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Stock Market Analysis Tools & Strategies
Analyzing the Wyckoff Wave,
O.P. Index and Trend Barometer

Part 2 - Trading Ranges

In order for the action of the Wyckoff Wave to have been dominated by down trends since the high in July 2007, there has to have been trading ranges in which the Wave was able to build the potential that has fueled the decline. The most important trading ranges stand out most clearly on the five hundred point figure chart of the Wave. The all time high of the Wave occurred in column two of the figure chart. The vertical chart of the Wave shows the July high to be the beginning of the decline. However, the figure chart indicates that it was also the end of a trading range that had developed earlier in the year.

It can be argued that each trading session provides a point of interest because it provides a piece of additional information about the move that is underway or being prepared. This examination will be limited to three particular points of interest. They are thrusts, inharmonious actions/divergences and Trend Barometer indications. These three tend to provide the most useful information as to the character of the stock market action that is unfolding at the moment or that is likely tounfold in the foreseeable future.

The stock market represented by the Wyckoff Wave seldom moves from point "A" to point "B" in a straight line. The moves that most traders trade are made up of a series of thrusts. The size of these thrusts, the amount of new progress that each makes and the extent to which each thrust is corrected indicate the overall health of an unfolding ove.

Ideally, each thrust in a move would be bigger than the previous thrust, make more new progress than the previous thrust and correct less than the previous thrust. In reality, this is very seldom how events unfold. The longer term down trend that has been guiding the Wyckoff Wave since last July has had three completed thrusts and is working on thrust number four. The first thrust began in column two of the vertical chart and ended in column 4. After that thrust was completed, the second thrust began in column nine and ended in column twelve. The third thrust started in the next column and ended in column sixteen. The current thrust had its beginning in column seventeen and appears to still be underway.

In most cases, the first thrust of a move will make the largest amount of new progress because it is starting at the very beginning of the move and is all new ground gained or lost. The first downward thrust of the Wave in the decline that began last July was 5700 points in round numbers from its top to its bottom and all of that was new ground gained to the down side. The second thrust was bigger than the first when measured from its top to its bottom. However, it only made 800 points of new down side progress after completing a decline of 6100 points. These observations provide several indications. The fact that the second thrust was bigger than the first suggested that the market became weaker during the second thrust than it had been in the first. The fact that the second thrust only made 800 points of new down side progress indicated that the bulls had been able to fight back against the bears on the correction of the first thrust. They made up almost all of the ground lost on the first thrust. On the correction of the second thrust. the bulls were considerably weaker than they had been on the first corrective phase. When the second correction was completed in column twelve, the Wave had recovered less than half of the ground covered by the second thrust compared to having recovered almost all of the ground covered by the first thrust. With the second thrust to the down side having been bigger than the first and with the second correction having corrected a smaller portion of the thrust before it, the indication as of the high in column twelve was that the market was weakening and that the decline would likely continue. During the third thrust to the down side, the Wyckoff Wave made more new down side progress than during the second thrust. This observation indicated that the Wave was still weak suggesting that the decline was not over. However, the third thrust and the correction that followed it provided indications that the Wave was not as weak as it was during the period of the second thrust and its correction. These indications were made by the fact that the third thrust was somewhat smaller than the second and by the fact that the Wave was able to regain a larger portion of the third thrust than had been the case on the correction of the second thrust.

The current thrust of the decline began on February 1. As of March 7, it appeared to be a work in progress. Therefore, any conclusions as to any indications it provides have to be subject to change when the thrust has been completed. However, as of now, the fourth thrust has been substantially shorter than any of the first three and no new down side progress has been made. The conclusion that comes from these observations is that the Wyckoff Wave is not as week as it had been during the previous thrusts in the decline. This conclusion suggests that an important change in character in the action may be developing. Therefore, the bears would do well to be more defensive with respect to managing existing positions or considering new ones and the bulls should be vigilant so as not to miss any new opportunities that may be presented during the weeks ahead.

The thrusts outlined above were all of what most Wyckoff traders would consider to be intermediate in nature. It should be noted that each of those thrusts was made up of smaller thrusts. Those smaller thrusts would have been the focus of attention of the somewhat shorter term trader looking to realize as much profit as possible from each thrust rather than being content to ride out the entire decline with one set of positions. Due to the process of rotation, the leaders during one thrust of a larger move may not be the leaders in the next thrust. Studying the indications from the smaller thrusts within the bigger moves can be helpful when one set of positions should be replaced by a new set.

Inharmonious actions between the Wyckoff Wave and O.P. Index are always points of interest. They indicate that there is an unstable relationship between the result expressed by the Wyckoff Wave and by the effort expressed by the O.P. The indication when one of these unstable relationships develops is that the Wave is likely to change direction from the direction it was moving when the inharmonious action or divergence first appeared. Inharmonious actions and divergences should not be considered to be timing tools. In other words, if one of those relationships develops today, do not assume that the Wave will respond tomorrow. There is, however, a general relationship between the magnitude of an inharmonious action or divergence and the amount of time it will take for a response to begin and be completed. If an inharmonious action or divergence develops over a long period of time, the response to it is likely to take longer to begin and complete. Those that develop over shorter periods of time should produce a quicker response and one that is completed sooner.

Since July of 2007, there have been several cases of inharmonious action or divergence. The first came in column three of the vertical chart when the Wyckoff Wave rallied to a lower top than had been recorded during July and the O.P. rallied to a higher top. That divergence was a case of up side effort unconfirmed by result. It suggested the likelihood of a reaction in the Wave. In that case, the response was immediate and severe as the Wave declined to its August low. When the Wave put in its October high in column twelve, it was only 400 points from its July high. However, the O.P. was approximately 1000 points below its high. This was a bearish inharmonious action. The response by the Wave was unconfirmed by the effort. The indication was for a decline in the Wave. In that case, the response also came quickly and it was substantial. At the November low in column twelve, the Wyckoff Wave was in new low ground relative to its August low. However, the O.P. was not. In that case, the down side result was unconfirmed by the effort indicating the likelihood of a turn to the up side by the Wave. As the Wave was putting in its December high, the O.P. was higher than it had been in October, but the Wave was not. This was another bearish divergence suggesting that a reaction in the Wave was likely and it declined to the January low. In the case of this divergence, it should be noted that the O.P. continued to try to pull the Wave higher into column fourteen. This widened the divergence and possibly helped the Wave make more down side progress than it might have made.

Thus far during 2008, there have been additional cases of divergence and inharmonious action. At the January low in column sixteen, the Wyckoff Wave was in new low ground relative to its November low and the O.P. was not. This result to the down side was unconfirmed by the effort and the Wave then responded with a rally to the high on February 1. At the end of February, the Wave was putting in a lower top relative to the one recorded at the beginning of the month while the O.P. was making a higher high. In this case, the O. P. had expressed an effort to the up side that the Wave had not confirmed. The response to that bearish divergence has lead to where things stand as of March 7. Now there is a bullish inharmonious action and a bullish divergence. The divergence can be seen by comparing the current position of the Wave and O.P. to where they were during the middle of February. The Wave is now lower and the O.P. is not. The unconfirmed result suggests a change in direction. At the same time, there is also a bullish inharmonious action that can be seen when the current positions of the indexes are compared to their January lows. The Wave is almost back to its January low, but the O.P. is not. This is another indication of a likely change in direction

The Trend Barometer is the final point of interest that will be examined. It is the name given to the Technometer and the Force Index. The Technometer indicates to what degree the market is over sold or over bought. The Force Index indicates whether the Wyckoff Wave is being influenced by down side pressure or up side pull.

Theoretically, the Technometer can have values as low as zero and as high as one hundred. However, neither of those numbers have ever been recorded and it unlikely that either will ever be recorded. Observations over the past seventy plus years have indicated that the Technometer spends most of the time below a reading of 50 and above a reading of 38. Therefore, readings at or above 50 are seen as indicating an over bought condition and reading at or below 38 are seen as indicating an over sold condition. An over sold condition indicates that the Wyckoff Wave is vulnerable to a rally and an over bought condition indicates that the Wave is vulnerable to a reaction. To be more precise, over bought and over sold conditions indicate that the Wave is vulnerable to corrective action. Most of the time that corrective action comes in the form of a rally or reaction. However, it can unfold as a period of horizontal action. As the Technometer moves higher above 50 or farther below 38, it becomes more over bought or more over sold. That means the Wave becomes more vulnerable to corrective action. It down not necessarily mean that the Wave becomes vulnerable to a bigger correction. A figure chart should be consulted to judge what the magnitude of the indicated correction is likely to be.

Some Wyckoff traders try to use the Technometer in a mechanical manner in an effort to bypass all of the other concepts that Wyckoff teaches. Traders who fall victim to this trap try to use Technometer readings of 38 and 50 as automatic buy and sell signals. Traders who use this approach usually find that the market rewards them for a while. Since July of 2007, there have been relatively few clearly over sold and over bought conditions. In every case, the market has rewarded to some degree the trader who has used the Technometer in a mechanical manner providing the trader was willing to ride out the gyrations that occurred between the entry point and the point at which the reward was offered by the market. However, it has never failed to be the case that at some point the market wants to get paid back by those who have used to Technometer mechanically. In these situations, the Technometer usually tells the mechanical trader to take a position and then fails to provide an indication to exit the trade until it is deep in the red.

The Force Index has no limits as to the readings it can reach. Its extremes are determined by the average level of volume. Higher average volume allows for greater extremes and lower average volume allows for lesser extremes. There are two ways in which the Force can be helpful in keeping a Wyckoff trader on the right track. One is by the development of divergences between the Force and the Wave. The other is by the tendency of the Force to trend.

In column six of the vertical chart, the Force put in a peak as the Wave approached its October high. In column nine the Wave put in a higher high, but the Force put in a lower peak. This was a divergence between the Wave and the Force. The up side result on the part of the Wave did not have enough up side pull from the Force to sustain it. The Wave responded by turning downward eventually reaching the November low. At the November low there was another divergence. The Wave made a lower low than it had in August, but the Force did not. In that case, the indication was that the down side result experienced by the Wave did not have the down side pressure from the Force to sustain it and the Wave responded with a rally

The Force Index exhibits a tendency to trend. The high in the Force in column one and the high as the action crossed from column three into four can be used to define a down trend. The down trend indicated that there was a bearish tone to the action confirming that the short side was the one to be trading and indicating that some one still trading the log side was likely in trouble. In column five, the down trend was broken indicating that the bearish tone to the action had ended encouraging those still short to be more defensive and encouraging the bulls to be more aggressive. This change in tone occurred as the Wave was recovering from its August low and moving toward its October high. The tone of the action changed again in column nine when the up trend in the Force was broken. In that case, the change in tone was indicated just as the Wave started down from its October high. The tendency of the Force to trend is not a timing tool. It doesprovide indications as to which side of the market the trader should be trading. As a rule, traders who are trading against the tend of the Force will end up paying for their mistake just as those who try to trade against the trend of the Wyckoff Wave are likely to have to pay for their error.

The points of interest outlined in the third part of this series should be viewed as being secondary to the character of the price and volume action. They should be used to confirm indications provided by the price an volume action. Trying to use any of them mechanically in lieu of an ongoing study of the price and volume will likely lead to unintended consequences.

The effort to leave that range to the up side failed resulting in an up thrust. The high point of an up thrust is a point from which a down count may be taken. Since there is only one posting at the 40000 level, it appears that there is no potential. Making this conclusion is the result of an overly mechanical approach to taking counts. Since the July high was an up thrust and an ending action, it is acceptable to count the potential created by the entire trading range even though there is only one posting at the high. In this case, it appears that the Wyckoff Wave began moving into the trading range during May when it first reached the 38500 level in column one of the figure chart. The potential built during the period from May to July was 4500 points for an objective of 35500. This objective was reached as the Wave approached its August low in column three of the figure chart.

After the Wyckoff Wave made its initial break to the down side from the July high, it made a corrective rally that ended at the 38500 level at the beginning of column three. This rally represented the test of the up thrust. The high point of the rally provided a place to take another and more aggressive measure of the potential in the trading range. This count began at the top of the test of the up thrust and extended to the left to where the Wave was rallying into May to the 38000 level in column one of the figure chart. The potential measured by this count was 7000 points indicating a down side objective range of 31000 to 33000. This objective was reached on the decline to the January 2008 low.

The August low in column four of the vertical chart was the end of the first major thrust of the entire decline from the July high to the present. Although it was not clearly defined, a trading range did develop following the August low. If the low in column four was interpreted to be the selling climax of that phase of the decline, the preliminary support can be seen as having been met at the low in column three of the vertical chart. If these two points had been defined, the high as the action crossed from column four into column five of the vertical chart would have been labeled as the top of the automatic rally making the low in column five the secondary test, which confirmed a new trading range. Since the action immediately left the range to the up side after the secondary test, it could be seen as also being a last point of support. Wyckoff tells us that the maximum count to the up side stretches from the last point of support to preliminary support. If that rule was used in this case, the result would have been a 3500 point potential at the 36000 level indicating an up side objective range of 38000 to 39500. The top of the objective range was reached at the October high.

An up trend was defined on the vertical chart off of the lows in column four and five. This trend was broken in column six. At the end of that column, the Wyckoff Wave made an attempt to reenter the up trend that failed. The failure confirmed the breaking of the up trend and began the defining of the next trading range. The failed attempt to reenter the up trend was used to define the resistance level of the new trading range and the low in the next column was used to define the support level. The action in column eight of the vertical chart provided an obvious ending action in the form of an up thrust of the resistance level. At the end of column three of the figure chart and extending into column four, the potential for the next decline was established. It was only 1500 points. However, when the up thrust was tested in column nine of the vertical chart, the potential had grown to 3000 points for an objective of 36500 to 35000, which was reached and over run on the decline to the November low.

The character of the trading range that developed during September and October points out the value of maintaining more than one figure chart. That trading range was relatively short term and was confined to a relatively narrow range. Frequently, the potential in trading ranges like this can be underestimated if the figure chart being used is long term in nature as is the case with the five hundred point chart. Keeping a one hundred point figure chart in addition to the five hundred point chart provides an intermediate interpretation of the action that can better estimate the potential developed in shorter term trading ranges.

The next trading range that developed was defined by the November low in column four of the figure chart and by the December high in column five. After the limits of this range were defined, the action moved into an apex. The action broke from the apex in column five of the figure chart as the Wyckoff Wave began its decline to the January low. When the apex was broken, a new down side potential could have been measured. This count was taken at the 35500 level and indicated an objective range of 29500 to 30500. This objective has not as yet been reached. It may or may not be reached based on the outcome of the current trading range.

The current trading range was defined by the January low and the February high. It was confirmed when the February low respected the support level of the range. After a trading range has been defined and confirmed, the expectation is for an ending action to develop to signal that trading range action is being completed and to provide an indication as to the direction of the next move. Thus far, there has been no ending action relative to the new trading range. Therefore, taking a count in either direction cannot be justified. However, it is acceptable to periodically measure how much potential might be developing so as to have a feeling as to how significant the next move might be. If the potential of the current range is measured at its widest point as of the last trading day in February, the potential could be as much as 8000 points if it is measured back to where the action was declining to the January low. The potential is somewhat less if it is measured only since the January low. If the anticipated ending action relative to the range points to additional down trend activity, the 29500 to 30500 objective range will likely be overrun by a wide margin. However, if the ending action points to an advance, it is likely that the lower objective mentioned will never be reached. The objectives that the action in trading ranges forecast should be seen as being indications only subject to being confirmed or denied by the character of the price and volume action.

Note: Part three of this series will focus on other points of interest that have developed since the all time high of the Wyckoff Wave was put in place last July.