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*My Personal Trading and Investment Thoughts*



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## Wave-to-Wave Trading Analysis SPY - June 1, 2012

### S&P 500 Index ETF (SPY)

Readers should read Part 1 of this analysis to better understand the bigger time-frame picture of the price for the SPY ETF coming into June 1<sup>st</sup>. Here was the short-term (3-minute) chart that we were expecting based on a traditional ABC corrective pattern.



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



So as Sean likes to say, traders need to flow with price action as it unfolds. Our expected price pattern was obviously not going to happen. So what does a wave trader do in preparing for the day knowing that the market was going to open emotionally via a large gap lower?

Well, traders would most likely look to their 60-minute charts to see if they can get odds of where price may go to today ...



As a reminder of the bigger pattern, the above 60-minute chart looks at the action with our bigger daily levels and expectations noted. Again, traders should expect a complex correction after the wave 2 low and then when price breaks that pattern, price should head down to our wave 3 target of \$126.25ish.

When is the complex corrective wave viewed as being complete? Generally, when price breaks and closes below the daily wave 2 low (\$129.55). As we saw on the earlier

3-minute chart, Price broke below that level in the pre-market action. As a general rule, I like to wait for 15 to 30-minutes of price action to be complete before I try to start drawing any conclusions.

In any case, traders should be prepared for the break of the daily pattern low in case it did indeed happen. What would that entail? Well, that break would be the kick-off to the 3<sup>rd</sup> wave lower on the daily chart, and we know that price will not go straight down to that \$126.25 area. The 60-min chart will make a series of waves into that expected daily target area.

The question is ... where can we expect the first leg of that initial 60-min wave lower to have odds of completing?



Well, if we forward extend the last corrective wave, we have a zone for price to possibly find support at today. That first target of that zone is \$128.36 (1.272x) with the bigger, lower target at \$126.84 (1.618x). I included a shaded box on this chart to highlight

where price was trading pre-regular hours on the 3-min chart. As you can see the majority of the range is below the daily wave 2 low and just above the 1.272x target (\$128.36).

Price will go where it wants to go, but now we have an area that we can look to that makes some sense for support to show up. What does that mean for a day trader? It tells traders to not short the SPY blindly at or near the lows of the pre-market range since there is a reason for price to find support around that \$128.36 area.

Again, all the pre-market planning could very well go for naught if price refuses to accept these lower prices ... that is also why, in general, traders need to let the market open and clear those emotional orders that are lined up in the system prior to the regular-market open. The odds of having structure in the price action is much greater once some of that built-up emotion clears.

So if price finds support at the 60-min 1.272x target, it could happen during the morning trading hours ... that tells us we should at least take a look at where a bounce could take us from that support area.



If price makes it to the 1.272x 60-min target, it will have broken the daily wave 2 low, thereby making a lower low. That is important as it puts resistance on any bounce off of that level.

I have drawn a retracement grid on the above chart, along with the possible path for price if it does find support at the 1.272x area. I have also included the 33% level of “hidden” symmetrical resistance. That level has provided value on prior bounces, so we need to monitor how price reacts as it comes into that area.

Ok, so that is how a trader can use the 60-minute chart to better prepare him or herself for the opening of the markets on Friday, June 1<sup>st</sup>. The key as always is to monitor the smaller time-frame waves using our rules and to be aware of the bigger 60-minute levels as possible support resistance magnets.



Before we leave the pre-market action, price could actually have completed an “ABC” push lower using the overnight and pre-market trading. The gap down can be

considered as the “A” wave which then went sideways in a bear-flag for wave “B” followed finally by the emotional push lower at 8:30am eastern that could be wave “C”.

I reverse extended the possible “B” wave to get a target zone for the “C” target. Price actually pushed right into that 1.272x – 1.618x zone pre-market and bounced. Note that the 1.618x “C” target is \$128.35 which is basically the same value (\$128.36) as the 1.272x “A” target drawn pre-market using the 60-min data. That confluence of support should give more possible meaning for that level going forward into regular-hour trading.

Here is the 3-min chart including the pre-market price action and the first ½ hour of regular hours.



Price will often gyrate back and forth during the first ½ hour of trading. After that emotion is cleared, price structure is much more normal. Friday’s action was interesting since the range was “inside” the pre-market trading high/low as shown by the pink

shaded area. To me when I see that type of open I think price is less likely to break the opening range and then trend materially lower. This gives our pre-market 3-min and 60-min support levels more credibility I believe.

Traders shouldn't sit out the first ½ hour or so of trading reading the paper or watching Jim Cramer blow a vein on CNBC. They should gear down to an even smaller time-frame chart to see the waves inside the 3-min waves used for intra-day trading.

Here is the first ½ hour of trading for the 1-min chart ...



Information that traders could use in the next little while includes the initial support and resistance levels of 78.6% and 61.8%. These levels should provide some value in terms of symmetrical targets. Also note that after the initial push lower, price reverse-extended down to the normal target area.

If price finds resistance at the symmetrical levels, aggressive traders could if they wanted, short the SPY down to the expected reverse-extended targets as shown in the next chart.



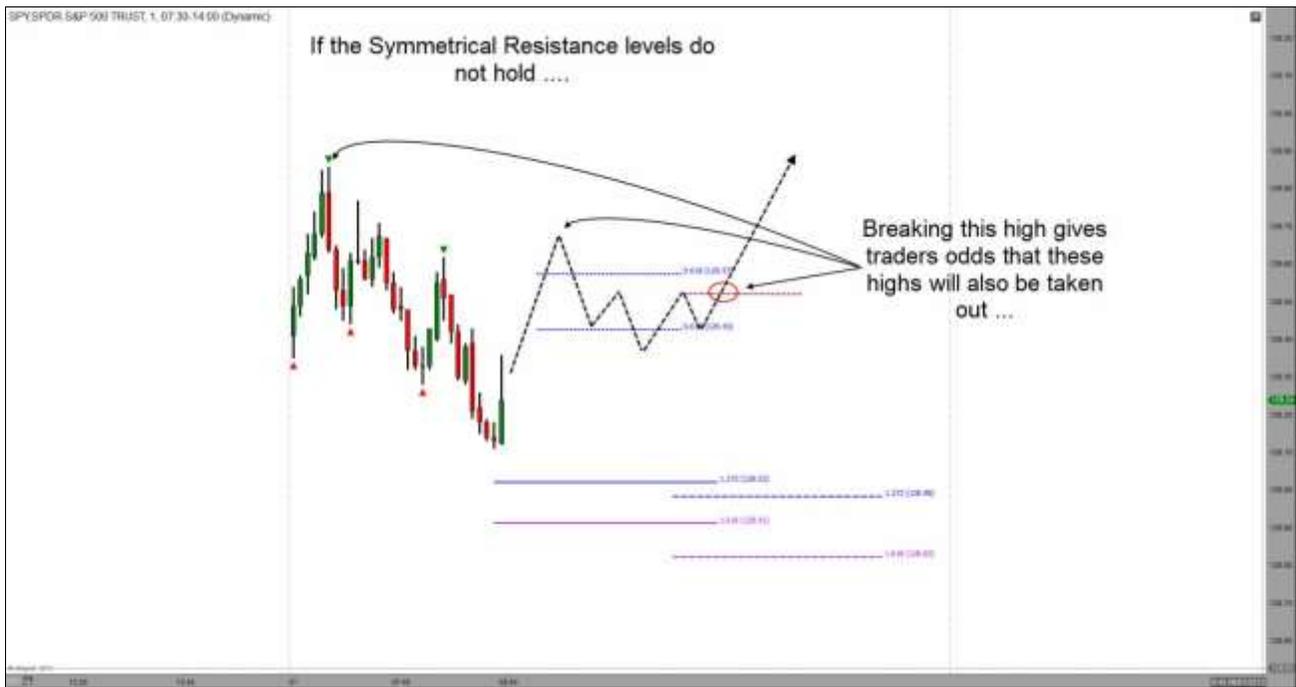
If price breaks above the major symmetrical level, that will be warning traders of a change in the price action. What would the possible change be? Normally, traders can expect one of two scenarios to play out:

1. A change in direction is beginning to unfold; or,
2. The price pattern is changing from minor to major.

The first scenario is pretty straight forward and traders need to monitor the near term price action to confirm a turn-pattern where they should be able to make money long. The pull-back off of the bounce's high will make a higher low during this turn pattern.

The second scenario is a little different in that traders can expect price to complete a second minor wave to a lower low. The combination of these two minor waves makes a complete major wave. That in itself is important because the price level where the major 2-wave structure ends should be the low for a new major (two minor waves) corrective bounce higher.

Here is how those two scenarios would likely look ...



If price is going to complete a turn pattern, the low of the day will hold and the prior wave highs will likely be exceeded.



Ok, that is a synopsis of the information that traders can derive by watching and measuring waves during the first ½ hour of trading. Once traders become comfortable with these concepts, drawing these levels and targets take seconds to complete during real-time trading. It becomes second nature once you understand how waves repeat.



As we follow price on the 1-minute chart, we can see price actually broke above the symmetry levels. Now traders should look for one of the two previously discussed scenarios.



So as it turned out on Friday, price broke the 78.6% level and that gave odds of Scenario #2 being valid ... traders should expect price to trade lower.

Where is price going to go? Again we have our 1.618x target from earlier ... that was at \$128.35. The 60-minute chart gave us a target zone of \$128.36 - \$126.84 ... that is a big range but the 1.272x target of \$128.36 matches our 3-min target, thereby creating confluence at that now more important level.

Price closed the last bar on the above chart at \$129.14 ... that provides an overall profit target of almost \$0.80/share. That is a nice intra-day profit trading the SPY ETF.

One other way to look for a potential target is as follows ...



The above chart uses the 3-minute time frame again and shows the pre-market trading in the pink-shaded area.

Note how the 1.272x extension target gives us a value of \$128.27 is right near the other 3-min target (\$128.35) and the 60-min target (\$128.36) ... this just builds the confluence of that price area.

So assuming that traders were getting short and playing the odds that price would extend down to at least the main confluence target, traders should just continue to monitor the structure of the waves.

It is the structure of the waves and our wave rules that should give us odds for what price may do going forward for the rest of the day.



The first corrective bounce after price tipped its hand that it intended to move lower saw resistance come in at 34.5%. Again, this is the “hidden” level of symmetry that traders need to monitor to determine if this second minor wave is complete.





I included this chart because it hammers home another important concept ... traders need to obey their rules for wave structure. Until price violates the Zone and exceeds the 78.6% level, traders need to respect that price can give you little fake outs ... especially when monitoring small charts like this 1-minute time frame.

Eager traders may get ahead of themselves when they saw the symmetrical resistance hold the push higher and then again on a second attempt ...

As you will see on the following page, price did not actually break below the Zone support levels ... it then eventually broke above symmetrical resistance, signaling to traders something else was happening to the current wave.



So what could the break of symmetry be telling us this time? Again, it is either that price is in the process of changing the direction of its trend or the price pattern is becoming major.



If we go back to the 3-minute chart, we can see that the breaking of the 1-min wave structure coincides with the first real corrective bounce since the earlier one into the start of regular hour trading. Where will that corrective bounce reverse-extend to?



The last corrective bounce show price reverse-extending to \$128.58 (1.272x) and \$128.38 (1.618x). The 1.272x target is right at the pre-market low ... that provides some value to that often important level, but the 1.618x target is close to that \$128.35ish area where we have strong confluence now for price to find support.

This report is getting long so I will skip to the end of the day and try and point out a few more items on the chart ...



Price did make its way down to that confluence area of support ... so there is reason for support here as we end the day. That implies that this area may provide traders a good level to trade long intra-day knowing that symmetrical resistance does not come into play until the \$129.03 area.

So if the market opens on Monday at around this confluence area, traders could be getting odds to trade long with a potential profit target of around \$.80/share once again.

I'll finish there ... again, I am a strong believer that price does not behave randomly, but in fact, creates waves which if studied and measured actually allow traders to create a series of rules that will provide Edge going into the future.

By following the wave-to-wave structure of price, traders should be able to anticipate where price is likely to go. That is incredibly powerful and something no trailing indicator is able to do.