Elliott Wave Basics By Andy Bushak

Definition of Elliott Waves

In the 1930s, Ralph Nelson Elliott found that the markets exhibited certain repeated patterns. His primary research was with stock market data for the Dow Jones Industrial Average. This research identified patterns or waves that recur in the markets. Very simply, in the direction of the trend, expect five waves. Any corrections against the trend are in three waves. Three wave corrections are lettered as "a, b, c". These patterns can be seen in long-term and short-term charts.

Ideally, smaller patterns can be identified within bigger patterns. In this sense, Elliott Waves are like a piece of broccoli, where the smaller piece, if broken off from the bigger piece, does, in fact, look like the big piece. This information (about smaller patterns fitting into bigger patterns), coupled with the Fibonacci 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.

There have been many theories about the origin and the meaning of the patterns that Elliott discovered, including human behavior and harmony in nature. These rules, though, as applied to technical analysis of the markets (stocks, commodities, futures, etc.), can be very useful, regardless of their meaning and origin.

Simplifying Elliott Wave Analysis

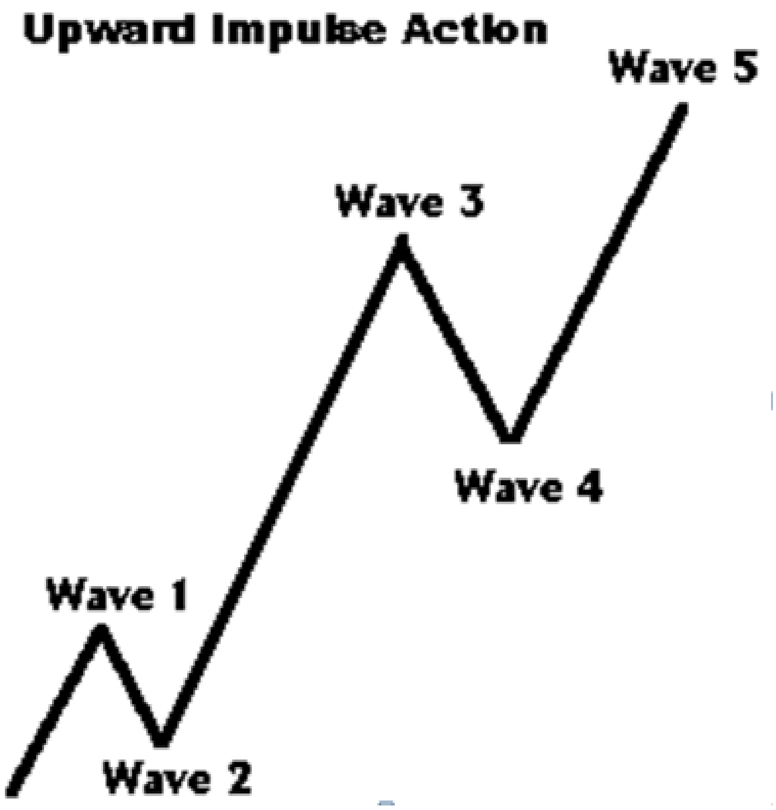
Elliott Wave analysis is a collection of complex techniques. Approximately 60 percent of these techniques are clear and easy to use. The other 40 are difficult to identify, especially for the beginner. The practical and conservative approach is to use the 60 percent that are clear. When the analysis is not clear, why not find another market conforming to an Elliott Wave pattern that is easier to identify? From years of fighting this battle, we have come up with a practical approach to using Elliott Wave principles in trading.

The whole theory of Elliott Wave can be classified into two parts:

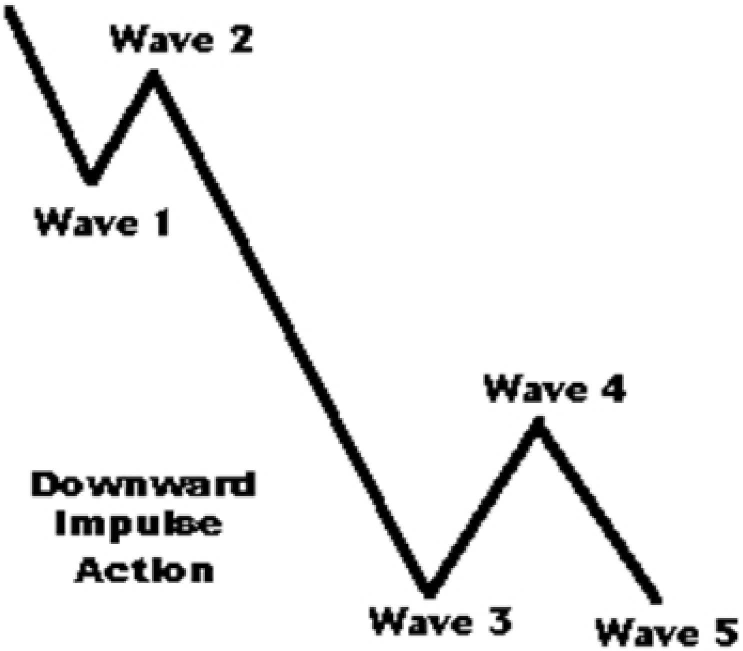
- Impulse patterns

- Corrective patterns

Elliott Wave Basics — Impulse Patterns

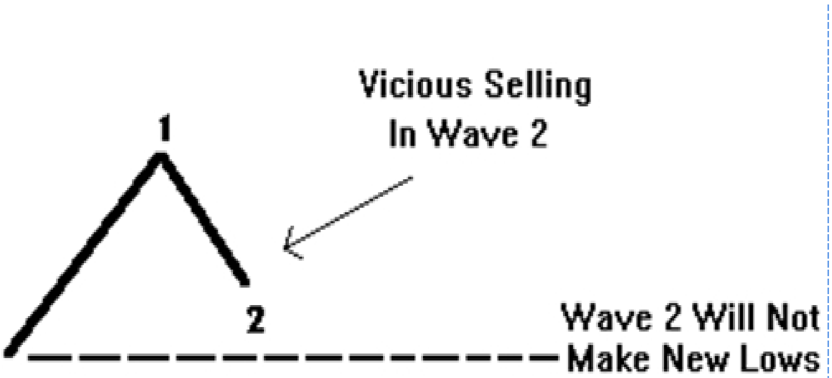


The impulse pattern consists of five waves. The five waves can be in either direction, up or down. Some

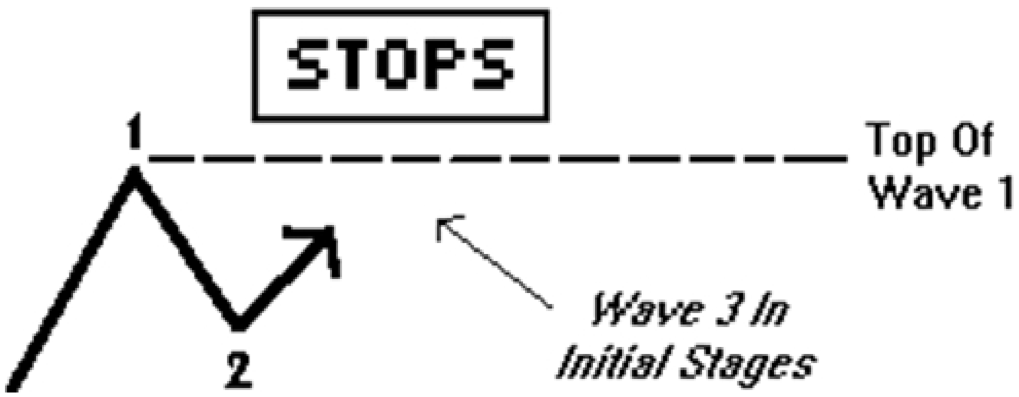


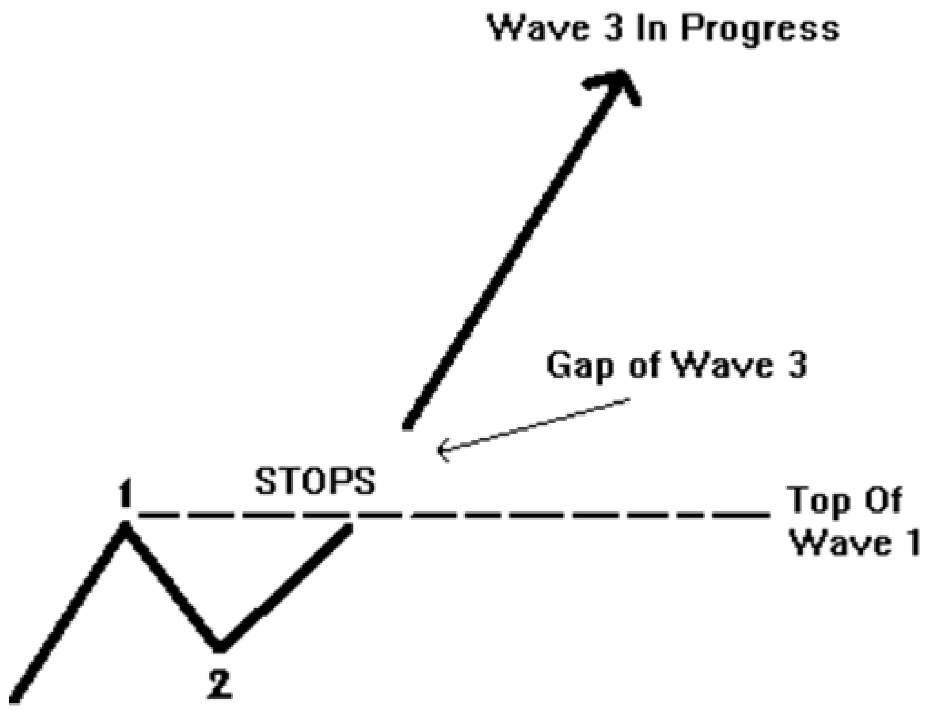
The initial stages of the Wave 3 rally are slow, and it finally makes it to the top of the previous rally (the t

At this time, there are a lot of stops above the top of Wave 1.



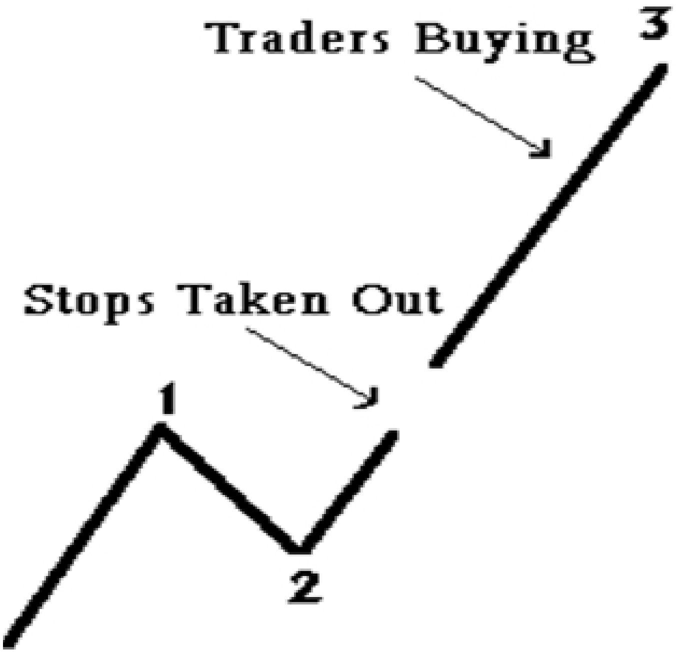
Traders are not convinced of the upward trend and are using this rally to add more shorts. For their anal





The Wave 3 rally picks up steam and takes the top of Wave 1. As soon as the Wave 1 high is exceede

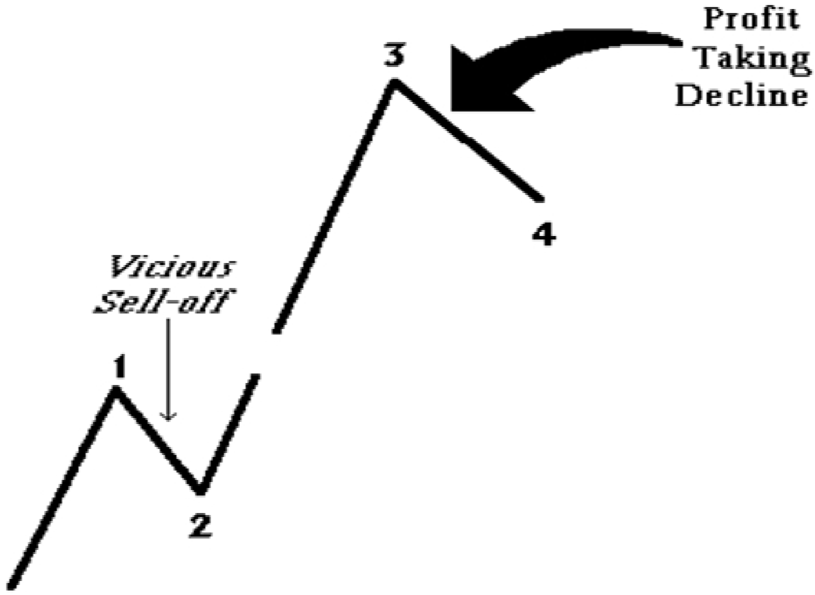
This is the time when the majority of the traders have decided that the trend is up. Finally, all the buyi

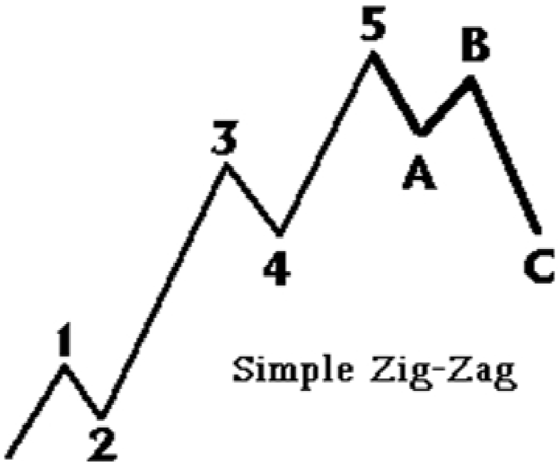


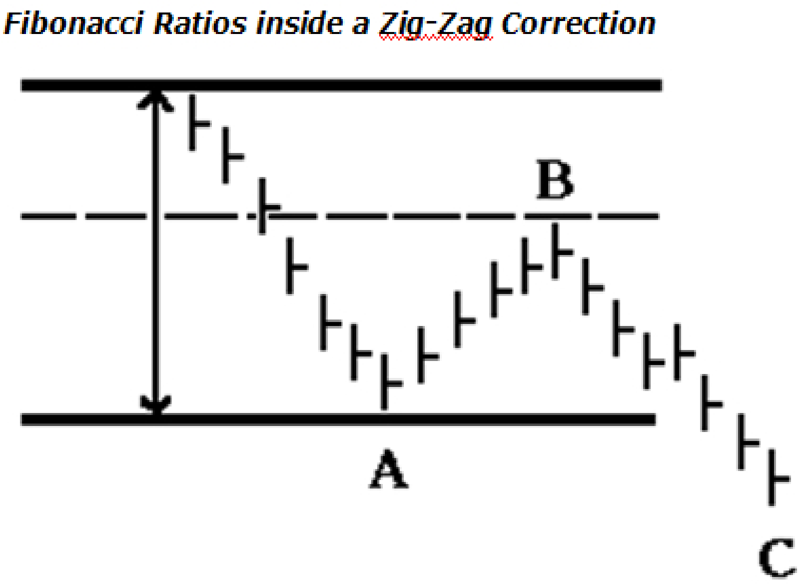
Profit-taking now begins to set in. Traders who were long from the lows decide to take profits. They ha

Wave 2 was a vicious sell-off; Wave 4 is an orderly profit-taking decline. While profit-taking is in progr

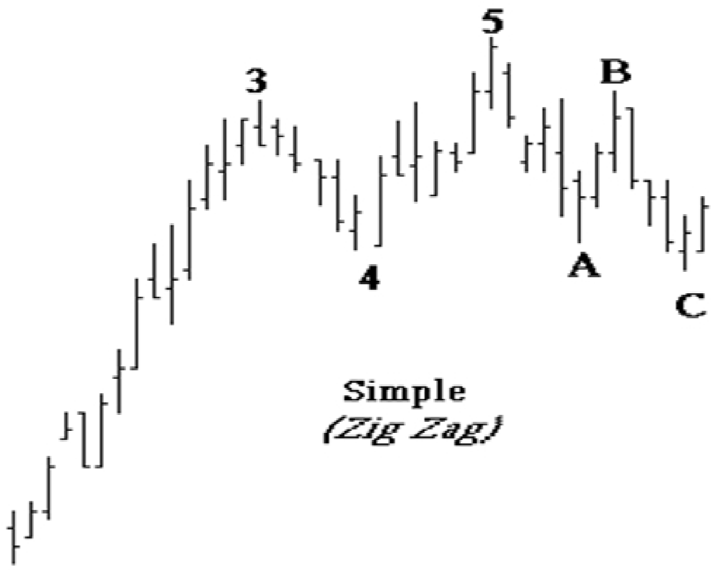
They consider this profit-taking decline an excellent place to buy in and get even.


Profit
Taking
Decline
3
Vicious
Sell-off
1
2
4

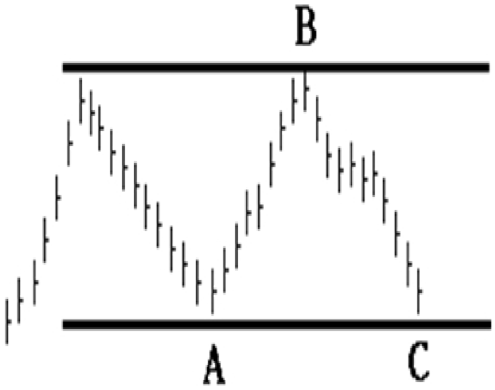

5
B
3
A
4
C
1
Simple Zig-Zag
2

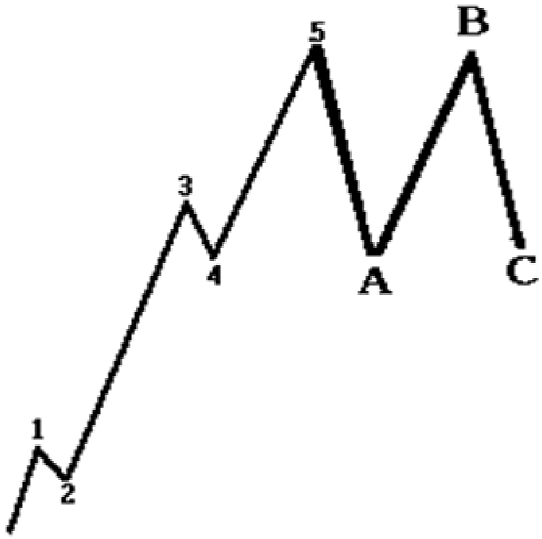


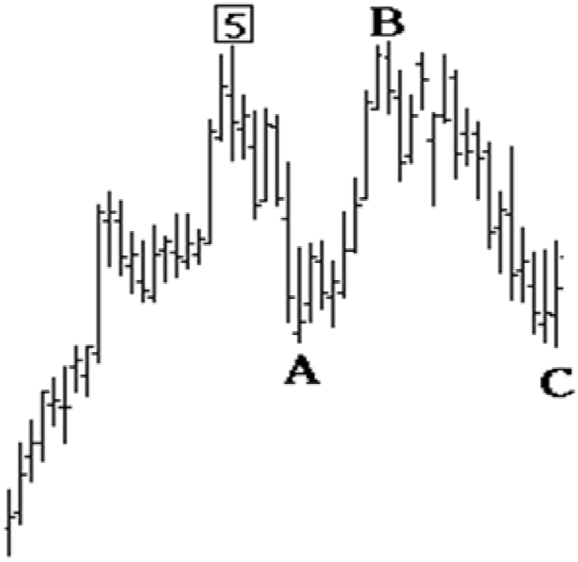
Wave B 50% of Wave A 62 Should not exceed 75% of Wave A



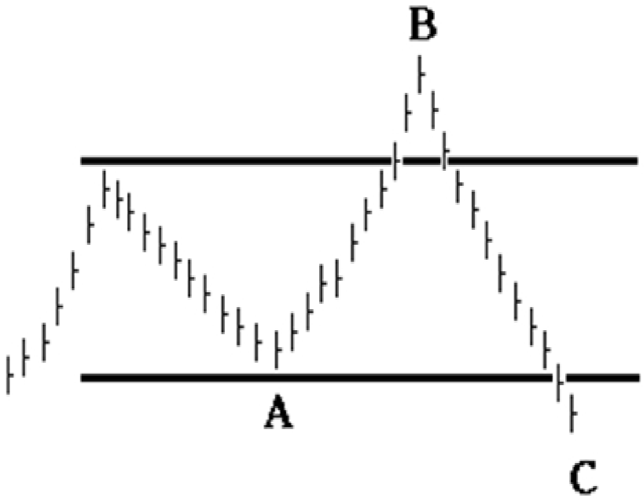
Complex Corrections (Flat, Irregular, Triangle)

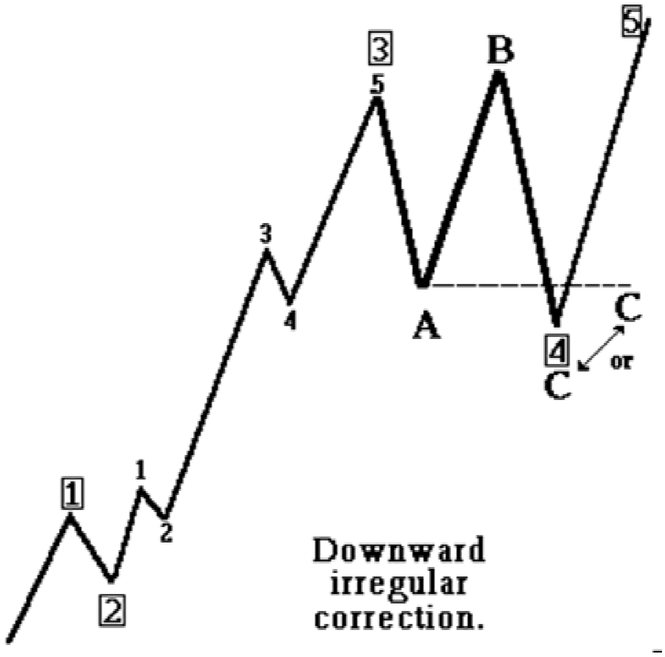




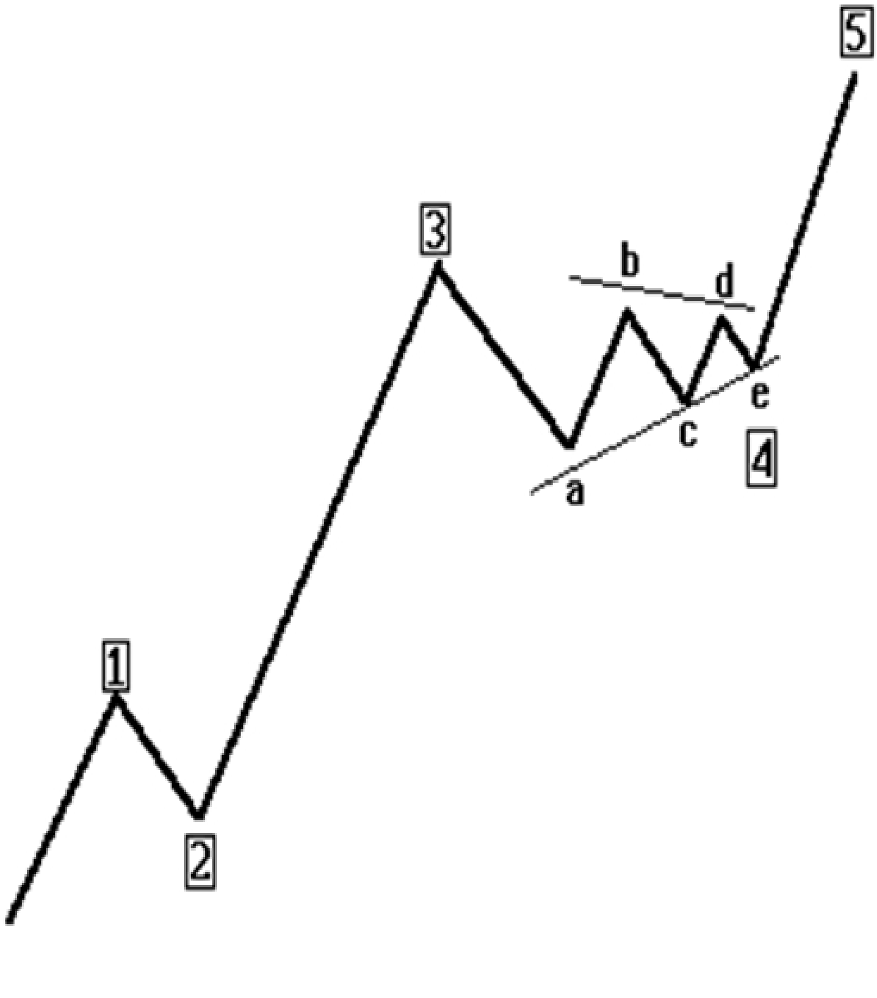


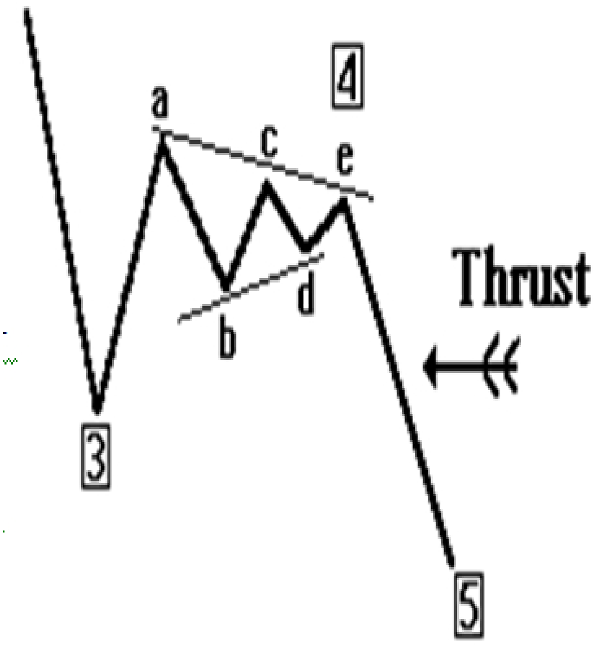
In *Irregular Correction*, Wave B makes a new high. The final Wave C may drop to the
beginning of Wave A, or below it.

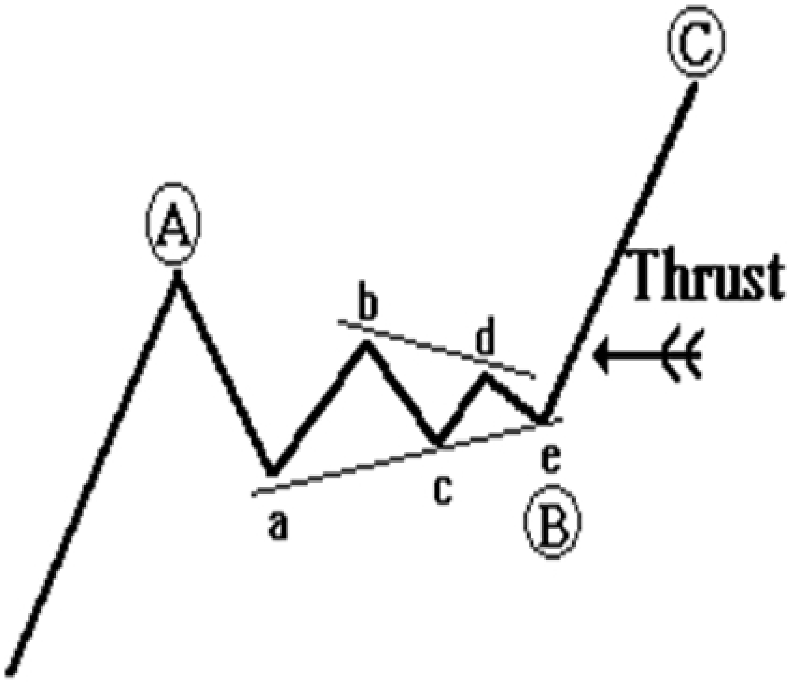




Fibonacci Ratios in an Irregular Wave




4
a
c
e
Thrust
d
b
3
5


C
A
Thrust
b
d
e
c
a
B