

## Part V

### Practical Guidance

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Success in using wave analysis is not merely a question of applying rules, anymore than, say, science or mathematics. It does not merely make the most combinations possible according to certain fixed laws or rules. The combinations so obtained would be so exceedingly numerous, cumbersome and practically useless. The true work of the analyst consists in choosing among these combinations so as to eliminate those of limited value, or rather to avoid the trouble of making them. The rules that must guide the choice are extremely fine and delicate. It is almost impossible to state them precisely; they must be felt rather than formulated.

The French astronomer, physicist, mathematician cum-philosopher, Jules Henri Poincaré who lived at the turn of the century, wrote in his "Foundation of Science" about determining which hypothesis or which facts to examine in situations which "admit an infinity of others".

Poincaré suggested that the selection is made by what he called the "subliminal self", an entity that can be likened to "pre-intellectual awareness". The subliminal self, Poincaré said, looks at a large number of solutions to a problem, but only the interesting ones break into the domain of consciousness. Mathematical solutions are selected by the subliminal self on the basis of "mathematical beauty", of the harmony of numbers and forms, of geometric elegance. "This is a true aesthetic feeling which all mathematicians know", Poincaré said, "but of which the profane are so

ignorant as often to be tempted to smile". It is this harmony and beauty that is the centre of it all. This is no romantic beauty that Poincaré was talking about. He meant "classic" beauty, that comes from the harmonious order of the parts, and which a pure intelligence can grasp.

It is this sense of beauty which should make an analyst choose the facts that contribute the most to this harmony. Usually, the facts by themselves do not suggest much, or are worth much. It is when the facts merge with the matrix of the wave structure that harmony, and therefore success, is achieved.

Poincaré suggested some rules in classifying facts leading to a mathematical hypothesis. With slight modifications, we can use his guidelines in determining the hierarchy of facts that should lead to a proper "count" of the wave structure.

The more general a fact, the more relevant it is. Those which serve many times are better than those which have little chance of recurring. So we ask: which facts are likely to appear? The simple facts. How to recognise them? Choose those that seem simple. Either this simplicity is real, or the complex elements are indistinguishable. If it is real, we are likely to meet this simple fact again, either alone, or as an element in a more complex fact. But start with the simple ones. Occam's razor is a compelling argument for simplicity.

The principle of Parsimony, otherwise known as Occam's Razor, holds that when tossing around explanations for a natural phenomenon you should opt for the simplest theory that fits the facts. As the fourteenth-century philosopher William of Occam puts it: "Non sunt multiplicanda entia preter necessitatem" (Entities should not be multiplied beyond necessity). Failure to heed Occam is generally an invitation to trouble.

It's proper to begin with the regular facts, but after a wave count is established, the facts in conformity with it become blasé because they no longer teach anything new. Then it's the exception that becomes important. So we seek not resemblances, but differences. And we choose the most accentuated differences not only because they are the most striking, but also because they are the most instructive.

The next thing to do is to look for cases in which this wave count has the greatest chances of failing: assume either a very large movement in price or a very large movement in time. Almost always, we find that in these extreme projections our wave counts are overturned. These "upsets" are important; they enable the analyst to see better the little change that may happen near his point of reference. What we are trying to do here is less the ascertainment of likenesses and differences but rather the recognition of likenesses hidden under apparent divergences.

If we focus on each individual rule or tenet in Elliot Wave analysis the collective rules and tenets seem to be discordant at first. But looking more closely, we will see in general that they resemble each other: different so as to matter, but alike in form, and similar as to the order of their parts. This makes wave analysis confusing at times. But as soon as one understands that the apparent complexity emanates from the multiplicity of possibilities because there are too few rules, then the task of looking at likenesses (similarities) becomes less daunting and can even become enjoyable.

Unsuccessful use of Elliot Wave Analysis does not always stem from failure to apply its rules and tenets precisely. In many cases where there is no significant progress, the analyst's sense of values and attitudes are more to blame than anything else. The most common contributors to failure are a) lack of persistence and intellectual honesty, b) inflexibility, c) too big an ego, d) anxiety, e) boredom, and f) impatience.

## A) Lack of persistence and intellectual honesty

An aspiring wave analyst needs a kind of "stubbornness" that is engendered by intellectual honesty. There can be no short-cuts in wave analysis. A recitation of a plausible scene in wave analysis will illustrate the point.

You are analysing a chart and a wave pattern appears which you can not classify. You "gloss" over it and continue with your wave count your mind is already racing ahead to what should evolve, so it takes a little time to realise that this unclassified minor annoyance of a "non-regular" pattern is not just irritating and minor. It has stopped you from proceeding any further. You are now completely stuck. You can no longer arrive at a sound wave count.

This is not a rare scenario in wave analysis. This is perhaps the most common problem of all. For the analyst this is the worst of all moments.

Reasoning out is no good to you now. You do not need any one to tell you what is wrong. It's obvious what is wrong. What you need is a hypothesis, how to classify the recalcitrant wave pattern. This is the zero moment of rationality. It is normal at this point to feel like tearing up the chart into little pieces. You think about it, and the more you think about it, the more you are inclined to throw this book into the dustbin and forget about the whole concept. It is outrageous how an unclassified "squiggle" in a chart can totally defeat your "perfect" count. However, the reality is that the market is not conforming to that count. So the "squiggle" must have a value, therefore the count is wrong.

The moral of the story is obvious. Be intellectually honest; the unclassified wave pattern is a problem, so treat it as such. Do not "gloss" over it. Resolve the situation because it will surely resurface later on to stymie your efforts.

If one finds oneself in this situation, obviously the solution is to find the relevant fact or set of facts that will enable you to put a label on the wave pattern.

According to the “doctrine of objectivity” we should keep our mind as a blank tablet which nature will fill for us, and then reason disinterestedly from the facts we observe. Clearly, this is easier said than done. As Poincare would have said, there is an infinite number of facts about the wave pattern, and the right ones do not necessarily dance up and introduce themselves. The right facts, the ones we really need are not only passive, they are elusive. You have to be searching for them, otherwise the true pattern will not unfold and the count will remain lost.

One of the key requirements of a good wave analyst is this ability to patiently select the relevant facts from the irrelevant ones, and to quickly recognise those errors as and when they occur.

The difference between a good wave analyst and a bad one is precisely this ability to select the good facts from the bad ones on the basis of a “feeling of harmony”. In wave analysis the application of pure logic is insufficient. You have to have a sense of “correctness”, a feeling for what is right. That is what will pull you through. This is a capability borne out of experience, persistence and intellectual honesty.

Despite rigorous efforts to be honest, one will still hit an Elliott dead-end occasionally. When this happens, it is better to consider the event as not so much a situation to be feared, but rather a moment to be cultivated. This is a situation where the entire problem-solving process goes beyond the mind-logic plane. As stated before, the solution to a problem often appears unimportant at first, even undesirable. Passage of time usually allows the solution to assume its true importance. Your mind, given enough time, will naturally and freely move towards a solution. This kind of

understanding or “feeling” is only acquired from practical experience; it can not be developed inside the lecture room where the concepts are only imported rather than “discovered”.

## **B) Inability to be flexible**

A rigid set of values often leads to the inability to assess what one sees. If your values are too rigid, it becomes very difficult to learn to accept new facts. This often shows up as pre-mature diagnosis, when you are sure you know what the eventual outcome will be. When this does not happen, a revision is required, and, given the normally volatile forex cash markets, reassessment. You will have to search for new clues, but before you can find them you have to clear your head of “old” opinions. If you are not flexible, you may fail to see the real answer even when it is staring you right in the face.

If you get caught in this trap, you have to slow down - you’re going to have to slow down anyway whether you want to or not - but do so deliberately and go over ground that you have been over before. This is to see if the things that you thought were important really were so, and to just stare at the chart. Just live with it for a while. Watch it the way you watch a line while fishing. Before long you’ll get a nibble; a new fact will come along. It may not be the fact that you are looking for but before long you may find that the nibbles you are getting are more interesting than the original purpose of classifying a recalcitrant wave pattern. When that happens you have arrived. You are no longer just a technical analyst. You are a wave analyst.

### C) Too big an ego

If you have a high evaluation of yourself, then your ability to recognize new facts is weakened. Your ego isolates you from reality. When the facts show that you just goofed, you're not likely to admit it. When false information makes you look good, you're likely to believe it. On any wave analysis, ego comes in for rough treatment. You're always being fooled; you're always making mistakes. An analyst who has a big ego to defend is at a terrific disadvantage.

If you know enough analysts to think of them as a group, and your observation is the same as mine, I think you'll agree that analysts tend to be rather modest and quiet. There are exceptions, but generally if they are not modest and quiet at first, the work seems to make them that way. As well as skeptical. Attentive, but skeptical and not egotistical. There is no way to "judge" your way into looking good on analysis, certainly not in the long term.

If modesty does not come easily or naturally to you, one way out of this trap is to fake the attitude of modesty anyway. There could be certain soothing if twisted mental benefits. If you deliberately assume a mediocrity, then your ego is boosted when the subsequent events prove the analysis as being correct. In this way you can keep going motivated by the success until you overreach yourself again.

I was going to say that the market analysis does not respond to your personality, but it does. It's just that the personality it responds to is your real personality, the one that genuinely feels and reasons and acts, rather than any false, blown-up personality images your ego may conjure. These false images are deflated so rapidly and completely by the market that you're bound to be very discouraged very soon if you derived your staying power from ego rather than from a desire to excel.

### D) Anxiety

When you are so sure that you will do everything wrong, the tendency is to feel like doing nothing at all. Often, this rather than laziness, is the real reason you find it hard to get started. Anxiety which results from over motivation can lead to all kinds of excuses stemming from excessive fussiness. You will relabel those wave counts that do not need relabelling, and chase after multiple alternate counts. You will jump to wild conclusions and build all kinds of rationale into the analysis. These errors, when made, will tend to confirm your original underestimation of yourself. This will lead to further errors and into a self-stoking cycle.

The best way to break this cycle is to work out the anxieties on the charts. Read everything you can on wave analysis. The more you read the greater the confidence you build into your analysis.

When beginning an analysis, prepare as many chart copies as you can, label the waves in coloured pens in as many ways as possible, then arrange them in proper sequence. You will discover that as you organise and re-organise the sequence again and again more and more ideas come to you. The time spent this way is much more productive than time spent staring at a blank chart.

You can reduce your anxiety by recognising the fact that all analysts have gone through the same learning curve and have all made errors. It is a painful learning curve, but just as I and countless others have survived, you, too will rise above your initial difficulties. A piece of iron is hardened by application of heat and repeated hammer blows. The making of a wave analyst follows pretty well the same procedure; in the end, all of us have to pay our dues in terms of bruised egos and lowered expectations. However, new and hardened resolve is enough compensation for this.

One thing to do when working with charts, as in many other tasks, is to cultivate "the peace of mind" which according to Poincare "does not separate one's self from one's surrounding". When that is done successfully, then most other things will follow naturally. Peace of mind produces right thoughts. Right thoughts produce right actions, and right actions produce work which will be a material reflection for others to see.

## E) Boredom

This is the opposite to anxiety and is commonly associated with ego problems. Boredom means that you are not seeing things freshly, and your analysis is vulnerable. When this occurs there is a need to focus your mind elsewhere for a time being other than at the chart, preferably on other supporting work such as momentum analysis, etc.

When you are bored, stop. Do something else and call it a day. If you do not stop then you will become susceptible to making a big mistake. Boredom plus a *big* mistake can lead to major losses. The best remedy for me has been coffee and sleep, or preoccupation with other aspects of technical analysis.

There are, as with all professions, boring tasks that, however, must be done and for the wave analyst the worst is in making a current analysis fit the main scenario all the way to the beginning of a sequence. If the daily pattern happens to be part of a sequence stretching back several months it becomes easy to become distracted. Sometimes, it seems such a waste of time. But back-tracking is essential to the understanding of the current pattern.

Boredom is usually a signal that the analyst is taking things for granted. On the first sign of boredom, go through what you have done

before, at least twice. This is a small price to pay, knowing that the penalties for sloth will sooner or later be great.

## F) Impatience

This is almost similar to, but not quite the same as boredom. Impatience almost always stems from one cause: an under-estimation of the amount of time the analysis will take. This is particularly true when market action has settled into a lazy sideways consolidation. You can never be certain what kind of pattern will turn up.

Impatience is the first reaction against a setback, and can soon turn into anger and frustration if one is not careful.

It is best handled by allowing an indefinite time for the task, or by doubling the allotted time when circumstances force time planning. It can also be prevented by scaling down the scope of what one wants to accomplish. Overall goals must be scaled down in importance, whilst immediate goals must be scaled up.

## Part VI

### A Typical Elliott Wave Trading Plan

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*There's a price for too much arrogance,  
a price for too much greed;  
And in complacent ignorance,  
we've sown the whirlwind seed.*

*Don Simpson, from the song "Serpent's Reach"*

Errors in trading occur due to a variety of reasons, but the most common causes of trading disasters can be traced to three *cardinal sins*, namely *arrogance, greed, and ignorance*.

The sin of arrogance is less frequently seen nowadays; increased volatility in the forex markets has taken its toll. Traders who presumed to possess the *inside track* on market movements, and speculators who tried to will the market to go their way before it is ready, did not survive this far. There are not enough of the cocky traders left to make a mark on the casualty chart.

On the other hand, the incidence of the sin of greed waxes and wanes like an epidemic with the rise and fall of prices in the currency markets.



There is no way to smooth the swings except by changing the way people think. And *that* is an even more difficult proposition than eliminating greed in the marketplace.

The sin of ignorance is the most pervasive of the lot. With the amount of money being shifted around at the slightest perception of impending market change, it's not unreasonable to presume that players involved in this *zero-sum* game actually understand the mechanics of price change. But the moans of victims who were zero-summed in their trading accounts at some point in the game is actually on the rise. So one is tempted to say that ignorance of market mechanics is endemic in the market place.

This last *sin* is one that nobody needs to suffer from. Even if the causes of price change are not yet fully understood (nobody knows exactly why people decide to buy or sell en masse at a point in time), it is enough to know what *does not* cause prices to fluctuate. For instance, the laws of cause and effect in the science of physics do not apply in the largely psychological phenomenon of price change. In another, price movements are not wholly random in all degrees of possible intervals between price changes; the October 1987 stock market crash drove this painful lesson home.

If a tool is workable, it is not of over riding importance to know exactly the *why's* and *wherefore's* as long as the basic truth behind it is understood. This is especially true of the Elliott Wave Principle. It suffices to know that the Principle is based on the proposition that the market is comprised of people, and that people will never change. They will react to similar situation in the same manner over and over again.

The Elliott Wave Principle, to my knowledge, was the first to explicitly recognize that market mechanics do not cause changes in market direction; only changes in psychology do. What R.N. Elliott has done is to establish normative behavior patterns from which specific rules can be declared; and from these rules broad guidelines and description of tendencies can be inferred. Specific market action can then be derived from these inferences.

Given the highly serialized structure of the model, a study of Elliott Wave Principle will train one to assess the probability and frequency of a future event. Situations which are deemed *impossible* under the various rules and guidelines are eliminated from consideration, thereby limiting the possible eventualities the trader has to cope with. Robert R. Prechter once likened the knowledge of the Elliott Wave Principle to the possession of a road map. With it, one can make a few deductions that will identify the most likely path that a bus will take (even if one has not made the trip before), thus eliminating 99 percent of other possible routes across unpaved lands.

It should immediately become obvious that the use of Elliott Wave Principle is not a mechanical approach to the market place. It is an approach in which *probability* rapidly becomes the catchword; it is a method in which the terms *prediction* and *forecasting* become irrelevant, even unwelcomed. One soon learns to replace these terms with the word *anticipate*.

Any analysis derived by application of its principles will always imply a forecast or prediction. Don't let the *implied* turn into *explicit*. While the Wave Principle is probably the most effective forecasting tool available, do not use it to forecast or to predict. Use it only to establish targets with high probability of achievement, or to establish alternative courses if subsequent market action nullifies the original objectives.

This may disappoint those who are looking for rigid, absolute answers to the forex markets' questions. But it is a fact of life that most predictions and forecasts are destined to fail; it is simply impossible to pinpoint the confluence of specific time and price elements at any part of a market movement. The best way to use the wave principle is to accept this fact. Provide for the occurrence of errors of judgement, then subsequently deal with the alternatives to produce winning strategies. There are no *guarantees* in the forex market, there are only *maybes*.

If one is to derive maximum benefit from this method, one has to learn to accept it for what it is, a tool to provide the input necessary to quantify the degree of risk or degree of reward in the current market structure. It is not a magical philosopher's stone; it does not turn base ideas into gold.

To a certain degree, this quantification process – let's call it “money management” – is more important than the analysis part of the tandem. To use an old analogy, analysis is the door to fabulous riches, while money management is the key that opens that door.

The first requirement of money management is a trading plan – a written, well-analyzed, step-by-step process, not a set of vague intentions kept in your head. This plan must not only provide for entering trades; it must also provide contingency for taking losses and accepting profits.

Put it this way. A trading plan without a system of cutting losses short and maximizing profit potential is like boarding a car without brakes and gearshift. You will certainly be able to depart, but it is doubtful if you will arrive at your destination. The worst, of course, is not having a trading plan at all. It's like boarding a car without a steering wheel. It is doubtful if

you can even depart; it is certain that you will never arrive.

In drawing up a trading plan, its spirit should be what Robert Beckman once said: "We are not trying to beat the market. We are trying to join it." There are subtle implications in Beckman's plea. The objective should be less in being "right" but more in being "successful". In other words, do not aim at getting a correct "forecast" for ego-boosting reasons. Rather, aim at making money on the trade, even when the forecast was wrong.

There is no contradiction involved here, from the standpoint of Elliott analysis. Most of the time, the probability of likely occurrence are so evenly distributed that favoring one scenario over others becomes a matter of preference. It is only at certain times in the market development that reliable, precise projections can be made. At most times, it is only possible to assess that being long is preferable to being short, or vice versa. With meticulous planning, that information is usually enough to succeed in the market place.