Selecting the best individual stocks

Wyckoff method of trading stocks part 9

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Our discussion of Wyckoff's analytical methods have so far concentrated on deductive reasoning to reach investment or trading conclusions. We first determined the position and trend of the general market, then the positions and trend of group averages, and finally selected individual stocks based on their ability to move in harmony with those larger trends.

The opposite approach-inductive reasoning-offers the experienced Wyckoff analyst a valuable way to double check those conclusions. I emphasize *experienced* analyst because determining the positions of individual stocks first and then proceeding to the market and groups requires more skill and judgment, as well as more analysis time.

To make inductive reasoning easier and to help the deductive analyst make better individual stock selections, Wyckoff devised a recordkeeping device in 1916 called the Position Sheet. A Position Sheet simply keeps track of the potential movements of individual stocks. This helps the Wyckoff analyst determine which stocks offer the best trading opportunities, judge stocks' turning points, determine group trends, forecast group movements, and ascertain the trend of the entire market.

The premise behind the Position Sheet is straightforward. Every stock is either bullish, bearish or neutral; in harmony or out of harmony with the general market's trend. The Position Sheet tracks individual stocks according to five possible positions which Wyckoff identifies as:

Position l- rally or minor move up without material reaction; the stock should indicate a **short** upward swing of roughly 10%-15% of its present market price.

Position 2- n advance without material reaction; the stock should be ready for a **long** upward swing which, in points, amounts to **more** than 10%-15% of its current market price.

Position 3- reaction without any material rally; the stock should indicate a **short** downward swing, a drop equivalent to 10%-15% of present market price.

Position 4- decline without any material rally; the stock should indicate a **long** downward swing amounting to **more** than 10%-15% of current market price.

Position 5- eutral; no definite indication of a move in either direction.

Knowing these positions for a number of stocks, the Wyckoff analyst can make decisions about the market and groups and, therefore, use that information to select individual stocks able to move quickly and surely in the forefront of the market.

Positions 2 and 4, the heralds of advance and decline, are the most important to a Wyckoff trader because they are the positions in which the most money can be made. These stocks promise such sufficiently large swings that it's realistic to expect an intermediate swing is in the works that will amount to 10, 20 or 30 points.

Positions 1 and 3, the rally and reaction, are less important but do tell the Wyckoff trader when to buy or sell to advantage; i.e.: the tops of rallies. These indications of short moves in the neighborhood of three to five or eight points for a moderately priced stock help Wyckoff analysts select the right time to take their trading positions.

Constructing a Position Sheet starts with a list of individual stocks-at least 50 but preferably 100 or more-arranged according to groups. To the left of the stock names are two columns, one for Position 1 and one for Position 2. To the right of the stock names are two more columns for Positions 3 and 4. Space is reserved in the lower right-hand corner of the page to tally the number of stocks in each position, to note the overall market's position and the analyst's trading position.

Although you can learn to keep a Position Sheet with only 20 stocks, in actual market operations Wyckoff recommends covering 50 to 100 or more-roughly an hour's work each day.

The daily Position Sheet begins with the analysis of figure and vertical charts of individual stocks to observe their technical positions. Preliminary decisions about Positions 2 and 4, the advance and decline, can be made from figure charts and the conclusions checked with the aid of vertical charts. Vertical charts are indispensable in determining Positions 1 and 3, the rally and reaction, because volume is the best means of judging the turning points of these minor swings.

For efficiency, Wyckoff recommends following stock movements with figure charts, and when a stock shows itself working into a promising position, making up its vertical chart to observe its behavior in detail to apply all the factors needed for complete analysis.

A stock can show its ability to develop a Position 1 minor upward move: 1) in the nature of its rally from a low point, 2) at a level where the minor move is the forerunner of a large advance, or 3) at a level in a trading range that indicates a small move through the previous top of the range.

To get into Position 2, the stock may show its promise of a large advance with: 1) evidence of accumulation at the bottom of a downward movement, 2) in a resting period that follows a previous advance where there was evidence of absorption (reaccumulation) in preparation for further advance, and/or 3) its ability to persistently advance through a series of higher tops and bottoms on successive minor moves-even though there was no evidence of previous preparation for the advance.

The small downward move of Position 3 may herald itself: 1) in the nature of a stock's reaction from a high point, 2) at a level where the reaction is the forerunner of a large decline, or 3) at a level in a trading range where the stock cannot rally and will probably drop through the previous support level.

Position Sheet

1	2	Stock	3	4
		Aerospace		
X		BA		
X	X	GD		
		LK	X	X
		MD		
X	X	NOC		
X		RTN		
		UTX	X	X
		Airlines		
		AMR	X	X
		DAL	X	X
		EAF	X	X
		FDX	X	
		NWA	X	
		LUV		
X	X	UAL		
		Amusements		
	X	DIS	X	
X		MCA		
		Auto		
X		C		
X		F		
X		GM		
		Banking		
		BAC	X	
		CMB	X	X
		FNC	X	X
		GWF		
X	X	JPM		
		Building Materials		
X	X	BCC		
	X	GP	X	
X	X	JWC		
		LPX	X	
		ML		
		OCF	X	
		WY	X	
		Brokerage Firms		
	X	EFH	X	
	X	MER	X	
X	X	PSB		
		PWJ		
		Chemicals		
		ACY		
X		BIG		
	X	DIA	X	
		DOW	X	
	X	DD		
X	X	EY		
X	X	IGL		
X	X	LZ		
	X	MTC	X	
	X	PG	X	
X	X	UK		
		Computers		
X		CDA		
X		CBU		
X		CVN		
		CYR	X	
X		DGN		
X	X	AUD		
		DEC	X	
X	X	HON		
		IBM		
		SY	X	X
24	21	**Total**	24	8

1	2	Stock	3	4
		Cosmetics		
	X	AVP	X	
X	X	GS		
		REV		
		Diversified		
	X	AXP	X	
		AVT		
		DKI	X	
X	X	FLR		
X	X	GW		
		ITT	X	
X	X	LIT		
	X	LTR	X	
	X	PC	X	
X	X	WCI		
X	X	WMB		
		TW		
		Drugs		
		ABT	X	
X	X	AHP		
		BMY	X	
	X	LLY	X	
X	X	MRK		
	X	PFE	X	
X	X	SQB		
X	X	SYN		
		UPJ		
		Electronics		
		AMP	X	
		GE	X	
		GLW		
		GRL	X	
X		HWP		
X		PKN		
	X	RCA	X	
		TEK	X	
	X	TRW	X	
X		TDY		
X		WX		
		Electronics/Semiconductor		
		AMD		
		MOT	X	
		NSM	X	
X	X	TXN		
X	X	UTR		
		Food		
		GIS		
		SA		
X		RAL		X
		PSY	X	X
		Hotels		
X		HIA		
		HLT		
		Insurance		
X		AET		
X	X	FG		
		LNC	X	X
		MMC		
X	X	TIC		
		Machinery		
X		CAT		
		CKL	X	X
X		CSP		
		DE	X	X
		DI	X	X
		IR	X	X
21	21	**Total**	19	3

1	2	Stock	3	4
		Medical		
		BDX	X	X
		BAX	X	
		HCA	X	
		HUM		
X	X	JNJ		
	X	MDT		
		Metals		
X		AA		
X		AMX		
X		N		
		NL	X	
		PD	X	X
		RLM	X	X
		Metals-Gold/Silver		
		ASA		
X	X	CRK		
X	X	DM		
	X	HM	X	
X	X	HL		
		Office Equipment		
		BGH		
		DBD	X	X
	X	MMM	X	
X	X	NCR		
		XRX		
		Oil/Gas		
	X	AHC	X	
		AN		
		ARC	X	
X	X	CHV		
X	X	XON		
		KMG	X	
X	X	LLX		
	X	MOB	X	
	X	OXY	X	
X	X	PZL		
X	X	RD		
		SNT		
		TX		
		Oil Exploration		
X	X	BKO		
		HT	X	
	X	HAL	X	
X	X	MSA		
	X	MDR	X	
X	X	SLB		
		Paper		
X	X	CHA		
		ZB	X	
		KMB	X	
		IP		
		Photo/Optical		
		BOL	X	
X		EK		
X		PRD		
		Publishing		
	X	GCI	X	
		MHP	X	
	X	TL	X	
X		DND		
		Radio & TV		
X		CCB		
		CBS		
		TFB	X	
21	22	**Total**	24	8

1	2	Stock	3	4
		Rail Equipment		
		GMT	X	
		Rail Shipping		
X	X	BNI		
X	X	UNP		
		Retailing		
		JCP		
		KM		
X		RDS	X	
		S	X	X
X		TAN		
		WMT		
		Soft Drinks		
X		KO		
X	X	PEP		
		Steel/Coal		
		BS	X	X
		X		
		Telephone		
X	X	T		
X		CQ		
		WU	X	X
		AIT	X	X
		GTE	X	X
		Textiles		
		CZ	X	X
		Tobacco		
		AMB	X	
		MO	X	
		RJR		
		No Group		
X	X	BLY		
	X	CLO	X	
X		ETN		
X		MDA		
X		MCD		
X		TOY		
15	8	**Totals**	15	6

1	2	Summary	3	4
24	21	Col. 1	24	8
21	21	Col. 2	19	3
21	23	Col. 3	24	8
15	8	Col. 4	15	6
81	72	**Totals**	82	25
		Trend Summary		
1	2	**Indicates**	3	4
	X	Averages	X	
X		Summary	X	

Position should be:

Long ~~Short~~ ~~Neutral~~

Date: May 1 Hr.:3 p.m.

A stock indicates its potential for the large decline of Position 4 when it: 1) shows evidence of being under distribution at the top of an advance, 2) is in a period of rest after a previous decline where it gives evidence of meeting new supply (redistribution) in preparation for a further decline, or 3) is at a level in a trading range where the stock persistently declines through a series of lower bottoms and tops on successive minor moves-even though there was no clear-cut evidence of distribution in preparation for the decline.

The Neutral Position is equally important since trading when indications are not clear is an invitation to losses. A stock is in a Neutral Position when there is no definite movement in either direction or there's doubt as to its ability to move decisively. This occurs where a stock: 1) gives tentative, but unconvincing indications that it will rally or react further, 2) hesitates during an advance or decline without convincing indication of a change of trend, 3) its price and volume indications are contradictory or inconclusive, or 4) when the price is extremely dull in a narrow trading range or swings up and down without developing any well-defined trend.

As the Wyckoff analyst determines the technical position of each stock, he or she places a pencil mark on the Position Sheet in the appropriate position column. Pencil, rather than pen, is recommended so the Position Sheet can be reused for the next day's decisions, something we'll touch on in a moment.

Once the day's analysis is complete and the Position Sheet filled, the next step is to determine the trend of the general market. It's simply a matter of totaling the number of stocks judged to be in each position, and comparing the number in the very bullish Position 2 to the total number judged to be in the very bearish Position 4. The ratio of bull to bear stocks indicates in which of the five positions the overall market sits. For example, if 40 stocks indicate they are in Position 2, and 10 are in Position 4, the market is obviously leaning to the bullish Position 2.

The next step is to determine the trend of the general market.

Although this analysis concentrates on Positions 2 and 4, stocks can be simultaneously in two positions. A combination of Positions 3 and 2 indicates a short move down before a long move up, or Positions 1 and 4 indicate a short move up before a long move down. The only contradictory combinations would be Positions 2 and 4-an advance and a decline, and the combination of Positions 1 and 3-a rally and reaction.

One position also can build into another-Position 1, the rally, can build into Position 2, the advance, but the reverse is not true. Likewise, Position 3 can build into Position 4, but not vice versa. So while a stock can change between Positions 2 and 4, these positions should not be reduced to Position 1 or 3.

As a double check of your conclusion about the market's position from the Position Sheet, compare it to an independent conclusion drawn from the trend chart of group averages. It's very unlikely an out-and-out contradiction between the Position Sheet and trend chart would actually occur in the market, so if it shows up, it's time to re-think some deductions.

The same procedure of totaling the number of stocks in each position and comparing the totals leads to the next step of determining which groups on the Position Sheet offer the best trading or investment opportunities. By comparing each group's position to the overall market position, a Wyckoff analyst finds the groups most closely aligned with the large-scale trend and most likely to contain stocks able to move first, fastest and farthest with the market.

In finally selecting individual stocks from the Position Sheet, the analyst again looks for the strongest positions in harmony with the market. Further research compares these stocks against each other, with the trend chart, and the vertical chart of group averages. The timing of actual purchases is guided by the technical position of the stock as shown on its individual vertical chart.

Maintaining a Position Sheet can be a valuable aid to judgment and Wyckoff recommends that it be constructed daily. If all position marks are made with pencil, one sheet can be reused for quite some time and a permanent summary of each day's work can then be charted on a Technical Position Barometer, a chart that becomes a valuable trend forecaster.

Constructing the Technical Position Barometer is a quick task requiring no more than a day-by-day plotting of the total number of stocks in each position. Each position is a separate line on the graph and the barometer shows at a glance whether the number of stocks in certain positions are gradually increasing or decreasing. This becomes a significant clue to the growing strength or weakness of the market's technical position.

To conclude this discussion of the Position Sheet, we can see how Wyckoff, himself, would judge the technical positions of an individual stock from its vertical or figure chart movements. At the beginning of the analysis, the price of Stock ABC has been hovering between 30 and 34 for two weeks with no sign of definite movement. It is in the Neutral Position.

When the price rises steadily for four successive days and the volume on the fourth day markedly increases, it suggests a buying climax. The fifth day's price hits a fractional higher top of 35 5/8, then closes near the low. The stock is due for a reaction and moved tentatively to Position 3. It is a tentative move because there is not sufficient data to determine how far it might react. A one-point figure chart should give an indication of the amount of reaction and a definite Position 3 would be given when it's clear the reaction would bring at least a 10% drop in price.

In this case, Stock ABC reacts normally and its price drops to 32, not quite a 10% drop. But instead of rallying, the stock price goes into a narrow range with shrinking volume and works itself into an apex or dead center-a definite Position 3.

The stock price continues to plummet toward a previous support level, and the steepness of the drop creates the possibility of an oversold position and a sharp volume increase on the decline suggests a minor selling climax. Continuing heavy volume and shortened downward price thrust in the next days says demand is overcoming supply and the reaction has achieved the objective forecast by the figure chart.

When the stock price moves laterally in a narrow range near a previous support level and with low volume for two more sessions, the position is moved to Neutral. The stock is too finely balanced between bearish and bullish forces to make a definite decision. The next days' actions must first be scrutinized.

Reviewing previous installments in this series and then sitting down with historical vertical and figure charts will help to develop the skill determining positions

A technical rally breaks a minor trend supply line and volume is relatively large. The rally continues a second day and is close to the objective indicated by the figure chart, but a volume surge warns to be on the lookout for another change. A quick reaction on the third day cancels the rise, the price hangs near former lows but volume is not much reduced. Several more days of sideways price movement at constant volume and lows that tend to edge upward looks like good buying rather than good selling and the stock goes into Position 1.

The stock won't move into Position 2 until there are additional indications that the campaign of accumulation has been completed and the groundwork for a significant advance is being laid. Until then, the stock may bounce from Position 1 to Neutral and perhaps even back to Position 3.

In this case, Position 2 comes about after two weeks' dull sagging price movement exhausts itself in a quick dip to the supporting level without bringing out any quantity of offerings. The figure chart, by now, promises a rise of more than 20 points and the springboard points directly at Position 2 and the time to buy.

Judging technical positions is a matter of practice and experience. Reviewing previous installments in this series and then sitting down with historical vertical and figure charts will help to develop the skill of determining positions. From there, apply your know-how to charts constructed in real time, from day to day.

Stock symbols shown on the Position Sheet are the same as used by Stock Market Institute, Inc., 715 E. Sierra Vista, Phoenix AZ 85014, a supplier of Wyckoff information and charts.

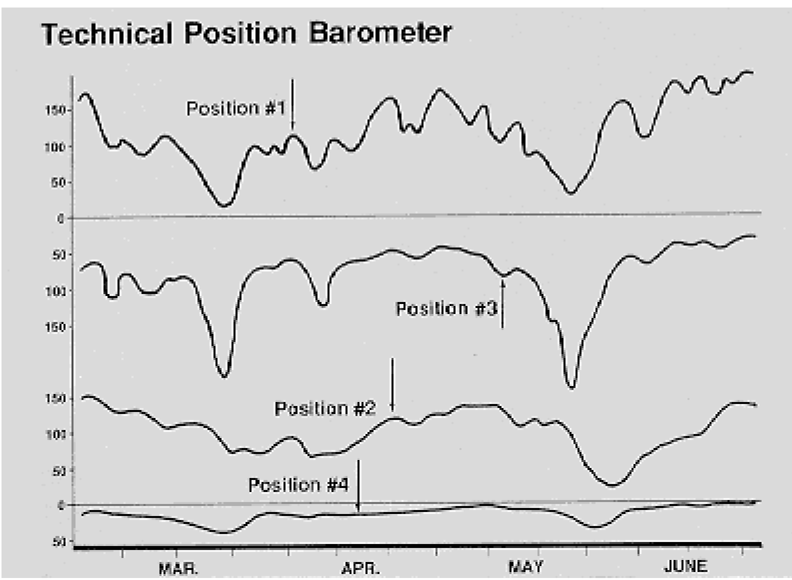

Figure 1

