

Wyckoff Stock Market Institute

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Stock Market Buying Tests - Part Three **How to take a profitable position in the Stock Market**

Wyckoffs sixth buying test was to look for a pattern of higher supports on reactions indicating that the bulls are willing to pay gradually higher prices for the shares that they are accumulating. The seventh buying test is passed when a pattern of higher tops on rallies is observed. This indicates that the bears are requiring gradually higher prices before they are willing to enter the market on the short side.

It also reflects a willingness on the part of the bulls to hold their positions longer before exiting the market. A pattern of higher tops on rallies can be identified while the price is in a trading range or after it has left the range and has begun to trend.

A pattern of higher tops on rallies and higher bottoms on reactions is most clearly observed after the price has left the trading range and has begun to trend. A consistent pattern of higher tops and higher bottoms is what defines an up trend. Perhaps the most important higher top is the one that is recorded on a jump across the creek. This is the thrust that propels the price out of the trading range and on its way toward its objective.

A Wyckoff trader wants to see a pattern of higher tops, but never buys as one is being put in place. An important rule in Wyckoff is to only buy on reactions and only sell on rallies. If a position is established on the back up that follows a jump, the expectation is that the next upward thrust will make an even higher top than was recorded on the jump. As long as the rallies continue to put in higher tops and the up side objective has not been reached, the position can be held. Traders should beware of the rally that fails to put in a higher top. When this happens, it is an indication that the character of the action is changing. When there is a change in character, the trader should become more defensive in the managing of any position that is held. This can take the form of raising the stop to a point closer to the current price. It can also take the form of closing out a portion of an existing position or exiting the position entirely.

Higher tops within a trading range and a consistent pattern of higher tops and bottoms in a range can signal that the price is getting ready to jump the creek and leave the range to the up side. If a position is established in anticipation of a jump, the Wyckoff trader needs to be very disciplined in managing it. If the price does not jump on the next rally or at least continue the pattern of higher tops within the trading range, consideration should be given to closing the position. If a position is established after a pattern of higher tops has been identified and the price is still in the trading range, the trader needs to feel comfortable placing the initial stop below the bottom of the trading range. The reason for this is the possibility that the price may need to spring the trading range before it is able to leave the range to the up side. If this happens and the stop has been

placed within the trading range, it will be caught and the position will be eliminated likely at a loss just before the move that was anticipated actually begins.

The eighth buying test for Wyckoff traders is to identify that a base has formed on a figure chart. This is another way of saying that there needs to be a trading range following a previous decline. The trading range or base contains the potential for the next move. Without that potential, meaningful up side progress is unlikely even if the action in the trading range appears constructive. There are no rigid rules in Wyckoff as to how large a base should be before consideration is given to establishing a position. This determination has to be based on the type of market operation the trader is conducting. Some traders get nervous easily. They are uncomfortable holding positions for a long time. They do not want to make the extra effort to defend a position as needed so as to allow a bigger move to be completed. They are looking to take a smaller profit quickly and then move on to another opportunity. These traders can be satisfied with a base that only indicates a five to fifteen percent move. Most Wyckoff traders are looking for an intermediate sized move. These are usually identified as being in the range of offering a 25% to 40% profit potential. Traders who are looking for these opportunities are going to be less active. The least active traders are those who require the largest bases before they will consider taking a position. Usually, these are bases that offer the possibility of at least a 50% move. Whatever profit potential a trader establishes, it is important that the requirement be met before a position is established.

The final buying test is one of the most important. Wyckoff teaches traders to never take a position unless the anticipated profit is at least three times the indicated risk. The figure chart of the action indicates what the profit potential is, but the trader determines what the indicated risk is. This is accomplished by the placement of a stop or alternate defensive measure. Some Wyckoff traders require a higher ratio of potential profit to indicated risk. These traders use closer stops. Closer stops will limit the potential loss on trades but they increase the vulnerability of being stopped out. The three to one ratio provides the position with an ample amount of wiggle room while at the same time providing a high level of protection.

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