

Part Two

Applying Technical Analysis

In This Section, You Will Learn About

- Elliott Waves and Oscillator
- Building an Indicator
- Elliott Waves
- Gann Techniques
- TJ's Web and TJ's Ellipse
- Fibonacci
- Andrews Median Lines
- Expert Trend Locator
- Make or Break
- Bias Reversal
- Joseph Trend Index
- Trade Profiles

C H A P T E R **6*****Elliot Wave Techniques******What is Technical Analysis?***

Technical Analysis can be defined as the examination of past price movements to forecast future price movements. Technical analysts are also known as chartists, due to the reliance on the study of charts for their analyses.

We'll begin our discussion of how the eSignal system can be used for Technical Analysis by applying it to Elliott Wave Technique.

The Practical Approach ~ In Conjunction with eSignal

Elliott Wave is a collection of complex techniques. About 60% of these techniques are clear and easy to use. The other 40% are difficult to identify, especially for the beginner. The practical and conservative approach is to use the 60% that are clear.

When the analysis is not clear, why not find another market that is conforming to an Elliott Wave pattern and is easier to identify?

After years of fighting this battle, I have come up with the following practical approach to using Elliott Wave principles in trading.

The whole theory of Elliott Wave can be classified into two parts:

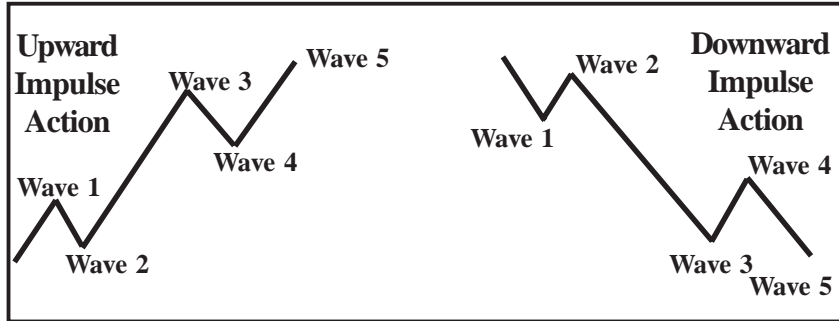
- 1) Impulsive Pattern
- 2) Corrective Pattern

We will discuss the impulse pattern and how to use the Elliott Oscillator to identify these impulse patterns. We will then discuss some general rules and guidelines followed by numerous examples.

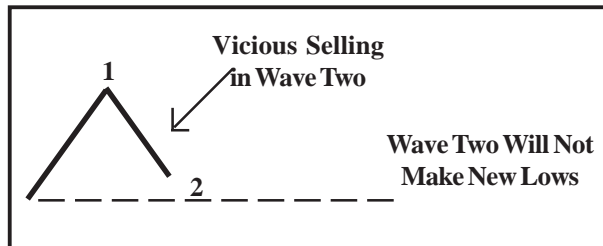


Impulse Patterns

The impulse pattern consists of five waves. The five waves can be in either direction, up or down.



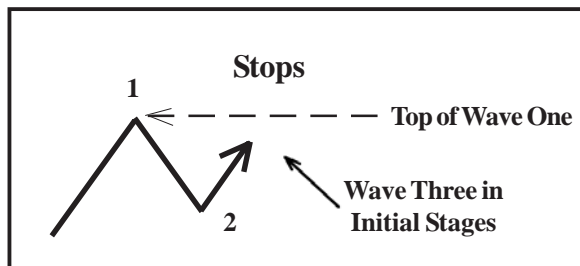
The first wave is usually a weak rally with only a small percentage of the traders participating. Once Wave 1 is over, they sell the market on Wave 2. The sell-off in Wave 2 is very vicious. Wave 2 will finally end without making new lows and the market will start to turn around for another rally.



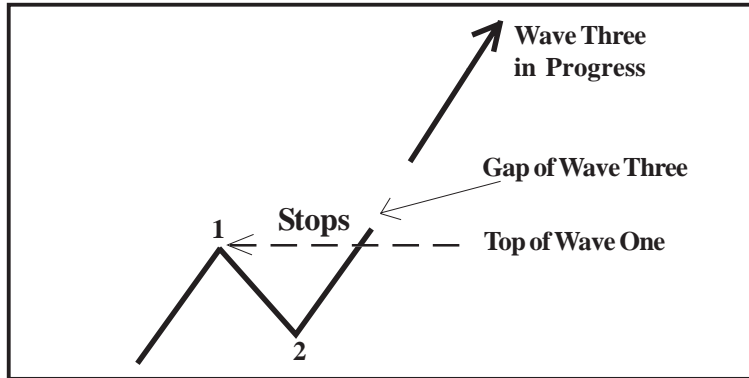
The initial stages of the Wave 3 rally are slow as it finally makes it to the top of the previous rally (the top of Wave 1). At this time, there are a lot of stops above the top of Wave 1.

Traders are not convinced of the upward trend and are using this rally to add more shorts. For the analysis to be correct, the market should not take the top of the previous rally.

Therefore, a large amount of stops are placed above the top of Wave 1.



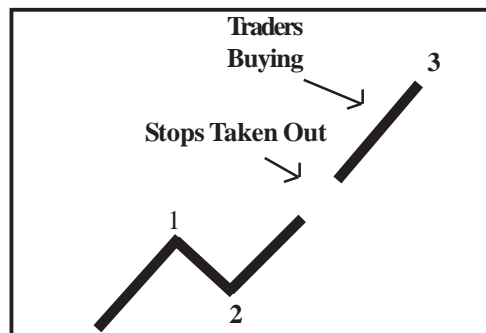
The Wave 3 rally picks up steam and takes the top of Wave 1. As soon as the Wave 1 high is exceeded, the stops are taken out. Depending on the amount of stops, gaps are left open. Gaps are a good indication of a Wave 3 in progress. After taking the stops out, the Wave 3 rally has caught the attention of traders.



Traders who were initially long from the bottom finally have something to cheer about. They might even decide to add positions.

The traders who were stopped out (after being upset for a while) decide the trend is up and they decide to buy into the rally. All this sudden interest fuels the Wave 3 rally. This is the time when the majority of the traders have decided that the trend is up.

Finally, after all the buying frenzy dies down, Wave 3 comes to a halt.

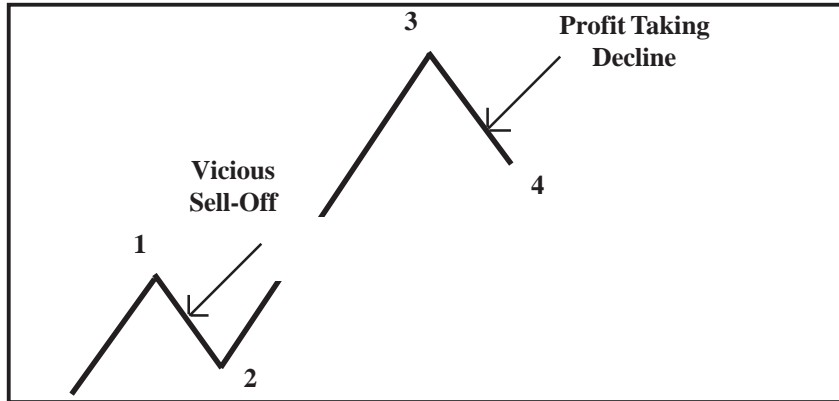


In general, a majority of traders decide and agree that the trend is up. Profit taking now begins to set in. Traders who were long from the lows decide to take profits. They have a good trade and start to protect profits.

This causes a pullback in the prices and is called Wave 4. Where Wave 2 was a vicious sell-off, Wave 4 is an orderly profit-taking decline.

While profit taking is in progress, the majority of traders are still convinced the trend is up. They were either late in getting in on this rally, or they have been on the sideline. They consider this profit taking decline as an excellent place to buy-in and get even.

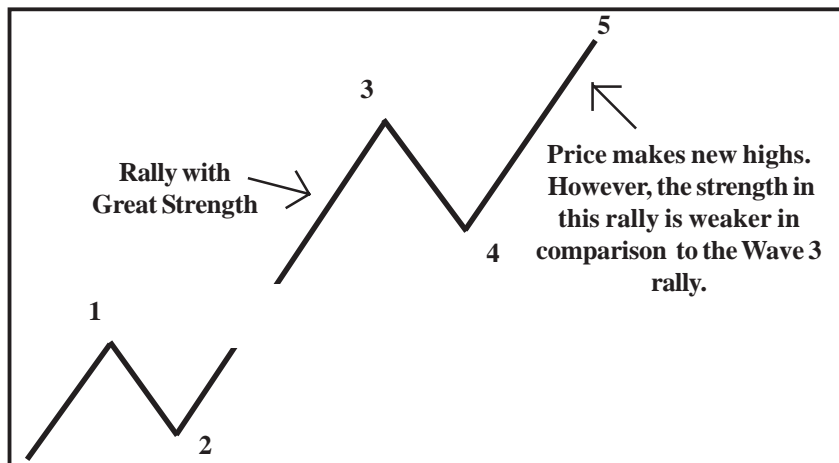
On the end of Wave 4, more buying sets in and the prices start to rally again.



The Wave 5 rally lacks the huge enthusiasm and strength found in the Wave 3 rally. The Wave 5 advance is caused by a small group of traders.

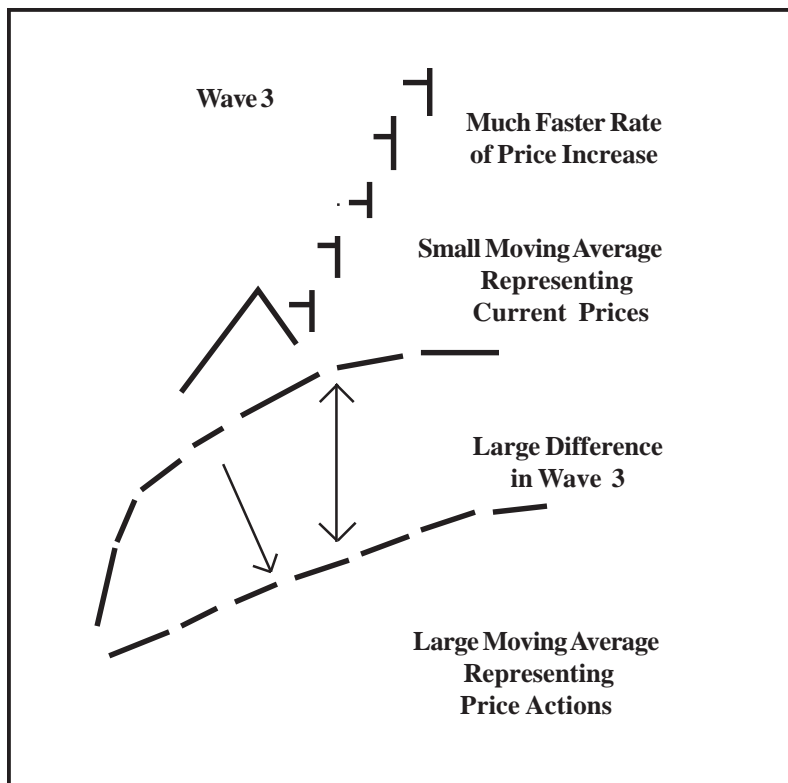
While the prices make a new high above the top of Wave 3, the rate of power, or strength, inside the Wave 5 advance is very small when compared to the Wave 3 advance.

Finally, when this lackluster buying interest dies out, the market tops out and enters a new phase.



To keep tab of the Elliott Wave logic, we require an indicator that measures the rate of price change in one wave against the rate of price change in another wave. Standard indicators fail to perform this comparison. They merely compare price against price and fail to compare the rate of price action. After years of research, the Elliott Oscillator was developed. The idea of the oscillator is described below.

An Elliott Oscillator is basically calculated from finding the difference between two moving averages. If we were to use a small moving average and a large moving average, the difference between the two will show the rate of increase in prices.

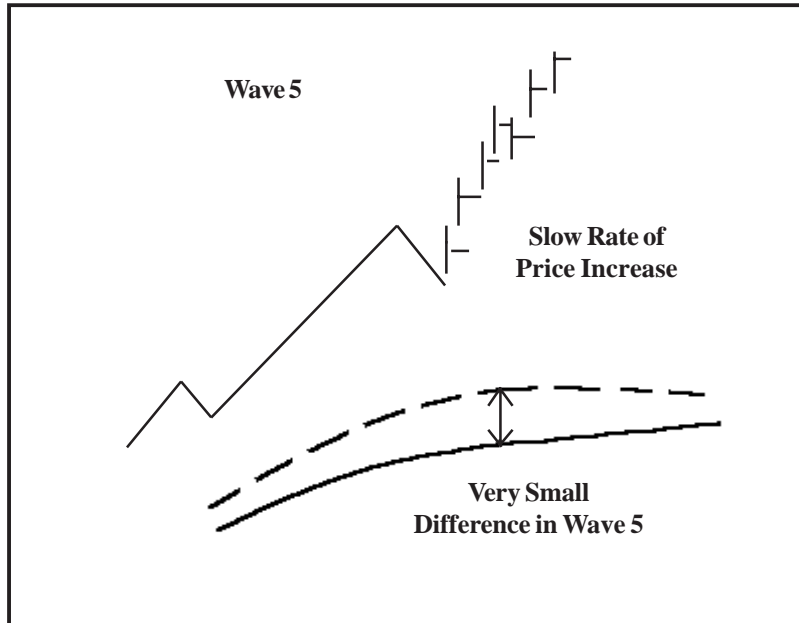


The small moving average represents the current price action, while the larger moving average represents the overall price action.

When the prices are gapping up inside a Wave 3, the current prices are surging; the difference between the small and large moving averages is great and produces a large oscillator value.

However, in a Wave 5 the current prices are not moving up at a fast rate and, therefore, the difference between the small and large moving averages is minimal. This produces a smaller oscillator value.

The analogy is similar to the two drivers.



Wave 3 is like Driver B, who accelerates beyond speed limits and has a higher rate of speed, while Wave 5 has a slow, dragging price action.

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Notes