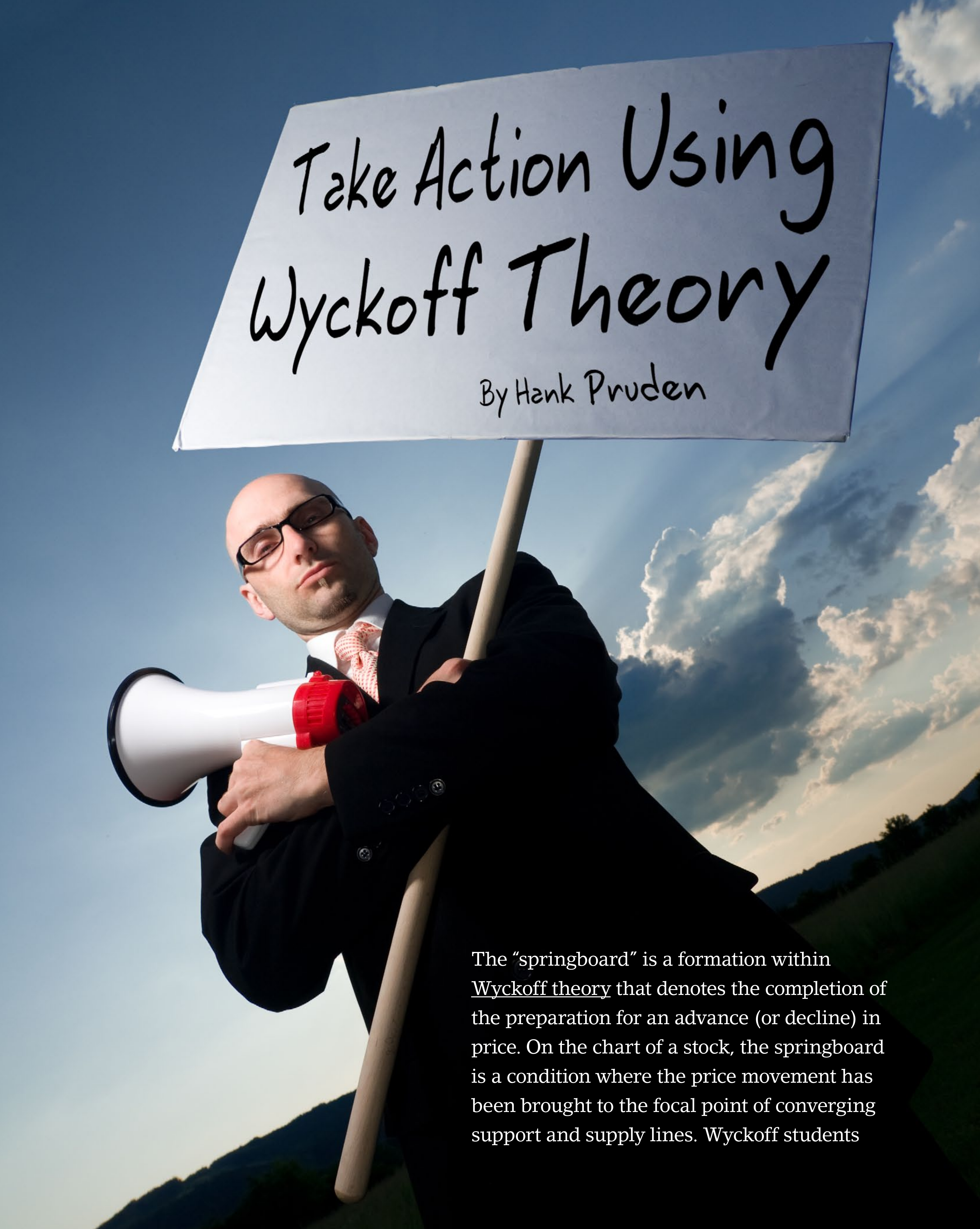
Take Action Using Wyckoff Theory

By Hank Pruden



The "springboard" is a formation within Wyckoff theory that denotes the completion of the preparation for an advance (or decline) in price. On the chart of a stock, the springboard is a condition where the price movement has been brought to the focal point of converging support and supply lines. Wyckoff students

FIGURE 1
Daily Point and Figure Price Chart of Apple Inc.

This chart shows a two-point box size and one-point reversal.

Source: PubliCharts.com

refer to the springboard as an apex, dead center, hinge, pivot or wedge.

According to Wyckoff theory, a stock is on the springboard for a sharp, immediate advance in price when the so-called composite man or smart money working behind the scenes has completed his or her accumulation or re-accumulation of the stock and is ready to remove his or her offerings at the resistance level and let the stock advance.

WYCKOFF IN ACTION

During the first week of June 2010, Apple Inc. was at the center of business news reports. Bloomberg News reported that Steve Jobs introduced the new iPhone on Monday, June 7, with features giving Apple fresh ammunition to use against rivals.

Also, MarketWatch observed that industry analysts expected this latest version of the smart phone to bring in new

FIGURE 2
Bar Price Chart of Apple Inc.

Source: PubliCharts.com

users and add to Apple's profit margins within the coming months.

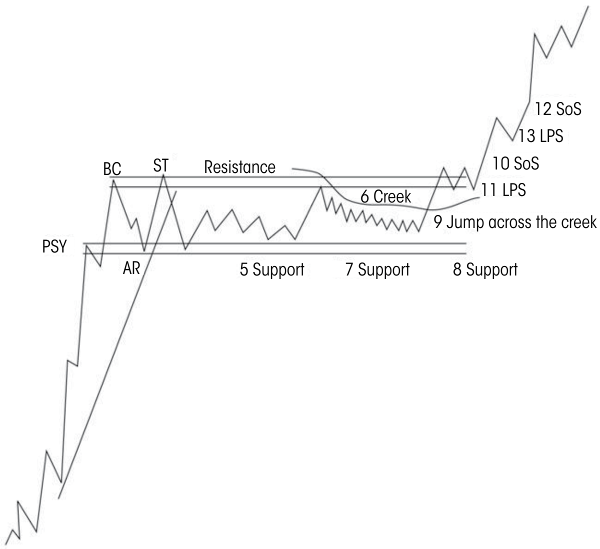
Figures 1 and 2 of Apple show an eight-week standoff by the bulls and the bears between about $270 and $200 per share. The question for the trader/investor in early June 2010 was whether the good news had already been discounted by the market and, thus, the recent trading range had been a preparation for a major decline in price toward $130 per share?

On the other hand, could this trading range have reflected the prospects for a resumption of the uptrend toward $400 to $500 per share?

A LITTLE BACKGROUND

The Wyckoff theory of technical market analysis can help resolve this dilemma. This judgmental technique relies heavily on a schematic of typical market behavior to help guide the trader.

FIGURE 3
Accumulative Gradient of Rising Bottoms



BC—Buying Climax: The point at which widening spread and the force of buying reaches a climax, and heavy or urgent buying by the public is being filled by larger professional interests at prices near a top.

AR—Automatic Reaction: With buying pretty much exhausted and heavy supply continuing, an AR follows the BC.

ST—Secondary Test: Revisiting the area of the selling climax to test the supply/demand balance at these price levels. If a top is to be confirmed, supply will outweigh demand, and volume and spread should be diminished as the market approaches the resistance area of the BC.

Creek: A wavy line of resistance drawn loosely across rally peaks within the trading range. There are, of course, minor lines of resistance and more significant ones that will have to be crossed before the market's journey can continue onward and upward.

Jump: The point at which price jumps through the resistance line; a good sign if done on increasing spread and volume.

SoS—Sign of Strength: An advance on increasing spread and volume.

LPS—Last Point of Support: The ending point of a reaction or pullback at which support was met. Backing up to an LPS means a pullback to support that was formerly resistance on diminished spread and volume after an SoS. This is a good place to initiate long positions or to add to profitable ones.

Source: Hank Pruden

According to Wyckoff theory, a market cycle consists of four basic phases: accumulation, re-accumulation, distribution and re-distribution.

Viewing Apple in light of Wyckoff theory highlights the dilemma.

The stock could be in its final upward stage that has already discounted its technological and market prospects. Hence, the recent trading range is part of an important distribution by smart money in preparation for a significant decline. Or the recent sideways trading range might be re-accumulation as smart money purchases the stock from tired and fearful owners in preparation for another bull campaign for Apple.

A CONUNDRUM

Both formations: distribution or re-accumulation appear similar at their commencement. Therefore, it is only as the trading range matures after a period of sideways movement that telltale signs of distribution or of re-accumulation reveal themselves in the stock's behavior.

One way to sort through this dilemma in Apple is to introduce an idealized schematic of a re-accumulation trading range, seen in Figure 3. This chart was chosen because the market price and volume action of the stock exhibit typical signs of re-accumulation.

Figure 3 is a schematic that appeared in a familiar bullish pattern of re-accumulation, namely ascending triangles,

Read Brecht's profile of Hank Pruden & Wyckoff theory basics.

and it is a product of my own research studies. (For more background and information, see *The Three Skills of Top Trading* p. 111-171.)

SEE FOR YOURSELF

Readers can compare Figure 3 with the behavior of Apple in Figures 1 and 2. Nothing is certain in the market, of course, but the behavior of the general market and the profile of Apple's action suggest that the stock's series of rising bottoms ought to lead to another markup phase.

If Apple passes the nine tests for re-accumulation (see the "9 Re-accumulation Tests"), then a purchase in anticipation of the advance can be entered. On the other hand, if the stock fails to pass these nine buying tests, no purchase should be made.

BOTTOM LINE

In sum, the news reports paint a bullish fundamental picture for Apple Inc. But does the technical picture support that view and say that now is the time to buy Apple? Here's what R. D. Wyckoff had to say about the springboard: "Of all times to take a position in a stock, this is the best."

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9 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 for prices
4. Higher highs for prices
5. Favorable relative strength: equal to or stronger than the market
6. Correction completed in price and/or time: e.g., one-half retracement, support line reached
7. Consolidation pattern formed: e.g., triangular formation
8. Stepping-stone confirming count
9. 3-to-1 reward-to-risk ratio