusual increase in the level of volume, which when combined with the price

action and an indication of preliminary support strongly suggest a climax. One thing that should be noted about Exhibit 2 is that as of the end of the chart the action at "C" can only be called a potential climax. More action is needed to prove the point.

The remaining two obvious tests that a stock will pass are the breaking of an established stride and the establishing of an estimated profit that sufficiently exceeds the indicated risk. Exhibit 3, the chart of TRW, shows a good example of the breaking of a downward stride. Notice how there were two penetrations of the supply line. At "A", the price was able to weaken the supply, but then fell back into the down trend. At "B", however, the price broke through the supply and continued to advance. The lesson to be learned here is to avoid impatience. There are many instances where the actual breaking of a stride will be preceded by a weakening of the support or supply to be broken. It is best to wait for a clear break to have occurred before concluding that this important test has been passed. To do otherwise may result in the taking of a premature position that runs a high risk of being stopped out on a later reaction.

The passing of the last obvious test is partly a function of the stock's action and partly a function of the investor's action. A horizontal build up on a figure chart will provide a measure of the estimated profit. As this approaches ten to fifteen percent for the short term trader, twenty to twenty-five percent for the intermediate trader, and forty to fifty percent for the long term investor, there is sufficient potential to justify a trade. However, the correct placement of the protective stop will determine whether the profit risk ratio indicates a passing of this test. Unless it is possible to place a stop below a relatively important support level or above a relatively important supply level and at the same time maintain at least a three to one ratio this test should not be considered to have been passed.

This discussion has dealt with the five most obvious tests on an individual basis. In actual market operation they will also occur one at a time, but not necessarily in the order mentioned here. Even though they occur one at a time, they should be looked upon as a group. Perhaps they could be called the obvious group. Unless this obvious group is complete, there is no way that a particular stock can justifiably be considered for a trade. Because of this, it is important to develop an ability to determine whether or when these tests have been passed. Exhibits 4 through 7 are intended to quiz your ability at determining which and when the obvious tests have been passed.

The question in Exhibit 4 is, have the obvious selling tests been passed? Has the upside objective been reached? Is there evidence of preliminary supply and a buying climax? Has the upward stride been broken? Does the anticipated profit sufficiently exceed the indicated risk? How would you answer these questions?

Are there signs of preliminary supply and a buying climax? Any indication of preliminary supply is questionable, but a buying climax does seem to exist. Notice the period of extremely high volume in columns twenty-three and twenty-four as the price penetrated the forty-four level and ran into the overbought line of its uptrend. These are conditions that frequently come together at a buying climax. The absence of any clear indication of preliminary supply does leave an unanswered question. In some instances such as this one the action believed to be the buying climax comes some time later.

Has the upside objective been reached? The answer here is much easier. The count established during the accumulation of 1978 and 1979 points to an objective of forty to forty-two. There is no doubt that this level has been reached. There is also no doubt that the upward stride has been broken. This occurred on the initial break down to the thirty-nine level in column twenty-seven.

What about the estimated profit and the indicated risk? A count taken at the thirty-nine level indicates an objective range of twenty-seven to thirty-two. It is generally best to anticipate no more than a move to the middle of the objective range. If the maximum count is needed to justify a position, the wisdom in actually taking that position is doubtful. This is because many stocks will not reach the maximum limits of their objective ranges.

With the midpoint of the objective range at about thirty, it seems reasonable to look forward to decline of about nine points. That would be a drop of intermediate proportions and one that most traders would likely find very interesting and extremely inviting. However, the decision on whether or not to actually take the position depends on how much has to be risked in an effort to realize the potential profit. In this case, we can see that the stop order was placed at 44.7, which is just above the important resistance level established by the buying climax. This is a sensible level at which to place a stop, but what does it do to the desirability of taking a position?

The stop marked on the chart is six points above the price. That means that six points are being risked in an

effort to make nine. The profit/risk ratio is one and one half to one, or only about half the acceptable minimum. Therefore, a position taken under these conditions would not pass all of the obvious selling tests. What should the trader who had been considering a short position in this stock do? Should he look for another stock? That is, of course, a reasonable decision, but there is an alternative. A stop placed three points above the price would maintain an acceptable profit/risk ratio and satisfy the selling test. This would result in the stop being placed at 41.7. Before taking a position and using this stop order, a determination should be made as to whether that particular level affords a measure of protection or invites being stopped out. The 44.7 figure marked on the chart is good because it guards against a disastrous advance and at the same time is above one very important resistance level and several lesser resistance levels. A stop order placed at 41.7 is above two resistance levels. Therefore it is not totally vulnerable, but it is an easier target than the higher stop order. This increased vulnerability is balanced, however, by a reduction in the amount being risked. Therefore, if a short position were taken with a stop set at 41.7, all of the five obvious selling tests would be met.

Having just considered Exhibit 4, Exhibit 5 should be rather simple even though the previous move is a substantial decline instead of significant advance. The first question to answer is has the downside objective been reached? The figure chart reveals two down counts. One is at the fifty-four level and the other is at fifty. The combined objective range of these two counts is forty-four to forty-six, which was over run on the decline. The buying test has been passed.

Are there signs of a selling climax preceded by preliminary support? The extremely heavy volume associated with the reaching of the low point in the decline plus the snap back in the price are indicative of a climax action. The circled area just prior to this gives evidence of preliminary support. Therefore, a second buying test has been passed.

Another question to consider is whether or not the downward stride has been broken. There should be no doubt that it has, and results in the passing of yet another buying test. That leaves the matter of estimated upside potential and indicated downside risk.

The figure chart shows an up count of ten points on the forty-four level. Therefore the middle of the indicated objective range is 52.4. That means about an eight point advance could be expected and a two and three quarter point stop placed to maintain an acceptable three to one profit/risk ratio. Anyone entering into this position under these conditions should have realized the vulnerability of his stop. Although it is positioned to maintain a three to one profit risk ratio, it is not located under any already established support level. It is likely that in this particular market a better candidate could have been found.

Exhibit 6 is intended to serve as an example of why judgment is so important in the application of the Wyckoff method and why a mechanical approach is so questionable. We will first consider the matter of whether or not the upward stride has been broken because this is where the problem lies with this example. Has the stride been broken? It is true that the support line of the uptrend has been penetrated many times. From a purely mechanical standpoint, this would be enough to say that the stride has been broken. However, from a more practical standpoint, it is not. The price continues to hold on the support line and could very easily follow it upward for quite some distance. This would result in an immediate paper loss and could produce a real loss if the price followed the support line up to a point where the stop order was triggered. The point here is that unless the stride has been decisively broken it is best not to conclude that it has.

With the exception of the above problem, the other obvious tests have been met. There are three upside objectives that all point to a potential target in the upper sixties and all of those objectives have been fulfilled. We also can see signs of preliminary supply and a buying climax. Notice that the highest volume comes on the preliminary supply and not the buying climax. This is not an uncommon occurrence. The way to tell that the preliminary supply is that and not the buying climax is to see if the upside objective has been fulfilled. If it has not, there is a good possibility that the buying climax has not occurred. Another way to tell is to assume that the preliminary supply is the climax. This means that some other prior action will be the preliminary supply. If the actual preliminary supply is incorrectly called the buying climax, it should be impossible to find any other action that can be the preliminary supply. Therefore, the error of the initial conclusion should be detected.

Exhibit 6 also provides an example of a very effective use of the stop order. At the end of the chart and the point at which it is assumed a position was taken the downside potential totaled ten points. An attempt to maintain a three to one profit risk ratio would have provided justification for a stop order at 70.3. It should be noted that this is above an important resistance level. Therefore, this is a good placement.

The last exhibit, Exhibit 7 is a chart of I.B.M. This is a case where the passing of all the obvious tests comes together. First, there is a prolonged period of preliminary supply providing clear evidence that the advance previously underway has run into some trouble. Then there is a final surge into a buying climax that occurred on extremely high volume. When this occurred, one selling test had been passed. At the same time a second test was passed because the upside objective of sixty-nine to seventy-four was being reached.

The breaking of the upward stride in this case requires the figure chart to determine. It is clear from the figure chart that the uptrend has been broken. Generally, it is not a good idea to rely solely on the figure chart when determining whether or not a trend line has been broken. This is particularly true in cases where the breaking of the trend line is not decisive. The reason for this is that figure charts tend to distort trend lines. What appears to be true according to the figure chart may not be confirmed by the more sensitive vertical line chart. In these cases, it is always advisable to follow the indication of the vertical line chart. In this particular instance, the breaking of the support line is so decisive that it is impossible for the similar line drawn on the vertical chart not to have been broken as well.

The last of the four obvious tests is met in the placing of a stop order at 75.3. The price is expected to decline to fifty-two. As of the end of the chart, the price was 69.4. Therefore, a stop order at 75.3 would maintain a three to one profit risk ratio.

Although it was not included in the group of obvious tests, determining whether a stock is stronger or weaker than the market is generally a relatively easy matter. The tools required to make this determination are the vertical line chart of the stock and of the Wyckoff Wave or other general market index.

The action of greatest interest will always be the last rally and reaction or reaction and rally just prior to the point at which a trade is being considered. If a long position is contemplated, the last rally in the stock should be proportionally larger than that which occurred in the general market. If it is, then an indication of relative strength is being given. One indication is not enough, however. That is why the reaction that is ending at the time the position is about to be taken is also very important. The stock that made a proportionally greater advance on the rally just mentioned will confirm its strength by making a proportionally smaller move on this last reaction. This combination increases the likelihood that on the next rally, the one that is anticipated to immediately follow the taking of the long position, the stock should again out perform the market. This assumes that the other buying tests have been passed as well and that there is a measure of upside potential remaining that provides the possibility that the stock can out perform the market. Relative strength is of little value if all the potential has been used up.

If a decline is anticipated in the general market, the stocks of primary interest should be those that are weaker than the market. The procedure for determining this is the opposite of that outlined above. The stock needs to give an indication of weakness by out performing the general market on the downside during the last reaction and then confirm that weakness by under performing the market during the rally leading up to the point at which the short position is to be taken. Again, we are assuming that the other selling tests have been met and that there is enough potential to allow the stock to out perform the market on the next reaction.

While the last rally and reaction are of greatest concern in establishing relative strength or weakness, adding another pair or two pairs of rallies and reactions can add a greater measure of confidence to any action that might be taken. If a stock has consistently out performed the market on the last two or three rallies and under performed it on the reactions, its relative strength to that point is unquestionable. The reverse would be true for a weak stock that has out performed the market on the downside over several reactions. If given a choice between trading a stock that exhibits one of these consistent patterns and one for which the pattern is mixed, the stock showing the consistent pattern should always be given first consideration.

There is one other critically important point that needs to be made with respect to determining a stock's relative strength or weakness. It is that the determination be made in the same perspective as the anticipated trade. That means a stock that has shown long term strength or weakness may be considered for a long term investment. Intermediate strength or weakness can be used to justify an intermediate commitment and a short term indication of strength or weakness can serve as the basis for a short term trade. Never allow yourself to use an indication given in one time frame to serve as the basis for a trade in another. The result may be a profit, but the odds are overwhelmingly against it.

A good example of this test being passed can be found in a comparison of Exhibits 4 and 8. Each of these exhibits has been numbered with six points that correspond to a series of successive rallies and reactions. The pattern

reflected by the Wyckoff Wave, which is intended to reflect the general market, is the one that the individual stocks must under perform or out perform to be seriously considered for a specific action.

The general market in this case is showing a pattern of lower tops on rallies, which is especially apparent between points "3" and "5". Its pattern on reaction lows, however, is much more inconsistent. It is not possible to point to a series of higher or lower bottoms. This mixed pattern, even though the pattern of the tops is lower, reflects a neutral position for the general market. Exhibit 4, on the other hand, clearly reflects a pattern that is not neutral. There is a similarity between the market and the stock in that both have lower tops on rallies. The stock, however, is also exhibiting a pattern of lower bottoms on reactions. This puts the stock in a relatively weak position as compared to that of the market and allows us to say that it has passed another selling test.

The investigation used to confirm relative weakness can also be used to illustrate the passing of another selling test. The consistent pattern of lower tops and lower bottoms is itself a selling test. A reverse pattern of higher tops and higher bottoms would represent the passing of yet another buying test. Our effort here to equate these two tests should not be taken as an indication of how opportunities always develop or should develop. A situation that does develop in this manner is simpler, but not necessarily better. The two tests mentioned here are separate and distinct. It is perfectly normal for them to be passed at different times without detracting from their desirability as a trade candidate.

It should be apparent at this point that beginning with the passing of the obvious tests can and often does lead into the tests that are often considered to be more obscure. In the example just discussed, the objective was to prove relative strength or weakness. At the same time, however, the test of lower tops and lower bottoms also fell into place. Another of the tests will often fall into place in much the same way. In Exhibit 5, on the way to passing the obvious tests, General Motors also formed a pattern of bullish behavior, which means higher volume on rallies and lower volume on reactions.

In moving from point one to point two, a rally, the volume declined. This is not bullish behavior. However, note how early this is in the preparation phase. The stock seems to have just come off a selling climax. That means the rally from one to two is the automatic rally and still very much under the influence of the down trend. There is no proof yet that the down move has been stopped. The move from two to three provides the first bullish indication with the continued low volume on the reaction. This is especially important in this case because the move from two to three is the secondary test of the selling climax. High volume here could have led to a breaking of the previous low and a resumption of the down move. From point three through point seven at the end of the chart, the bullish pattern begun on the move from two to three is maintained. There is no precise way of pinning down how long this pattern should be in evidence before the test may be considered passed. However, two consecutive cycles of rally and reaction would seem to be a good minimum standard. Of course, the longer the pattern has been in effect at the time the position is actually taken the better should be the odds of a profitable outcome. A reverse application of these ideas would lead to the indication of bearish behavior and the passing of a selling test.

The final test to be considered is whether a base or crown is forming. The passing of this test is quite vague. A stock indicates that it has entered a new period of preparation upon completion of a successful secondary test. That suggests that a crown or base has begun to form and technically resulted in the passing of this test. Since this test seems so easy to pass, one might be inclined to wonder about its importance. This test may be of relatively less importance. However, this can be changed substantially by making a slight change in the wording. Instead of using the word "forming", substitute the word "formed". This implies that the base or crown, bottom or top, has been completed. This is indicated by such actions as springs, tests of shakeouts, back ups, terminal upthrusts and rallies back to the ice all of which are prime position taking opportunities. This relatively insignificant word change turns this test into the pivotal one because it has zeroed in on that point in the action where the stock is moving from the preparation phase to either the marking up or marking down phase. Our goal should be to take positions as close to this point as possible.

Unless the change in wording mentioned above is made, the investor or trader should realize that the selecting of a stock as a potential candidate and the actual trading of that stock are very different. As a stock passes the various buying or selling test, it is reasonable to anticipate a trading opportunity. What is not reasonable is to expect the stock to be ideally positioned for a trade at the exact moment that the final test is passed. An additional period of days or even weeks may be needed for such a position to develop. In some respects, this extra time is a very important benefit. It can help blunt that often irresistible urge to trade and it provides an opportunity to investigate other stocks. The one under consideration may be a good opportunity, but additional study may reveal a better one.

Even if additional stocks are not considered, the options available in the one that is can be more fully examined during the waiting period for a favorable trading position. For example, there is time for the investor to realize that the trading opportunity for which he is waiting is not likely to be the only one in the stock's future. It may have the greatest profit potential, but may also have a large degree of uncertainty. A later opportunity may bring with it a smaller potential profit but a greater certainty, which may be considered an acceptable trade off.

The thought process involved in the buying or selling tests leading up to the selection of a stock or the taking of a position is extremely important. It must be logical, thorough, and perhaps most important absolutely objective. This ability may take some students years to develop. It often involves the breaking of many bad habits. However, with a solid effort, most find a good measure of success. Some find a remarkable degree of success. Part of this success is likely due to an ability to deal with the unforeseen, which is an ever present possibility.

In analyzing a stock, it should be remembered that we are always dealing in maybe's. The actions we take are based on what should or could happen. There is really no room for a belief that something must or has to happen simply because the success of our position is dependent upon it. We are playing a game of odds. The best we can do is try to keep those odds in our favor. If we do, the likelihood of winning is tremendously improved.

Since our analysis of stocks is not based on absolutes, each addition to the picture provided by each trading session is important because it may bring with it a basic change in the picture. That is to say that it may make it more positive or negative. When we select a stock and then take a position it is based on a perception of the picture as it existed at a particular point in time. With this perception will come an expected response. When that response does not develop as expected, it is an indication that something is wrong. There has either been a dramatic change in the picture, or a major error existed in the original perception. When it becomes apparent that something is wrong, immediate evasive action is warranted. Hoping for an improvement will not produce a profit. Logical and objective action may prevent a loss.

If a stock does not live up to expectations, the investor or traders first consideration should be to getting out. Failure to do this invites being stopped out. The individual who thinks he has avoided this possibility by not using a stop order invites being wiped out. Admittedly, the choice is not a particularly good one, but when faced with it, the investor should remember that his primary objective is to protect his pool of funds. This is the only way that he can reach his second objective of making a profit.

The process of selecting a stock is a complex and detailed one. It is not engineered to be this way. It just is and there is nothing we can do about it and still have hopes of meeting our objectives. Fortunately, however, we have the buying and selling tests, which afford the possibility of turning a complex procedure into one that is totally logical and hopefully substantially objective. Through these tests, we are guided to make decisions that many find so overwhelming that they remain spectators of the market forever. Others who do not know of or use these tests fall into the group of those who leap into a situation before they have looked it over thoroughly. Neither group will ever truly reach the desired ends of protection and profit.

Advances in Market Technology

Fifty years ago when Richard D. Wyckoff first summarized his accumulated knowledge of the stock market, he wrote that everything that happens in the market can be traced to just three basic laws. They, of course, are the law of supply and demand, the law of cause and effect, and the law of effort versus result. What was true then is still true today and will remain true for as long as securities are traded in an auction type market. To say this might make some people uncomfortable, but there is no reason for this. These laws represent the science of the market, and like other scientific laws, such as the laws of gravity and motion, they are absolute and never changing. What we do with these laws, how we measure them and make them serve our own purposes, is the technology of the market. It does change and hopefully improves with time as our understanding increases.

When Wyckoff wrote his course, he provided a base of principles with which we could understand the workings of the basic laws. He also left us with the concept of the Wyckoff Wave and two of the three Trend Barometer indexes. Later, the third index was added and market technology took a step forward. In the 1950's, Robert G. Evans formulated the O.P. Index and started to teach the concept of the divergence. This represented a major leap forward for market technology. Since then things have remained substantially unchanged. Throughout this period, however, logical extensions of current applications have been possible and have been waiting to be put to use. Now they have been and the intended result is better stock selection and improved market timing.

The tone of the Wyckoff text indicates that Mr. Wyckoff intended his course primarily for the benefit of the longer term investor. However, even from the beginning most of the tools developed seemed to lean toward the intermediate and shorter term. In recent years as the market has become increasingly more volatile, this bias has actually worked in favor of many traders. However, it has been at the expense of the longer term investor, which is what most individuals should be either because of limited funds, limited time, limited discipline, or any combination of the three.

Some years ago, we started publishing a weekly chart of the Wyckoff Wave to help the longer term investor maintain a proper perspective. The daily charts that we tend to use most of the time can result in concentrating our attention on the present moment. The weekly chart lets us see how that moment fits into the bigger picture and may keep us from acting prematurely. Even though this chart does include the total weekly volume, its emphasis is on price, which is contrary to the Wyckoff way of thinking. Therefore, we more recently added a plotting of the O.P. Index's weekly closes. This allows us to see the progress, or lack of it made by both price and volume. It also allows us to be aware of developing major long term divergences, which often mark important turning points.

Although this combination of price and volume indications is a valuable addition to our knowledge about the market, it can lead to some problems if certain points are not remembered. One of these is that the market tends to be less reliable in its response to long term divergences. On a short term basis, a divergent condition is almost certain to produce at least some sort of response. On a long term basis, there seems to be a greater likelihood of a divergence being worked out instead of achieving a result. In addition, the market tends to be less responsive to a long term divergence. A short term divergent condition tends to receive its response immediately or almost immediately.

Another factor that should not be overlooked is the magnitude of the response. It is reasonable to expect a larger response to a long term divergence than to one that develops intraday or over a few days. Even so, the divergence itself guarantees nothing as to the magnitude of the response. That is strictly a result of cause and effect. If a cause has not been built prior to the development of the divergence, there cannot be much of a response. It is possible for the divergence to develop first and for the cause to be built later. In a case like this, the Wave might begin to respond to the divergence, but then quickly go into a trading range with the bulk of the response coming later after the cause is in place. This can result in a good deal of uncertainty as to when investment grade positions should be established.

Many times, the Trend Barometer indexes act as a safety valve for the short and intermediate trader. The trader may want to take action. He may be able to justify that action from the price, volume, and O.P. action, but a consideration of the Barometer says wait. His interpretation may be correct, but the Barometer indexes will often indicate that the timing is wrong and timing may be the most critical element. The long term investor using the weekly Wave and O.P. chart has never had this benefit. The best he has been able to do is to attempt using the Barometer indexes for a long term indication, or to guess when conditions might be right. That is about to change, however. Exhibit 9 is the customary weekly chart of the Wave and O.P., but with the addition of weekly

Barometers, which are based on the idea of each week being a unit instead of each day as with the indexes that are published every day on the Pulse of the Market. Other than this, the construction of the indexes is the same. This being true, the important question becomes whether or not the interpretations are the same.

Most regular users of the Trend Barometer indexes look to the Technometer first. This is as it should be. Since the Technometer is an indicator of overbought and oversold conditions, its action suggests the likelihood of turns in market action at any particular point in time. Although no specific reading on the Technometer has ever been found to give an absolute indication of an immediate turn, it has been determined over the years that readings of fifty or higher strongly favor a downturn in the market and readings of thirty-eight or lower are very indicative of a rally. Do these same relationships apply to the longer term indications given by a weekly Technometer?

It appears as though the relationships do hold true. This can be seen by examining the conditions in effect at points "1" and "2". At one, the Technometer experienced two readings above the fifty level, which are clearly indications that the market had become overbought. At point two, which represents a time ten months after point one and approximately six hundred points lower on the Wyckoff Wave, the Technometer gave two readings below the thirty-eight level. These are clear oversold indications and point to the possibility of another important turn in the market. It should be noted that between these two points the market never gave a clearly overbought or oversold indication. Therefore, an investor using the weekly Technometer in a purely mechanical manner (an unwise practice at best) could have remained on the short side of the market from November 21, 1980 through September 25, 1981.

Assuming that an individual had made a mechanical application between points one and two, how might he have profited? The answer to this question in the final analysis would have depended upon the stock selections of the individual investor. Some who have the bad habit of not paying attention to such critical factors as relative strength and weakness, cause, and the other buying and selling tests could have managed to select only those stocks that would have produced a loss, but the odds against this would have been great. At point number two, one hundred ninety of the stocks that had been on SMI's Daily Stock Report at point one were still on the report. Of that total, 157 had declined in price while only 33 had advanced. Therefore, even with a random selection the odds would have been almost four to one in favor of a profit on the short side. A more thoughtful selection using the nine selling tests almost certainly would have improved these odds and probably would have increased the chances of selecting from those stocks that did decline, some of the issues that experienced the biggest drops in price.

Although the evidence suggests that a purely mechanical application and random selection would have produced a profit and that an intelligent selection could have produced a substantial profit, there is reason to avoid the purely mechanical approach. A good example of why can be found in the action at and surrounding point "3".

At point three, the Technometer did not reach the fifty level. Therefore, someone using a mechanical approach would have overlooked the action at this point. This could have resulted in missing many fine short selling opportunities. Even though the fifty level was not reached, the reading that was recorded in excess of forty-nine pointed to a relatively overbought condition. For the person inclined to rely on his own judgment, this would have provided an indication to take a closer look. If he did, he would have found a very troubling relationship developing between the Wyckoff Wave and O.P. Index. The Wave was still securely locked inside the trading range. The O.P., on the other hand, was indicating a substantial excess of upside effort over the result that was being achieved. This divergent condition in combination with the relatively overbought condition of the Technometer provided a good confirmation of the indication given back at point one and was a strong indication of its own. In many stocks, the establishing of short positions at point three would have produced results much sooner than positions taken at point one. On other cases, the action at three would have allowed for adding to positions that were already producing profits. This is something that a purely mechanical approach would have failed to do.

At point "2" on September 25, the weekly Technometer indicated an oversold condition. The longer term figure charts were also indicating that an important downside objective was close at hand. In addition, a major divergence between the Wave and O.P. had just developed (see Exhibit 10). All of these factors reflected the likelihood of an important change in the market. Anyone acting upon this indication at the beginning of the next week would have found himself taking long positions on the day of the selling climax, which is perfect timing. Of course, it is questionable whether this degree of accuracy would always be present, but a tool that provides it even occasionally is worthy of regular consideration.

What about the action following point two, does it tell us anything of significance? Notice how quickly the Technometer moved to a relatively overbought reading at point "4" and how little upside progress was made in relation to the decline that had come in the previous decline. This is a warning. Ordinarily, we would expect to see a substantial rise in the Wave on a move in the Technometer from point two to point four. The fact that we did not see such a move indicates a lack of readiness to move to higher levels and gives reason to be especially protective of long positions taken at point two.

Why would the market fail to respond to a shift in the Technometer such as the one that occurred from two to four? One reason would be a lack of count or cause. Without it, there will be no effect. In the case illustrated in Exhibit 9, there was very little cause, so this provides a partial explanation. There is, however, another factor that should be considered. It is the weekly Force Index.

On the daily Barometer, the Force is an indicator of the underlying push or pull being exerted on the market. It is the force which the overbought and oversold indications of the Technometer and the up or downside interest being expressed by the Momentum have to overpower or submit to. This makes it a very important factor. Its importance seems to be multiplied many times over in the weekly format. Here the idea of being an underlying current does not seem to be an important enough comparison. Rather, it appears more appropriate to look at the weekly Force Index as an indicator of the basic tidal forces that influence all currents underlying or otherwise. We can see that at point four the tide had started to go out, but it appears as though the inertia was still in the process of swinging from downward to upward. That being the case, the oversold indication of the Technometer had to swim against an unsettled current. As a result, the market did not make the kind of progress that might have been expected.

Another point about the weekly Force Index that seems worth noting is the smoothness of its curve. This is something not present with the daily Force, which tends to be more erratic in its movement. This can be especially troublesome for the longer term investor who is trying to find only the best times to take his positions. With an index like the weekly Force that flows more gradually and smoothly, an investor has a greater likelihood of picking the better places to trade and of avoiding the uncertainty that can be created by the daily Force Index.

The third weekly Barometer index is the Momentum. As with the daily version of this index, it measures the up and downside interest. On a daily basis, the Momentum is the most volatile of the Barometer indexes and that is clearly true on a weekly basis as well. When taking positions, the objective is to have the interest moving in favor of your position. If it is not, there is reason to question the wisdom of taking action at that time. The Momentum can be the catalyst that takes a new position and quickly puts it into the profit column. This is important should something go wrong and the position have to be closed out earlier than had been expected. Without the interest in the market helping a new position, it will be more difficult for that position to show an immediate or quick profit.

In the case of the daily Momentum, it has been found that extremely high or low readings tend to correspond to the ends of moves. The idea is that once a maximum level of interest has been brought out on a particular move there will be no way to maintain the advance or decline. Therefore, there is likely to be a turn. This seems to have happened at points five and six and may be in the process of happening at point seven. The peak in the Momentum at five came at the top of an important rally within the trading range. At point six, the low in the Momentum came at the selling climax. If the extremely high peak recorded at seven is going to continue the pattern, the indication being given is that the market is not going to escape the trading range on the rally in progress at the end of the chart. Therefore, there is no reason to chase after any particular stock because it is likely to be reacting back sometime soon.

The longer term investor can avoid being drawn into the market prematurely through the use of the weekly Barometer figures. Since these are only available after the close of trading on Friday, and since it is unlikely that all good long term trading opportunities will magically appear the following Monday, he can then switch to the daily indexes to fine tune his timing. He also has the benefit of two market holidays (Saturday and Sunday) to apply the buying or selling tests to the stocks he is following to see which appear to be the most likely candidates.

The buying and selling tests discussed earlier form the basis for stock selection. However, they only tell whether an issue is a candidate. They do not indicate exactly when. It is very much as is the case with the general market. The Wyckoff Wave, O.P. Index, and volume indicate whether a particular market is a candidate to be bought or sold short. It is the Trend Barometer, though, that says whether or not a particular time is right for taking action. This being the case, would it not be desirable to have an O.P. Index and Barometer indexes for individual stocks? These could provide added confirmation about a stock's desirability as a trade candidate and potentially

critical information as to the timing of those trades. The answer to the question about would it be desirable to have O.P. and Barometer figures for individual stocks is clearly yes. Now through new applications of the principles used to formulate the general market versions of these indexes we have O.P. Indexes and Barometer indexes (excluding Momentums) for the eight component stocks of the Wyckoff Wave. Charts of General Electric and I.B.M. showing this new information are pictured in Exhibits 11 and 12.

It might be asked why the eight stocks in the Wave were chosen to begin development of these tools for individual stocks. After all, they are not the most volatile stocks. Would there not be more profit to be made in a group of stocks that all have consistent wide price swings? There might be, but there likely would also be a great deal of greed involved, which could prove very destructive. In addition, there are some special benefits to be derived from using the Wave components.

With the detailed daily picture of the market that has been available for many years and with the detailed weekly picture that is now possible, we are able to know a great deal about the general market. We should also know that the market as depicted by the Wave cannot do anything without the cooperation of a majority of its component stocks. Therefore, the better we know the eight stocks the better we will know the Wyckoff Wave and through it the general market. We may apply our conclusions to other stocks or to the eight that helped provide the conclusions. This seems to be the purest application. Those who insist on volatility that these stocks tend not to display can more than compensate for the lack through the trading of options instead of the stocks.

The development of these indexes is based on a belief that all stocks are subject to the buying and selling waves of the general market. Some stocks may not respond well to either the buying or selling waves for a period of time resulting in a relatively strong or weak stock, but they are all subject to those waves. Therefore, we have used the same intraday waves for the individual stocks as for the general market. By keeping detailed records of the volumes and prices of the stocks during the intraday waves, we arrive at the raw data needed to construct the O.P., Technometer and Force. Momentum figures have not as yet been developed.

Because of the fact that even the most heavily traded stock has only a small percentage of the volume of the total market, an adjustment is needed for the construction of the indexes. In the case of the O.P.'s, for example, instead of making one million shares equal to one point ten thousand shares is given that value. Even with this adjustment, the net changes in the O.P.'s of the less heavily traded stocks can be small for many days in a row. To prevent a lack of sensitivity in these cases, the scales used to plot the data are made more sensitive so that small movements show up as being more important. Other than this one area of substantial difference, the work done with the individual stocks parallels that of the general market very closely. Therefore, the results should be reliable.

Let's begin a more detailed study of these concepts with the chart of General Electric, which is pictured on Exhibit 11. The first things worth noting here are the characters of O.P., Technometer, and Force Index. They all tend to be more volatile and subject to greater extremes than are the similar indexes for the general market. This should not be especially surprising. The general market is a composite created out of stocks that are responding well, that are responding poorly and that are not responding at all to the buying and selling waves. The individual stocks do not have this composite quality. Therefore, the extremes are less likely to be evened out as they are with the general market. The only changes in interpretation that seems warranted because of these differences are that the Technometer seems subject to greater extremes in its overbought and oversold conditions before a turn begins and that what would seem to be widely divergent or inharmonious conditions between the price and O.P. may not bring as striking a result as would be expected from the general market should a similar situation develop there.

There are many indications that could be studied on this chart. As a sample of some of them consider the move from "A" to "B". There was an enormous run up in the O.P. for the stock between the two points indicating a tremendous upside effort. What type of upside result occurred? It was very feeble to say the least. This created a significant lack of harmony, which pointed to a change in direction. Since the stock was moving up at the time, the change would be in favor of the downside. This idea was supported by the relatively overbought condition of the Technometer at the time. The stock responded by moving down to point "C".

At point "C", a reverse of the condition that had existed between "A" and "B" developed. Here, the price had made good downside progress from where it had been at "A". This had occurred, however, with a relatively small amount of net downside effort, which resulted in an inharmonious condition that suggested the likelihood of a change. It should also be noted that at point "C" General Electric's Technometer had become oversold. This indicated that the stock was vulnerable to a rally, which confirmed the likelihood of a change indicated by the inharmonious action between "A" and "C".

The need to avoid mechanical applications of any of these indexes can be seen in what happened at point "D". Notice that the Technometer had become almost as oversold as it had been at "C". This meant the stock was again vulnerable to a rally, but this time it did not respond. Instead, it continued to move lower for another week. Anyone attempting to use the Technometer in a purely mechanical fashion would have been disappointed and might have been stopped out if an especially close stop had been in place. The reason the stock did not respond in this case can be found in the Force Index. At point "D", it was as heavy on the downside as it had been any time during the previous months. In addition, it remained heavy through and after the period during which the Technometer was oversold. This is significant because it works against the rally indicated by the Technometer. In this case it was so effective that no rally developed. In other instances, a rally might develop, but it would be much less impressive than would otherwise be expected. As a general rule, it is advisable to go with an indication of the Technometer when the Force is moving in the direction of the indicated rally or reaction.

The final development of significance came at point "E". The stock was at the top of its trading range and apparently poised for an upside breakout. Why did it fail? The answer can be found in the amount of effort required to raise the stock to point "E". From "F" to "E", there was no net upside price progress. However, this required a substantial amount of net upside effort. The result was an important lack of harmony indicating the likelihood of a change. It appears as though the previously established resistance level was the obstacle that turned the stock back.

On the chart of IBM (Exhibit 12) many of the same types of relationships that had been found on the General Electric chart are also present. One of the best can be found at the beginning of the chart between points "A", "B", and "C". There is a very obvious divergent pattern here. The effort is clearly on the upside across the three points while the result is just as clearly on the downside. Experience tells us that this is not a positive combination. It should also be noted that the stock became overbought at the top of each rally providing further indications of the likelihood of a reaction. When the stock left point "C" it made about a ten percent decline before a rally got underway.

Between points "D" and "E" a minor divergence developed with the O.P. making a small amount of downside progress while the price made a small amount of upside progress. This type of minor divergence would not be cause for any great expectation for the upside and nothing spectacular did develop. The stock did eventually make it to point "F" but this was a relatively minor advance. There is something about the rally to point "F" that should be immediately apparent. It is the incredible amount of upside effort that was required to produce that relatively small rally. This says loud and clear that something was wrong. The Technometer was dangerously overbought and as soon as the Force Index began to round over, the stock began a fifteen percent decline.

The action of the stock alone at point "F" gives reason enough to look for a reaction. However, if the action of the general market at this time had also been considered, the reasons to have been expecting a reaction would have been greatly increased. At "E", the market experienced action that appeared to be a selling climax. As IBM moved from "E" to "F", the market was making its automatic rally. After an automatic rally is completed, there has to be a secondary test. The best stocks in which to participate in such a certain reaction are those that have performed poorest during the automatic rally. That being the case, IBM due to the tremendous lack of harmony at point "F" would have been a prime candidate for a short sale.

After the reaction indicated at "F" and the corrective rally that brought the price back up to point "G", another divergence developed along with an overbought condition. Again the stock reacted. The chart ends at point "H" and still the stock is being subjected to divergent conditions that continue to point to the possibility of reactions. Harmony has been restored over the short term between points "G" and "H", but there is still a significant divergence between "F" and "H" and the possibility of a major divergence between points "A" through "C" and "H". Should the market and the stock become overbought again, it would have to be considered as a candidate for a short position.

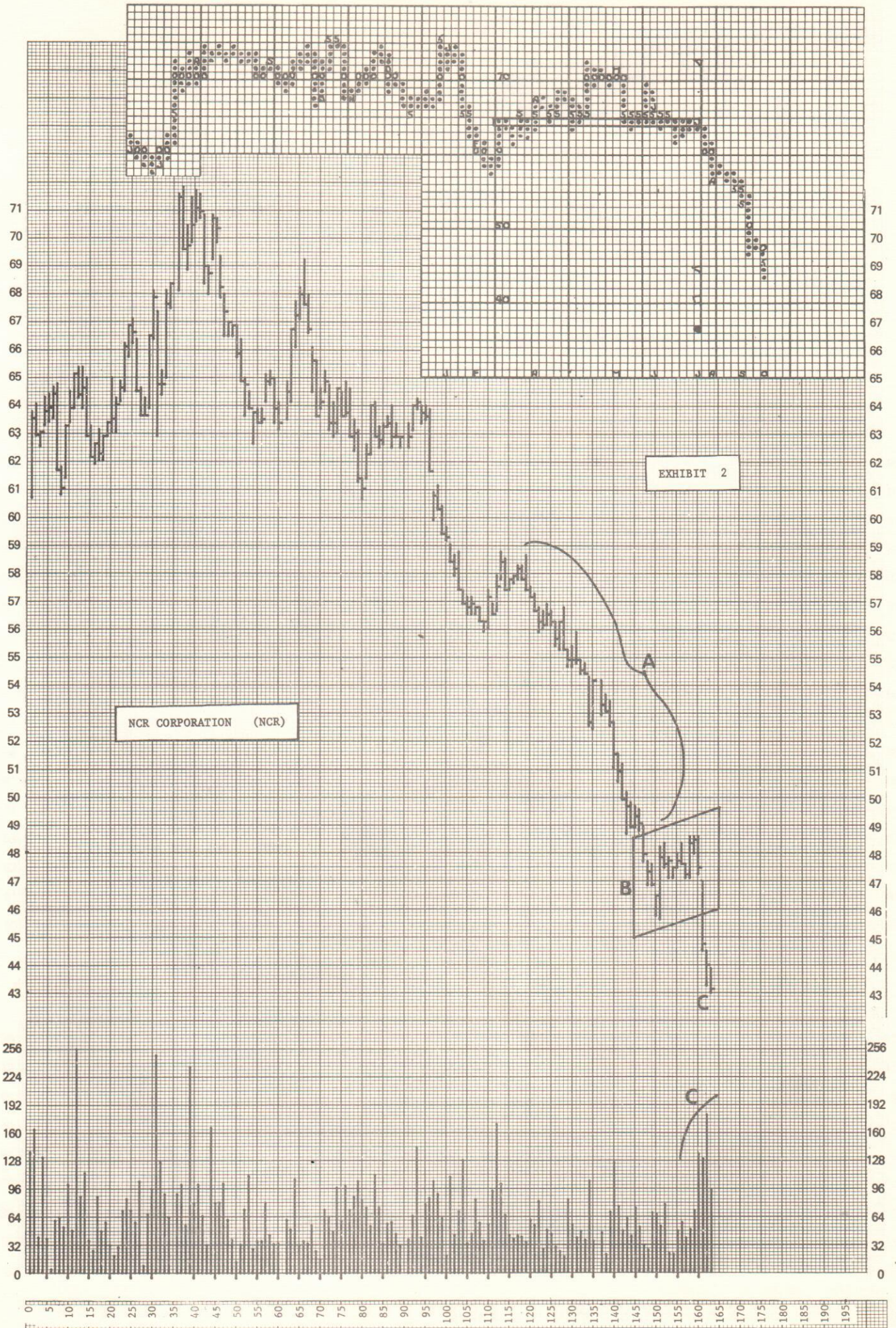
The principles and concepts used to analyze the General Electric and I.B.M. charts were no different than those that have been used to interpret the action of the general market for the past fifty years. The only difference was that the conclusions arrived at could then be applied directly to the vehicle being analyzed. There was no need for transferring the conclusions from the market to a particular stock. This should help reduce the incidence of being right on the market but wrong on the stock.

The importance placed on the individual stock in the preceding analysis should not be taken as a lessening of the importance of the general market. Every stock is a part of that market and therefore subject to its action to some degree. The best course of action should be to find those situations where the market and the stock seem to be saying the same thing as was the case at point "F" on the IBM chart.

Finally, it must be restated that the ideas of weekly Barometer figures and O.P. and Barometer figures for individual stocks are experimental applications of market technology. Although the evidence gathered over a year of experimentation is encouraging, it cannot be considered conclusive, that will take more time. The Wyckoff principles that we now accept as fact took forty years to develop and have been practiced for fifty years since. It probably will not take ninety years to prove the reliability of the new applications presented here, but one should not become so enthralled with the possibilities that these applications present that a period of personal practice and study is not undertaken before actual market application is attempted. This is the Wyckoff way—learn, practice, and then profit.

The weekly Barometer figures and the O.P. and Barometer figures for the eight stocks in the Wyckoff Wave that have been discussed here will be available to Pulse of the Market subscribers via SMI's regular business office number (602) 248-8244 beginning January 4, 1982.





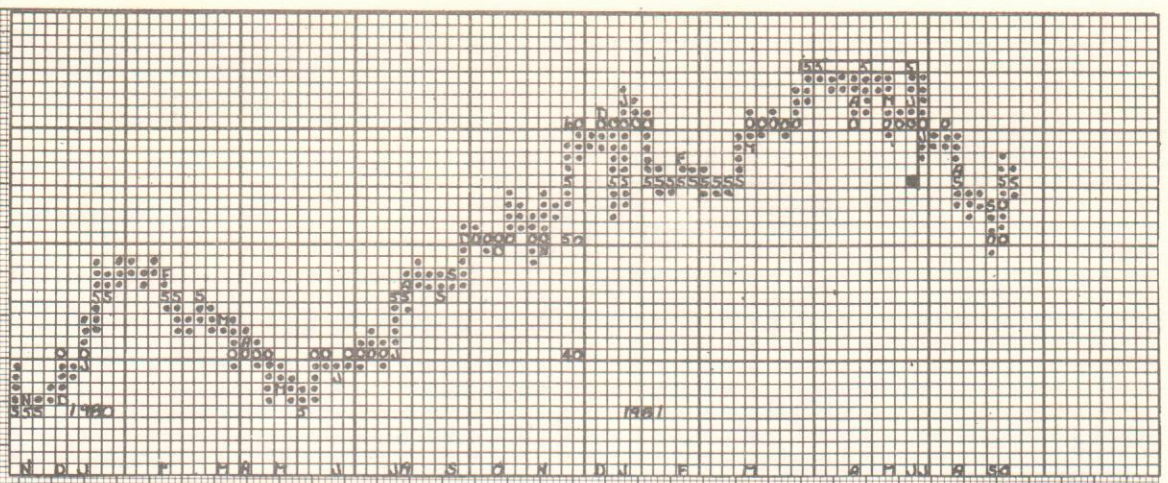
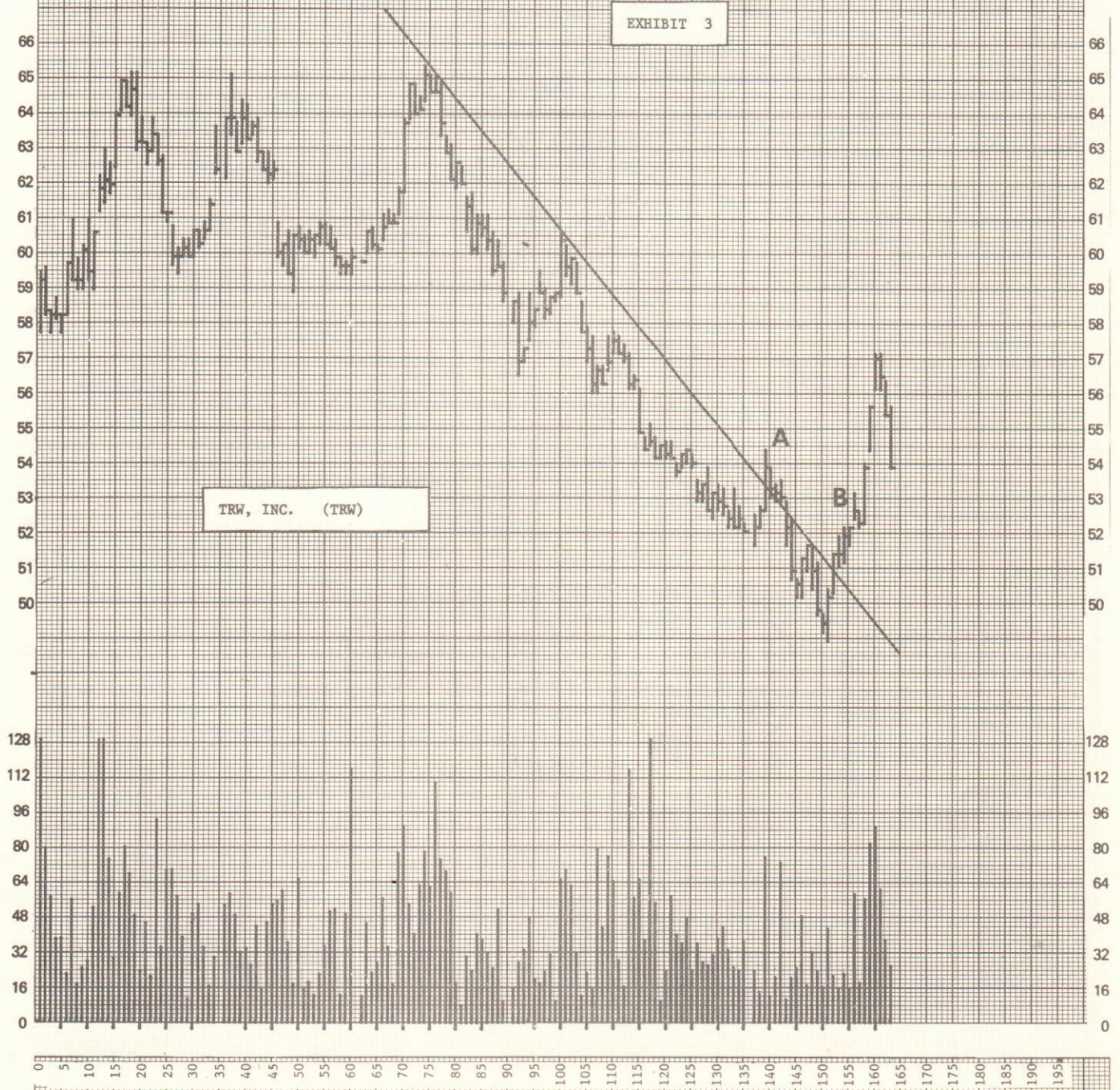


EXHIBIT 3



(XON)

C.B.O.E. (p&c)

BC

stop.

Creek

BC

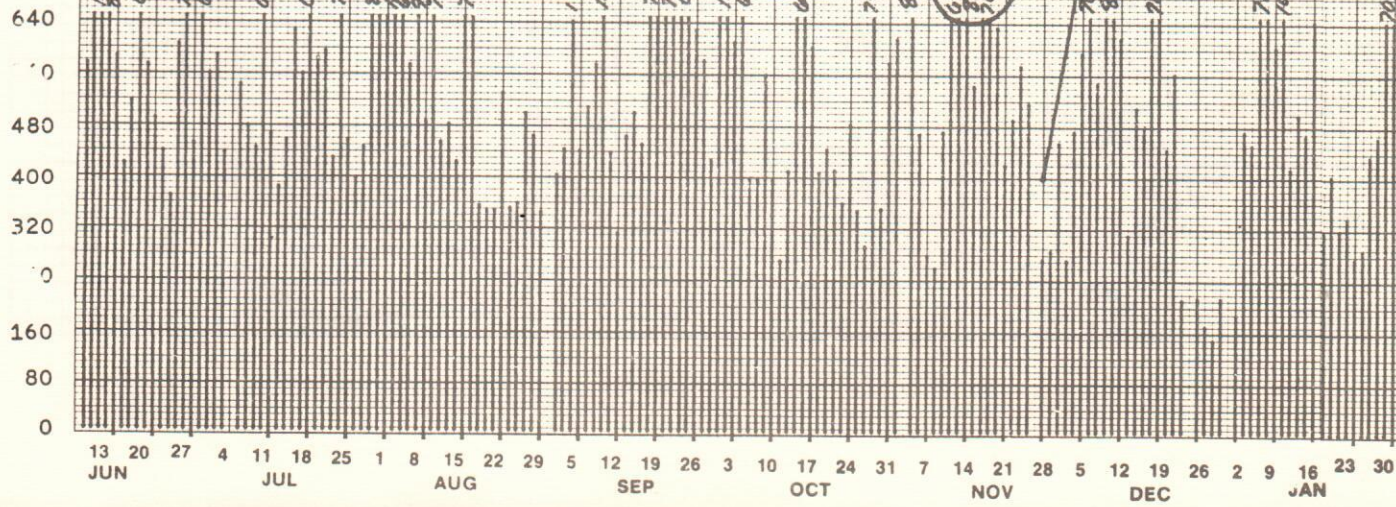
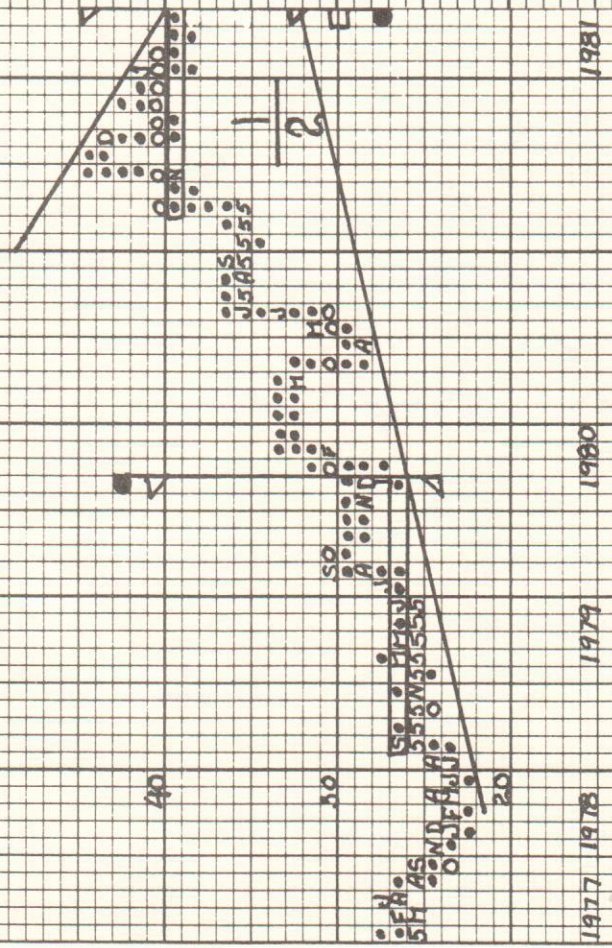


EXHIBIT 4A



GENERAL MOTORS

(GM)

C.B.O.E. (p&c)

AUTO

EXHIBIT 5

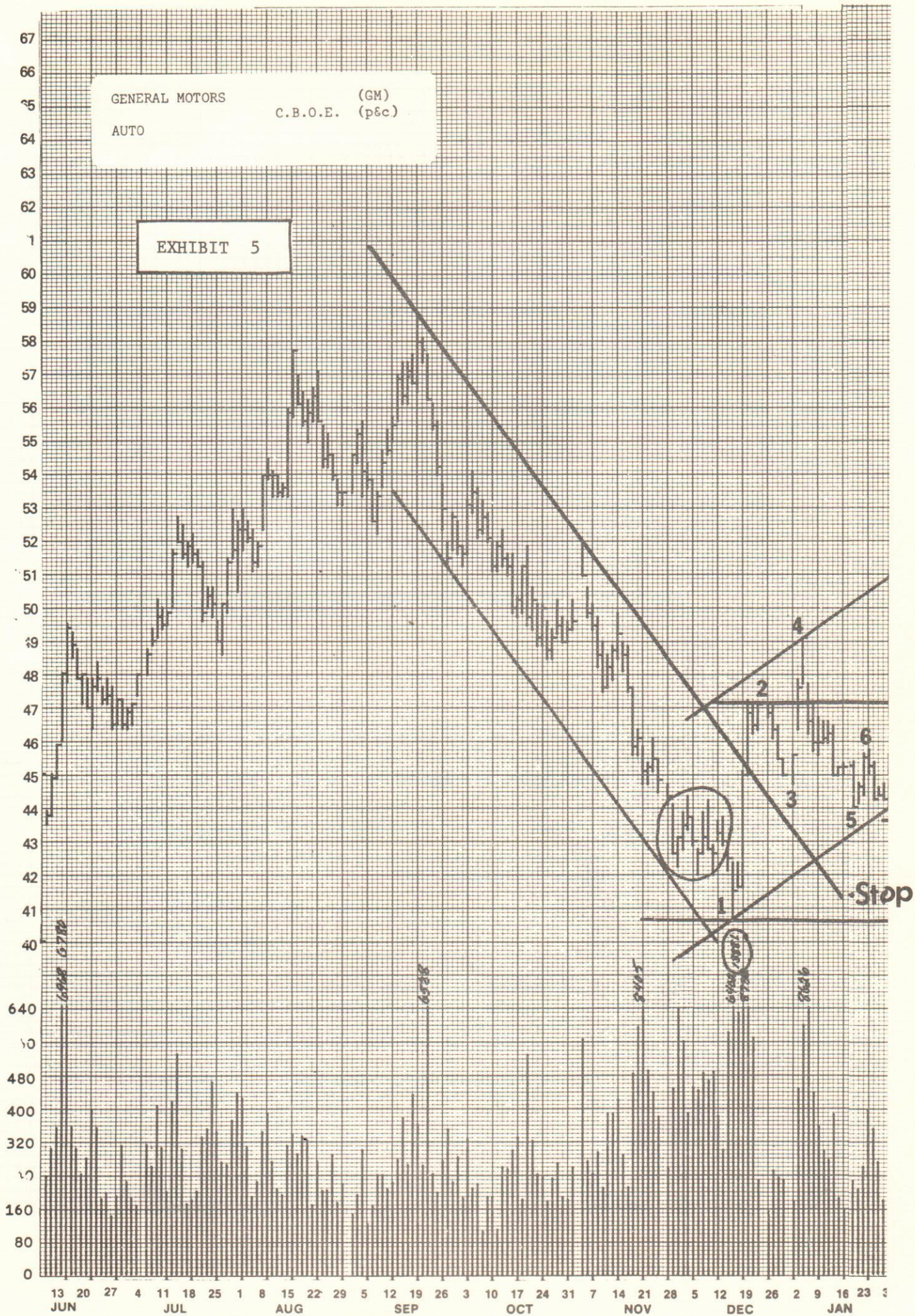
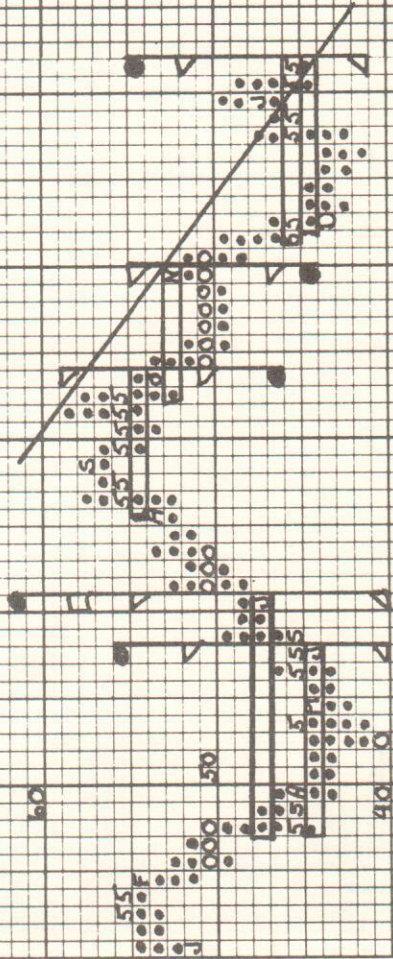


EXHIBIT 5A



1980

1998

GENERAL ELECTRIC (GE)
ELECTRICAL EQUIPMENT C.B.O.E. (p&c)

EXHIBIT 6

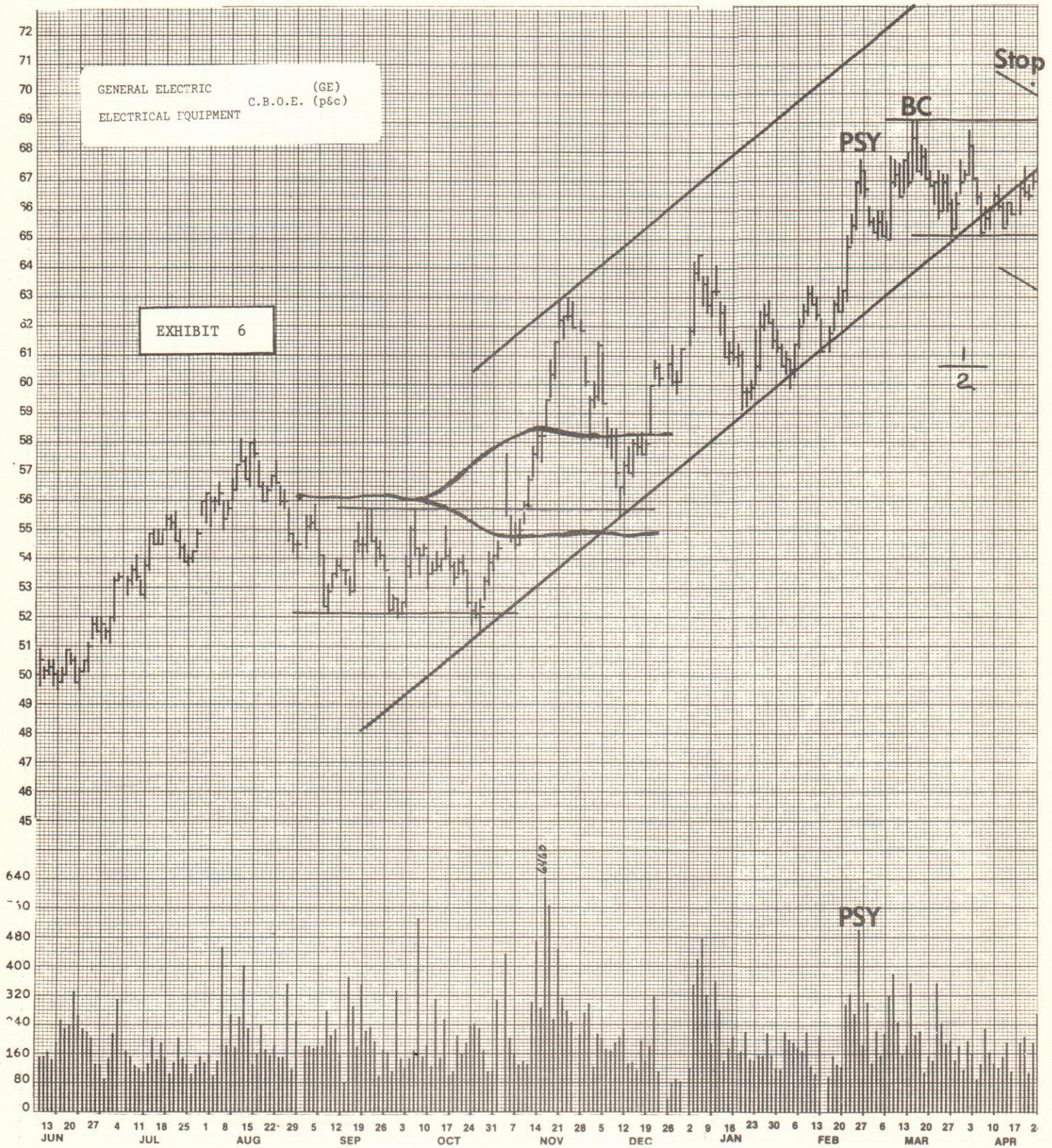
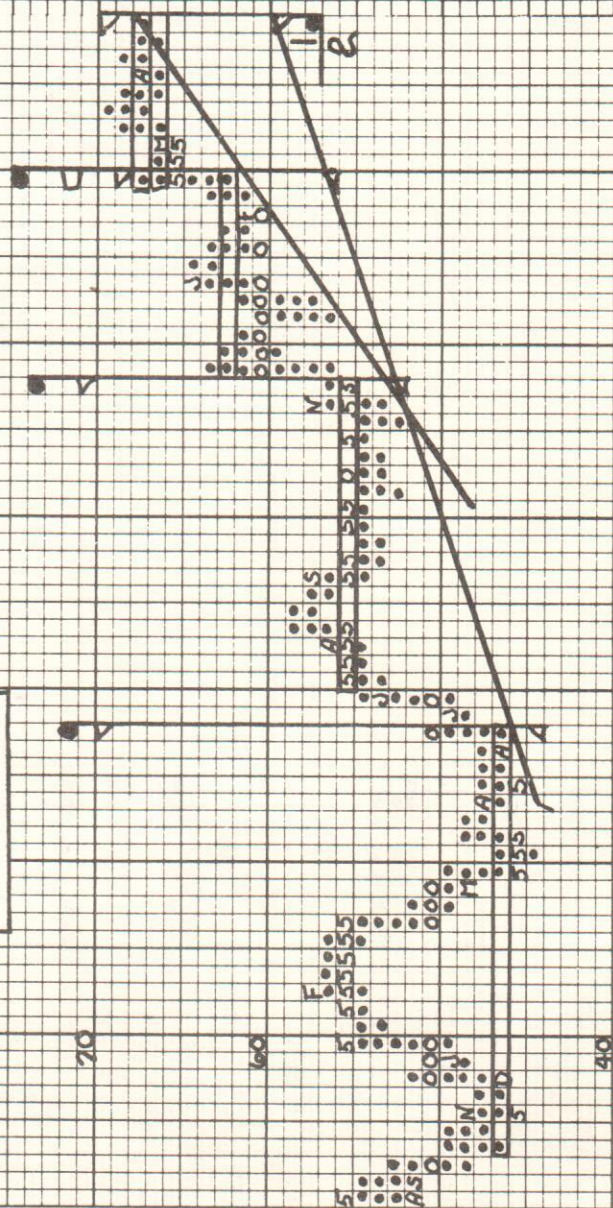


EXHIBIT 6A



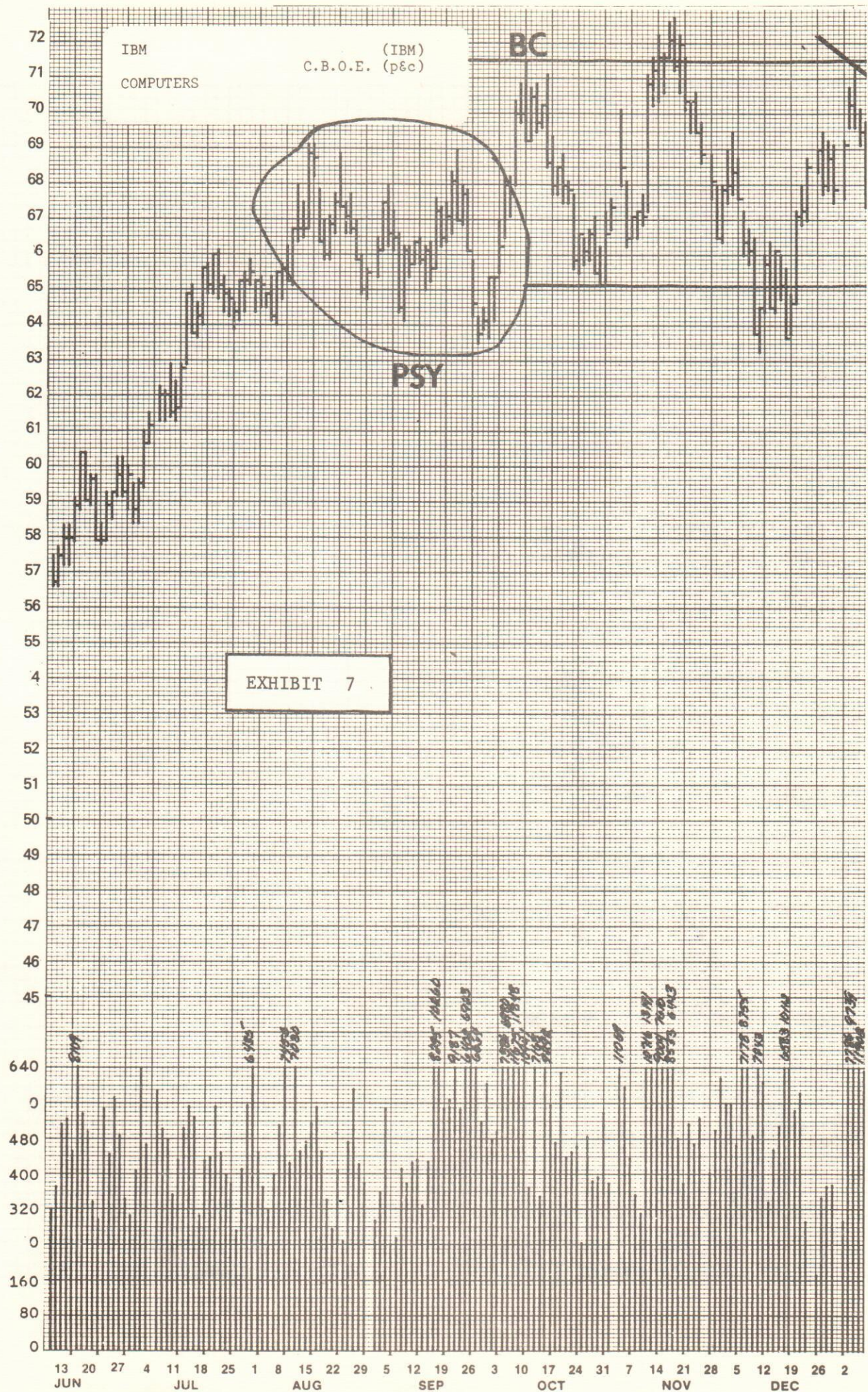


EXHIBIT 7A

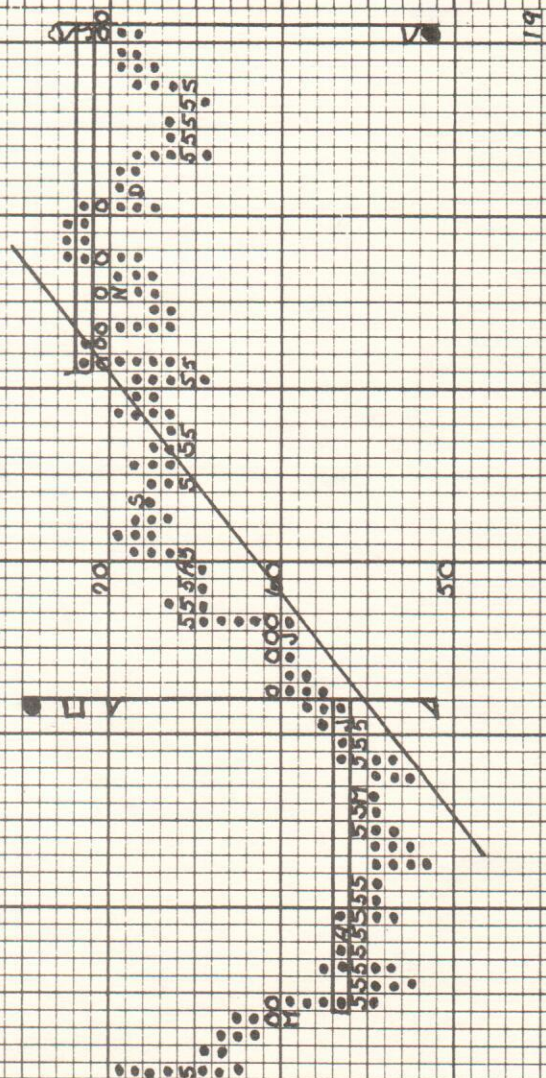
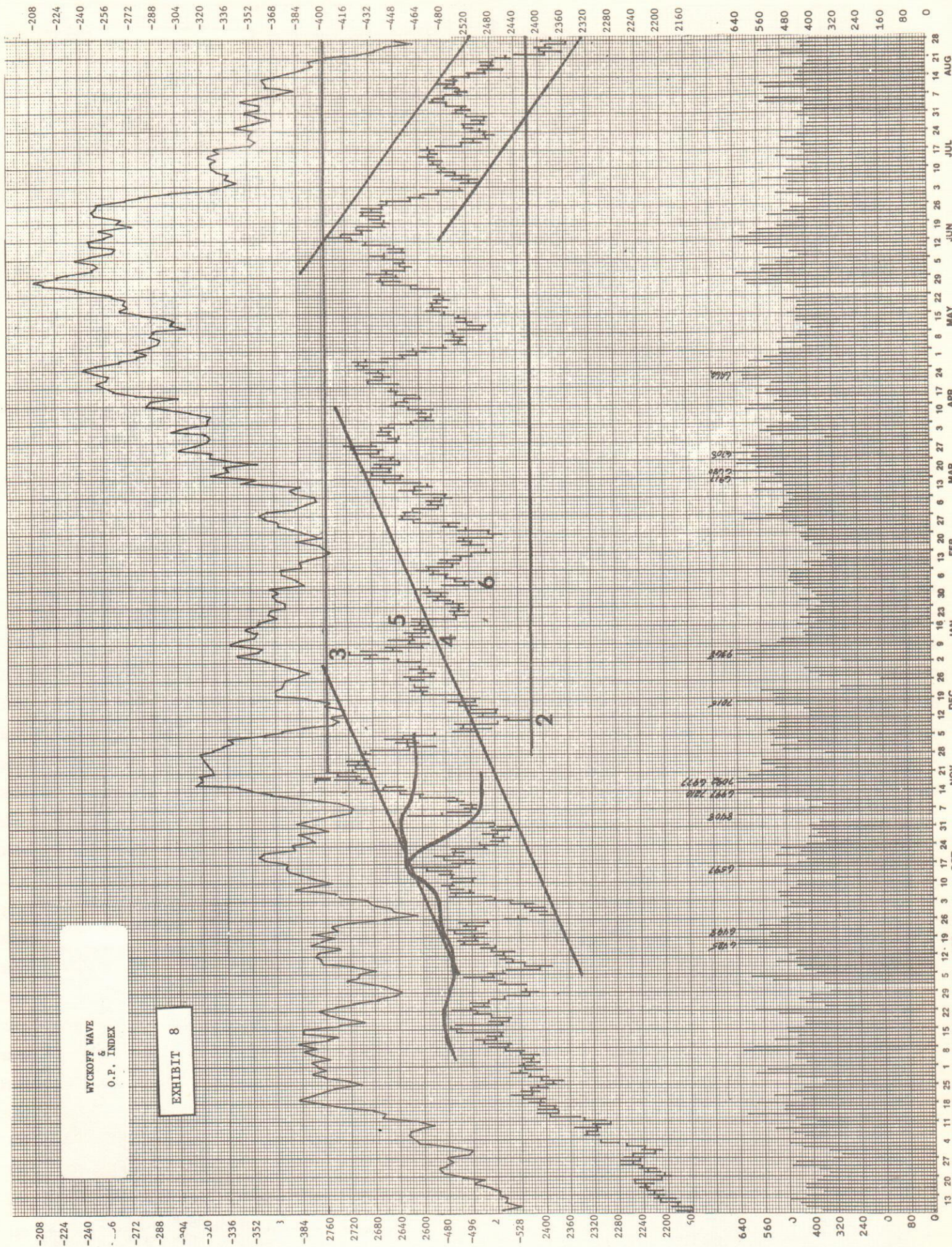
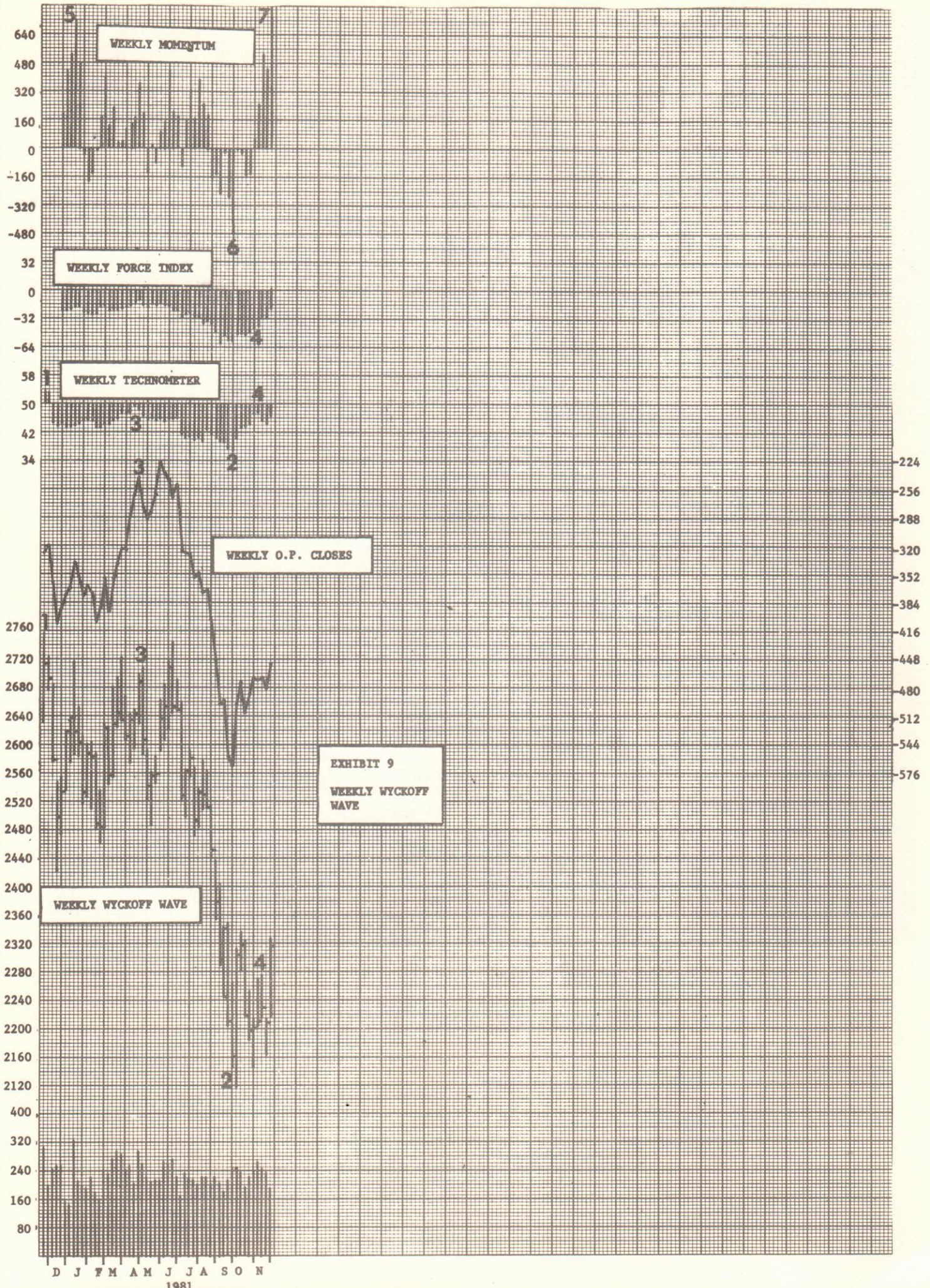


EXHIBIT 8





2950
2900
2850
2800
2750
2700
2650

EXHIBIT 10

WEEKLY WYCKOFF WAVE

WEEKLY O.P. CLOSES

250
200
150
100
50
0

- 50
- 100
- 150
- 200
- 250
- 300
- 350
- 400
- 450
- 500
- 550

200
150
100
50

