The Wave Principle Guide

Rules, Patterns and Characteristics

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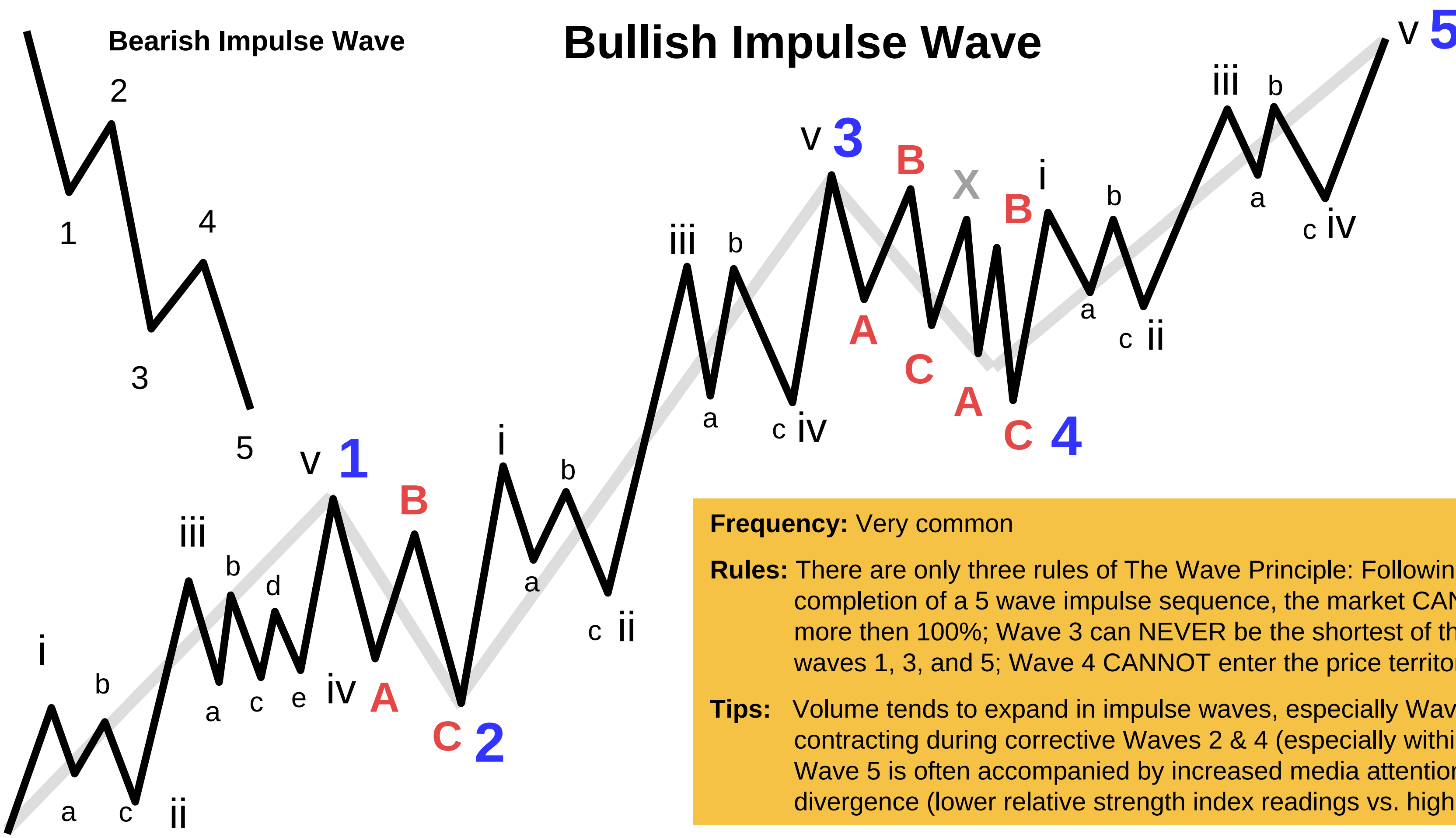
The Impulse Wave



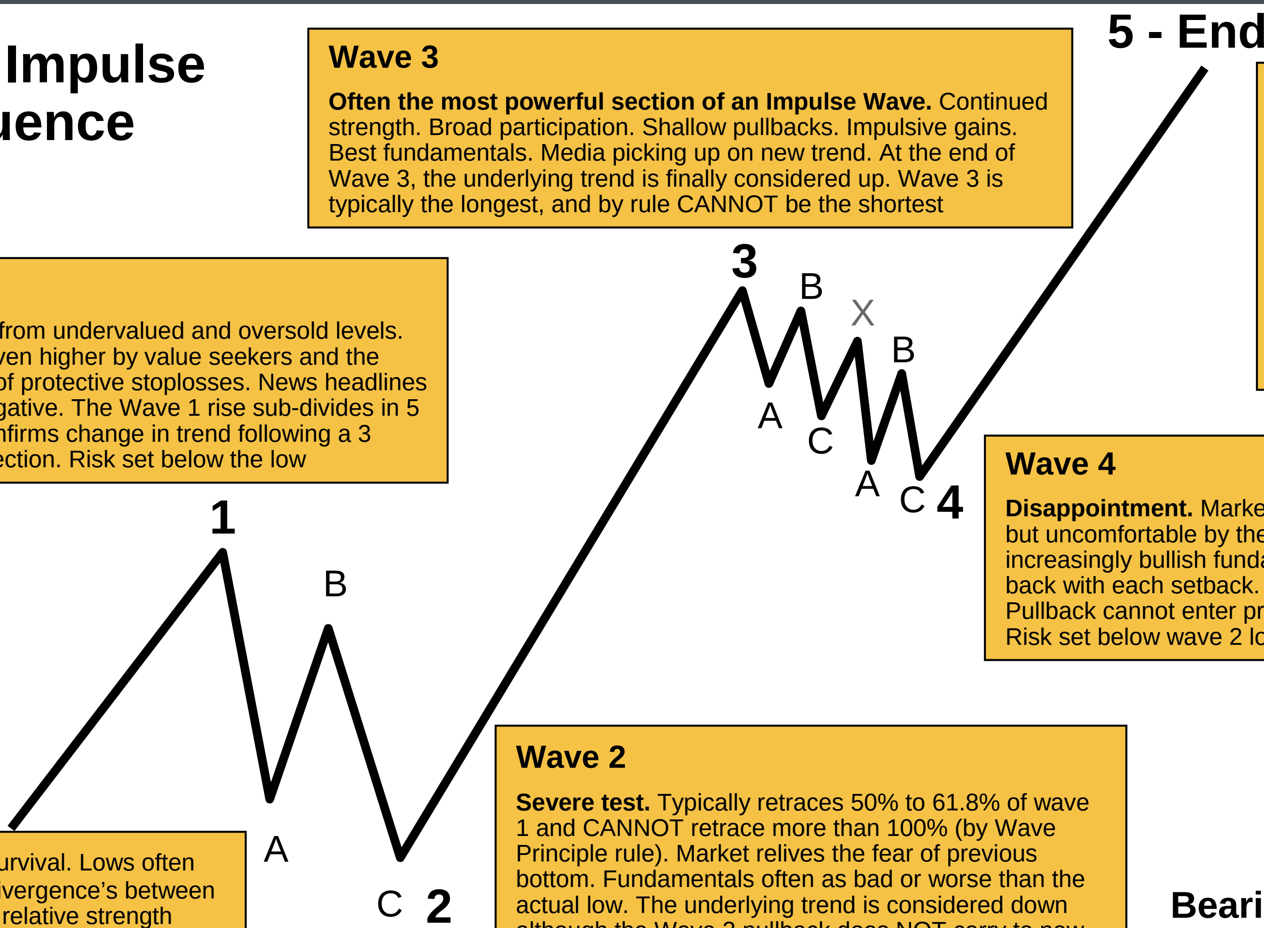
Frequency: Very common

Rules: There are only three rules of The Wave Principle: Following the completion of a 5 wave impulse sequence, the market CANNOT retrace more then 100%; Wave 3 can NEVER be the shortest of the impulse waves 1, 3, and 5; Wave 4 CANNOT enter the price territory of wave 1

Tips: Volume tends to expand in impulse waves, especially Wave 3, contracting during corrective Waves 2 & 4 (especially within triangles). Wave 5 is often accompanied by increased media attention and bearish divergence (lower relative strength index readings vs. higher prices)

Characteristics of an Impulse Wave Sequence

Bullish Impulse Sequence



Bottom. Question of survival. Lows often accompanied by bullish divergence's between new price lows and rising relative strength index readings. Sentiment reaches extremes. Media attention increases with negative headlines taking the front page. The layman becomes aware of the impending doom

Wave 1

Rebound from undervalued and oversold levels. Market driven higher by value seekers and the triggering of protective stoplosses. News headlines remain negative. The Wave 1 rise sub-divides in 5 waves; confirms change in trend following a 3 wave correction. Risk set below the low

Wave 2

Severe test. Typically retraces 50% to 61.8% of wave 1 and CANNOT retrace more than 100% (by Wave Principle rule). Market relives the fear of previous bottom. Fundamentals often as bad or worse than the actual low. The underlying trend is considered down although the Wave 2 pullback does NOT carry to new lows. Negative headlines resurface. Bulls sweat

Wave 3

Often the most powerful section of an Impulse Wave. Continued strength. Broad participation. Shallow pullbacks. Impulsive gains. Best fundamentals. Media picking up on new trend. At the end of Wave 3, the underlying trend is finally considered up. Wave 3 is typically the longest, and by rule CANNOT be the shortest

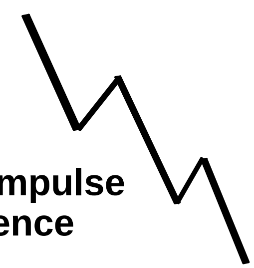
Wave 4

Disappointment. Market long and comfortable but uncomfortable by the lack of follow-through on increasingly bullish fundamentals. Positions pared back with each setback. Media coverage limited. Pullback cannot enter price territory of wave 1. Risk set below wave 2 low

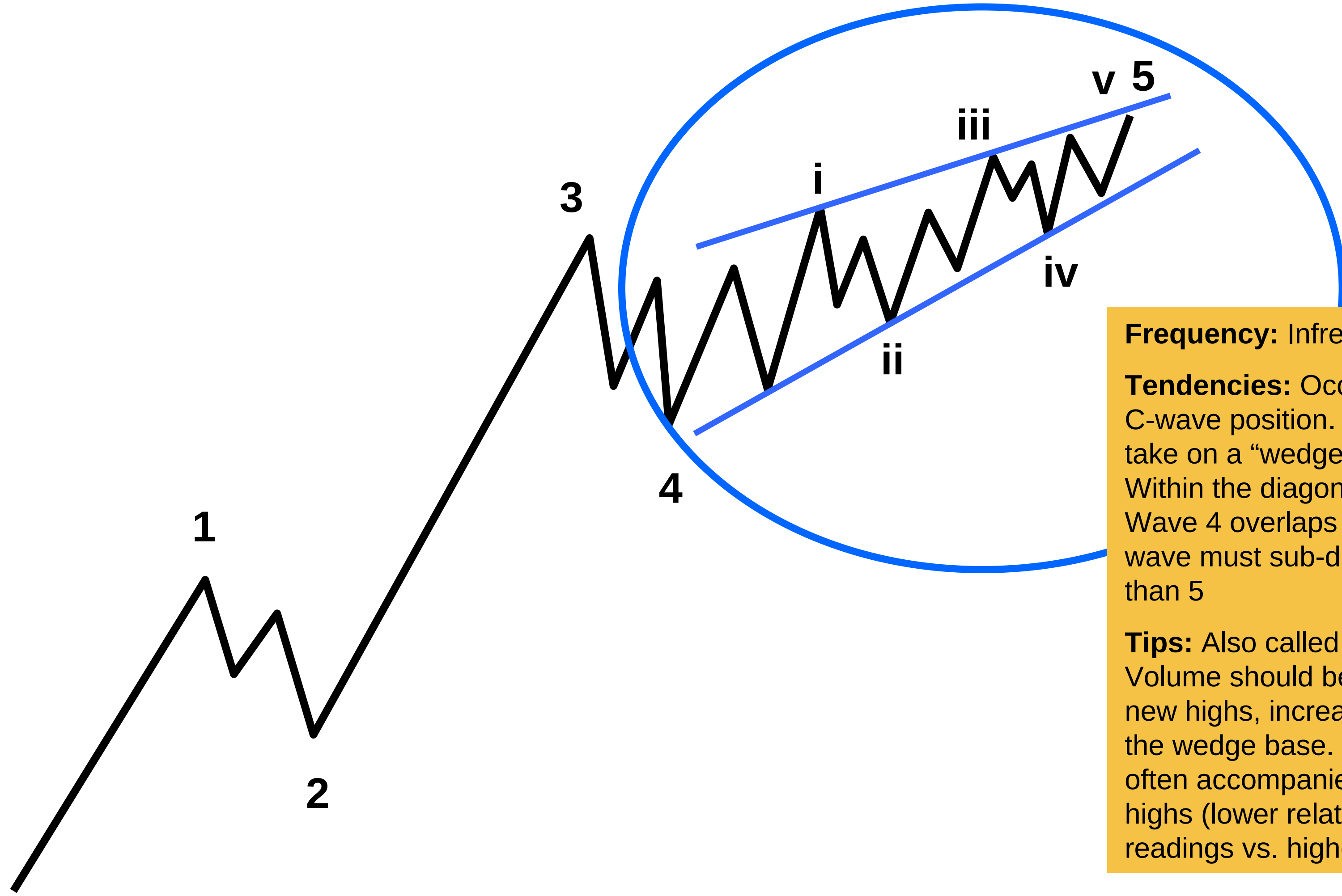
Wave 5

Final leg. Fundamentals improve, but often not to the levels of the Wave 3 peak. Bearish divergences typically form. Media attention again increases. Renewed upside momentum and high sentiment creates overvaluation. Market begins to react less and less to good news = saturation = end

Bearish Impulse Sequence



Impulsive: Diagonal Triangle - Type 1



Frequency: Infrequent

Tendencies: Occurs in 5th or the C-wave position. The pattern should take on a "wedge" like appearance. Within the diagonal triangle pattern, Wave 4 overlaps Wave 1, and each wave must sub-divide in 3 waves, rather than 5

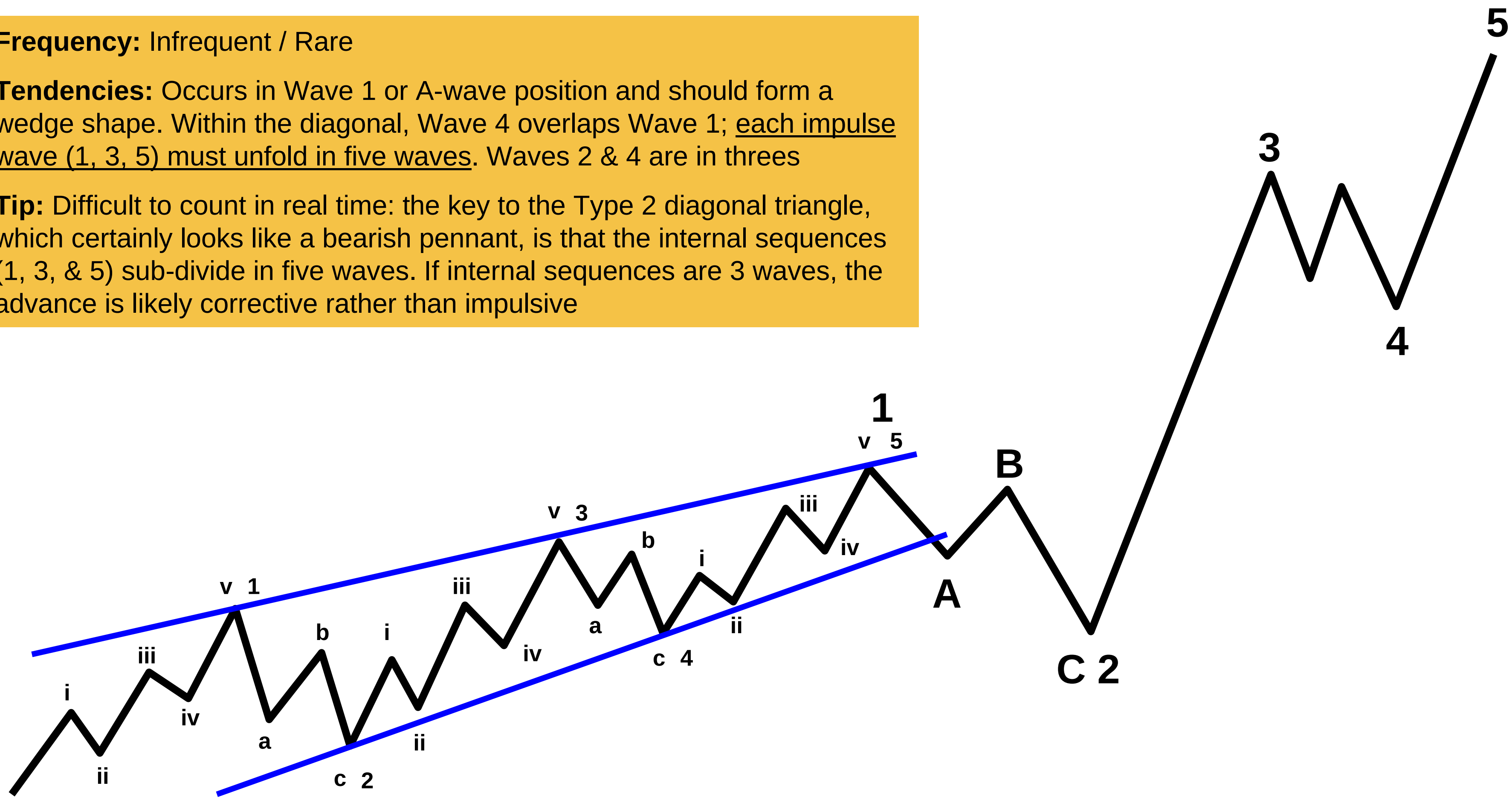
Tips: Also called an "ending sequence." Volume should be light on the marginal new highs, increasing on a break below the wedge base. Bearish divergence often accompanies the marginal new highs (lower relative strength index readings vs. higher prices)

Impulsive: Diagonal Triangle - Type 2

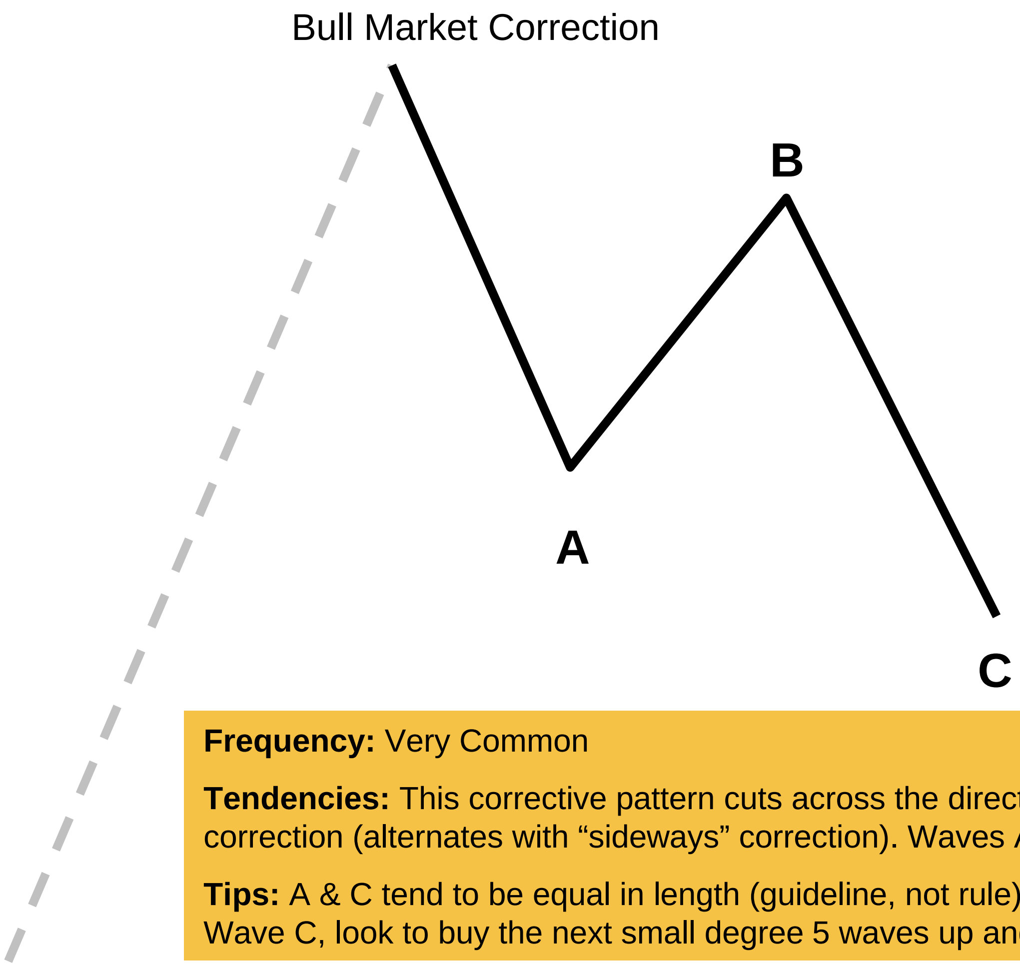
Frequency: Infrequent / Rare

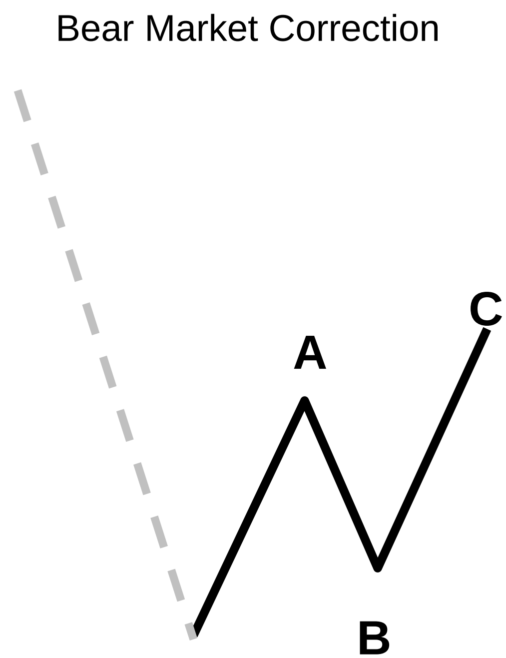
Tendencies: Occurs in Wave 1 or A-wave position and should form a wedge shape. Within the diagonal, Wave 4 overlaps Wave 1; each impulse wave (1, 3, 5) must unfold in five waves. Waves 2 & 4 are in threes

Tip: Difficult to count in real time: the key to the Type 2 diagonal triangle, which certainly looks like a bearish pennant, is that the internal sequences (1, 3, & 5) sub-divide in five waves. If internal sequences are 3 waves, the advance is likely corrective rather than impulsive



Corrective: Zig-Zag



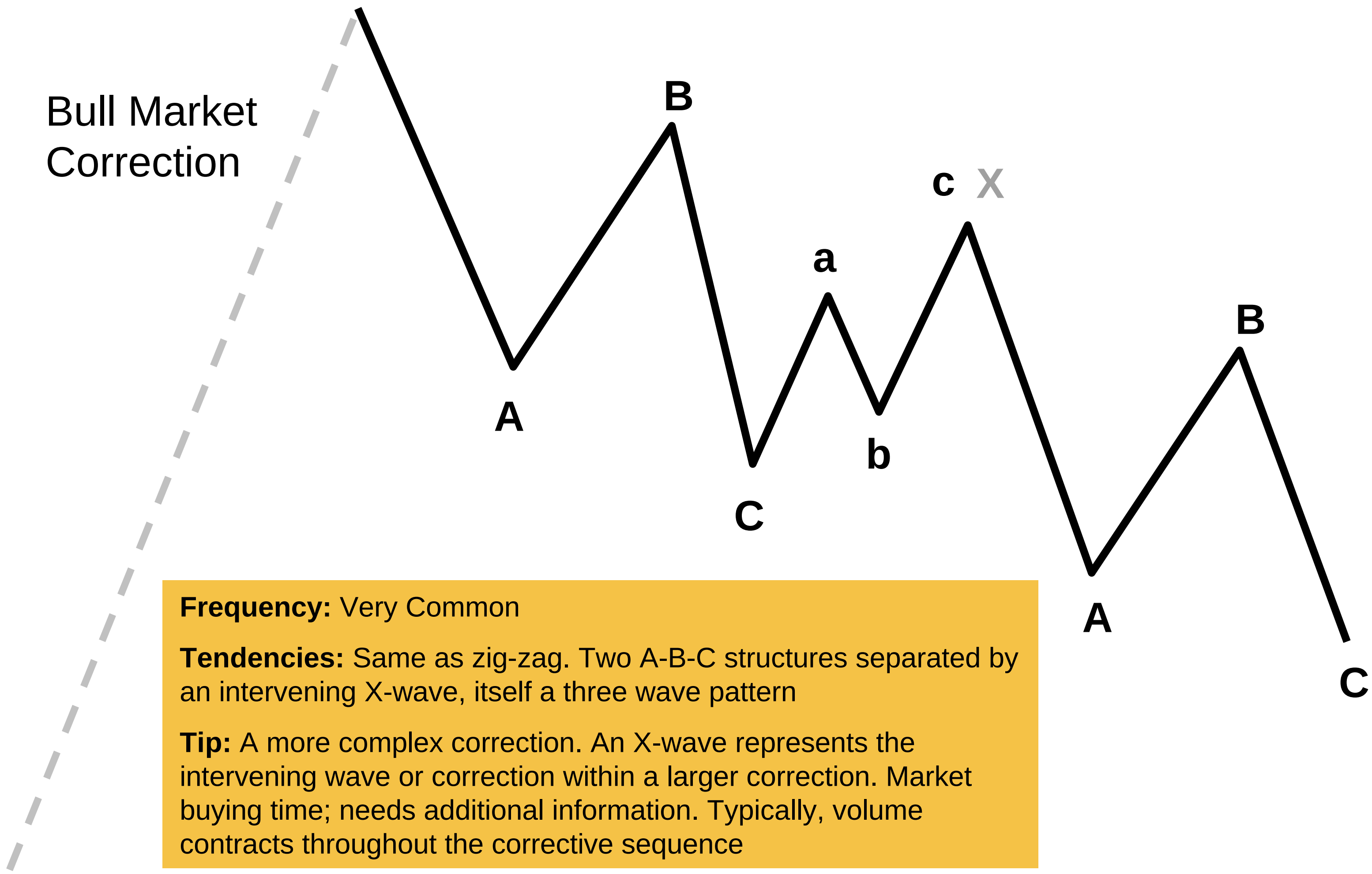


Frequency: Very Common

Tendencies: This corrective pattern cuts across the direction of the larger trend; classified as a “sharp” correction (alternates with “sideways” correction). Waves A & C sub-divide in five sub waves

Tips: A & C tend to be equal in length (guideline, not rule). Low risk entry; if able to count five waves down in Wave C, look to buy the next small degree 5 waves up and set stoploss below the Wave C low

Corrective: Double Zig-Zag

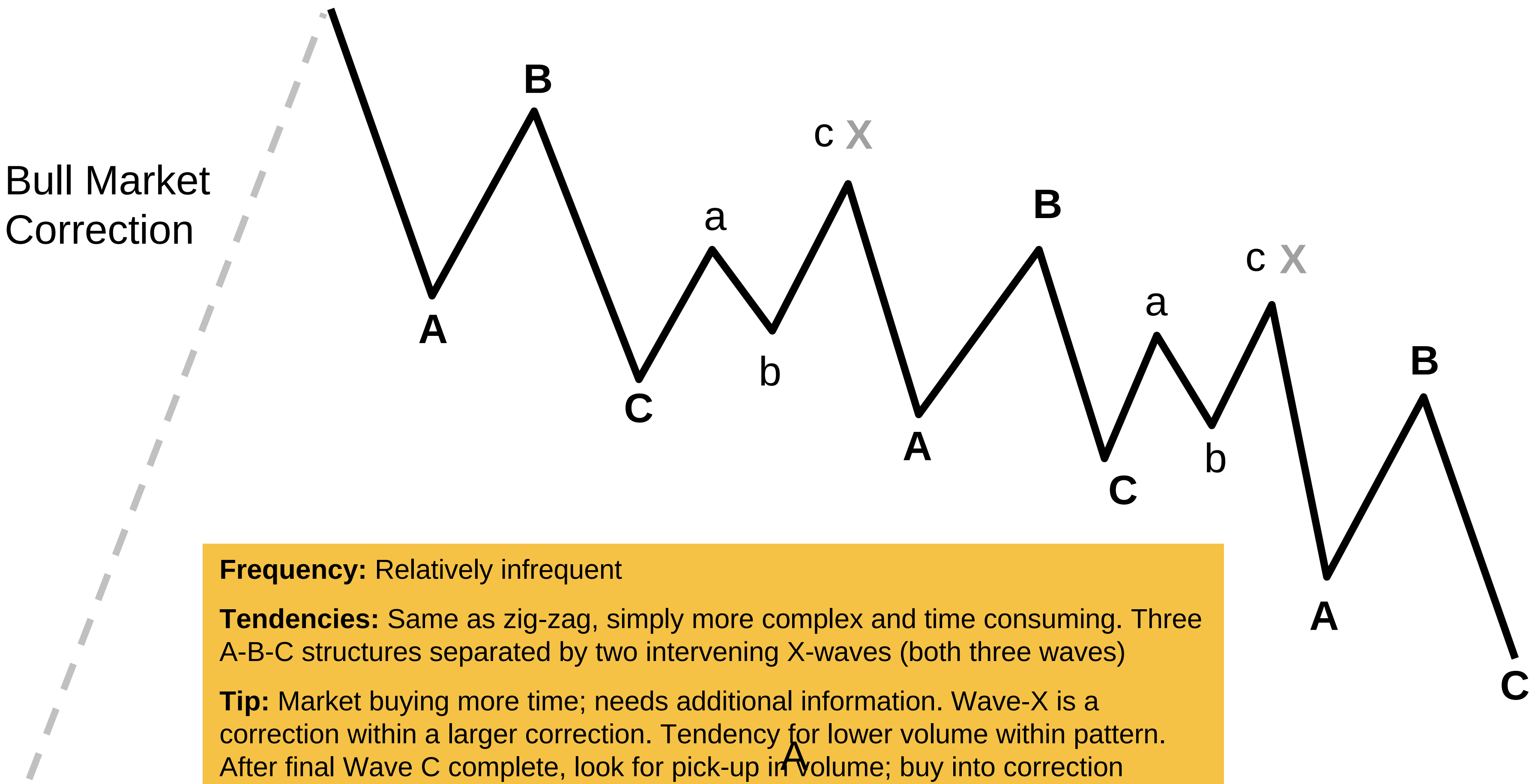


Frequency: Very Common

Tendencies: Same as zig-zag. Two A-B-C structures separated by an intervening X-wave, itself a three wave pattern

Tip: A more complex correction. An X-wave represents the intervening wave or correction within a larger correction. Market buying time; needs additional information. Typically, volume contracts throughout the corrective sequence

Corrective: Triple Zig-Zag

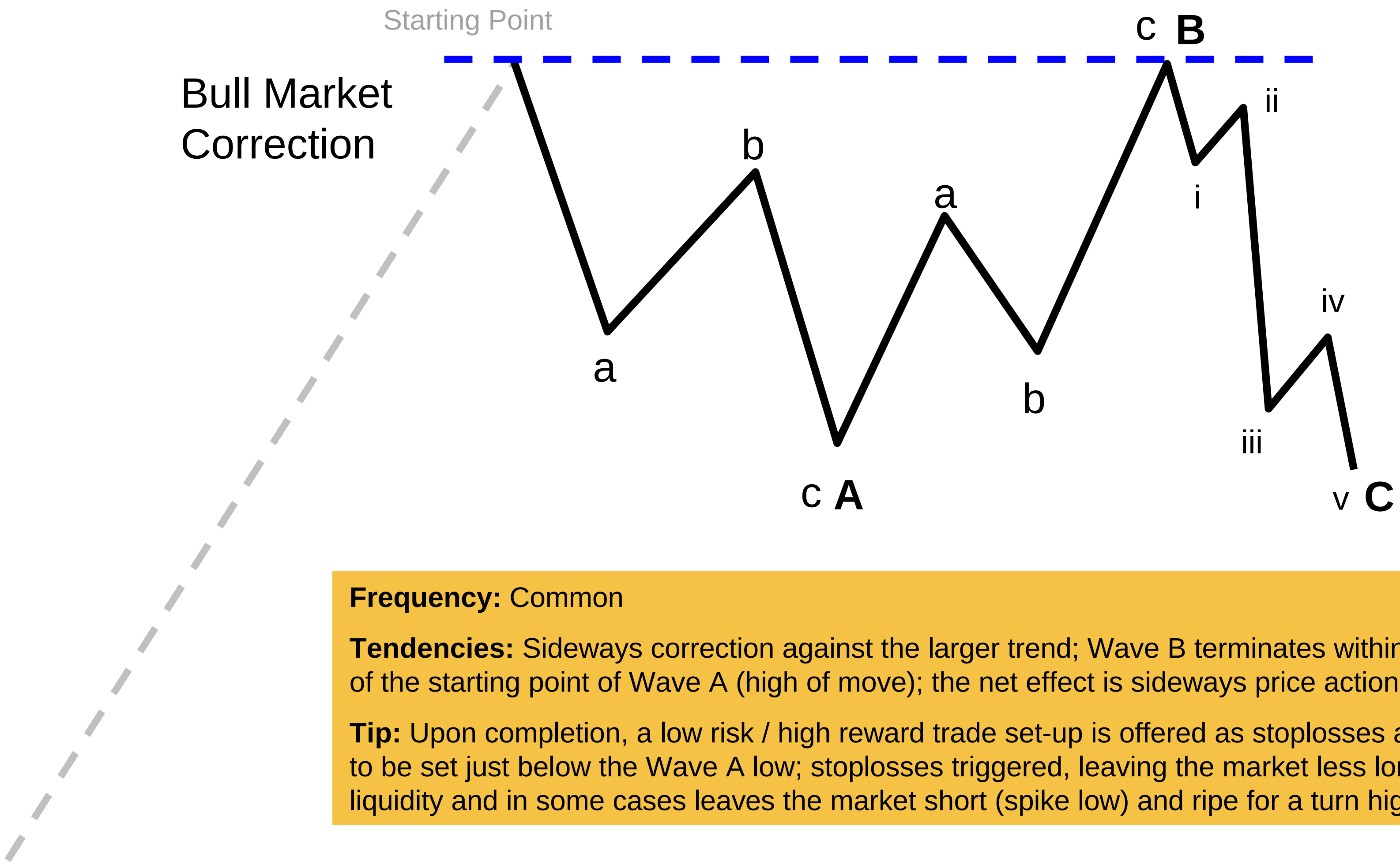


Frequency: Relatively infrequent

Tendencies: Same as zig-zag, simply more complex and time consuming. Three A-B-C structures separated by two intervening X-waves (both three waves)

Tip: Market buying more time; needs additional information. Wave-X is a correction within a larger correction. Tendency for lower volume within pattern. After final Wave C complete, look for pick-up in volume; buy into correction following small degree 5 wave advance. Set stoploss below the Wave C low

Corrective: Flat

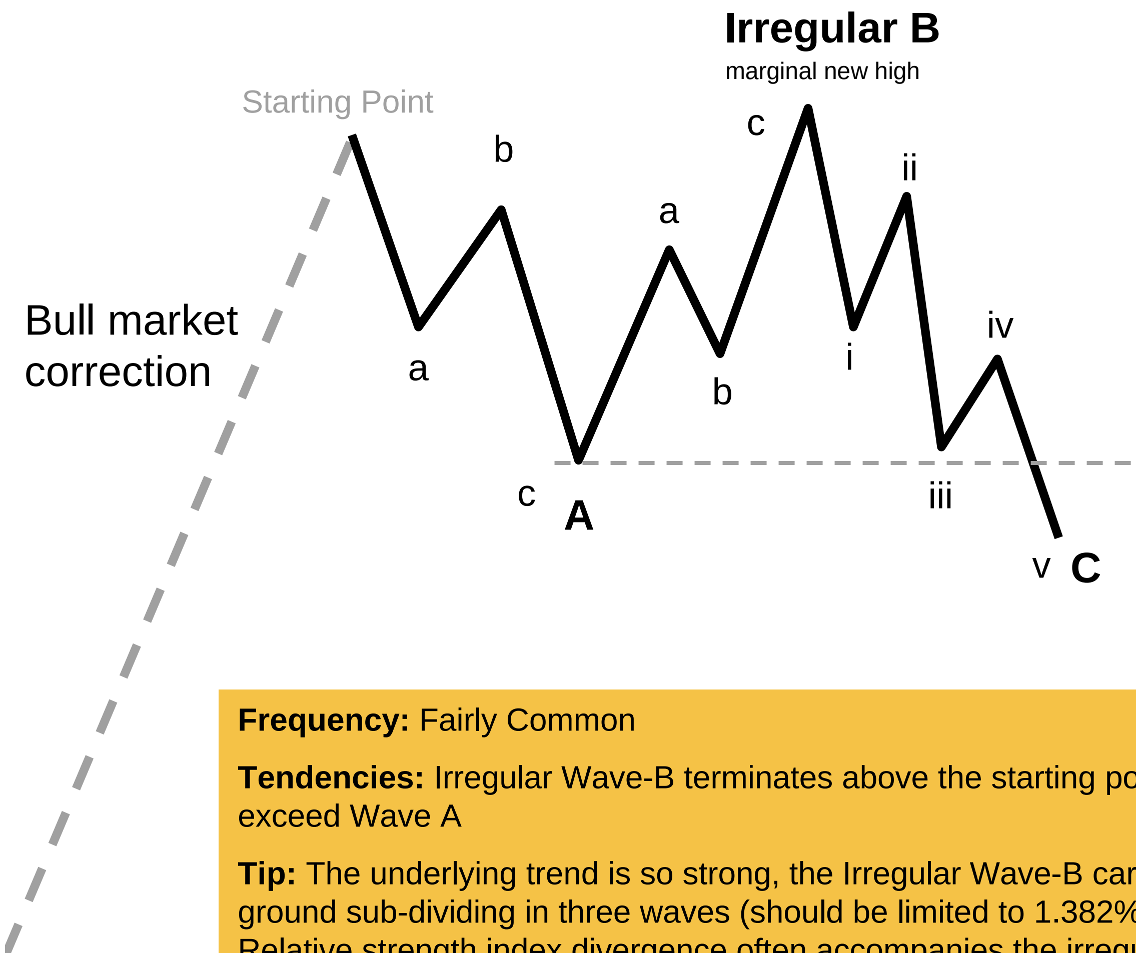


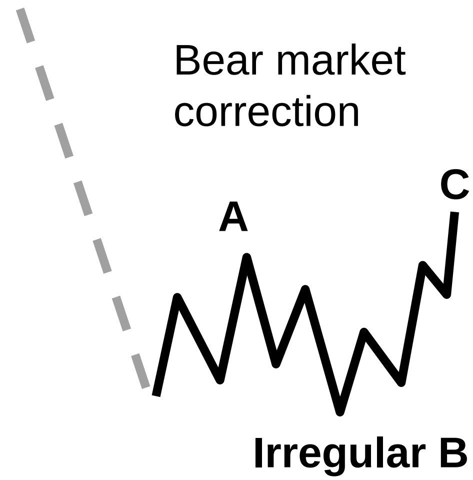
Frequency: Common

Tendencies: Sideways correction against the larger trend; Wave B terminates within proximity of the starting point of Wave A (high of move); the net effect is sideways price action

Tip: Upon completion, a low risk / high reward trade set-up is offered as stoplosses are likely to be set just below the Wave A low; stoplosses triggered, leaving the market less long, adds liquidity and in some cases leaves the market short (spike low) and ripe for a turn higher

Corrective: Irregular or Expanding Flat





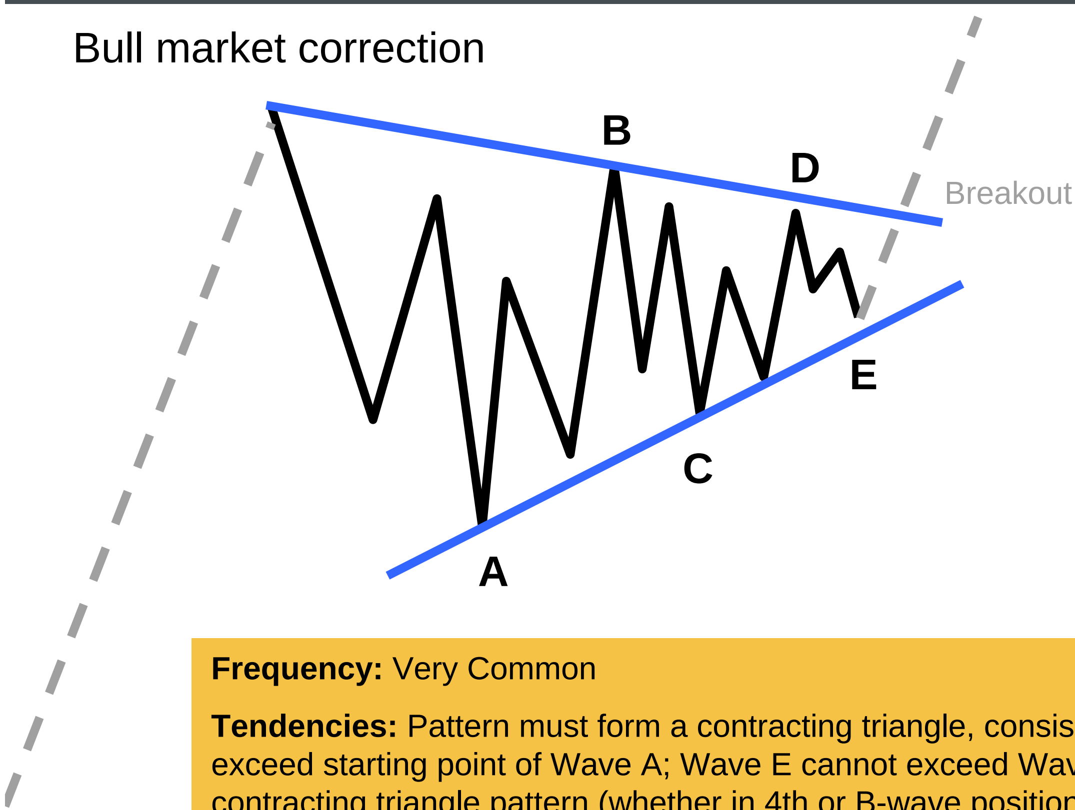
Frequency: Fairly Common

Tendencies: Irregular Wave-B terminates above the starting point of Wave A. Wave C should meet / exceed Wave A

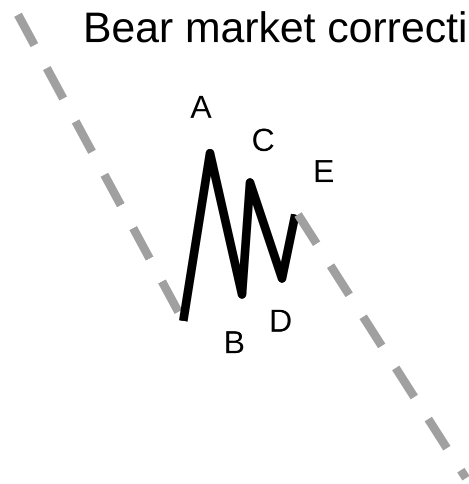
Tip: The underlying trend is so strong, the Irregular Wave-B carries prices into marginally higher ground sub-dividing in three waves (should be limited to 1.382% times the length of wave A). Relative strength index divergence often accompanies the irregular B-wave

Corrective: Contracting Triangle

Bull market correction



Bear market correction

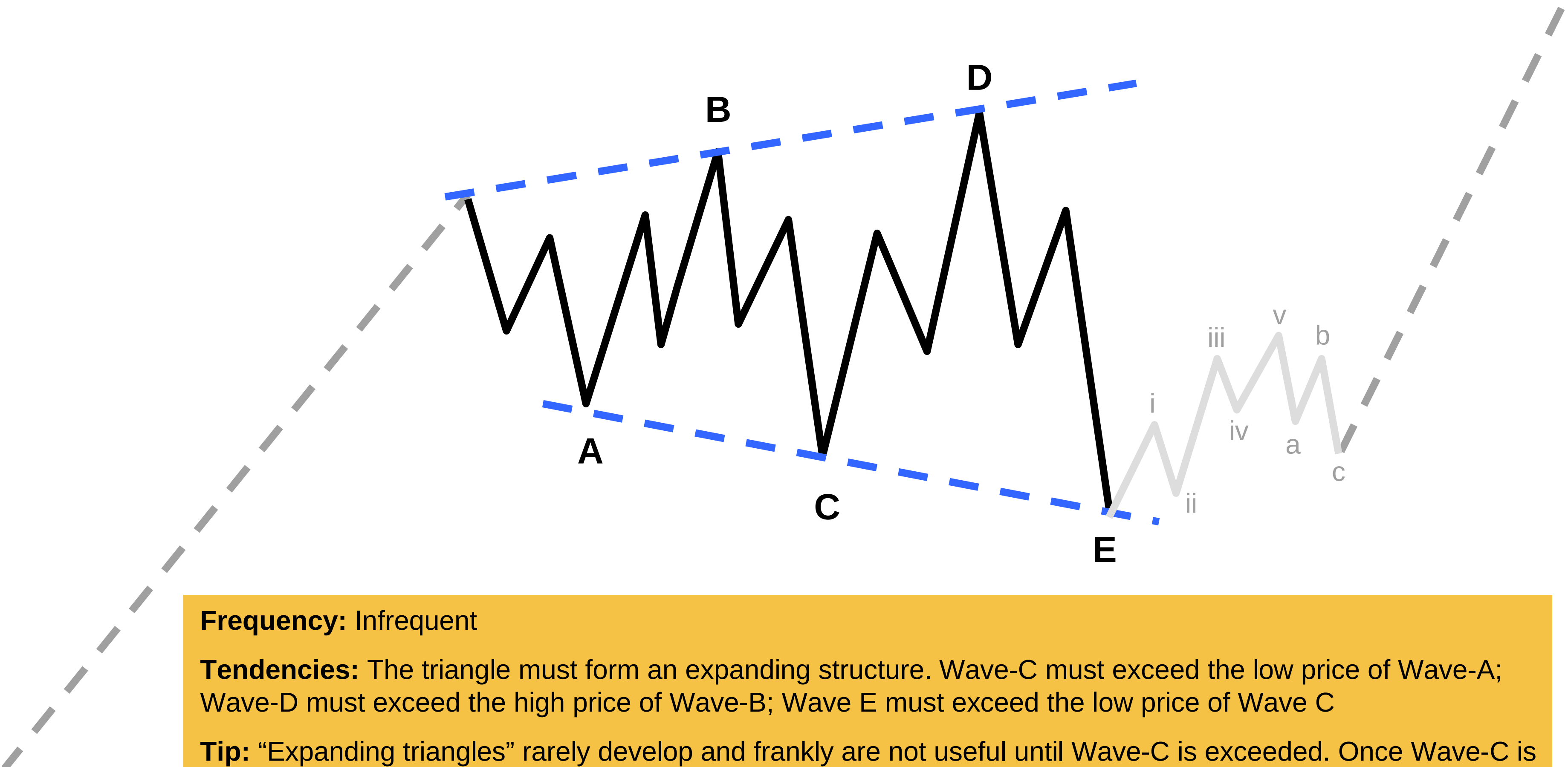


Frequency: Very Common

Tendencies: Pattern must form a contracting triangle, consisting of three wave structures; Wave C cannot exceed starting point of Wave A; Wave E cannot exceed Wave C and precedes the final leg within the contracting triangle pattern (whether in 4th or B-wave position)

Tip: All is fair in love, war and triangles! Very tricky business with many false starts, breakouts and re-drawing of triangle boundaries (obey rules). Use stochastic tool within the boundaries of the range; provides mechanical buy / sell signals with momentum shifts. Volume contracts within triangle and expands on the breakout

Corrective: Expanding Triangle

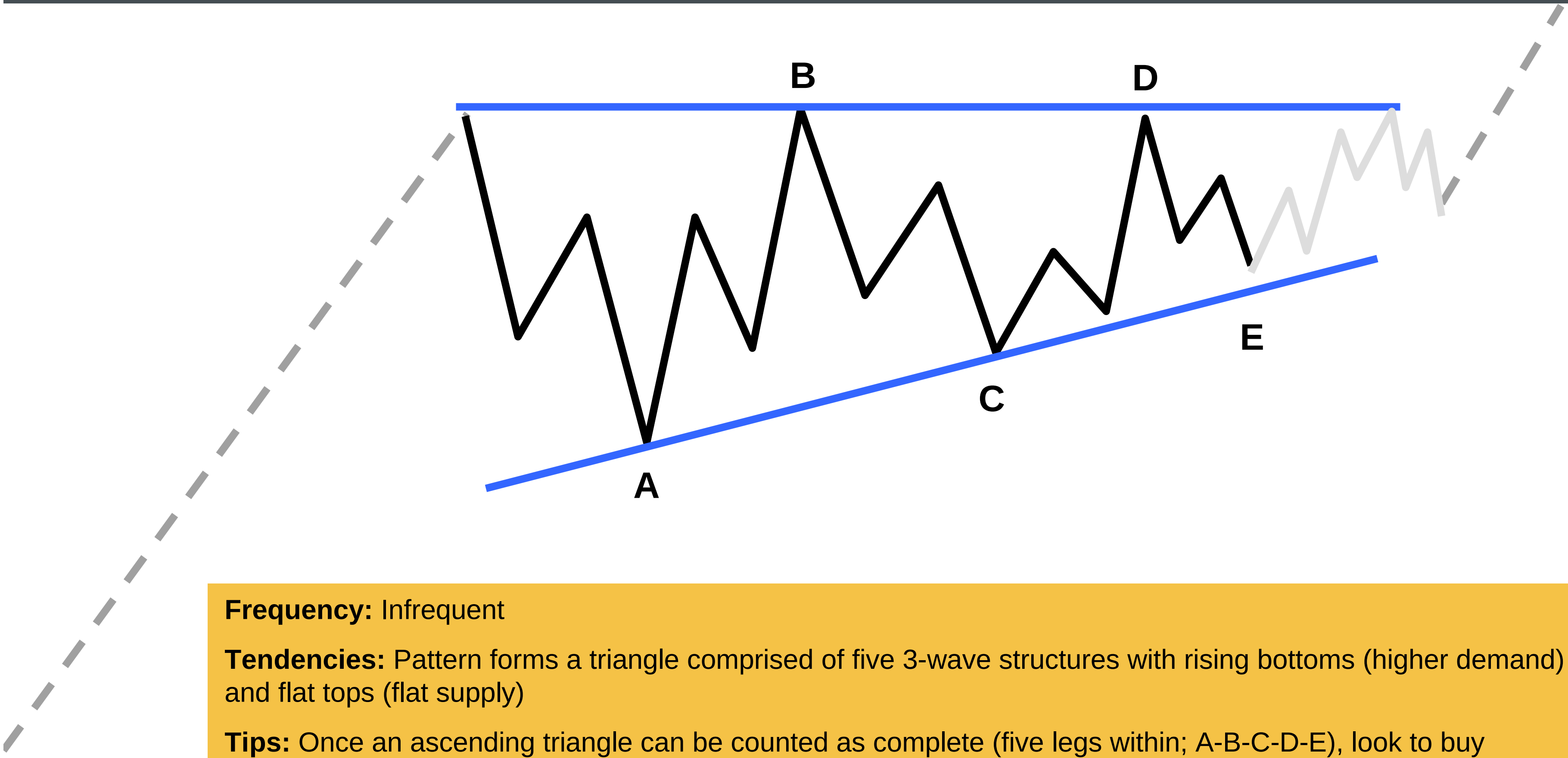


Frequency: Infrequent

Tendencies: The triangle must form an expanding structure. Wave-C must exceed the low price of Wave-A; Wave-D must exceed the high price of Wave-B; Wave E must exceed the low price of Wave C

Tip: “Expanding triangles” rarely develop and frankly are not useful until Wave-C is exceeded. Once Wave-C is exceeded (to complete Wave-E), look for a small degree 5 wave advance to announce a bottom is in place

Corrective: Ascending Triangle

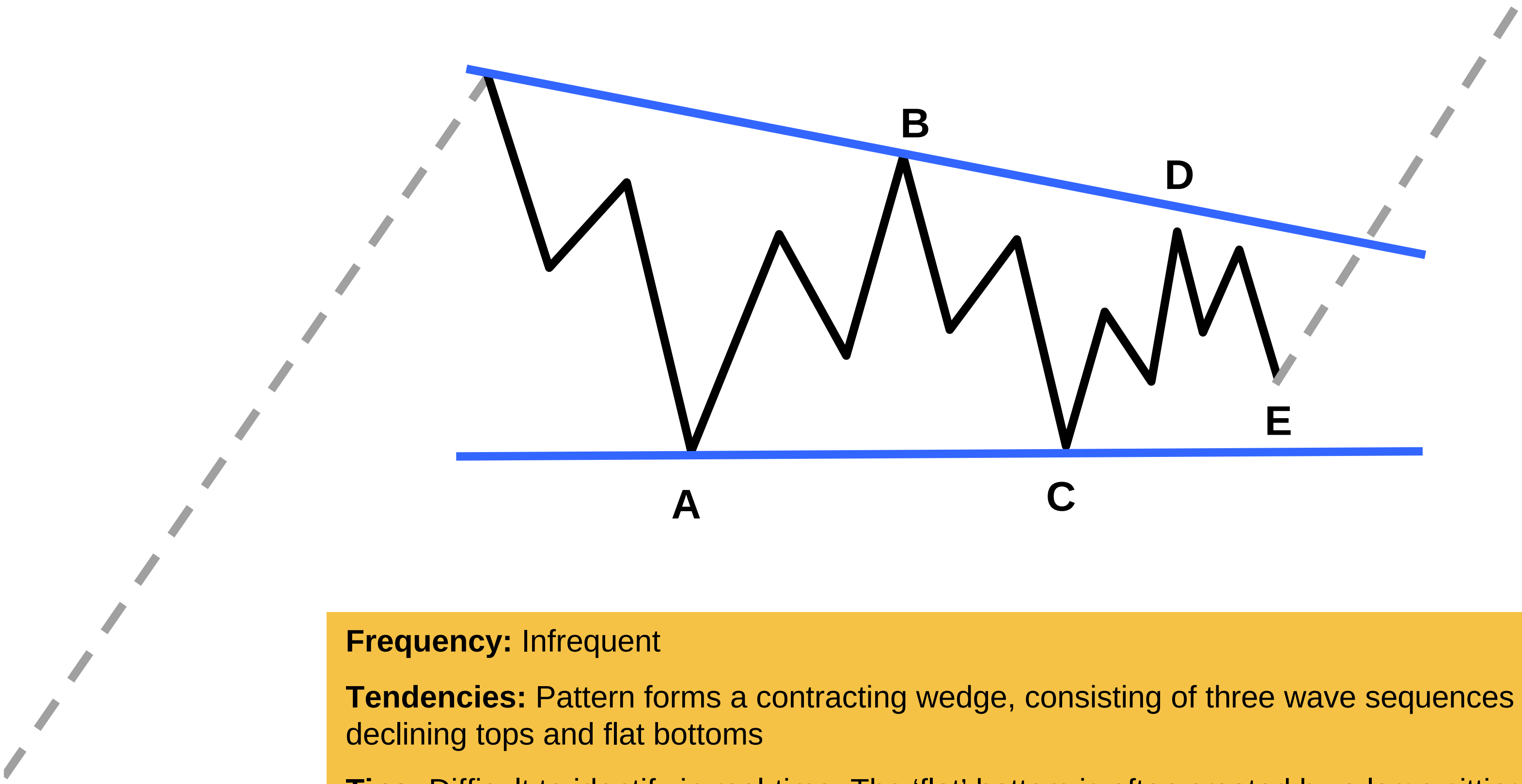


Frequency: Infrequent

Tendencies: Pattern forms a triangle comprised of five 3-wave structures with rising bottoms (higher demand) and flat tops (flat supply)

Tips: Once an ascending triangle can be counted as complete (five legs within; A-B-C-D-E), look to buy following a small degree 5 wave advance and / or on a break of the 'flat' tops (B & D)

Corrective: Descending Triangle



Frequency: Infrequent

Tendencies: Pattern forms a contracting wedge, consisting of three wave sequences with declining tops and flat bottoms

Tips: Difficult to identify in real-time. The ‘flat’ bottom is often created by a large sitting order to buy (demand). Buy into a completed 3-wave corrective sequence off of the wave D peak and / or on a break back above D. Risk below Wave C

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