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# ELLIOTT WAVE PRINCIPLE

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CONCEPTS, WAVE PATTERNS,  
AND PRACTICE EXERCISES

CONSTANCE BROWN



# **MASTERING ELLIOTT WAVE PRINCIPLE**

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Elementary Concepts, Wave Patterns, and  
Practice Exercises

**Constance Brown**

**BLOOMBERG PRESS**

An Imprint of



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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

Published simultaneously in Canada.

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***Library of Congress Cataloging-in-Publication Data:***

Brown, Constance M.

Mastering Elliott wave principle : elementary concepts, wave patterns, and practice exercises /  
Constance Brown.

p. cm. — (Bloomberg financial series)

Includes index.

ISBN 978-0-470-92353-5 (cloth); 978-1-118-23515-7 (ebk); 978-1-118-22130-3 (ebk);

978-1-118-25977-1 (ebk)

1. Elliott wave principle. 2. Speculation. 3. Stocks. I. Title.

HG6041.B748 2012

332.63'2042—dc23

2011046138

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1



*An ocean traveler  
has even more vividly the impression  
that the ocean is made of waves  
than that it is made of water.*

—Sir Arthur Stanley Eddington  
in a lecture at the  
University of Edinburgh, March 1927



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# Acknowledgments

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I would like to express my sincere appreciation to the team at John Wiley & Sons: Kevin Commins, Meg Freeborn, and Stacey Fischkelta. The subject of the Elliott Wave Principle presents several unique challenges. The fractal nature of the method carries a message in charts that reflects on the bigger picture of the market in discussion. Therefore timing was an issue for the manuscript. I would also like to acknowledge and thank the efforts of the creative team.

There is no topic more difficult to edit as a number within a chart could mean a point to help focus the reader's attention, or it could be a critical number within a larger wave interpretation. The editorial team has helped us all by allowing me to use quote marks to define the start and end of wave notations. In practice this has helped my followers find it a little easier to read the unique dialog that develops within the analysis of wave patterns.

A special acknowledgment must be given to Robert Prechter, Jr., who saved this analysis method from obscurity. The work of R.N. Elliott might have been lost had it not been for his efforts. I once analyzed the S&P 500 market throughout the trading day before a real-time global audience for Elliott Wave International. It was the last step I needed to build my confidence that I could step out on my own and start my own company and Hedge Fund in 1996.

I cannot let it be unsaid that all eight of my books can be traced back to the confidence and guidance of Stephen Isaacs with Bloomberg Press. My loyalty to him explains the multiple publishers I have worked with over the years.



# Introduction

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After 20 years of experience helping other traders become more confident in how they apply the Elliott Wave Principle, I know how difficult it can be for many people. But over the years these people have helped me evolve my way of teaching this subject so that even the most challenged may finally see markets move in repeating fractal price patterns.

## **Why This Teaching Approach Is Different**

We have failed to help you understand that price swings and Elliott Waves *are not the same thing*. Everyone begins with counting price swings since these are the easiest to understand, but the final result is disastrous. Why? You learn to ignore the internal construction of a price swing and overlook the rules that are intellectually understood, but then incorrectly applied. It is such a widespread problem that it merits the effort to try something new to explain these concepts.

Though our words are carefully chosen to match impeccable market charts, we have failed to really test your understanding by having you stop your reading at critical points to challenge your understanding. This is one subject that must offer ways for you to check your progress in small incremental steps before the learning curve becomes hopelessly entangled. Many traders on professional desks have told me they wish they had a way to test their understanding. Then they want to compare their errors with a detailed description of where they likely stepped off course. So often I see people correctly verbalize a rule or correctly identify and name an isolated pattern, only to then fail miserably five minutes later when asked to identify it in the context of a market chart. It is clear that my mission must include helping you bridge this gap. There will be numerous personal tests to ensure you are ready to move forward. I also have a method of drawing boxes to help you understand how connections develop within trends and corrections.

Another common problem people experience with the Elliott Wave Principle is developing a misunderstanding of what expectations they should be able to accomplish for their level of skill. There are in fact three major skill levels before the fourth level where you become truly proficient with a high level of expertise. There are several steps leading toward a level of proficiency. The steps in general are:

- Developing the ability to recognize the 14 price patterns as isolated components within larger price moves and to understand the basic rules. At this level you likely cannot apply the Elliott Wave Principle within a real-time chart and identify all the patterns connecting the whole.
- Developing the confidence to understand other people's wave interpretations. You should be starting to recognize when other people's charts contain major errors that warn you the credibility of the entire chart might be suspect. At this level you cannot develop your own wave interpretations from scratch, but you can recognize a five-wave pattern and isolate a few corrective patterns within the larger trend. You can also be easily confused, and an encounter with an X wave followed by a complex A-B-C in a daily report would be grounds for taking a break to grab a coffee. Your confidence level is on shaky ground.
- The next skill level is dangerous because this is when many people fail. You begin to correctly label static charts, but you cannot develop future patterns to describe how a market could move to your own price targets. You are probably proficient with the basic tenants of the Wave Principle, but you discover that applying these principles within a real-time environment is unnerving. This is a dangerous skill level because many people build error upon error and do not know they have misunderstandings. Their efforts start to fall apart like a house of cards as they think they know and understand, but the market proves they are missing pieces of the puzzle. They cannot figure out what they did wrong on their own.
- The next level is developing the ability to create future wave patterns that would explain and accompany the oscillator movement you expect to follow.
- Master: You have arrived at the highest level of proficiency. You know the Elliott Wave Principle is just a tool. It is now an intuitive working language to describe and develop a working game plan of how future market movements will unfold. You have no concern for the time horizon or whether you are given a market you have never seen before. The future swings track your hypothesis and show others that you are right more often than you are wrong. You know how to balance conflicting signals in wave

patterns and indicators within different correlated markets and different time intervals. You can develop a wave pattern to connect these conflicts and explain how to bring the markets into sync with projected future pattern development. You have the ability to see the markets that are leading and lagging around the world *based on the internals of their individual wave structure*. You have the necessary proficiency with the Elliott Wave Principle to see how global markets can create a dominoes effect, and you easily lean on one market for timing while trading an entirely different market you know to be lagging. I should also add that when you are confused, you should realize that the rest of the world has been struggling for a much longer period of time. This is not to be confused by periods of mass public panic, which you calmly recognize to be a major point of reversal and opportunity.

You are now reading the first of two books on this subject. Here you will learn the basics and develop a correct eye for form, balance, and proportion of these patterns. The goal is to reach the last step toward mastering the Elliott Wave Principle. We all have to pass through the same steps of development to attain proficiency. Understanding that the journey ahead is a series of smaller steps will help. Releasing two books will allow me to add content regarding our global market top that is developing at this time. The cash flow analysis from the global financial patterns in 2011 is creating a second book. It will be of tremendous help for future study if I take the time to record these patterns and explain each for you. Therefore, know that you are not ending your journey as you conclude this beginner's level book.

The complex corrective patterns will be discussed in the second book. Only the basic patterns will be needed at this level. You therefore should not expect that with one reading you will be able to develop wave interpretations on your own or label all components of a trend. Both books will be needed to reach that level of proficiency. But even the beginner level alone is a powerful level of market position recognition, since many people do not understand market participant psychology. Few methods provide a sense of where a market is currently relative to a much bigger picture.

Having a realistic sense of expectations for your level of ability is also important to prevent becoming frustrated. Sadly, too many people complete the first steps and feel they have failed when they cannot perform at the highest level of excellence. Have patience and give yourself time. Try to set aside what you have heard and forget how difficult it may have been for you in the past. I will guide you toward each milestone to becoming a

Master. I've been taught by the best. My personal start was with Bob Prechter and Dave Allman, the two Masters who remain at levels higher than myself. But I know of no others when it comes to equity indexes and—my personal expertise—the S&P 500. My skills have been shaped and refined by the markets themselves and the traders that struggled before you. They have had lots of great ideas to help us all. Give them a chance to show you what worked and what made it easier. As an example, let me show you the missing piece of the puzzle that connected everything for “Mr. Lehman.” The exercise you are about to do has since bridged the gap for many others whom I have taught.

## **Elliott Waves and Market Swings Are Not the Same**

What is the first thing we do for you normally to begin explaining what the Elliott Wave Principle is about? We put a stick diagram in front of you with three long lines punctuated by two lines that serve to interrupt the trend. We assume that is the best place to start, but it is not.

In 2006 I had a very sharp individual fly in from Europe. He was responsible for all retail brokers throughout Europe for his firm. He said people had thought he was crazy, but he felt he needed to make a career change and had a sense of urgency. He wanted to be clearly on the side of measurable productivity as a trader. He felt he should have nothing to do with derivatives and wanted to focus on outright position trading. He was making a major career change and was willing to start as a junior trader. He had already been offered the job by another firm. What was the firm he was leaving? Lehman. He continues to enjoy a professional career as a trader today. The lesson from this story is to always listen to the inner voice we all privately know. He was out of the firm and had cashed out his options two years before the Lehman bankruptcy.

If it had not been for this individual, I likely would not have made the connection that we Elliott teachers fail right up front as we assume too much. He struggled and could not see waves in price charts to save his soul. Yet he could recite the rules and identify the isolated patterns without pause or error. I struggled to find a way to make the connection for him. Suddenly, in the middle of the night, a solution presented itself politely. He doesn't know how to read a price chart, to begin with, and I have never tested him to see how his eye works through the swing relationships within the price data. I then realized I had never seen anyone explain how to read price data with regards to balance and proportion.