

*Now this is the law of the jungle  
As old and as true as the sky;  
And the wolf that keep it may prosper,  
But the wolf that shall break it must die.  
As the creeper that girdles the tree trunk,  
The law runneth forward and back-  
And the strength of the pack is the wolf  
And the strength of the wolf is the pack.*

—Rudyard Kipling

## In this issue

Letter from the President, **1**  
Letter from the Editor, **2**

### FEATURED ARTICLES

Trading with The Specialist:  
The Smart Money, **3**  
Wyckoff Tests: Nine Classic  
Tests for Accumulation;  
Nine New Tests for  
Re-Accumulation, **6**

### EDUCATION

Technical Market Analysis  
Course Offerings for Fall:  
Golden Gate University, **7**  
From Reminiscences to  
Wyckoff, **8**

### RAVE REVIEWS

Identifying Bear Market  
Bottoms and New Bull  
Markets, **9**  
Plaudits for How Technical  
Analysis Works, **10**

## Letter from the President

Hank Pruden, PhD

August 2002

Dear Colleagues and Friends,

Four significant development or events are in the offing and I want to bring them to your attention:

- The Malcolm S. M. Watts III Memorial
- The one-day TSAA Annual Conference
- The Wyckoff Method of Technical Analysis
- Innovations in Continuing Education

### The Malcolm S. M. Watts III Memorial

Malcolm S. M. Watts III was already a past President of the TSAA when he died at the age 44. Malcolm was beloved by all. Hence, then President Dr. Gerald Butrimovitz initiated a memorial in Malcolm's name to fund an Adjunct Professor to teach Technical Market Analysis at Golden Gate University. During the past three-years, Harvey Baraban has proudly worn the title, Malcolm S. M. Watts III Adjunct Professor, while he was doing a superb job of advancing technical analysis education at Golden Gate University and for the TSAA. This September 2002, the baton will pass from Harvey to David Wood.

### The One-Day TSAA Annual Conference

All of you will have the pleasure of getting to know David as the Chair of this year's TSAA Conference and/or the energetic and innovative Wyckoff Method Instructor at Golden Gate University.

The Annual Conference scheduled for October 23 at the Marines' Memorial Club in San Francisco will be path breaking. Central to the theme of this year's conference will be the examination of Single Stock Futures. Speakers will discuss the implications of Single Stock Futures for technical analysis and portfolio management. Contributions to the art and science of technical analysis and to the mental discipline required for effective trading and investing will also be covered during the Conference (see enclosed description). All in all this Conference will be a tremendous value and so I urge you to reserve early.

### The Wyckoff Method of Technical Analysis

San Francisco has become a power center for the Wyckoff Method of technical analysis. Many students and practitioners of Wyckoff reside in the Bay Area and are members of the TSAA. The Wyckoff Method is continuously renewed and reinvigorated by the TSAA membership. David Wood will speak to us about the latest breakthrough in Wyckoff when he addresses the TSAA in September dur-

ing lunch at Alfred's Restaurant This meeting at Alfred's will also serve to memorialize the passing of the Malcolm S. M. Watts III Adjunct Professorship. Dave will be teaching Wyckoff I in the fall at GGU and so he'll have something to say on that topic.

### **Innovations in Continuing Education**

Continuing Education remains an important quest of the TSAA. This Association is an open forum; I want to learn of your interests and invite your contributions. The TSAA monthly meetings, the TSAA Review (issued quarterly), along with the Annual Conference, are the vital organs for replenishing your vitality as investors, traders, and technicians. Let us continue to utilize these vital organs and indeed strengthen them. Please allow me to hear your thoughts on those scores. In addition, possibilities exist to increase the frequency of email reports, expand the coverage of our website, encourage CMT study groups, increase use of the TSAA library housed at GGU, etc. Many of you have creative suggestions that we may be able to implement for the benefit of all.

## **Letter from the Editor**

August 2002

Having worked in different TSAA jobs over the years, I know how this organization works. A job needs doing—someone volunteers—then it gets done—with the help of our friends. In this case, I volunteered to step in and fill Brent Leonard's editorial shoes while he fulfills other commitments. Hank Pruden told me what he's been telling me for the last 25 years or so—"Don't worry, you can do it." He was right! All we had to do was put out the word for submissions to our extremely talented members. And I must say, people came through with some interesting submissions. If you have articles of interest to technical analysts, please feel free to submit them for inclusion in future editions of *TSAA Review*.

**BUT FIRST!** Get ready for the 19th TSAA Annual Conference! It will be held on Wednesday, October 23, 2002 at the Marines' Memorial Club in San Francisco. Speakers include Martin Pring, John Bollinger, Howard Simons, Tim Hallbom, and Henry Pruden. An announcement will be out soon with more information, but mark your calendars NOW so you don't forget.

### **What's on the plate for this newsletter?**

- First, Brent Leonard with some timely comments about the Market Technicians Association 2002 Charles H. Dow Award.
- A short book review by Hank Pruden.
- *Trading With The Specialist: The Smart Money Edge*, written by Christopher Tyler, who recently spoke at a TSAA luncheon. This article was previously published at TradingMarkets.com.
- *Wyckoff Tests: Nine Classic Tests for Accumulation; Nine New Tests for Re-Accumulation*, by Dr. Henry Pruden. This article first appeared in the *MTA Journal*.
- and finally, if you want to learn to do your own Wyckoff analysis, check out the Wyckoff coursework available at Golden Gate University. Hank writes about the program in his article, *From Reminiscences to Wyckoff*.

—Tom Larsen, Co-Editor

## TSAA Review

The *TSAA Review* is a quarterly periodical published by and for members of the Technical Securities Analysts Association of San Francisco. Its purpose is to facilitate communication of informative and useful information to members. Articles of interest to members are welcome and are subject to acceptance after editorial review. All articles are the viewpoint and the sole responsibility of the author. Publication of an article does not necessarily reflect the opinions of the TSAA.

All copy for publication should be submitted to Editor, TSAA Review, via email at the address below.

Tom Larsen, Co-Editor  
Brent Leonard, Co-Editor  
[editor@tsaasf.org](mailto:editor@tsaasf.org)

## FEATURED ARTICLES

### Trading with The Specialist: The Smart Money

By Christopher Tyler, [TradingMarkets.com](http://TradingMarkets.com)

*Christopher A. Tyler was an Equity Options Market Maker on the American & Pacific Exchanges from 1992 to 1999. He is currently trading off floor in his own proprietary account employing technical analysis and option strategies in his trade decisions. Christopher is a member of [TradingMarkets.com](http://TradingMarkets.com).*

Since the humble beginnings of the NYSE under a buttonwood tree, one group of individuals has consistently outperformed the rest of the investment community. These people are called Specialists on the floor of the NYSE. (On Nasdaq listed securities, they are called Market Makers, or Dealers, and perform the same functions but through an electronic network, rather than on a physical floor.) In this article, I will focus on the role of the NYSE Specialists, but one group is easily substituted for the other as far as job functionality is concerned.

The function of a NYSE Specialist is to provide depth and liquidity in the securities that he/she is assigned in times of imbalances in either supply or demand. The Specialist executes this activity in his/her capacity as a Dealer. In times that demand outstrips supply, the Specialist is obligated to sell either his/her firm's (Limited Partnerships with financial ties to well-capitalized clearinghouses/ financial institutions are standard practice) existing inventory, or go short the stock. This process is most often done at prices higher than the current bid/ask spread.

The Specialist is negating the imbalance, but in doing so is assuming risk in his/her Dealer account, and therefore the acceptance of this risk is usually transacted at a market premium. The inverse of this process is when supply is greater than demand, and the Specialist must purchase or go long the stock and accumulate inventory until the imbalance is worked out. This particular sequence would likely result in the Specialist purchasing shares at prices lower than the current quoted market, and would likely continue until an equilibrium between buyers and sellers could be established.

The Specialist also operates as a Broker in his/her assigned stocks. When the Specialist is not participating as a Dealer for his/her firm's trading account, his/her responsibility is to maintain a fair and orderly market as a Broker in the product being traded. As a Specialist, this is his/her first priority regardless of the capacity he is fulfilling (broker or dealer, or both) at that time. Making sure that a fair and orderly market exists, in his/her Broker capacity, requires that all competitive bids and offers in his trading book, and those represented by other Traders and Brokers in the trading crowd are executed according to price, size, and time.

The role that we as traders are concerned with is the Specialist's function as a Dealer. Seats on the NYSE are currently trading near record levels, with the last recorded sale at \$2.5 million. In a market environment that has left many successful traders scratching their heads, or taking extended vacations, why is there a demand for seats on the floor of the exchange? I know that I could elicit many answers from the people buying up the seats in the first place, but most likely, an educated guess would point towards the fact that the floor community, where the Specialist reigns like royalty, is still making money.

As traders always looking for an edge, we have to continually look for what's working in the market and discard any additional baggage, so to speak. Considering the fact that for brokers, the commission business has all but gone the way of the quarter slice of pizza, it's not difficult to emphasize that if the Specialists as a group are still making money, it must be primarily a function of their activities as a Dealer.

## The Question Remains

Is there a way to capitalize on the Specialist system's apparent edge? I believe the answer to be a resounding yes, but one must realize that in order to participate, you as a trader must first know yourself inside and out. Financial as well as mental constraints must be examined and acknowledged, before trading profitably alongside the "smart money." There's a saying on Wall Street: *The market is an expensive place to find out who you are.* As we start to unfold some of the inner workings of the Specialists' trading edge I think these words of wisdom will definitely ring true.

So how is it that the Specialists or "smart money" always seems to land on two feet? Whether the markets are going up, or down, this group is able to weather the storm as well as any Captain riding out sometimes treacherous conditions.

First off, one must realize that the Specialist is in a unique position. As the primary marketplace for listed securities the NYSE Specialists probably has, on average, the best knowledge of what the overall supply/demand conditions are, at any given moment, in the stocks that he or she deals in. Is this infallible, no, but it's definitely privileged information that comes with the responsibilities of being a Specialist. This information might be in the form of resting orders on the Specialist's book, representing support and resistance levels away from the current price, or it could be from working with the trading crowd, and the order flow they represent. Either way, this is a legitimate edge that as a Dealer, the Specialist can take advantage of, by means of accumulating long or short positions based on supply and demand in the marketplace (of course this Dealer activity must abide by the rules of the NYSE).

The other edge, and equally important, if not more so is the Specialist's role as the buyer or seller of last resort. This falls under the function of providing depth and liquidity in times of supply/demand imbalance. Under normal market conditions, in laymen's terms, it allows the Specialist to buy on the bid, and sell on the offer, and thereby profiting from the spread. More importantly, to the trader wishing to unlock the "smart money" edge, is the fact that in times of high volatility it allows the Specialist to accumulate or distribute inventory at levels that would, under normal market conditions, be considered at a huge discount (accumulating) or premium (distribution) to fair market value.

But, what is fair value, other than what the market is willing to bear? In times of market panics, when fear or greed is running rampant, (by the way this happens in both directions, for those of you who don't remember the Fall of '99 into the Spring of 2000), when liquidity has vanished from the markets and the Specialists have little or no competition you can bet that "fair value" is at a huge discount. As the provider of last resort in times of high market volatility, the Specialists have the ability to accumulate positions at extreme price levels that are considered "fair value" temporarily, as other investors are more than willing to exit their positions for piece of mind.

Now consider the statistic that the Specialists on average, only participate in roughly 10% of NYSE volume (NYSE.com), and one can surmise that a Specialist in his function as a Dealer, really is the "smart money." When one realizes the fact that dealer activity is limited to this percentage level, and the fact that this group of market professionals consistently makes money, it's safe to assume that their accumulation and distribution of inventory happens at very advantageous price levels.

As traders, this means we would love to follow in the footsteps of NYSE Specialists. We might not have the same access to information or privileges that the Specialist has as a direct result of his job description, but fortunately without having to buy a seat on the Exchange, we can follow their activities as Dealers. As traders, we can make a very good educated guess about when the "smart money" is mounting a campaign of accumulation or distribution through price and volume charts (or statistics for the mathematically inclined) and sentiment indicators, such as the *Connors VIX Reversal system*.

The technology and access to the markets has changed over the years, thank-

fully for the active trader. What moves the markets, namely the constant cycle of fear and greed, the frailty of the human condition, fortunately has not changed. What this means for today's technician is the ability to gauge market extremes better than ever, and pinpoint with better accuracy what the Specialist might be doing, thereby affording us the opportunity to trade alongside a consistent winner.

### In Times of Crisis

The tragic events of September 11 will go down as a day of infamy. The social and economic repercussions were swift and severe, forever changing our country. The financial markets were a mirror image of the investment community's anxiety and fear over the consequences and uncertain geopolitical future. Once again, fear ruled on Wall Street.

My intention here is not to downplay this tragedy, especially since, as a former

member of the American Stock Exchange, it struck very close to home. The point is that amid the ensuing financial chaos, the Specialists in their capacity as providers of depth and liquidity, were able to ultimately profit handsomely from other investors' need to liquidate at whatever prices the "smart money" would bear as buyers of securities.

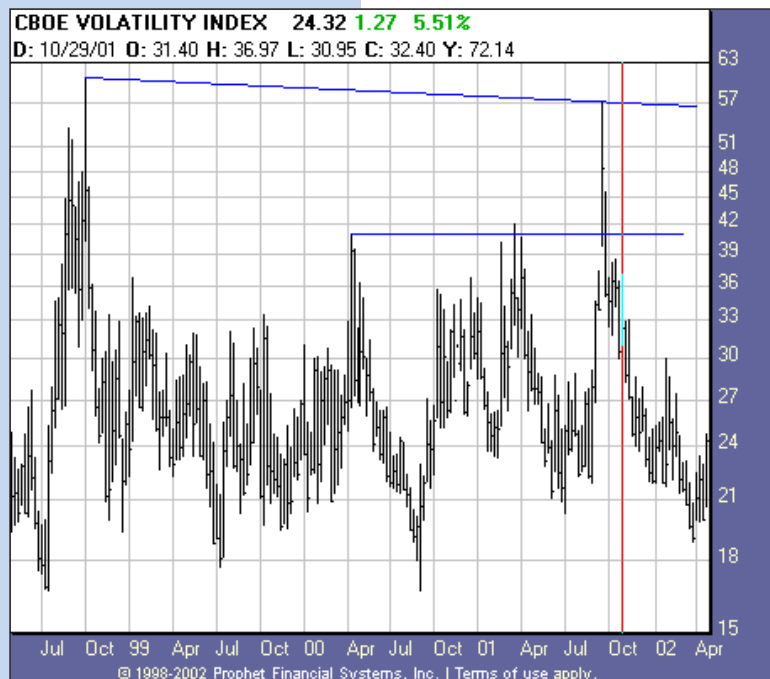
From a technical perspective, the price charts in conjunction with technical rules and sentiment indicators hinted strongly at which side would ultimately prevail. Of course, knowledge of the Specialist accumulating stock in of itself doesn't necessarily help us as traders. The Specialist has much deeper pockets than most of us could ever fathom. During a campaign of accumulation this process does indeed use, and need this financial muscle. Otherwise, during the period of time that his campaigning is taking place (dollar cost averaging) this provider of last resort would become as helpless as those that he is profiting from.

Inevitably, as was the case during the week after the markets reopened, anyone who bought the day the markets reopened with the intention of turning a quick profit was most likely sadly mistaken. If a trader was applying money management principals he or she could have encountered many lumps in the form of stop losses before the eventual bottom, and reversal in the markets.

The Specialist in his capacity doesn't have the luxury in times of crisis of stopping himself out with small losses, but instead needs to focus on being able to accumulate at levels that are attractive enough to withstand temporary punishment in the form of paper losses. With their financial and market acumen they are able to do this, but for us, just the knowledge of their accumulation is not enough. The "smart money's" accumulation might be an excellent starting point for us, but for the trader to thrive and use this information effectively requires using a technician's arsenal.

The above charts demonstrate how a trader could have effectively profited from knowledge of accumulation by the "smart money."

The first chart is a four-year weekly of the





**TSAA Officers****President**

Henry O. Pruden  
*Golden Gate University*

**Vice Presidents**

Chris Chan  
*E\*Trade Financial*

David Wood  
*Wood & Associates*

**Treasurer**

Daniel K. Beatty  
*John W. Brooker & Company,  
CPAs*

**Secretary**

Audrey P. Lewak  
*Merrill Lynch*

**Newsletter**

Brent L. Leonard  
*Adjunct Professor  
Golden Gate University*

Tom Larsen  
*Individual Investor*

**IFTA Representative**

Gerald P. Butrimovitz  
*Gerald Butrimovitz and  
Associates*

VIX. The VIX represents equity option premium levels. The higher the VIX, the more fear that's hanging over the market. The *Connors VIX Reversal* strategy takes advantage of this contrarian sentiment indicator, which is detailed in the *Trading Markets indicator* section, but for illustration purposes in this article we only need to recognize the fact that panic was definitely permeating the market.

The VIX hadn't seen levels this extreme since the Fall of '98, coincidentally a prior market bottom. Now take a look at the chart of Tenet Healthcare (*THC*). *THC* had all the trappings of a strong market performer prior to the events of September 11. Tenet was in a strong up trend from the last week of May (the longer-term trend began in July 2000), and had just made fresh 52-week highs two days earlier.

With the events of Sept.11, along with any group that wasn't related to a wartime economy, *THC*, which had clearly been a strong RS stock, was taken down approximately 12 % during the next few trading sessions. The up trend line was broken, but the astute market technician reacting to the extreme VIX readings and the technical picture of *THC* would have been alerted to a great opportunity on the buy side.

On September 21 *THC* made a perfect double bottom test of the August low at 52.5, which also lined up within .50 of a 38% Fibonacci Retracement (a tad bit over). *THC* went on to score a 20% gain during the next month as the markets rallied off their September lows. I quoted an old Wall St. adage earlier, about how the markets can be a very expensive place to find out who you are. I'll add to that now by saying, "If you know who the Specialist is, and you know yourself as well, Wall Street can be a very nice street indeed."

## Wyckoff Tests: Nine Classic Tests for Accumulation; Nine New Tests for Re-Accumulation

By Henry O. (Hank) Pruden, PhD, Golden Gate University

**Preamble**

The Wyckoff Method is a school of thought in technical market analysis that necessitates judgment. The analyst- trader acquires judgment through experience and through well-guided illustrations of basic principles. Although the Wyckoff Method is not a mechanical system *per se*, nevertheless high reward/low risk entry points can be routinely and systematically judged with the aid of a checklist of "Nine tests." Each test in the list of "Nine tests" represents a Wyckoff Principle. One purpose of this article is to demonstrate the Classic "Nine buying tests" of the Wyckoff Method at work via a case study of the stock of the San Francisco Company. Although for the sake of economy the illustrations in this article feature the bull side of the market, they can be inverted to illustrate the bear-side of the market.

The classic set of " Nine buying tests" (and "Nine selling tests") was designed to diagnose significant reversal formations: the "Nine buying tests" define the emergence of a new bull trend. A new bull trend emerges out of a base that forms after a significant price decline. (The "Nine selling tests" help define the onset of a bear trend out of top formation following a significant advance.) These nine classic tests of Wyckoff are logical, time- tested, and reliable. However, the original set of nine tests was not designed to include all of those very crucial consolidation periods that occur during bull markets and bear markets. Students of the Wyckoff Method refer to consolidations as re-accumulation or re-distribution. There exists a void in the Wyckoff Method with respect to tests to define the trends that emerge out of

*continued on page10*

### About TSAA

As a nonprofit, independent association, the Technical Securities Analysts Association of San Francisco is committed to the principles of fellowship, education, and development of its members. TSAA believes that individual growth and excellence can best be created in an environment of encouragement and support. As a dynamic organization, the Association embraces all concepts of technical market analysis, encourages its members to pursue their own unique approach to the market, and provides for the exchange of ideas and methodologies. TSAA provides leadership opportunities and educational pathways for the beginning and advanced member alike to achieve effective market mastery.

## Save the date!

TSAA's Nineteenth Annual Conference

# Single-Stock Futures and Trading Better from the Inside Out

*featuring*

Martin Pring  
John Bollinger  
Howard Simons  
Tim Hallbom  
Hank Pruden

**Wednesday, October 23, 2002**  
**Marines' Memorial Club, San Francisco**

Watch for mailed program announcement in late September  
Stay informed; visit [www.tsaasf.org](http://www.tsaasf.org)

## EDUCATION

### Technical Market Analysis Course Offerings For Fall: Golden Gate University

The finance department is offering three courses in technical market analysis this fall, which reflect the leadership position that Golden Gate University holds in the vital and growing field of behavioral finance and technical analysis. The courses, taught in San Francisco, are available for the sophisticated working professional, the self-directed investor or the beginning student.

Dr. Hank Pruden supplements FI 352 Technical Analysis of Securities with "skills drills" that will help students prepare for the final examination in the course, which is equivalent to the Chartered Market Technicians Association Level One (CMT I) Examination. Students who earn a grade of B or better in the course simultaneously earn the CMT designation, making this a great two-for-one value.

David Wood is following up his highly rated performance in the Wyckoff Method III course (offered last spring) by taking the helm of FI 354 Wyckoff Method I. Wood will use his considerable energies to bring technological modernization and fresh chart materials to augment the classic lessons of this popular course.

The equally popular FI 498R Online Investing course created by Harvey Baraban will feature Bruce Charnas, Adjunct Professor of Technical Market Analysis.

For information on how to register, contact Tracy Weed at 415-442-6585 or [tweed@ggu.edu](mailto:tweed@ggu.edu); or Dr. Hank Pruden at 415-442-6583 or [hpruden@ggu.edu](mailto:hpruden@ggu.edu).

### TSAA Membership

Membership in the TSAA is open to individuals who are interested in technical analysis as part of their investment strategy. Annual dues provide members with member-rate admission to seminars, meetings, and luncheons as well as a subscription to the TSAA Review.

For membership information contact us at one of the addresses below. Please include your postal delivery address, and our membership information packet will be mailed to you.

Technical Securities Analysts  
Association  
5 Third Street, Suite 724  
San Francisco, CA 94103-3200  
415-957-1202  
Fax 415-543-2112  
[staff@tsaasf.org](mailto:staff@tsaasf.org)

## From Reminiscences to Wyckoff

By Hank Pruden, PhD

For most people, one reading of Edwin Lefevre's *Reminiscences of a Stock Operator* whets their appetite. Most readers would like to discover a codification of the best principles and practice of technical analysis and trading that are evident or hinted at in *Reminiscences*. Happily, such a codification of the best practices of the old-time market operations was made available through the observations, writings and the teachings of Mr. Richard D. Wyckoff. Indeed, Mr. Wyckoff was a contemporary of Mr. Lefevre and undoubtedly knew him. The story found in *Reminiscences* and the analytical principles found in Wyckoff are complementary. They are approaches to the same subject. Taken together *Reminiscences* and the Wyckoff Method furnish the bases for a solid "CMT Level Two" type of formal course in TA.

For over a decade The Wyckoff Method has formed the heart of a course, later three courses, in Technical Market Analysis at Golden Gate University. Those familiar with the Wyckoff Method appreciate that it is a pattern recognition approach necessitating the use of judgment by the analyst. This calls for practice and experience and simply not the formulation of hard and fast rules associated with Mechanical trading systems. Hence, along with the organization of a course into a logical sequence of topics comes the development of pedagogical tools designed to take the student-analyst investor through high order thinking and skill building through a simulation procedure. Hank Pruden developed the "Action Sequence Method" of active-learning to accomplish this mission. In essence it is learning by doing. The student begins with a brief period in the evolution of a stock or market to which he/she applies Wyckoff principles, interpret the motives of the "composite operator" and takes a position. Then the next episode of market history is then revealed and the observations of Mr. Wyckoff or another expert mentor are given. Thus the Wyckoff student is afforded the opportunity to compare her/his actions to the master(s) and modify accordingly. By also referring to pertinent passages in *Reminiscences* The Lesson is further driven home to the student. Thus effective teaching and learning of the Wyckoff Method is a combination of what is learned and now it is learned. Students familiar with the Harvard case-method of instruction will immediately grasp the value of hands on real-world decision making in building skills, knowledge and confidence.

A new syllabus used in the Wyckoff course at Golden Gate University appears below.

### FI-354—WYCKOFF I

**Fall 2002, M(4 :00–6:40) David Wood, Instructor**

#### Course Description

This course is the first of a four part series that is designed to prepare the student for a successful career in trading and money management. Wyckoff I introduces the Wyckoff Method of technical analysis of stocks and commodities. The course will enhance the Wyckoff Method by introducing a feedback procedure to help the practitioner to stay in tune with the market.

#### Course Objectives

In this class, you will learn the three laws of market action. Through the use of numerous case studies you will learn to recognize the laws in stock charts. This foundation will allow you to identify and act on market opportunities as they present themselves. The student will practice these principles through a series of Action Sequences.

#### Prerequisites

There are no prerequisite.

#### Required Text and Materials

Edwin Lefevre, *Reminiscences of a Stock Operator*; Jack Schwager, *Market*



### TSAA eGroup

You are invited to join this TSAA-beta group, an email group that is free and easy to use. By joining this group, you'll be able to send messages easily to fellow group members using just one email address. eGroup also makes it easy to store photos and files, coordinate events and more.

To join, go to [www.egroups.com/invite/TSAA-beta](http://www.egroups.com/invite/TSAA-beta) and click the *Join* button. We'll see you there!

Wizards; Stock Market Institute, Introduction to the Wyckoff Method of Stock Market Analysis. The student will be charged a \$20 materials fee to cover the cost of handout during the term.

### Grading

In Class Assignment: 50 percent  
Chart of the Weeks: 25 percent  
Final Exam: 25 percent

### Course Assignments

Class Assignment: Each week the student will complete an action sequence.  
Chart of the Week: Beginning in week 12 the student will complete an analysis of a new stock chart each week. This analysis will identify the market principles at work.  
Final Exam: A final exam will be given to test the student on the Laws of Market Behavior.

## RAVE REVIEWS

### MTA 2002 CHARLES H. DOW AWARD

#### *Identifying Bear Market Bottoms and New Bull Markets*

By Paul F. Desmond

The annual Barron's contest, won by MTA Past President Desmond, couldn't be more timely as we realize we are finally in a Bear market and wonder when it will end. The key signal, Desmond begins, is to recognize when the balance of Supply and Demand finally shifts to the upside, since Economic indicators, the media's negative bias, and even the Technical 200-day MA are lagging indicators, by as much as 6 to 9 months. Also, psychological changes must pass through the chain of complacency to concern to fear, finally to panic, where Prices of book values fall to a discount.

His contention is that the usual signals of Selling Climaxes, unusually active Volume and a large number of New Lows do not stand up under critical examination as convincing indicators. Rather, the intensity of these selloffs should be measured by a formula tracked since 1938 by his employer—Lowry's.

The ingredients of this formula are four daily totals—Upside Volume and Points Gained, Downside Volume and Points Lost. The signal is given when a 90% downside day (Downside Volume 90% of Total Volume combined with 90%-of Total Points- Lost Points) is followed by a reversal of a 90% upside day—half the time it will occur within 5 days. This data can be compiled from The Wall Street Journal's tables. The mathematical formula is  $\text{Up Vol}/(\text{Up Vol} + \text{Down Vol}) \times 100$ , doing the same with Points Gained and Lost. Alternative signals can be given by two back-to-back 80% days, although rare.

Through the use of several charts and a detailed table of market data, Desmond illustrates the largest market bottoms of the last 69 years—from 1933 to present. Many caveats are issued with this system, such as: even though a bottom is reached, an immediate and sustained sharp rise (V-Spike) is not necessarily guaranteed, as base-building is usually necessary, as are retests of the lows. Snap back (short-covering) rallies can be traded frequently, however. In the inimitable, capricious nature of the stock market, no two bottoms are alike, but share similar characteristics.

If the reader missed the Barron's article of May 20, 2002, it can be found on the MTA's website, which is linked to the TSAA's. Many thanks to Paul for this well done and timely piece.

*Brent L. Leonard, CMT*  
TSAA Review Co-Editor

## BOOK REVIEW

### Plaudits for *How Technical Analysis Works*

By Bruce Kamich, CMT

This book should appeal to a wide audience. Combining simplicity and clarity of expression and illustration with an intimacy of technical analysis in practice gained from his personal experience as analyst and trader. Bruce Kamich, CMT, acts like a guide at your side. As you wend through such topics as trend construction and interpretation, support and resistance, reversal and continuation patterns, price and volume, and moving averages and oscillators. Mr. Kamich is there to point out the investor psychology operating below the surface and the nuances of interpretation and the action you should take. One comes away from a reading of this book with an intimate grasp of how and why technical analysis works. An ideal book for the beginner, it also offers a fine refresher for the veteran user of technical analysis. Mr. Bruce Kamich deserves plaudits for a job very well done.

*Reviewed by Henry (Hank) O. Pruden, PhD*  
*Nagel T. Miner Professor of Business and*  
*Executive Director of the Institute for Technical Market Analysis.*  
*Agno School of Business, Golden Gate University*

## WYCKOFF TESTS *continued from page 6*

consolidation formations. Thus, a second major purpose of this article is an attempt to fill a void in the Wyckoff Method by introducing a new set of "Nine buying tests" for re-accumulation." This new set of "Nine buying tests for re-accumulation" shall be illustrated with the same San Francisco Company case study to which will be applied "classic 9 tests" mentioned in the preceding paragraph.

The San Francisco Company (SF) case study used in this article reflects an actual trade made by an expert in the Wyckoff Method. This Wyckoff expert used the stock options listed on SF as his trading vehicle. Although the case name is disguised as the San Francisco Company (SF), it does represent an actual company in the energy sector. Vertical line (bar) charts and figure (point and figure) charts of SF will be used to illustrate both sets of "Nine buying tests," for accumulation and for re-accumulation.

As the reader approaches this case of "Nine buying tests," he/she ought to keep in mind the following admonitions from the *Reminiscences of a Stock Operator*:

*"The average ticker hound—or, as they used to call him, tape-worm—goes wrong, I suspect, as much from overspecialization as from anything else. It means a highly expensive inelasticity. After all, the game of speculation isn't all mathematics or set rules, however rigid the main laws may be. Even in my tape reading something enters that is more than mere arithmetic. There is what I call the behavior of a stock, actions that enable you to judge whether or not it is going to proceed in accordance with the precedents that your observation has noted. If a stock doesn't act right don't touch it; because, being unable to tell precisely what is wrong, you cannot tell which way it is going. No diagnosis, no prognosis. No prognosis, no profit."*

*“This experience has been the experience of so many traders so many times that I can give this rule: In a narrow market, when prices are not getting anywhere to speak of but move within a narrow range, there is no sense in trying to anticipate what the next big movement is going to be—up or down. The thing to do is to watch the market, read the tape to determine the limits of the get-nowhere prices, and make up your mind that you will not take an interest until the price breaks through the limit in either direction. A speculator must concern himself with making money out of the market and not with insisting that the tape must agree with him.*

*“Therefore, the thing to determine is the speculative line of least resistance at the moment of trading; and what he should wait for is the moment when that line defines itself, because that is his signal to get busy.*

### The Classic “Nine Buying Tests” of the Wyckoff Method

This case situation of SF involves a Wyckoff oriented-trader who diagnosed trading opportunities in SF. While the general market index is not shown here,

these trading opportunities exhibited good relative strength compared to the general market index. The “Nine buying tests” were passed at the conclusion of the base-building period and the trader elected to buy call options on SF and to enter stop-loss orders (mental) just below prior supports in the trading range. Later, as periods of consolidation come to a halt, the trader could roll his options forward to a later month and to a higher strike price. At the end of the SF case, the option trader is in a position to wrap-up his campaign, take his profit, and go home.

The First Wyckoff “buying test” to be passed was Downside (price) objective accomplished. This test was passed at point #4 on the figure chart, which is the \$21 level for SF. The preceding top in SF around point #3 built the cause for the decline, and at \$21 the maximum effect of this cause was realized.

The Second Wyckoff “buying test” was passed at point #8 on the bar chart, which was a “secondary test” that occurred on relatively light volume and narrowing downside price movement compared to the “selling climax” at point #4. At point #4 the relative increase in volume and the price closing at the high

#### Wyckoff Buying Tests: Nine Classic Tests for Accumulation Nine Buying Tests (applied to an average or a stock after a decline)\*

Indication	Determined from
1. Downside price objective accomplished	Figure Chart
2. Preliminary support, selling climax, secondary test	Vertical and Figure
3. Activity bullish (volume increases on rallies and decreases on reactions)	Vertical
4. Downward stride broken (i.e., supply line penetrated)	Vertical or Figure
5. Higher supports (daily low)	Vertical or Figure
6. Higher tops (daily high prices rising)	Vertical or Figure
7. Stock stronger than the market (i.e., stock more responsive on rallies and more resistant to reactions than the market index)	Vertical Chart
8. Base forming (horizontal price line)	Figure Chart
9. Estimated upside profit potential is at least three times for the loss if protective stop is hit	Figure Chart Profit Objective

\*Adapted with modifications from Jack K. Hutson, Editor, *Charting the Market: The Wyckoff Method* (Technical Analysis, Inc., Seattle, Washington, 1986), page 87

#### New Wyckoff Buying Tests Modified for Re-Accumulation

##### Nine Re-Accumulation Tests

1. Resistance Line Broken (Horizontal Line across the Top of The Trading Range)
2. Activity Bullish (e.g., volume expanding on rallies, shrinking on declines)
3. Higher Lows (price)
4. Higher Highs (price)
5. Favorable Relative Strength (equal to or stronger than the market)
6. Correction Completed in price and/or time (e.g., retracement, support line reached)
7. Consolidation pattern formed (e.g., triangular formation)
8. Stepping Stone Count Confirming Count
9. 3-1 Reward to Risk Ratio

of the day signaled to our Wyckoff-oriented trader that a provisional “selling climax” might be at hand. At point #4 demand was entering the market to absorb the supply of stock being offered in the vicinity of the downside price objective (buying test one). At this juncture the trader should have covered any outstanding short sales on SF at the open of the next day.

The successful secondary test at point #8 revealed that supply was being exhausted for the moment and so the downtrend was stopped, at least temporarily. It was now the job of the trader to sit patiently on the sidelines until an accumulation base had been formed.

“Buying Test Three” requires judging the volume on the rising and falling price waves in the trading range. A visual inspection reveals that by point #16 on the SF chart, volume was expanding on the rallies and shrinking on the declines. By the time that point #16 was reached on the vertical chart, SF would have passed the test: “Activity bullish.”

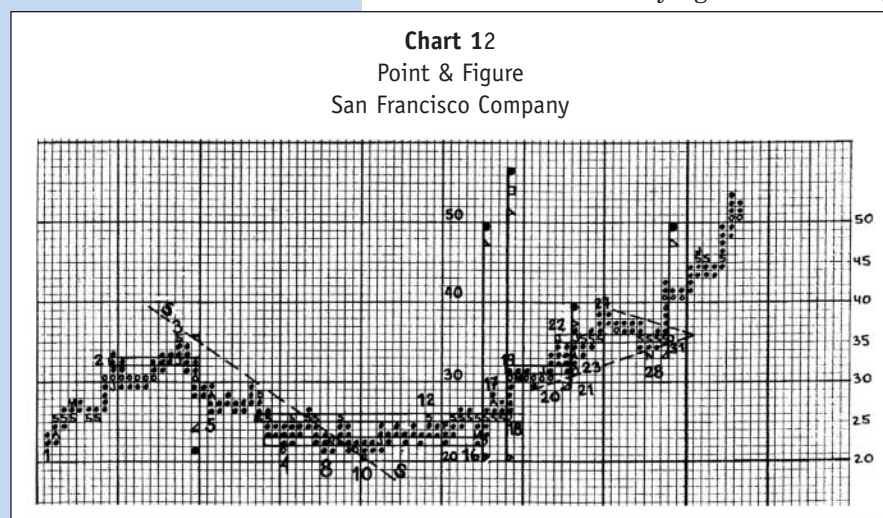
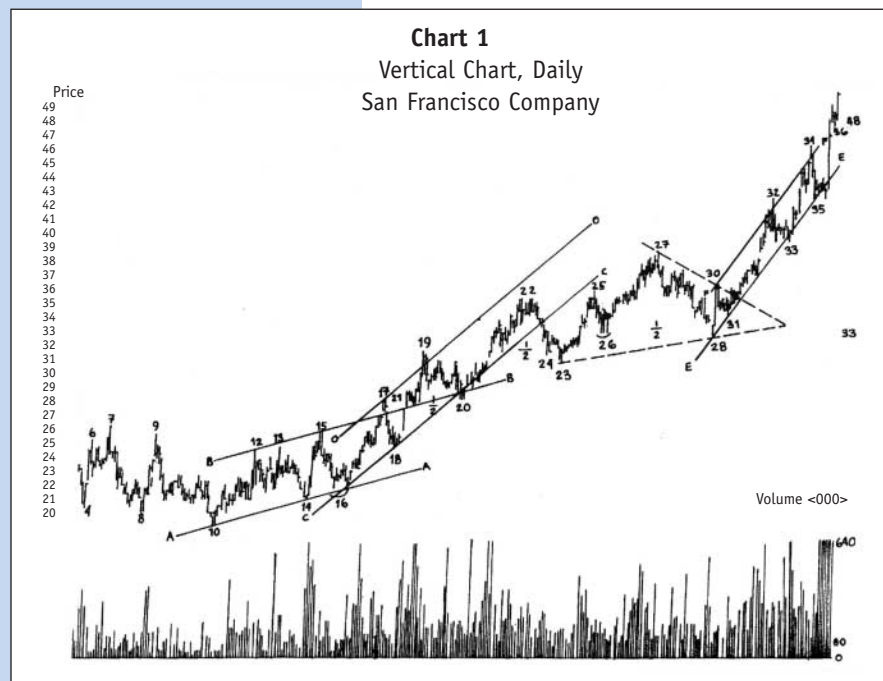
Turning once again to the figure chart discloses that in the vicinity of point #10 the downward sloping supply line (dashed line SS) was broken. Thus around point #10 the Fourth Buying Test was passed. These four forgoing tests,

although necessary, were not sufficient evidence of accumulation, so the trader had to remain patient until all of the “buying tests” clearly revealed that a base had been formed and that the evidence had accumulated to prove that the line of least resistance was decidedly upward.

The next two Wyckoff Tests are crucial to the definition of an upward line of least resistance. Buying Test Five is higher lows (higher supports) and Buying Test Six is higher highs (higher tops). The vertical line or bar chart of SF showed higher price lows along the gradient of points #14, #16, and #18. In a parallel fashion a series of rising price peaks appeared at points #12, #13, #15, and #17. At points #17 and #18 the trader-analyst could clearly declare that the higher highs and higher lows had been reached and, therefore Wyckoff Buying Tests Five and Six had been passed.

Points #15 and #16, and then again #17 and #18 on the charts may also be viewed as “Jumps and Backups,” hence legitimate junctures at which to enter a long position. (See January 2001 issue of the *Active Trader* magazine). At point #16

on the charts, and even more definitely at point #18, the trader in the SF case concluded that a base had been formed, a cause had been built and a favorable reward-to-risk ratio was present. The “count” taken along the \$22 line of the figure chart from point #16 back to beyond point #4 generated a cause of 27 points for upside projections of \$47-49, when that count was added to the low of the trading range at \$20 and to the count line itself at \$22. Moreover, the count along the \$25 level at point #18 sanctioned price projections as high as \$57. As a result of these analyses,





the trader was justified in concluding that the eighth test had been passed.

Entering a long position in SF at \$25 (point #18) and setting a protective stop-loss order just below support at \$19 would create a risk exposure of \$6. The figure chart count along the 25 line equaled 31 points of upside potential. Thus the estimated profit potential exceeded the indicated risk by over three times, so Buying Test Nine was also passed. A comparison of the SF chart to its relevant market index (not shown) would have revealed that SF was comparatively stronger than the market. Consequently SF was favored as a candidate with superior upside prospects. (Buying Test Seven was passed.)

By the time SF had reached point #18 all of the “Nine Buying Tests” had been passed. The line-of-least-resistance had defined itself as upward trending and the trader could have entered call option positions with favorable reward to risk parameters. At this stage the trader did purchase SF call options that were at the money.

### **“Nine New Buying Tests” for *Re-Accumulation***

In a quest for unity and economy, numerous principles of the Wyckoff Method were distilled into “Nine Buying Tests” and “Nine Selling Tests.” As explained above, the nine buying tests were originally designed to define trends coming out of major areas of accumulation that followed significant price declines. In addition to these major reversal formations at bottoms and tops, there also appear many important continuation patterns known by students of Wyckoff as “re-accumulation” and “redistribution.” However, these important consolidation patterns lack an appropriate set of “Nine Tests” to define the resumption of the upward trend or downward trend. Re-Accumulation and re-distribution areas simply lack a set of buying tests /selling tests that are equivalent to the “classic 9 tests” for major accumulation or major distribution. Unfortunately, the original set of Wyckoff tests that were used to define departures from bottoms or tops cannot be transferred easily nor applied en toto to zones of re-accumulation or redistribution. Some tests, such as “Preliminary Support and Selling Climax and Secondary Test” simply do not apply. The selling climax is good for signaling the onset of a bottom after a bear market decline. But re-accumulation zones start after a price advance and thus most often commence with a buying climax. A straightforward modification of the “climax rule” to fit re-accumulations is made even more ambiguous by the fact that distribution after a bull market advance may likewise start with “preliminary supply and a buying climax.”

Similar limitations apply to other tests found in the original list of nine. For instance, neither “The fulfillment of downside (upside) price objectives” nor the “breaking of downward (upward) sloping price line” are necessarily relevant for analyzing re-accumulation (redistribution). In their place it is suggested that we substitute other Wyckoff rules that tell us more clearly that a correction has been completed in time and price. These substitute measures are, for example, the interception by price of the upward sloping demand line and/or the reaching of the re-tracement level.\*

It is suggested that in place of “downward stride broken” the relevant buying test for re-accumulation become the “breaking of the horizontal resistance line along the top of the trading range.” That horizontal resistance line serves to confine the sideways trend channel in much the same way as the downtrend slanting supply lines confines a bearish trend channel. Moreover, when a wedge or triangular formation appears, the Wyckoff literature advises the student to enter upon the significant price-and-volume breaking of the resistance (support) line.

The “Stepping Stone Confirming Count” measures the amount of potential gen-

---

\*Examples of these and other tests for re-accumulation are available in the Wyckoff literature. In Basic Lecture Number 12 of the SMI/Wyckoff course, for instance, the narrator counsels the student to place resting buy orders at the \_ re-tracement level in order to add positions during corrections in a bull market. Elsewhere in the Wyckoff literature the student is admonished to purchase when the price intercepts and encounters support along an important upward slanting demand line.



erated during a re-accumulation trading range. The “stepping stone confirming count” deserves special consideration as a re-accumulation test because it possesses an important Wyckoff timing principle. Thus the trader should be alert to the possible resumption of the upward trend when the figure chart has generated enough re-accumulation potential or “count” to confirm the target from the original base. In the case of SF this means the trader should be poised for a resumption of the upward trend when the count generated during a consolidation grows large enough to meet the price objectives that equals the objectives generated during the original accumulation base. If along the \$35 level, for instance, the up and down price waves during a period of sideways consolidation reach a point where the figure chart count measures 14 points, thereby projecting to \$49, then the trader should become highly alert for the possible resumption of the upward trend. Remember that the original base count along the \$22 level (point #16) projected to a maximum of \$49. If a consolidation projects to the same objectives then we say that it “Confirms” the original count taken along the base. The “stepping stone confirming count” appears as Re-Accumulation Test Number Eight on Side Bar #2.

### Failed Tests

To illustrate the new list of modified Wyckoff Tests for Re-Accumulation let us return to the case study of the SF Company. After the base had been completed, the Wyckoff-oriented trader entered a long option position at point #18 on the SF charts. The SF stock then moved up sharply from point #18 to point #19 where it encountered enough supply to halt its advance and so SF entered a period of hesitation and sideways movement starting at #19. This period of hesitation commenced with a “buying climax” around point # 19, which would also have alerted the trader of the possible the onset of re-accumulation before resumption of the upward trend or even possibly distribution leading to a reversal of trend. The trader, who was actually operating in SF at the time of this case study, recounted his upside figure chart objective to \$49 and chose to wait out is interruption in the trend.

At point #20 the trader observed a “Spring” situation and so presumably he could have ventured a long position around the \$29 level (see *Active Trader* magazine, August 2000 for “Springs and Upthrusts”). At this juncture he could have consulted side bar 2 for the checklist of Re-Accumulation Tests. At point #20 he could have concluded that Re-Accumulation Buy Tests Number Two and Number Three had been passed. At point #20 the volume had dried up considerably and the downside price progress was minimal, which taken together revealed a lack of supply being pressed upon the market. Moreover, the interception of the rising support line c-c indicated that a sufficient correction in time and price had taken place (Test Six). However, it was not until the subsequent surpassing of the resistance along the \$31 level on June 11, on wide upside price movement and expanded volume, that SF satisfied several other Re-Accumulation Tests, such as Test Number One “Resistance Line Broken” and Test Number Four, “Higher High (price).” Then at point #23 a pullback to a “Higher Low” was executed (Test Three) and a count of the Figure chart along the 31 level would have projected upward to 37-39 dollars. However, this count was insufficient to confirm the earlier price target projections of \$47-49 taken along the \$22 level. Hence, Re-Accumulation Test Number Eight was not passed. Moreover, a trade taken at 31 also would have fallen short of the 3-1 reward-to-risk minimum because a stop would need to have been placed 3 points away at 28, and the re-accumulation count was only 8 points. Thus, Test Number Nine also failed. Presumably a pattern analyst could have labeled the consolidation from #19 to #20 a “pennant” (Test seven).

### Re-Accumulation Tests Passed

With two tests already failed our trader chose to pass up adding to his position at the point #23 juncture on the charts. Shortly thereafter the SF stock shot up from point #23 to point #27 and underwent a more prolonged correction. This complex correction would have been a challenge to the pattern recognition skills of most Wyckoff Analysts. Nonetheless, the Wyckoff expert who was operating in the stock

identified it as a large wedge or apex (often called a “one-eyed-Joe” by Wyckoffians), which thus fulfilled Re-Accumulation Test Number Seven. He took a count taken across the \$35 level back to the zone around point #22. That count indicated a re-accumulation that was sizable enough to reach the \$47-49 target that was first established at point #16, and in the process it flashed a “Stepping Stone Confirming Count” (Re-Accumulation buy signal Number Seven).

As price broke out of this wedge formation it burst through the (downward sloping) “Resistance Line” connecting points 27 and 30, thereby triggering a passage of Re-Accumulation Test Number One. On balance, the volume tended to expand during the rallies and shrink during the declines while the SF stock was in the triangular trading range (passage of Re-Accumulation Test Number Two). Price registered a series of higher lows from point #23 to point #28 to point #31 (passed Re-Accumulation Test Three) These series of higher lows by SF contrasted sharply with series of lower lows that were occurring in the general market index at that time (passage of Re-Accumulation Test Number Five). Moreover, at point #28 and #31 price met support near the \_ retracement level of the move from point #20 to point #27 (“\_ mark on Chart 1), thus fulfilling Re-Accumulation Test Number Six. At either point 28 or point 31 the trader would have had a better than 3-1 reward to risk ratio (14 count vs. 3-4 points of risk) for the passage of Re-Accumulation Test Number Nine.

The trader under the foregoing re-accumulation circumstances should have (and did) roll his options contract forward to a later expiration and higher strike price. He simultaneously increased the size of his line. The passage of all 9 re-accumulation tests had created a compelling enough case for him to roll his option contracts forward at the \$35 strike and to add to his position.

## Conclusion

When SF reached the \$49 level, the trader exited his SF options position. He judged that the relatively high volume occurring in the price-objective zone around \$49 was sufficient reason to exit. To make the case for exiting even more enticing, the general market index had started to weaken and diverge from the higher price set by SF around \$49.

There were targets outstanding at \$51-\$57, but this Wyckoff-oriented trader elected to take his profits at \$49 because that was the maximum effect of the cause built during the re-accumulation stepping-stone-count along the \$35 line (point #22 to point #31). He reckoned that he would have to weather another sideways to down correction/consolidation as further preparation for the final advance. He further reckoned that the risk did not justify waiting to capture the final 8 points available beyond \$49. Of course, as we can see retrospectively, he exited prematurely because SF promptly advanced to \$54. (Upon further reflection, this Wyckoff trader said that he would do the same thing again because “bulls make money, bears make money, and pigs get slaughtered.”)

The case study of the San Francisco Company (SF) demonstrated how, with the help the “Classic Nine Wyckoff Buying Tests,” an option trader could have entered favorable reward-to-risk long positions just as the line-of-least resistance became defined with the passage of the 9 classic tests for accumulation and as the stock was leaving the base formation. This case study also demonstrated how an option trader could have later employed a new set of the “Nine Re-Accumulation tests” to both roll his contracts forward and to add to his position. The fulfillment of the “stepping stone confirming count” nature of this re-accumulation consolidation gave the trader added reason to hold on to his positions until his longer-term base targets were being reached at \$49. Furthermore, the “stepping stone confirming count” provided an additional compelling reason for him to exit his long options on the burst of strength as SF reached the \$49 level.

In general, the “Nine Classic Wyckoff Tests” and the set of “Nine New Tests for Re-Accumulation” can help investors and traders to advance forward in their quest to control risk, ride winners and take home maximum profits.

*Henry O. (Hank) Pruden, Ph.D., is Professor of Business and Executive Director of The Institute for Technical Market Analysis at Golden Gate University, San Francisco, CA, and he was also Editor, Market Technicians Association Journal. Hank can be reached at hpruden@ggu.edu, 415-442-6583 and www.hankpruden.com. This article is reprinted with permission from the MTA Journal, Spring-Summer 2001 issue.*

*This article was reviewed, edited and approved by David Upshaw, CFA, CMT, Associate Editor, MTA Journal.*

### **References**

- Forte, Jim, CMT, "Anatomy of a Trading Range," *MTA Journal*, Summer-Fall 1994
- Hutson, Jack K. ,Editor, *Charting The Market: The Wyckoff Method*, Technical Analysis,Inc.,1986
- Mathis, David, "Santa Fe: A Classic," audio tape and charts, Stock Market Institute,1978
- Pruden, Henry O. (Hank), Ph.D., "Trading the Wyckoff Way: Buying Springs and Selling Upthrusts," *Active Trader* magazine, August 2000
- Pruden, Henry O. (Hank), Ph.D., "Wyckoff Axioms: Jumps and Backups," *Active Trader* magazine, January-February 2001
- \_\_\_\_\_,Introduction to the Wyckoff Method of Stock Market Analysis—Text Exhibits and Illustrations, Stock Market Institute,1983
- \_\_\_\_\_, "Basic Lecture No.12," audio tape and charts, Stock Market Institute,1968

*Article reprinted with the permission of the Editor of the MTA Journal, Spring-Summer 2001.*