

Module 1

Disclaimer

Please keep in mind that all comments made by FX Traders EDGE instructors and representatives are for educational purposes only and should not be construed as investment advice regarding the purchase or sale of Securities, Forex, Options, Futures or any other financial instrument of any kind. Consult with your investment advisor before making an investment decision regarding responsibility for your trading and investment results.

Information for the Forex observations was obtained from sources believed to be reliable, but we do not warrant its completeness or accuracy, or warrant any results from the use of the information. The author as well as other representatives and "affiliated" individuals may have a position or effect transactions in the securities herein (or options thereon) and/or otherwise employ trading strategies that may be consistent or inconsistent with the provided strategies.

There is a very high degree of risk involved in any type of trading. Forex, Options and Futures trading is not suitable for all investors. Past results are not indicative of future returns. FX Traders EDGE and all "affiliated" individuals assume no responsibility for your trading and investment results.

Learning Objects

- Foundation of Elliott Wave Theory
- Basic Wave Patterns
- Wave Characteristics
- Introduction of Mathematical Applications
- Three Essential Rules
- Labeling of Waves
- Quiz

© 2012 FX Trader's EDGE™ All Rights Reserved



In this learning object we will learn:
The Foundation of Elliott Wave Theory
Basic Wave Patterns
Wave Characteristics
An Introduction of Mathematical Applications concerning Elliott Wave
Three Essential Rules that must never be broken
Labeling of Waves and how to plot them on your charts
At the end of this module, there will be a quiz.

FOUNDATION OF ELLIOTT WAVE THEORY



Ralph Nelson Elliott
1871 – 1948

Ralph Nelson Elliott developed the Elliott Wave Theory in the 1930's by studying various market indices spanning over a 75-year period. He discovered that stock markets, thought to behave in a somewhat chaotic manner, in fact, did not.

They traded in repetitive cycles, which he discovered were the emotions of investors as a cause of outside influences, or predominant psychology of the masses at the time.

Elliott stated that the upward and downward swings of the mass psychology always showed up in the same repetitive patterns, which were then divided into patterns he termed "waves."

© 2012 FX Trader's EDGE™ All Rights Reserved



Ralph Nelson Elliott developed the Elliott Wave Theory in the 1930's by studying various market indices spanning over a 75-year period. He discovered that stock markets, thought to behave in a somewhat chaotic manner, in fact, did not.

They traded in repetitive cycles, which he discovered were the emotions of investors as a cause of outside influences, or predominant psychology of the masses at the time.

Elliott stated that the upward and downward swings of the mass psychology always showed up in the same repetitive patterns, which were then divided into patterns he termed "waves."

FOUNDATION OF ELLIOTT WAVE THEORY



Ralph Nelson Elliott
1871 – 1948

As mass psychology swings from pessimism to optimism and back to neutral in a natural sequence, the wave patterns of price movements are created. These specific patterns translate into trends, sideways markets and beginnings and ends of market cycles.

Subsequently, many other Elliott Wave theorists have applied his principles to markets other than stocks, such as Forex and commodities, with great success. This is to say that the theory is transferable to virtually all traded markets.

© 2012 FX Trader's EDGE™ All Rights Reserved



Subsequently, many other Elliott Wave theorists have applied his principles to markets other than stocks, such as Forex and commodities, with great success. This is to say that the theory is transferable to virtually all traded markets.

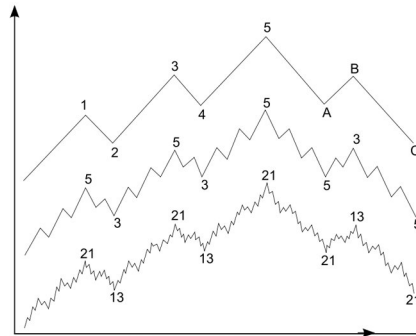
FOUNDATION OF ELLIOTT WAVE THEORY



Ralph Nelson Elliott
1871 – 1948

❖ *The Wave Principle* (1938)

- + Also known as the *Elliott Wave Principle*
- + Tied collective human behavior patterns to the **Fibonacci sequence** or golden ratio



© 2012 FX Trader's EDGE™ All Rights Reserved



Elliott's work was published in 1938 in a monograph titled *The Wave Principle*, which has come to be known as the *Elliott Wave Principle*. He tied these patterns of collective human behavior to the Fibonacci sequence, or golden ratio, well known by mathematicians and scientists. There will be more on Fibonacci later in this and following modules.

FOUNDATION OF ELLIOTT WAVE THEORY



❖ *The Wave Principle* (1938)

- + Also known as the *Elliott Wave Principle*
- + Tied collective human behavior patterns to the **Fibonacci sequence** or golden ratio

❖ *Elliott Wave Supplement* (1953)

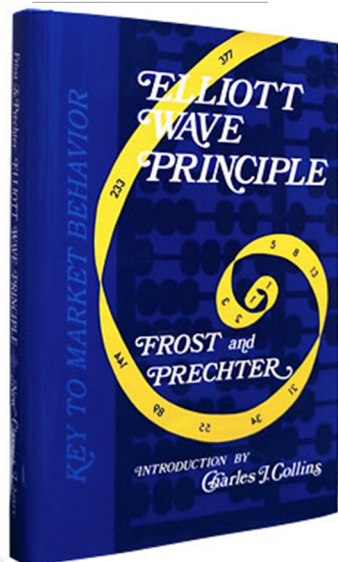
- + By A. Hamilton Bolton
- + Annual report published for the next 14 years

© 2012 FX Trader's EDGE™ All Rights Reserved



In 1953, A. Hamilton Bolton, the founder of the *Bank Credit Analyst*, published the *Elliott Wave Supplement*. This annual report was published for the next 14 years until his death,...

FOUNDATION OF ELLIOTT WAVE THEORY



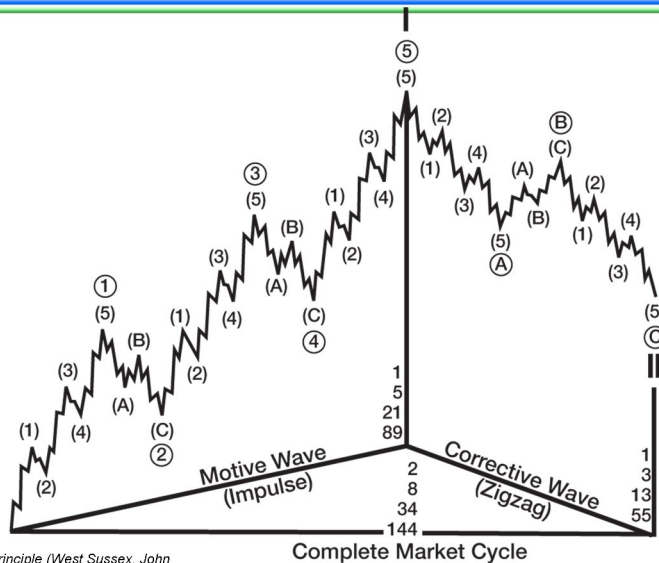
- ❖ *The Wave Principle* (1938)
 - + Also known as the *Elliott Wave Principle*
 - + Tied collective human behavior patterns to the **Fibonacci sequence** or golden ratio
- ❖ *Elliott Wave Supplement* (1953)
 - + By A. Hamilton Bolton
- ❖ *Elliott Wave Principle* (1978)
 - + By A.J. Frost and Robert Prechter

© 2012 FX Trader's EDGE™ All Rights Reserved



at which point A.J. Frost, in collaboration with Robert Prechter, took over the supplements. In 1978, together they wrote the *Elliott Wave Principle*, considered one of the definitive textbooks on wave theory. Prechter further published several other books on Elliott and his principles.

MARKET CYCLE



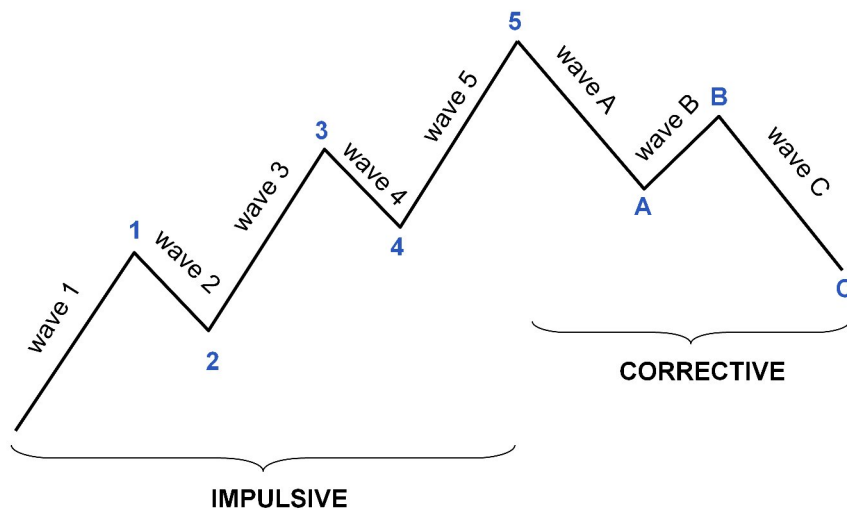
Frost, A.J. and Robert Prechter. *Elliott Wave Principle* (West Sussex, John Wiley & Sons Ltd, 1999).

© 2012 FX Trader's EDGE™ All Rights Reserved



This illustration reflects the Wave Principle, which is that in any market cycle, waves will subdivide until a complete market cycle is established. As the market unfolds in repetitive wave forms, which are governed by man's social nature, they have predictive value. Waves are patterns of directional movement. Since a wave is any one of the patterns that naturally occur, when we learn these patterns, which is the subject of this course, we will be more apt to recognize market movement as it occurs.

MARKET CYCLE



© 2012 FX Trader's EDGE™ All Rights Reserved



MARKET CYCLE

One complete cycle consists of eight waves. To start, a movement will unfold in its primary direction in a series of 5 waves, labeled 1 through 5. This 5-wave impulsive sequence is also called a motive wave or simply a "five." The 5-wave pattern is followed by a 3-wave corrective sequence, also called a "three." The impulsive sequence is numbered 1 through 5, and the corrective sequence is labeled A-B-C. In this example, the A-B-C sequence corrects the 1-2-3-4-5 sequence. Another way of saying this is, at any time a price in the market moves in the direction of the larger trend, it will form a 5-wave sequence followed by a 3-wave sequence which moves against or corrects the trend.

This type of movement also creates the necessary environment for progress in either an upward or downward direction.

FOUNDATION OF ELLIOTT WAVE THEORY

Fractals (frāk'təls)

Noun. Self-similar patterns composed of smaller copies of themselves ad infinitum.

- ❖ Often associated with recursive operations
- ❖ Repeating the process indefinitely

© 2012 FX Trader's EDGE™ All Rights Reserved



Fractals are self-similar patterns composed of smaller copies of themselves ad infinitum. It is often associated with recursive operations on shapes or sets of numbers, in which the result of the operation is used as the input to the same operation, repeating the process indefinitely.

FOUNDATION OF ELLIOTT WAVE THEORY



The Science of Chaos

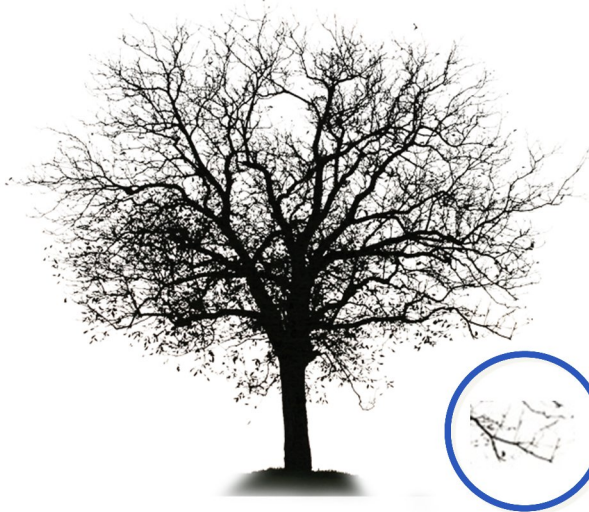
- ❖ Complex shapes that look more or less the same at a variety of scale factors
- ❖ A fractal is a geometric structure that is self-similar when scaled

© 2012 FX Trader's EDGE™ All Rights Reserved



The Science of Chaos, and specifically fractal analysis, became popular 50 years after Elliott concluded that the progress of the market was fractal in nature by discerning patterns that are repetitive in form. Elliott isolated these patterns, or waves that recur in market price data. These fractal forms—complex shapes which look more or less the same at a wide variety of scale factors, are everywhere in nature. Fractals are found from the coastlines of continents to the courses of rivers, clouds in the sky, branches of plants and veins in their leaves. These fractals, which are self-similar or self-identical patterns, abound. A fractal is a geometric structure that is self-similar when scaled.

FOUNDATION OF ELLIOTT WAVE THEORY



Occurrences in nature

Tree
Cauliflower
Romanesco broccoli
Fern

© 2012 FX Trader's EDGE™ All Rights Reserved



A branch of a tree is often used as an example. The branch is similar to the whole tree, and if you break a twig off the branch, the twig is similar to the branch. In a true, mathematical fractal, this scaling goes on forever. Fractals become clear when we look at occurrences in nature.

FOUNDATION OF ELLIOTT WAVE THEORY



Occurrences in nature

Tree
Cauliflower
Romanesco broccoli
Fern

© 2012 FX Trader's EDGE™ All Rights Reserved



Examples of fractals in nature are cauliflower...

FOUNDATION OF ELLIOTT WAVE THEORY



Occurrences in nature

- Tree
- Cauliflower
- Romanesco broccoli
- Fern

© 2012 FX Trader's EDGE™ All Rights Reserved



Romanesco broccoli...

FOUNDATION OF ELLIOTT WAVE THEORY



Occurrences in nature

- Tree
- Cauliflower
- Romanesco broccoli
- Fern

© 2012 FX Trader's EDGE™ All Rights Reserved



and the Fern.

FOUNDATION OF ELLIOTT WAVE THEORY

- ❖ Market movements reflect mass human psychology. These movements form patterns that predict market behavior.
- ❖ When market behavior looks similar to various scales of resolution, it is said to be fractal.
- ❖ Elliott Waves are fractal with waves embedded within waves, within waves, within waves, etc.

© 2012 FX Trader's EDGE™ All Rights Reserved

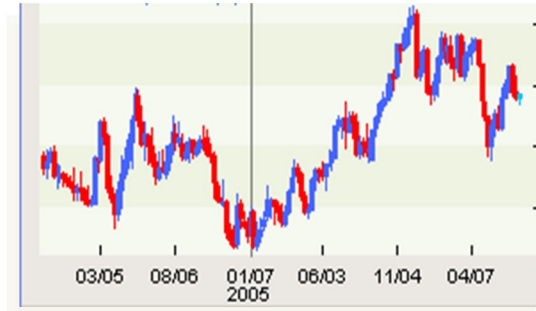


Market movements reflect mass human psychology. These movements form patterns that predict market behavior. Elliott named and characterized these patterns or waves he found in the market data. He also described how they link together to form larger versions of themselves, and then link to form the same patterns at the next larger level. When behavior looks similar at various scales of resolution, it is said to be fractal. Elliott Waves are fractal with waves embedded within waves, within waves, etc.

FOUNDATION OF ELLIOTT WAVE THEORY

The chart below could easily be a 15 minute, hourly, daily or monthly chart, when in fact, it is a **weekly**.

hourly?
daily?
weekly?
monthly bars
or candlesticks?



© 2012 FX Trader's EDGE™ All Rights Reserved



For example, have you ever looked at a chart and could not readily determine if they were hourly, daily, weekly, or monthly bars or candlesticks?

Look at the chart visual here. This chart could easily be a 15-minute, hourly, daily or monthly chart, when in fact it is a weekly. These replicating wave structures produce a progression of patterns which Elliott called the Wave Principle.

FRACTAL NATURE OF WAVES

The fractal nature of markets means that patterns repeat themselves in different time frames.

Waves of any degree in any series are made up of waves of a lesser degree.

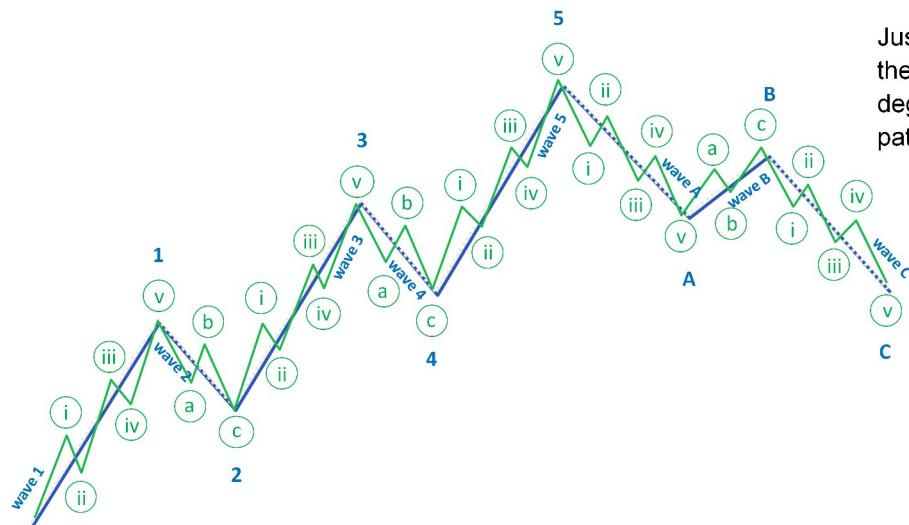
© 2012 FX Trader's EDGE™ All Rights Reserved



The fractal nature of markets means that patterns repeat themselves in different time frames.

Waves of any degree in any series are made up of waves of lesser degree.

FRACTAL NATURE OF WAVES



Just as nature reproduces in the same patterns of different degrees, so too do market patterns.

© 2012 FX Trader's EDGE™ All Rights Reserved



Just as nature reproduces in the same patterns of different degrees, so too do market patterns.

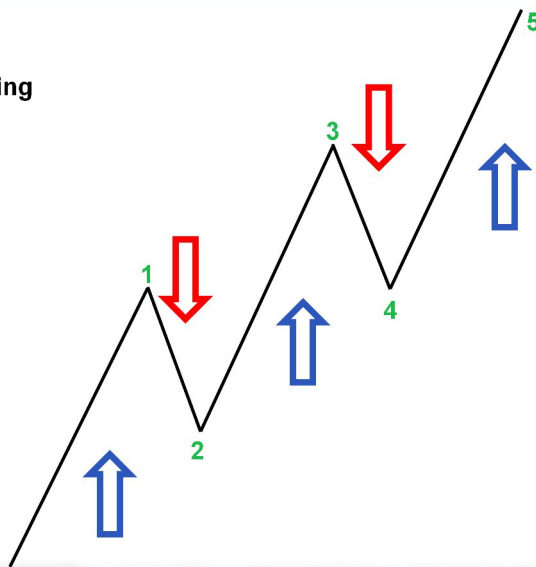
Notice this 5-wave sequence subdividing into waves of a lesser degree, found in a smaller time frame.

Whether a monthly, weekly, daily, 4-hourly, hourly, or 15-minute chart, the patterns repeat themselves.

This enables one to trade any time frame using the Elliott Wave Principle.

BASIC WAVE PATTERNS

The basic 5-wave structure in a **rising** market or uptrend consists of three upward movements that are intermediated by two downward movements, termed “impulsive” or “motive.”



© 2012 FX Trader's EDGE™ All Rights Reserved



The basic 5-wave structure in a rising market or uptrend consists of three upward movements that are intermediated by two downward movements. This 5 wave structure is termed “motive.”

Waves 1, 3, and 5 are called impulsive or motive waves and move in the direction of the trend, and in this example, an uptrend, they are rising waves. Waves 2 and 4 are called corrective waves and are countertrend interruptions, moving against the trend. This is the basic 5-wave count.

BASIC WAVE PATTERNS

Then followed by the basic 3-wave structure consisting of two downward movements that are intermediated by one upward movement, termed "corrective."



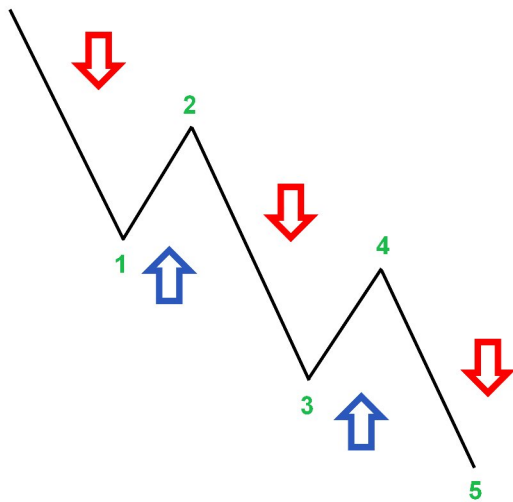
© 2012 FX Trader's EDGE™ All Rights Reserved



Then it is followed by the basic 3-wave structure consisting of two downward movements that is intermediated by one upward movement, termed "corrective." The correction is lettered A-B-C.

A 5-wave advance or decline is followed by a 3-wave move in the opposite direction. The basic rhythm is five waves corrected by three waves, no matter what time frame is being looked at. We call the A-B-C pattern the corrective sequence. The 5-wave advance is the numbered phase and the 3-wave correction is the lettered phase. This sequence remains constant no matter what degree of wave is being analyzed.

BASIC WAVE PATTERNS



The basic 5-wave structure in a **falling** market or down trend consists of three downward movements that are intermediated by two upward movements, termed "impulsive" or "motive."

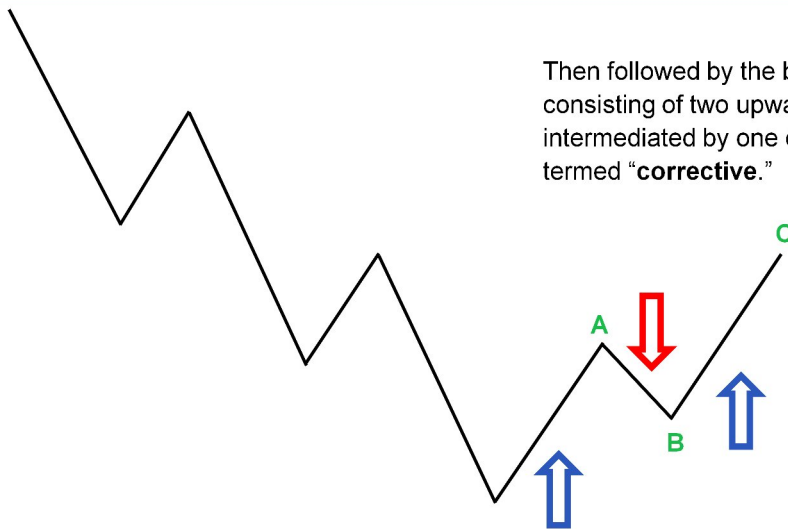
© 2012 FX Trader's EDGE™ All Rights Reserved



The basic 5-wave structure in a falling market or down trend will repeat itself in the opposite direction when a complete cycle occurs. As such a downward wave structure will consist of three downward movements that are intermediated by two upward movements. Just as in an uptrend a complete 5-wave pattern moving downward is termed "impulsive or "motive."

BASIC WAVE PATTERNS

Then followed by the basic 3 -wave structure consisting of two upward movements that is intermediated by one downward movement, termed "**corrective**."



© 2012 FX Trader's EDGE™ All Rights Reserved



Then it is followed by the basic 3-wave structure consisting of two upward movements that is intermediated by one downward movement, termed "corrective." The correction is lettered A-B-C.

THE COMPLETE WAVE CYCLE

In an uptrend or rising market:

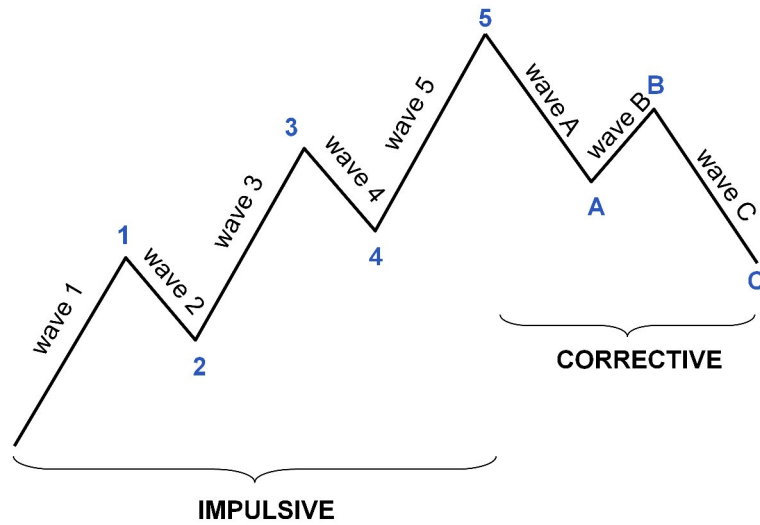
- ❖ The **impulsive wave** moves with the predominant uptrend.
- ❖ The **corrective wave** moves against the predominant uptrend.

© 2012 FX Trader's EDGE™ All Rights Reserved



In an uptrend or rising market the impulsive wave moves with the predominant uptrend. The corrective wave moves against the predominant uptrend.

THE COMPLETE WAVE CYCLE



© 2012 FX Trader's EDGE™ All Rights Reserved



THE COMPLETE WAVE CYCLE

Can you spot the impulsive and corrective waves in this uprising trend?

THE COMPLETE WAVE CYCLE

In a downtrend or falling market:

- ❖ The **impulsive wave** moves with the predominant downtrend.
- ❖ The **corrective wave** moves against the predominant downtrend.

© 2012 FX Trader's EDGE™ All Rights Reserved

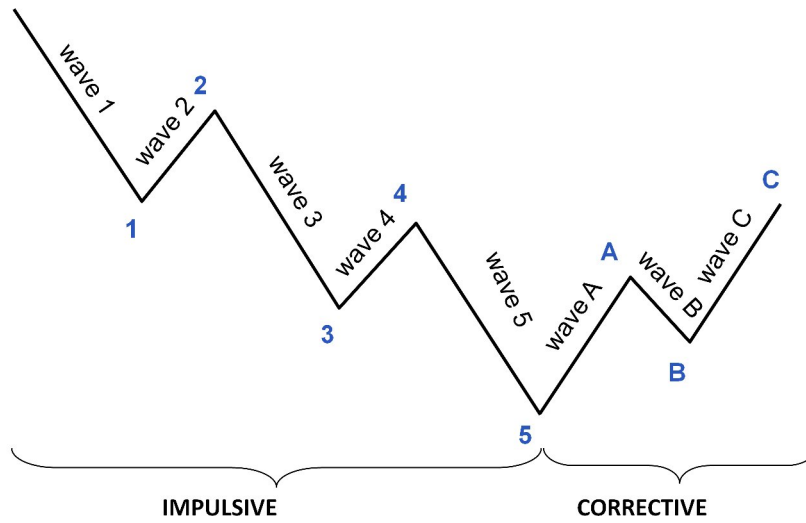


In a downtrend or falling market:

The **impulsive wave** moves with the predominant downtrend.

The **corrective wave** moves against the predominant downtrend.

THE COMPLETE WAVE CYCLE



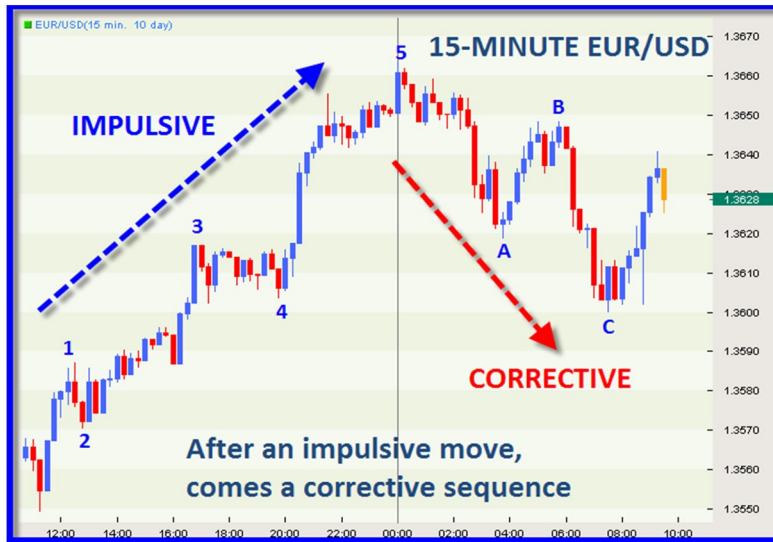
© 2012 FX Trader's EDGE™ All Rights Reserved



THE COMPLETE WAVE CYCLE

Again we illustrate how the full sequence works equally in a falling market as it does in a rising one.

EUR/USD 15-Minute Uptrend Example #1



A 15-minute complete market cycle then sub-divides further into 5-wave and 3-wave patterns which become clear on a smaller time frame such as the 5-minute chart.

Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



EUR/USD 5-Minute Uptrend Example #2

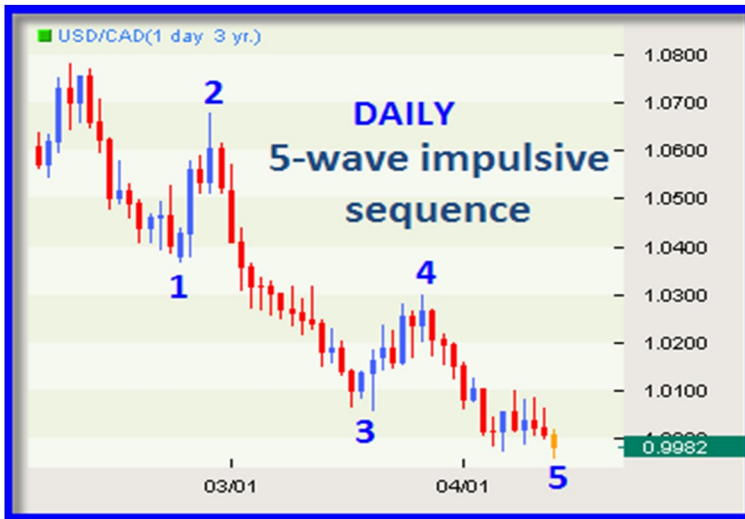


Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



USD/CAD Daily Downtrend Example #1



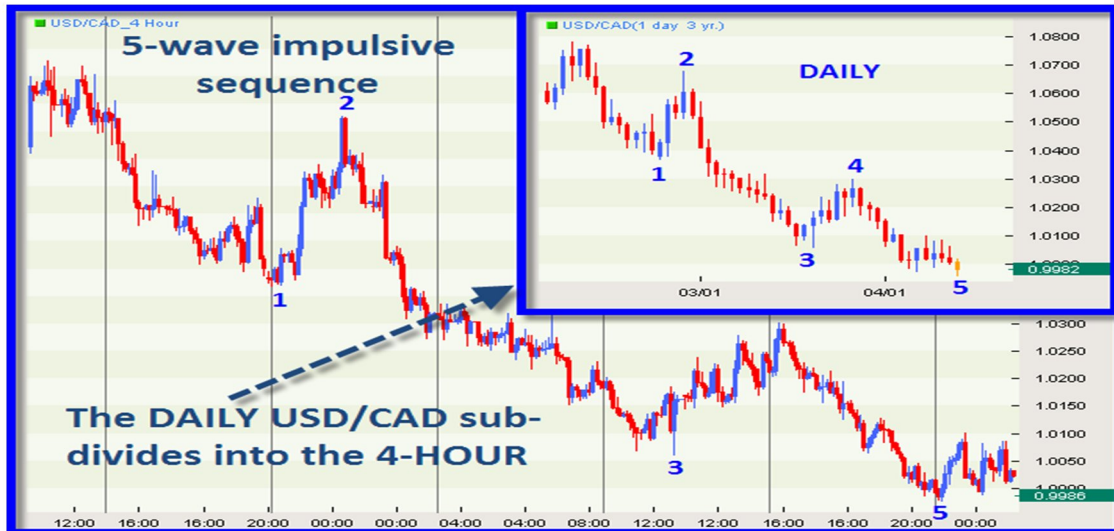
A Daily 5-wave impulsive sequence then sub-divides into 5-wave and 3-wave patterns which become clear on a smaller time frame such as the 4-Hour chart.

Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



USD/CAD 4-Hour Downtrend Example #2



Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Combining Cycles with Market Direction

The basic rhythm of the market is the Elliott Wave.

Elliott waves are the best indicator of where you are in the market from down to up and back down again.

The Elliott Wave is a top and bottom picker – In the Elliott Wave Series you will learn various strategies to find the top and bottom of market cycles in any time frame.

Elliott Wave Analysis takes us to a higher altitude, where we can take a top down approach and feel comfortable with the directional view of the current time frame in which we are trading. In other words, the Elliott Wave trader will learn how to trade with the trend.

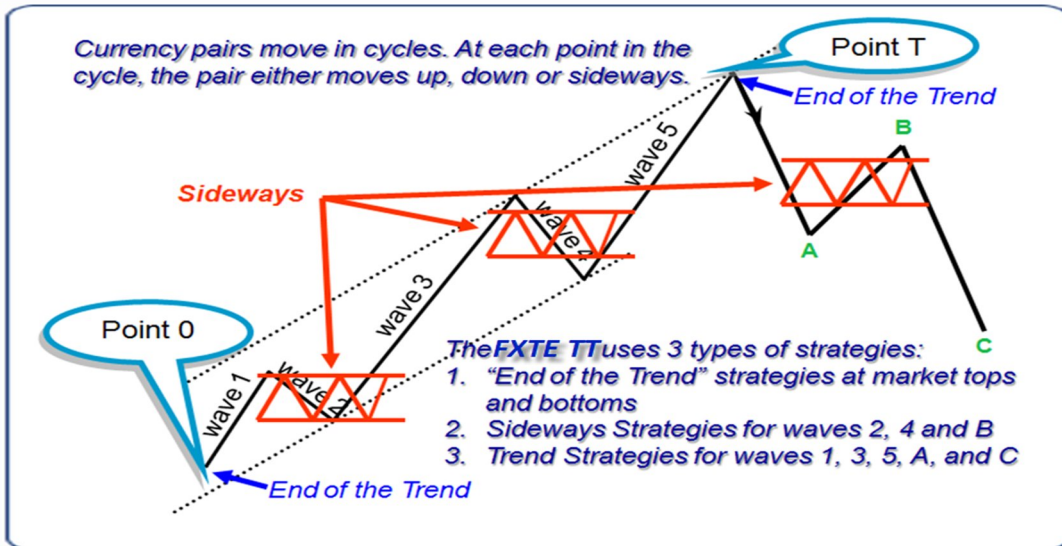
Combining Cycles with Market Direction

The Elliott sequence consists of a basic rhythm of a trend move followed by a correction or consolidation.

An uptrend usually unfolds in 5 waves and the subsequent correction usually unfolds in 3 waves. In the Wavy tunnel course, the Elliott Wave trader will learn strategies to trade the corrections.

A downtrend usually unfolds in 5 waves and the subsequent correction usually unfolds in 3 waves. In the Wavy Tunnel course, the Elliott Wave trader will be able to distinguish which part of the cycle we are in and will know what strategies to use.

Combining Cycles with Market Direction



Combining Cycles with Market Direction

Each phase in the cycle warrants different position sizing and risk management techniques.

Various patterns are used to determine where we are in the cycle in order to know when to get excited about a trend move.

Identifying which phase of the cycle a currency pair is in is important to successful trading. It helps to reduce losing trades by trading in the direction of the trend. The Elliott Wave trader understands when to trade, when not to trade and how to place high probability trades.

Combining Cycles with Market Direction

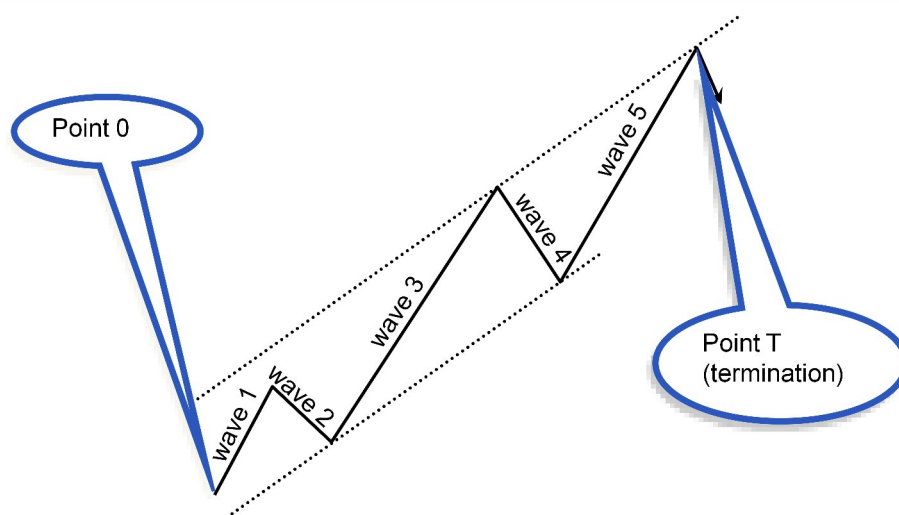
Each wave in the cycle has a distinct personality driven by traders emotions.

Each wave in the cycle calls for a specific trading strategy.

The Elliott Wave trader will make most of his bigger profits in trend waves and will learn to sit back and wait patiently during consolidation waves. A larger percentage of time is spent during these corrective moves.

Five out of the eight waves are trend-following. For most traders, three out of the eight waves tend to be choppy, volatile, and difficult to trade. The Elliott Wave trader learns to recognize the patterns that are evident in each phase of the cycle and develops confidence in the ability to read and trade any phase of the cycle.

WAVE CHARACTERISTICS

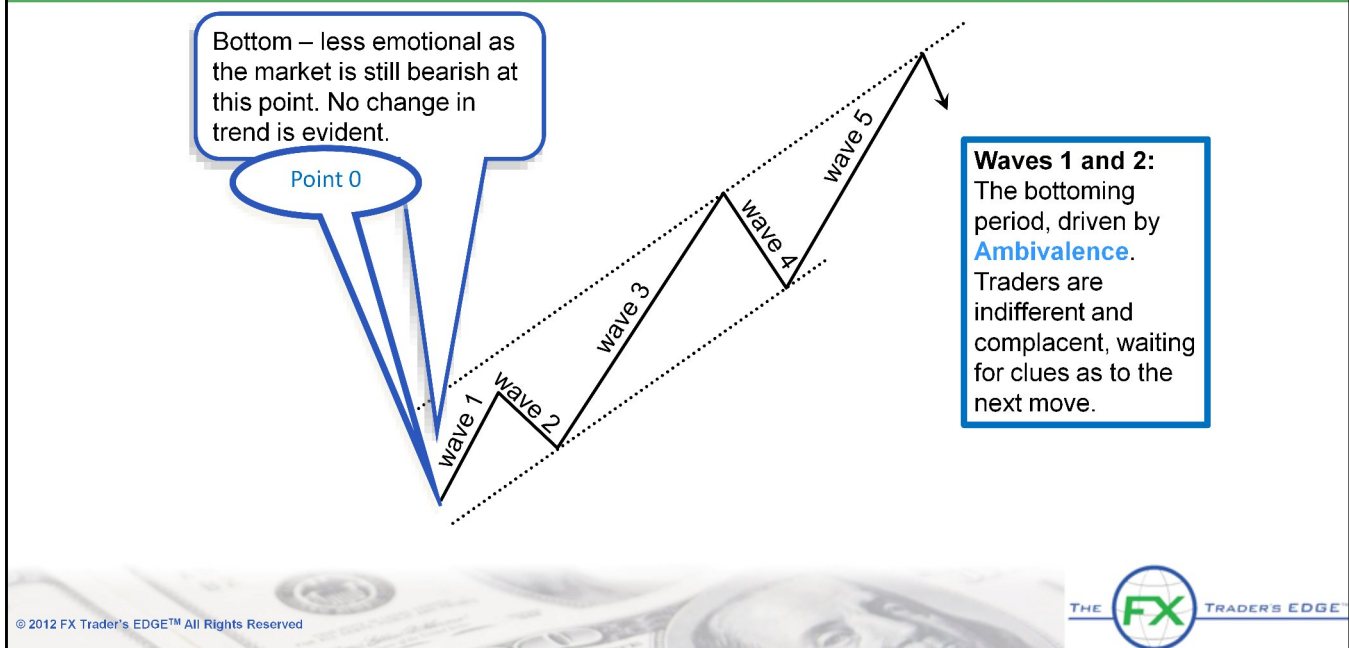


© 2012 FX Trader's EDGE™ All Rights Reserved



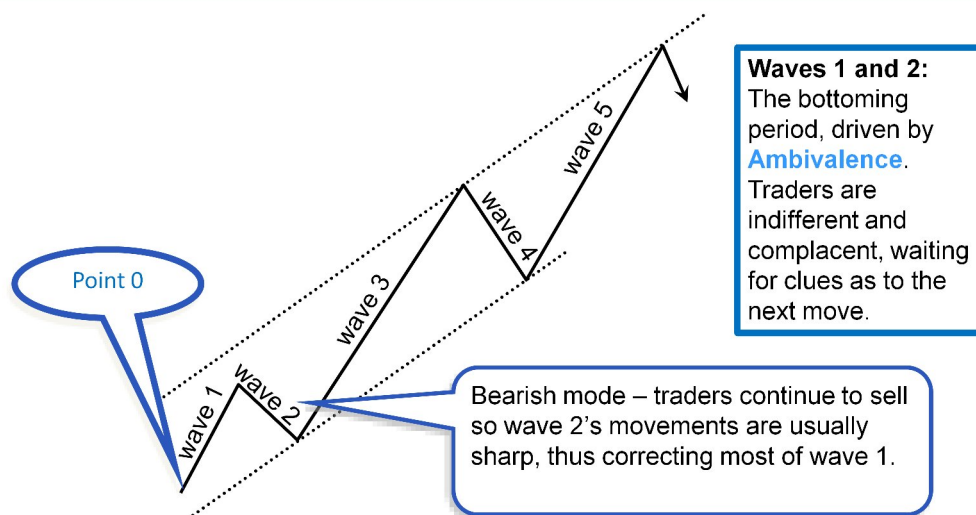
Wave characteristics are a direct reflection of human market behavior. Wave personalities exist at every level of the wave count. We call the start of wave 1 point zero. Where the 5-wave impulsive sequence ends is called Point T for termination.

WAVE CHARACTERISTICS



Between point zero and the end of wave 1, the market is still bearish. Wave 1 is always part of a basing process. There are no momentum clues yet for a change in the trend. The price action is less emotional with little or no volatility as the crowd is still bearish at this point, so the market participants are still in sell mode since no change in trend is evident.

WAVE CHARACTERISTICS



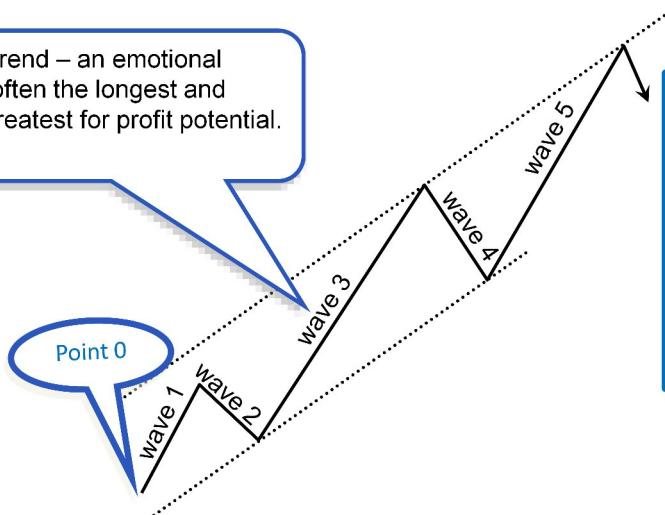
© 2012 FX Trader's EDGE™ All Rights Reserved



Once the first wave has finished, we anticipate a second wave in the opposite direction. Second waves are created by new selling in an uptrend or buying in a downtrend because traders who are selling in an uptrend do not recognize that this up move is a wave 1 in a new direction. These traders believe wave 1 is simply another correction in a continuing down move, so they sell at the top of wave 1. Wave 2 moves are usually sharp, correcting most of wave 1.

WAVE CHARACTERISTICS

Powerful uptrend – an emotional thrust most often the longest and strongest. Greatest for profit potential.



Wave 3: The biggest trend period, driven by **Confidence**. Traders make the most money here –it is hard to lose money unless a trader gets in too late.

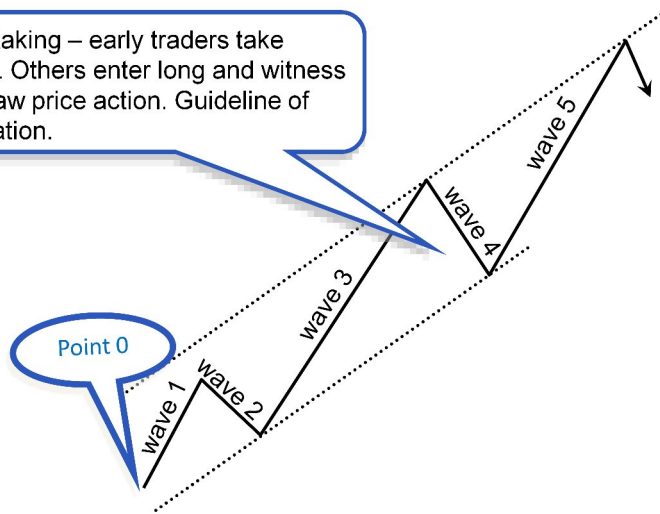
© 2012 FX Trader's EDGE™ All Rights Reserved



Wave 3 gives us the greatest profit opportunities. Robert Prechter calls wave 3 a “wonder to behold.” One way to recognize a wave 3 is by its steep slope and rocket thrust movement. It is generally steeper than a wave 1. Wave 3 sometimes seems almost vertical. During wave 3 the economic background begins to support the move and fundamental reasons begin to support the technical indicators. Wave 3 is almost always the longest and the strongest with the greatest profit potential. It often extends because the fundamentals improve in a third wave, volume picks up, and the price action is emotional.

WAVE CHARACTERISTICS

Profit taking – early traders take profits. Others enter long and witness whipsaw price action. Guideline of alternation.



Wave 4: Driven by **Indecision**. Too much whipsaw and choppiness.

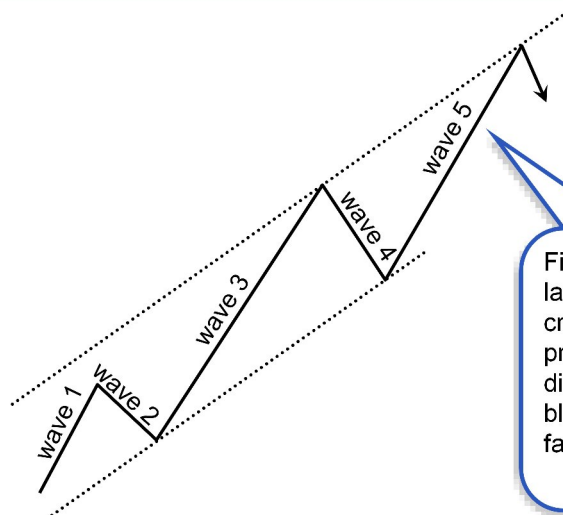
© 2012 FX Trader's EDGE™ All Rights Reserved



Once wave 3 is over, profit taking enters the picture. The most skillful traders who were into the trend the earliest, are now sitting on profits. The character of wave 4 is different from wave 2, although still corrective in nature. Most trading whiplashes occur during wave 4. Many traders lose money in wave 4. Generally, wave 4 corrections last much longer and do not retrace as much as wave 2.

WAVE CHARACTERISTICS

Wave 5: The final advance, driven by Greed.



Final advance – last struggle to create new high prices, momentum divergences, blow-offs, and failures.

© 2012 FX Trader's EDGE™ All Rights Reserved



Wave 5 is the final advance to Point T, the termination point. In commodity bull markets they are often characterized by explosive blow offs but in currencies and stocks they are usually not. Wave 5 is the trader's last struggle to create new high prices. It is not as enthusiastic or euphoric as wave 3. Generally, the slope of the price line is less steep than in wave 3. Momentum divergences are evident as the momentum slows, since it is the end of a 5-wave sequence. Optimism continues, and this is the best time not to be part of the optimistic herd mentality. In the currency markets, fifth wave failures are often present, as the fifth wave fails to make a new high above wave 3 because there are too many participants looking for that last move up.

Impulsive Wave Characteristics Example #1

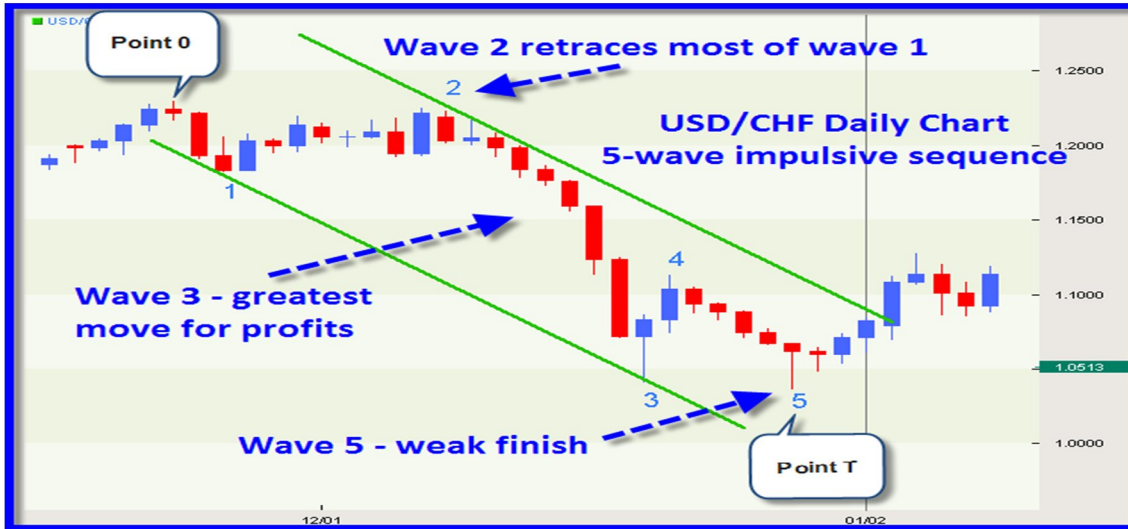


Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved

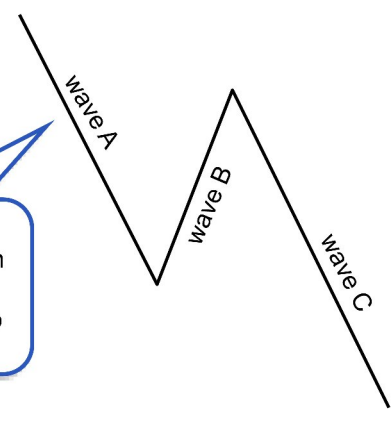


Impulsive Wave Characteristics Example #2



Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

WAVE CHARACTERISTICS



Top of wave 1, 3 or 5. Market still bullish in an uptrend. This is a correction only. Look to buy market dips.

Waves A and B:
The topping period, driven by **Uncertainty**. Traders are waiting for new clues as to the next move. Is it just a correction or will the market move lower with a trend change?

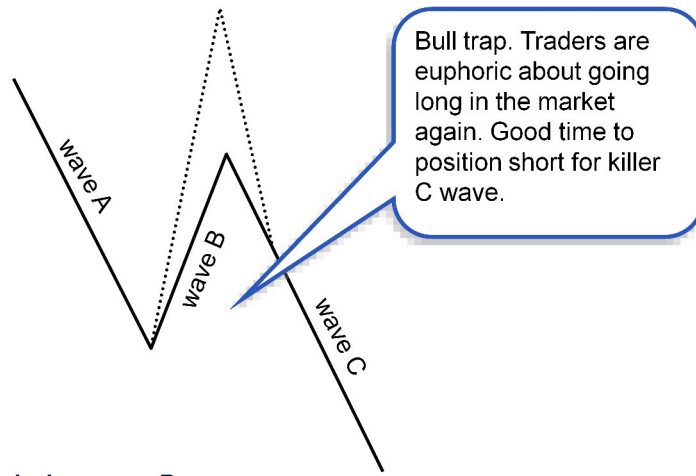
© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective waves have their own characteristics.

The A wave kicks off the corrective move. Whether it's the second, fourth, or simply the A-B-C following the larger 5-wave sequence, the characteristics are the same. This is the wave where traders are convinced that this is just a simple pullback before the next leg of the move up in the case of an uptrend. The A wave sets the tone for the B wave move. If A travels in 5 waves, the correction is likely to go deep as a zigzag move. If A travels in 3 waves, then the correction is likely to be a flat correction or a triangle.

WAVE CHARACTERISTICS



EW Traders learn how to position during wave B.

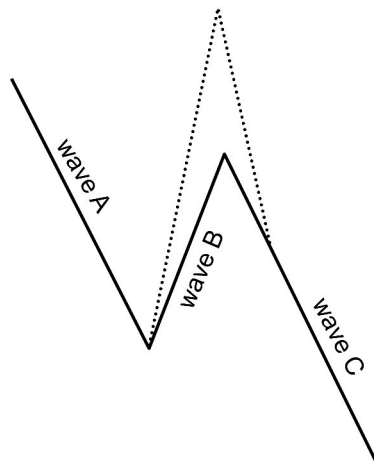
© 2012 FX Trader's EDGE™ All Rights Reserved



Wave B's are usually bull traps and sucker plays. After an A wave, especially if it is 3 waves, the market looks to re-buy the uptrend, not recognizing that the correction isn't over yet. The market gets very euphoric about the continuation of the trend and the move up is actually quite weak and corrective—a big disappointment! However, a 5-wave move in wave A followed by a 3-wave correction in wave B, provides a great setup for positioning for the wave C move down.

WAVE CHARACTERISTICS

Wave C: The bearish period, driven by **Fear**.



Bearish mode. Killer wave C wipes out long positions as prices drop relentlessly. Often an extended wave but when it's over, it's over, and then it's time to buy.

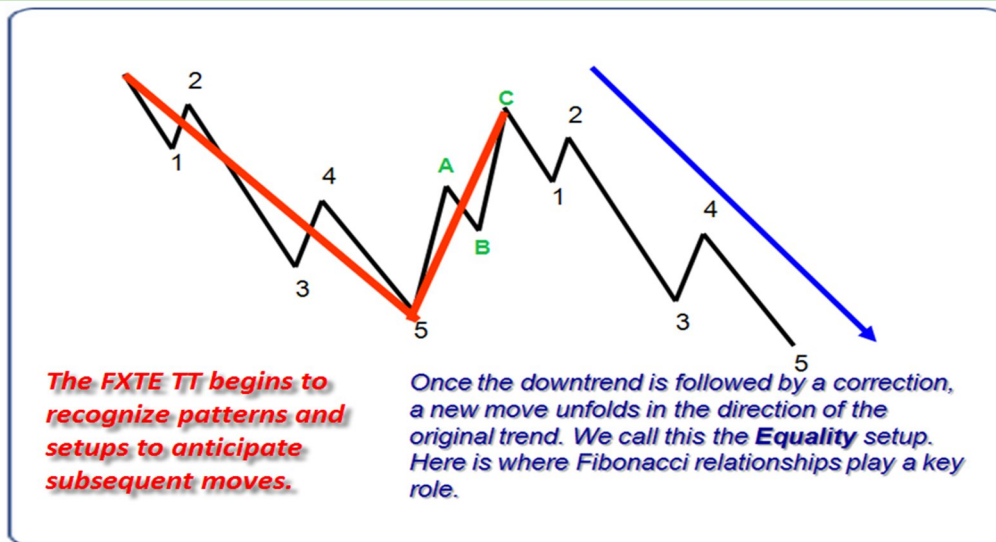
EW Traders learn how to ride the killer wave C.

© 2012 FX Trader's EDGE™ All Rights Reserved



Wave C is often called the killer wave, for it can be just as strong and long as a wave 3. It knocks all of the long positions out of the way in the case of an impulsive uptrend. But once wave C is done, it is done. Targeting the end of wave C is a good time to go long again. However, a highly profitable trade is to sell the corrective wave B pullback to be able to ride the killer C wave.

Corrective Wave Characteristics



© 2012 FX Trader's EDGE™ All Rights Reserved



Notice what happens after the downtrend is corrected up in an ABC form. The macro time frame begins to set lower highs and a larger downtrend develops. Once the FX Traders EDGE Trained Trader (FXTE TT) sees this setup developing, another move down of the same size as the initial move can be expected to occur.

Corrective Wave Characteristics EUR/USD Monthly

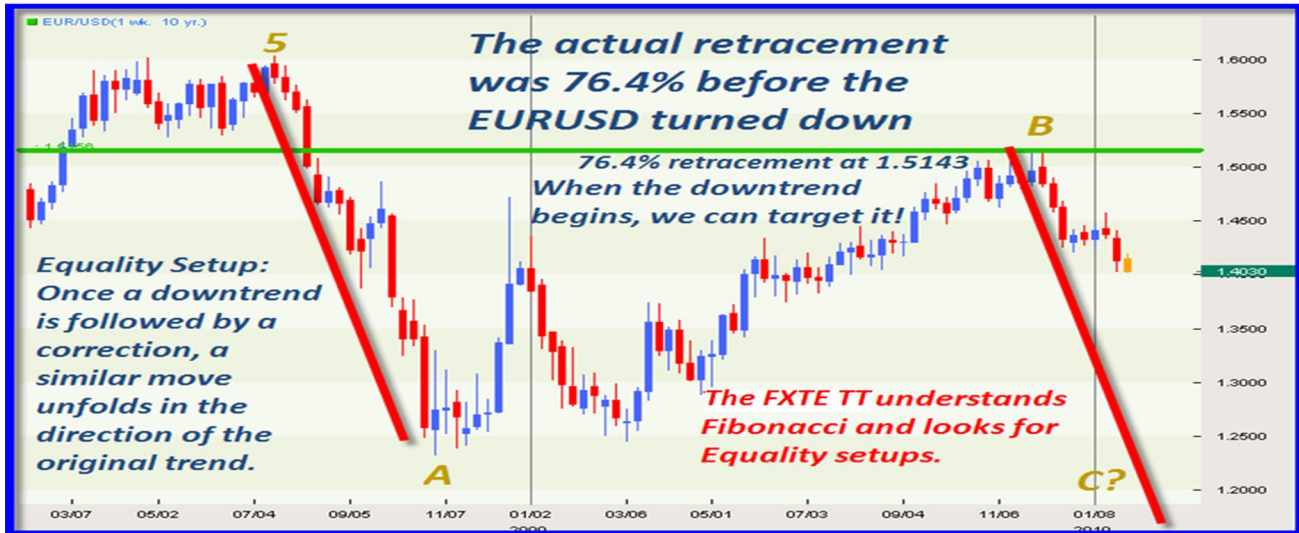


Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective Wave Characteristics EUR/USD Weekly



Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective Wave Characteristics EUR/USD 15-minute

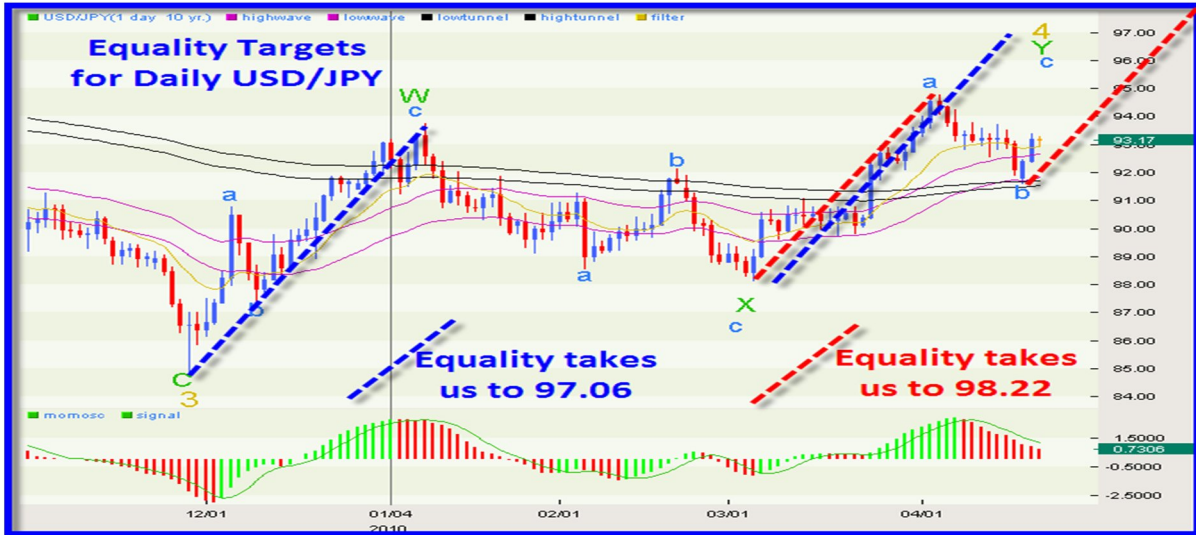


In a downtrend or falling market:

The **impulsive wave** moves with the predominant downtrend.

The **corrective wave** moves against the predominant downtrend.

Corrective Wave Characteristics USD/JPY Daily

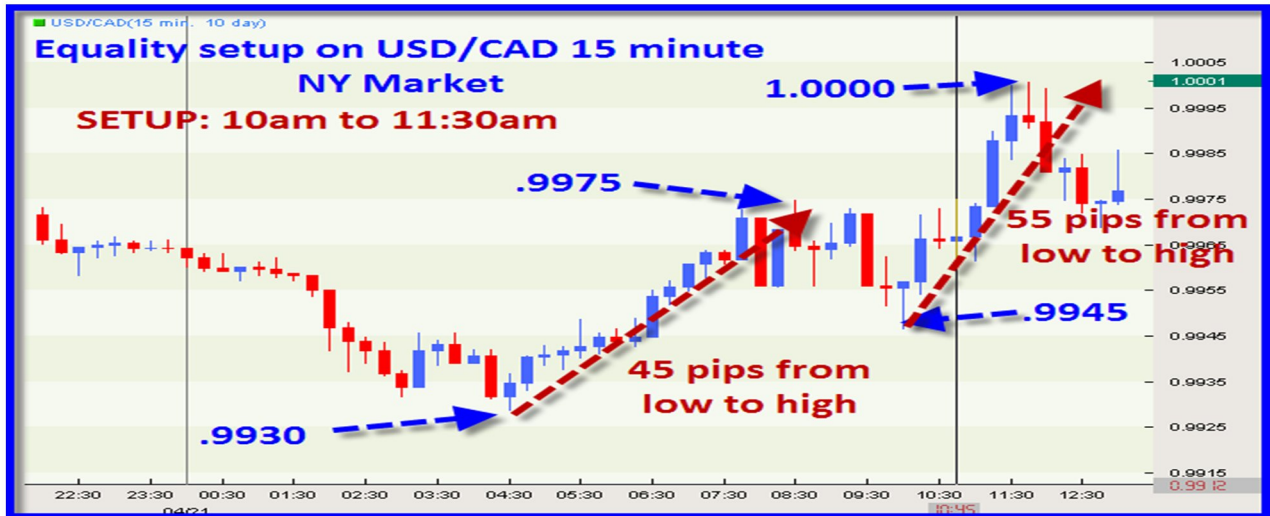


Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective Wave Characteristics USD/CAD 15 minute



Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective Wave Characteristics USD/JPY 5 minute

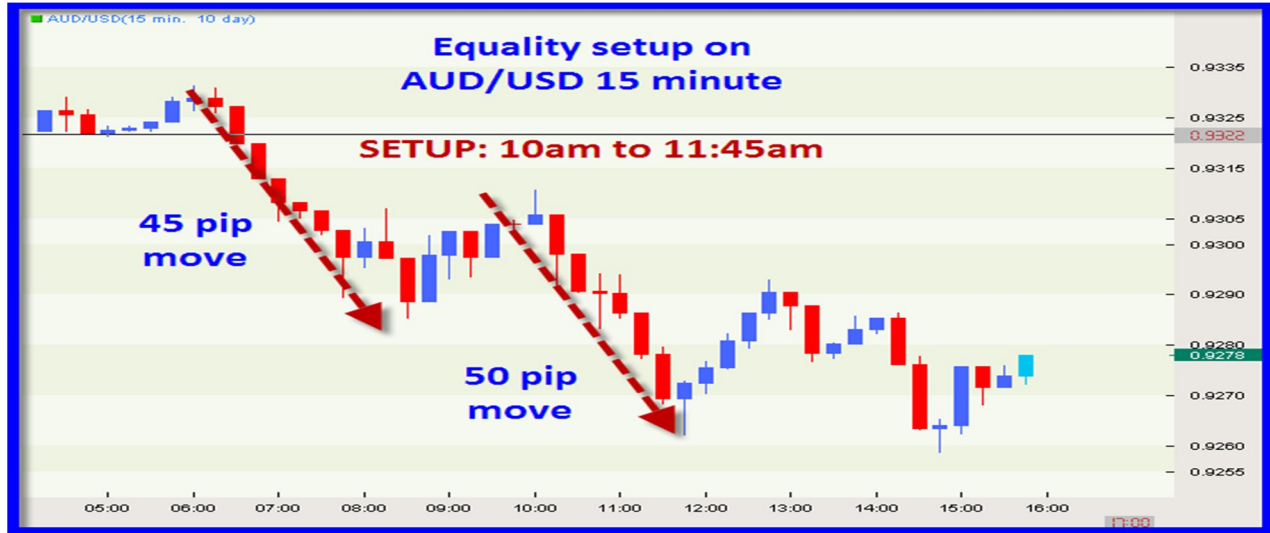


Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective Wave Characteristics AUD/USD 15 minute

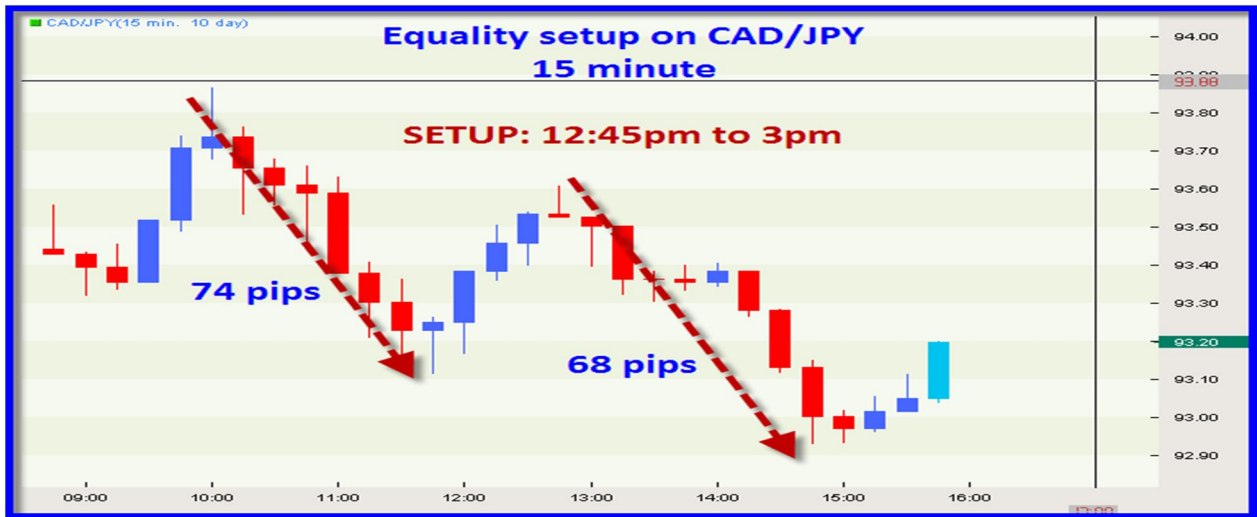


Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Corrective Wave Characteristics CAD/JPY 15 minute



Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



INTRODUCTION TO MATHEMATICAL APPLICATIONS



Fibonacci
1170-1250

Leonardo Fibonacci was an Italian mathematician born in the 12th century.

He is known to have discovered the

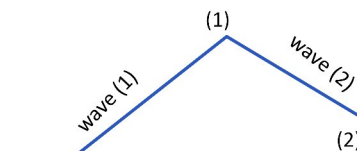
Fibonacci sequence of numbers

A sequence of numbers after zero and one, where each successive number is the sum of the two previous numbers.

0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

Fibonacci numbers appear when counting Elliott Waves.

(1) and (2) = 2 waves



© 2012 FX Trader's EDGE™ All Rights Reserved



Introduction to Mathematical Applications

Leonardo Fibonacci was an Italian mathematician born in the 12th century.

He is known to have discovered the Fibonacci sequence of numbers.

The Fibonacci number sequence is a set of numbers after zero and one, where each successive number is the sum of the two previous numbers.

Fibonacci numbers appear when counting Elliott Waves.

(1) and (2) = 2 waves

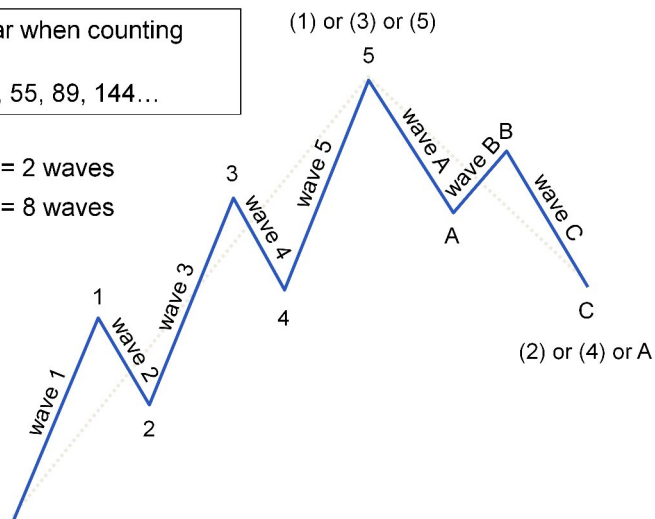
FIBONACCI NUMBERS

Fibonacci numbers appear when counting Elliott Waves.

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

(1) and (2) = 2 waves

1, 2, 3, 4, 5, A, B, C = 8 waves



© 2012 FX Trader's EDGE™ All Rights Reserved

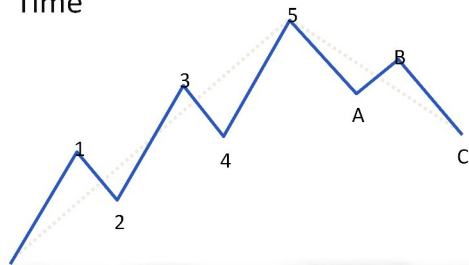


Now, you are beginning to see the repetitive nature of the waves that Elliott first described, when he looked at the stock market as a fractal. The complete 8-wave cycle, 1-2-3-4-5-A-B-C, is really 2 waves of a larger degree. We can look at it another way as well. Looking at this sequence as waves 1 and 2, we can say that waves of any degree in any series always subdivide into waves of a lesser degree. Specifically, waves 1 and 2 of the daily chart will subdivide into waves of a lesser degree which can be seen on the hourly chart.

FIBONACCI NUMBERS

The three important aspects of wave theory are:

- ❖ Wave Form
- ❖ Ratio
- ❖ Time



Elliott observed in his work that patterns in the market are repetitive in form, but not necessarily in time or amplitude.

Pattern refers to this wave sequence completing a cycle in any time frame and is considered the most important element of the three in wave analysis.

However, we will look very closely at ratio analysis, and introduce time analysis as well.

© 2012 FX Trader's EDGE™ All Rights Reserved



Elliott observed in his work that patterns in the market are repetitive in form, but not necessarily in time or amplitude.

Pattern refers to this wave sequence completing a cycle in any time frame and is considered the most important element of the three in wave analysis.

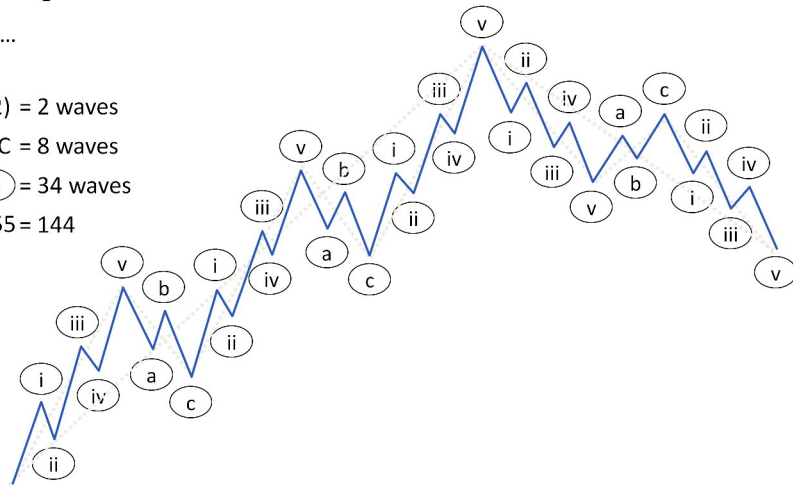
However, we will look very closely at ratio analysis, and introduce time analysis as well.

FIBONACCI NUMBERS

Fibonacci numbers appear when counting Elliott Waves.

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

(1) and (2) = 2 waves
1, 2, 3, 4, 5, A, B, C = 8 waves
i ii iii iv v a b c = 34 waves
 $89 + 55 = 144$



© 2012 FX Trader's EDGE™ All Rights Reserved



To summarize, we have subdivided the 8 wave cycle into its subwaves to get 21 waves for the impulse sequence and 13 waves for the corrective sequence. Adding them together gives 34 waves. If we were to break the waves into further subwaves, we would get 89 waves for the impulse sequence and 55 waves for the corrective sequence, which add up to 144 waves.

THE GOLDEN SECTION

Examples of occurrences

Nautilus sea shell
Sunflower
Vitruvian Man
Parthenon

A special value, related to the Fibonacci numbers, is called the Golden Section.

Also called the divine proportion, the Golden Section is regarded as the reason for aesthetically pleasing, harmonious proportions in nature, architecture, art, and music.

© 2012 FX Trader's EDGE™ All Rights Reserved



A special value, related to the Fibonacci numbers, is called the Golden Section.

Also called the divine proportion, the Golden Section is regarded as the reason for aesthetically pleasing, harmonious proportions in nature, architecture, art, and music.

THE GOLDEN SECTION

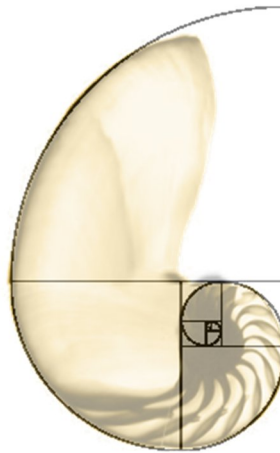
Examples of occurrences

Nautilus sea shell

Sunflower

Vitruvian Man

Parthenon



© 2012 FX Trader's EDGE™ All Rights Reserved



In the nautilus sea shell, each section subdivides in area to one of the percentages of the Golden Ratio.

THE GOLDEN SECTION

**Examples of
occurrences**

Nautilus sea shell

Sunflower

Vitruvian Man

Parthenon



© 2012 FX Trader's EDGE™ All Rights Reserved



In a sunflower, seeds grow in a pattern in distance of the Golden Ratio.

THE GOLDEN SECTION

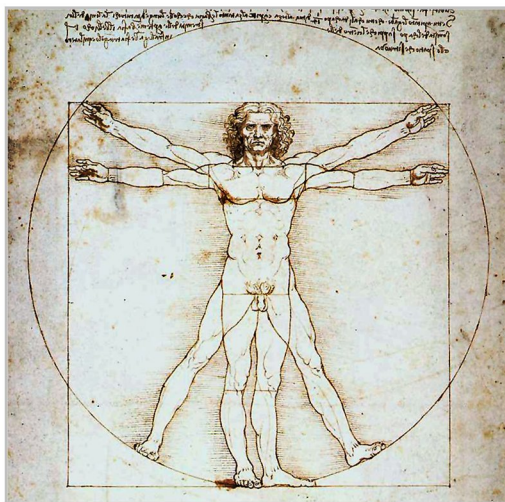
Examples of occurrences

Nautilus sea shell

Sunflower

Vitruvian Man

Parthenon



© 2012 FX Trader's EDGE™ All Rights Reserved



Perhaps the most well-known example is the Vitruvian Man by Leonardo da Vinci. Sometimes called the Canon of Proportions, da Vinci's work illustrates how the human body is subdivided into proportionate percentages.

THE GOLDEN SECTION

Examples of occurrences

Nautilus sea shell

Sunflower

Vitruvian Man

Parthenon



© 2012 FX Trader's EDGE™ All Rights Reserved



In architecture the most stable and most eye-pleasing structures incorporate Golden Ratio percentages.

THE GOLDEN SECTION

The Golden Section is obtained by finding the ratio between successive values in the Fibonacci series of numbers.

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377...

❖ Denoted by the Greek Letter *phi*

$$\Phi = \sim 0.618$$

❖ Inverse of *phi*:

$$1 / \Phi = \sim 1.618$$

+ Also calculated by taking the ratio of any Fibonacci number to its next lower number

The *golden section* is normally denoted by the Greek letter *phi*. There are also other properties of these numbers which are worth noting. As discussed, 1/phi is the inverse of 0.618, which is 1.618. 1/phi, or 1.618, is also calculated by taking the ratio of any number to its next lower number. For example, $34/21 = 1.619$, $55/34 = 1.618$ and $89/55 = 1.618$. The higher the numbers go, the closer the ratio is to 1.618.

THE GOLDEN SECTION

The Golden Section is obtained by finding the ratio between successive values in the Fibonacci series of numbers.

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377...

| Number | Divided By | Ratio |
|--------|------------|-------|
| 8 | 13 | 0.615 |
| 13 | 21 | 0.619 |
| 21 | 34 | 0.618 |
| 34 | 55 | 0.618 |
| 55 | 89 | 0.618 |
| 89 | 144 | 0.618 |

© 2012 FX Trader's EDGE™ All Rights Reserved



The golden section is obtained by taking the ratio of successive terms in the Fibonacci series:

For example, the ratio of any number to its next higher number approaches 0.618.

For example, $8/13=0.615$, $13/21=0.619$, $21/34=0.618$, $34/55=0.618$, and $55/89=0.618$, $89/144=0.618$ and so on.

If you plot a graph of these values you'll see that they seem to be approaching a limit. For Math enthusiasts this limit is actually the positive root of a quadratic equation and is called the *golden section*, *golden ratio* or sometimes the *golden mean*.

THE GOLDEN SECTION

Or by finding the ratio between every second value in the Fibonacci series of numbers.

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377...

| Number | Divided By | Ratio |
|--------|------------|-------|
| 34 | 89 | 0.382 |
| 89 | 233 | 0.382 |
| 55 | 144 | 0.382 |
| 34 | 13 | 2.615 |
| 89 | 34 | 2.618 |
| 144 | 55 | 2.618 |

© 2012 FX Trader's EDGE™ All Rights Reserved



Now, take the ratio of alternate numbers going forwards and backwards. The ratios of alternate numbers going forwards approach 0.382 or its inverse, 2.618. For example, $144/55 = 2.618$ and $55/144 = 0.382$. $34/89 = .382$ and $89/34 = 2.618$.

Take note of these numbers because in the next two modules, we will use these ratios in targeting impulsive and corrective sequences.

THE GOLDEN SECTION

Or by finding the ratio between every third value in the Fibonacci series of numbers.

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377 ..

1
2
3
3
2
1

| Number | Divided By | Ratio |
|--------|------------|-------|
| 34 | 144 | 0.236 |
| 55 | 233 | 0.236 |
| 89 | 377 | 0.236 |
| 89 | 21 | 4.238 |
| 144 | 34 | 4.235 |
| 233 | 55 | 4.236 |

© 2012 FX Trader's EDGE™ All Rights Reserved



Finally, take the ratio of every third number going forwards and backwards. For example, $89/377 = .236$ and $233/55 = 4.236$. Again, all these percentages will come into play when we discuss targeting an impulsive wave or measuring the retracement of a corrective wave.

THE GOLDEN SECTION

The mathematical application of the Golden Section on Elliott Waves will become apparent in **Module 2: Impulsive Patterns** and **Module 3: Corrective Patterns**.

© 2012 FX Trader's EDGE™ All Rights Reserved



The mathematical application of the Golden Section on Elliott Waves will become apparent in **Module 2: Impulsive Patterns** and **Module 3: Corrective Patterns**.

THREE ESSENTIAL RULES

The rules that should not be broken:

1. Wave 2 never retraces more than 100% of wave 1.
2. Wave 3 is never the shortest wave.
3. Wave 4 does not enter into the same price territory as wave 1.

If any one of these rules is violated, then the operative wave count is incorrect and there must be an alternative wave count to follow.

© 2012 FX Trader's EDGE™ All Rights Reserved



Three Essential Rules

There are three rules of the Elliott Wave Principle that can not be broken. The rules that should not be broken are:

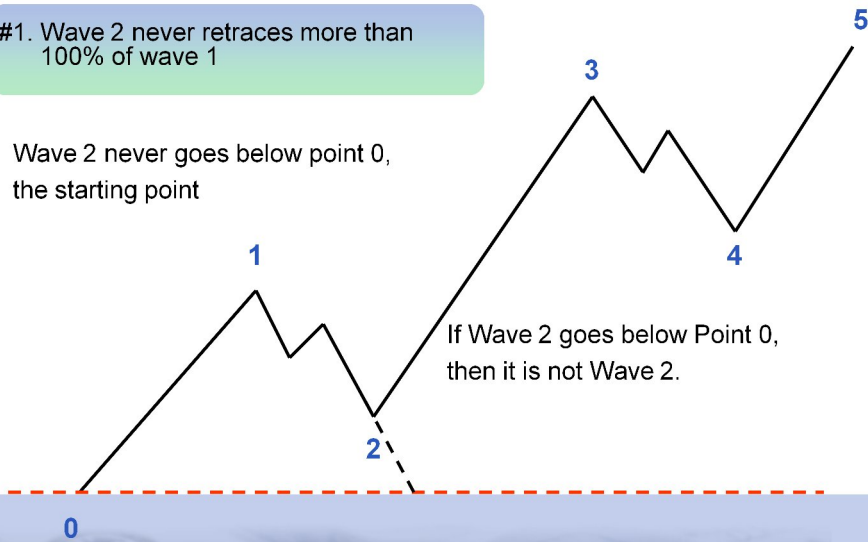
1. Wave 2 never retraces more than 100% of wave 1.
2. Wave 3 is never the shortest wave.
3. Wave 4 does not enter into the same price territory as wave 1.

If any one of these rules is violated, then the operative wave count is incorrect and there must be an alternative wave count to follow.

THREE ESSENTIAL RULES

#1. Wave 2 never retraces more than 100% of wave 1

Wave 2 never goes below point 0, the starting point



© 2012 FX Trader's EDGE™ All Rights Reserved

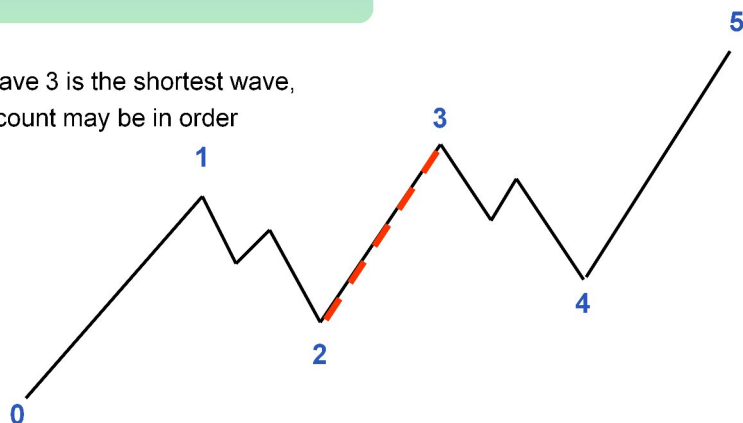


Rule # 1: Wave 2 never retraces more than 100% of wave 1.
Wave 2 never goes below point 0, the starting point.
If Wave 2 goes below Point 0, then it is not Wave 2.

THREE ESSENTIAL RULES

#2. Wave 3 is never the shortest wave

When Wave 3 is the shortest wave,
another count may be in order



© 2012 FX Trader's EDGE™ All Rights Reserved

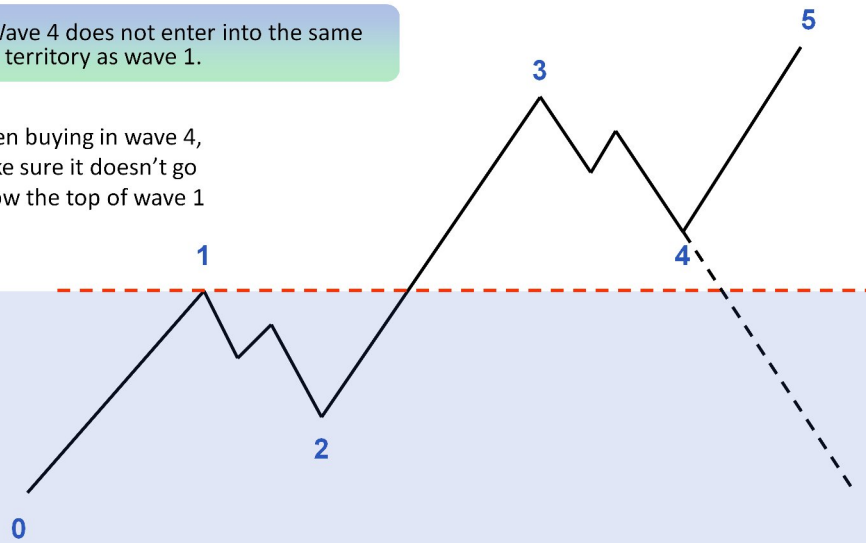


Rule #2: Wave 3 is never the shortest wave. When Wave 3 is the shortest wave, another count may be in order.

THREE ESSENTIAL RULES

#3. Wave 4 does not enter into the same price territory as wave 1.

When buying in wave 4,
Make sure it doesn't go
below the top of wave 1



© 2012 FX Trader's EDGE™ All Rights Reserved



Rule #3: Wave 4 does not enter into the same price territory as wave 1. This is also known as overlap. When buying in wave 4, make sure it doesn't go below the top of wave 1.

LABELING OF WAVES

Naming conventions:

- ❖ Primary wave degrees on monthly charts
① ② ③ ④ ⑤ A B C
- ❖ Intermediate wave degrees on weekly charts
(1) (2) (3) (4) (5) (A) (B) (C)
- ❖ Minor wave degrees on daily charts
1 2 3 4 5 A B C
- ❖ Minute wave degrees on hourly charts
i ii iii iv v a b c

Wave degrees have names and labels. When labeling a top down approach, start with the top nomenclature and work down to the subwaves.

© 2012 FX Trader's EDGE™ All Rights Reserved



Labeling of waves

Before we look at some examples from the market, we will talk about the naming convention for counting waves. Wave degrees have names and labels. Primary wave degrees (seen on the monthly charts) are noted as follows: circled 1, 2, 3, 4, 5, capital A,B, and C.

Intermediate wave degrees found on the weekly charts are noted as numerals and letters 1, 2, 3, 4, 5, A, B, and C in parentheses.

Minor wave degrees found on the daily charts are noted as numerals and letters without parentheses.

Finally, minute wave degrees found on the hourly charts are noted as circled, lowercase Roman numerals 1 through 5 and lower case A, B, and C.

LABELING OF WAVES

| Wave Degree | 5-wave Impulsive | 3-wave Corrective | Time Frame |
|-------------------|-------------------------|-------------------|------------|
| Grand Super Cycle | I II III IV V | a b c | |
| Super Cycle | (I) (II) (III) (IV) (V) | (a) (b) (c) | Annual |
| Cycle | I II III IV V | a b c | Quarterly |
| Primary | ① ② ③ ④ ⑤ | A B C | Monthly |
| Intermediate | (1) (2) (3) (4) (5) | (A) (B) (C) | Weekly |
| Minor | 1 2 3 4 5 | A B C | Daily |
| Minute | i ii iii iv v | a b c | Hourly |
| Minuette | (i) (ii) (iii) (iv) (v) | (a) (b) (c) | 15-minute |
| Subminuette | i ii iii iv v | a b c | 5-minute |

© 2012 FX Trader's EDGE™ All Rights Reserved



The naming convention used is consistent with Elliott's labeling, as he named nine degrees of waves which you can see in this chart. Each wave degree subdivides into waves in the smaller degree.

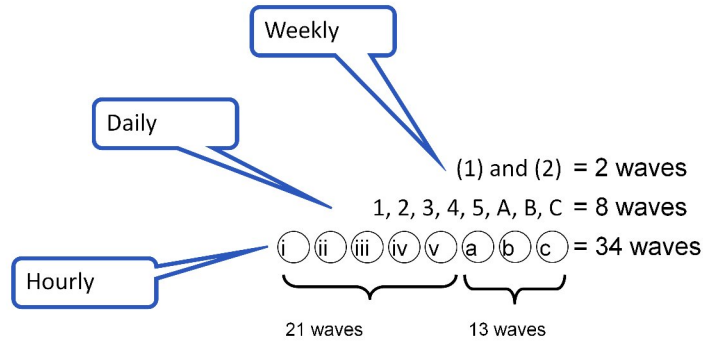
Elliott also added degrees as necessary. The numbers label the impulsive waves and the letters label the corrective waves. The impulsive waves alternate between Roman numerals and Arabic numerals. Labeling below Minor degrees is in lower case Roman numerals. Labeling above Primary degrees is in upper case Roman numerals. The corrective waves are labeled in lower case for the Roman numerals, and in upper case for the Arabic numerals.

The final column in the chart is labeled Time Frame. Here, I labeled which wave degree applies to which time frame in the currencies. The weekly charts are the Intermediate wave degree, the daily charts are the Minor wave degree, the hourlies are the Minute wave degree, and the 15 minute is labeled as the Minuette degree. It is merely a guide and there are other conventions. Most important to know is whether we are in a 5- or a 3-wave sequence than to know exactly how to label the move.

FIBONACCI NUMBERES

Look at a shorter time frame and suddenly 2 waves turns into 8 waves. On a smaller time frame, 8 waves breaks down into 34 waves.

The 34 waves includes the 5-wave sequence which has 21 waves, and a 3-wave sequence which has 13 waves.

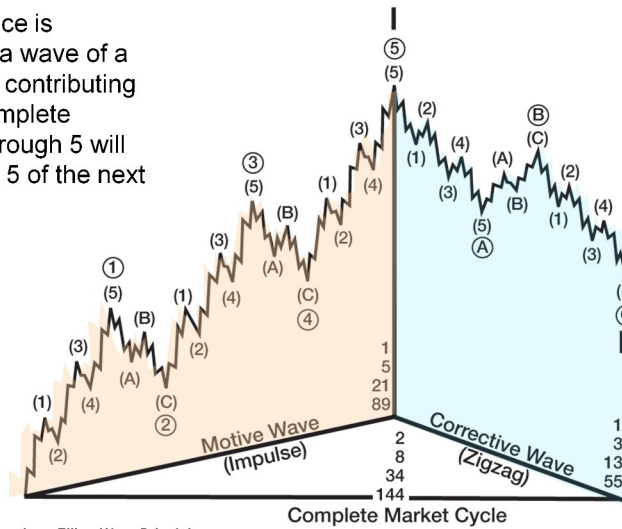


Look at a shorter time frame and suddenly 2 waves turns into 8 waves and 8 waves on a smaller time frame breaks down into 34 waves.
The 34 waves includes the 5-wave sequence which has 21 waves, and a 3-wave sequence which has 13 waves.

MARKET CYCLE

After a five wave sequence is complete, it will become a wave of a larger degree, or a wave contributing to a larger wave. The complete movement of waves 1 through 5 will complete a wave 1, 3, or 5 of the next higher wave sequence.

For example, waves 1 2 3 4 and 5 on the Daily chart might appear as wave (1) (3) or (5) on the Weekly chart.



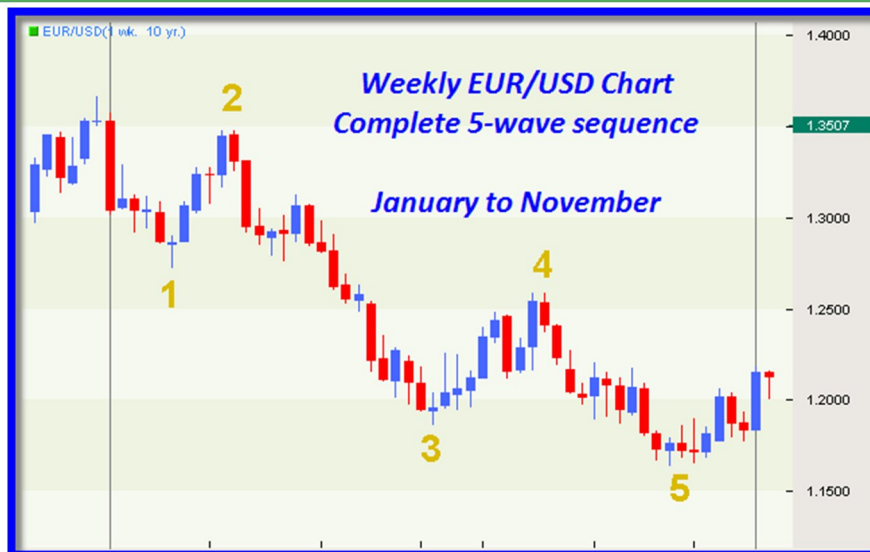
Frost, A.J. and Robert Prechter. *Elliott Wave Principle* (West Sussex, John Wiley & Sons Ltd, 1999).

© 2012 FX Trader's EDGE™ All Rights Reserved



After a five wave sequence is complete, it will become a wave of a larger degree, or a wave contributing to a larger wave. The complete movement of waves 1 through 5 will complete a wave 1, 3, or 5 of the next higher wave sequence. For example, wave 1 will appear as a straight line on the daily chart, and when broken down on the hourly chart, will appear as a five wave sequence. The complete corrective movement of waves A, B and C will complete either a wave 2 or a wave 4. For example, the ABC correction can unfold in hourly data, which can be represented by waves 2 or 4 of the daily price data.

EXAMPLE 1



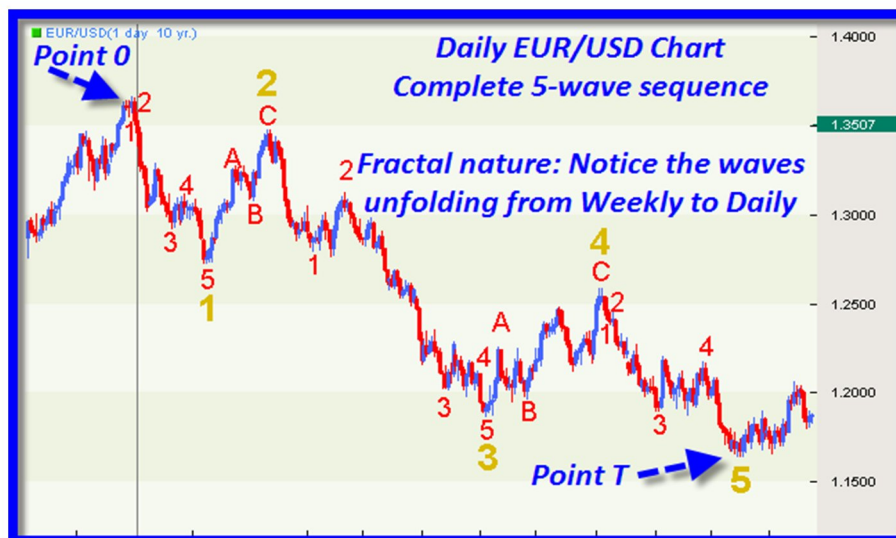
Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



Now we will look at some market examples to illustrate the basic rhythm of the Elliott Wave. The first example is the weekly EUR/USD chart from January to November of 2005. See if you can count the 5 wave impulsive sequence waves 1-5. Start to envision yourself trading those waves, once you have mastered all of the tools that will be made available to you in this course. The 5-wave sequence starts at 1.3666 and ends at 1.1640, taking almost a full year to complete.

EXAMPLE 2



Source: FXtrek IntelliChart™ Copyright 2001-2012 FXtrek.com, Inc.

© 2012 FX Trader's EDGE™ All Rights Reserved



In this slide, notice the 5-wave sequences followed by 3-wave corrections. We are looking at the daily EUR/USD chart for the same time period as the weekly chart, but we have broken down the 5 wave sequence into its component subwaves. Again, Elliott found that the wave patterns were self-identical in different time frames as is evident here. Waves 1, 3 and 5 break down into their respective five subwaves in the direction of the trend, which is down. Waves 2 and 4 break down into their ABC 3-wave corrective patterns which correct the trend. 21 waves are evident on this chart, but of course we could further label the subwaves and come up with 89 subwaves. This illustrates how the Fibonacci sequence is evident in the wave patterns or form.

Now, let's talk about market psychology. Let's suppose that in the news on Jan 2005, most of the news items were very bullish on the Euro. In November 05, the news items were extremely bearish on the Euro. That is exactly why the Elliott wave principle works, because of human emotions. People tend to be the most bearish when the press is very negative and the prices have been dropping for a while. They are also very bullish at market tops looking for further moves up. In other words, people think in herds and go mad in herds. That produces tremendous opportunity in the markets as long as you are not part of the herd at the wrong time.

End of Learning Object
Continue on to the Quiz

© 2012 FX Trader's EDGE™ All Rights Reserved



Module 1 Quiz

On the pattern shown here, which rule is being violated? Choose one answer.

- a) Wave 3 cannot be shorter than wave 1
- b) Wave 3 cannot be the shortest impulse wave
- c) You cant but stock in "Get Shorty"
- d) Wave 3 cannot be shorter than wave 5
- e) Wave 4 cannot be shorter than wave 2



Which count do you use? Choose one answer.

- a) (1), (2), 1, 2, 3, 4, 5, (3), (4), (5)
- b) 1, 2, 3, 4, 5, (1), (2),(3), (4), (5)
- c) (1), (2), (3), (4), 1, 2, 3, 4, 5, (5)
- d) Both b. and c. are correct
- e) None of the above



© 2012 FX Trader's EDGE™ All Rights Reserved



1. b)
2. d)

Module 1 Quiz

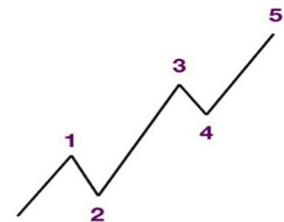
If you count the waves as shown, which rule are you violating? Choose one answer.

- a) Wave 4 cannot overlap wave 1
- b) You cannot have 1-2-1-2 pattern
- c) You forget the cha-cha-cha!
- d) You have not violated any rules
- e) Wave 2 cannot go below the top of wave 1



Which two statements are incorrect?

- a) Wave 4 is a corrective wave, in an A-B-C pattern
- b) Wave 5 is always extended
- c) Wave 2 moves are usually sharp, correcting most of wave 1
- d) Wave 3 moves have the smallest slope of the waves
- e) Wave 1 is an impulsive 5-wave sequence



© 2012 FX Trader's EDGE™ All Rights Reserved

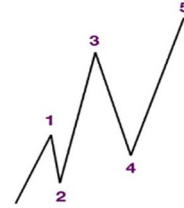


- 3. d)
- 4. b) d)

Module 1 Quiz

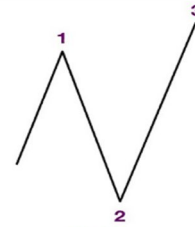
Which rule is being violated here? Choose one answer.

- a) Wave 4 cannot overlap wave 1
- b) You have one too many zigzags for Elliot's liking
- c) Wave 3 cannot be shorter than wave 5
- d) You clearly need a haicut!
- e) None of the above



Which rule is being violated here? Choose one answer.

- a) Impulse waves rule!
- b) Wave 2 cannot go below wave 1
- c) Wave 3 cannot be longer than wave 1
- d) Wave 4 cannot overlap wave 1



© 2012 FX Trader's EDGE™ All Rights Reserved

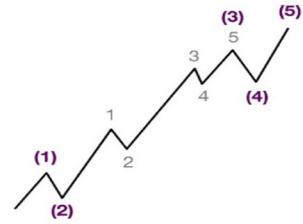


- 5. a)
- 6. b)

Module 1 Quiz

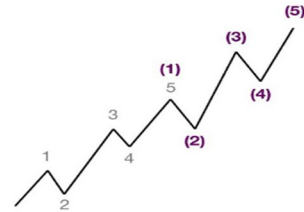
Which wave is extended? Choose one answer.

- a) You dont have enough money for an extension
- b) Wave (3)
- c) None of the above because the count is wrong
- d) Wave (5)
- e) Wave (1)



Which wave is extended? Choose one answer.

- a) Wave (1)
- b) Wave (3)
- c) Wave (4)
- d) Wave (5)
- e) Wave (2)



© 2012 FX Trader's EDGE™ All Rights Reserved



- 7. b)
- 8. a)