

Lines, Circles, And Waves

Trading Elliott Waves Using A Top-Down Approach

When applying Elliott waves to your charts, one of the challenges is to know which trend to use. Here is an approach that could help you do just that.

by Mircea Dologa, MD, CTA



Most novice traders may not be aware of the importance of identifying the origin of a trend on the timeframe they are using. The top-down

Elliott wave approach is one of the best strategic tools when practicing Elliott wave trading.

There are many advantages of using this top-down approach. The easiest to understand would be *never trade against the trend*. But which trend? Is it the ongoing trend on the operational timeframe, or is it the dominant trend, which is situated on a higher timeframe? Can you rely on upper timeframes like monthly, weekly, daily, and hourly to better understand the kinematics of the market flow on the 15-minute chart?

NEO GRAPHIC, SOFTULKA/WAVE, NITAWAT CHOTSUWAN/
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ELLIOTT WAVES

STATIC TOP-DOWN ANALYSIS

I start by looking at the static aspect of analyzing the market. The first step here is to do a top-down analysis where I search for the static market characteristics to set the stage for my trading decisions.

I first study the monthly chart and go through this checklist, which I'll walk you through. See Figure 1 for the following:

- **Dominant direction.** There is a dominant uptrend being corrected by the current three-swing correction. The market is in the process of terminating its last local corrective swing.
- **Elliott waves.** There is a global impulsive pattern in progress, which is currently in v-subwave of (iii)-subwave of C-subwave of W(4)-wave.
- **Fibonacci price & time ratios.** They are used to establish clusters that will reverse; temporarily halt, or cause a trend continuation; or cause a sideways move in the market.
- **Simple moving averages (SMAs).** There is a faithful follow-up of the 50-SMA(C) and 200-SMA(C), with the market well below both of them. This characterizes a strong down-sloping momentum.
- **End run**—There is an efficient search for the elements of the end of a run revealing support & resistance levels in the immediate past, especially in front of the market susceptible to continue, reverse, halt, or move sideways.
 - I use ahead-of-the-market levels to confirm a pullback of a probable continuation in uptrend, or to ensure a rally of a probable continuation in a downtrend. You'll need some knowledge of Gann and Elliott wave analysis to understand the significance of these levels.
 - 3884 level – $C = 0.666 * A$ key level
 - 3775 level – last low level
 - 3700 level – G3 main Gann number
 - 3507 level – 100% (i) subwave expansion level and (iii) = $2.0 * (i)$ level
 - 3320 – A-wave terminal level
 - 1065 – W(3) origin level
 - 1042 – $261.8\% (i)$ subwave expansion level.
 - I use behind-the-market levels to confirm a reversal.
 - 5092 level – last high
 - 6258 level – penultimate high
 - Classic chart patterns – In Figure 1 there are three patterns:
 - There's a regional ascending rectangular triangle



FIGURE 1: STATIC TOP-DOWN ANALYSIS. On the monthly chart of crude oil from 2001–2015 you see most elements of a top-down analysis applied.

with its two parallel trendlines of the hypotenuse, encompassing the entire C-subwave of W(4) wave.

- There're local descending channels with their two internal trendlines, embedding the iii, iv, and v subwaves of (iii)-wave. The latter subwave is developing on the upper half of this channeling.
- There's a local mini descending channel with its two limit trendlines visible on CL-monthly time chart, encompassing the terminal swing, the v-subwave.
- Confirming indicators – Again, there are three:
 - On-balance volume (OBV) for confirming trending or accumulation/distribution behaviours. The TL-1, TL-2, TL-3, and TL-4 trendlines progressively monitor future reversal or trend continuation.
 - I use OSC (5, 35) to confirm the impulsive/corrective waves with their correct labeling.
 - I use the 14-period average true range, or ATR (14), to confirm a reversal or sustained trend continuation in a high-steamed momentum move. The TL-1 and TL-2 trendlines corroborate market behavior and degree of momentum. The last registered value of monthly ATR(14) on the chart is 9.26 pts, for a value of \$9,260 (926 x \$0.01 per barrel x 1000 barrels).

Next, I turn to the weekly chart (Figure 2), which tends to magnify regional and local parts of the market. I use the weekly timeframe to enter the trade, calculate the reward/risk value, and establish the initial stop-loss and trailing stops.

- **Dominant direction.** The market is in its last swing of the three-swing correction.
- **Elliott waves.** The market is in the terminal phase of the C-wave of W(4)-wave, which is currently the v-subwave of (iii)-subwave of C-subwave of W(4)-wave.
- **Fibonacci price & time ratios.** There aren't any time studies on this weekly chart.
- **SMA's.** There is a faithful follow-up of 50-SMA(C) and 200-SMA(C).
- **End run.** The search for the elements of the end-run gives the same results as the monthly timeframe (reveals support & resistance levels in the immediate past, especially in front of the market susceptible to continue, reverse, halt, or move sideways).

- Ahead of the market levels:
 - 3884 level – $C = 0.666 * A$ key level
 - 3775 level – last low level
 - 3700 level – G3 main Gann number
 - 3507 level – 100% (i) subwave expansion level and (iii) = $2.0 * (i)$ level
 - 3320 – A-wave terminal level
 - 1065 – W(3) origin level
 - 1042 – 261.8% (i) subwave expansion level.
- Behind the market levels, used to define a reversal:
 - 5092 level – last high
 - 6258 level – penultimate high
- Chart patterns – there are two:
 - Regional ascending rectangular triangle with its two parallel trendlines of the hypotenuse, encompassing entirely the C-subwave of W(4)-wave.
 - Local descending channel with its two internal trendlines, embedding the iii-, iv- and v subwaves of (iii)-wave of C-wave. The v subwave is developing on the upper half

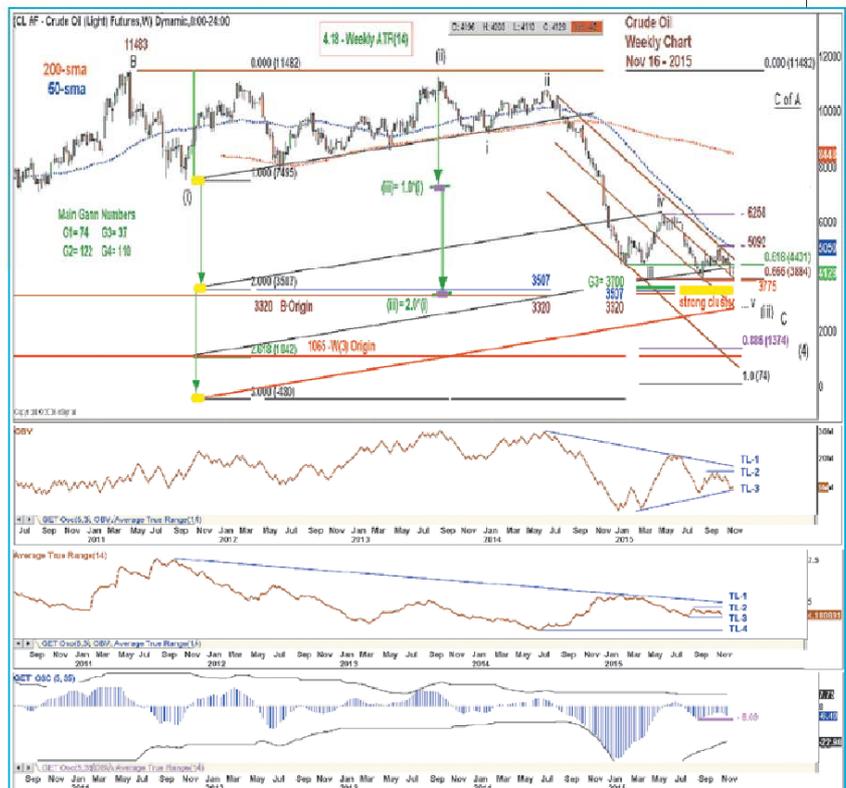


FIGURE 2: TOP-DOWN ANALYSIS ON A WEEKLY CHART. The same elements as in the monthly chart are analyzed. The weekly timeframe is used to enter the trade, calculate reward/risk values, and establish initial stop-loss and trailing stops.



FIGURE 3: TOP-DOWN ANALYSIS ON DAILY CHART. The analysis is similar to monthly and weekly charts and is used to fine-tune entries, add to existing positions, and exit trades.

of this channeling.

- Confirming indicators – there are three I mainly use:
 - OBV, as in the monthly chart
 - OSC (5, 35) shows the impulsive structure of (iii)-subwave of C: W(4)
 - ATR (14), as in the monthly chart. The last registered value of weekly ATR(14) in Figure 2 is 4.18 pts, for a value of \$4,180 (418 x \$0.01 per barrel x 1,000 barrels).

To fine-tune entries, add to trades, and to exit trades, I use the daily chart. Even if I enter based on the weekly chart, I find the daily chart helpful to be consistent in my profitable trades. I use the same checklist and look for direction, Elliott waves, Fibonacci price & time ratios, SMAs, and the end run. I look for ahead of the market levels, behind the market levels, chart patterns, and the confirming indicators.

In the chart in Figure 3, the market appears to be in its terminal subwave of the last swing of a three-swing correction. The market is also in the terminal phase of the last subwave of the v-subwave of (iii): C: W(4). It shows that we are currently developing the iii-subwave of v: v: (iii): C: W(4). The SMAs are indicating what they did in the weekly chart.

- Ahead of the market levels are:
 - 4045 level – Triple pivotal cluster (40.48, 40.47 & 40.41) - refer to Figure 4
 - 3884 level – C= 0.666*A key level
 - 3775 level – Last Low level (cluster 1)
 - 3700 level – G3 main Gann number (cluster 1)
 - 3507 level – 100% (i) subwave expansion level and (iii)= 2.0*(i) level
 - 3320 – A-wave terminal level
 - 1065 – W(3) origin level (cluster 2)
 - 1042 – 261.8% (i) subwave expansion level (cluster 2).
- Behind the market levels, used to define a reversal:
 - 4538 level – The 50-SMA (C) level
 - 5092 level – Last High
 - 6258 level – Penultimate High.
- Chart patterns – there are two:
 - Regional ascending rectangular triangle (not shown)
 - Local descending channel with its two internal trendlines, embedding the iii-, iv- and v subwaves of (iii)-wave of C-wave. The v subwave is developing in the upper half of this channeling.
 - Confirming indicators – there are three of them, which are efficient, indispensable, and ergonomic:
 - On-balance volume (OBV)
 - OSC (5, 17)
 - The last registered value of daily ATR(14) is 1.785 pts, for a value of \$1,785 (178.5 x \$0.01 per barrel x 1000 barrels).

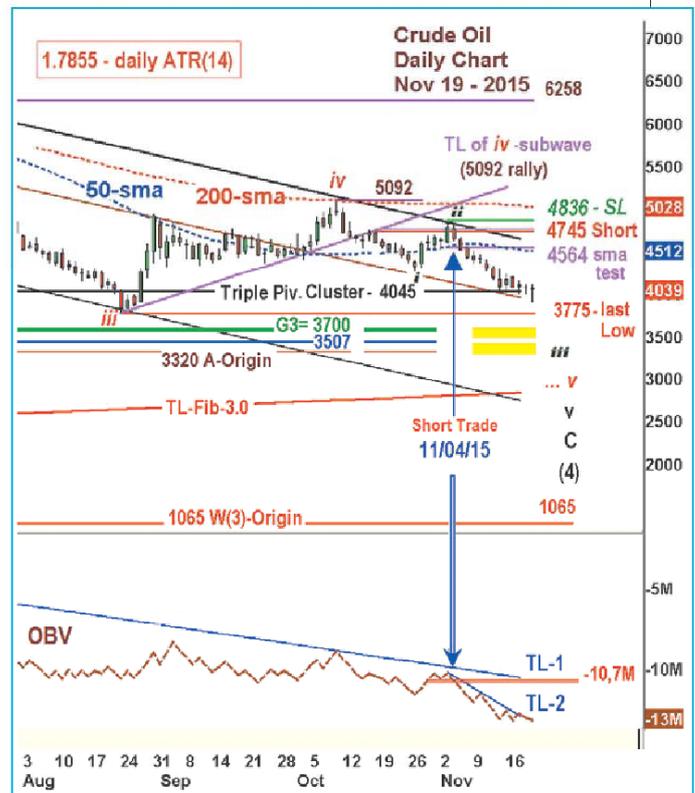


FIGURE 4: RESISTANCE LEVEL. The triple pivotal cluster at the 4045 level represents a strong resistance area.



DYNAMIC TOP-DOWN ANALYSIS

Before making any trading decisions, the astute trader must understand the context of the market, that is, find out where the market is coming from, where it is situated, and where it will eventually go.

Going back into the top-down analysis study, we will find the following:

- If you look at a chart of crude oil, you will see that it fell from its highest high of \$147.27 in July 2008 to \$37.
- The highest high of the uptrend, which formed the W(3)-wave, is corrected by the development of the W(4)-wave.
- In retrospect, you understand that the most probable scenario is the market flow sloping down through the last subwave of W(4)-wave.
- When you know the price move is in the final phase of its correction, you can utilize all your optimal tools to take advantage of the market movements.
- Elliott waves will reveal the current market location: in the iii-subwave of v: v: (iii): C: W(4). You can go to an even lower timeframe than the daily, such as the 240- or 120-min chart. It'll give you better visibility of the terminal phase of this subwave.
- 50-SMA(C) on the weekly chart is better positioned to indicate increasing or decreasing down-sloping momen-

tum. This is done by evaluating the distance between the price and the SMAs on weekly and daily charts.

- Applying Fibonacci price & time ratios could reveal the optimal levels that can reverse the market.
- An overall evaluation of price will reveal the different cluster zones located in front of the market flow. These cluster zones could be an indication of an imminent market reversal. These are the cluster zones in decreasing order:



FIGURE 5: FIBONACCI LEVELS AND CLUSTER ZONES. This shows a strong chance that a price reversal will take place around December 2015.

Cluster 1

- The triple pivotal cluster at the 4045 level, composed of 40.48, 40.47, and 40.41 key levels (see Figure 4). This represents a strong resistance area.

Cluster 2

- 3775 level – Last low level
- 3700 level – G3 main Gann number
- ber

Cluster 3 labeled c.z. in Figure 5

- 3775 level – Last low level
- 3742 level – Fibonacci level: [(iii)= 1.875*(i)]
- 3634 level – Fibonacci level: [v= 1.25*i]
- 3577 level – Fibonacci level: [v= 0.382*0-iii]
- 3507 level – Fibonacci level: [(iii)= 2.0*(i) - through expansion]
- 3320 level – B-wave origin level
- 3243 level – Fibonacci level: [(iii)= 2.0*(i)]
- 3110 level – Fibonacci level: [v= 1.5*i]
- 2900 level – A forecasted reversal level (Figure 6)
- 2748 level – Fibonacci level: [v= 0.5*0-iii]

Far below the current market zone are

- 1374 level – Fibonacci level: [C= 0.886*i]
- 1065 level – W(3)-wave origin level
- 1042 level – Fibonacci level: [(iii)= 2.618*(i) - through expansion]

What is the role of these clusters? In Figure 5 you can observe the status of the market via its downward-sloping development of W(4) wave, which reached the 0.886-1.0 time zone with regard to the time span of W(2)-wave. In two to three monthly bars the market flow will reach the temporal cluster defined by C= 9.5*A and (iii)= 6.0*(i). At that period in time (January – February 2016) there is a high probability of a reversal. That should be confirmed by volume and OBV.

There is another confirming time factor for a highly prob-



FIGURE 6: TIME/PRICE JENKINS CIRCLE. There is an almost perfect harmony with the market and the Fibonacci ratio cycles. All important ratio cycles were tested.

able reversal that could take place around December 2015. The timespan from the highest high on July 31, 2008 to end of November 2015 is 88 months. If you include December in the time calculation, there will be exactly 89 month bars, which is a strong Fibonacci number. There is a high probability of a reversal in December 2015 (89 bars), January (89+1 bar), or February (89+2 bars) with an error margin of +/- 2 bars.

For a more accurate probability apply the same timespan techniques to weekly and daily timeframes.

By studying the impact of the time/price Jenkins circle (Figure 6), I noticed in hindsight an almost perfect harmony concerning the market and the Fibonacci ratio circles (R= 1). Almost all the important ratio circles were tested at 0.382, 0.618, 1.0, 1.236, and 1.382 levels. There is a high probability that a new event, probably a reversal, will occur at the confluence of next 1.5 ratio circular boundary with 3775, 3320, and 2900 key levels.

This needs to be confirmed by volume and OBV. I apply the same timespan techniques as in the static top-down analysis to weekly and daily timeframes.

The chart patterns in Figure 3 show local descending channels with this two internal trendlines embedding the iii-, iv-, and v subwaves of (iii)-wave of C-wave. The v subwave is

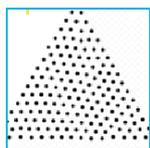
developing in the upper portion of this channel that is being halted by the triple pivotal cluster at 4045. If price breaks below this level, it'll signal a strong downward market. If, on the other hand, price breaks above the upper limit of the channel, it'll indicate a reversal, but the market must break the 50-SMA (C) at the 4538 level and then at the 5092 level, which is also the location of the 200-SMA (C).

Confirming indicators also play a role in price forecasting. The OSC (5, 17) in Figure 3 illustrates the most probable scenario of the market flow. A breaking down of the three clusters will certainly confirm this scenario. It will be invalidated if the market breaks up above the 5092 key level, which is the terminal threshold of iv-subwave of v: (iii): C: W(4).

The OBV is valuable in making decisions because of its ability to indicate market direction and the shift from trend to reversal or a sideways-moving market. Because of its lower fractal degree, the trendlines on the daily chart will be the first to engage with the market flow, in case of a sudden movement. It will then be followed by the weekly chart and then by the monthly chart. If the market remains under the TL-2 trend line, on the daily chart, it will serve as a signal for the continuation of the downtrend. If the market tries to approach the TL-1 trendline without breaking above it, it means that it was only a pullback. The concrete OBV values are less important than some of the delimiting tools such as channels, trendlines, pitchforks, rectangles, triangles, and so on.

If the market breaks above the TL-1 trendline on the daily chart, you could expect a market reversal. Keep in mind that OBV signal is only a confirmation factor, which has the double advantage of being, not only a faithful follower of the market flow, but also a concomitant trading signal.

The daily ATR(14) is low, at 1.78, compared with its maximum value, which is over 3.0. If on the daily chart the ATR(14) remains under 1.84, under the tl-3 and tl-4 trendlines, it will serve as an excellent tool to signal the down-sloping continuation of the small-bar market flow. Once big bars start to appear on the chart, it could mean there is an increase in market volatility. Price could exceed the 2.13 threshold and eventually break up the tl-2 and tl-1 trendlines. This signal is only a measure of momentum strength. It does not indicate market direction, which is why it is a good idea to associate the signal with a directional indicator such as RSI & OBV. You should add another momentum indicator such as volume with its moving average and OBV.



THE TRIGGER PHASE

The typical rule of entering a short trade is to wait for the end of a rally and then execute the trade in association with confirming indicators. The beginning and the termination of a rally can be better seen on the lower timeframe rather than the operational timeframe. The problem is if there are support & resistance levels at that end run, especially clusters in front of the market. That'll make it more difficult to identify the beginning and end of a trend.

Let's analyze a short entry on a weekly chart (Figure 7).

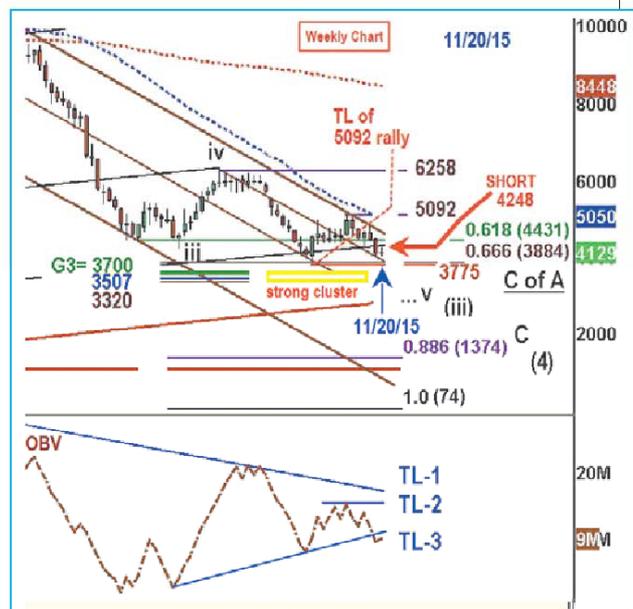


FIGURE 7: THE TRIGGER PHASE. Here you see a detailed analysis that led to taking a short trade at 4248 on November 20, 2015.

Mainly, the classic rule is that you should do your analysis on a lower timeframe chart than the one you trade. In this case, I am trading on the weekly timeframe so I will study the static elements and future kinematics on the daily chart.

Here are the main reasons for executing this trade.

- Accrued weakness of the market expressed by a second lower high, 4836 with respect to the first lower high, at 5092 key level (Figure 4).
- From the Elliott wave point of view, the market just terminated a rally and started downwards the new iii-subwave of v: v: (iii): C: W(4), giving the trader a high potential of profit.
- From the perspective of chart patterns, the market location tested the upper channel limit causing a test and re-test from below (backwards down-sloping bounce).
- All four indicators support this short trade: volume, OBV, ATR(14), and OSC(5,35), respectively. The transition from up to down volume is visible on Figure 3.
- There is a harmonious direct correlation between the crude oil and its two correlated currencies (\$CAD & NOK).
- Apply money management practices by placing an initial stop-loss with a R/R of 7.69.

Here's how I would execute the trade (see Figure 4):

- Enter short at 4745 on November 4, 2015 with a stop-loss at 4836, which is located less than a quarter of the weekly ATR(14) stop-loss of 4.18 value. The risk expressed by the stop-loss would be 0.91, or \$910.
- The first objective would be the triple pivotal cluster at 4045 key level, resulting in a reward of 7.0 points, or \$7,000.

- The current R/R ratio will be 7.69, (\$7,000/\$910).

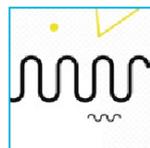
If I were to add on to the trade, I would do it when the market flow is testing the 50-SMA (C), from below, at 4564 key level. I would use a trailing stop (TS) as follows:

- The first TS is equal in size to the initial stop-loss, meaning 0.75 – 1.5 of the ATR(14) of the operational timeframe. The size of the stop-losses depends on the trader's capital. I recommend not going more than 2% higher than the cost of the trade.
- As the market advances and multiple trailing stop-losses are necessary, things become more complicated. You will have to find the right equilibrium between the percentage of the ATR(14), which decreases from 100% to 25%; the latter is used as the last TS, at the end of the trend. It automatically gets you out of the market near the reversal zone.

Moving on to the indicators ... looking first on the daily chart.

- The OBV turned out to be quite helpful (Figure 3). On the day of the short entry (November 4, 2015), the OBV completed a double top, and at the same time executed a failure with regard to the TL-1 trendline, falling under the -10.7 M value. This shows a weakness, which is ideal for a short trade.
- ATR (14) on the daily chart shows that on the day of the short entry, the ATR(14) finished a double top and tested the 1.84 value. It remains under the tl-4 trendline, which signals a down-sloping continuation and is ideal for a short trade.
- The OSC (5, 17) illustrates the most probable scenario of market flow: the iii-subwave of v: v: (iii): C: W(4). The breaking down of the three clusters will confirm the labeling. It will be invalidated if the market breaks up above the 5092 key level, which is the terminal threshold of iv-subwave of v: (iii): C: W(4).
- Price is too close to the 50-SMA(C), less than a daily ATR(14) of 1.7855.

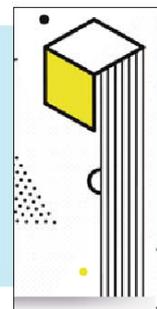
To compare the trading results on two different timeframes, I analyzed the same short trade on a weekly timeframe and a daily chart. On the weekly timeframe, I entered the trade at 4248 key level on November 20, 2015, and on the daily, the trade was executed at 4745 key level on November 4, 2015. The price difference was 497 ticks, or \$4,970.



ALL LINED UP

This top-down approach goes hand in hand with Elliott wave practice and will prepare the trader to access the highly sought-after proficiency and profitability in the art of trading. In order to have optimal profits, the astute trader should align trading direction on operational timeframe with those of the upper timeframes.

When the price move is in the final phase of its correction, you can utilize all your optimal tools to take advantage of the market movements.



Mircea Dologa, MD, CTA, began his investment and trading career in 1987 as a Commodity Trading Advisor and a registered general securities representative. He subsequently moved into teaching practical aspects of trading using techniques he developed. He is a contributor to many magazines around the world, the author of several books published in several languages, and is publisher of the monthly World Charting Report, which covers international indexes, commodities, and forex charts. He is a member of several technical analysis associations (ATAA & STA) and an MTA associate member. He may be contacted at mircdologa@yahoo.com, via his website at www.pitchforktrader.com, or via his YouTube channel at <https://www.youtube.com/watch?v=6NE3Jlk8mzE>.

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- †See *Traders' Glossary* for definition

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