Wyckoff in action

by David H. Weis

In 1908, Richard D. Wyckoff began publishing *The Ticker*, a monthly magazine designed to educate the public on how to understand and profit from the stock market. The early popularity of this magazine can be attributed to the series of articles which Wyckoff wrote on tape reading. He had spent 20 years on Wall Street and learned the secrets of the most successful traders who studied every transaction on the stock ticker. In describing James Keene, a successful syndicate manager, Wyckoff mentioned how he poured over the tape as if in a trance, analyzing "prices, volumes, and fluctuations down to the finest imaginable point."

Wyckoff, too, mastered the art of tape reading which he defined as a "method for forecasting from what appears on the tape now, what is likely to appear in the future." By studying the flow of buy and sell orders into the marketplace, Wyckoff learned to recognize the behavior on the tape that revealed large interests building a position prior to a markup or markdown in price. This approach was discussed in Wyckoff's autobiography:

> Anyone who undertook to read (from the tape) the minds of the momentary buyers and sellers was able to measure, to a certain degree their eagerness to sell or buy. Also he was able to measure the force of the buying or selling power as shown by the number of shares (volume). He could also judge the purpose behind the action—whether it was to buy without advancing the price, or to force the price up or to mark it down, or to discourage buying or selling by others, as the case might be. Not all transactions (on the tape) were significant but the interpreter must detect those which were. He must see that one indicated a purpose. Some one or some group was carrying or attempting to carry something through. He must take advantage of that.

Tape reading of commodity prices was hampered by the lack of intraday volume until computers began calculating tick volume for any desired time period. Today, the tape reader who uses the right hardware can have 5-minute or 60-minute bar charts with tick volume for interpreting the on-going struggle between buyers and sellers. Tick volume represents trading activity—that is, how many times prices change in a given time period, not how many contracts traded.

There is no difference between judging market action on an intraday basis or on daily, weekly, and monthly charts except for the frequency of trading opportunities. Wyckoff wrote in *Studies in Tape Reading* (1910) that "it is unimportant whether you are endeavoring to forecast the next small half-hourly swing or the trend for the next two or three weeks. The same indications as to price, volume, activity, support, and pressure, are exhibited in the preparation for both."

As a bond trader, I maintain 45-minute bar charts (with 45-minute tick volume) and use Wyckoff's techniques for capitalizing on price swings that usually cover several days. For day-trading purposes, a smaller time period is required. The following discussion deals with actual trading situations in June '82 bonds over a 30-day period.

Figure 1 shows the 45-minute price ranges from March 23rd through April 7th.

Although the larger picture is not a primary concern for tape reading, previous resistance and support

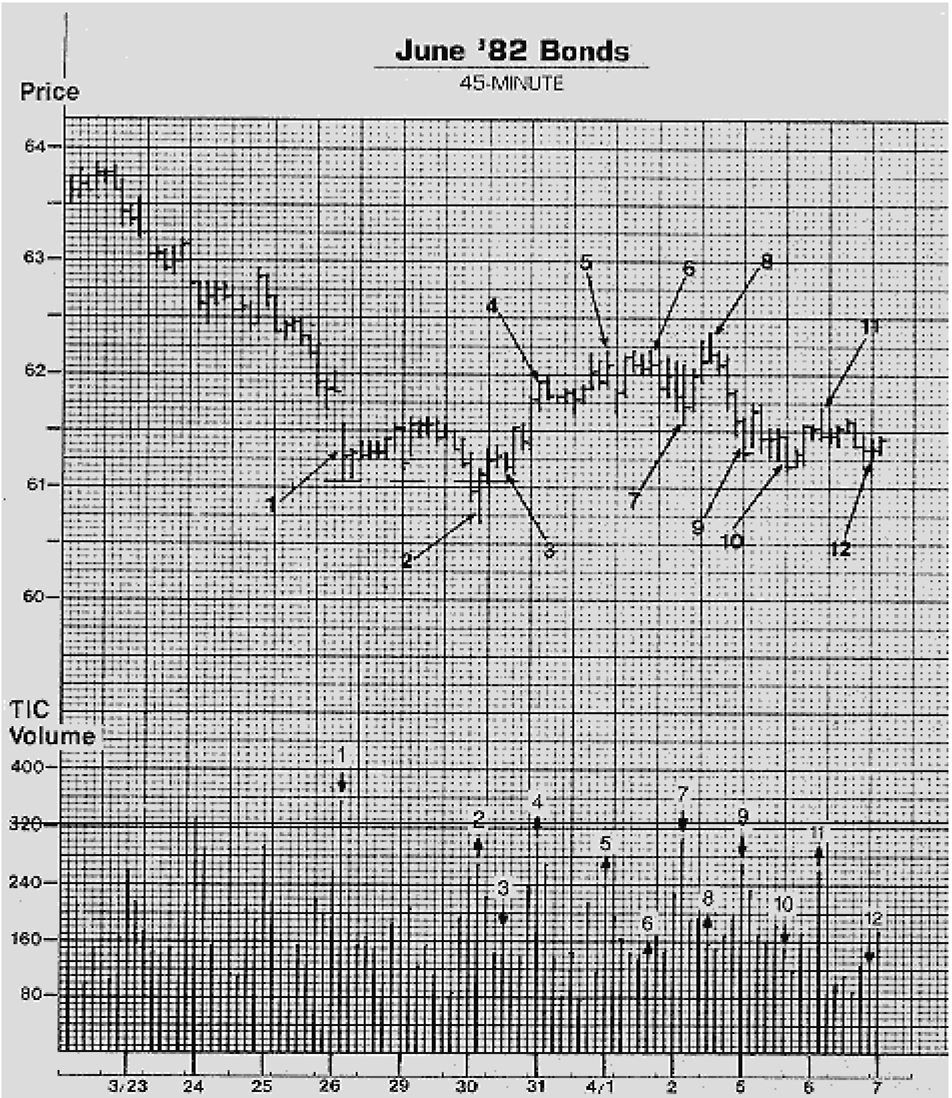

Figure 1: June '82 Bonds: 45-minute

levels are kept in mind. In this case, June '82 bonds had bottomed in September, 1981 at 56-08. The first rally topped in November at 66-23 and a re-test of the low ended in February, 1982 at 57-10.

From the February bottom, prices advanced to 64-08 (the underside of the November top area) and a trading range formed between 64-08 and 61-08. Figure 1 picks up with a decline from the March 23rd high (63-28) within this trading range.

For the purpose of this study, let's assume that today is April 7, 1982 and we are reviewing the volume/price behavior for clues about the future direction of June bonds. Here are some observations about what has taken place:

1. Point #1 is a selling climax as volume was heavier there than at any time within the decline from 63-28. Bonds closed in the middle of the range indicating that buying was present.

2. After a 2-day lateral movement, prices make new lows, but reverse at point #2, negating much of the recent weakness. The market is in position to spring upward. (A spring occurs when prices decline below a support level and then reverse. If the next pull-back holds above the low of the reversal and volume contracts, then the spring has been tested and prices should rally vigorously. If the response is weak, the spring will probably fail.)

Actually measuring the bullish strength or bearish weakness in a group requires attention to points of resistance and support.

3. Prices return to the minor trading range and there is no volume on the pull-back to #3. The range between the high and low is narrow at #3 indicating the market's unwillingness or inability to move lower. Bonds are on the springboard for a fast rally—an excellent place to go long and protect with a stop below the reversal.

4. Demand is present on the rally to #4 as volume is heavy. But at #5, demand meets resistance because the market is unable to make much headway despite the effort. Demand tires at #6.

5. Supply is evident on the break at #7 as volume increases sharply. However, the longs make one last effort to force prices higher on the rally to 62-12 at #8. Volume does not expand on this rally and notice how bonds give ground on the closings. The force of demand is weak.

6. The latest gains are quickly erased, trapping the weak longs who bought the "break-out" at #8. The sellers are in control at #9. Bonds try to recover but the resistance at 61-24 is overwhelming.

7. At #10, the market penetrates 61-08 and is poised to re-test the March low. The inability of volume to increase on this breakdown would raise suspicions about the strength of the selling. But some indication of demand is needed before we will know that the downwave is ending.

8. Demand re-enters the market on the rally to #11 as revealed by the increase in volume and magnitude of the recovery. The poor closing at #11 shows that selling is still present at the 61-24 resistance level.

9. Prices slowly retreat without any sign of renewed selling pressure. In the area of #12, bonds close for three consecutive time periods within a 2/32 range. The force of the selling has died. The bond market on April 7th is at one of those "critical points" which Wyckoff described years ago:

   Successful tape reading is a study of Force; it requires ability to judge which side has the greatest force

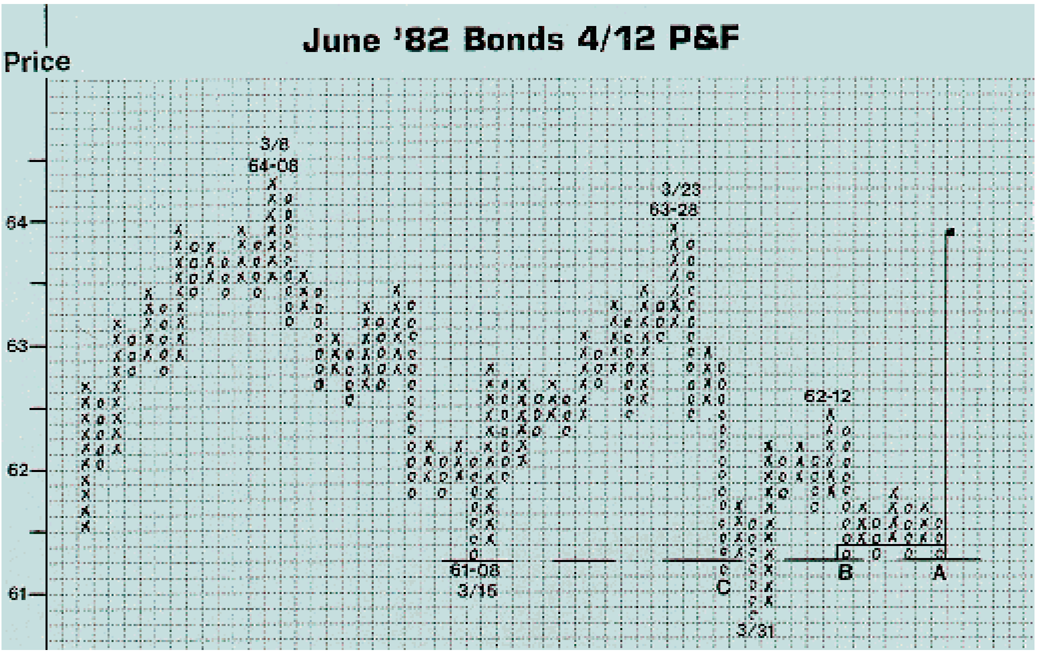

Figure 2: June '82 Bonds 4/12 P&F

> behind it. One must have the courage to go with that side. There are critical points which occur in each swing... At these junctures it seems as though a feather's weight on either side would determine the immediate trend. Anyone who can spot these points has much to win and little to lose, for he can always play with a stop placed close behind the turning point.

We have observed the details of an 8-day trading range. As prices unfolded, the evidence mounted—with an occasional tinge of uncertainty—that some large interests were accumulating bonds. In retrospect, we can reconstruct their operations.

At #1, these large traders were taking profits on short positions under the cover of a selling panic created by longs scrambling to liquidate. During the 2-day period from #1, the operators began buying. To find out how much more supply was around, they pressed the market lower to #2. We cannot know for sure, but perhaps they even made a public display of bearishness in the bond pit on this down-drive.

When their efforts failed to generate another onslaught of selling, the operators quickly covered all shorts and bought aggressively, causing the fast spring action from #3 to #4. At #5, they began taking profits, and the high volume at #7 signaled they were attempting to push prices lower for the purpose of buying more bonds.

On the rally to #8, they withdrew their offerings to observe if demand was coming in from another quarter. Nothing significant happened, so they began pressing the market and probably with great fanfare. The floor monitors for the brokerage houses reported that well-known, large traders were selling; clients were notified and more selling entered the market on the decline to #9. When the volume of selling diminished at #10, the operators began covering shorts and going long on the rally to #11. They quietly bought more on the slow correction to #12.

Wycoff relied on point and figure charts to measure how far prices can move out of a congestion area.

All the evidence points to an upswing in bonds. The tape reader would immediately go long and place a protective sell stop below #10. The risk on the trade is 6/32nds.

Wyckoff relied on point and figure charts to measure how far prices can move out of a congestion area. For this study I have included a 4×12 point and figure chart (Figure 2). Each block equals 4/32nds, and reversals of 12/32nds or more are plotted. This chart shows the trading range that developed from the March, 1982 high at 64-08.

It is appropriate to view the downwave to the March 31st low and recovery to 62-12 as the beginning of a spring. The pull-back from 62-12 tested the spring and a fast upmove should follow. Counting across the 61-08 line, the tight congestion between points A and B projects a conservative target of 63-28 which equals the March 23rd high. The larger objective is 66-28 based on the distance from A to C. A tape reader focuses on the conservative objective and remains alert for volume/price behavior that warns of another shift in trend. In the second installment of this study, we will see the markup in June '82 bonds and a new distribution phase.