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Stock Market Trading, The Wyckoff Method

Two Goals, Three Laws and Five Steps

Applying the Wyckoff approach to stock market trading can be complicated due to the many variations in the manner in which stock market action can unfold. However, the foundation upon which the method is built is quite simple. The foundation of the Wyckoff method consists of two goals, three laws and five steps all of which can be simply stated in a relatively few words. The stock market trader or investor who builds his understanding of the Wyckoff approach on this foundation can become consistently successful no matter how complicated the curves are that the markets throw at him.

One goal of the Wyckoff stock market trading approach is to make a profit on a consistent enough basis that exceeds the rewards available from investment vehicles where the return is absolutely guaranteed and for those profits to exceed guaranteed returns by a wide enough margin to make the effort worth while. However, this is not the most important goal of the Wyckoff method. The most important goal is the preservation of capital. Every time the stock market is entered capital is put at risk. There is no way around this. However, risk can always be managed. Wyckoff teaches that no position should be taken unless it has a predetermined exit strategy. The stock market provides vehicles such as stops and options that help manage risk. One or more of these tools should always be in place when position is taken. Protection of capital should never be an after thought. Having something in mind to do later if developments warrant frequently results in doing nothing until the pain of a mounting paper loss becomes unbearable.

The three laws in the foundation of the Wyckoff stock market trading method are the law of supply and demand, the law of cause and effect and the law of effort vs. result. The price of every trading or investment vehicle moves up or down because there is an excess of demand over supply or supply over demand expressed in the form of urgency to exchange dollars for shares or contracts or to exchange shares or contracts for dollars. The law of cause and effect states that the excesses that develop in supply and demand are not random but are the result of key events in market action or the result of periods of preparation. Wyckoff teaches what these developments are and how to judge when they are unfolding in time to take advantage of the excesses in supply or demand that will follow. The law of effort vs. result states that the change in price of a trading vehicle is the result of an effort expressed by the level of volume and that harmony between effort and result promotes further price movement while lack of harmony promotes a change in direction.

The third cornerstone of the foundation of the Wyckoff approach are the five steps. These are the general procedures that every student of the Wyckoff stock market method needs to employ each and every time the action of a market or trading vehicle is considered. Here are those five steps. Determine the trend and position of the market being traded. Determine the relative strength or weakness of the issue being considered. Select issues that are presenting a cause that is likely to produce an acceptable effect. Determine the readiness of an issue being considered to respond to its cause. Time trades in individual issues to anticipated turns in the market in which they are traded. Learning how to correctly apply each of these five steps is what makes a successful trader or investor. Most of what Wyckoff teaches is the finer details of applying these steps.

Once a trader or investor understands the foundation of the Wyckoff approach to stock market trading and accepts the philosophy that it embraces, he can begin building the knowledge that can lead to a more successful market operation. In the next installment of this series, a closer look will be taken at the first step of the Wyckoff stock market method.