Wyckoff Stock Market Institute
P.O. Box 4130
Clifton Park, NY 12065
www.wyckoffstockmarketinstitute.com

Analyzing Trends using the Wycloff Method

Wyckoff tells us that the most important thing that anyone can know about the market or an individual issue is its trend. The trend is most simply defined as being the line of least resistance. Prices will tend to follow the line of least resistance until there is a significant development in the action that suggests that a change in trend should be anticipated. A trader can look at the price of a market or issue and compare it to the price from the previous day, week, month or year and determine the direction in which it is trending. While this can be helpful in keeping a trader on the right side of the action, Wyckoff had something more specific in mind for determining the trend. He provided guide lines as to the proper way to define a trend so that it could be more helpful in applying the five steps of the Wyckoff Method.

Trends can be defined in three directions and in at least three time frames. There are up trends, down trends and horizontal trends normally referred to as trading ranges. Trends can be short term in nature, intermediate term or long term. The time frames that one Wyckoff trader uses to define the three durations of trends may be different than another Wyckoff trader uses. This does not necessarily mean that one trader is correctly defining the trends and the other is incorrectly defining them. The important point is that the trends that are defined by consistent with the time frame of the market operation that is being undertaken. A short term trader may define the short term trend as being one that is defined and completed in just a few days. This trader may view intermediate term trends as being those that are defined and completed over several weeks and he may look at long term trends as those that last no more than a couple months. The intermediate term or longer term trader may see the short term traders idea of a long term trend as being his short term trend. These traders may look at intermediate trends as lasting for several months and long term trends as lasting a year and more. These traders cannot be faulted for the different time frames they use to define trends of different durations. A problem only develops if a trader defines trends in one time frame, but then attempts to operate in a different time frame. This type of error can be fatal for a market operation.

An up trend in any time frame is defined by a demand line and an over bought line. A demand line connects the low points of two consecutive reactions of similar significance where the second reaction low is at a higher level than the first. Finding two reaction lows where the second is higher than the first is a simple matter. However, some Wyckoff traders who are new to the approach have difficulty with the idea of similar significance. Looking for reactions that last for approximately the same number of days or move the price approximately the same distance can be helpful in identifying reactions of similar significance. While Wyckoff would not necessarily frown on this approach, he would prefer that the trader identify two consecutive reaction lows that are both important points in the action. The most important points in the action for those looking for an up trend are the primary buying opportunities. Combining two of these to define the demand line of an up trend is seen as being the best approach.

To complete the definition of an up trend, the Wyckoff trader needs to define the over bought line of the trend. This line is constructed parallel to the demand line. It passes through the top of the rally or advance that is between the two reaction lows used to define the demand line. A common error that new Wyckoff traders make in defining the over bought line is to use a top that comes before or after the two lows used to define the demand line. Making this error will result in a trend channel that is either too wide or too narrow. The purpose of the over bought line is to indicate where thrusts in the up trend are likely to end. Defining a trend that is too wide or too narrow can result in the trader looking for rallies to end higher than is likely or to close out positions at prices that are lower than necessary.

A down trend is defined by a supply line and an over sold line. The supply line connects the high points of two consecutive rallies of similar significance where the top of the second rally is at a lower level than the first/ Wyckoff would prefer that two consecutive lows that are both important points in the action be used to define the supply line. The most important points in the action are those that Wyckoff identifies as primary selling opportunities. The over sold line of a down trend is constructed parallel to the supply line through the low point of the reaction or decline that separates the two points used to define the supply line. Defining the over sold line through a point before or after the two points used to define the supply line will result in a distorted trend.

Normal trend development will have an up trend and a down trend or two trends pointing in the same direction separated by a horizontal trend or trading range. Trading ranges are defined by a support level and a resistance level. If a trading range is following an up trend, the resistance level will be defined first. If a trading range is following a down trend, the support level will be defined first. The resistance level of a trading range following an up trend is defined horizontally through the high point of the up trend that is being completed. The support level of this trading range is constructed parallel to the resistance level and passes through the low point of the reaction that follows the point used to define the resistance level. The trading range is confirmed by the rally that follows the low used to construct the support level if that rally respects the resistance level of the range. The support level of a trading range following a down trend is defined horizontally through the low point of the down trend being completed. The resistance level of this trading range is constructed parallel to the support level and passes through the high point of the rally that follows the point used to define the support level. This trading range is confirmed by the next reaction if that reaction does not make a lower low than the one used to define the support leve,

Since the trend is the most important thing that any Wyckoff trader can know about the action of a market or an issue, defining the appropriate trend or trends for the time frame of the market operation that is being undertaken is the first thing that a trader should do each time an assessment of the action is made. A chart that does not have accurately defined trends drawn on it is unlikely to produce a profit for the trader. Without trend channels, it is not possible to identify buying or selling opportunities or to properly asses the progress of an existing position. The trend is your friend as long as you trade in harmony with it.