

# WYCKOFF TESTS: NINE CLASSIC TESTS FOR ACCUMULATION; NINE NEW TESTS FOR RE-ACCUMULATION

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## PREAMBLE

The Wyckoff Method is a school of thought in technical market analysis that necessitates judgment. The analyst-trader acquires judgment through experience and through well-guided illustrations of basic principles. Although the Wyckoff Method is not a mechanical system *per se*, nevertheless high reward/low risk entry points can be routinely and systematically judged with the aid of a checklist of “Nine Tests.” Each test in the list of “Nine Tests” represents a Wyckoff Principle.

One purpose of this article is to demonstrate the “Nine Classic Buying Tests” of the Wyckoff Method at work via a case study of the stock of the San Francisco Company. Although the case name is disguised as the San Francisco Company (SF), it does represent an actual company in the energy sector. For the sake of economy, the illustrations in this article feature the bull side of the market, they can be inverted to illustrate the bear-side of the market.

The classic set of “Nine Classic Buying Tests” (and “Nine Selling Tests”) was designed to diagnose significant reversal formations: the “Nine Classic Buying Tests” define the emergence of a new bull trend (See Side Bar #1). A new bull trend emerges out of a base that forms after a significant price decline. (The “Nine Selling Tests” help define the onset of a bear trend out of top formation following a significant advance.) These nine classic tests of Wyckoff are logical, time-tested, and reliable. However, the original set of nine tests was not designed to include all of those very crucial consolidation periods that occur during bull markets and bear markets.

Students of the Wyckoff Method refer to consolidations as re-accumulation or redistribution. There exists a void in the Wyckoff Method with respect to tests to define the trends that emerge out of consolidation formations. Thus, a second major purpose of this article is an attempt to fill a void in the Wyckoff Method by introducing a new set of “Nine Buying Tests for Re-accumulation.” This new set of “Nine Buying Tests for Re-accumulation” (See Side Bar #2) shall be illustrated with the same San Francisco Company case study to which will be applied “Nine Classic Buying Tests” mentioned in the preceding paragraph.

The San Francisco Company (SF) case study used in this article reflects an actual trade made by an expert in the Wyckoff Method. This Wyckoff expert used the stock options listed on SF as his trading vehicle. Vertical line (bar) charts and figure (point and figure) charts of SF will be used to illustrate both sets of “Nine Classic Buying Tests,” for accumulation and for re-accumulation.

As the reader approaches this case of “Nine Classic Buying Tests,” he/she ought to keep in mind the following admonitions from the Reminiscences of a Stock Operator (See Appendix):

“The average ticker hound – or, as they used to call him, tape-worm – goes wrong, I suspect, as much from overspecialization as from anything else. It means a highly expensive inelasticity. After all, the game of speculation isn’t all mathematics or set rules, however rigid the main laws may be. Even in my tape reading something enters that is more than mere arithmetic. There is what I call the behavior of a stock, actions that enable you to judge whether or not it is going to proceed in accordance with the precedents that your observation has noted. If a stock doesn’t act right don’t touch it; because, being unable to tell

precisely what is wrong, you cannot tell which way it is going. No diagnosis, no prognosis. No prognosis, no profit.

“This experience has been the experience of so many traders so many times that I can give this rule: In a narrow market, when prices are not getting anywhere to speak of but move within a narrow range, there is no sense in trying to anticipate what the next big movement is going to be – up or down. The thing to do is to watch the market, read the tape to determine the limits of the get-nowhere prices, and make up your mind that you will not take an interest until the price breaks through the limit in either direction. A speculator must concern himself with making money out of the market and not with insisting that the tape must agree with him.

“Therefore, the thing to determine is the speculative line of least resistance at the moment of trading; and what he should wait for is the moment when that line defines itself, because that is his signal to get busy.”

## THE “NINE CLASSIC BUYING TESTS” OF THE WYCKOFF METHOD

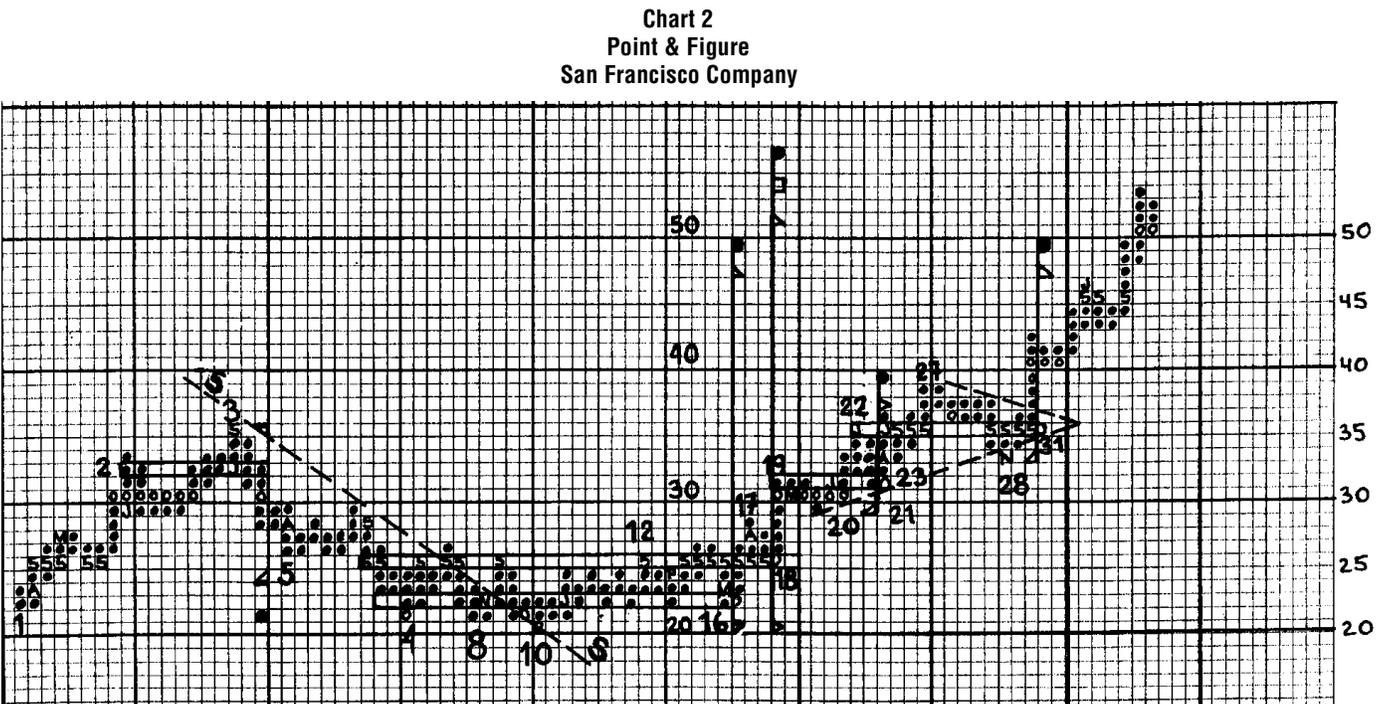
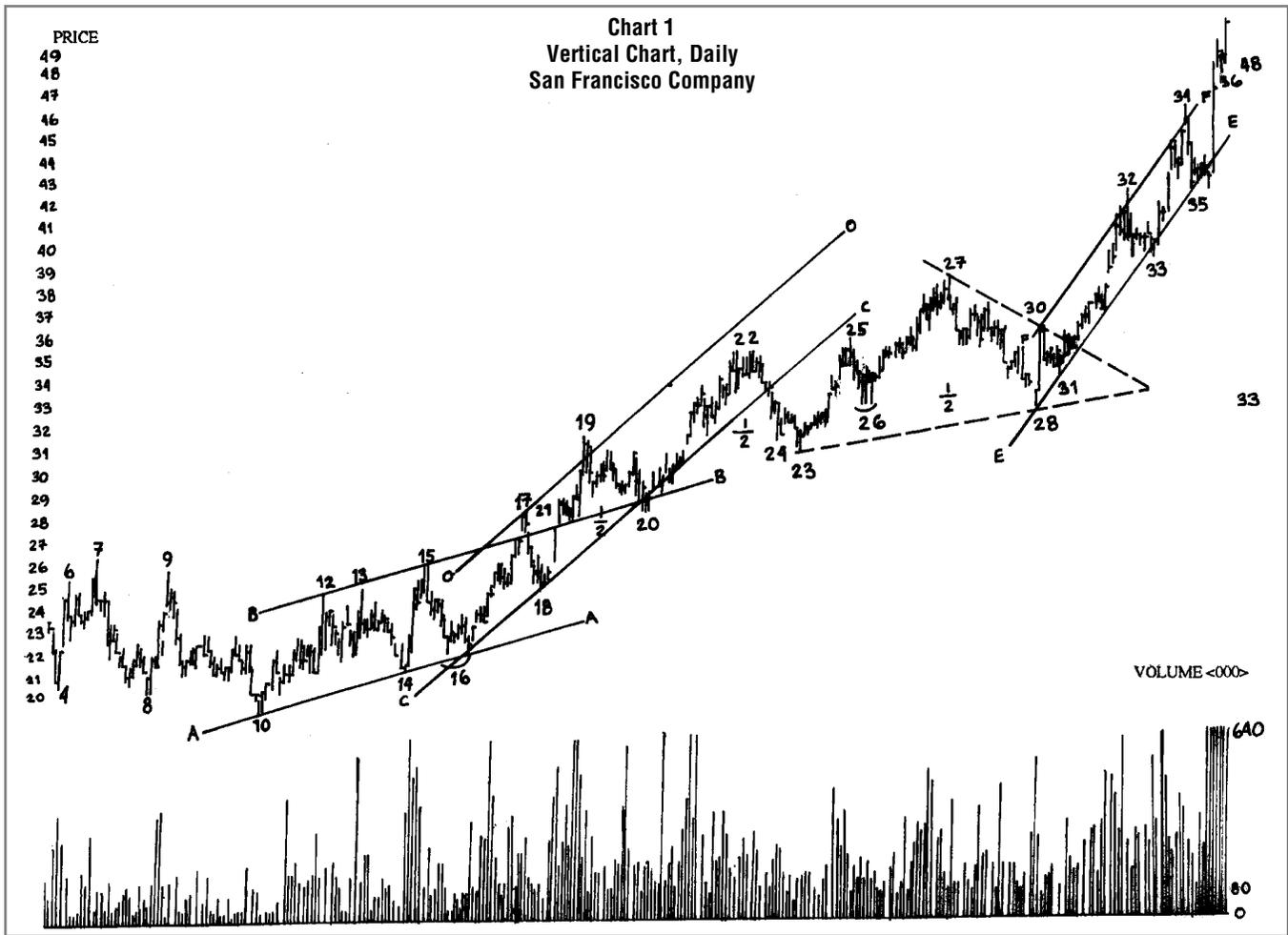
Side Bar #1 lists the “Nine Classic Buying Tests” of the Wyckoff Method. Chart #1 exhibits a vertical chart of the SF Company; Chart #2 shows a figure chart of SF. A guide to “How to Make Price Projections Using a Figure Chart” is attached as an Appendix to “Wyckoff Tests.”

This case situation of SF involves a Wyckoff-oriented trader who diagnosed trading opportunities in SF. While the general market index is not shown here, these trading opportunities exhibited good relative strength compared to the general market index. The “Nine Classic Buying Tests” were passed at the conclusion of the base-building period and the trader elected to buy call options on SF and to enter stop-loss orders (mental) just below prior supports in the trading range. Later, as periods of consolidation come to a halt, the trader could roll his options forward to a later month and to a higher strike price. At the end of the SF case, the option trader is in a position to wrap up his campaign, take his profit, and go home.

The First Wyckoff buying test to be passed was Downside (price) objective accomplished. This test was passed at point #4 on the figure chart, which is the \$21 level for SF. The preceding top in SF around point #3 built the cause for the decline, and at \$21 the maximum effect of that cause was realized.

The Second Wyckoff buying test was passed at point #8 on the bar chart, which was a “secondary test” that occurred on relatively light volume and narrowing downside price movement compared to the “selling climax” at point #4. At point #4 the relative increase in volume and the price closing at the high of the day signaled to our Wyckoff-oriented trader that a provisional “selling climax” might be at hand. At point #4, demand was entering the market to absorb the supply of stock being offered in the vicinity of the downside price objective (buying test one). At this juncture the trader should have covered any outstanding short sales on SF at the open of the next day.

The successful secondary test at point #8 revealed that supply was being exhausted for the moment and so the downtrend was stopped, at least temporarily. It was now the job of the trader to sit patiently on the sidelines until an accumulation base had been formed.



### Side Bar #1

#### Wyckoff Buying Tests: Nine Classic Tests for Accumulation

Nine Buying Tests (applied to an average or a stock after a decline)\*

Indication:	Determined From:
1) Downside price objective accomplished	Figure Chart
2) Preliminary support, selling climax, secondary test	Vertical and Figure
3) Activity bullish (volume increases on rallies and decreases on reactions)	Vertical
4) Downward stride broken (i.e., supply line penetrated)	Vertical or Figure
5) Higher supports (daily low)	Vertical or Figure
6) Higher tops (daily high prices rising)	Vertical or Figure
7) Stock stronger than the market (i.e., stock more responsive on rallies and more resistant to reactions than the market index)	Vertical Chart
8) Base forming (horizontal price line)	Figure Chart
9) Estimated upside profit potential is at least three times the loss if protective stop is hit	Figure Chart for Profit Objective

\* Adapted with modifications from Jack K. Hutson, Editor, *Charting the Market: The Wyckoff Method (Technical Analysis, Inc., Seattle, Washington, 1986), page 87*

### Side Bar #2

#### New Wyckoff Buying Tests Modified for Re-accumulation

Nine Re-accumulation Tests:

1. Resistance Line Broken (Horizontal Line across the Top of The Trading Range)
2. Activity Bullish (e.g., volume expanding on rallies, shrinking on declines)
3. Higher Lows (price)
4. Higher Highs (price)
5. Favorable Relative Strength (equal to or stronger than the market)
6. Correction Completed in price and/or time (e.g., 1/2 retracement, support line reached)
7. Consolidation pattern formed (e.g., triangular formation)
8. Stepping Stone Count Confirming Count
9. 3-1 Reward to Risk Ratio

Buying Test Three requires judging the volume on the rising and falling price waves in the trading range. A visual inspection reveals that by point #16 on the SF chart, volume was expanding on the rallies and shrinking on the declines. By the time point #16 was reached on the vertical chart, SF would have passed the test: "Activity bullish." Turning once again to the figure chart discloses that in the vicinity of point #10 the downward sloping supply line (dashed line SS) was broken. Thus around point #10, the Fourth Buying Test was passed. These four foregoing tests, although necessary, were not sufficient evidence of accumulation, so the trader had to remain patient until all of the "buying tests" clearly revealed that a base had been formed and that the evidence had accumulated to prove that the line of least resistance was decidedly upward.

The next two Wyckoff Tests are crucial to the definition of an upward line of least resistance. Buying Test Five is higher lows (higher supports) and Buying Test Six is higher highs (higher tops). The vertical line or bar chart of SF showed higher price lows along the gradient of points #14, #16, and #18. In a parallel fashion, a series of rising price peaks appeared at points #12, #13, #15, and #17. At points #17 and #18, the trader-analyst could clearly declare that the higher highs and higher lows had been reached, and, therefore, Wyckoff Buying Tests Five and Six had been passed.

Points #15 and #16, and then again #17 and #18 on the charts, may also be viewed as "Jumps and Backups," hence legitimate junc-

tures at which to enter a long position. (See January 2001 issue of the *Active Trader* magazine). At point #16 on the charts, and even more definitely at point #18, the trader in the SF case concluded that a base had been formed, a cause had been built and a favorable reward-to-risk ratio was present. The "count" taken along the \$22 line of the figure chart from point #16 back to beyond point #4 generated a cause of 27 points for upside projections of \$47-49, when that count was added to the low of the trading range at \$20 and to the count line itself at \$22. Moreover, the count along the \$25 level at point #18 sanctioned price projections as high as \$57. As a result of these analyses, the trader was justified in concluding that the Eighth Test had been passed.

Entering a long position in SF at \$25 (point #18) and setting a protective stop-loss order just below support at \$19 would create a risk exposure of \$6. The figure chart count along the 25 line equaled 31 points of upside potential. Thus, the estimated profit potential exceeded the indicated risk by over three times, so Buying Test Nine was also passed. A comparison of the SF chart to its relevant market index (not shown) would have revealed that SF was comparatively stronger than the market. Consequently, SF was favored as a candidate with superior upside prospects. (Buying Test Seven was passed.)

By the time SF had reached point, #18 all of the "Nine Classic Buying Tests" had been passed. At point #1: the line-of-least-resistance had defined itself as upward trending and the trader could have entered call option positions with favorable reward to risk parameters. At this stage the trader did purchase SF call options that were at the money.

### NINE NEW BUYING TESTS FOR RE-ACCUMULATION

In a quest for unity and economy, numerous principles of the Wyckoff Method were distilled into "Nine Classic Buying Tests" and "Nine Selling Tests." As explained above, the nine buying tests were originally designed to define trends coming out of major areas of accumulation that followed significant price declines. In addition to these major reversal formations at bottoms and tops, there also appear many important continuation patterns known by students of Wyckoff as "re-accumulation" and "redistribution." However, these important consolidation patterns lack an appropriate set of "Nine Tests" to define the resumption of the upward trend or downward trend. Re-accumulation and redistribution areas simply lack a set of buying tests /selling tests that are equivalent to the "Classic Nine Tests" for major accumulation or major distribution. Unfortunately, the original set of Wyckoff tests that were used to define departures from bottoms or tops cannot be transferred easily nor applied *en toto* to zones of re-accumulation or redistribution. Some tests, such as "Preliminary Support and Selling Climax and Secondary Test" simply do not apply. The selling climax is good for signaling the onset of a bottom after a bear market decline. But re-accumulation zones start after a price advance, and thus most often commence with a buying climax. A straightforward modification of the "climax rule" to fit re-accumulations is made even more ambiguous by the fact that distribution after a bull market advance may likewise start with "preliminary supply and a buying climax."

Similar limitations apply to other tests found in the original list of nine. For instance, neither "The fulfillment of downside (upside) price objectives" nor the "breaking of downward (upward) sloping price line" are necessarily relevant for analyzing re-accumulation (redistribution). In their place it is suggested that we substitute other Wyckoff rules that tell us more clearly that a correction has been completed in time and price. These substitute measures are, for example, the interception by price of the upward sloping demand line

and/or the reaching of the 1/2 re-tracement level.\*

It is suggested that in place of “downward stride broken,” the relevant buying test for re-accumulation become the “breaking of the horizontal resistance line along the top of the trading range.” That horizontal resistance line serves to confine the sideways trend channel in much the same way as the downtrend slanting supply lines confine a bearish trend channel. Moreover, when a wedge or triangular formation appears, the Wyckoff literature advises the student to enter upon the significant price-and-volume breaking of the resistance (support) line.

The “Stepping Stone Confirming Count” measures the amount of potential generated during a re-accumulation trading range. The “stepping stone confirming count” deserves special consideration as a re-accumulation test because it possesses an important Wyckoff timing principle. Thus the trader should be alert to the possible resumption of the upward trend when the figure chart has generated enough re-accumulation potential or “count” to confirm the target from the original base. In the case of SF, this means the trader should be poised for a resumption of the upward trend when the count generated during a consolidation grows large enough to meet the price objectives that equal the objectives generated during the original accumulation base. If along the \$35 level, for instance, the up and down price waves during a period of sideways consolidation reach a point where the figure chart count measures 14 points, thereby projecting to \$49, then the trader should become highly alert for the possible resumption of the upward trend. Remember that the original base count along the \$22 level (point #16) projected to a maximum of \$49. If a consolidation projects to the same objectives, then we say that it “Confirms” the original count taken along the base. The “stepping stone confirming count” appears as Re-accumulation Test Number Eight on Side Bar #2.

### FAILED TESTS

To illustrate the new list of modified Wyckoff Tests for Re-accumulation that appear in Side Bar #2, let us return to the case study of the SF Company. After the base had been completed, the Wyckoff-oriented trader entered a long option position at point #18 on the SF charts. The SF stock then moved up sharply from point #18 to point #19, where it encountered enough supply to halt its advance, and so SF entered a period of hesitation and sideways movement starting at #19. This period of hesitation commenced with a “buying climax” around point #19, which would also have alerted the trader of the possible onset of re-accumulation before resumption of the upward trend or even possibly distribution leading to a reversal of trend. The trader, who was actually operating in SF at the time of this case study, recounted his upside figure chart objective to \$49 and chose to wait out its interruption in the trend.

At point #20 the trader observed a “Spring” situation and so presumably he could have ventured a long position around the \$29 level (see *Active Trader* magazine, August 2000, for “Springs and Up-thrusts”). At this juncture he could have consulted side bar #2 for the checklist of Re-accumulation Tests. At point #20, he could have concluded that Re-accumulation Buy Tests Number Two and Number Three had been passed. At point #20 the volume had dried up considerably and the downside price progress was minimal, which

\* Examples of these and other tests for re-accumulation are available in the Wyckoff literature. In Basic Lecture Number 12 of the SMI/Wyckoff course, for instance, the narrator counsels the student to place resting buy orders at the 1/2 re-tracement level in order to add positions during corrections in a bull market. Elsewhere in the Wyckoff literature the student is admonished to purchase when the price intercepts and encounters support along an important upward slanting demand line.

taken together revealed a lack of supply being pressed upon the market. Moreover, the interception of the rising support line C-C indicated that a sufficient correction in time and price had taken place (Test Six). However, it was not until the subsequent surpassing of the resistance along the \$31 level on June 11, on wide upside price movement and expanded volume, that SF satisfied several other Re-accumulation Tests, such as Test Number One “Resistance Line Broken” and Test Number Four, “Higher High (price).” Then at point #23, a pullback to a “Higher Low” was executed (Test Three) and a count of the Figure chart along the 31 level would have projected upward to \$37-39. However, this count was insufficient to confirm the earlier price target projections of \$47-49 taken along the \$22 level. Hence, Re-accumulation Test Number Eight was not passed. Moreover, a trade taken at 31 also would have fallen short of the 3-1 reward-to-risk minimum because a stop would need to have been placed 3 points away at 28, and the re-accumulation count was only 8 points. Thus, Test Number Nine also failed. Presumably a pattern analyst could have labeled the consolidation from #19 to #20 a “pennant” (Test Seven).

### RE-ACCUMULATION TESTS PASSED

With two tests already failed our trader chose to pass up adding to his position at the point #23 juncture on the charts. Shortly thereafter the SF stock shot up from point #23 to point #27 and underwent a more prolonged correction. This complex correction would have been a challenge to the pattern recognition skills of most Wyckoff Analysts. Nonetheless, the Wyckoff expert who was operating in the stock identified it as a large wedge or apex (often called a “one-eyed-Joe” by Wyckoffians), which thus fulfilled Re-accumulation Test Number Seven. He took a count taken across the \$35 level back to the zone around point #22. That count indicated a re-accumulation that was sizable enough to reach the \$47-49 target that was first established at point #16, and in the process it flashed a “Stepping Stone Confirming Count” (Re-accumulation buy signal Number Seven).

As price broke out of this wedge formation, it burst through the (downward sloping) “Resistance Line” connecting points 27 and 30, thereby triggering a passage of Re-accumulation Test Number One. On balance, the volume tended to expand during the rallies and shrink during the declines, while the SF stock was in the triangular trading range (passage of Re-accumulation Test Number Two). Price registered a series of higher lows from point #23 to point #28 to point #31 (passed Re-accumulation Test Number Three). These series of higher lows by SF contrasted sharply with series of lower lows that were occurring in the general market index at that time (passage of Re-accumulation Test Number Five). Moreover, at point #28 and #31 price met support near the 1/2 retracement level of the move from point #20 to point #27 (“1/2” mark on Chart 1), thus fulfilling Re-accumulation Test Number Six. At either point 28 or point 31, the trader would have had a better than 3-1 reward to risk ratio (14 count vs. 3-4 points of risk) for the passage of Re-accumulation Test Number Nine.

The trader under the foregoing re-accumulation circumstances should have (and did) roll his options contract forward to a later expiration and higher strike price. He simultaneously increased the size of his line. The passage of all nine re-accumulation tests had created a compelling enough case for him to roll his option contracts forward at the \$35 strike and to add to his position.

### CONCLUSION

When SF reached the \$49 level, the trader exited his SF options position. He judged that the relatively high volume occurring in the price-objective zone around \$49 was sufficient reason to exit. To make

the case for exiting even more enticing, the general market index had started to weaken and diverge from the higher price set by SF around \$49.

There were targets outstanding at \$51-\$57, but this Wyckoff-oriented trader elected to take his profits at \$49 because that was the maximum effect of the cause built during the re-accumulation stepping-stone-count along the \$35 line (point #22 to point #31). He reckoned that he would have to weather another sideways to down correction/consolidation as further preparation for the final advance. He further reckoned that the risk did not justify waiting to capture the final 8 points available beyond \$49. Of course, as we can see retrospectively, he exited prematurely because SF promptly advanced to \$54. (Upon further reflection, this Wyckoff trader said that he would do the same thing again because “bulls make money, bears make money, and pigs get slaughtered.”)

The case study of the San Francisco Company (SF) demonstrated how, with the help the Wyckoff “Nine Classic Buying Tests,” an option trader could have entered favorable reward-to-risk long positions just as the line-of-least resistance became defined with the passage of the “Nine Classic Tests” for accumulation and as the stock was leaving the base formation. This case study also demonstrated how an option trader could have later employed a new set of the “Nine Re-accumulation Tests” to both roll his contracts forward and to add to his position. The fulfillment of the “stepping stone confirming count” nature of this re-accumulation consolidation gave the trader added reason to hold on to his positions until his longer-term base targets were being reached at \$49. Furthermore, the “stepping stone confirming count” provided an additional compelling reason for him to exit his long options on the burst of strength as SF reached the \$49 level.

In general, the Wyckoff “Nine Classic Buying Tests” and the set of “Nine New Tests for Re-accumulation” can help investors and traders to advance forward in their quest to control risk, ride winners and take home maximum profits.

## APPENDIX TO “WYCKOFF TESTS”

### *“How to Make Price Projections Using a Figure Chart”*

by Prof. Hank Pruden, Ph.D., Golden Gate University

“The average ticker hound – or, as they used to call him, tape-worm – goes wrong, I suspect, as much from overspecialization as from anything else. It means a highly expensive inelasticity. After all, the game of speculation isn’t all mathematics or set rules, however rigid the *main laws* may be. Even in my tape reading, something enters that is more than mere arithmetic.”

- *Reminiscences of a Stock Operator*

The Wyckoff Method rests upon three main laws: (1) the law of supply and demand, (2) the law of effort vs. result, and (3) the law of cause and effect.

According to the Wyckoff Law of Cause and Effect, the trader-investor-analyst measures the extent of the cause built up during a trading range and then projects a price objective the potential effect of that cause. The relationship between the cause and the subsequent effect is one-to-one, which means that every unit of cause that is measured horizontally in a trading range translates into an expected one unit of vertical effect.

The cause is created during the up and down buying and selling waves that occur during a trading range.\* The cause is measured and projected on the figure chart according to the Wyckoff “Count guide.” The Wyckoff Count Guide is stated as follows (Source: Wyckoff/Stock Market Institute):

- After having identified a Sign of Strength (SOS) on the vertical line chart, locate the last point at which support was met on a reaction – the Last Point of Support – (LPS). Locate this point on your figure chart also and count from right-to-left, taking your most conservative count first and moving further to the left as the move progresses.
  - In moving to the left, turn to your vertical line chart and divide the area of accumulation into phases, adding one complete phase at a time. Never add only part of a phase to your count. Volume action will usually show where the phase began and ended.
  - As the moves progress you will often see a lateral move forming at a higher level. Very often such a move will become a “Stepping Stone Confirming Count” of the original count. Thus, as such an level forms, you can often get a timing indication by watching the action of the stock as the potential count begins to confirm the original count. A resumption could begin at such a point.
  - For longer term counts one should add his/her count to the exact low, or a point about one-half way between the low and the count line. You will thus be certain that the most conservative count is being used.
  - Counts are only points of “Stop, Look and Listen,” and should never be looked upon as exact points of stopping and turning. Use them as projected points where a turn could occur, and use the vertical line chart to show the action as these points are approached.
  - In the case of a longer-term count, often the Last Point of Support (LPS) comes at the original level of climax, and this level should be looked at first in studying the longer term count. The climax itself indicated a reversal, with the subsequent action being the forming of the cause for the next effect. For the Last Point of Support (LPS) to come at such a level of climax usually makes it a more valid count. Very often the climax is preceded by preliminary support and the Last Point of Support often occurs at the same level as the preliminary support.
  - A #3 Spring or the Secondary test of a #2 Spring, quite often constitutes the Sign of Strength and the Last Point of Support in the same action which is reached at the same point and at the same time. Usually a Spring will be followed by a more important Sign of Strength and the reaction following that Sign of Strength is also a valid Last Point of Support.
  - Frequently, long term counts on three- and five-point charts are confirmed by subsequent minor counts on the one-point chart as the move progresses. Watch for this confirmation very carefully as it often indicates when a move will be resumed.
  - In case of three-point or five-point charts, the same count line should be used as for the one-point chart.
- Analysts who wish to use the Wyckoff Count Guide must appreciate and comprehend certain philosophies and procedures unique to the Wyckoff figure chart. Four key elements of Wyckoff figure chart analyses are as follows:
1. Figure charts play a special supplementary and complementary role in the Wyckoff Method. The key law of Supply and Demand relies upon the vertical chart to diagnose the present position and future trend of the market. The figure chart is not used per se for determining the trend of the market, because the volume information of the vertical chart makes it a superior tool for determining the trend. Philosophically, Wyckoff analysts believe the verti-

\* For readers who recall their high school physics lessons, the law of the cause and effect can be likened to Hooke's Law of Elasticity. Hooke's Law declares the agitations up and down build up energy, the cause (e.g. agitating a metal coat hanger back and forth) and the resultant effect (bend the hanger out of shape) expends energy in an exactly one-to-one proportion to the preceding energy built up.

cal chart ought to be used for trend analysis; however determining the potential extent of the move is the special province of the figure chart, sometimes referred to as the "cause and effect chart."

2. Procedure. The building blocks of the figure chart are box size, intraday data, number of reversal points and full-unit crossing. Most commonly the box size is one point. Hence, intraday price action must meet or exceed the full price levels to trigger a figure chart entry.

Reversal points are normally one point or three-point. For the "one point figure" chart, a very special consideration to keep in mind under the Wyckoff figure chart procedure is the necessity of having at least two entries in any column. Many software programs change columns when price changes direction, even if only a single entry exists in a column. To compensate for this, the analyst must shift prices to create a column with at least two entries in a column before price can move to the next column. Hence a quick down, up, down of one point each would remain in a single column.

For larger moves, the analyst has the option to either relying upon the three-point reversal or an increase in the box size.

3. Perspective. The analyst can visualize horizontal counts as fitting within a saucer appearing bottom and a dome looking top. The first count line should be conservative, nearest the lows, and be considered as the minimum possible. The next count line will usually be within the trading range, broader, and considered the likely objective. Finally, the pullback following the upside "jump" or valid/breakout creates the widest count and the highest upside count, and is thus the least conservative measurement (this is the last-point-of-support that follows after a more important sign-of-strength).

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## BIOGRAPHY

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