Intraday swings with wave charts

The Wyckoff method of trading stocks part 12

by Jack K. Hutson

The serious follower of Wyckoff, a trader who embraces the entire scope and intricate details of this methodology, has not completed his or her analytic arsenal without the Wyckoff Wave, a price vs. time chart that tracks intraday swings much like a doctor taking a patient's pulse.

Whether you trade by the hour or the year, it's the intraday swings, where bears and bulls test each other's strengths and weaknesses minute by minute, that grow and merge into the minor, intermediate and longest-term trends of most profit taking. By revealing this innermost working of the market, the Wave Chart frequently warns its reader of upcoming trend changes several days to a week before they would become apparent in the composite averages. It provides vital information for determining technical position and timing commitments. On a more intuitive level, its use heightens the trader's innate sense of critical market changes and important turning points.

In mastering the Wave Chart, traders seek to substantially increase the accuracy of their judgement and transaction timing by better understanding how the market signals trend changes before they are well under way.

For traders without the time or inclination to study the market as it actually unfolds each trading day, the Wave Chart is a condensed, easily understood record of significant changes in supply and demand that can be studied at leisure. The chart also can be prepared at leisure since its purpose is not to make intraday trading decisions, but to forewarn traders of impending inter-day moves. A number of sources provide intraday price data in various forms- *The Wall Street Journal*, on-line data transmission services, brokerages, the Chicago Mercantile Exchange yearbook and the Stock Market Institute in Phoenix that teaches the Wyckoff Method are just a few.

Graphically, a Wave Chart is a zigzag line representing the cumulative price that five leading stocks reach each time intraday buying and selling waves hit their peaks and valleys. Leading stocks are used since the market seldom moves contrary to the trend of the leaders for a great while, and seldom more than temporarily. In most cases, important market movements start with these stocks—and practically no important move starts without these stocks being affected immediately. The five stocks are selected based on their activity and influence in the most recent months, and the roster is adjusted as often as necessary to keep the chart at the forefront of market trends.

In constructing a Wave Chart (Figure 1), the cumulative price of the leading stocks, measured in fractions, runs up the vertical scale. Time, measured in minutes, runs along the horizontal axis and marks the duration of each intraday swing. A fully illustrated Wave Chart also displays what Wyckoff calls "activity," or the rate at which orders flow into the market. Activity is an index measuring the size of lot orders— whether the market is moving due to the 100-share lots of public trading or the 1,000-share lots of professional market manipulation. Volume, although not illustrated on the chart, is a vital part of Wave Chart interpretation and is usually contained in a data table alongside the chart.

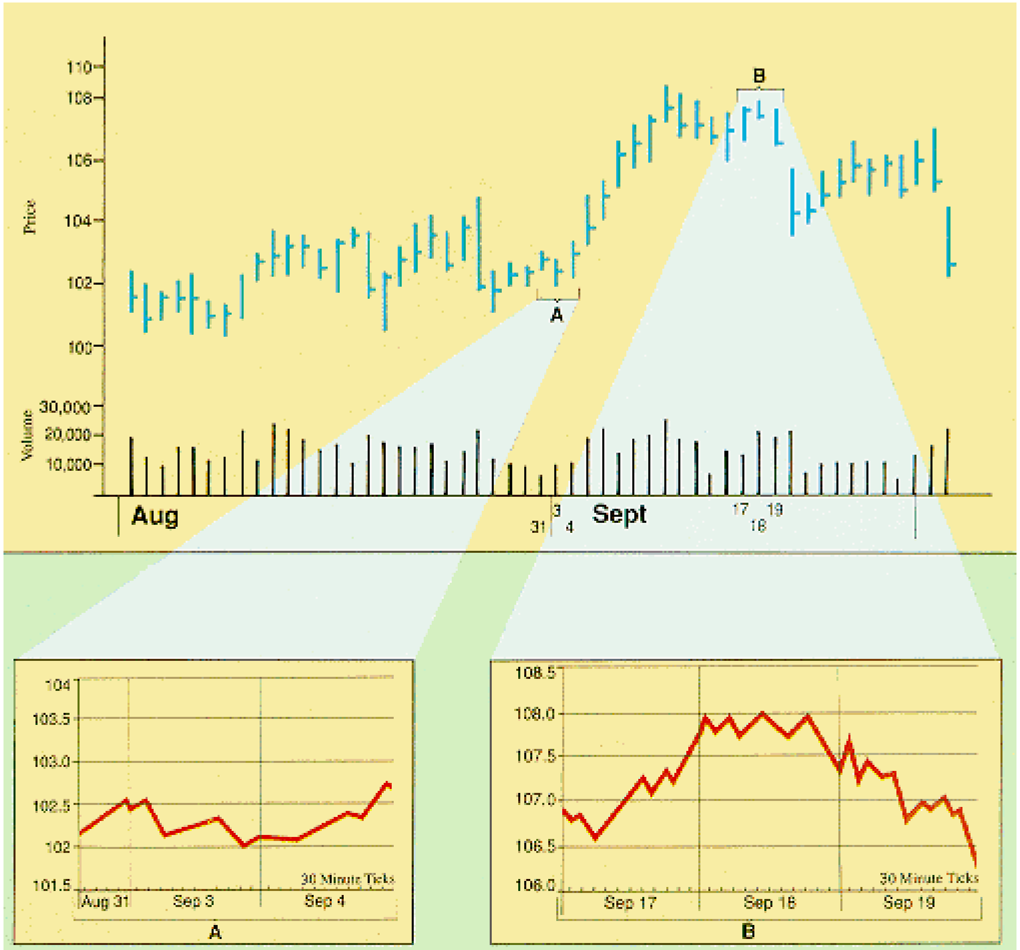

FIGURE 1: *Intraday vertical line bar chart of Wyckoff wave. The price plotted is the sum of the top five issues within an industry group.* **A** *intraday swing chart of Wyckoff wave bottom.* **B** *Intraday swing chart of Wyckoff wave top.*

Building a Wave Chart starts with the total price of the five leading stocks at market opening. As soon as the first wave— either up or down—exhausts itself, the trader marks the time to the nearest five minutes and calculates the total highest or lowest price the indicator stocks reached at that time, including fractions.

The volume, or amount of stock, that market participants are willing to trade at a certain price is a strong indication of the bullish or bearishness of the immediate future.

If a stock price does not respond to the prevailing trend, if its price declines on an upwave or advances during a downwave, it's regarded as a delayed transaction rather than contrary movement. The summation, at that point, uses the price the contrary stock reached on the previous wave. When the stock's price comes into line with the prevailing trend, the total is adjusted to reflect the price in accordance with the true trend.

This process continues until the market closes and the day's Wave Chart is completed by marking the five stocks' total closing price for the day, which then becomes the starting point for the next day's charting.

As part of his advisory service, Wyckoff provided his subscribers with Wave Charts and commentary on their movements. He valued the Wave Chart because, as he told his students, "Learn to judge small daily movements, and then you will be able to apply the same reasoning to the 3- to 5-point swings; to the 10-, 20- and 30-point swings, and finally to the great swings that run over a period of years. In time, you will become proficient in all kinds of markets."

You can think of a Wave Chart as an exploded view of each bar on the Vertical Chart, much the same as a state road map enlarges the view of a major city's thoroughfares. In reading intraday waves, Wyckoff suggests that students first learn to interpret price movement and wave duration. Slight increases in distance and time warn the Wyckoff trader to be on the lookout for change.

As a simple example, let's assume the market has just opened and first sustains a 20-minute upwave that lifts the five leading stock prices a total of three points. This is followed by a 15-minute downwave that loses two points. The downwave's effect on price is less than the upwave's and its duration is shorter. Buying power contained in the upwave is obviously stronger than the selling pressure contained in the downwave. Demand is greater than supply.

Suppose the next upswing lasts 45 minutes and carries the total stock price four points higher than its previous upwave. This signals an apparent increase in buying power. The ensuing reaction which lasts 20 minutes and drops prices 1-1/2 points confirms the buying power since this second downwave lasted five minutes longer than the first downwave and produced less price change.

The additional information of intraday volume and Wyckoff's intraday measure of activity gives the trader a better handle on upcoming price movements. The volume, or amount of stock, that market participants are willing to trade at a certain price is a strong indication of the bullish or bearishness of the immediate future. Volume that follows the price trend is usually bullish; volume that runs counter to the price trend is usually bearish. In other words, increased volume with rising prices or decreased volume with declining prices is bullish. Increased volume with declining prices or decreased volume with rising prices is bearish. In either case, a sudden and abnormally large volume can indicate the approach or culmination of a move.

What is vital about the Wave Chart is the cumulative impression it builds about the longer trends, the wider price swings.

Activity fine-tunes this judgment by telling a trader more about the "quality" of the volume—whether it's made up of many public traders buying or selling small lots of 100 shares or less or whether volume is the result of large traders moving 1,000-share and larger lots. Heavy public trading is considered poor quality volume since the public doesn't have the financial clout to manipulate the market and can only follow what large-scale traders set up. It helps the Wyckoff analyst understand whether manipulators are in the midst of a campaign or winding one up. For example, it's important to know whether low volume means offerings are scarce because they were bullishly sopped up in large lots in a preceding reaction or if it signifies the poor quality of small public lots and further decline. Likewise, is rallying volume the result of short covering or an engineered attempt to unload stocks before a major decline gets under way?

However in analyzing intraday moves, don't expect every daily chart to send a clear, unconfused message. The market's actions for several days may be indecisive. What is vital about the Wave Chart is the cumulative impression it builds about the longer trends, the wider price swings. At important turning points, the intraday swings will convey very vital information about the market's critical condition.

Wyckoff recommends that casual observation, not mathematical comparison, is the way to approach a Wave Chart and that the analyst not waste effort or create confusion by making volume and activity comparisons when the market is not displaying critical behavior.

The relationships of price, duration, volume and activity are especially important when price approaches former levels of support and resistance. Figure Charts created from the Wave Chart—Wyckoff recommends a 1-point, a 3- to 5-point chart for intermediate swings, and a 10-point chart for the largest trends—will help indicate whether large-scale operators are nearing their price objectives.

As a rule of thumb, successive failures to rally beyond former highs or to drop through former lows warns of impending, important trend changes. It is accumulating evidence of a change from strength to weakness or vice versa. Together, the Wave and Figure charts will illustrate the situation in graphic detail.

It's clear, therefore, that trading long trends shouldn't limit technical analysis to the same time frame. Digging into the smallest of the market's actions and reactions can teach a trader important lessons about lifting power vs. selling pressure, the market's responsiveness or lack of it to rotation of supply and demand, the speed of advances and declines, and what changes in activity and volume reveal about the character of buying and selling.

