

Elliott Wave Advanced Trading Guide

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In the 1930s, Ralph Nelson Elliott discovered that freely traded markets are patterned. More specifically, he discovered that moves in the direction of the larger trend unfold in 5 waves and that moves against the larger trend (corrections) unfold in 3 waves.

Elliott studied multiple time frames, ranging from yearly to half-hourly, of the Dow Jones Industrial and Dow Jones Transport (considered more important at the time) indexes. He found the same patterns, regardless of time frame. This concept, that a market exhibits a similar structure at all degrees of trend (much like tree, which is made up of smaller versions of itself), would later come to be known as fractal (see Figure 1).

Although initially concentrated on stock markets, Elliott expanded his study to various commodities markets and found the same patterns! He wondered why markets that are supposedly driven by different outside events would exhibit the same patterns. The answer is that market trends are not a product of outside forces, but are instead a product of human psychology, which follows the wave principle.

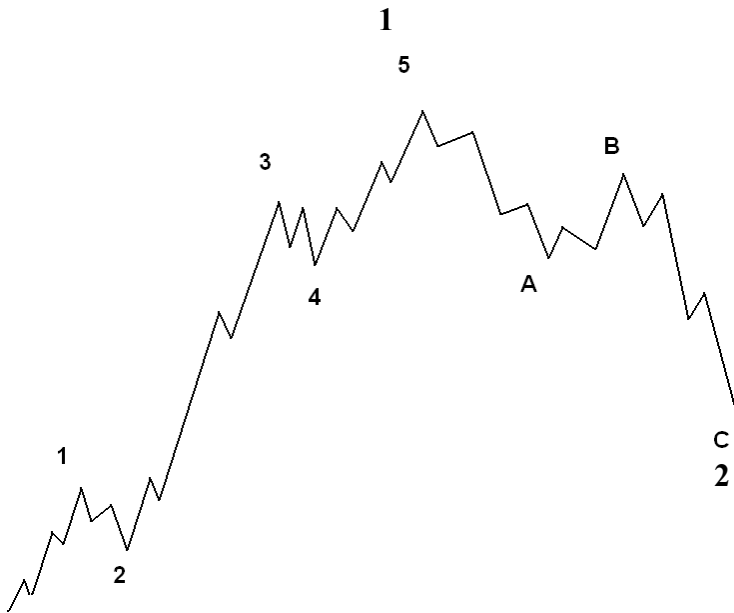


FIGURE 1: The basic 5-3 pattern is evident at all degrees of trend

This advanced guide expands on the basic Elliott Wave guide by presenting in more detail the patterns that Elliott discovered.

Motive Waves

Movements in the direction of the trend of one larger degree trend unfold in 5 waves are referred to as motive waves. Notice in Figure 1 that waves 1, 3, 5, A, and C each divide into 5 waves. These waves are with the trend of one larger degree, which divide into 5 waves. On the other hand, waves 2, 4, and B divide into 3 waves because these waves are against the trend of one larger degree. All motive waves obey 2 rules.

- 1.) Wave 2 never retraces more than 100% of wave 1
- 2.) Wave 3 is never the shortest wave

Impulse

Impulse waves are the most common type of motive wave. In an impulse, wave 4 does not enter into the price territory of wave 1 (although in FX, with the high degree of leverage, you will see overlapping on intraday charts; but rarely).

Extensions

In an impulse, one of waves 1, 3, or 5 is extended. Wave 1 is rarely extended. Wave 3 is often the extended wave.

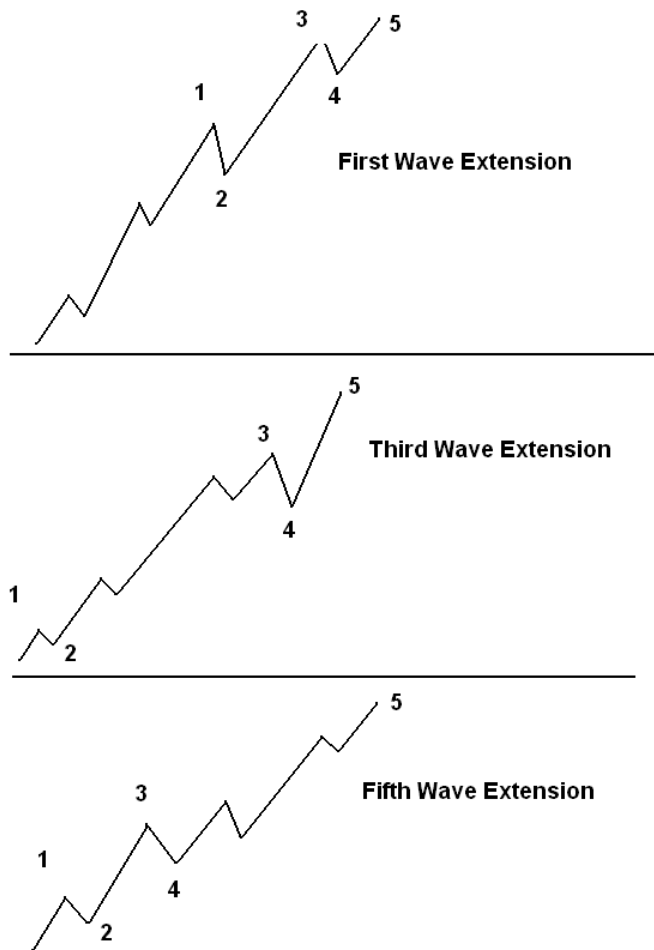


Figure 2: One of waves 1, 3, or 5 is always extended

Diagonal

Diagonals are known to traditional chartists as wedges. A diagonal is most common in the 5th wave position that follows an especially strong 3rd wave. In such instances, the pattern is referred to as an ending diagonal. In an ending diagonal, each wave (1,2,3,4,5) consists of 3 waves and waves 2 and 4 *can* overlap.

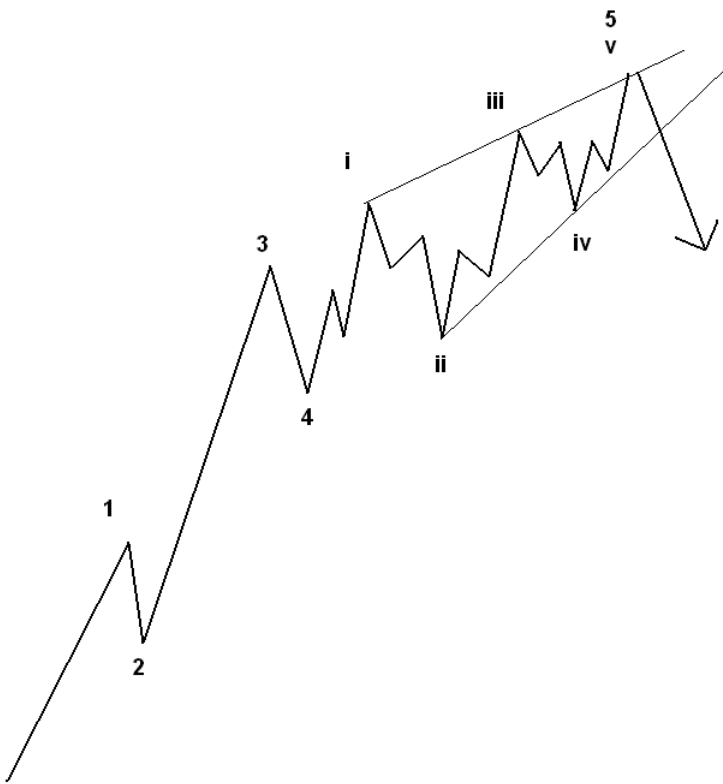


Figure 3: An ending diagonal in the 5th wave position following an especially strong 3rd wave

Reversals from ending diagonals are sharp and the entire diagonal is usually fully retraced. The position is initiated near the line that connects waves i and iii (this estimates the end of wave v). The initial stop is not clearly defined since the position is initiated near the 5th wave extreme.

Corrective Waves

Triangles

Triangles are common as 4th waves, B waves (and X waves...see combinations). The pattern consists of 5 overlapping (and usually contracting) waves labeled A, B, C, D, and E. Each one of these waves is composed of 3 waves.

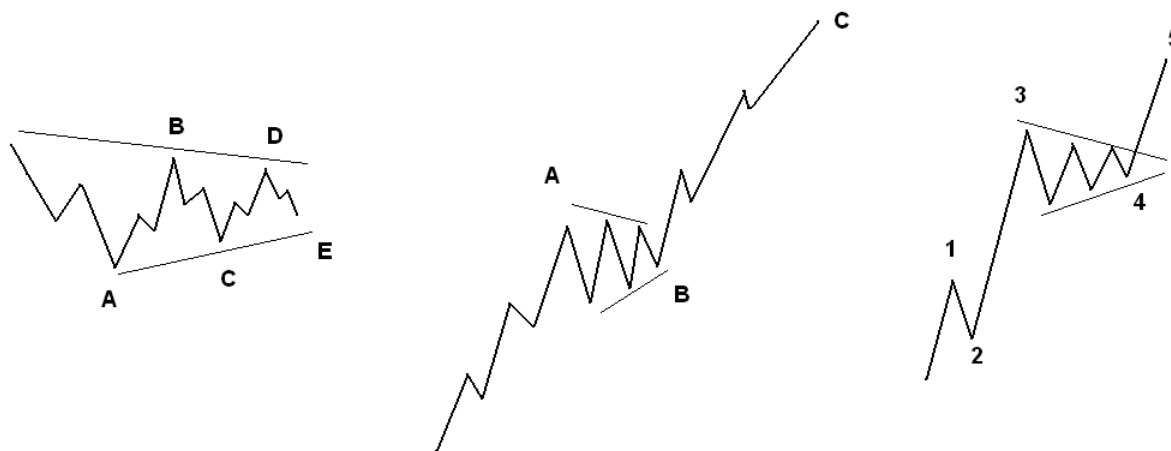


Figure 4: Detailed structure of a triangle (left), a triangle as a B wave (middle), and a triangle as a 4th wave (right)

At the beginning of the triangle, the trader does not know that the pattern unfolding is actually a triangle. Towards the end of the triangle, the pattern is quite clear and the trader can position for the wave that will succeed the triangle (5th wave or C wave). Positions are initiated near the end of wave E and a stop is placed below wave A.

Zig-zags

Zig-zags are common as 2nd waves and B waves. The pattern consists of 3 waves and is labeled A-B-C. Waves A and C are composed of 5 waves (impulses) and wave B is composed of 3 waves (correction).

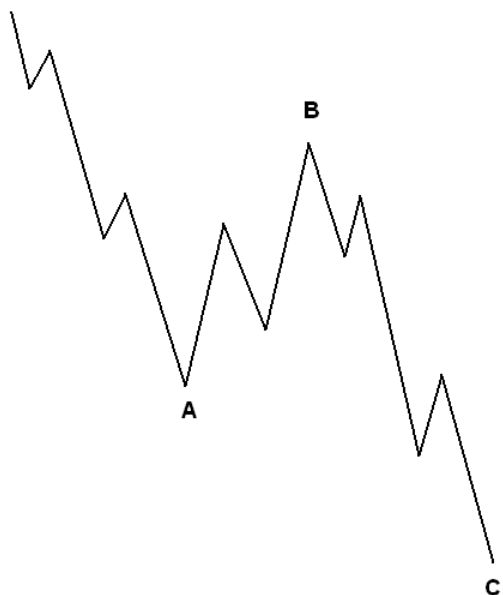


Figure 5: A bull market zigzag (bull market because the zigzag is down, against the larger trend)

Flats

Flats occur commonly as 4th waves and B waves. The pattern is labeled the same as a zigzag, A-B-C, but the compositions of the subwaves differ from that of a zigzag. While a zigzag's divisions are 5-3-5, a flat's divisions are 3-3-5. Wave A is just in 3 waves. Wave A is weak (only 3 waves), therefore wave B terminates near or beyond the origin of wave A. Wave C will typically end just beyond the end of wave A. There are 3 kinds of flats. Regular, expanded, and running. Expanded flats are actually more common than expanded flats and running flats are rare.

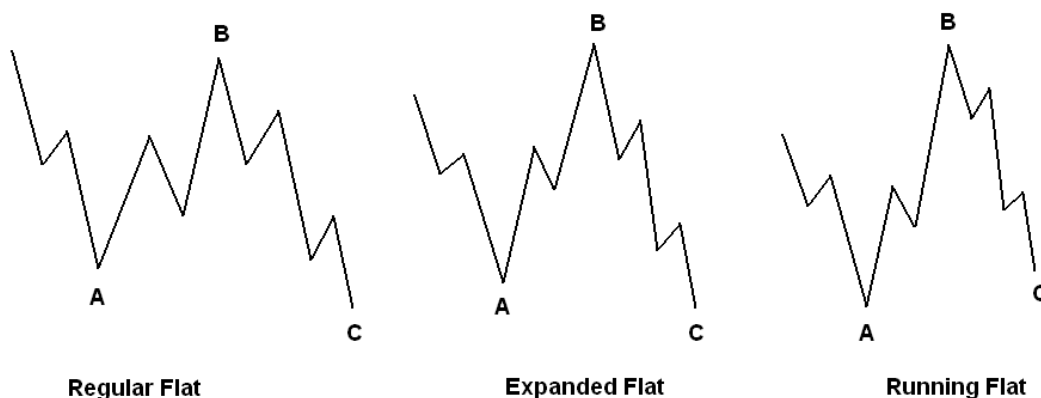


Figure 6: A regular flat (left), an expanded flat (middle), and a running flat (right)

Combinations (complex corrections)

Prolonged sideways / corrective action is the result of a combination, also termed a complex correction. A complex correction is 2 or 3 (but no more than 3) corrective patterns connected by an X wave(s). The first and third patterns are labeled W and Y. In a triple combination, there is a fifth pattern that is labeled Z.

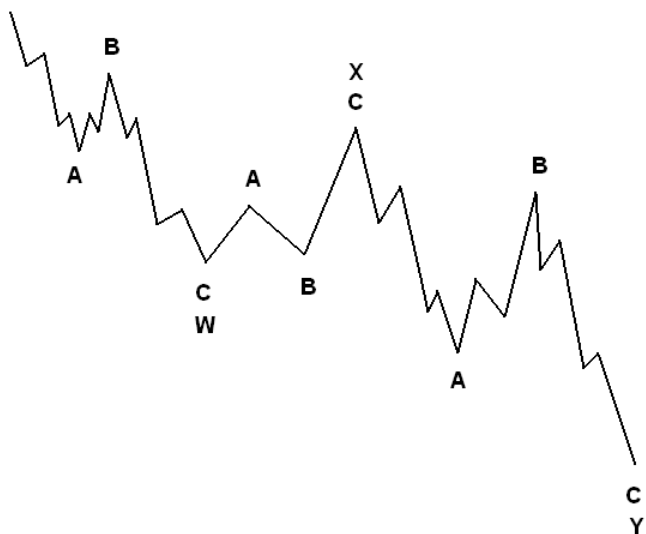


Figure 7: A double zigzag (2 zigzags connected by a 3 wave movement known as an X wave. A triple combination would have another X wave connecting waves Y and Z.

Elliott in Action

Elliott wave practitioners will often say that “it’s all about 5’s and 3’s”. 5 waves in one direction indicate that the larger degree trend is in that direction. Knowing the larger degree trend enables the trader to position for the big move. Can you count the waves from the November 2007 top in the GBPUSD? What wave is unfolding now?



Go to the next page to see the labels.



The decline from 2.1160 unfolded in 5 waves, therefore the trend at the next larger degree is down. This means that at least one more 5 wave decline will occur before a bottom is in place. Following the 5 wave decline, the GBPUSD has traded sideways in a corrective pattern in what will be either a flat or triangle. Either way, there is still upside potential. In the case of a flat, the GBPUSD will exceed 2.04 before reversing lower and dropping below 1.9337 (wave 5 price extreme). Just using the wave principle, we know that the GBPUSD is likely to rally a bit more before embarking on a decline that does not end until below 1.9337.

Well Worth the Time

There is much more to wave analysis than what has been presented here. Anything that is worth learning takes time. The wave principle is no different. Successful application requires a good deal of practice. This introduction should whet your appetite. Interested? If so, visit our [Elliott Wave Forum](#) and read the Daily Technicals and Crosses, published everyday [DailyFX](#).

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