

# Wyckoff Stock Market Institute

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## **Stock Market Analysis Tools & Strategies Wyckoff Wave, Optimism-Pessimism Index & Trend Barometer**

### **Part 3 - Points of Interest**

In addition to helping analyze stock market trends and trading ranges, the Wyckoff Wave and its related indicators the O.P. and the Trend Barometer provide other points of interest that can be helpful in determining when to consider taking new stock market positions, how to manage existing positions and when to consider exiting those positions.

It can be argued that each stock market 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 action that is unfolding at the moment or that is likely to project stock market action in the foreseeable future.

Like the stock market, the Wyckoff Wave seldom moves from point "A" to point "B" in a straight line. The moves that most stock 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 move. 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 stock market and naturally, 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 weak as it had been during the previous thrusts in the decline. This conclusion suggests that an important stock market change in character may be developing. Therefore, the market 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 market 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 inharmonic action or divergence and the amount of time it will take for a response to begin and be completed. If an inharmonic 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 inharmonic action or divergence. The first came in column three of the vertical chart when the stock market reflected by 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 inharmonic 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 inharmonic 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 led to where things stand as of March 7. Now there is a bullish inharmonic 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 inharmonic 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 is 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 does 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 the 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 upside result on the part of the Wave did not have enough upside 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 downside result experienced by the Wave did not have the downside 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 long 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 does provide indications as to which side of the market the trader should be trading. As a rule, traders who are trading against the trend 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 and 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.

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