

Elliot Wave Rule Explained

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This E-book Explains

The Basic principle of Elliot wave

How to construct 1-2-3-4-5 impulsive wave ?

How to Construct A-B-C wave ?

How to construct the Elliot wave calculator ?

Introduction: over the years the traders are wondering how the Elliot wave sequence is being interpreted and applied in the trade. Number of book tools by nominate authors and technocrats often explain the wave principle in a more complex way. Certainly the principle is complex and difficult to understand but it is not impossible to master this principle.

The wave principle treats each price action whether raise or fall into two categories. A. Impulsive categories, B. Corrective categories. This convention of naming is being decided based on the force or magnitude of the pricing action. If the price falls in great degree then the action will be treated as an impulsive action. In contrast the corrective action is defined as the smaller force or smaller magnitude of the action. The impulsive wave is named as 1-2-3-4-5 waves and the corrective wave is named as A-B-C waves. The last basic assumption made in this study is the price action of the speculative financial instrument follows the harmonic nature of the motion. The harmonic motion is defined as the probability of returning to the old path in any future time.

Why Elliot principle adopted this definition? The price of financial instrument has greater possibility to revisit its old recorded value in any point of time in future.

How the wave principle has changed the dimension of analysis? This principle has taken the price time analysis of any financial instrument from statistical average indicator and oscillator approach to the more dynamic approach of price motion, behavior, force, velocity. Since so many new dimensions are being added to the price time study then it has become a need to govern these dynamic actions through a set of common rule. Then the second advance evolution come in this principle is to abide by certain guide line while applying the rules. Take one small example “A person convicted in the theft case must be arrested by police as per the rule however police has some guide line to file FIR and dispose him before the judge in a stipulated time etc”

In wave principle the same procedure is being followed. However no one knows how the future price action will be. Then the next complex question comes how we will apply it in real trade practice. Quite simple we will construct the waves which will project the future considering the basic rule of construction. If future goes with our anticipation then no need to worry. If the future violates any of our future projection then we will look into the guideline and reconstruct the waves. This process of ours will continue till infinity. Hence we will be doing 2 jobs.

1. Construct the waves as per the rule.
2. Follow the guide line if it violate in any point of time then reconstruct it.

Now let me define the Elliot waves 1-2-3-4-5 impulsive wave sequence based on its

relationship with the Fibonacci proportion sequence. In order to draw the wave we must have to take prior trends high and low price into account. This is because we need to start from a point of our choice. Assuming that we have a high and low price of a prior trend in our hand we will start the construction in the following ways.

Wave 1: this is the 1st wave of the impulsive cycle and it will be 0.382 % retracement of the prior swing.

Wave 2: this is 0.618 retracement of the wave-1.

Wave 3: this is 1.272 retracement of the wave 1 and has the capacity to extend till the 1.618 retracement of wave 1. Some experts even say it will expand till 2 retracement of wave 1.

Wave 4: This is 0.618% retracement of wave 3

Wave 5: this is the most critical wave in this sequence as per the definition it will have same length of wave 1 and initial expansion of this wave expand till 1.618 retracement of wave 1. This wave too has a secondary expansion which is 1.618 retracement of wave 3.

The wave 1, wave 3, wave 5 are the same directional wave and happen in the direction of the major trend. Wave 2, wave 4 are against the trend of the main trend or called as counter trend wave. While making an entry trader must look into 2 points in the impulsive cycle. Wave 3 construction point is the best point to enter the trade or wave 4 termination points.

Similarly the corrective wave sequence A-B-C has following Fibonacci rule

Wave –A this is 0.618 retracement of the prior wave it must be against the prior trend.

Wave –B this is 0.618 retracement of wave – A and may expand till 1.272 retracement of the wave –A

The above discussed points focus on the construction of the waves. While constructing the waves we never knew whether the waves will complete its journey. If the wave fails to achieve the termination or target points then the entire wave pattern uses to take different shapes. Those shapes are defended as Elliot wave patterns. In wave principle 13 different patterns and being given the point of importance. Same time before shaping towards the pattern the failure of waves sequence will inform you how much gap is being formed. The most important thing which we need to look if the pattern is failed is the wave guideline and other wave rules associate with each wave. Those guide line and

other generalized rules will give you the in-depth understanding of the future wave pattern, direction of the future trend, future volatility and many more.

In order to simplify your learning I have devised one [simple Elliot wave calculator](#) which will give you the construction of each wave based on the above discussed Fibonacci principle. The detail usability with example is explained in the calculator manual. You too can construct a wave calculator using the above discussed principle. However to get the deeper understanding of the wave principle you need to read and spend some time on the individual wave guidelines , other generalized rules and wave patterns.