

The Wyckoff Method Applied in 2009: A Case Study of the US Stock Market

by Hank Pruden

A test of Wyckoff point-and-figure projections first appeared in the Journal in 2004 with the article “Wyckoff Laws: A Market Test (Part A)”. That first article in the series defined and illustrated the three basic laws of the Wyckoff Method and then applied them to the Dow Jones Industrial Average (DJIA). In the 2009 case study we present a continuation of the real-time tests of the Wyckoff Method from both the 2004 and 2008 studies.

In the first article the spotlight zeroed in on the Law of Cause and Effect and the Wyckoff Method’s application of the Point-and-Figure Chart. It concluded with the expectation that the DJIA would rise from about 8,000 to around 14,400 during the 2003 Primary-trend bull market.

The second article, appearing in the 2008 issue of the Journal, reported the successful achievement of the 2004 prediction. In 2007, the market reached within 5% of DJIA 14,400 and the article concluded that the empirical data generated by the DJIA, in that natural laboratory experiment of the market, supported the contentions of the Wyckoff Law of Cause and Effect.

Although no article was published to report upon the top pattern that formed in the DJIA during 2007 and the subsequent decline into 2009, there nevertheless appeared a study after the fact. A Wyckoff student at Golden Gate University conducted a back-testing research project on the 2007 top and the subsequent drop to the low in 2009.

Using a point and figure chart of the S&P 500, the student’s study revealed that a point and figure count of the S&P 500 in 2009 gave an accurate forecast of the 2009 price low, (please see Appendix no.1 by Mr Brad Brenneise for fuller details of that backtesting study).

A companion article that fitted into the Wyckoff series appeared in the Journal in 2010. The article, “Wyckoff Proofs”, elaborated upon the concept of “market test” that occupied an important role in those studies of the Wyckoff Method. The 2010 article defined and illustrated three distinct types of Wyckoff Tests: (1) Tests as decision rules, such as the nine Buying Tests and the nine Selling Tests; (2) Testing as a phase in a trading range as seen in schematics of accumulation or distribution, and (3) Secondary tests as witnessed in the compound procedures of action and then test.

This, the fourth article in the series, harkens back to the first article published in 2004. Like the first article, which under-took to study the 2002-03 accumulation base in the DJIA with emphasis upon the point and figure chart projection to 14,400, this article is another study of a base in a similar vein. The article undertakes an examination of the 2008-09 accumulation base in the Dow Industrial Average and emphasis is once again placed upon the Law of Cause and Effect and the point and figure price projections for the DJIA with a forecast and a re-cap of Mr Richard D. Wyckoff methods, principally the Wyckoff Laws and the Wyckoff Tests.

Schematics for an accumulation base including places along the base to take a long position will be laid out alongside the classic Wyckoff nine Buying Tests. Considerable attention shall be focused upon the bar and figure charts of the Dow Industrial Average that generate price projections from the 2008-09 base to render the expected extent of the markup phase of the 2009-? bull-market.

Richard D. Wyckoff and his market Investment Theory

A pioneer in the technical approach to studying the stock market, Richard Wyckoff was a broker, a trader and a publisher during the classic era of trading in the early 20th Century.

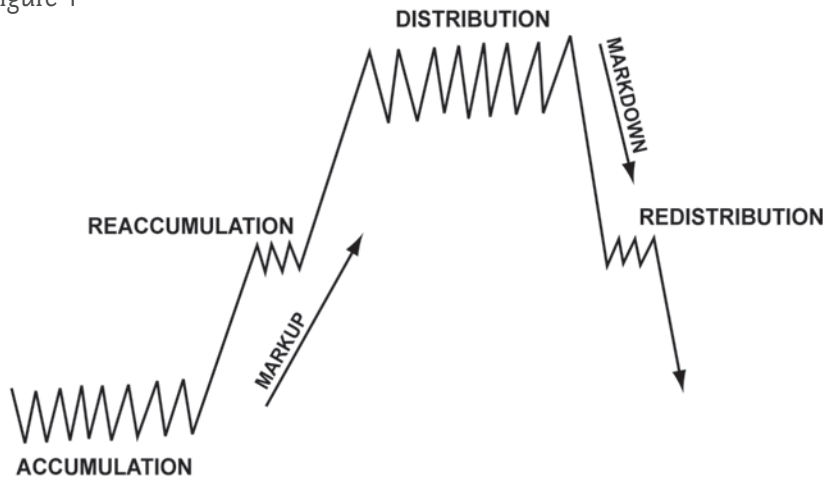
He codified the best practices of legendary traders such as Jesse Livermore and others, into laws, principles and techniques of trading methodology, money management and mental discipline. Mr Wyckoff was dedicated to instructing the public about “the real rules of the game” as played by the large interests behind the scenes. In 1930 he founded a school which later became the Stock Market Institute. Students of the Wyckoff Method have repeatedly time tested his insights and found they are as valid today as when they were first promulgated.

Wyckoff believed that the action of the market itself was all that was needed for intelligent, scientific trading and investing. The ticker tape revealed price, volume and time relationships that were advantageously captured by charts.

Comparing waves of buying versus waves of selling on the bar chart revealed the growing strength of demand or supply. With the aid of schematics of accumulation or distribution, the speculator is empowered to make informed decisions about the present position and probable future trend of a market. The figure chart is then added to project the probable extent of a price movement.

Wyckoff also revealed how to interpret the intentions of the major interests that shape the destiny of stocks and how to follow in the footsteps of those sponsors at the culmination of bullish or bearish trading ranges.

Figure 1



these annotations reflect the contribution of Mr Robert G. Evans, who carried on the teaching of the Wyckoff Method after the death of Mr Wyckoff in 1934. Mr Evans, a creative teacher, was a master at explaining Wyckoff principles via analogies.

One objective of the Wyckoff method of technical analysis is to enhance market timing or when to enter a speculative position in anticipation of a coming up-move. These high reward/low risk entries typically occur around the culmination of sideways trading ranges. Trading ranges (TRs) are phases where the previous move has been halted and there is relative equilibrium between supply and demand. It is here within the TR that a campaign of accumulation is conducted by the strong hands, the smart money, and the composite man in preparation for the coming bull or bear trend. It is this force of accumulation that can be said to build a cause that unfolds in the subsequent uptrend. The building up of the necessary force takes time, and because during this period the price action is well-defined, TRs can also present favourable short-term trading opportunities with potentially very favourable reward/risk parameters for nimble traders. Nevertheless, the Wyckoff Method contends that reward comes more easily and consistently with participation in the trend that emerges from the trading range.

Table 1

WYCKOFF LAWS

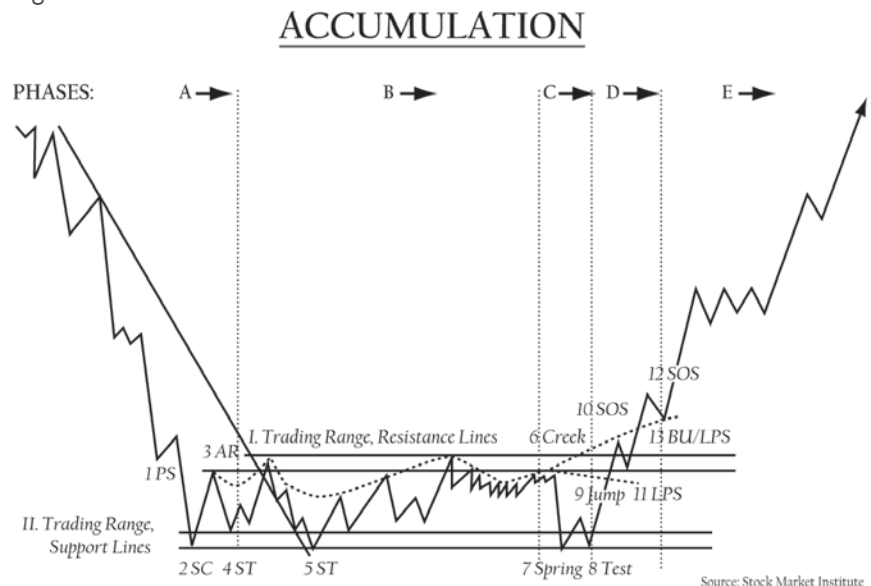
- 1. The Law of Supply and Demand** – states that when demand is greater than supply, prices will rise, and when supply is greater than demand, prices will fall. Here the analyst studies the relationship between supply versus demand using price and volume over time as found on a bar chart.
- 2. The Law of Effort versus Results** – divergences and disharmonies between volume and price often presage a change in the direction of the price trend. The Wyckoff “Optimism versus Pessimism” index is an on-balanced-volume type indicator helpful for identifying accumulation versus distribution and gauging effort.
- 3. The Law of Cause and Effect** – postulates that in order to have an effect you must first have a cause and that effect will be in proportion to the cause. This law’s operation can be seen working as the force of accumulation or distribution within a trading range, working itself out in the subsequent move out of that trading range. Point and figure chart counts can be used to measure this cause and project the extent of its effect.

Wyckoff Schematics of Accumulation

The Wyckoff Method empowers the trader-analyst with a balanced, whole-brained approach to technical analysis decision making. The Wyckoff schematics provide picture diagrams as a right-brained tool to complement the left-brained analytical checklists furnished by the Wyckoff three laws and nine tests.

This section of the article presents the sequence of three schematics that help to demonstrate the Wyckoff Method of technical analysis. With each schematic appear alphabetical and numerical annotations that define Wyckoff’s key phases and junctures found during the evolution of accumulation into the mark up phase. Several of

Figure 2



The Schematic of Accumulation in Figure 2 provides an idealised visual representation of the Wyckoff market action typically found within a TR of accumulation. While this idealised Wyckoff model for accumulation is not a schematic for all the possible variations within the anatomy of a TR, it does provide the important Wyckoff principles that are evident in an area of accumulation. It also shows the key phases used to guide our analysis from the beginning of the TR with a selling climax, through building a cause until the taking of a speculative long position.

Phases A through E in the trading range are defined below. Lines A and B define support of the trading range, while lines C and D define resistance. The abbreviations appearing on the Schematic indicate Wyckoff principles and they are also defined below:

Phases in Accumulation Schematic and their Functions

- **Phase A:** To stop a downward trend either permanently or temporarily
- **Phase B:** To build a cause within the trading range for the next effect and trend
- **Phase C:** Smart money “tests” the market along the lower and/or the upper boundaries of the trading range. Here one observes “springs” and/or “jumps” and “backups”
- **Phase D:** Defines the “line of least resistance” with the passage of the nine buying tests
- **Phase E:** The mark up or the upward trending phase unfolds

Annotations in the Accumulation Schematic Defined

1. **PS** – preliminary support, where substantial buying begins to provide pronounced support after a prolonged down-move. Volume and the price spread widen and provide a signal that the down-move may be approaching its end.
2. **SC** – selling climax, the point at which widening spread and selling pressure usually climaxes and heavy or panicky selling by the public is being absorbed by larger

professional interests at prices near the bottom. At the low, the climax helps to define the lower level of the trading range.

3. **AR** – automatic rally, where selling pressure has been exhausted. A wave of buying can now easily push up prices, which is further fuelled by short covering. The high of this rally will help define the top of the trading range.
- 4+5. **ST** – secondary test, price revisits the area of the selling climax to test the supply/demand at these price levels. If a bottom is to be confirmed, significant supply should not resurface, and volume and price spread should be significantly diminished as the market approaches support in the area of the SC.
6. The “**Creek**” is a wavy line of resistance drawn loosely across rally peaks within the trading range. There are minor lines of resistance and a more significant “creek” of supply that will have to be crossed before the market’s journey can continue onward and upward.
- 7+8. “**Springs**” or “**shakeouts**” usually occur late within the trading range and allow the dominant players to make a definitive test of available

supply before a markup campaign will unfold. If the amount of supply that surfaces on a break of support is very light (low volume), it will be an indication that the way is clear for a sustained advance. Heavy supply here usually means a renewed decline. Moderate volume here may mean more testing of support and a time to proceed with caution. The spring or shakeout also serves the purpose of providing dominant interests with additional supply from weak holders at low prices.

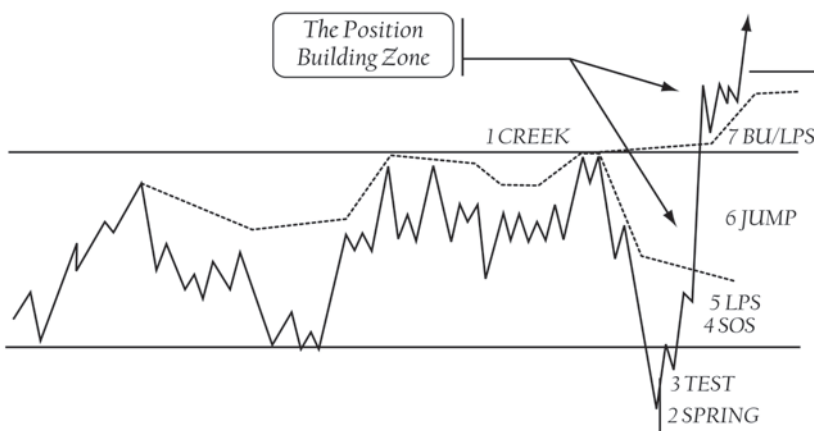
9. “**Jump**” – continuing the creek analogy, the point at which price jumps through the resistance line; a bullish sign if the jump is achieved with increasing speed and volume.
- 10-12. **SOS** – sign of strength, an advance on increasing spread and volume, usually over some level of resistance
- 11-13. **BU/LPS** – last point of support, the ending point of a reaction or pullback at which support was met. Backing up to an LPS means a pullback to support that was formerly resistance, on diminished spread and volume after an SOS. This is a good place to initiate long positions or to add to profitable ones.

Figure 3

WYCKOFF SET-UPS FOR TAKING A POSITION:

TAKING ACTION

- PHASES OF TESTING
- THE READINESS TO MOVE



Source: Institute for Technical Market Analysis at Golden Gate University

Whereas the three Wyckoff laws give a broader, big-picture approach to the Wyckoff method's study of charts, the nine tests are a set of principles that are more narrow and specific in their applications. The Wyckoff tests logically follow as the succeeding step to the Wyckoff laws

The Nine Buying Tests are important for defining when a trading range is finally coming to its end and a new uptrend (markup) is commencing. In other words, the nine tests define the line of least resistance in the market.

The nine classic buying tests in Table 2 define the emergence of a new bull trend out of a base that forms after a significant price decline.

Table 2: **Wyckoff Buying Tests: Nine Classic Tests for Accumulation***

Indication	Determined From
1 Downside price objective accomplished	Figure chart
2 Preliminary support, selling climax, secondary test	Vertical and figure
3 Activity bullish (volume increases on rallies and diminishes during reactions)	Vertical
4 Downward stride broken (that is, supply line penetrated)	Vertical or figure
5 Higher supports	Vertical or figure
6 Higher tops	Vertical or figure
7 Stock stronger than the market (that is, stock more responsive on rallies and more resistant to reactions than the market index)	Vertical chart
8 Base forming (horizontal price line)	Figure chart
9 Estimated upside profit potential is at least three times the loss if protective stop is hit	Figure chart for profit objective

* Applied to an average or a stock after a decline.
Adapted with modifications from Jack K. Huston, ed., *Charting the Market: The Wyckoff Method* (Seattle, WA: Technical Analysis, Inc., 1986), 87.

Figure 4



A Case Study of the US Stock Market, 2009

An opportunity to apply the Wyckoff Laws and the Wyckoff Tests occurred in the US stock market during 2009. Figures 4 and 5 show the bar chart and the point and figure charts of the Dow Industrial Average 2008-2009.

The reader is encouraged to use this application as a learning exercise. The laws of the supply and demand can be seen operating on the weekly bar chart of the Dow Industrials (Figure 4). A definition of the uptrend, the line-of-least resistance was revealed at around the 8,100 level for the Dow. At that point the Wyckoff analysts could conclude that the nine buying tests found on Table 2 had been passed. Therefore, the expectation was for a bull market to unfold. At that same juncture of 8,100 a last point of support (LPS) was identified for which a count could be taken on the point and figure chart.

Once the LPS was identified, the Wyckoff analyst would turn to the point and figure chart of the Dow (Figure 5) to apply the Law of Cause and Effect and to make upside price projections.

By counting from right to left along the 8,100 level the analyst finds 37 columns. Since this is a 3 box reversal chart, with each box worth 100 Dow points, the count becomes $37 \times 300 = 11,100$ points of cause built up in the 2008-09 accumulation base. Added to the low of 6,500 the upside projection is to a price level of 17,600 on the DOW. Then from the count 8,100 line itself, the accumulation base of 11,100 adds up to an upside maximum projection of 19,200.

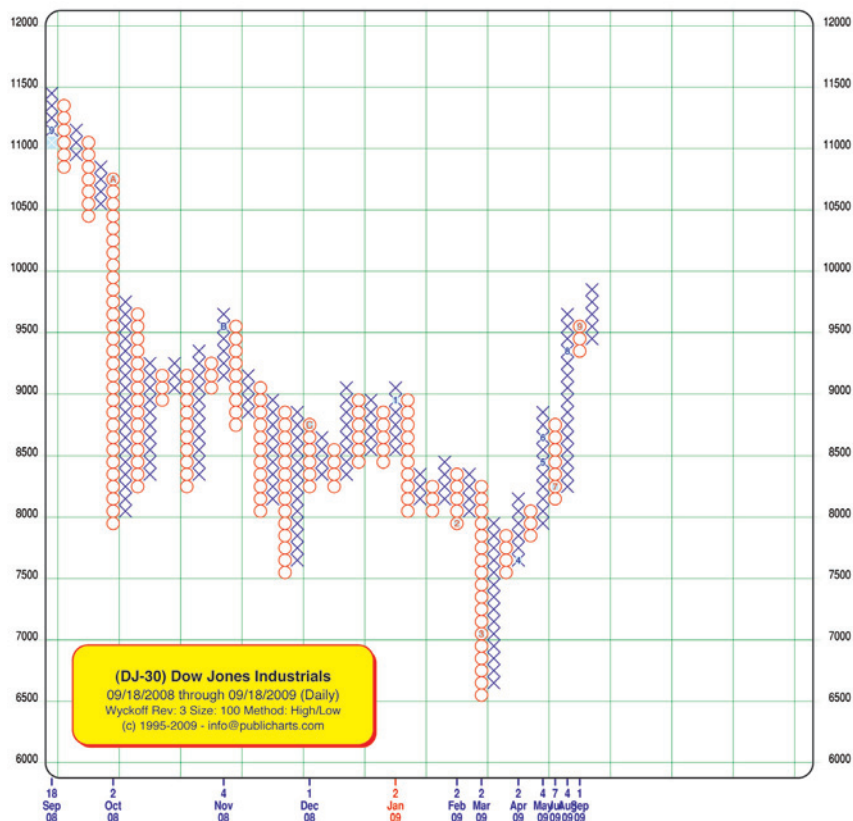
The Wyckoff analyst should “flag” those upside counts on the point and figure chart of the DOW to provide a frame of reference that may help to keep the long-term trader/investor on the long-side while the market undergoes inevitable corrections and reactions along its path toward 17,600-19,200. Of course, risk should be contained with trailing stop orders and the anticipation of further upside progress suspended or reversed with a change in the character of the market behaviour suggests the arrival of a bear market.

The last Point of Support, the Count Line and Upside Price Projections to DJIA 17,600–19,200

The pullback or back-up after the sign of strength on the bar chart of the Dow Jones Industrials defined the place on the point and figure chart to take the count. That count line turned out to be the 8,100 level on the 100-box-sized Dow Industrial P&F chart. Along the 8,100 level counting from right to left there were 37 columns of three point reversals for a total P&F count of 11,100 points accumulated during the 2008-2009 basing period. Using the Wyckoff Law of Cause and Effect and the Wyckoff Count guide (defined in the IFTA Journal 2008, page 14) one should add that 11,100 point count to the low of 6,500 to project a 17,600 minimum count. Adding that 11,100 point count to the count line 8,100 projects a maximum count of 19,200.

In conclusion, the expectation is for the Dow Industrials to rise into the price objective zone of 17,600-19,200 before the onset of the next primary trend bear market.

Figure 5



Author’s note: The article gained its title: “The Wyckoff Method Applied in 2009: A Case Study of the U.S Stock Market” as it is based upon a presentation by the same name that I gave at the 22nd Annual IFTA Conference in Chicago, IL., U.S.A on October 8, 2009.

Appendix

Wyckoff Point and Figure Projection of the S&P 500 2009 Low

This is the projection of the S&P 500 cash index from the 2007 high to the 2009 low using Wyckoff Point and Figure techniques and shows the points when the market gives clues that it is entering into a trading range and turning down.

The trading range projections points are from the Preliminary Supply (PSY) to the point labeled as the “Ice Hole Failure.” The idea here is that the market has fallen through the ice (FTI) and it attempts to get back up above it. Failing to find a hole back through the ice, it drowns and sinks down. Another way to look at this point is the standard “action” of thrusting down and “test”, where the test shows resistance to any further climbing.

The points chosen for the projection are the most obvious points when seen from a point and figure chart.

In Figure 8 the settings are for 20 points per box with a 3 box turn around (total of 60 points). The projection range is shown in brown.

This technique projected the S&P 500 to within 10 points of the low off the conservative estimate point.

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Charts and Data

Courtesy:

Publiccharts, San Jose, California, USA, 2009.

Institute for Technical Market Analysis, Golden Gate University, San Francisco, CA, USA.

**Figure 6
S&P 500 Cash Index**



**Figure 7
A possible Wyckoff interpretation**



**Figure 8
Point and Figure chart of the S&P 500**

