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Wyckoff Stock Market Selling Tests - Part One

Wyckoff identified nine selling tests. They are developments in the price and/or volume action of the market or an individual issue that suggest an opportunity on the short side is developing. As the tests are passed, the odds of a mark down phase beginning increase. When the price moves into a primary selling position such as an up thrust, test of an up thrust, rally back to the ice or completes a normal correction, the trader should examine the action to that point to see how many of the tests have been passed. If all or most of them have been passed, the trader can take advantage of the primary selling position with confidence that he will be rewarded with an opportunity to take a profit as the action continues to unfold.

The first thing the trader wants to do is determine whether the up side objective has been reached. The indicated up side objective is provided by the figure chart. It was set in place during the trading range that developed before the advance that the Wyckoff trader believes is nearing an end. The danger in taking a position before the indicated up side objective has been reached is that the advance may have one more thrust left it that could result in the trader being stopped out of a position just at the time when it should be entered. There is nothing more frustrating than to be taken out of a position just before the price goes on to do exactly what was anticipated. Many times, an up side potential will have more than one clearly defined phase. Each time the objective of one of those phases is reached, the move is potentially over. However, the trader should not automatically assume that it is. An indication that the advance has been completed can be found in the character of the price and volume action.

The second test that the Wyckoff trader wants to apply is to judge the character of the action. The activity needs to be bearish in order to justify taking a position on the short side. Bearish activity is indicated by particular combinations of price action and volume. Wide price spreads to the down side on increased volume leading to poor closes represent bearish activity. The indication is that supply is present. Wide spreads to the down side on reduced volume leading to a poor close can also represent bearish activity. These indicate a lack of demand. A lack of demand is also indicated by narrow spreads to the up side on reduced volume. If narrow spreads to the up side are accompanied by increased volume, the indication is that supply is present. This is also seen as being bearish activity. Bearish activity can be present on a day to day basis, or it can be seen over a series of days that form a reaction or rally within the overall action. It is not necessary that every day provide an indication of bearish activity. Early in an advance, most days will exhibit bullish activity. However, as the price reaches or approaches an objective, the number of days that demonstrate clearly bullish activity will begin to diminish and the number that indicate bearish activity will start to increase. When this shift is seen, this selling test has been passed.

The Wyckoff trader also wants to see a clearly defined stopping action at the top of an advance. This involves four steps. They are the meeting of preliminary supply, a buying climax, an automatic reaction and a secondary test. As an advance is approaching an objective, a reaction will develop over several days where the activity is clearly bearish. This is preliminary supply. It represents the first wave of bulls who bought at lower levels taking their profits. The meeting of preliminary supply is an early warning that an opportunity on the short side may start to develop soon. After preliminary support has been met, there will be one more thrust to the up side usually on wide spread and increased volume into an up side objective. This is the buying climax. It provides a clearer warning to the potential short seller that an opportunity is beginning to develop. The stopping action is completed by the automatic reaction and the secondary test. The automatic reaction is the decline that immediately follows the buying climax. It is caused by the exhaustion of demand on the buying climax. As the automatic reaction unfolds and the price retreats from the high recorded on the buying climax, some bulls will be re-energized and will begin buying again. However, at this point, they will be in the minority. The rally that their activity is able to accomplish will have less volume than wad present as the price rallied to the buying climax. It will also tend to have narrower price spreads to the up side and it will put in a lower top than was recorded on the buying climax. This is referred to as being the secondary test of the buying climax. It completes the stopping action and allows the price to begin preparing for the next move.

Although the stopping action at the top of an advance is vital to the development of an opportunity to begin a campaign on the short side, it does not guarantee that the next move will be down. In longer term bull markets, there will likely be a series of advances each being preceded by the stopping of the previous advance. For the Wyckoff trader who is looking for an opportunity on the short side to know that a resumption of up side progress is not likely, he looks for the passing of additional selling tests as the action continues to unfold.