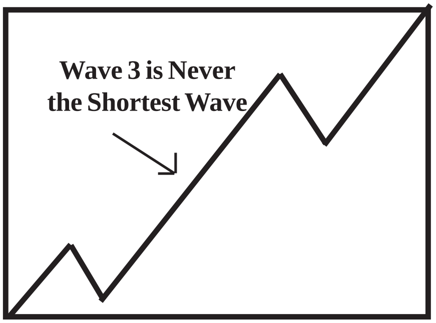
CHAPTER 9
Elliott Waves

Rules and Guidelines

Rule 1: Wave 3 Is Never the Shortest

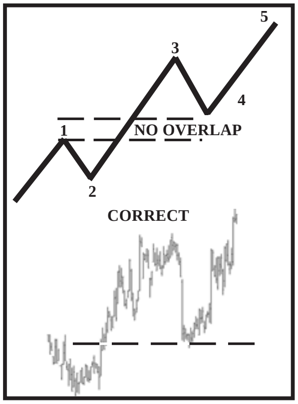
This rule means that Wave 3 is always longer than at least one of the other two waves (Waves 1 or 2). Usually, Wave 3 is longer than both these waves.

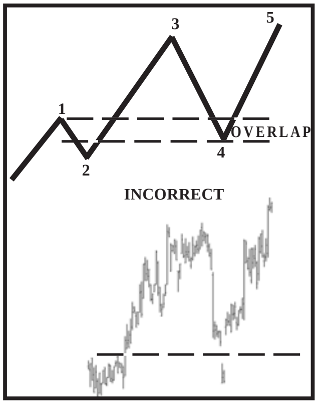


You should never look for Wave 3 to be shorter than both the other two waves. At times, Wave 3 may end up to be equal in length, but never the shortest. There is no exception to this rule.

Rule 2: Wave 4 Should Not Overlap Wave 1

This means the end of Wave 4 should not trade below the peak of Wave 1. This rule cannot be violated in Cash markets. In the Futures markets, a 10% to 15% overlap can be allowed.





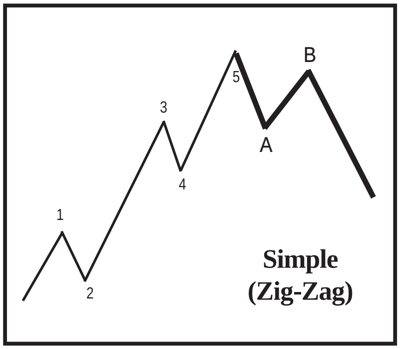
Elliott Wave Corrections

Corrections are very hard to master. Most Elliott Traders make money during an impulse pattern and then lose it back during the corrective phase.

An impulse pattern consists of five waves. The corrective pattern consists of 3 waves, with the exception of a triangle. An Impulse pattern is always followed by a Corrective pattern. Corrective patterns can be grouped into two different categories:

1) Simple correction
2) Complex correction

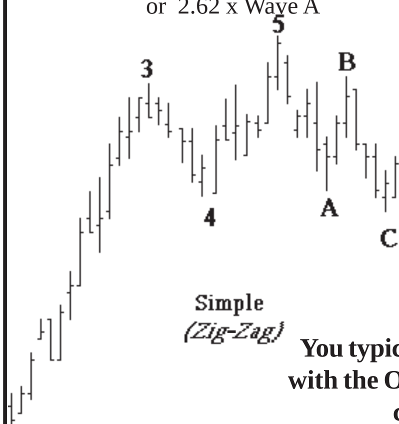
Simple Corrections



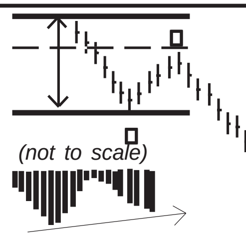
A simple correction has one pattern only. This pattern is called a Zig-Zag correction. A Zig-Zag correction is a 3-wave pattern where the Wave B does not retrace more than 75% of Wave A. Wave C will make new lows below the end of Wave A. The Wave A of a Zig-Zag correction always has a 5-wave pattern. In the other two types of corrections (Flat and Irregular), the Wave A has a 3-wave pattern. Thus, if you can identify a 5-wave pattern inside Wave A of any correction, you can then expect the correction to turn out as a Zig-Zag formation.

Fibonacci Ratios Inside a Zig-Zag Correction

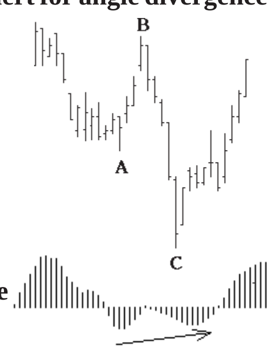
Wave B = usually 50% of Wave A
Wave B should not exceed 75% of Wave A
Wave C = either 1 x Wave A
or 1.62 x Wave A
or 2.62 x Wave A



A simple correction is commonly called a Zig-Zag correction.



Be alert for angle divergence

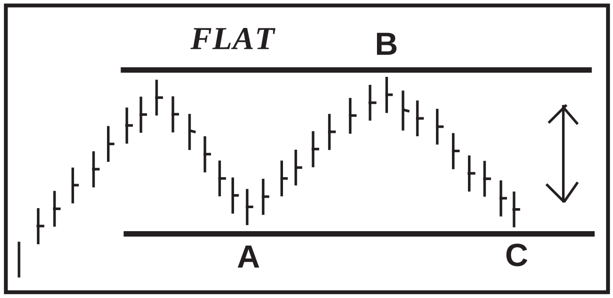


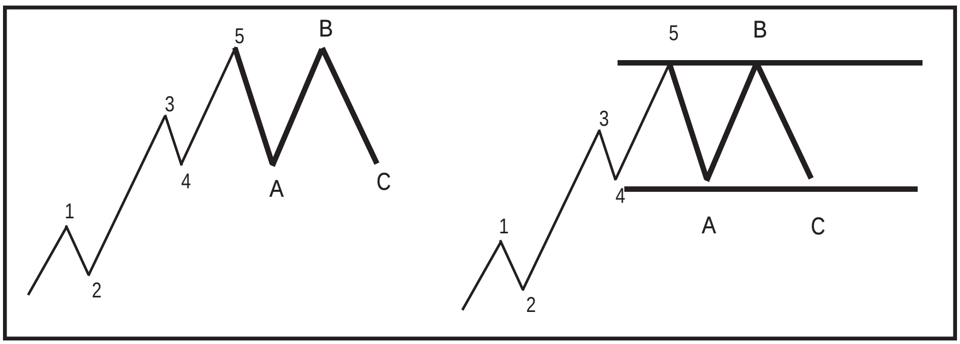
You typically see divergence with the Oscillator in a simple correction.

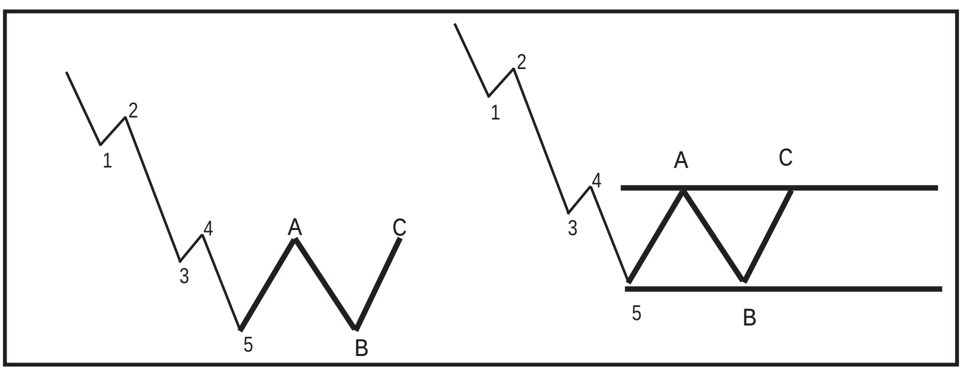
Complex Corrections ~ Flat, Triangle and Irregular

Flat Correction

In a Flat correction, the length of each wave is identical. After a 5-wave impulse pattern, the market drops in Wave A. It then rallies in a Wave B to the previous high. Finally, the market drops one last time in Wave C to the previous Wave A low.







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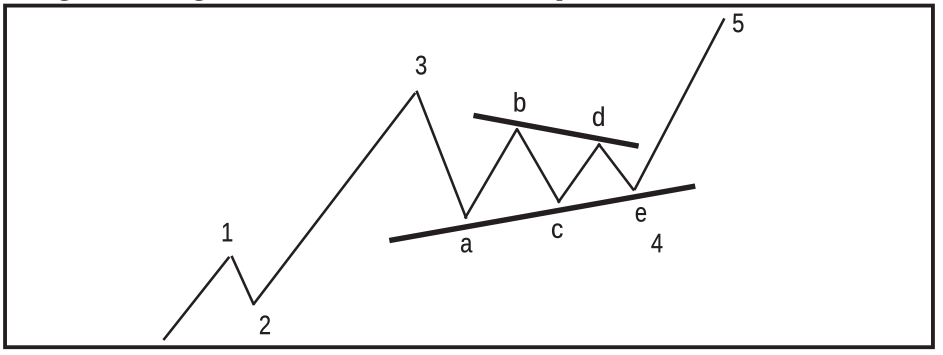
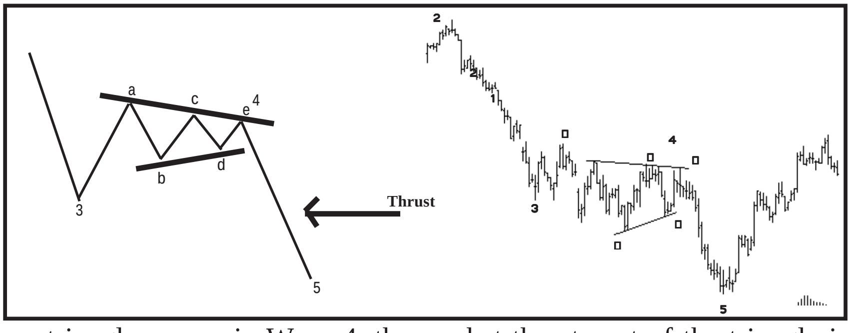
Triangle Correction

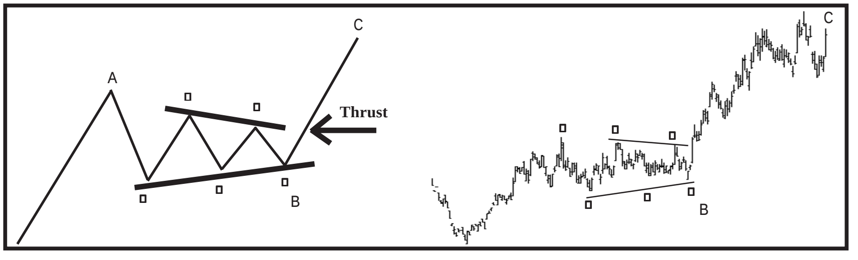
In addition to the 3-wave correction patterns, there is another pattern that appears time and time again. It is called the Triangle pattern. The Elliott Wave Triangle approach is quite different from other triangle studies. The Elliott Triangle is a 5-wave pattern where all the waves cross each other. The five sub-waves of a triangle are designated A, B, C, D, and E in sequence.



Triangles are by far most common as fourth waves. One can sometimes see a triangle as the Wave B of a 3-wave correction. Triangles are very tricky and confusing. One must study the pattern very carefully prior to taking action. Prices tend to shoot out of the triangle formation in a swift "thrust."

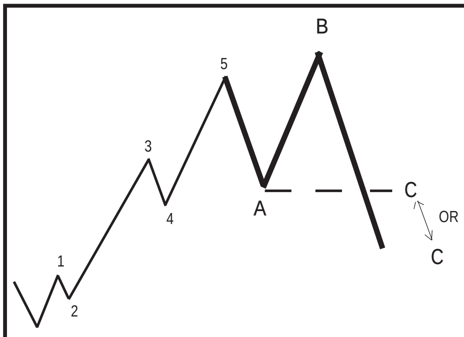


When triangles occur in Wave 4, the market thrusts out of the triangle in the same direction as Wave 3. When triangles occur in Wave B, the market thrusts out of the triangle in the same directions as the Wave A.

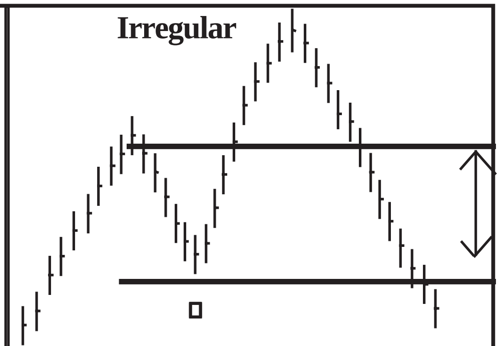


Irregular Correction

In this type of correction, Wave B makes a new high. The final Wave C may drop to the beginning of Wave A, or below it.



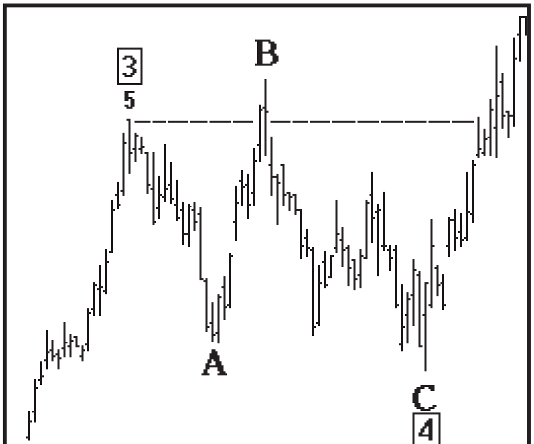
Downward Irregular Correction



After 75% retracement, it is then considered a complex correction.

Fibonacci Ratios in an Irregular Wave

Wave B = either 1.15 x Wave A
or 1.25 x Wave A
Wave C = either 1.62 x Wave A
or 2.62 x Wave A



Downward Irregular Correction

Alteration Rule

- ♦ If Wave 2 is a simple correction, expect Wave 4 to be a complex correction.
- ♦ If Wave 2 is a complex correction, expect Wave 4 to be a simple correction.

Notes

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