

# Wolfe Waves

## Bill Wolfe

### Table of Contents

Introduction.....	4
	What is The Wolfe
Wave.....	5
	The Theory of the Wolfe
Wave.....	5
	Bullish
Wave.....	6
	Rules for Bullish Wolfe Wave
Structure.....	6
	Bearish
Wave.....	7
	Rules for Bearish Wolfe Wave
Structure.....	7
	Practical
Application.....	8
	Tactical Notes (Mental)
	8
	Understanding the goals of Wave
trading.....	8
	The tremendous rewards of
patience.....	8
	Why the Wolfe Wave is a must for super
trader.....	8
	Try to Fade at least half of your
trade.....	9
	Doing your homework at
night.....	9

.....	.....9
pressure.....	Dealing with.....9
.....	.....9
zone.”.....	Prepare yourself mentally to enter the “sweet.....9
Stops.....	.....10
.....	Turning your record keeping into a happy.....10
job.....	How to avoid scaring yourself out of a.....10
trade.....	.....10
.....	Identifying Risk.....10
.....	.....10
(Technical).....	Tactical Notes.....11
Notes.....	About the Tactical.....11
.....	Watch for heavy tic.....11
volume.....	.....11
.....	Look for broken trend.....11
lines.....	.....11
frames.....	Waves develop in all time.....11
.....	.....11
point.....	Always watch the 4.....11
.....	.....11
Reading).....	Tactical Notes (Chart.....11
.....	Setting up your.....11
charts.....	.....11
.....	The Perfect.....12
Wave.....	.....12
Waves.....	Waves are canceled by contrary.....12
.....	.....12

	How to anticipate contrary	
Waves.....		.....12
	How to approximate Wave	
4.....		.....12
	How to approximate Wave 5, the “Sweet	
Zone.”.....		.....12
	Signs that a Wave <i>will</i> make it to the 1 to 4 target	
line.....		.....13
	Signs that a Wave <i>will not</i> make it to the 1 to 4 target	
line.....		.....13
	Identifying Spikes and tips for trading them.	
		.....13
	Profiting from	
gaps.....		.....13
	The Dominant	
Wave.....		.....14
	Tactical Notes (Miscellaneous)	
		.....14
	Equal Tic	
Charts.....		.....14
	Program Execution alarm.	
		.....14
	The better you execute, the better your	
position!.....		.....14
	EXHIBIT 1	
		.....15
	perfect	
wave.....		.....15
	EXHIBIT 2	
		.....16
	perfect Bearish	
Wave.....		.....16

EXHIBIT 3

.....17  
.....17  
Watch for heavy tic  
volume.....

EXHIBIT

3a.....18  
.....18  
saucer like shape in tic volume is a reassuring  
sign.....18

EXHIBIT 4

.....19  
.....19  
Monotony is  
good.....

EXHIBIT 5

.....20  
.....20  
Broken trend  
lines.....

EXHIBIT 6

.....21  
.....21  
Another broken trend line.

EXHIBIT 7

.....22  
.....22  
Be suspicious of light volume.

EXHIBIT

7a.....23  
.....23  
Caution due to light volume.

EXHIBIT 8

.....24  
.....24  
Identifying the “Sweet  
Zone.”.....24

# EXHIBIT

8a.....	.....25
	Calculating risk using the Sweet
Zone.....	.....25
	EXHIBIT
8b.....	.....26
	Three lessons in one
chart.....	.....26
	EXHIBIT 8c
.....	.....27
	The Sweet Zone using the 1 point for a
parallel.....	.....2
	7
	EXHIBIT 9
.....	.....28
	Identifying
Spikes.....	.....28
	EXHIBIT
10.....	.....29
	Using a gap for a 1
point.....	.....29
	EXHIBIT
11.....	.....30
	Confidence
builder.....	.....30
	Wolfe Wave FAX: 08/27/96 11:12 PM New York time.
	.....31
	Wolfe Wave FAX: 08/28/96 09:23 PM New York time.
	.....32
	Wolfe Wave FAX: 09/02/96 07:42 PM New York time.
	.....34
	Wolfe Wave FAX: 09/03/96 10:21 PM New York time.
	.....35
	Wolfe Wave FAX: 09/04/96 10:43 PM New York time.
	.....36
	Wolfe Wave FAX: 09/06/96 7:43 PM New York time.
	.....37

Wolfe Wave FAX: 09/08/96 11:37 PM New York time.	38
Wolfe Wave FAX: 09/09/96 10:31 PM New York time.	39
Wolfe Wave FAX: 09/10/96 08:16 PM New York time.	40
Wolfe Wave FAX: 09/11/96 08:42 PM New York time.	41
Wolfe Wave FAX: 09/12/96 07:18 PM New York time.	42
Wolfe Wave FAX: 09/15/96 06:58 PM New York time.	43
Wolfe Wave FAX: 09/16/96 07:40 PM New York time.	44
Wolfe Wave FAX: 09/17/96 07:55 PM New York time.	45
Wolfe Wave FAX: 09/18/96 07:48 PM New York time.	46

### 3

My Wave methodology is the product of about thirty some odd years of studying technical analysis. Early on, I had the good fortune of having John Magee of Edward's and Magee fame, introduce me to some excellent books and reliable chart patterns.

One chart pattern that I found to be particularly reliable was rising wedge. I found that pattern so intriguing that I literally took it apart to see what made it tick. My conclusion was that everything you needed to know was in a trend line. Time and space.

After years of practice, I figured out how to balance time and space (price) so I could theoretically predict an Estimated Time of Arrival (ETA) and the Estimated Price at Arrival (EPA). As you will see, perfection is sometimes attained.

After demonstrating this to a good friend and rocket scientist, he nick named it the Wolfe Wave. The name stuck. In the book Street Smarts..., Market Wizard Linda Raschke refers to a group of us as "Wolfe Wave practitioners".

--Bill Wolfe Simply put, the Wolfe Wave is a natural rhythm that exists in all markets, or all motion for that matter. It is made up of waves of supply and demand that form their own equilibrium.

It was not "invented" by me but discovered. The key to its accuracy is in identifying the 1, 2, 3, 4 & 5 points. These are what give it its proper balance or equilibrium. Identifying the proper time frame is also important. As in the oceans of the world, little waves mix with larger waves and so on.

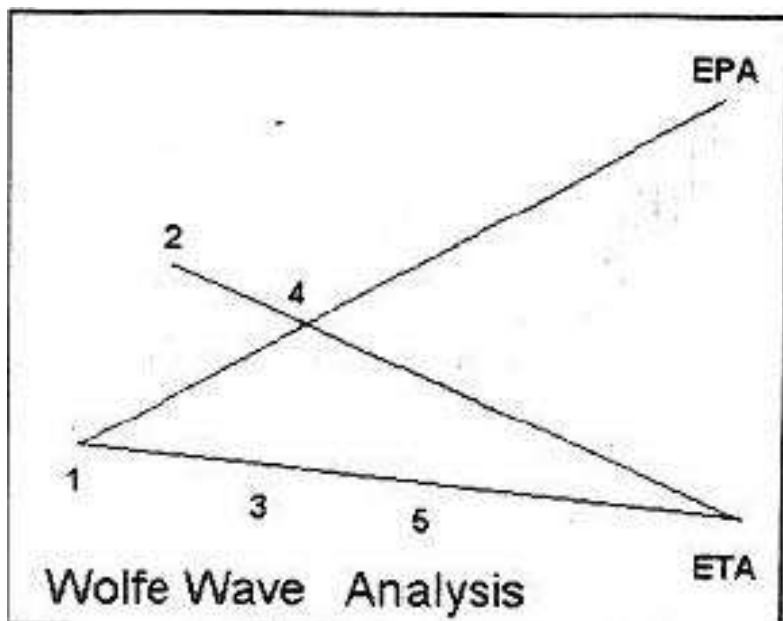
After a bit of practice, just like a surfer at the beach, you will get the hang (no pun intended) of it. It is very important to identify the dominant Wave and then to trade "what ifs" within the Wave. It is somewhat like recognizing those 3-D pictures. After a while a smile comes to your face and you say: "Wow, I see it."

# The Theory of the Wolfe Wave

The theory of my Wave structure is based on a law of physics that for every action there is an equal and opposite reaction.

This action/reaction often shows a definite rhythm with extremely valuable projecting capabilities to the trained eye. Many times however, little waves mix with larger waves and the waters become muddled. Sometimes everything is in synch and you will get a rogue wave effect similar to what occurs in the oceans of the world. These can be extremely profitable in the futures and stock market.

On the following two pages, you will find the rules and the theoretical, bullish and bearish Wolfe Wave structures.



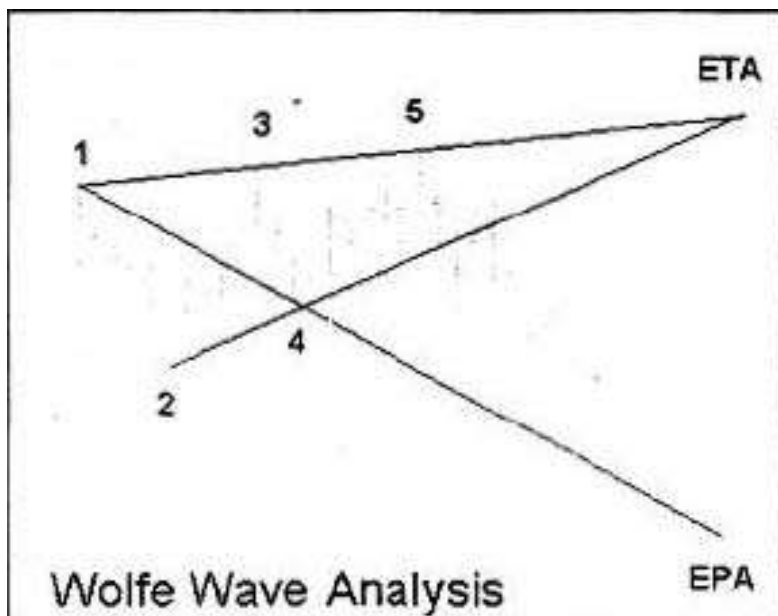
## Rules for Bullish Wolfe Wave Structure

Please note the odd sequence in counting, as you will see, it is necessary for the inductive analysis. By starting with a top we are assured of beginning our count on a new wave. The 2 point is a top. The 3 point is the bottom of the first decline. The 1 point is the bottom prior to point 2 (top), that 3 has surpassed.

The 4 point is the top of the rally after point 3. The 5 point is the bottom after point 4 and is likely to exceed the extended trend line of 1 to 3. ***This is the entry point for a ride to the EPA line (1 to 4).***

**Estimated Price at Arrival (EPA) is trend line of 1 to 4 at apex of extended trend line of 1 to 3 and extended trend line of 2 to 4.** Estimated Time of Arrival (ETA) is apex of extended trend line of 1 to 3 and 2 to 4.

4. Trend line of 1 to 3 and trend line of 2 to 4 must converge.



## Rules for Bearish Wolfe Wave Structure

Please note the odd sequence in counting, as you will see, it is necessary for the inductive analysis. By starting with a bottom we are assured of beginning our count on a new wave. The 2 point is a bottom. The 3 point is the top of the first rally. The 1 point is the top prior to point 2 (bottom), that 3 has surpassed.

The 4 point is the bottom of the decline after point 3. The 5 point is the top after the 4 point and is likely to exceed the extended trend line of 1 to 3. ***This is the entry point for a ride to the EPA line (1 to 4).***

**Estimated Price at Arrival (EPA)** is trend line of 1 to 4 at apex of extended trend line of 1 to 3 and extended trend line of 2 to 4. **Estimated Time of Arrival (ETA)** is apex of extended trend line of 1 to 3 and 2 to 4.

4.

The Wolfe Wave is perfection in technical analysis. My belief has always been to shoot for the Moon and then scale back when I have a working model. For me, the ETA and EPA's are like shooting for the Moon. I know that perfection is embedded in the design, but it is much more practical to nail down profits as they come.

I like to get in at the 5 point and plan for a move to the 1 to 4 line but will get out at the first sign of trouble. I also do not count on the ETA as this adds just too many variables to the equation.

In the chart examples we give several that are perfect and several that are not. The perfect examples are to demonstrate that the theory is valid. The examples that are not perfect are to demonstrate that you do not need perfection to make money.

## Tactical Notes (Mental)

**Understanding the goals of Wave trading.**



Wave trading tries to exploit the swings of the market with as little exposure as possible. I view exposure as risk and try to avoid it. The most important thing that you must understand is that you are not a trend follower. Wave trading looks for precise moments to jump in for a fast measured move and then exits to wait for the next Wave to develop. Often I will compare Wave trading to a surfer at the beach looking for a good ride. The two are remarkably similar and you should view charts the same as a surfer views waves. In the beginning only trade well defined Waves. After some experience you will find more and more Waves to ride. Do not bemoan the fact that you are not always in the market. Exposure is risk!

### **The tremendous rewards of patience.**

Many investors will tell you that courage and patience are two of the most important ingredients for successful long term investing. You need the courage to stand by your choices and the patience to ride out the dips in the market. It is very similar for successful trading except that while you still need the courage in your methodology you need the patience to WAIT out the market for the opportune time to strike. As you gain confidence in Wave trading you will see that regardless of market conditions, a tradable Wave soon appears. This patience will be tremendously rewarded, over and over again. Be patient.

### **Why the Wolfe Wave is a must for super trader.**

To be a super trader you must be able to do what others cannot. My Wave methodology has you buying and selling at such opportune areas that it is impossible to duplicate with indicators. Test it for yourself. You will soon see why some win and some lose. They cannot do what you can.

### **Try to Fade at least half of your trade.**

By fading I mean buying into a declining market or selling into an advancing market. This usually produces positive slippage which is very rewarding monetarily and mentally.

### **Doing your homework at night.**

Just like most things, charts look different at night. After the market closes you don't have the distraction of blinking prices and adrenaline rushes. You are able to see the ebb and flow of the Waves just like you would at the beach, and just as enjoyably. Have separate pages setup for the different vehicles that you trade. Get into the habit of anticipating where the next Wave is likely to form. In this way you will be ready when the markets open in the morning. Spontaneous trading is for amateurs and amateurs loose.

### **Plan the trade, trade the plan.**

Many books and particularly the media romanticize trading. They portray successful traders as "gunslingers" with nerves of steel. Men and women that can bet on the toss of a coin and *always* be right. Nothing can be further from the truth. Successful trading requires that you *plan the trade* in advance. When you are in the trade you will act naturally because you have already run the trade through, many times in your head. You will have *traded the plan*. Try to recognize the dominant Wave and then try to anticipate the five turning points.

### **Dealing with pressure.**

Pressure is created by anxiety. The anxiety of not knowing what will be asked of you. The uncertainty that comes with spontaneous trading. This should not be you. Once you have the confidence, through testing, that a methodology has good logical design, then and only then, will you begin to trade with a calmness that is associated with professionals.

### **Prepare yourself mentally to enter the “sweet zone.”**

As many of you may already know, paper trading is not at all like real trading. When you look at chart and think that a top or bottom would have been a good place to buy or sell, you are in effect paper trading. To pick up the phone and say NOW is another story. Wolfe Wave analysis mentally prepares you for this opportune spot that I call the “Sweet Zone.” You will know in advance where it will take place. While others are panicking, you, after you have confidence in this method, will calmly pick up the phone and fade the market. It may look scary, but it only lasts for a short period of time before you have a profit. You will quickly learn why some people win and some people loose. They cannot do what you can.

### **Stops.**

The subject of stops requires that you Know Thyself. I am not firmly for or against the use of stops. My argument against the use of stops is that they are often used as a crutch and that traders wait until a top or bottom is made before entering a position just so they have an idea where to place a stop. Still, there’s no guarantee that the top or bottom will hold. In doing this I feel you are giving away your edge. Wave analysis provides very clear points where a reversal should take place and it’s greatly to your advantage to fade when in the appropriate area. My argument for the use of stops is to protect yourself against a blowout. This is very serious stuff when trading commodities. Ideally, I think that you should fade an entry and then place a stop at a dollar value away, to protect yourself. This will give you the benefit of entering when others are panicking while protecting yourself against a big loss. If you Know Thyself and feel, that you may someday freeze, never trade without a stop.

### **Turning your record keeping into a happy job.**

Successful trading brings with it more than just monetary rewards. When you are loosing, the brain does not want to open mail and enter the trades. You start procrastinating. I think psychiatrists call it avoidance behavior. It is an overall bad place. When you start winning, you can’t wait for the mailman to come. It’s an overall good feeling. Enter your trades immediately and enjoy the high that comes with doing things the right way.

### **How to avoid scaring yourself out of a trade.**

Trading is a mental challenge just as much as it is a skill. It is very important that you keep things in perspective when you are in, or about to enter a trade. A sure fire way to frighten yourself, possibly to death, is to change time frames from the one that you are trading. For example. You are watching a 15 minute chart and calmly decide that NOW is the correct time to enter. You pick up the phone, ... but first want to take one more look at it on a ONE minute chart. It’s like petting a kitten that turns into a Bengal tiger. You are not keeping things in perspective and probably, monetarily frightened yourself from taking the trade. Five minutes later you switch back to the 15 minute chart and see that things are progressing as anticipated, except that you missed the trade. Recognize the tricks that the mind plays and soon will be able to use them as an ally.

## **Identifying Risk.**

Wave trading excels in fast choppy markets. (See Exhibit 8c.) Being able to identify risk should play an important roll in selecting which Waves to trade. When the market is trending, the Sweet Zone is rapidly expanding with time. This is not to your advantage when trading Waves that are against the main trend. Until you gain experience, carefully select the Waves that you trade. Try to avoid Waves with a rapidly expanding Sweet Zone.

## **About the Tactical Notes.**

Being that Waves are made up of a natural rhythm, two Waves will often look similar. It doesn't matter that one might be a 1 minute chart and the other may be a monthly. This is very helpful to the student of Waves. As you gain experience, you will begin to anticipate how the new Wave might develop from the experience you have gained in Wave reading. Often, throughout this book I will use the same text from these Tactical Notes to explain what I see in a particular Wave. Monotony is good! What we should strive for is seeing the same old pattern repeat itself.

## **Watch for heavy tic volume.**

Important turning points are often accompanied by stopping volume. (See Exhibits 3 and 4.) As the reversal gets going, volume has a tendency to lessen and then increase again at the next stopping point. On a chart, it will have a saucer like appearance.

## **Look for broken trend lines.**

Waves develop after a trend line is broken. (See Exhibits 5 and 6.) It is a natural reaction for price to try to get back onto a broken trend line. The right shoulder of a head and shoulders pattern is often a potentially explosive Wolfe Wave.

## **Waves develop in all time frames.**

A good way to deal with this is to treat each time frame as a separate commodity. Try to trade the dominant Wave or within it.

## **Always watch the 4 point.**

Ideally you would like to get a ride to the 1 to 4 line. However, resistance often occurs in this area. Get out at the first sign of trouble such as: a contrary Wave, unusually heavy volume or just a very nice fast profit.

# **Tactical Notes (Chart Reading)**

## **Setting up your charts.**

The neater your chart the easier it will be to identify the Waves. For best results I would suggest that you use a price and tic volume chart only. Please, do yourself a favor and eliminate all "jewelry". By jewelry I mean indicators, oscillators, moving averages etc. They do nothing but clutter up the chart and add to analysis paralysis. I would suggest that you save a 5 minute and 15 minute chart for intraday trading. In fast markets you could also save a 2 minute chart. Get into the habit of drawing potential Waves as they develop so that you will see them coming. I

save 3 up charts and 3 down charts and keep drawing potential bullish (up) and bearish (down) Waves as the day progresses.

### **The Perfect Wave.**

There was a movie several years ago about a group of surf bums that traveled the globe looking for the perfect surfing wave. I sort of do that with my computer. Not as exciting I'm sure. In the realm of their experience, they had their criteria for what made up the perfect wave as do I. Anyway, the point here is that even on a perfect Wave, you must exit at the 1 to 4 line. You will have a euphoric feeling at this point and think that the trade will continue forever. Train yourself. *Shoreline* and *1 to 4 line* rhyme and both mean the end to a perfect Wave. (See Exhibits 1 and 2.)

### **Waves are canceled by contrary Waves.**

Example: If I were long on a 15 min. chart and the price had not yet reached the 1 to 4 line but a contrary bearish Wave developed on a 5 min. chart, I would get out. If the Bearish Wave were to develop on a 1 min. chart, I would be less concerned. Judge the consequences of ignoring the contrary Wave. Is the 1 to 4 line very steep? Do I want to give back any of my profit?

### **How to anticipate contrary Waves.**

Ideally speaking, you would like to see the move from point 4, to point 5, as clean (uninterrupted) as possible. In some cases it may even have a parabolic curve to it. The reason for wanting to see this is that every "bump" along the way creates another "bump" for the next move, which would be the move to the 1 to 4 line. These "bumps" create support/resistance or potential contrary Waves. For example. If you had a completed Wave with a 1 to 4 target line indicating a big move, and the previous move from 4 to 5 was "clean", it would have a better chance of success than if the move from 4 to 5 had a lot of "bumps".

### **How to approximate Wave 4.**

It is very important that you train yourself to see from one Wave to the next. Sometimes it is difficult because news events cause many ripples on the chart. However, with practice you will begin to see likely areas for waves to end. Once we know points 1, 2 and 3, of a new Wave, point 4 should not be too difficult to find. First we draw a line from point 1 to 3. Then we parallel it to point 2. We now know that Wave 4 must terminate within that space or else it would be impossible for it to be a Wave as the lines 1 to 3 and 2 to 4 could not converge. Next we look at the move from point 2 to 3 and look for a "hole" (gap) or the fewest amount of vertical lines that we can find. We then draw a line from point 1 through the gap or the fewest lines that we can find. This is the approximate balance line of supply/demand. When the price hits this line, it will likely stop and form a smaller contrary Wave and then move to point 5. (See Exhibits 3 and 4.) With experience, you will be able to eyeball this without drawing lines. It is a very satisfying feeling.

### **How to approximate Wave 5, the "Sweet Zone."**

Finding what I call the "sweet spot" is probably the most rewarding part of Wave analysis. The sweet spot, or zone, is the area of entry on Wave 5. It is safe to say that once you pass (or equal) point 3 you have a completed Wave and you can expect a move to the target line of 1 to 4.

However, the throw over can be quite substantial on some Waves and quite expensive, particularly if you are trading longer period charts. What I do is parallel points 2 and 4 to point 3 or in some cases point 1. Often you will notice that the parallel line coincides with other support/resistance areas on the chart. The area from the price of point 3, to the parallel of points 2 and 4, to point 3, is the sweet zone. Heavy volume is another sign that price is stopping. Be very careful not to wait too long. Price can reverse as soon as it touches the price of point 3. Generally speaking, if you enter at any price in the “sweet zone” you will have a very good position. (See Exhibit 8.)

### **Signs that a Wave *will* make it to the 1 to 4 target line.**

The most important thing is the structure of the Wave itself. A well formed Wave with few “bumps” that will eventually cause interruptions in the next Wave has the best chance of success. Next, you want to pay very close attention to the tic volume. Ideally, you would like to see very heavy stopping volume at the 5 point. Then, as the price reverses it should do so on declining volume. As the price approaches the 1 to 4 line, the volume should increase again and finally stop the price. It should have a saucer like pattern on the chart.

### **Signs that a Wave *will not* make it to the 1 to 4 target line.**

A poorly formed Wave has less of a chance than a well formed Wave. If volume is not relatively heavy at the 5 point, you should be suspicious. As the price reverses, the volume should decrease. If it does not, move to a shorter time frame and be on the look out for a contrary Wave forming. Get out at the first sign of trouble and wait for the next Wave to form. If you entered in the “sweet zone” you probably have a profit anyway. (See Exhibit 7.)

### **Identifying Spikes and tips for trading them.**

Spikes are isolated vertical bars that stick out of Waves 1 and 3. When drawing your trend line from 1 to 3 they will sometimes cause it to be too high or low as the case may be and consequently Wave 5 will not get to the price of Wave 3 before reversing. A way to deal with this would be to enter prematurely at Wave 5. I do not recommend jumping the gun for beginners and most definitely do not do it if the trend line is at a steep angle. Spikes are usually associated with openings or round numbers or other areas where stops may have been triggered. When the stops are satisfied, the price quickly returns to the norm for that area. (See Exhibit 9.)

### **Profiting from gaps.**

When the market gaps open, (see Exhibit 10) and appears to be forming a Wave but a suitable 1 point can't be found, use an imaginary 1 point just below 2 and level with 3. I do not recommend this for beginners. Trading somewhat ambiguous Waves should be practiced by advanced students only.

### **The Dominant Wave.**

Often I will refer to the dominant wave and I am quickly asked how I determine which Wave is dominant. The dominant Wave is relative. If I were trading off a daily chart, I would look to a weekly chart to see if there were any Waves that might influence the daily. If I were trading a 5 min. chart I would look to a 15 min. chart. Generally speaking, if the Waves that you are trading are not making it to the 1 to 4 line, you are not in the correct time frame.

## Tactical Notes (Miscellaneous)

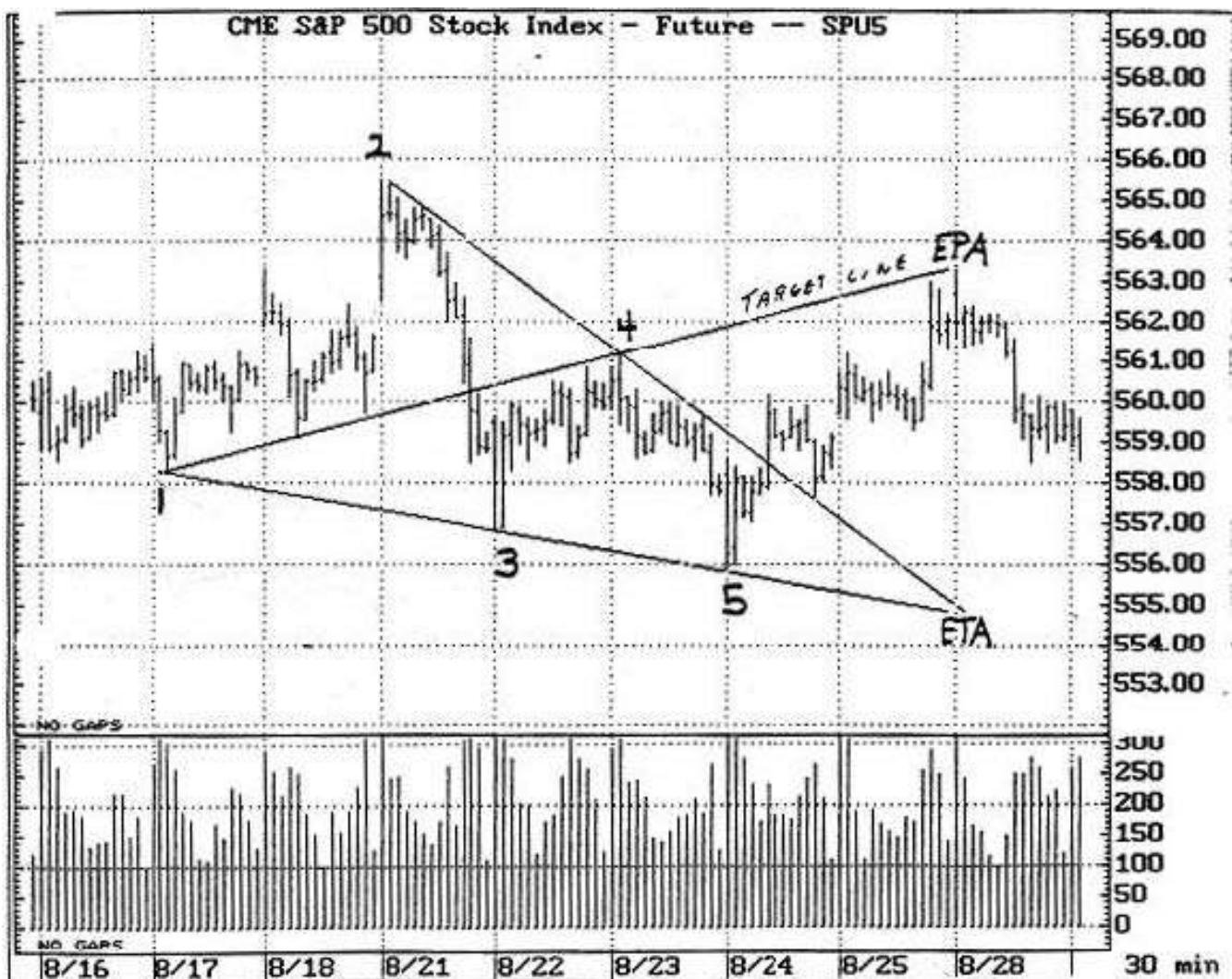
### Equal Tic Charts.

Some software packages allow you to construct vertical bars that are made up of a number of tics rather than an amount of time. When matching indicators such as stochastic to Waves, equal tic charts are superior. The reason for that is that when volume varies in time bars, they are not as statistically significant as equal tic bars.

### Program Execution alarm.

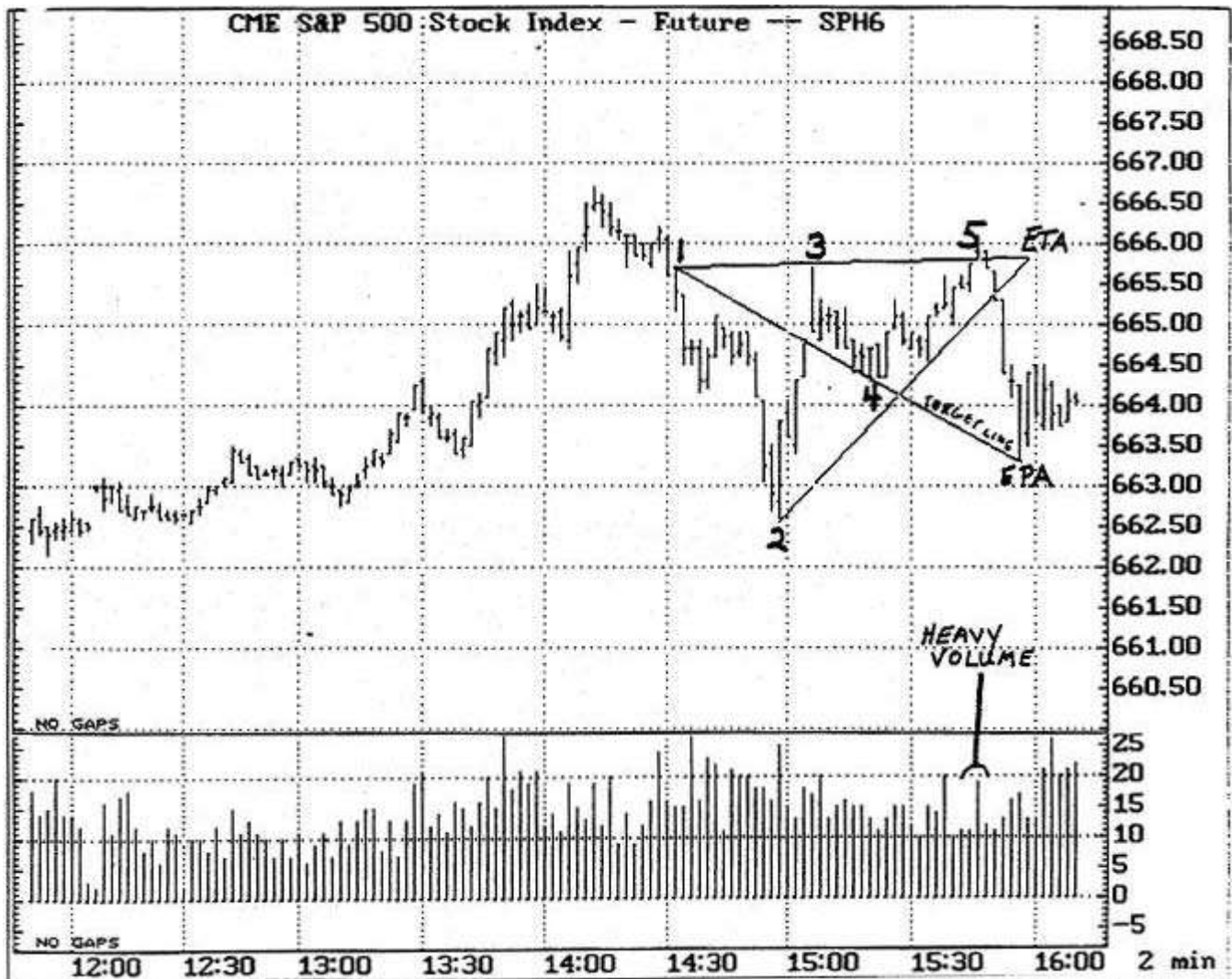
The TICKI is the last TICK on the DJIA. An alarm that will alert when it is  $>20$  for overbought and  $<-20$  for oversold sometimes coincides with the 5 point on short term Wolfe Waves. The reason for this is that plus or minus 21 or more usually indicates that a buy or sell program is being executed and that a short term imbalance of supply/demand is created. The 5 point on a Wave also indicates an extreme Zone. I generally don't like to use indicators as I feel they retard execution, this one however, being a leading indicator is superb and often adds confidence to the trade. Please remember that it is the Wave that you should trade and not the indicator.

**The better you execute, the better your position!**

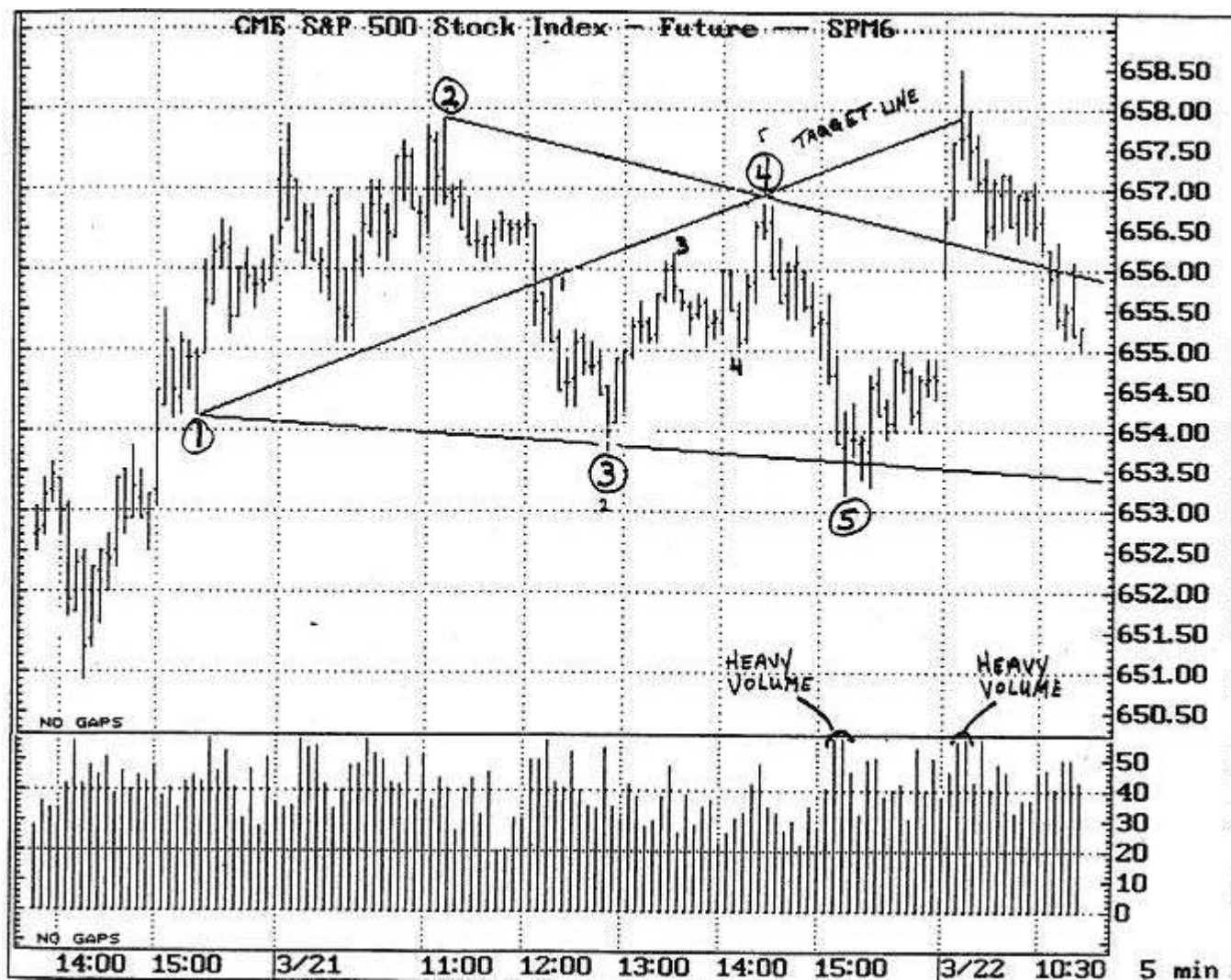


If you will compare this 30 min. S&P char to the Rules for a Bullish Wolfe Wave Structure, you will see that it is perfect. The ETA and EPA are right on target. Follow the rules point by point

so that you will become familiar with the count. At point 5 you want to be ready to go long for a move to the 1 to 4 line. Do not expect perfection all the time. It is not necessary!

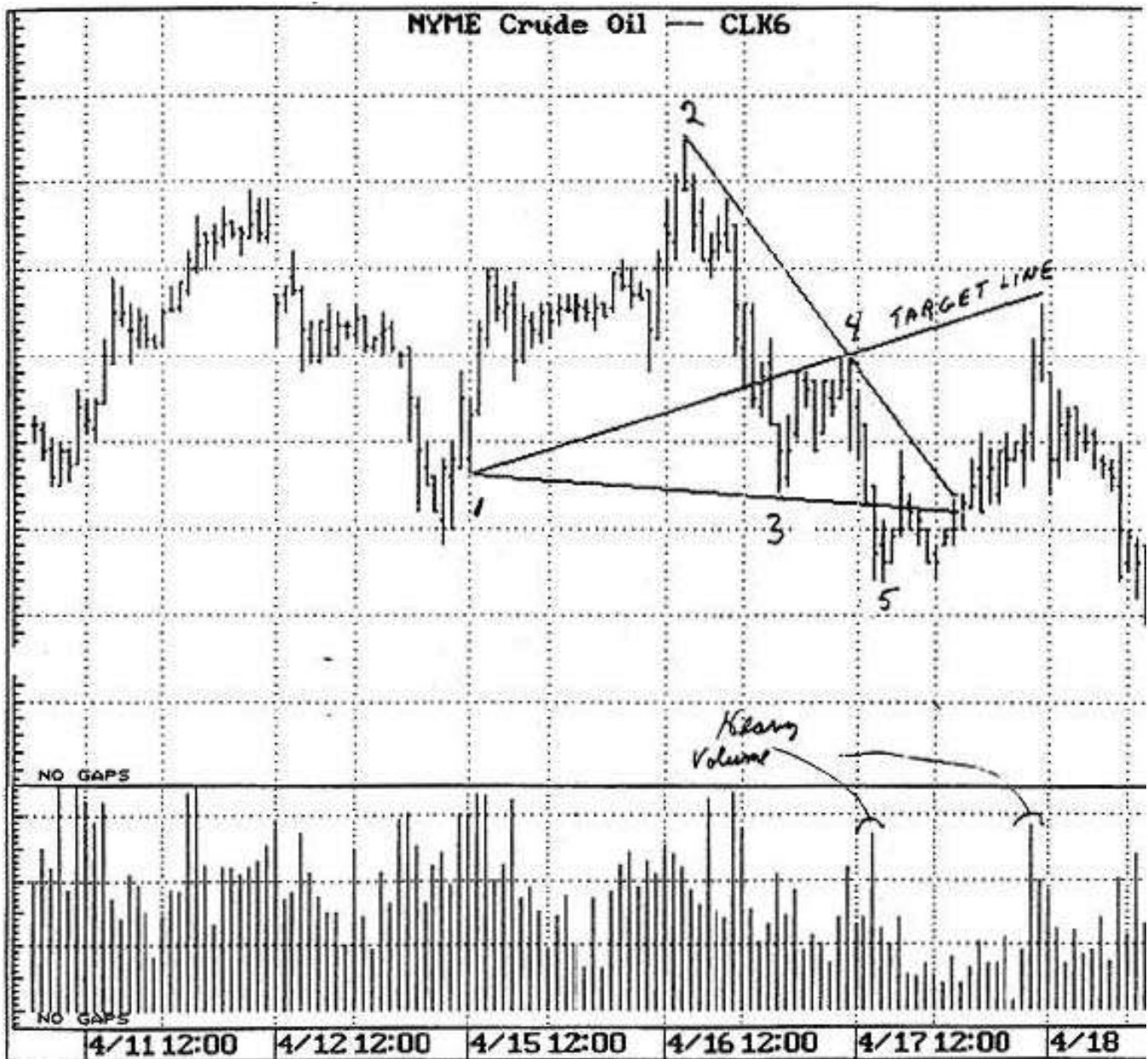


If you will compare this 2 min. S&P char to the Rules for a Bearish Wolfe Wave Structure, you will see that it is perfect. The ETA and EPA are right on target. At point 5 you want to be ready to go on short for a move to the 1 to 4 line. Again, do not expect perfection all the time. You will see that it is not necessary.

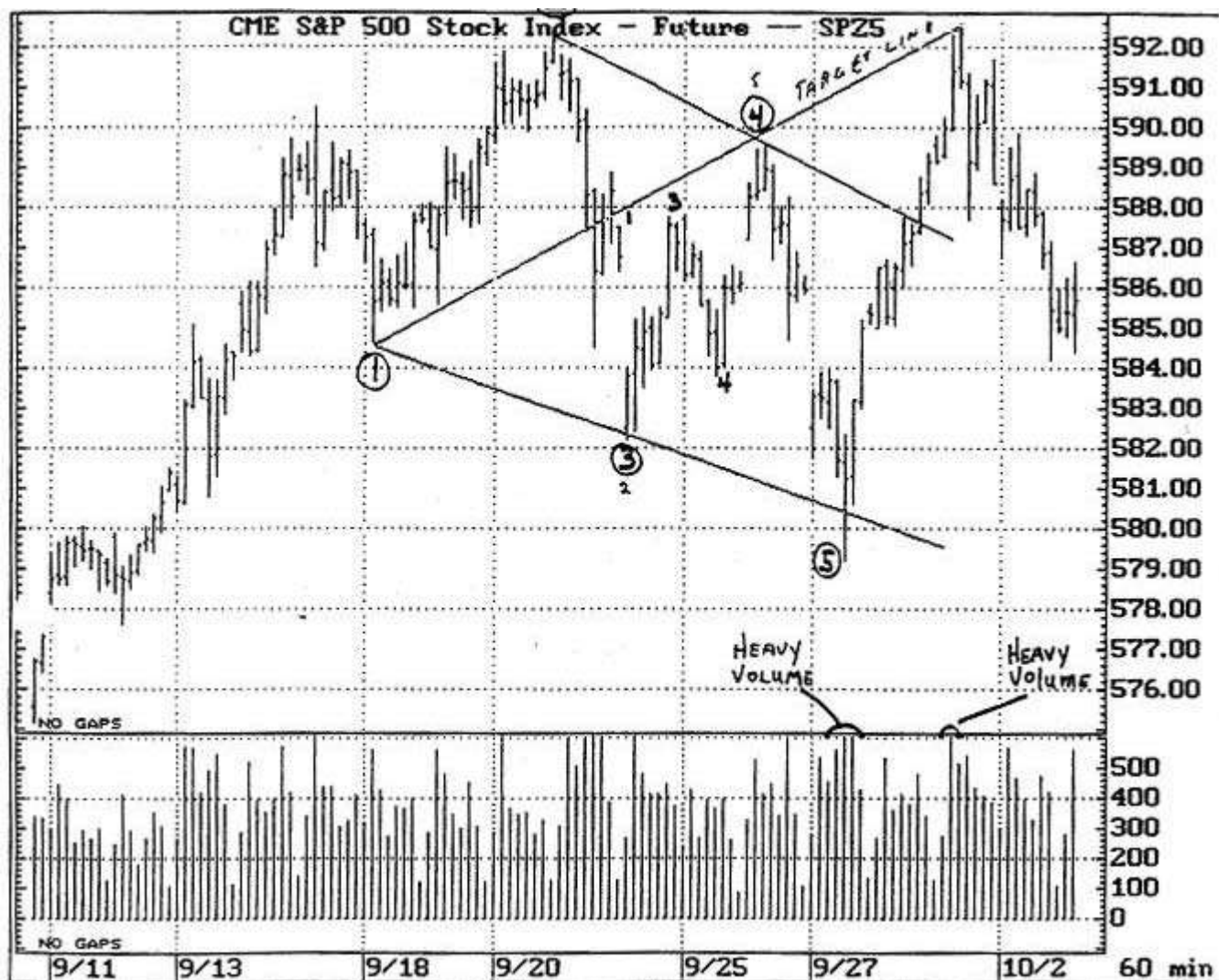


In commodities, actual volume is not reported until the following day. Fortunately, tic volume has a very strong correlation and can be used instead. Important turning points are often accompanied by heavy stopping volume. Note the heavy volume at 5 and then again at the target line. Can you see the smaller Wave that made up points 3 and 4? Let the heavy volume on the smaller Wave guide you to its' 2 and 5 point.

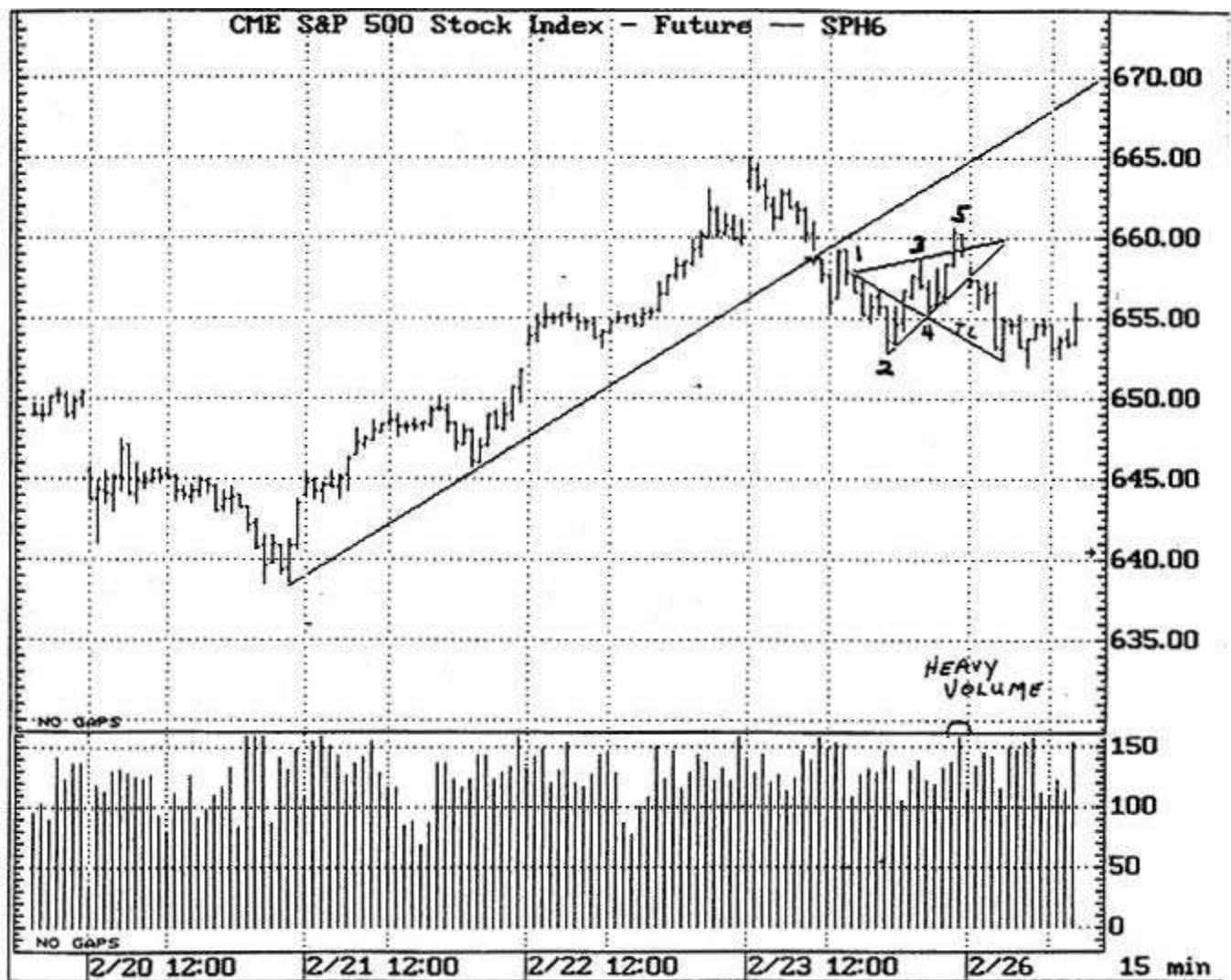




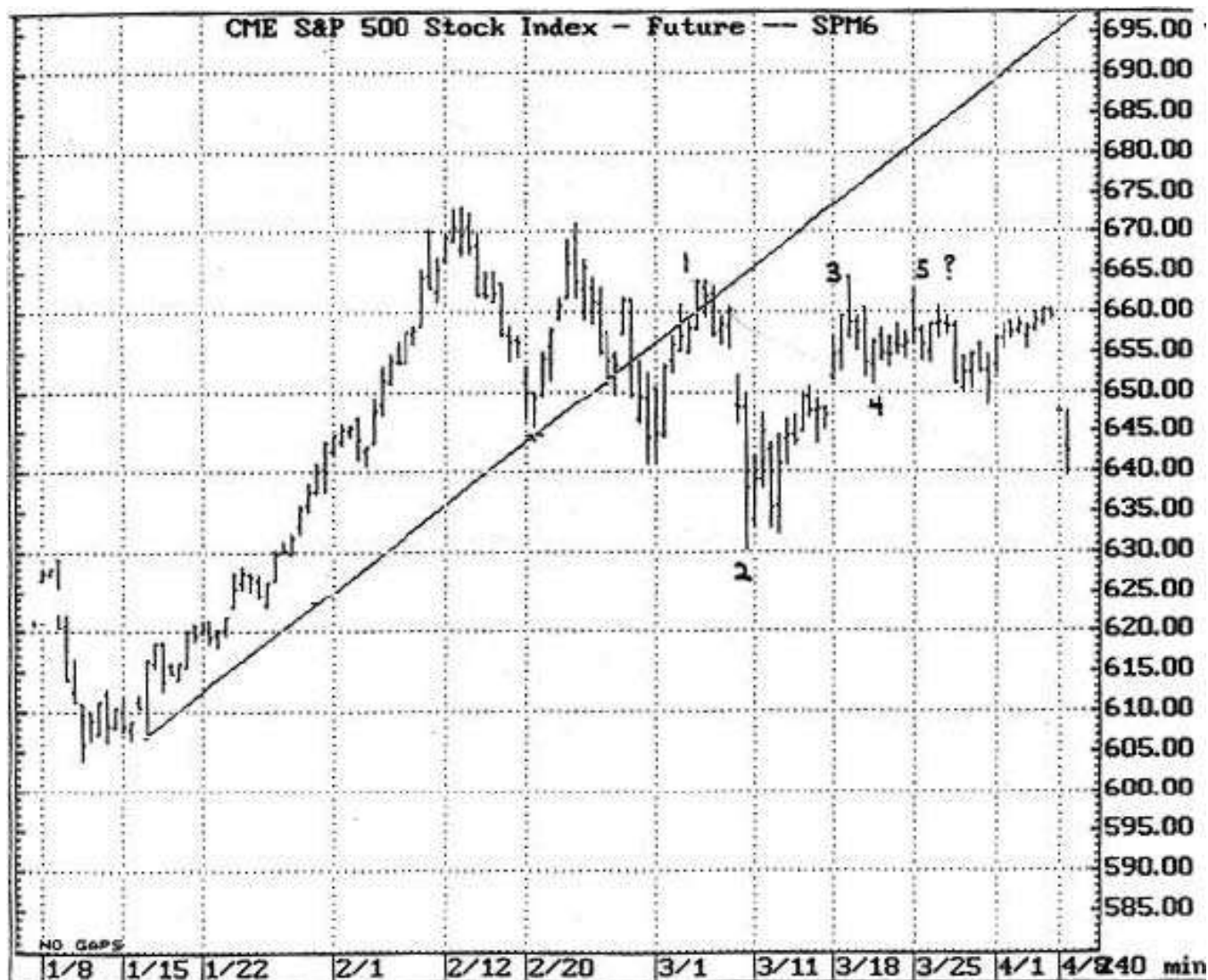
As the price gets to the 5 point, expect to see heavy tic volume. After all, this is an auction and there must be a difference of opinion if we expect to see a change in direction. A good sign that the price has reversed is to see the volume start to decline as the price moves along freely. As it approaches the 1 to 4 target line, volume will start to increase as another difference of opinion is expressed. Eventually it will stop the price. On the chart it will often have a saucer like shape.



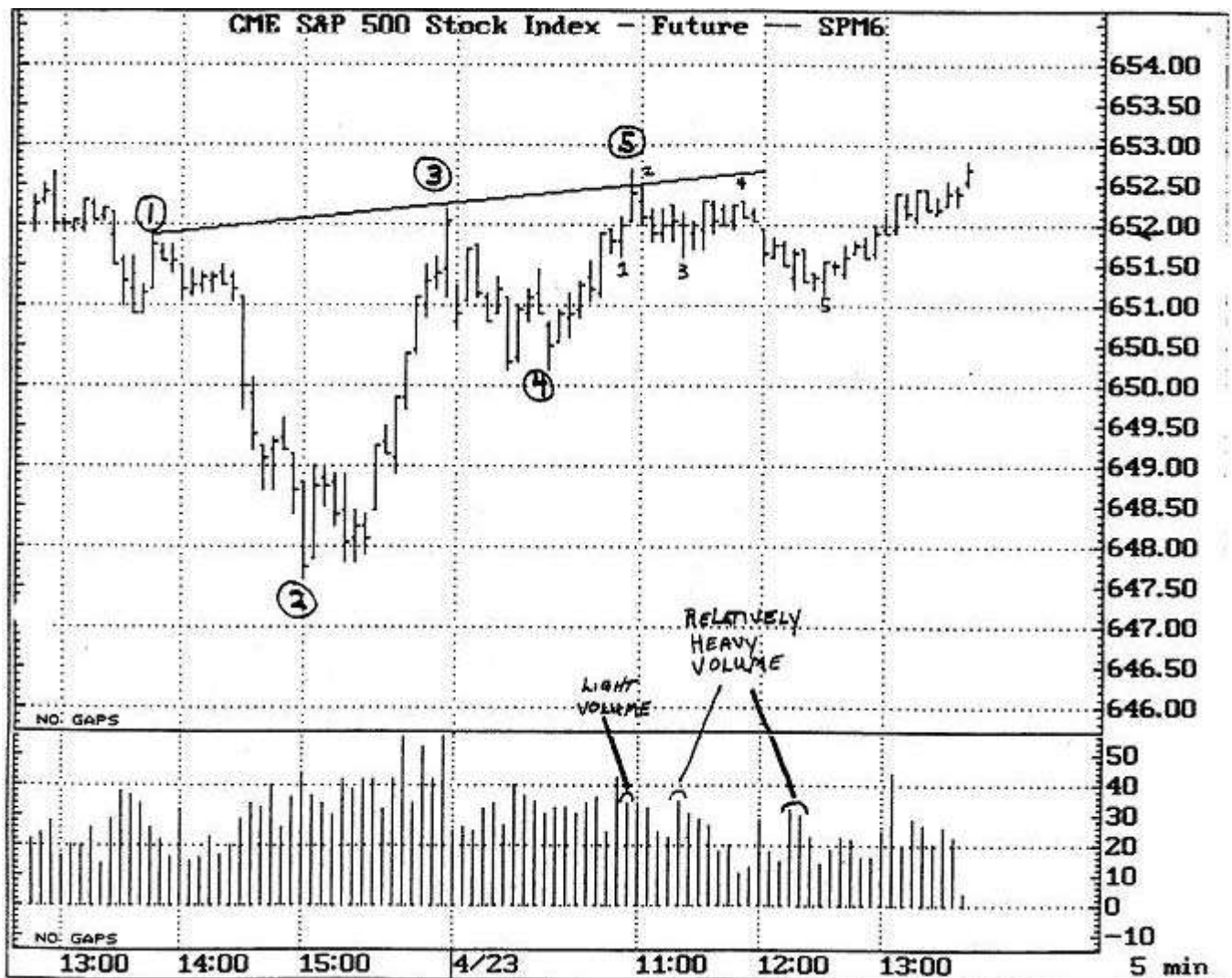
Notice how similar this 60 min. chart is to the 5 min. chart on the previous page. The volume patterns are the same and even points 3 and 4 are made up of a smaller Wave. This is not a coincidence. Waves are a natural rhythm and continuously repeat themselves. Get into habit of watching how one Wave influences the next.



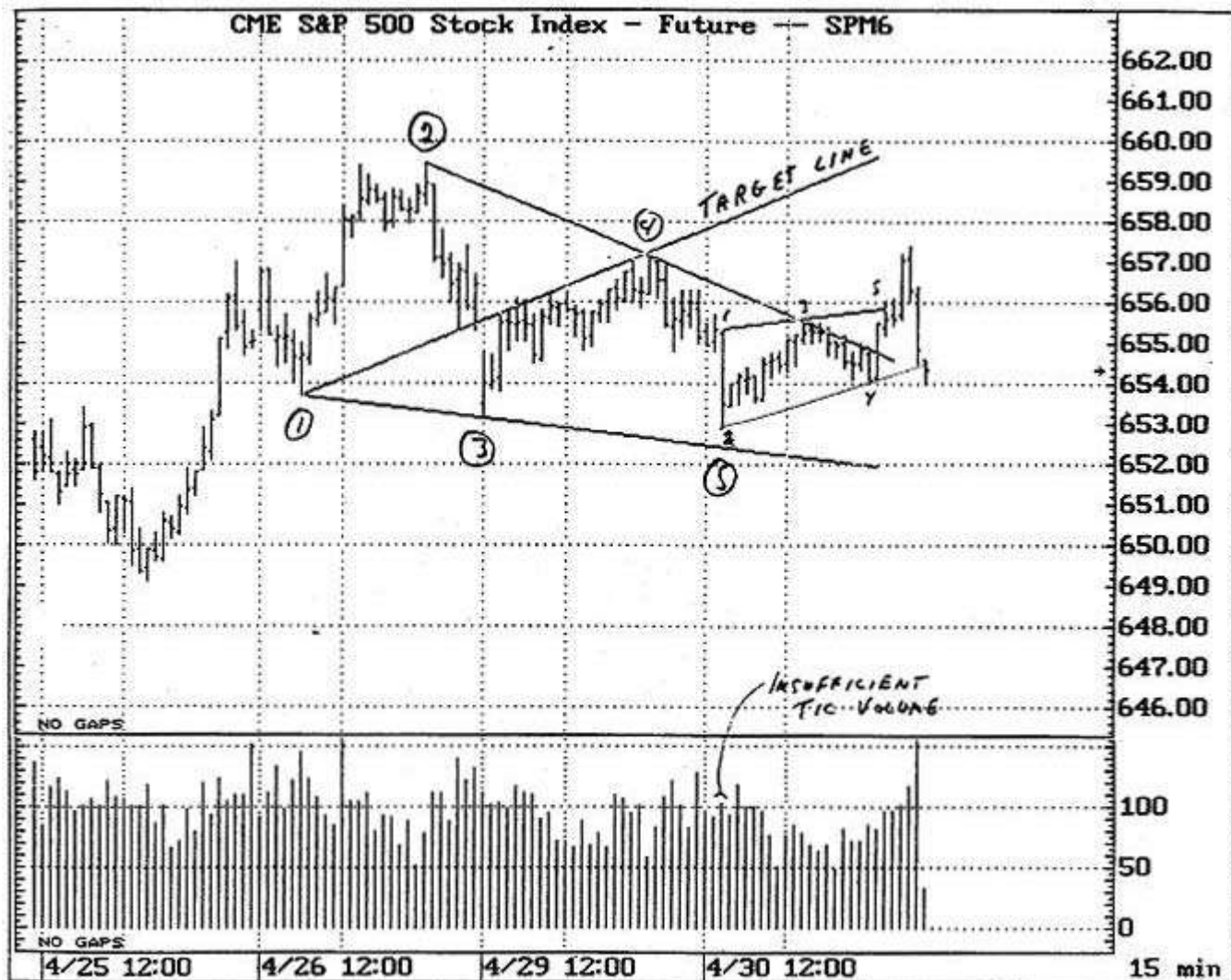
Whenever a trend line is broken, it is almost a guarantee that you will find a Wave. Initially, heavy selling drops the price below support of the trend line. As the price struggles to get back, it meets resistance. The ingredients are in place and the motion acts naturally and forms a Wave. It is very important that you believe through understanding, the physics of Wave trading. In this way you will gain the confidence that is necessary to be a super trader.



What happens big, happens small. In this 240 min. chart a loosely formed Wave developed after a break in the trend line. The price has difficulty rallying and fails in two attempts to reach the 5 point. The next day the market falls 20 S&P points and nails the 1 to 4 line!

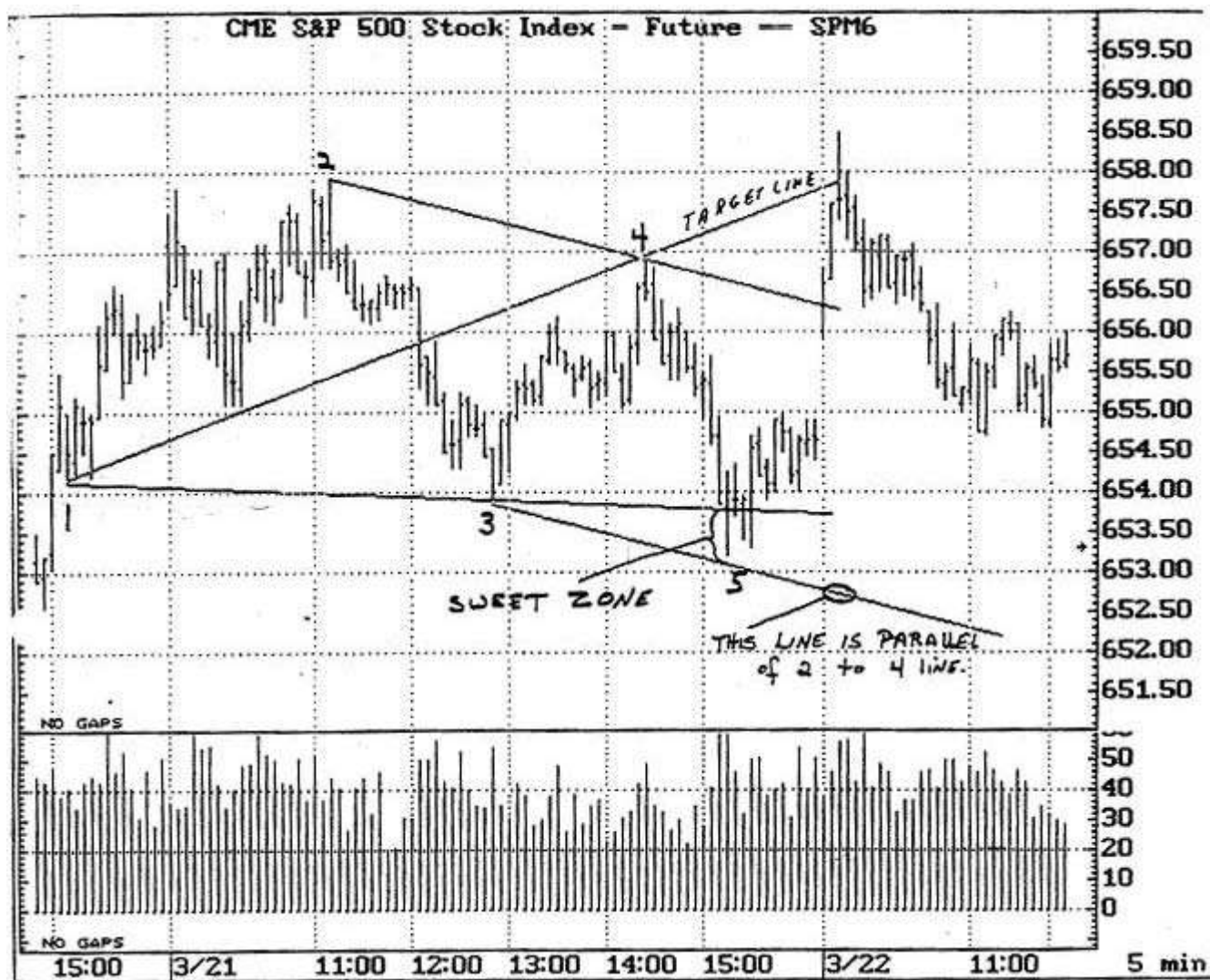


When the 5 point does not have heavy stopping volume, immediately look to a shorter time frame for a contrary Wave. In this case the volume was not heavy at 5 and it encountered heavy resistance to the decline just six bars latter. This indicated that it could be a 3 of smaller contrary Wave. It then put in a small rally for a 4 point and then turned down and made a 5 on heavy stopping volume. At this point you would have exited your short position with a small profit.

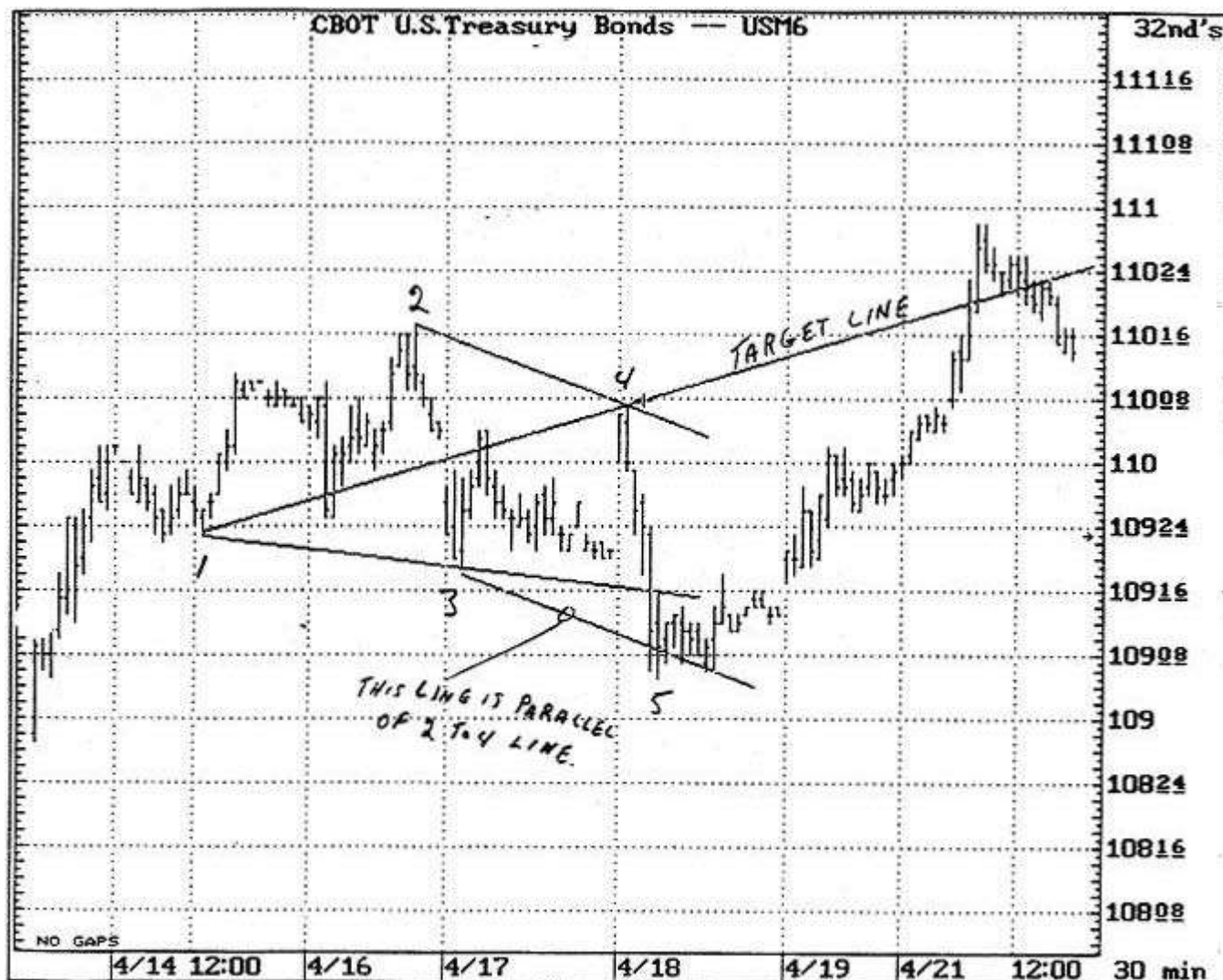


I was anxiously awaiting this trade as the Wave form telegraphed its arrival a day in advance. I went long as soon as it made a low below the price of point 3 as I felt the spike of 3 would mean that a probe down would be short lived. Immediately I was disappointed by the lack of heavy volume. While the price rallied nicely on declining volume, I was forewarned to be on the lookout for a contrary Wave. When the contrary Wave appeared, I was prepared and exited the trade at the 5 point. Was I disappointed that it didn't make it to the target line? Yes, but the satisfaction of *trading the plan* more than made up for it.





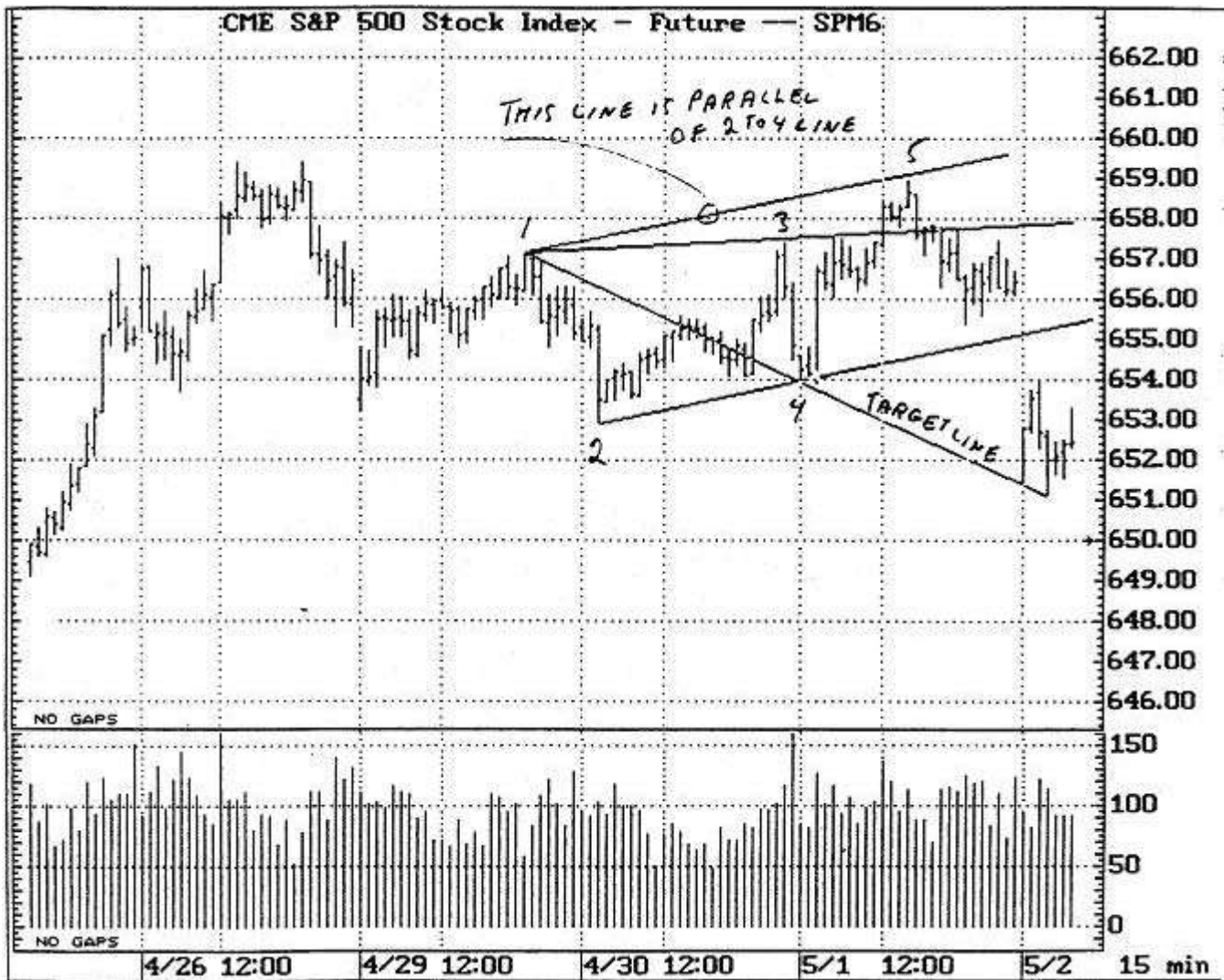
The sweet zone is the area of entry on Wave 5. Once you pass or equal point 3, the Wave is complete and you can expect a move to the 1 to 4 line. However, the throw over can be substantial in some cases and expensive if you are trading a longer period chart. What I do is parallel points 2 and 4 to point 3 and in some cases point 1. The area from the price of point 3, to the parallel of points 2 and 4 to point 3 is the sweet zone. This can be extremely valuable as it alerts you to potential risk. In this case the risk was minimal and you had a strong confirmation with volume.



As you gain experience, it is very important that you concentrate as much as possible on your entry. This is the starting gate. The price that you pay is going to color your thinking throughout the trade. Note how the parallel of the 2 to 4 line to the 3 point pretty much contained the price. Knowing this in advance will allow you to act with confidence. When you have a good position, you are much more likely to *trade the plan* and in this case for a very nice ride to the 1 to 4 target line.







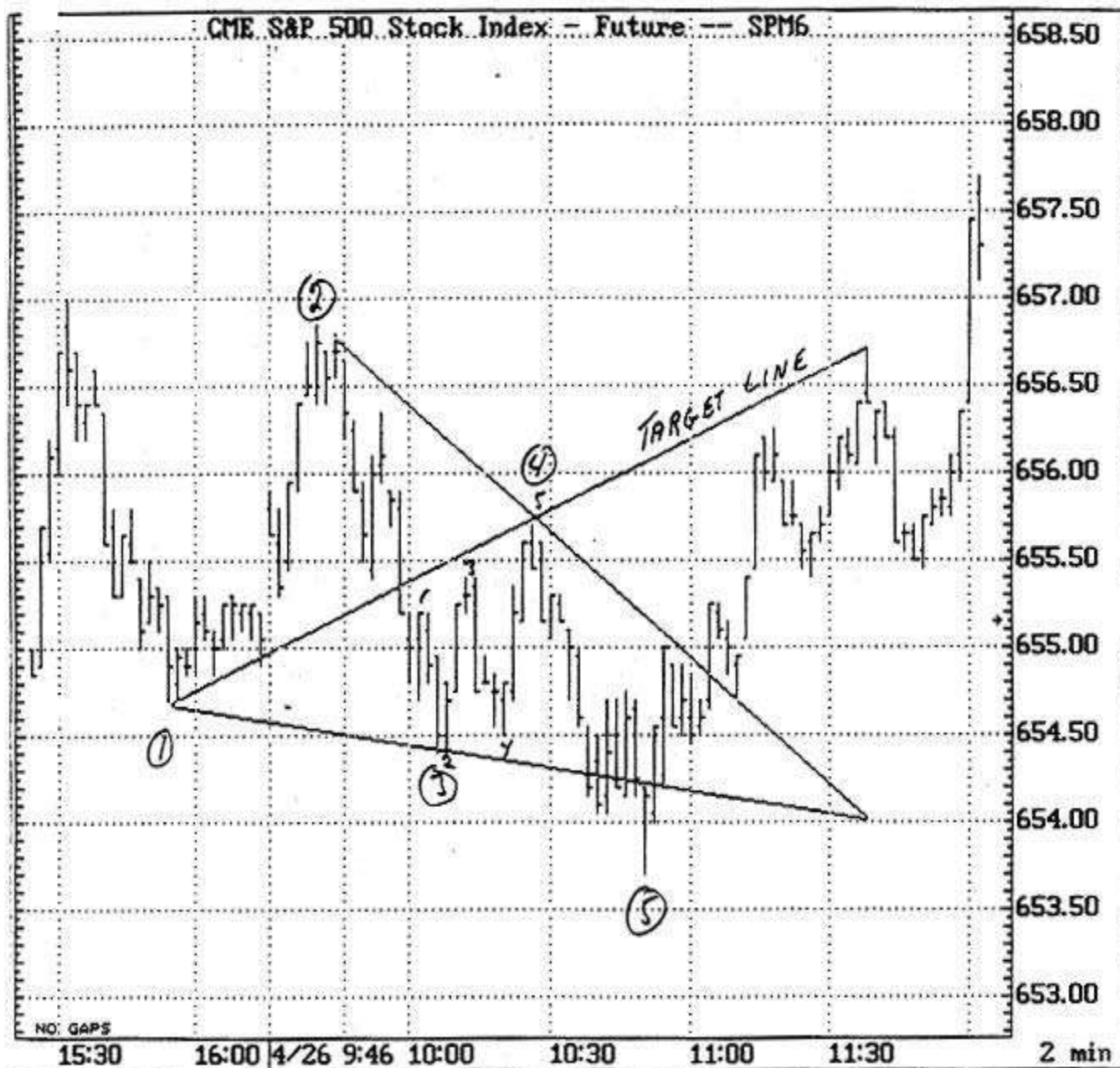
Wave trading excels in fast choppy markets. The reason for this is that when the market is moving sideways, neither side has the upper hand and when the music stops, as in musical chairs, there is a mad dash, in this case for the 1 to 4 target line. When paralleling for the sweet zone, it is a good idea to also parallel to the 1 point as there is usually not much difference from using the 3 point as the wave is almost rectangle in shape. Note that the market *opened* at the 1 to 4 target line. A nice way to start the day.



Spikes are isolated vertical bars that stick out of Waves 1 or 3 or both. When drawing the trend line from 1 to 3 they will sometimes cause it to be too high or too low as the case may be and consequently Wave 5 will not get to the price of Wave 3 before reversing. Spikes are usually associated with openings or round numbers or other areas where stops may have been triggered. When the stops are satisfied, the price quickly returns to the norm for that area.



When the market gaps open and appears to be forming a Wave but a suitable 1 point can't be found, use an imaginary 1 point just below 2 and level with 3. I do not recommend this for beginners. Trading somewhat ambiguous Waves should be attempted by advanced students only.



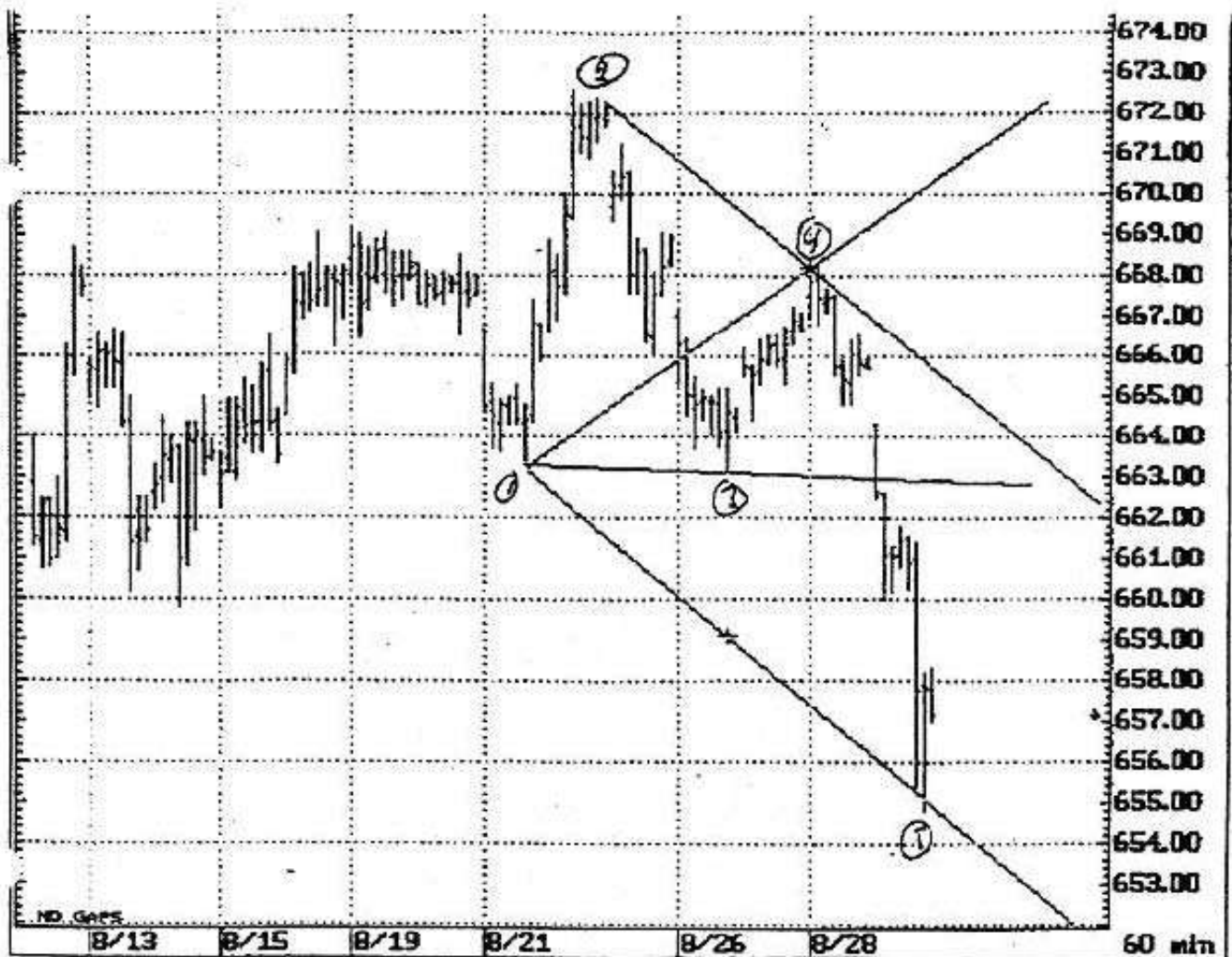
Hey! I recognize that pattern. Of course you do. You have seen it enough. Look at the points. 1 2 3 4 5. Look at the smaller Wave. 1 2 3 4 5. The Wolfe Wave is a *natural* rhythm that constantly repeats itself. You have to believe in a methodology before you can trade it. You will soon get so accustomed to seeing the Wave work, that you will be pulling the trigger with confidence. Others fail because, they cannot do what you can.



The two questions that I am most frequently asked are: Is there an easy way to find the 1 point and; what makes for a high probability Wave. The easiest way to find the 1 point is to draw a horizontal line to the left of the 3 point and to use the first price bar that it hits for the 1 point. To identify Waves that have a high probability of hitting the 1 to 4 target line, you should look for well structured Waves. A well structured Wave has a contrary Wave between points 3 and 4. (See Exhibits 3, 4, 8b and 11.) Today we had two Wave possibilities and neither had a well structured 4 point. The top chart could have produced a profit for a nimble trader, but neither chart hit the 1 to 4 target line.

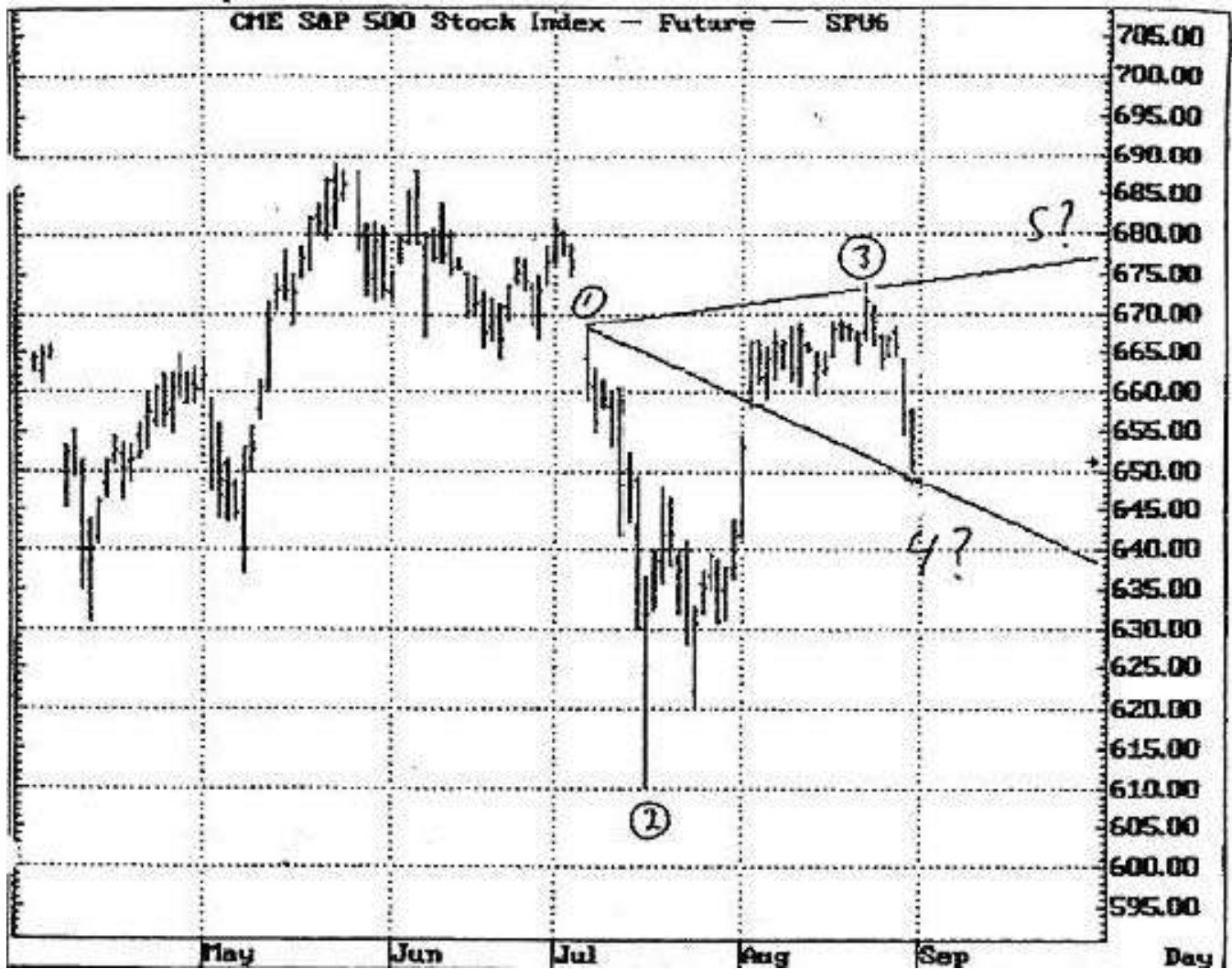




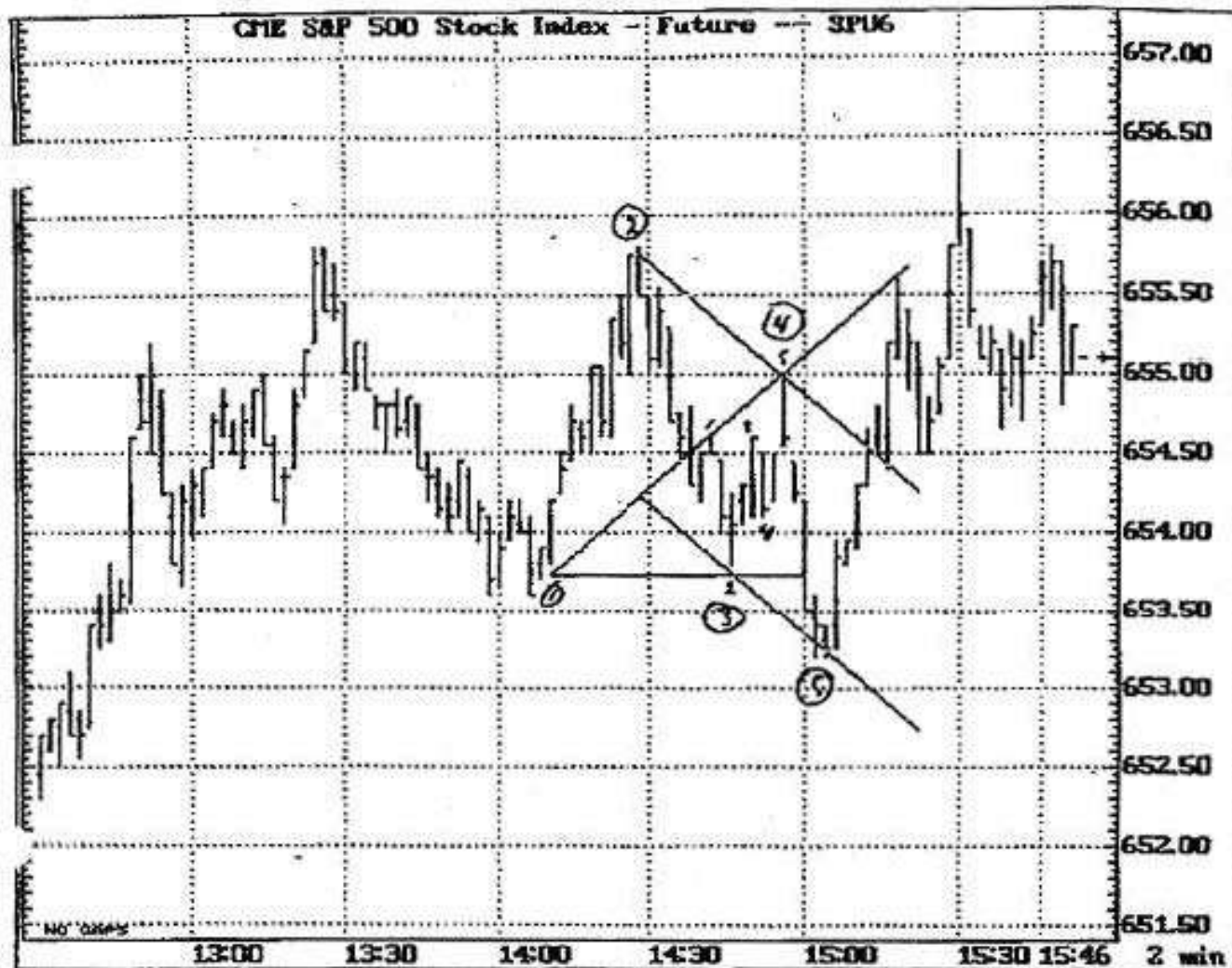


-Bill Wolfe For long term position traders, there is the possibility of a very bearish Wave forming on a daily chart. It looks like we have a well formed 1, 2 and 3. If we can get Wave 4 to be made up of a contrary Wave, that will take us above the high of 672.55, the stage would be set for a sharp decline. This is very speculative at this point, but nevertheless it should prove a good example as to how Waves form.





-Bill Wolfe In trending markets it is often necessary to go down to 2 minute charts to find a well structured Wave to trade. I keep stressing “well structured,” because it is common for beginners to find Waves all over the place. By forcing yourself to wait for only high probability trades, you are not only building trading habits, you are also studying and learning from the Waves as they develop. The above chart has a very clear example that has a small contrary Wave between points 3 and 4 and then exhibits support on the parallel of the 3 point. The trade could have produced a 2 point profit in less then 20 minutes.



-Bill Wofe Yesterday we had a bullish Wave set up but the move from 4 to 5 was not clean. It had wobble or multiple 4 points. The three prominent 4 points I labeled 4-a, 4-b and 4-c. While this was a bona fide Wave, to properly estimate your risk/reward ratio, you must always move your 1 to 4 target line to the most conservative 4 point. If we entered a long position at 5 and had we not had 4-b and 4-c, our potential reward would be about 3 points. Being that we had a 4-c exiting at the 1 to 4 target line would produce less than a 2 point profit. It is important that you calculate this before you take a position.

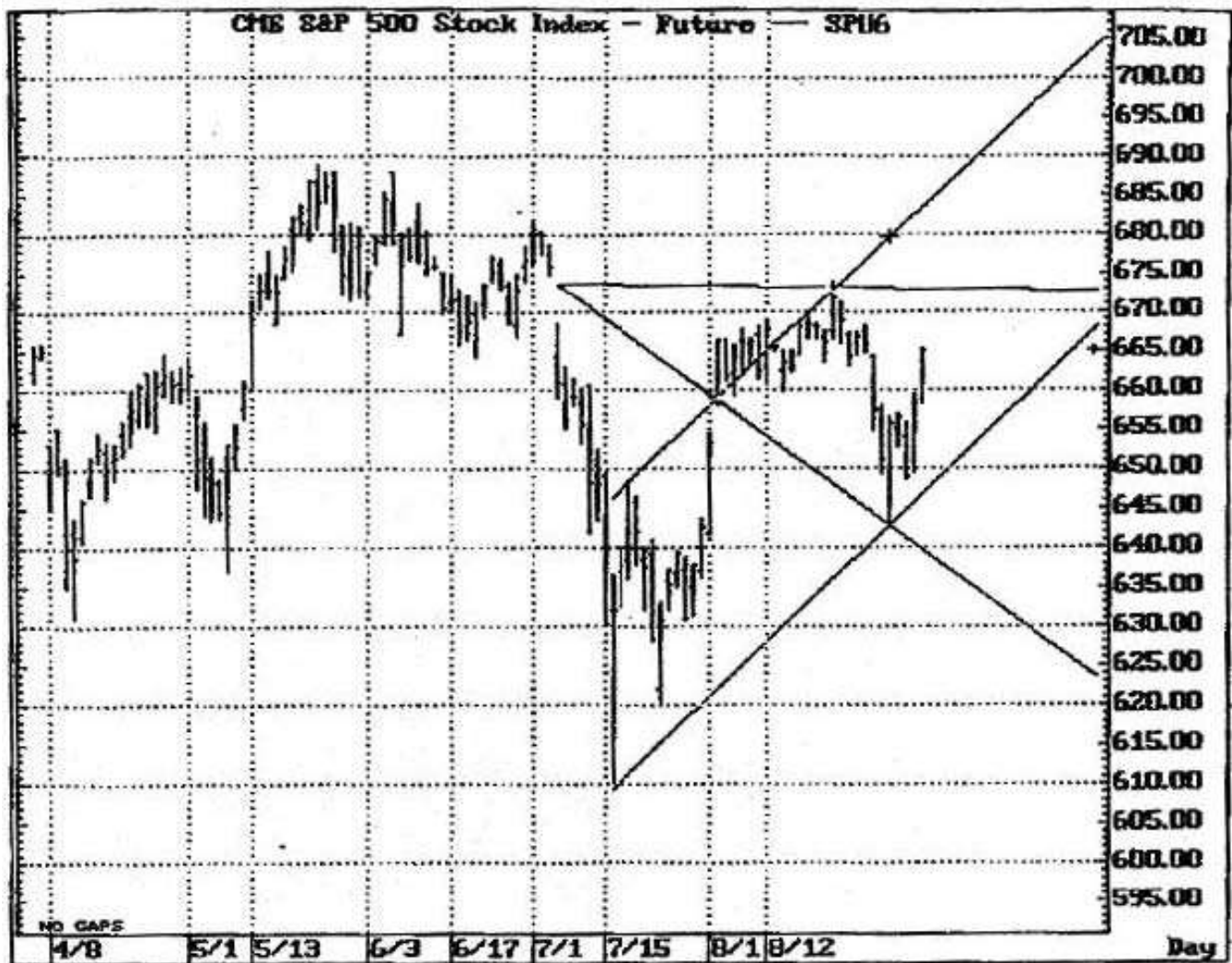




-Bill Wolfe On Friday I mentioned that I didn't think that a rally could take place until the 5 point was reached on the 120 minute chart. (Top chart.) The bottom chart is a 120 minute chart with the Globex (overnight) market incorporated into it. At 8:30 on Friday morning the Globex market got down to 642.00, which completed the 5 point on the 120 minute chart. The market then rallied over 17 points to the 1 to 4 line. This did not occur on the regular hours SPU6. In the past I have ignored the Globex market in identifying Waves. In the future, perhaps Globex should be taken into consideration on long period charts.

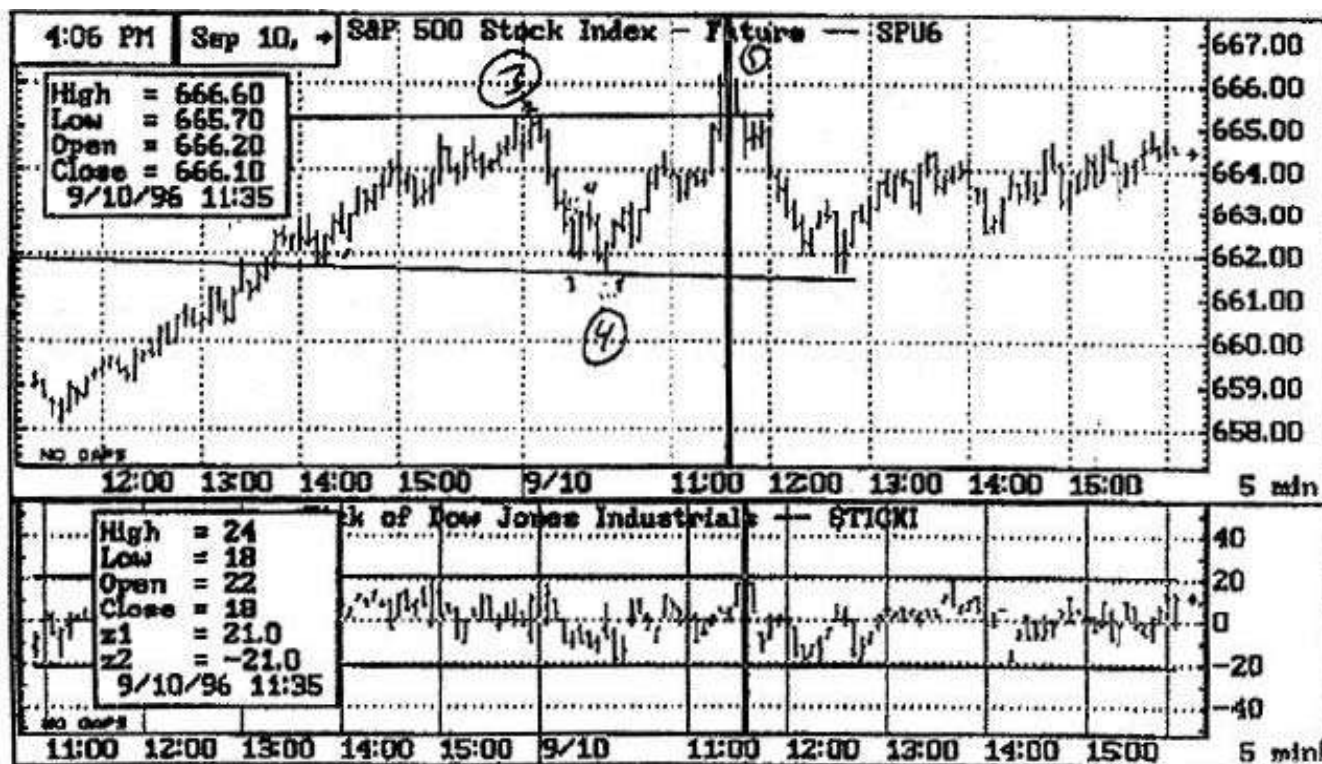


-Bill Wolfe Several days ago I mentioned a daily chart that was in the beginning stage of forming a very bearish Wave. A few days have gone by and the Wave is looking more probable. The sweet zone is not too wide, relatively speaking and heavy volume, again relatively speaking, will be evident on the DJIA. The Wave looks similar to Exhibit 2 and Exhibit 5.



-Bill Wolfe The TICKI is a valuable indicator for short term market timing. Today we had a Wave that was visible on a 30 minute chart by drawing a horizontal line to the left of the 3 point. You had to zoom down to a 5 minute chart to see the contrary Wave form between point 3 and 4. When the market rallied to the 5 point, the TICKI alarm went off signaling an extremely overbought market that was vulnerable for a correction. Traders should get in the habit of watching this indicator for added confirmation at important turning points.



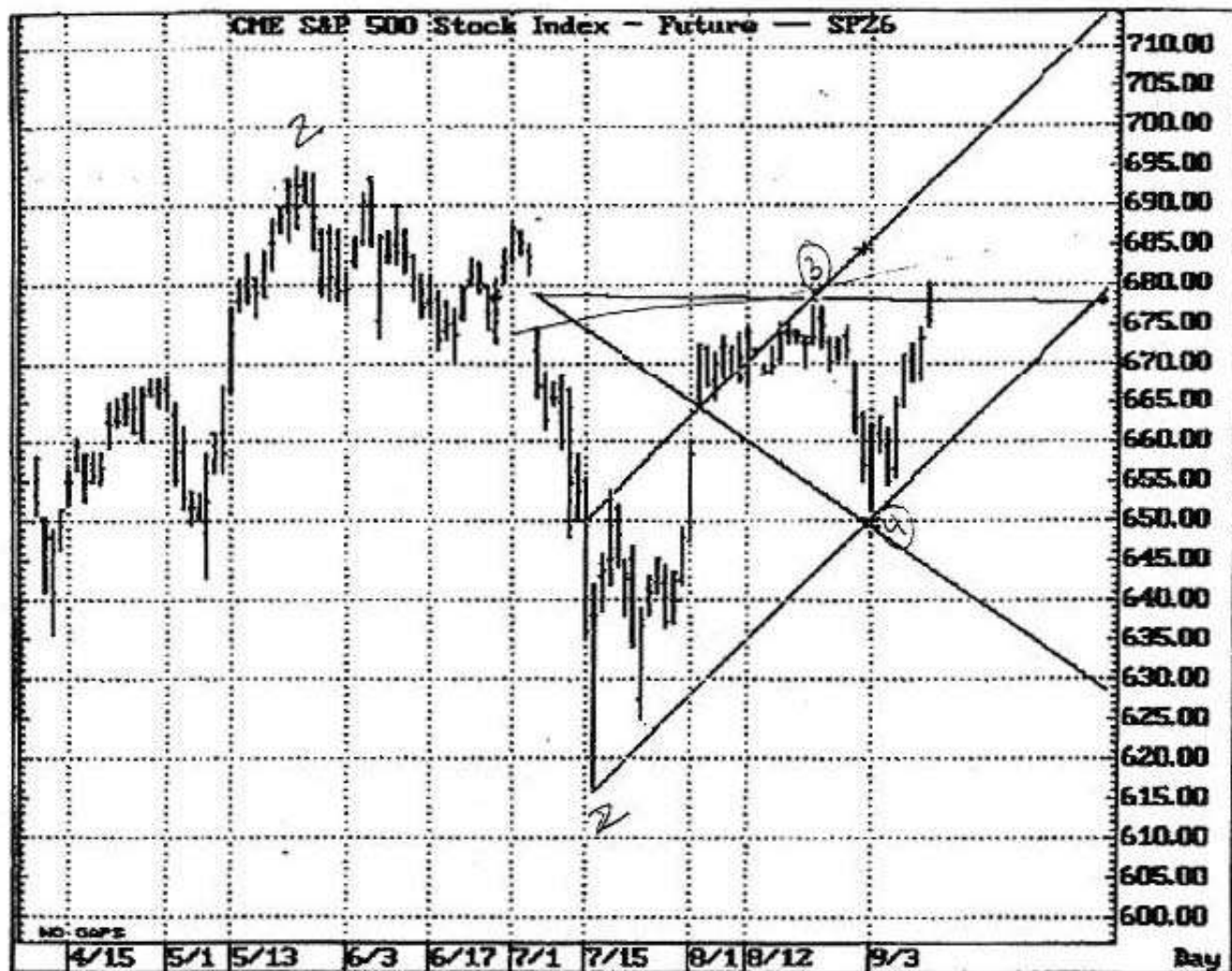


-Bill Wolfe There were a couple of tradable Waves today and perhaps the most frustrating was the one in the beginning of the day. The market gapped lower and missed a bona fide 5 point two ticks. Aggressive traders could have jumped the gun on a spike (Exhibit 9). The bottom chart is the daily Wave that I have mentioned in the last few days. Resistance can be expected when it gets in the sweet zone.

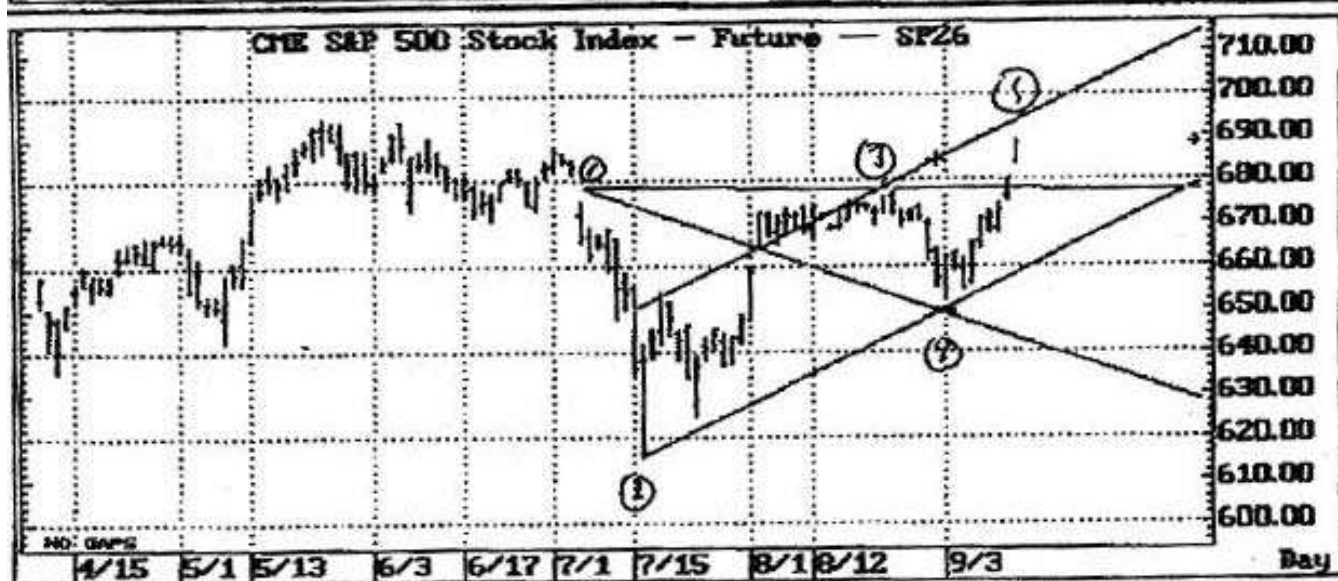
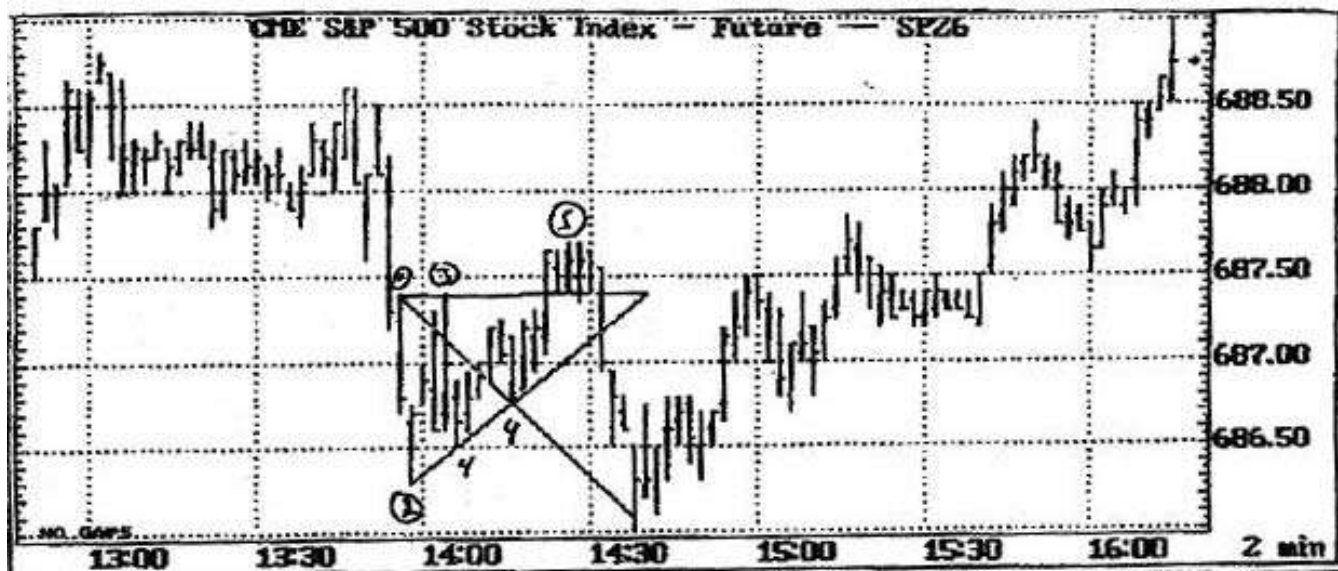


-Bill Wolfe The bearish Wave that we have been watching develop on the daily chart, is now in the sweet zone. The NYSE volume was a bit over 400 million today and that was the heaviest in several weeks. Today is a triple witching Friday and typically they have huge increases in volume. While there is still some room in the sweet zone, Waves usually come up against heavy resistance in this area. Look for old tops to form the 1 point for bearish Waves, primarily on 2 and 5 minute time frames.

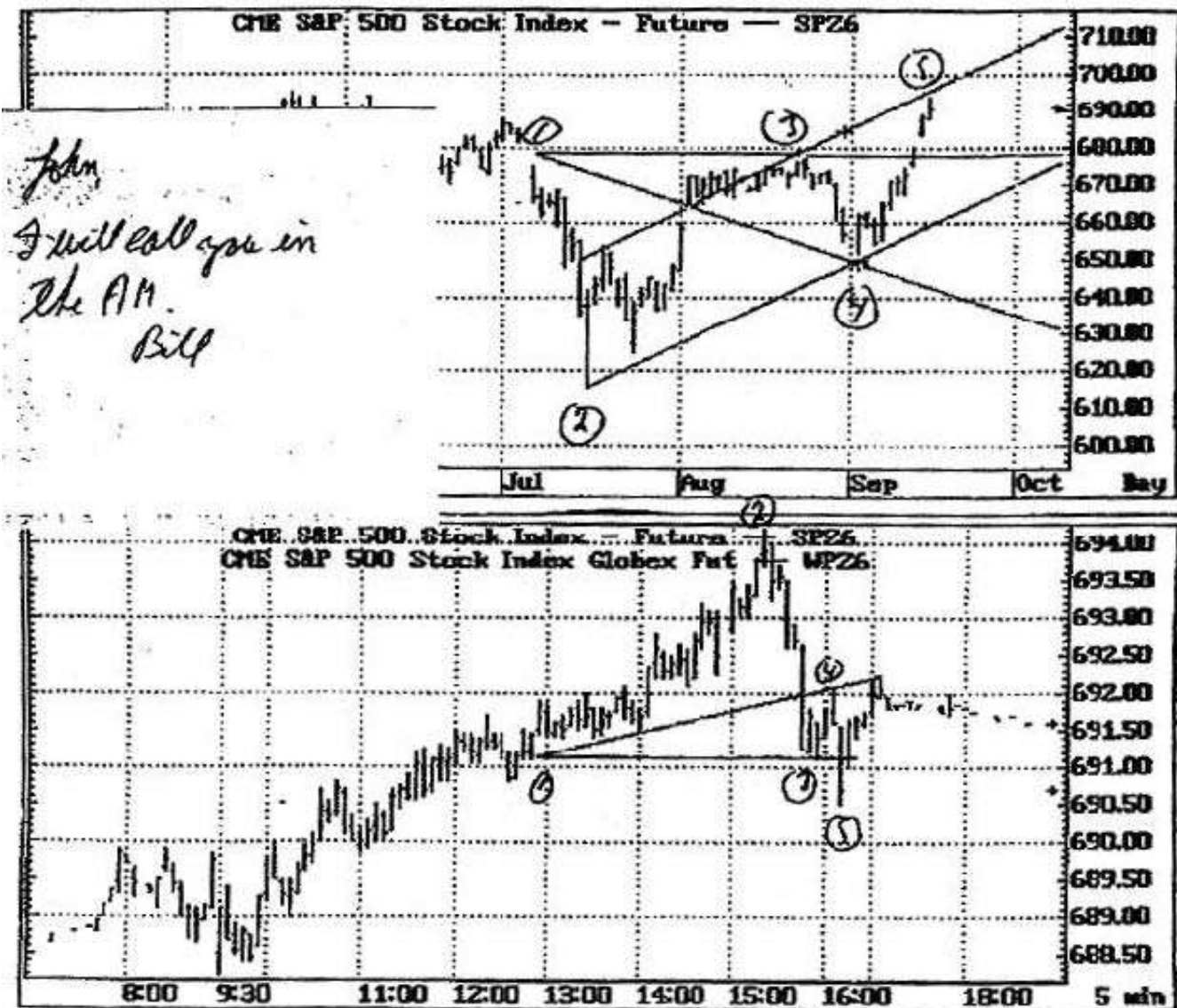




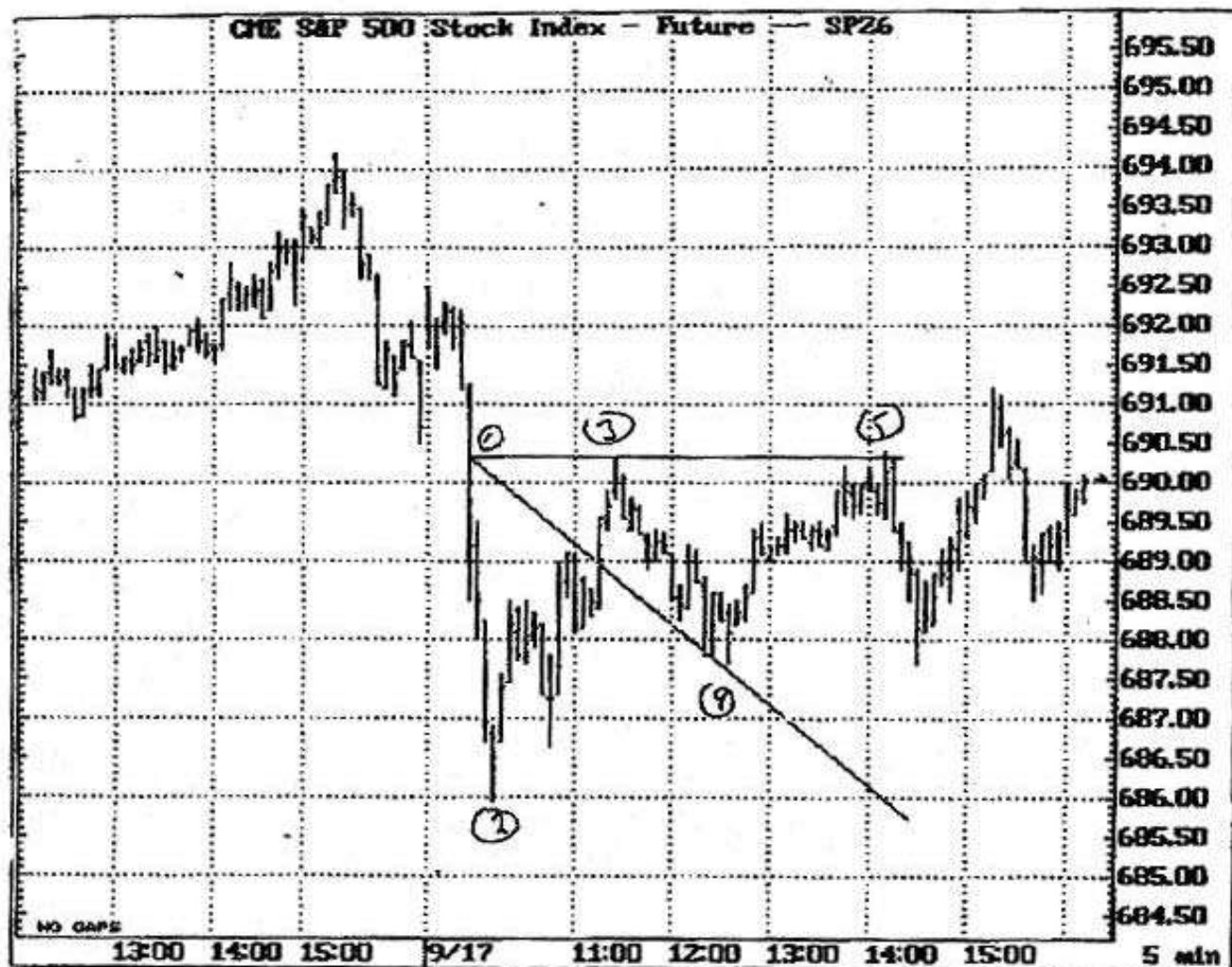
-Bill Wolfe There were a few tradable Waves on Friday, both bullish and bearish. The one that I highlighted has two 4 points. Whenever this occurs, it is wise to use the most conservative 4 point. The daily chart that I have been following is now deep in the sweet zone and a reversal is probable. Pay close attention to previous tops for bearish Waves to develop around.



-Bill Wolfe When you look at the top daily chart, which incidentally, today hit the parallel of the 3 point, it is evident that gaps are occurring more frequently. More and more trading is taking place after hours, especially on newsy days. The bottom chart is a 5 minute that “closed” at the 5 point at 4:15 PM New York time. Twenty-five minutes later – after the market “closed” the price hit the 1 to 4 target line. This should definitely be something to watch especially for traders that hold overnight.



-Bill Wolfe The market did not provide any really good tradable Waves today. The one that I highlighted had good structure whereas the 4 point was made up of a contrary Wave, but it lacked heavy volume at the 5 point. Aggressive traders probably went short at the 5 point when the Ticki alarm went off. It fell for a quick two points before reversing at the 4 point. Always watch the 4 point for signs of a reversal as it is the most likely place for support, being a previous bottom.



-Bill Wolfe The top chart is a 15 minute that hit the 5 point in the first hour of trading. It was a heavy volume reversal and for added confirmation, the ticki alarm went off right at the bottom. The rally ran into resistance about three points higher and then formed a contrary Wave. The chart below is a 5 minute. It shows how a second contrary Wave formed to take it to another high. The high of the day proved to be an excellent sell as it immediately reversed and hit the 1 to 4 target line.



-Bill Wolfe