Dynamic Trader Daily Report

Comprehensive Analysis and Education For the Serious Trader and Investor

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Wave 4 – Price, Time and Pattern

Last week I was discussing the trade strategies to use to capture the maximum Profits if the advance off a Wave 2 or B low turned out to be a Wave 3. Once we are stopped out of the Wave 3 trade, the next trading opportunity is to enter on the completion of a Wave 4 correction for the Wave 5.

Pattern

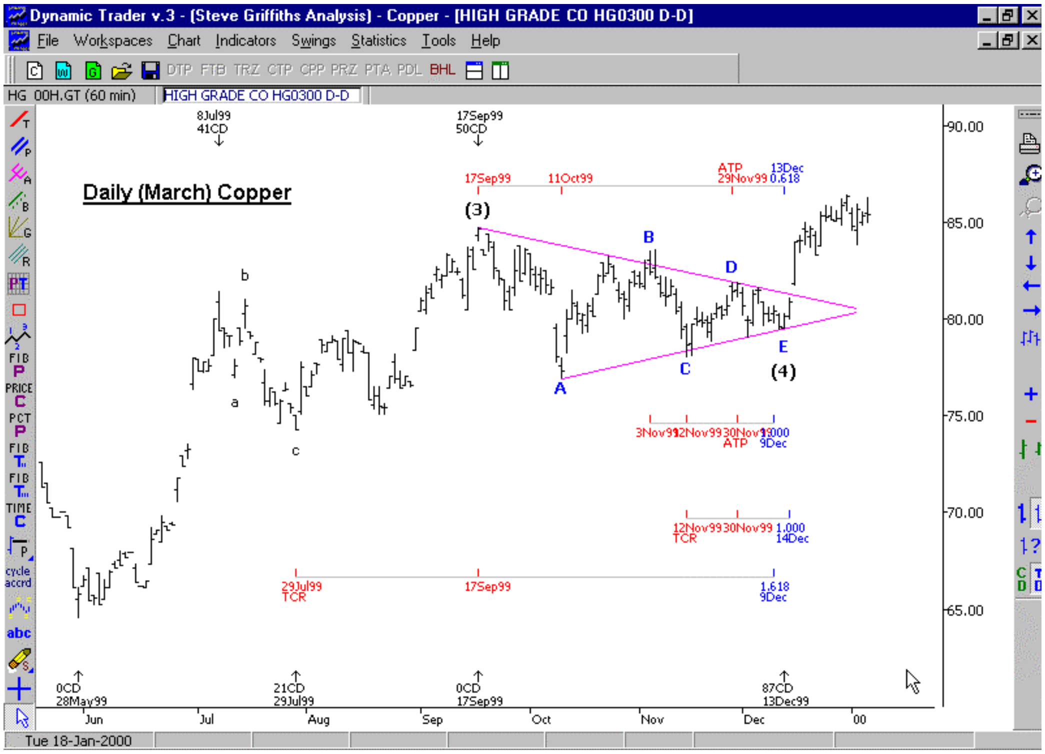
As with all corrections we always start with the assumption that the correction will be a *minimum* of a simple ABC where the Wave C exceeds the Wave A extreme. This is the same for Wave 4's. However, as we have seen from some of our recent examples, particularly on Sugar, the Wave 4 correction many eventually turn out to be something more complicated. This is usually the case as Wave 2's are typically simple ABC's, whereas Wave 4's usually turn out to be more complex.

This is the one area where standard Elliott Analysis has become far too complicated, and why I believe Elliott Wave gets such a bad reputation sometimes. If you look at some of the Elliott Wave books they are filled with a vast array of complex corrections: ABCDE triangles, running flats, contracting triangles, expanding triangles etc etc, the list goes on. From a practical trading perspective, they are all very difficult to trade and hence result in many losses and incorrect counts.

This is why I concentrate on trading ABC's, as I prefer to have the probabilities on my side when I take a trade. Remember the KISS rule, (Keep it simple stupid); it is far better to skip on a pattern that is starting to get too complicated in favor of a better and more obvious set-up elsewhere.

Although these complex corrections are more difficult to trade, they usually terminate at a **Price** and **Time** *cluster* from prior swings. So, we do have the tools to be able to identify *in advance* when these terminations are likely.

For example on Copper, where the 17th Dec to 13th Dec correction formed as part of a contracting triangle;



Here the correction terminated right in a **Time** *cluster* of:

- 1.618% last major swing,
- 100% last minor swing (Wave D)
- 100% 1st Alt (Wave C)
- 0.618% 2nd Alt (Wave A)

But from a practical trading perspective, is it far better to keep things simple, 5's and 3's, 5's and 3's. Particularly in the early days I suggest concentrating on trading, and hence specializing in identifying the termination of 12345's and ABC corrections.

Compare the Copper example with a recent Wave 4 in Heating Oil:

Here we see the Wave 4 forming as a nice and simple ABC, with the Wave 2 being the complex correction, not appearing to sub-divide at all.

This is the principle of alternation. One of the Elliott Rules (or guidelines as I prefer to think of them), is that the pattern of Wave 2 and Wave 4 *alternate*. In other words, *if* the Wave 2 was a simple ABC then the Wave 4 will be complex, or *if* the Wave 2 unfolded as a complex correction then the Wave 4 is likely to be a simple ABC.

From a practical trading perspective, even if the correction is complex, the individual waves of the correction will normally sub-divide into 3's and 5's, and the whole correction will usually terminate at a **Price** and **Time** cluster of prior swings.

This is what I will move onto tomorrow and Wednesday; the *minimum*, *typical* and *maximum* **Price** and **Time's** for Wave 4's.

Today's Trading Lessons

1. The principle of alternation: If Wave 2 unfolds as a simple ABC then Wave 4 will *normally* unfold as one of the many complex corrections and visa versa.
2. The termination of Wave 4, even if it is unfolding as a complex correction, will normally be at a **Price** and **Time** *cluster* of prior swings.
3. From a practical trading perspective, even if the correction is complex the individual waves of the correction will normally sub-divide into 3's and 5's.

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Potential Trade Set-ups and Trade Follow-ups

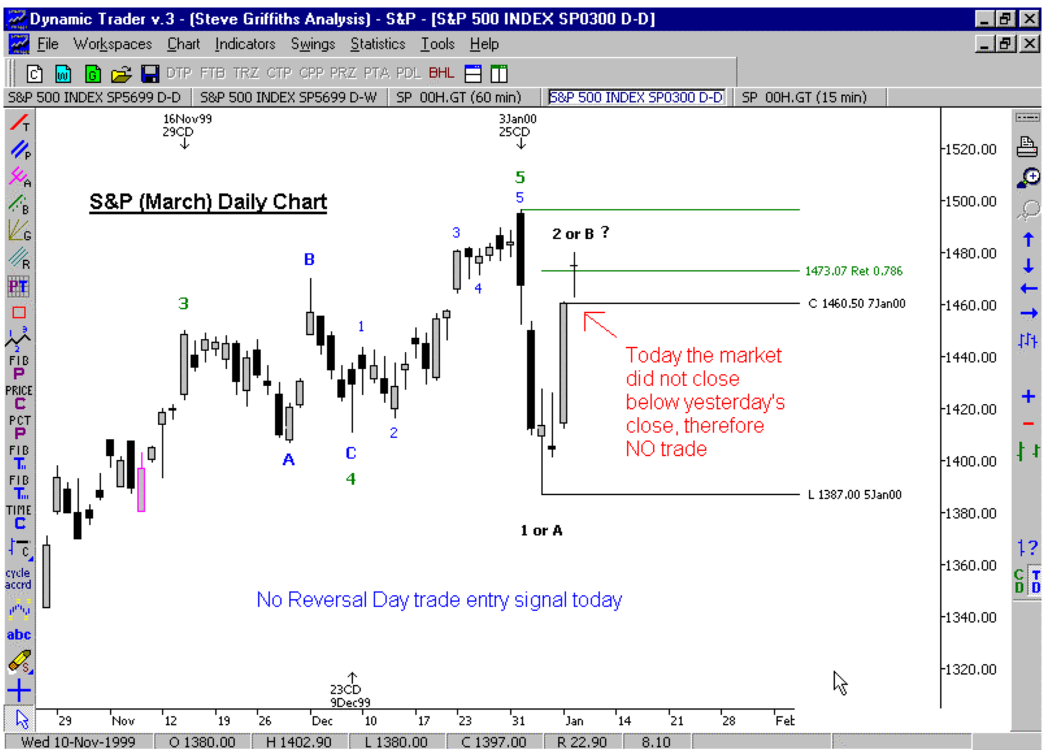
I would like to clarify the trade recommendation from the weekend report, for the benefit of the new subscribers to the report. The normal trade entry we use at a trend reversal is via a Reversal Day.

From Chapter 6 of Robert Miner's Book, *Dynamic Trading,* a Reversal Day is defined as "a day where the market makes a new daily high but closes below the prior day's close and the current day's open". (for an up trend).

The trade entry would then be *to sell on the close* of the Reversal day if the above criteria have been met, with your protective stop placed 1 tick above or below the Price extreme of the Reversal Day.

So the specific trade recommendation on the S&P should have read "If the market trades to at least 1466.50 sell **ON THE CLOSE** on any day where the close is below the prior day's close and today's open. A close above 1473.10 invalidates this set-up".

I apologize for not being specific here, and I hope this helps clear this possible discrepancy for the new subscribers to the report.



While we are on trade entries, I would also like to go over the Trade entry in the Lean Hogs, where we are using the break from the trading range created in the first hour of trading to enter a new short position.

This is based on work performed in the 1970's which found that 80% of the highs and lows of a day's trading range are formed in the first 60min of trading *if* the day turned out to be a trending day. In other words, once a day starts to trend it should not look back *if* the current minor trend is valid.

Hence we can use this technique to enter a position once a trend reversal has been identified, but we missed the initial trade entry.

S&P (Feb)

Although not a specific trading recommendation, as the market closed beyond our 1473.10 level outlined in the weekend report. The close at 1475 is only just above this level, this combines with today's pattern unfolding as a dojo, a Japanese candlestick pattern where the open and close for the day are the same. Although this is not one of our normal Daily Reversal patterns, I still see this as a potential top.

Hence for tomorrow I would use the break from today's range to signal the next short-term trend. In particular a break below the low of 1462.50 would signal this Wave 2 or B high is probably complete.

Lean Hogs (Feb)

Although not a specific trading recommendation, for those of you who missed this Sell set-up today, Hogs made an *inside day.* Hence you may consider selling below Friday's low of 55.55 for a *trend continuation set-up*.

Good Trading,

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