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Elliott Wave Theory

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1) Elliott Wave Theory: Modern Theory for 21st Century Market

1.1 History

Elliott Wave Theory is named after Ralph Nelson Elliott (28 July 1871 – 15 January 1948). He was an American accountant and author. Inspired by the Dow Theory and by observations found in the natural world, Elliott concluded that the movement of the stock market could be predicted by observing and identifying a repetitive pattern of waves.

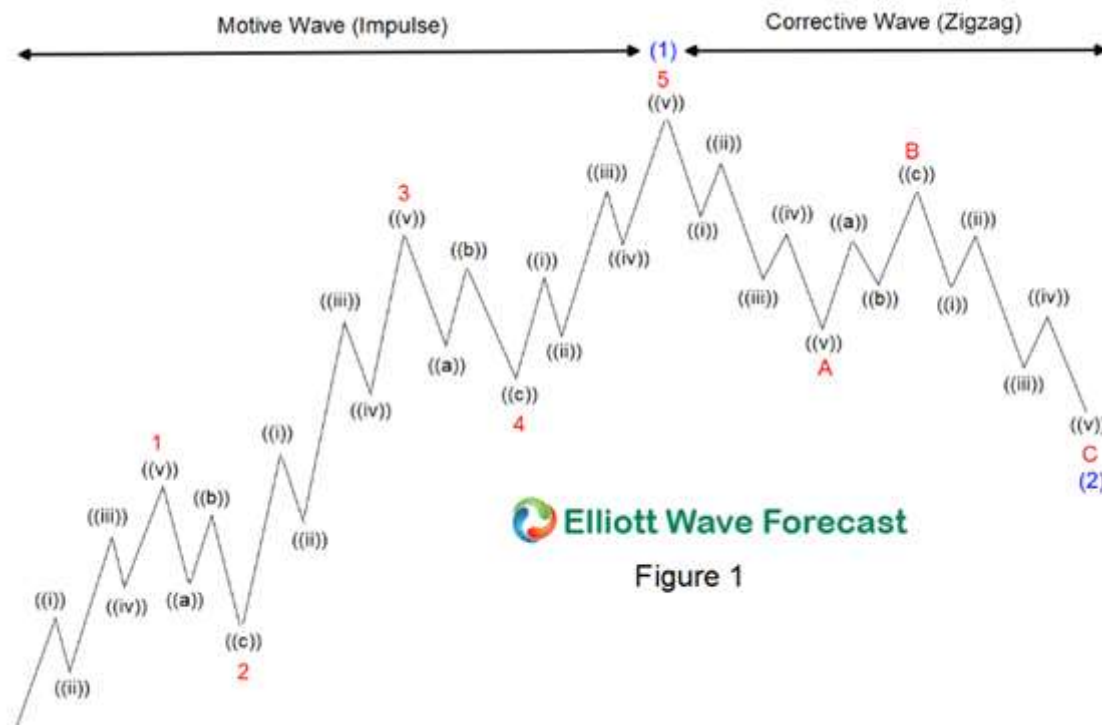
Elliott was able to analyze markets in greater depth, identifying the specific characteristics of wave patterns and making detailed market predictions based on the patterns. Elliott based part of his work on the Dow Theory, which also defines price movement in terms of waves, but Elliott discovered the fractal nature of market action. Elliott first published his theory of the market patterns in the book titled *The Wave Principle* in 1938.

1.2 Basic Principle of the 1930's Elliott Wave Theory

Simply put, movement in the direction of the trend is unfolding in 5 waves (called motive wave), and a correction against the trend is in three waves (called corrective wave). The movement in the direction of the trend is labelled as 1, 2, 3, 4, and 5. The three wave correction is labelled as a, b, and c. These patterns can be seen in long term as well as short term charts.

Ideally, smaller patterns can be identified within bigger patterns. In this sense, Elliott Waves are like fractals, where the smaller piece, if broken off from the bigger piece, does, in fact, look like the bigger piece. This information (about smaller patterns fitting into bigger patterns), coupled with the relationships between the waves, offers the trader a level of anticipation and/or prediction when searching for and identifying trading opportunities with solid reward/risk ratios.

1.3 The Five Waves Pattern (Motive and Corrective)



In Elliott's model, market prices alternate between an impulsive, or motive phase, and a correction on all time scales of trend. Impulses are always subdivided into a set of 5 lower-degree waves, a again between motive and corrective character, so that waves 1, 3, and 5 are impulses, and wave are smaller retraces of waves 1 and 3.

In Figure 1, wave 1, 3 and 5 are motive waves and they are subdivided into 5 smaller degree labelled as ((i)), ((ii)), ((iii)), ((iv)), and ((v)). Wave 2 and 4 are corrective waves and they are subdivided into 3 smaller degree waves labelled as ((a)), ((b)), and ((c)). The 5 waves move in wave 1, 2, 3, 4, and 5 in a larger degree motive wave (1)

Corrective waves subdivide into 3 smaller-degree waves, denoted as ABC. Corrective waves start with a five-wave counter-trend impulse (wave A), a retrace (wave B), and another impulse (wave C). The A, B, and C make up a larger degree corrective wave (2)

In a bear market the dominant trend is downward, so the pattern is reversed—five waves down followed by three waves up

1.4 Wave Degree



Grand Super Cycle :	((I)) (((II)) ((III))((IV))((V)) ((a)) ((b))((c)) ((w)) ((x)) ((y))
Super Cycle :	(I) (II) (III) (IV) (V) (a) (b) (c) (w) (x) (y)
Cycle :	I II III IV V a b c w x y
Primary :	((1)) ((2)) ((3)) ((4)) ((5)) ((A)) ((B)) ((C)) ((W)) ((X)) ((Y))
Intermediate :	(1) (2) (3) (4) (5) (A) (B) (C) (W) (X) (Y)
Minor :	1 2 3 4 5 A B C W X Y
Minute :	((i)) ((ii)) ((iii)) ((iv)) ((v)) ((a)) ((b)) ((c)) ((w)) ((x)) ((y))
Minutte :	(i) (ii) (iii)(iv)(v) (a) (b) (c) (w) (x) (y)
Subminutte :	i ii iii iv v a b c w x y

Elliott Wave degree is an Elliott Wave language to identify cycles so that analyst can identify pos wave within overall progress of the market. Elliott acknowledged 9 degrees of waves from the Gra Cycle degree which is usually found in weekly and monthly time frame to Subminuette degree found in the hourly time frame. The scheme above is used in all of EWF's charts.

1.5 The Rise of Algorithmic / Computer-based Trading

The development of computer technology and Internet is perhaps the most important progress tl and characterize the 21st century. The proliferation of computer-based and algorithmic trading new category of traders who trade purely based on technicals, probabilities, and statistics wi human emotional aspect. In addition, these machines trade ultra fast in seconds or even mil buying and selling based on proprietary algos.

No doubt the trading environment that we face today is completely different than the one in t when Elliott first developed his wave principle. Legitimate questions arise whether Elliott Wave can be applied in today's new trading environment. After all, if it's considered to be common expect today's cars to be different than the one in the 1930's, why should we assume that technique from 1930 can be applied to today's trading environment?

1.6 The New Elliott Wave Principle – What is Changing in Today's Market

The biggest change in today's market compared to the one in 1930s is in the definition of a t counter-trend move. We have four major classes of market: Stock market, forex, commodities, ar

The Elliott Wave Theory was originally derived from the observation of the stock market (i.e. Dow) but certain markets such as forex exhibit more of a ranging market.

In today's market, 5 waves move still happen in the market, but our years of observation suggest waves move happens more frequently in the market than a 5 waves move. In addition, market moving in a corrective structure in the same direction. In other words, the market can trend in a corrective structure; it keeps moving in the sequence of 3 waves, getting a pullback, then continue the same again in a 3 waves corrective move. Thus, we believe in today's market, trends do not have to be in 5 waves and trends can unfold in 3 waves. It's therefore important not to force everything in 5 waves when you find the trend and label the chart.

2) Fibonacci

2.1 Introduction

Leonardo Fibonacci da Pisa is a thirteenth century mathematician who discovered the Fibonacci series. In 1242, he published a paper entitled *Liber Abacci* which introduced the decimal system. The book's work came from a two-year study of the pyramids at Giza. Fibonacci is most famous for his Fibonacci Summation series which enabled the Old World in the 13th century to switch from Arabic number (1234 = 24) to the arithmetic numbering (24) that we use today. For his work in mathematics, Fibonacci was awarded the equivalent of today's Nobel Prize.

2.2 Fibonacci Summation Series


One of the most popular discoveries by Leonardo Fibonacci is the Fibonacci Summation series. It starts with 0 and adds 1 as the first two numbers. Succeeding numbers in the series add the previous numbers and thus we have 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89 to infinity. The Golden Ratio (1.618) is derived by dividing a Fibonacci number with another previous Fibonacci number in the series. As an example, 55 divided by 34 would result in 1.618.

2.3 Fibonacci Ratio Table

Various Fibonacci ratios can be created in a table shown below where a Fibonacci number (numerator) is divided by another Fibonacci number (denominator). These ratios, and several others derived from them, appear in nature everywhere, and in the financial markets. They often indicate levels at which

resistance and support will be found. They are easily seen in nature (seashell spirals, flower structure of tree branches, etc), art, geometry, architecture, and music.

Fibonacci Ratio Table


**Elliott Wave
forecast**
signals and comments from forum experts

	Numerator										
	1	2	3	5	8	13	21	34	55	89	144
1	1.00000	2.00000	3.00000	5.00000	8.00000	13.00000	21.00000	34.00000	55.00000	89.00000	144.00000
2	0.50000	1.00000	1.50000	2.50000	4.00000	6.50000	10.50000	17.00000	27.50000	44.50000	72.00000
3	0.33333	0.66667	1.00000	1.66667	2.66667	4.33333	7.00000	11.33333	18.33333	29.66667	48.00000
5	0.20000	0.40000	0.60000	1.00000	1.60000	2.60000	4.20000	6.80000	11.00000	17.80000	28.80000
8	0.12500	0.25000	0.37500	0.62500	1.00000	1.62500	2.62500	4.25000	6.87500	11.12500	18.00000
13	0.07692	0.15385	0.23077	0.38462	0.61538	1.00000	1.61538	2.61538	4.23077	6.84615	11.07692
21	0.04762	0.09524	0.14286	0.23810	0.38095	0.61905	1.00000	1.61905	2.61905	4.23810	6.85714
34	0.02941	0.05882	0.08824	0.14706	0.23529	0.38235	0.61765	1.00000	1.61765	2.61765	4.23529
55	0.01818	0.03636	0.05455	0.09091	0.14545	0.23636	0.38182	0.61818	1.00000	1.61818	2.61818
89	0.01124	0.02247	0.03371	0.05618	0.08989	0.14607	0.23596	0.38202	0.61798	1.00000	1.61798
144	0.00694	0.01389	0.02083	0.03472	0.05556	0.09028	0.14583	0.23611	0.38194	0.61806	1.00000

Toward Perfect Ratios

Some of the key Fibonacci ratios can be derived as follow:

- 0.618 is derived by dividing any Fibonacci number in the sequence by another Fibonacci number immediately follows it. For example, 8 divided by 13 or 55 divided by 89
- 0.382 is derived by dividing any Fibonacci number in the sequence by another Fibonacci number found two places to the right in the sequence. For example, 34 divided by 89
- 1.618 (Golden Ratio) is derived by dividing any Fibonacci number in the sequence by another number that is found 1 place to the left in the sequence. For example, 89 divided by 55, 144 divided by 89

2.4 Fibonacci Retracement and Extension

Fibonacci Retracement in technical analysis and in Elliott Wave Theory refers to a market correction (counter trend) which is expected to end at the areas of support or resistance denoted by key Fibonacci levels. The market is then expected to turn and resume the trend again in the primary direction.

Fibonacci Extension refers to the market moving with the primary trend into an area of support or resistance at key Fibonacci levels where target profit is measured. Traders use the Fibonacci Extension to determine their target profit.

Below is the list of important Fibonacci Retracement and Fibonacci Extension ratios for the financial markets.

Retracement	<ul style="list-style-type: none"> • 14.6% (0.146) • 23.6% (0.236) • 38.2% (0.382) • 61.8% (0.618) • 76.4% (0.764) • 85.4% (0.854) 	
Extension	<ul style="list-style-type: none"> • 61.8% (0.618) • 100% (1.00) • 123.6% (1.236) • 161.8% (1.618) • 200% (2.00) • 261.8% (2.618) 	<ul style="list-style-type: none"> • 323.6% (3.236) • 423.6% (4.236)

2.5 Relation Between Fibonacci and Elliott Wave Theory

Fibonacci Ratio is useful to measure the target of a wave's move within an Elliott Wave structure. The length of waves in an Elliott Wave structure relates to one another with Fibonacci Ratio. For example, in an uptrend, wave 2 is typically 50%, 61.8%, 76.4%, or 85.4% of wave 1.

- Wave 2 is typically 50%, 61.8%, 76.4%, or 85.4% of wave 1
- Wave 3 is typically 161.8% of wave 1
- Wave 4 is typically 14.6%, 23.6%, or 38.2% of wave 3
- Wave 5 is typically 61.8%, 100%, or 123.6% of wave 1

Traders can thus use the information above to determine the point of entry and profit target when entering into a trade.

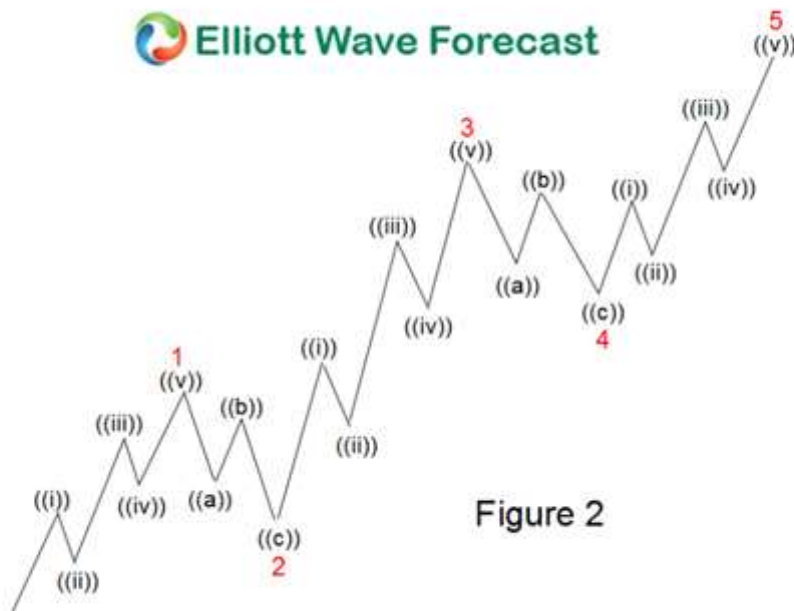
3) Motive Waves

In Elliott Wave Theory, the traditional definition of motive wave is a 5 wave move in the same direction as the trend of one larger degree. There are three different variations of a 5 wave move which is common in the financial markets.

motive wave: Impulse wave, Impulse with extension, and diagonal.

EWf prefers to define motive wave in a different way. We agree that motive waves move in the same direction as the trend and we also agree that 5 waves move in the same direction is a motive wave. However, we agree that motive waves do not have to be in 5 waves. In today's market, motive waves can unfold in 3 waves. For this reason, we prefer to call it motive sequence instead.

3.1 Impulse



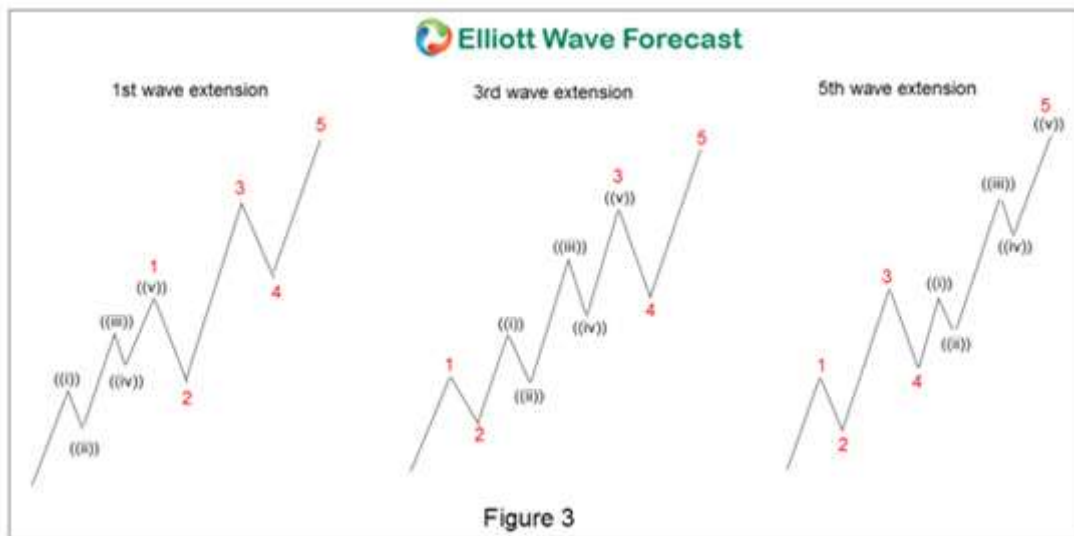
Guidelines

- Impulse wave subdivides into 5 waves. In Figure 2, the impulse move is subdivided as 1, 2, 3, 4, 5 in minor cycle.
- Wave 1, 3, and 5 subdivisions are impulse. The subdivision in this case is ((i)), ((ii)), ((iii)), ((iv)), and ((v)) degree.
- Wave 2 can't retrace more than the beginning of wave 1
- Wave 3 can not be the shortest wave of the three impulse waves, namely wave 1, 3, and 5
- Wave 4 does not overlap with the price territory of wave 1
- Wave 5 needs to end with momentum divergence

Fibonacci Ratio Relationship

- Wave 2 is 50%, 61.8%, 76.4%, or 85.4% of wave 1
- Wave 3 is 161.8%, 200%, 261.8%, or 323.6% of wave 1-2
- Wave 4 is 14.6%, 23.6%, or 38.2% of wave 3 **but no more than 50%**
- There are three different ways to measure wave 5. First, wave 5 is inverse 123.6 – 161.8% retracement of wave 1-4. Second, wave 5 is equal to wave 1. Third, wave 5 is 61.8% of wave 1-3

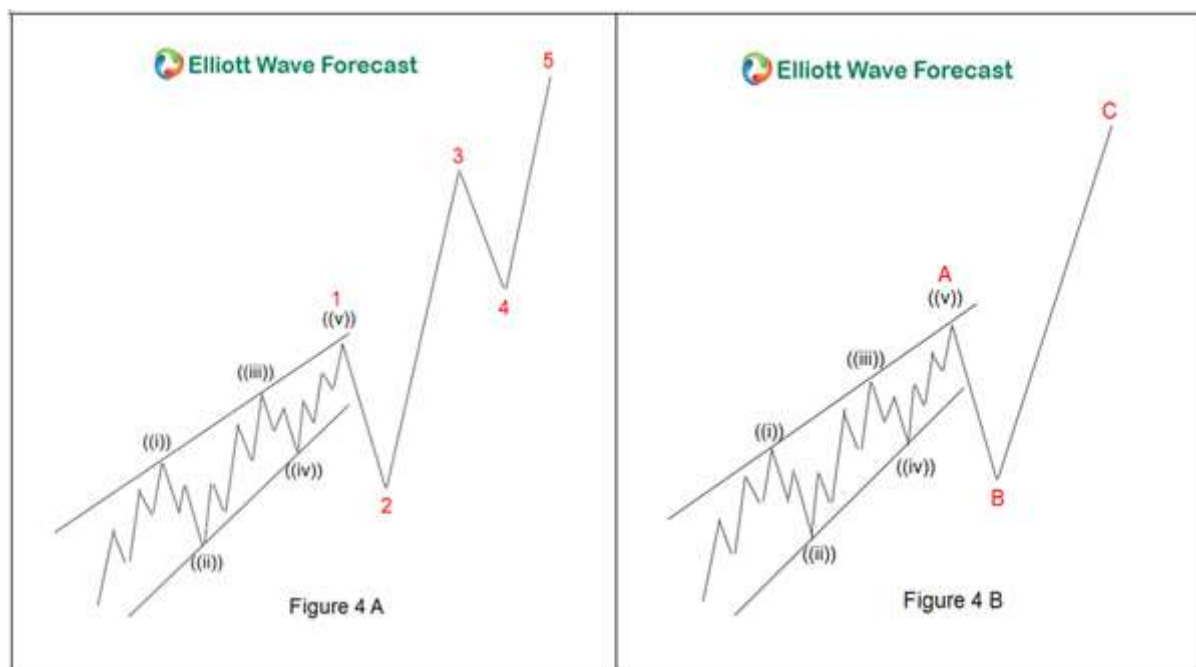
3.2 Impulse with Extension



Guidelines

- Impulses usually have an extension in one of the motive waves (either wave 1, 3, or 5)
- Extensions are elongated impulses with exaggerated subdivisions
- Extensions frequently occur in the third wave in the stock market and forex market. Commoditi commonly develop extensions in the fifth wave

3.3 Leading Diagonal

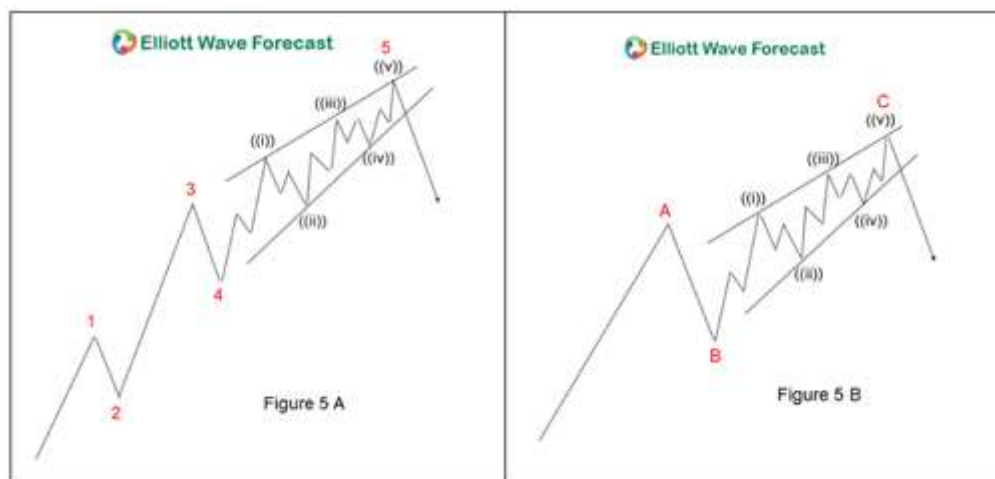


Guidelines

- Special type of motive wave which appears as subdivision of wave 1 in an impulse or subdivision of wave A in a zigzag
- In Figure 4A, the leading diagonal is a subdivision of wave 1 in an impulse. In Figure 4B, the leading diagonal is a subdivision of wave A in a zigzag

- Leading diagonal is usually characterized by overlapping wave 1 and 4 and also by the wedge shape between wave 1 and 4 is not a condition, it may or may not happen
- The subdivision of a leading diagonal can be 5-3-5-3-5 or 3-3-3-3-3. The examples above show a leading diagonal with 5-3-5-3-5 subdivision

3.4 Ending Diagonal



Guidelines

- Special type of motive wave which appears as subdivision of wave 5 in an impulse or subdivision of wave C in a zigzag
- In Figure 5A, the ending diagonal is a subdivision of wave 5 in an impulse. In Figure 5B, the ending diagonal is a subdivision of wave C in a zigzag
- Ending diagonal is usually characterized by overlapping wave 1 and 4 and also by the wedge shape. The overlap between wave 1 and 4 is not a condition and it may or may not happen
- The subdivision of an ending diagonal is 3-3-3-3-3

3.5 Motive Sequence

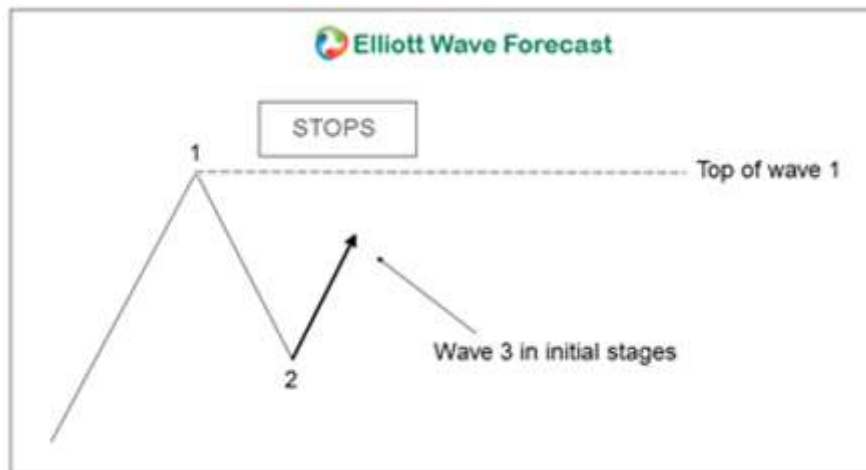
Motive waves move in the same direction of the primary trend, but in today's time, we believe they necessarily have to be in impulse. We instead prefer to call it motive sequence. We define motive sequence simply as an incomplete sequence of waves (swings). The structure of the wave is corrective, but the sequence of the swings will be able to tell us whether the move is over or whether we should expect an extension in the existing direction.

Motive sequence is much like the Fibonacci number sequence. If we discover the number of swings in a chart is one of the numbers in the motive sequence, then we can expect the current trend to continue further.

Motive Sequence: 5, 9, 13, 17, 21, 25, 29, ...

4) Waves Personality

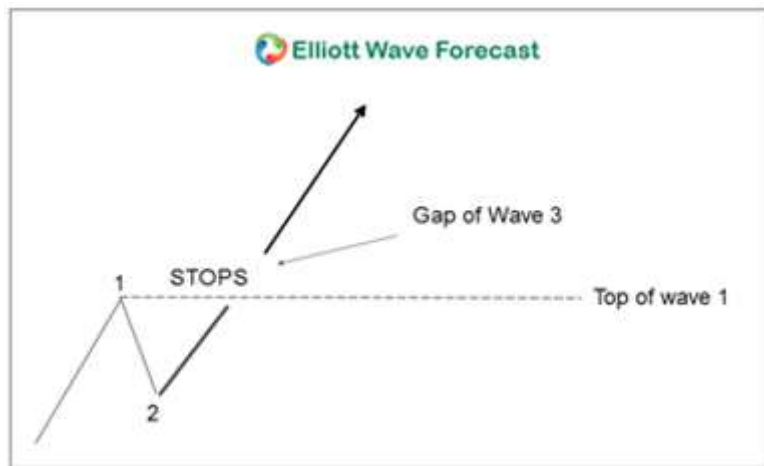
4.1 Wave 1 and wave 2



Wave 1: In Elliott Wave Theory, wave one is rarely obvious at its inception. When the first wave of a market begins, the fundamental news is almost universally negative. The previous trend is conspicuously in force. Fundamental analysts continue to revise their earnings estimates lower; the market probably does not look strong. Sentiment surveys are decidedly bearish, put options are in vogue, implied volatility in the options market is high. Volume might increase a bit as prices rise, but not enough to alert many technical analysts.

Wave 2: In Elliott Wave Theory, wave two corrects wave one, but can never extend beyond the point of wave one. Typically, the news is still bad. As prices retest the prior low, bearish sentiment builds, and "the crowd" haughtily reminds all that the bear market is still deeply ensconced. Some positive signs appear for those who are looking: volume should be lower during wave two than during wave one, prices usually do not retrace more than 61.8% (see Fibonacci section below) of the wave one gains, and prices should fall in a three wave pattern.

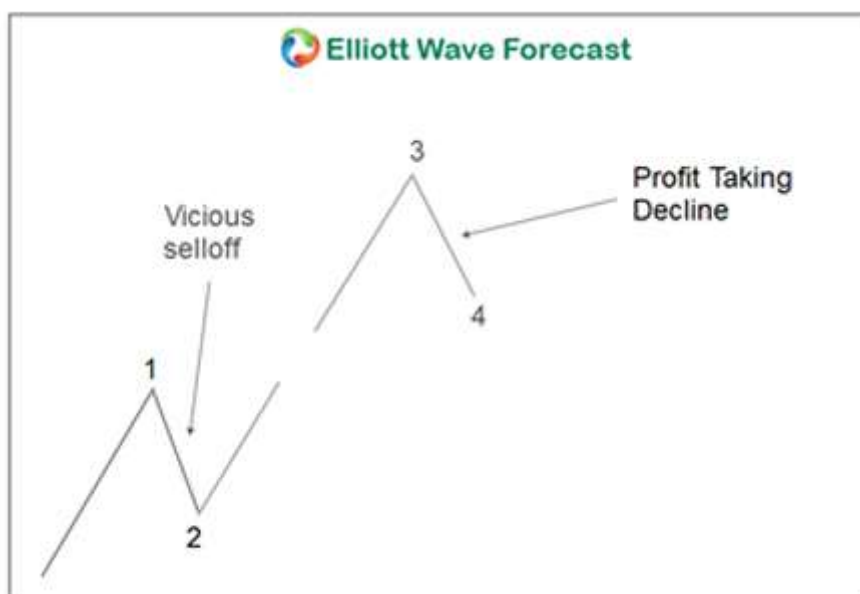
4.2 Wave 3



Wave 3: In Elliott Wave Theory, wave three is usually the largest and most powerful wave in a cycle (although some research suggests that in commodity markets, wave five is the largest). The news is positive and fundamental analysts start to raise earnings estimates. Prices rise quickly, corrections are short-lived and shallow. Anyone looking to "get in on a pullback" will likely miss the boat. As wave three starts, the news is probably still bearish, and most market players remain negative; but by wave three midpoint, "the crowd" will often join the new bullish trend. Wave three often extends wave one by 1.618:1.

Wave 3 rally picks up steam and takes the top of Wave 1. As soon as the Wave 1 high is exceeded, stops are taken out. Depending on the number of stops, gaps are left open. Gaps are a good indicator of Wave 3 in progress. After taking the stops out, the Wave 3 rally has caught the attention of traders.

4.3 Wave 4



At the end of wave 4, more buying sets in and prices start to rally again. Wave four is typically corrective. Prices may meander sideways for an extended period, and wave four typically retraces less than 38.2% of wave three. Volume is well below that of wave three. This is a good place to look back if you understand the potential ahead for wave 5. Still, fourth waves are often frustrating because of their lack of progress in the larger trend.

4.4 Wave 5

Wave 5: In Elliott Wave Theory, wave five is the final leg in the direction of the dominant trend. It is almost universally positive and everyone is bullish. Unfortunately, this is when many average investors finally buy in, right before the top. Volume is often lower in wave five than in wave three, and momentum indicators start to show divergences (prices reach a new high but the indicators do not reach a new peak). At the end of a major bull market, bears may very well be ridiculed (recall how forecasts of a top in the stock market during 2000 were received).

The wave 5 lacks the huge enthusiasm and strength found in the wave 3 rally. Wave 5 advance is called the "last push" and is carried by a small group of traders. Although the prices make a new high above the top of wave 3, the rate of advance inside wave 5 is very small when compared to wave 3 advance.

4.5 Wave A, B, and C

Wave A: Corrections are typically harder to identify than impulse moves. In wave A of a bear market, fundamental news is usually still positive. Most analysts see the drop as a correction in a still-active market. Some technical indicators that accompany wave A include increased volume, rising volatility in the options markets and possibly a turn higher in open interest in related futures markets.

Wave B: Prices reverse higher, which many see as a resumption of the now long-gone bull market. A trader familiar with classical technical analysis may see the peak as the right shoulder of a head and shoulders reversal pattern. The volume during wave B should be lower than in wave A. By this point, fundamentals are probably no longer improving, but they most likely have not yet turned negative.

Wave C: Prices move impulsively lower in five waves. Volume picks up, and by the third leg of wave C, almost everyone realizes that a bear market is firmly entrenched. Wave C is typically at least as long as wave A and often extends to 1.618 times wave A or beyond.

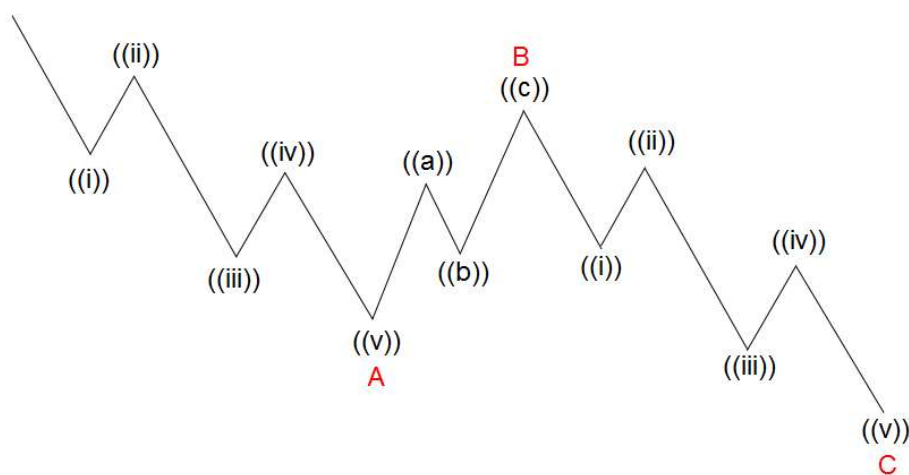
5) Corrective Waves

The classic definition of corrective waves is waves that move against the trend of one greater wave. Corrective waves have a lot more variety and are less clearly identifiable compared to impulse waves. Sometimes it can be rather difficult to identify corrective patterns until they are completed. However, as we have explained above, both trend and counter-trend can unfold in a corrective pattern in today's market, especially in the forex market. Corrective waves are probably better defined as waves that move in the opposite direction to the previous wave. Only motive waves are fives.

There are five types of corrective patterns:

- Zigzag (5-3-5)
- Flat (3-3-5)
- Triangle (3-3-3-3-3)
- Double three: A combination of two corrective patterns above
- Triple three: A combination of three corrective patterns above

5.1 Zigzag



Guidelines

- Zigzag is a corrective 3 waves structure labelled as ABC
- Subdivision of wave A and C is 5 waves, either impulse or diagonal
- Wave B can be any corrective structure
- Zigzag is a 5-3-5 structure

Fibonacci Ratio Relationship

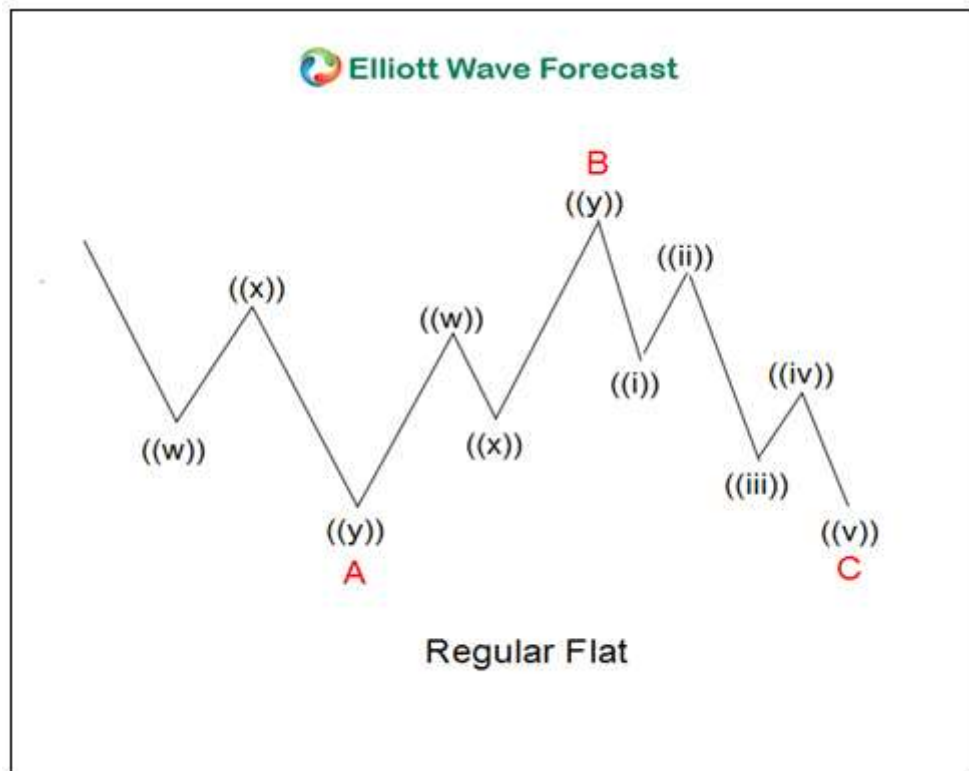
- Wave B = 50%, 61.8%, 76.4% or 85.4% of wave A
- Wave C = 61.8%, 100%, or 123.6% of wave A

- If wave C = 161.8% of wave A, wave C can be a wave 3 of a 5 waves impulse. Thus, one way to label beat and impulse is whether the third swing has extension or not

5.2 Flat

A flat correction is a 3 waves corrective move labelled as ABC. Although the labelling is the same, it differs from zigzag in the subdivision of the wave A. Whereas Zigzag is a 5-3-5 structure, Flat is a 3-3-5 structure. There are three different types of Flats: Regular, Irregular / Expanded, and Running Flats

5.2.1 Regular Flats



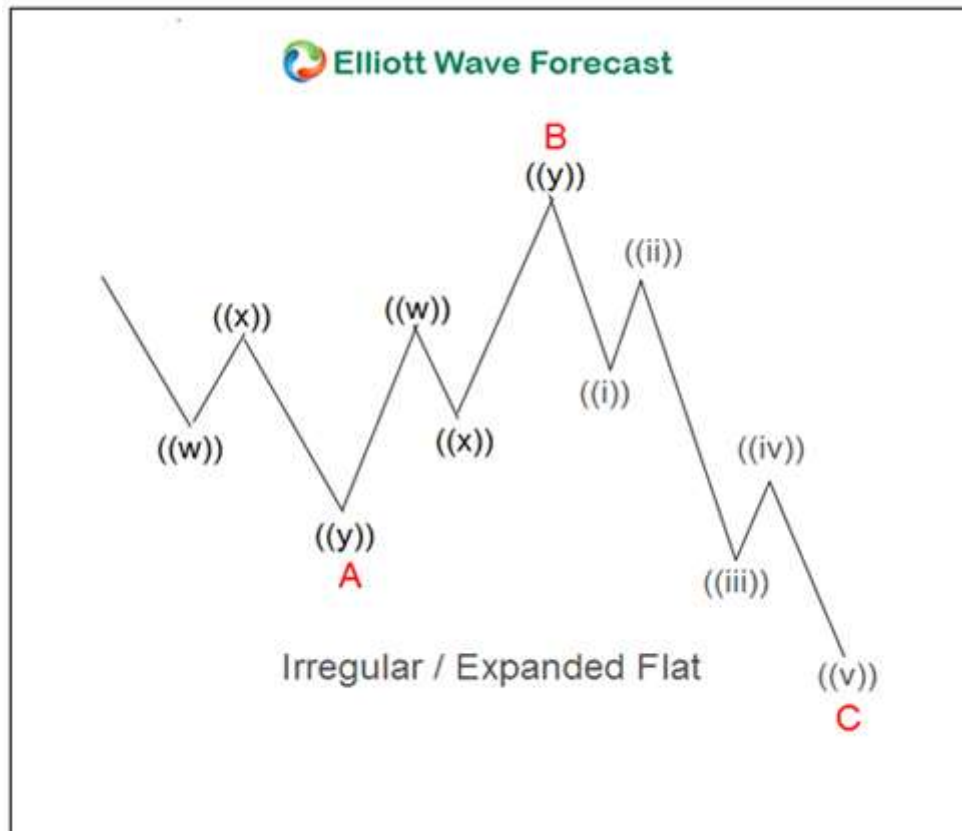
Guidelines

- A corrective 3 waves move labelled as ABC
- Subdivision of wave A and B is in 3 waves
- Subdivision of wave C is in 5 waves impulse / diagonal
- Subdivision of wave A and B can be in any corrective 3 waves structure including zigzag, flat, double three
- Wave B terminates near the start of wave A
- Wave C generally terminates slightly beyond the end of wave A
- Wave C needs to have momentum divergence

Fibonacci Ratio Relationship

- Wave B = 90% of wave A
- Wave C = 61.8%, 100%, or 123.6% of wave AB

5.2.2 Expanded Flats



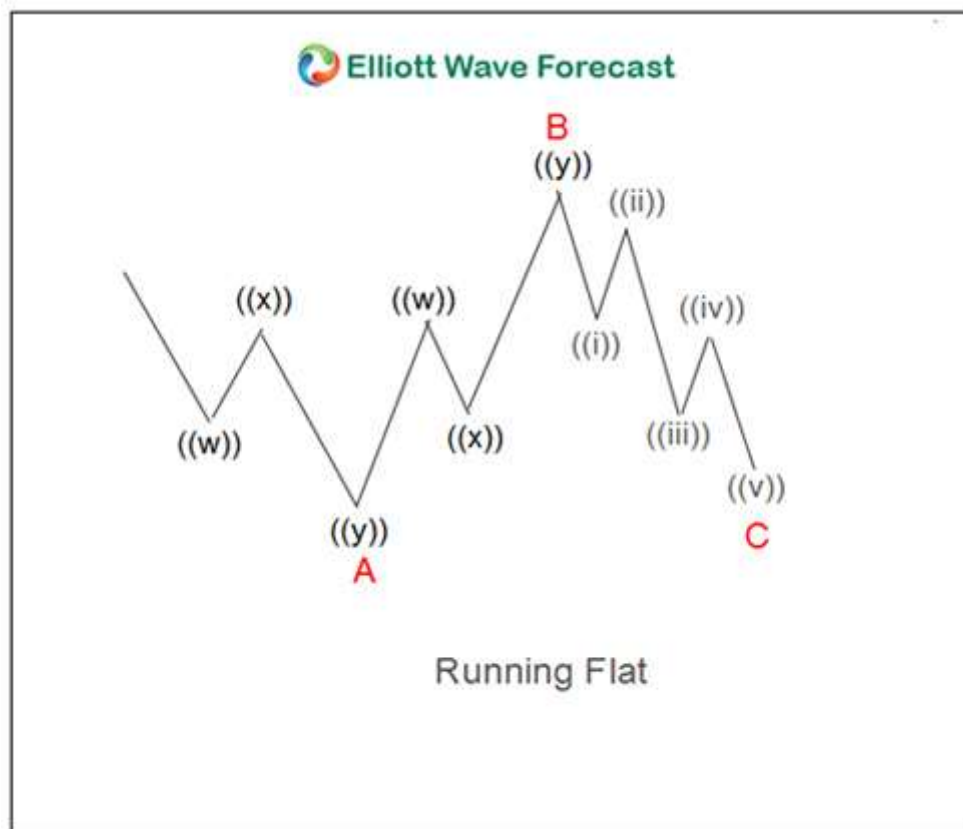
Guidelines

- A corrective 3 waves move labelled as ABC
- Subdivision of wave A and B is in 3 waves
- Subdivision of wave C is in 5 waves impulse / diagonal
- Subdivision of wave A and B can be in any corrective 3 waves structure including zigzag, flat, double three
- Wave B of the 3-3-5 pattern terminates beyond the starting level of wave A
- Wave C ends substantially beyond the ending level of wave A
- Wave C needs to have momentum divergence

Fibonacci Ratio Relationship

- Wave B = 123.6% of wave A
- Wave C = 123.6% – 161.8% of wave AB

5.2.3 Running Flats



Guidelines

- A corrective 3 waves move labelled as ABC
- Subdivision of wave A and B is in 3 waves
- Subdivision of wave C is in 5 waves impulse / diagonal
- Subdivision of wave A and B can be in any corrective 3 waves structure including zigzag, flat, double three
- Wave B of the 3-3-5 pattern terminates substantially beyond the starting level of wave A as in an expanded flat
- Wave C fails travel the full distance, falling short of the level where wave A ended
- Wave C needs to have momentum divergence

Fibonacci Ratio Relationship

- Wave B = 123.6% of wave A
- Wave C = 61.8% – 100% of wave AB

5.3 Triangles

A triangle is a sideways movement that is associated with decreasing volume and volatility. Triangles have 5 sides and each side is subdivided in 3 waves hence forming 3-3-3-3-3 structure. There are 4 triangles in Elliott Wave Theory: Ascending, descending, contracting, and expanding. They are illustrated in the graphic below

Bull Market	Bear Market
<p data-bbox="391 153 829 184" style="text-align: center;">Ascending (Top flat, bottom rising)</p>	
<p data-bbox="358 506 862 537" style="text-align: center;">Descending (Top declining, bottom flat)</p>	
<p data-bbox="248 825 974 856" style="text-align: center;">Contracting or Symmetrical (Top declining, bottom rising)</p>	
<p data-bbox="199 1171 1023 1203" style="text-align: center;">Expanding or Reverse Symmetrical (Top rising, bottom declining)</p>	

Guidelines

- Corrective structure labelled as ABCDE
- Usually happens in wave B or wave 4
- Subdivided into three (3-3-3-3)
- RSI also needs to support the triangle in every time frame
- Subdivision of ABCDE can be either abc, wxy, or flat

5.4 Double Three

Double three is a sideways combination of two corrective patterns. We've already looked at corrective patterns including zigzag, flat, and triangle. When two of these corrective patterns are combined together, we get a double three. In addition,

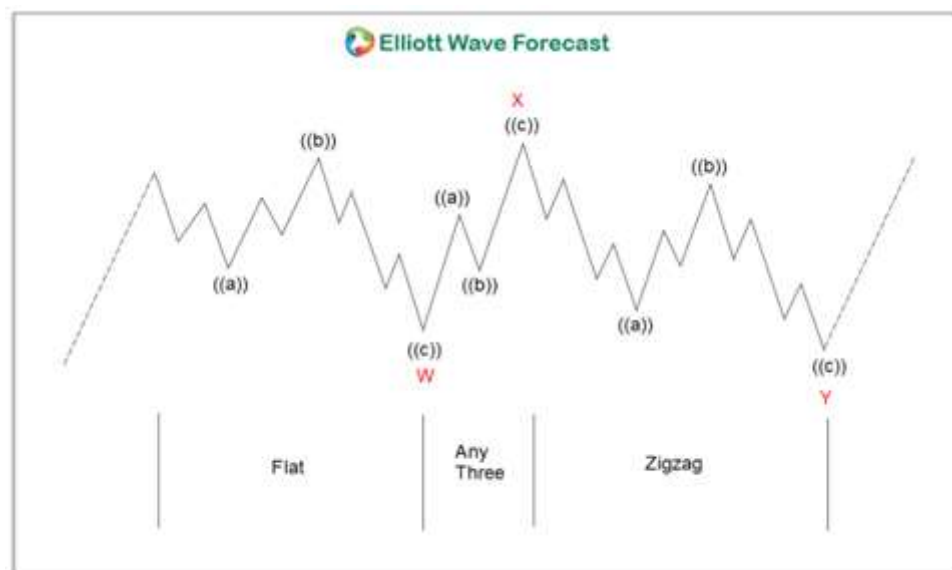
Guidelines

- A combination of two corrective structures labelled as WXY
- Wave W and wave Y subdivision can be zigzag, flat, double three of smaller degree, or triple three of smaller degree
- Wave X can be any corrective structure
- WXY is a 7 swing structure

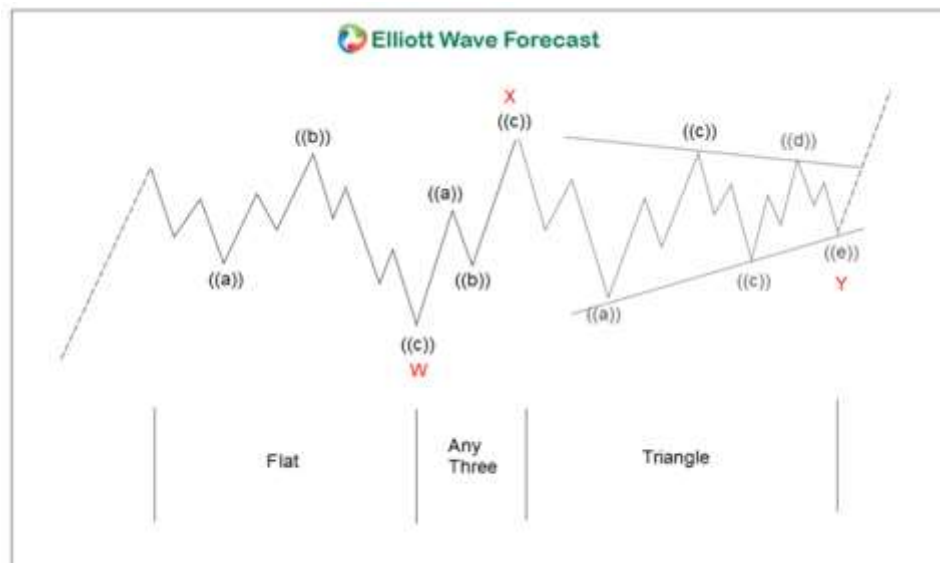
Fibonacci Ratio Relationship

- Wave X = 50%, 61.8%, 76.4%, or 85.4% of wave W
- Wave Y = 61.8%, 100%, or 123.6% of wave W
- Wave Y can not pass 161.8% of wave W

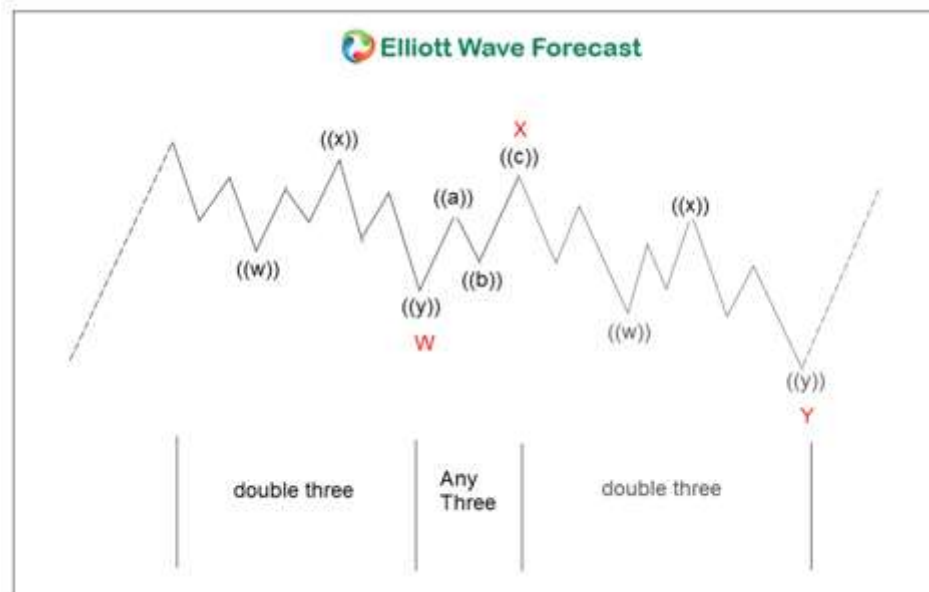
Below are examples of different combinations of two corrective structures which form the double



Above figure is a combination of a flat and a zigzag



Above figure is a combination of a flat and a triangle



Above figure is a combination of two double threes of lesser degree

5.5 Triple Three

Triple three is a sideways combination of three corrective patterns in Elliott Wave Theory

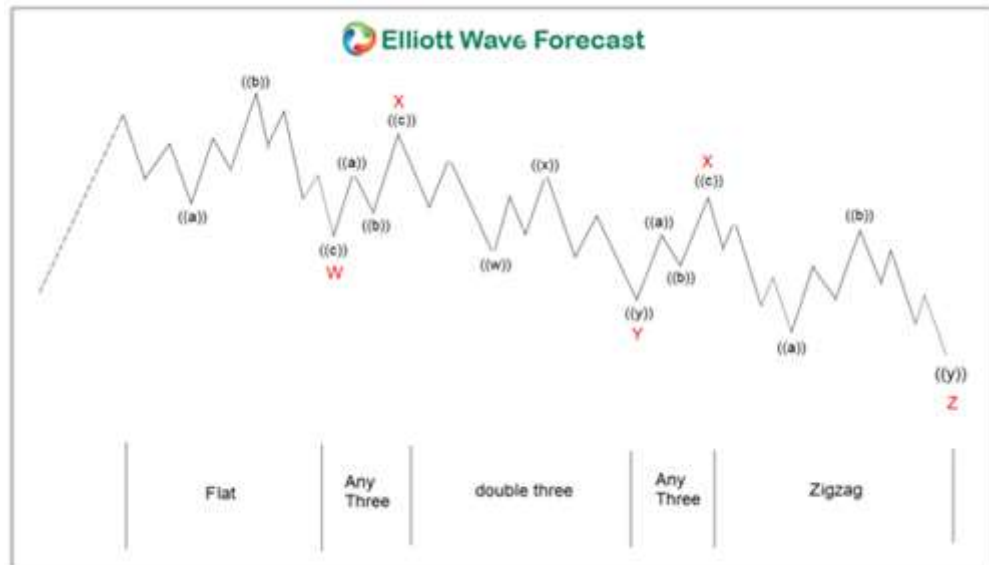
Guidelines

- A combination of three corrective structures labelled as WXYZ
- Wave W, wave Y, and wave Z subdivision can be zigzag, flat, double three of smaller degree, or tripl smaller degree
- Wave X can be any corrective structure
- WXYZ is an 11 swing structure

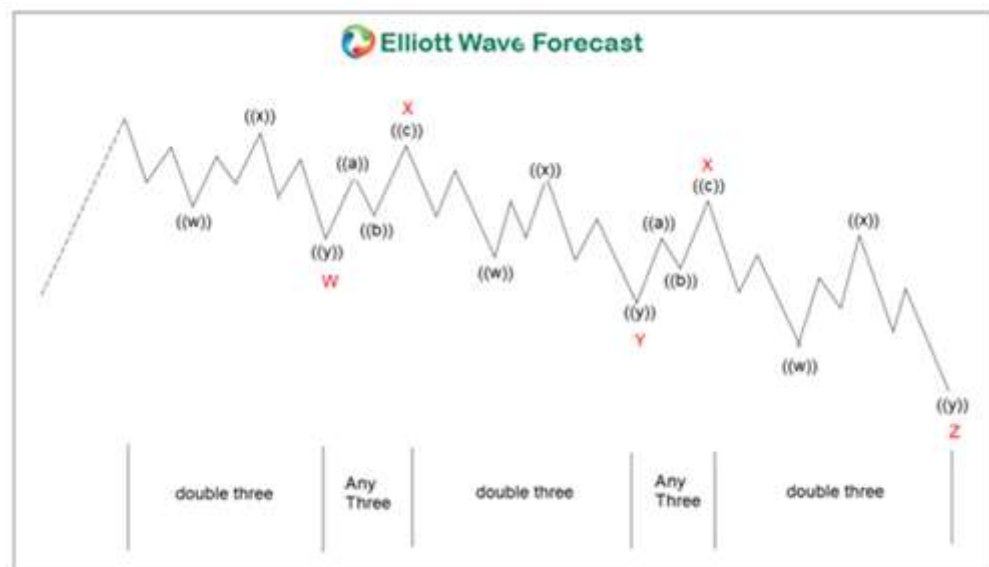
Fibonacci Ratio Relationship in Elliott Wave Theory

- Wave X = 50%, 61.8%, 76.4%, or 85.4% of wave W
- Wave Z = 61.8%, 100%, or 123.6% of wave W
- Wave Y can not pass 161.8% of wave W or it can become an impulsive wave 3

Below are examples of different combinations of three corrective structures which form the triple t



Above figure is a combination of a flat, double three, and zigzag



Above figure is a combination of three double threes

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