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Wyckoff Stock Market Selling Tests - Part Three

Moving on to selling test number seven, Wyckoff advises traders to look for a pattern of lower bottoms on reactions. If the market or an individual issue is making lower lows on reactions, the indication is that bulls are requiring lower prices before they are willing to enter the market and that the bears are being rewarded and may continue to be rewarded for entries they made on the short side earlier. A pattern of lower supports may be identified within a trading range as the price prepares for a mark down phase, or it may be seen after the price has left a trading range and is trending lower. Ideally, it will be seen in both places. Within the trading range, lower bottoms suggests that the price is preparing to leave the range to the down side. After the trading range, lower bottoms indicates that additional down side progress is possible following the next corrective rally.

Before any short position is considered, there must be what is referred to as a crown. This is created by the development of a trading range following an advance. It will present itself as an obvious period of horizontal action on both the vertical chart and the figure chart. If a figure chart is being used, the size of the crown will provide an indication as to the down side objective when the price leaves the range and begins its mark down phase. Wyckoff provides no rules as to how large the crown must be before the trader considers an entry on the short side. This consideration is left to the discretion of the trader. In making this determination, the trader should be consistent with the type of market operation that is being undertaken. If the trader is an active shorter term trader looking to hold a position from several weeks to a couple of weeks, a crown that indicates a ten to fifteen percent potential may be seen as being acceptable. However, if the trader is less aggressive and wishes to hold a position for several months to perhaps as much as a year, he may want to require that a crown offer a potential several times larger than the short term trader might accept before entering a position.

The final selling test is to make sure that the position being considered can be adequately protected with a stop order. Wyckoff tells us to never risk more than one point for every three points of anticipated profit when placing a stop. Some Wyckoff traders elect to risk less than one point for each three points of potential profit. This is acceptable. However, the trader needs to realize that as the ratio of potential profit verses indicated risk is increased, the odds of being stopped out increase. Therefore, the trader who requires a very close stop may be stopped out so many times that the total in losses over time is greater than it is for the trader who elects to use a wider initial stop. The trader who feels the need to use a very close initial stop may be reflecting a lack of confidence or ability. The cure for this is practice trading. Once an initial stop or any stop for that matter has been placed, never change that stop so as to increase the size of the risk.

Selling tests should be used in conjunction with primary selling opportunities. This can be accomplished in one of two ways. The Wyckoff trader may choose to make a list of the tests and check them off as the market or an individual issue passes each. When all of the tests or a number of them that has been selected as being acceptable have been passed, the trader should watch the action closely for the development of a primary selling position. When one is identified, a positions may be opened with confidence. A trader may also choose to do the process in reverse. First, find the primary selling opportunity and then back track to see if all or an acceptable number of selling tests have been passed. If so, the position under consideration has a good chance of providing the anticipated profit