WYCKOFF METHOD

How to apply the 5 step method with our proprietary

"Pulse of The Market" Charting Software.

Step One

In the Wyckoff Course, Wyckoff teaches that the most important thing anyone can know about a market or an individual stock is its trend and the position that it occupies in the trend. The trend is the line of least resistance. It indicates the direction in which price wants to move. Profits are more likely to be realized when positions are in harmony with the trend.

You determine the trend of the market by going to our Pulse of the Market Charting Software, and examine the Wyckoff Wave (WW) chart that is the default chart when you load the software. You want to determine the trend of the market from this chart. You have the O-P, Force, and Technometer indicators added automatically to the bottom of the chart. These indicators helpful the Wyckoff student determine the trend of the Wave. You can also add trendlines to the charts to easily show the short, intermediate, and longer term trends.

Step Two

Step two of the Wyckoff Method is very simple, but yet so very important in achieving consistent success in the market.

Wyckoff teaches us to always trade stocks that are in harmony with the market. Trading in harmony with the market means taking long positions when the market as measured by the Wyckoff Wave is in a defined up trend channel. It means taking short positions when the market is in a defined down trend channel. When the defined trend is neutral or a trading range, trading in harmony with the market can mean standing aside and let the bulls and bears battle for control of the action, or consider opportunities on both sides of the market.

An important concept in applying step two of the Wyckoff Method is relative strength and/or weakness. Although most individual issues will be in the same trend as the general market and many of them will even be in the same position in their trends as the market, not all of these are the best candidates for new positions. All up trends and down trends are the result of a series of trusts in the direction of the trend separated by corrections. Some individual issues that are in harmony with the market from the stand point of the direction in which their trends are pointed will make relatively larger thrusts and experience relatively smaller corrections than the market as a whole.

These are the issues that are most likely to have the best potential to produce a profitable trade. Relative strength or weakness can be measured as soon as the first thrust in a trend has been completed. This will likely be even before the trend channel has been clearly defined. Those issues that have made larger thrusts than the market are the ones that should be watched closely as the prices make their first correction. The issues that have made the largest thrusts relative to that made by the market and that then make the smallest corrections relative to the market are most likely to perform well on the next thrust in the direction of the trend. These are the stocks that deserve the most consideration for new positions. This technique can also be used later in the development of an advance or decline when there are additional thrusts and corrections to consider. Those issues that most consistently outperform the market are most likely to produce a profitable trade.

The concept of relative strength and weakness can be helpful in locating trade candidates when the market is in a defined trading range. If the market is in a trading range, most individual issues will also be in trading ranges. However, some will be in up trends and some will be in down trends. Those that are trending up or down are relatively stronger or weaker than the market. These are the issues to consider first when looking for new positions. However, consideration must always be given to the position of the market in its trading range and the individual issue in its up or down trend. If both positions do not favor the likelihood of a rally or reaction, opening a position in that individual issue is discouraged. After the stocks that are trending up or down, attention can be directed to those that like the market are also in trading ranges. Here again, the positions of both the market and the stock are important issues to consider before opening a position.

With our Pulse of the Market Charting Software we have made it much easier to be able to find those stocks trading in harmony with the trend, and those that are stronger or weaker than the Wyckoff Wave. When you have the Wyckoff Wave (WW) chart in front of you with the software, you can go to the right side of the navigation bar and click the "Compare Sectors" button. This brings up a comparison chart that highlights the Wyckoff Wave with a dark line, and then 3 Wyckoff Indices appear as well as 13 Wyckoff Sectors appear in colored lines. You can then easily compare those that are stronger or weaker than the Wyckoff Wave.

Step Three

Step three of the Wyckoff method is intended to help traders avoid marginal trades. Wyckoff teaches us to select only those issues that have built a cause. A cause can be defined in more than one way.

In step three, Wyckoff is referring to the use of a figure chart to get an indication as to how far from its current level, the price of an issue is likely to move. This indication is derived by taking a count on a figure chart.

While an issue is in preparation for a move, its action produces a horizontal formation on a figure chart. The horizontal formation contains the count. When the price has completed its preparation and begins to move out of the area in which the preparation was done, the count has been completed and can be measured. To measure the count, the trader selects the appropriate price level within the horizontal formation and simply counts the number of horizontal divisions on the chart beginning at the right side of the formation and ending at the left side of the formation. The trader counts all the horizontal divisions both those that have a posting in them and those that do not. The total number of horizontal divisions is the count. It provides an indication as to how far from the level at which the count was taken the price is likely to move.

If the price leaves the zone of preparation, normally referred to as the trading range, to the up side, Wyckoff says to add the count to the level at which it was measured to get an indication as to how high the price is likely to go. If the price leaves the trading range to the down side Wyckoff says to subtract the count from the level at which it was measured to get an indication as to how low the price is likely to go.

The anticipated ending point of a move indicated by a count is called its objective. An objective may be a single level, but is more often than not a range of values referred to as the objective range. If a count for an advance is taken at the very bottom of the trading range, it will indicate a single level as the objective of the move. However, if the count is taken at some other level within the trading range, the result will be an objective range.

This range is determined by adding the count to the level at which it was measured and by adding it to the lowest level in the trading range. If a count for a decline is taken at the very top of the trading range, it will indicate a single level as the objective of the move. If the count is taken at a lower level in the trading range, the result will be an objective range. In this case, the objective range is determined by subtracting the count from the level at which it was measured and by also subtracting it from the highest level in the trading range.

Individual issues are not the only place were counts are taken and objectives are measured. They can also be taken and measured for a general market index. If a trader is operating in the options or futures derived from an index, it is essential that the trader take a count and determine an objective for the index that is being traded. When the index reaches its objective range, the move is likely to end and the position in the derivative trading vehicle can be closed. Measuring counts and determining objectives on the underlying index usually provides more reliable indications than does taking the counts and determining objectives on the particular trading vehicle that has been selected.

Traders who only operate in individual issues should not ignore the indications for the general market. Situations where both the general market and an individual issue are indicating an objective above or below current levels are the most desirable. If the market and an individual issue both have higher or lower objectives, the movement of the market as a whole is likely to help the individual issue reach its objective. If the general market does not have an objective that is in harmony with that of an individual issue being considered, the individual issue may still reach its objective, but the odds of that happening are not as good as they are when the market has a similar objective to that of the individual issue.

Wyckoff does not provide specific directions as to how large of a count an issue should have to be considered for a trade. In making this determination, the trader needs to be realistic. If the trader only wants to hold positions for a short period of time, smaller counts should be identified with relatively nearby objectives. Identifying much larger counts with much higher or lower objectives and expecting those objectives to be reached in a short period of time is not realistic. Traders who are comfortable with the idea of holding a position for an extended period of time should also be realistic. It is a waste of time and effort for these traders to focus on small counts and nearby objectives. A trader who is willing to wait for his reward to develop should demand a larger count and more distant objective before taking a position.

All Wyckoff traders should always remember what Wyckoff says about figure charts, counts and objectives. They provide indications only. Above all else is the character of the price and volume action. If it supports the idea of the indications being realized, positions can and should be held. However, if the character of the action does not support the idea of the indications being realized, positions should be closed.

Figure charts are available with our Pulse of the Market Charting Software. In the navigation bar, you go to "Price Style", scroll down to the last choice, Point & Figure. Once the chart loads, you can hover over the chart symbol at top left, and right click Format. At this point you can change the variable setting to those you choose.

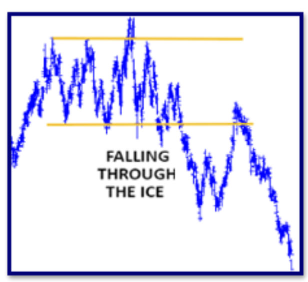
Step Four

In step four of the Wyckoff Method, Wyckoff tells us to determine a stocks readiness to move. Taking a position in an issue that has not or has not nearly completed it preparation for its next move is wasteful and dangerous. It is wasteful in that funds committed to a position that is not making progress in the intended direction could be better used in a position that begins to move in the desired direction quickly.

It is dangerous in that time spent waiting for an issue to begin moving in the intended direction is time during which the character of the action can change making the desired move less likely or not likely at all.

Determining an issues readiness to move involves two considerations. The first consideration is the position of the price in its trend. The second consideration is the character of the price and volume action that has brought the price to its current position.

Wyckoff teaches that there are a relatively small number of what have come to be called primary trading positions. These are places in the unfolding stream of the action where a worthwhile move in one direction or the other has a high probability of beginning. There is a set of primary trading positions that favor the start of moves to the up side and another set that favor the start of down moves. Those that favor advances are the spring position, the test of the spring, the back up to the edge of a creek and the normal correction of a previous advance. Those that favor declines are the up thrust position, the test of the up thrust, the rally back to an ice level and the normal correction of a previous decline. In each case, the primary trading position represents a last point of support following a sign of strength if an up move is anticipated, or a last point of supply following a sign of weakness if a down move is anticipated.



Wyckoff identifies a potential spring position as a price penetration of a previously defined support level. For a potential spring position to be worthy of consideration of an entry point on the long side, the price spreads should narrow on a day to day basis as the price approaches and penetrates the support level. Generally, this type of price action in combination with declining volumes results in the highest quality springs. If the price responds to a spring position as it should with a rally. the response will in the overwhelming number of cases be followed by a test of the spring. The purpose of the test of the spring is to confirm the bullish indication provided by the spring. This is accomplished by a narrowing of the price spreads as the price approaches the low point of the spring. As was the case with the spring itself, a higher quality test generally results if the test of the spring unfolds on declining volumes. It is also desirable for the low point of the test of the spring to be higher than the low point of the spring and for the average volume during the testing phase to be lower than the average volume as the price approached the spring position.

The jump across the creek is defined by Wyckoff as an advance that takes the price through a zone of resistance defined by the tops of earlier rallies. The characteristics of a jump are wide spreads to the up side with strong closes and high volumes. The jump across the creek is not a primary trading opportunity. However, following the jump across the creek there will likely be a back up to the creek that can provide a primary trading opportunity. This is the phase in the action when the price reacts back toward the zone of resistance that was overcome on the jump.

The purpose of the backup is to confirm that the former zone of resistance has been converted to a zone of support. The confirmation is provided by a combination of narrowing price spreads and declining volumes as the price approaches the former resistance. The uptrend that is defined as the price of an issue leaves a trading range to the up side will normally consist of a series of thrusts. Following the completion of each thrust, there will be a corrective reaction. A normal correction will result if the price returns to the vicinity of the halfway point of the previous advance. A primary trading opportunity exists if the price approaches the halfway point on narrowing spreads and declining volumes.

The first primary trading position that is likely to develop on the short side is identified by Wyckoff as being the up thrust. The price of an issue enters an up thrust position when it penetrates a previously defined resistance level. A high quality up thrust is one from which the price begins a prompt decline. A high quality up thrust is one that develops on narrowing price spreads as the price approaches and penetrates the resistance level. Generally, a high quality up thrust will also unfold on declining volumes. After the price has responded to the upthrust with a decline, there will almost always be a test of the up thrust. The test is another primary trading position for the short side. The characteristics of a high quality test of an up thrust are narrowing price spreads to the up side on decreasing volumes. It is also desirable for the test to not put in a higher high than the up thrust and for the average volume as the price makes the test to be lower than was the case on the up thrust itself.

When the price of an issue leaves a trading range to the down side, there will frequently be what Wyckoff refers to as a fall through the ice. Ice is identified as the zone of support defined the bottoms of previous reactions in the action. The fall through the ice occurs when the price trades through this zone on widening spread and increasing volumes. The fall through the ice is not a primary trading opportunity. However, the rally that follows the fall through the ice can develop into a primary trading position. This advance is identified as the rally back to the ice. The purpose of the rally back is to confirm that the former support provided by the ice has been converted to resistance. When this confirmation is in place, the price can resume down side progress. The rally back that is likely to provide the best entry point on the short side if it unfolds on narrowing price spreads to the up side and declining volumes as the price approaches the zone of former support. Down trends that develop as the price leaves a trading range consist of a series of thrusts and corrections. The correction of each thrust can provide a primary trading position if it is completed in the vicinity of the halfway point of the previous thrust to the down side and if it unfolds on declining volumes.

Primary trading positions in individual issues should not be considered to be automatic buy or sell points. Although most will provide an opportunity to take a profit, there are some that are likely to be more profitable than others. One consideration that goes into determining which primary trading positions are better than others is the indication provided by the figure chart of the issue. Those that indicate the largest potential are likely to provide the biggest profits. Another consideration that is involved in judging which primary trading positions should be acted upon and which should not, is covered in the fifth and final step of the Wyckoff method.

Step Five

The final step of the Wyckoff method is the one that actually results in a position being established. Wyckoff tells us to time trades in individual issues to anticipated trends in the general market. While it is true that there are always individual issues that make substantial moves in the opposite direction of the general market, most move with the market to some degree.

By identifying a point in the general markets action from which it is likely to turn in the direction of an established trend or begin the development of a new trend and taking a position in an individual issue at that time, the Wyckoff trader has a better chance of realizing a profit from that position and realizing a better profit than if the position is established in a more random manner.

The market is most likely to make a turn that can benefit a position in an individual issue if it located near but not below the demand line of an uptrend, near but not above the supply line of a down trend, or near the support level or resistance level of a trading range.

It is not necessary that the individual issue in which a position is being considered be in the same position as the general market. It is necessary that the positions of both the individual issue and the general market compliment each other. For example, the general market may be in a trading range and positioned in a potential spring from which an immediate response to the up side is anticipated. If the individual issue under consideration is also in a trading range but is testing an earlier spring, the two positions compliment each other and a position in that individual issue is likely to perform better than it might otherwise perform because of the anticipated turn in the general market.

The general market and the individual issue do not have to be in the same trend to compliment each other. For example, the general market may be in a trading range and testing an earlier spring position. The test assuming it has been constructive is a position from which the market is likely to make an immediate turn.

At the same time, an individual issue that has already begun to trend higher by jumping the resistance level of a trading range may be backing up toward the former resistance. As the general market begins to respond to its bullish position, it is likely to help the individual issue complete its back up and resume up side progress possibly moving into new high ground.

The above examples are both cases in which the individual issue is ahead of the market in the development of a bullish scenario. These situations should be considered first. The second set of situations that should be considered are those where the market and the issue are in the same position that is likely to produce an immediate move at the same time.

The third set of situations that should be considered are those where the general market is ahead of the individual issue in the development of its bullish or bearish scenario. In the above examples, the positions of the market and the issue could be reversed and establishing a position in the individual issue could be justified because the markets position suggests an immediate turn.

Wyckoff traders have three tools that can assist them in judging whether a turn in the market should be anticipated. These tools are the O. P. Index, Force and Technometer. The O.P. Index when used in combination with the Wyckoff Wave indicates whether the result indicated by the Wave is in harmony with the effort indicated by the O.P. If they are and the market is in a position from which an immediate turn can be anticipated, the harmony between effort and result is likely help a position in an individual issue perform as anticipated.

However, a lack of harmony between the Wyckoff Wave and the O.P. Index can be even more helpful in assisting the market make an anticipated turn. For example, consider the situation where the Wyckoff Wave has previously been in a spring position and is now testing the spring with a higher potential bottom. If at the same time the O.P. is making a lower low than it did when the Wave was in spring position, a bullish divergence is in place. The indication is that there has been too much down side effort for the result. This situation leaves the Wyckoff Wave more vulnerable to making a turn than one where the Wave and O.P. are in harmony.

Divergences should be used to confirm indications provided by the position of the market. Divergences that develop when the Wyckoff Wave is not in a position from which an immediate turn may be anticipated are interesting, but they do not provide a reason to establish a position in an individual issue.

The Technometer and the Force are like the Wyckoff Wave/O.P. relationship in that they are intended to confirm an indication of an impending turn by the Wave. If the Wave is in a primary buying position, it is most likely to make an immediate response out of that position if the Technometer is indicating an oversold condition at the same time. These situations are when trades on the long side in individual issues are more attractive. The same is true if there is a bullish relationship between the Wyckoff Wave and the Force.

Divergences between the Wave and the Force develop in a manner similar to the divergences that develop between the Wave and O.P. Primary buying or selling positions in the Wave that develop in conjunction with bullish or bearish divergences between the Wave and the Force are more likely to result in an immediate turn in the general market than those that develop without such divergences. The ultimate in confirmation that there is likely to be an immediate turn in the market is when it is in a primary trading position and all three of the confirmations mentioned are in place. At that point, a position in an individual issue can be established with the greatest degree of confidence that it will yield a profit.

The OP, Force, and Technometer readings are an important part of any Wyckoff analysis. These custom indicators are at the bottom of every default chart. The OP is also available on the intraday 5 minute chart for all symbols. These three custom indicators are updated throughout the trading day, to provide you the most up-to-date information for your trading.