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Stock Market Selling Tests Tests of Up Thrusts - Part Two

Most up thrusts are tested. The test of an up thrust provides the Wyckoff trader who established an initial position on the up thrust with an opportunity to add to that position. For other traders, the test of an up thrust provides an opportunity to consider taking an initial position. Many Wyckoff traders prefer to open their initial position on the test of an up thrust. There are two reasons for preferring the test rather than the up thrust itself. One is that the response to the up thrust has provided the price of the issue being considered to demonstrate some weakness. The other reason is that the top of the up thrust has defined a resistance level that provides a measure of protection against being stopped out.

For the trader looking to take a position on the test of an up thrust, the up thrust is a wake up call. It alerts the Wyckoff trader that a potential short candidate has been identified. The response to the up thrust provides the trader with an opportunity to make an initial judgment as to how much interest there should be in establishing a position when the up thrust is tested. If the up thrust penetrated the resistance level of an established trading range, the Wyckoff trader wants to see the response to the up thrust take the price to at least the middle of the trading range. This is considered a normal response. When a response is normal, it improves the odds of the test being successful and of a mark down phase following the test. If the price of an issue under consideration can reach the lower portion of the trading range on the response to the up thrust, it becomes a better candidate for a trade on the test because it has demonstrated greater weakness. Traders should beware of the response to an up thrust that is less than normal. These leave the price with less room in which to complete the test increasing the odds that the test will not be successful.

The average level of volume on the response to an up thrust is also an important factor for the potential short seller to consider. If the average level of volume on the response to an up thrust is equal to or greater than the average level of volume on the rally leading up to the up thrust, the trader has reason to be especially interested in that candidate because it has provided another indication of weakness. The Wyckoff trader wants to see the average level of volume on the rally that produces the test of the up thrust to be less than the volume on both the rally that produced the up thrust and the reaction that represented the response to the up thrust. This indicates a lack of buyers and improves the odds of a successful test. There is a situation where high volume on the test of an up thrust can be a good thing for the potential short seller. If the price rallies into the test of the up thrust on narrowing price spreads and increasing volumes, the indication is that supply is present and supply is what is needed to make the anticipated mark down phase be productive.

At what price should the test of an up thrust be completed? It is not possible for a Wyckoff trader to pick an exact price at which the test of the up thrust is likely to end. However, it is possible to identify a range of values where the test is likely to be completed. Frequently, this range of values is relatively narrow. It is defined by the price of the resistance level that was up thrust and by the price that represents the halfway point of the reaction that was the response to the up thrust. Most but not all successful tests will be completed in the zone defined by these two levels. Those candidates that fail to reach the zone likely will turn out to be missed opportunities unless there is some characteristic of the price and volume action that indicates an unusual surge in supply or lack of demand. Those candidates that overrun the short selling zone should be seen as being of lower quality. This is especially true if the top of the test of the up thrust is higher than the top of the up thrust. These poor quality tests have a greater chance of failing and leading to additional up side progress. Even when they are successful, the Wyckoff trader can feel confident that there will be an additional test. If that more important test is of better quality than the first, a position can be taken.

Although the test of an up thrust is not as dangerous a danger point as the up thrust, any short position established on the test must be protected. If the protection selected is a stop order, the stop needs to be placed above the high point of the upthrust. How far above the top of the up thrust is a matter of personal choice. Making the choice should be determined by comparing the amount being risked to the anticipated profit. Wyckoff traders should never risk more than one point for every three points of potential profit. Placing a stop just above the top of the up thrust as some traders do can be just as unwise as placing it too high. A stop that is that close runs a greater risk of being caught. There is nothing more frustrating than to be stopped out of a position and then watch from the side lines as the price goes on to do exactly what was anticipated.

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