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My Personal Trading and Investment Thoughts

Wave-to-Wave Trading Analysis
June 1, 2012

S&P 500 Index ETF (SPY)

Successful traders understand that there are waves within waves … 5-minute waves inside of 60-minute waves inside of daily waves, inside of weekly waves. 5-min waves complete at 60-min support and resistance, which complete at daily support and resistance.

I am writing these reports to try and see if I can actually describe in detail the theory that I have been learning from Sean McKisson. Sean's theory is pretty simple in that stocks travel in waves that repeat time after time. These waves have certain characteristics that allow a student of trading to eventually develop an edge in trading since once you understand how waves work, you should be able to anticipate what price is "going to do" in the future. Of course, I meant "should do" in the future as we all know that the market will throw the occasional curve ball at traders.

These PDF's are broken into two parts – the first part is an analysis of the daily, 60-minute and short-term charts leading up until the end of trading on May 31, 2012. The second part is an analysis of the intra-day waves and price action of the SPY during June 1st.

I am really just writing these reports to test my knowledge of Sean's theories at this date in time … the added bonus is that the market and therefore the SPY ETF's are both at important decision points on the 60-min chart.

I will do a follow-up to these PDF's next weekend after we have another week of trading to see if the levels we are watching had value in real-time.

Daily Chart Analysis

Coming into Friday's trading here is the analysis of the daily charts for the SPY ETF …

(**double click on any chart to bring up a separate copy**)

The current daily wave started back on Nov 25, 2011. The first major corrective wave ended on Dec 19th and found support at the 65% level. That level could provide symmetrical support as the daily chart completes waves inside of waves going forward.

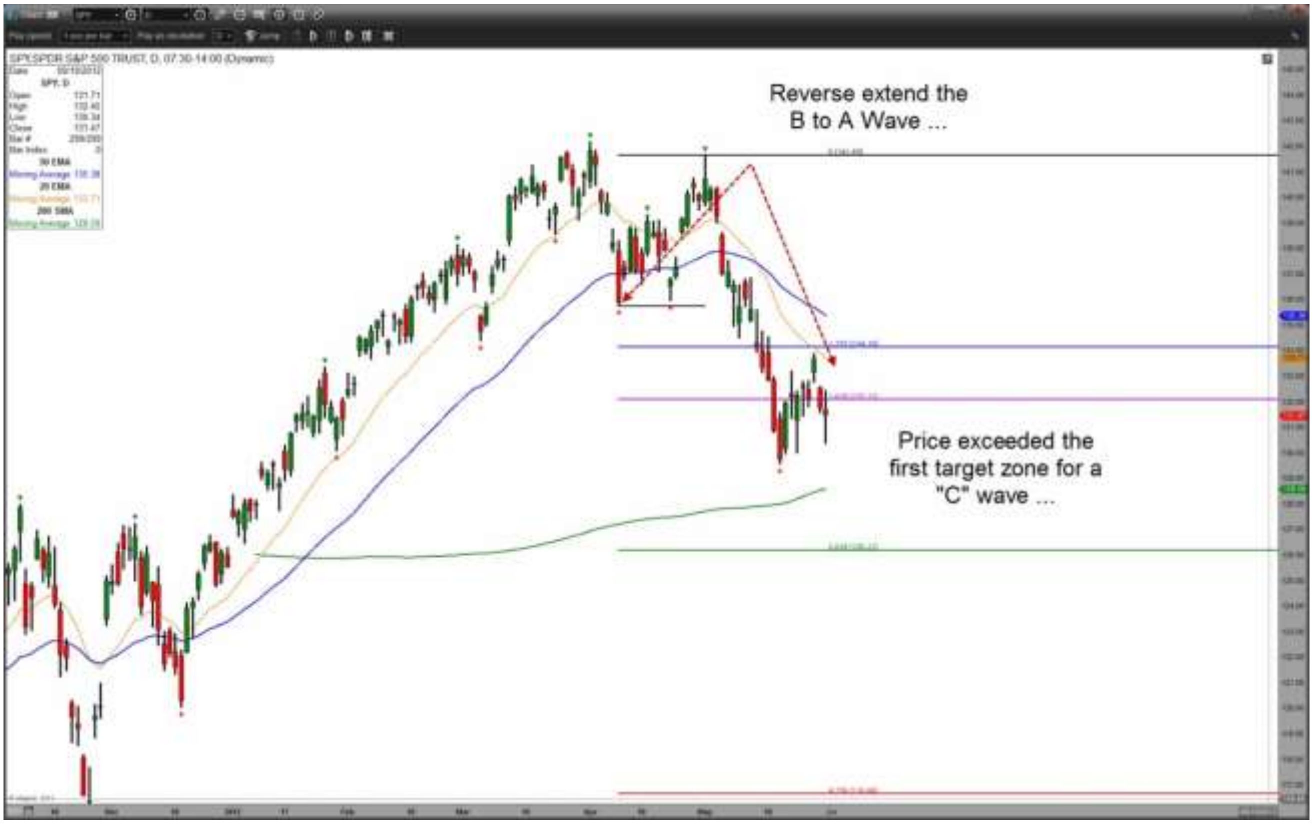
The 65% symmetrical level applied to the current wave provides minor support at $127.80. Using the complete bigger wave structure, symmetrical support is hidden at the $125.30 level.

Looking at the daily chart, the current pull-back has not quite made it back into the major retracement zone (the "Zone"). Therefore, there is no retracement/support "reason" for the May 18th low of $129.55 to be **the** low for the current daily price structure.

Even though we have not yet reached the Zone, we need to check and see if the wave structure inside this push lower (the waves inside the waves) can confirm our reading of the price action.

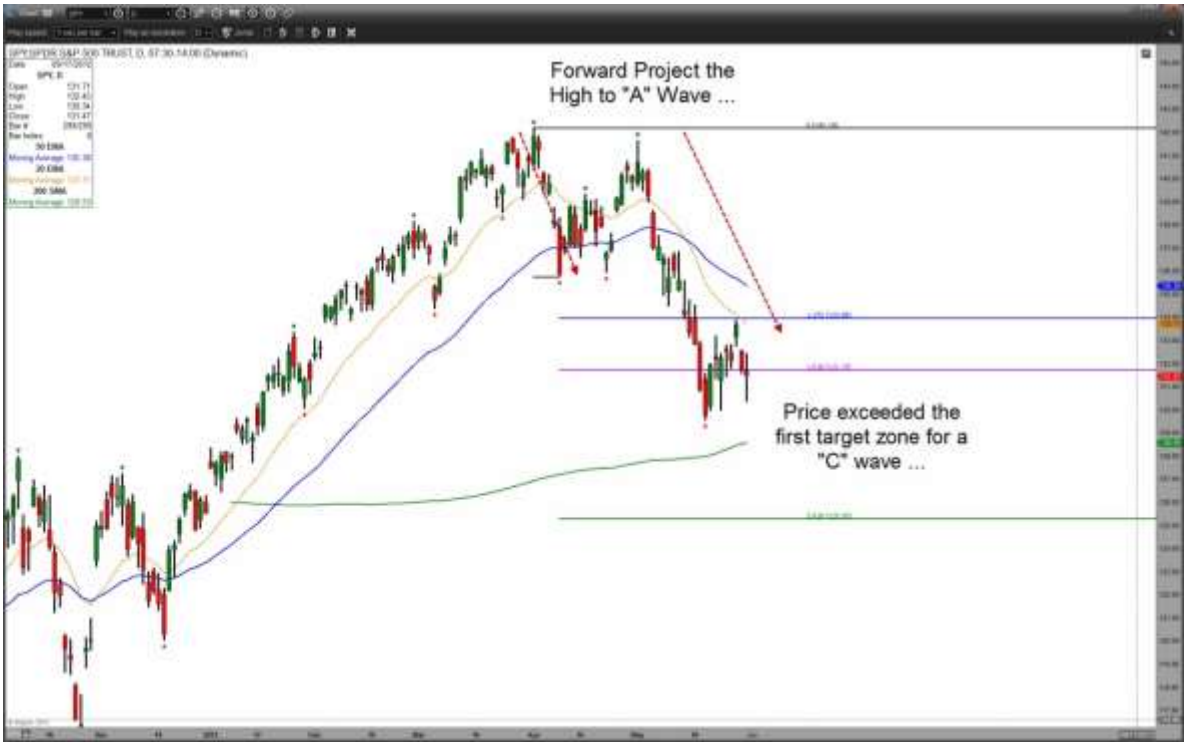
The first assumption that traders should always make is that the correction will be a simple “ABC” structure. A quick glance confirms that “look”.

Next, we need to look at the levels for the current “C” low to see if they equal levels we would expect using our wave rules.

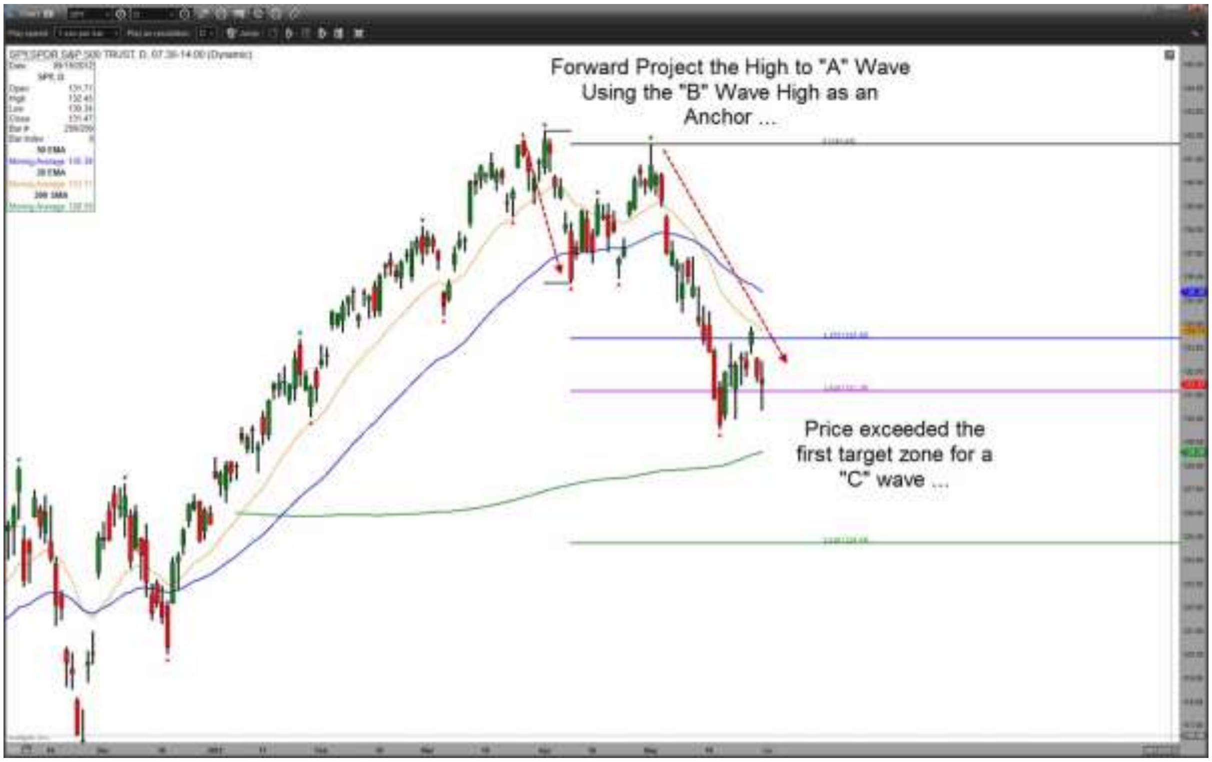


The primary method to project the end to Wave C is to reverse extend the B to A wave forward. Price exceeded the primary target zone (1.272x – 1.618x). We then need to look at the result of projecting forward the High to A wave forward to see if that has any value.

You will see on the following page that price once again exceeded the expected target zone for Wave C.



The last projection method used to confirm a possible “ABC” structure uses the High-to-A wave but it anchors the projection to the high of the B Wave.



The three standard "C" projection methods are telling us that the current correction is not likely an ABC structure but instead, odds are that the wave is morphing into a 1-2-3 structure.

The 3rd Wave target is derived by extending the length of the 2nd wave using the default 1.272x and 1.618x ratios. Third waves can extend past the 1.272x level, but our general rule is that it will end at that first target. We want to be taking profits into that first target since Wave 3's are in essence, just a price squeeze. Do not count on price to continue squeezing much past the 1.272x target.

How does this projected Wave 3 target compare to our Fibonacci support targets? The chart on the next page shows that the Wave 3 target of $126.25 ends just above the 61.8% level of $126.13.

Major support levels are more dominant or important than projected termination levels and as such, price can be expected to "reach" to the 61.8% level or even down to the major symmetrical support level at 65% at $125.30. That zone of $125.30 - $126.25 is the most likely area for price to conclude its move lower.

So if we are to conclude that the daily chart has odds of completing into the Wave 3 target, the current price action is part of a complex correction. To get odds of when that complex correction is over, traders need to drill down to the smaller time frame charts (the 60-min and 5-min charts).

60-Minute Chart Analysis

So similar to how we looked at the daily chart, we need to look at the chart's support/resistance levels as well as the actual structure of the price action to see if we can get odds of what price is going to do next.

Even if you ignore what the daily chart is telling us to expect (Wave 3), traders know that the new low in price for the current move from the April 2nd high "tells" us to expect resistance on any move higher.

Where should traders expect price to retrace to? Again, traders need to watch two areas … the first is the Zone and the other is the "hidden" symmetrical support. On the above 60-minute chart, you can see that the first pull-back during the bigger wave 2 was back on May 8th-10th. That pullback was contained to 33%, so we need to watch for that hidden level going forward.

Price pushed on May 29th up into that 33% symmetrical resistance level. Does that mean price is finished going higher? Possibly … there was reason for that level to stop price from going higher, but we need to see price complete a turn pattern to confirm that price is restarting the bigger wave lower.

Where is price headed to if the 60-minute chart confirms a turn pattern? It will head to Daily support … we have determined that to be a Wave 3 target of approximately $126.25.

We will look at the 60-min chart to determine if a turn pattern is complete in a minute or so, but let's finish our look at the resistance level first. We know that there was reason for price to stall at the 33% symmetrical level … now let's look at the structure of that move.

A move into a level of Fibonacci or symmetrical resistance has higher odds of containing price action if there is an ABC structure into that level. So that is ideally what traders will see when trying to get odds of whether or not a level will hold.

I moved the data back to show just the price action into that symmetrical resistance area so we can concentrate on the structure that traders would have seen as price completed into that zone.

You can see that price did not complete wave “c” into the normal 1.272x – 1.618x level. Again, bigger resistance areas, in this case, the 33% symmetrical resistance zone, will typically “over-rule” or dominate the projected c-wave target. In fact, you can see that price made a second attempt to get up to that “c” target but that move failed and the prior high held.

I don’t have the “b” wave retracement grid up on this chart … the pull-back actually exceeded and closed beyond the 78.6% level. Normally this should make traders view the pull-back not as a “b” wave but a new low from which the price structure would need to reset and then the “a” wave would be redrawn going forward.

Again, normally that is what traders need to do, but in this case, the leading market index (the NASDQ) had held and closed only to the 70% retracement level. Traders need to get confirmation at decision points that the index they are looking at is in sync with the rest of the market. In this case, the fact that the leading market index was holding the Zone should have signaled traders to accept this "low" b-wave as ok going forward.

Ok … so the SPY 60-minute chart found resistance at the "hidden" 33% symmetrical level and it did so with an ABC structure. That doesn't mean price can't move higher as part of a bigger correctional move. In either case, traders should expect price to pull-back into the support levels of the ABC structure.

Once price finishes its pullback into support, it will eventually hold that support and proceed to break to a higher high above the 33% resistance level, or it will fail to hold support, roll-over and then head to daily support.

The following chart is how the market finished May as traders awaited the all-important Jobs Number.

As you can see, price is right in the middle of a 60-minute decision point. Right above is resistance from the prior wave and just below is the lower resistance level for the overall corrective bounce.

No one knows which way it could go … we have odds that price wants to make it down to $126.25, but price could break higher here and still make it down to the bigger daily support levels later/further right on this chart.

Here is how that would look …

Until price clears the bigger resistance levels above, traders need to assume that price will complete an ABC corrective pattern before heading lower to make a lower low.

Again, price was at a Decision Point heading into Friday. What do traders do at a 60-Minute Decision Point? They drill down to the 5-Minute chart to try and identify a turning pattern.

3-Minute Chart Analysis

The 3-minute and the 5-minute charts are basically the same in terms of wave analysis. The only difference between the two is essentially the number of candles that the charts show … the 3-min chart has 130 candles a day and the 5-min has 78.

The 3-min will often show waves more clearly and that is the reason I choose to use the 3-minute chart as my small time-frame chart which I use to trigger my entries and exits from trades. Some traders prefer the 5-min chart **because** there are fewer candles … to each his/her own.

Here is the 3-minute chart that traders would have seen coming into June 1st …

I will look closer at the 3-minute waves in just a second, but I wanted readers to see the 60-minute support and resistance levels that I carried over from that bigger time frame. You can see how price has been squeezed into an important decision point on the 60-min chart.

Ideally, looking at the 3-min (or 5-min) chart will hopefully give traders an early warning of which way the bigger charts are going to break.

So as traders, we try and figure out the likelihood of wave completion into the bigger time frame support and resistance levels. Ideally, traders can anticipate the beginnings and ends of the 3 or 5-minute waves and when those levels have confluence from the bigger time frame support/resistance, traders will have bigger odds of finding important turning points in the price action.

Let's take a look at the price action on May 31st after price bounced off of the 60-min support level (78.6% - $130.49).

Price bounced off of the 78.6% support level … that was the reason for price to bounce on the 3-minute chart. Many traders would not have known that important 60-min level, but it was there for prepared traders.

The first corrective pull-back on the 3-minute chart did not get into the Zone … it stopped at the 46% level. Traders need to monitor that level as symmetrical support for future pull-backs. As you can see the next minor wave pulled back to the 46% level of that prior minor wave. We refer to that support as "minor" symmetrical support.

The next pull-back is different … the most obvious thing is that this pullback is much larger than the two prior minor pullbacks. That is telling traders that something has changed. If you apply your Fibonacci retracement grids to this pull-back, you will find that it actually held "major" symmetrical support – by that I mean support of the entire move off of the day's low, not just the prior minor wave.

What does that mean? Typically when you are in the first move higher off of a new low, the first pull-back to the "major" symmetrical support indicates that the thrust higher (pattern) is becoming major.

In layman's terms, that means the move is going to be making the second of the two waves need to make one bigger/major wave.

With that knowledge, traders can label and project forward the end of the second minor wave higher. The chart on the following page shows the ABC structure implied by the move into major symmetrical support.

Here is how price bounced off that major symmetrical support …

As you can see price did complete into the target/resistance zone. Why is that important? Well, a trader who knows these levels now has odds that this could be a "C-Pattern Sell".

A "C-Pattern Sell" is when a wave structure completes a C wave into a projected target area that is also a higher time frame resistance zone. Again in layman terms, you have the end to a short-term wave structure that is also right in an area that on the bigger time frame charts, could also lead to the reversal/change in the direction of price. Bottom line is that you have increased odds that the reversal from this level will be major in terms of the smaller time frame chart.

In any case, all traders should be selling their long positions into this area of confluence.

Price shown on the above chart was not quite at the end of the day on May 31st … where should traders expect price to go from this confluence of resistance? To support of course …

The market never makes it easy for traders … price closed the day having made a single wave lower that stopped short of the Zone support. So going into June 1st, traders needed to be prepared for price action in both directions …

Will the market open and drive higher into minor resistance before completing the ABC pattern into support? Or does the market have something else in store for us?

We know the look of ABC moves into support … they tend to look like the one drawn above. The market will often make that pattern move (or some derivative thereof), but on occasion, the market will throw us a curve ball.

The market did, in fact, throw a curve ball on June 1st, due in part to the bad economic news regarding US employment.

So there you have it … this was the bigger and smaller time frame of the SPY ETF heading into June 1st. In the second part of this PDF review, I will dissect the wave-to-wave intra-day price action from June 1st and then conclude with a quick review of the bigger time frames.

Next weekend I will write a follow-up PDF report to see if the levels I identified had any value for trading during the week in real time.

Cheers …