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Follow The Leader

The Composite Man's Bull Market Campaign

Will the principles of 20th-century chartist Richard D. Wyckoff still work in today's markets? You might be surprised. Here's a reenactment of Wyckoff's original campaign as applied to the 2008–14 stock market.

by Hank Pruden, Bruce Fraser, and Roman Bogomazov

In the year 1931, Richard D. Wyckoff created a message of instruction to his subscribers and followers. It was an idealized account about how the "Composite Man," or smart-money pool operator, would conduct a bull-market campaign. It explained in detail how the Composite Man would conduct the accumulation of a line of stock (that is, buying stock of a company over time) while prices were low and the public was depressed. It then discussed how the following markup phase was conducted. Finally, it discussed how the campaign was concluded, his line of stock sold to the public, and how the Composite Man would prepare for the subsequent decline via a campaign of distribution designed to exhaust the remaining demand of the late-arriving buyers.

In today's markets

Most of what Wyckoff noted then can be restated in the parallel scenario of the stock market from 2008–14. Here, we will use the recent/current bull market as a reenactment of the original campaign described by Wyckoff. We have made an attempt to utilize the same language that Wyckoff employed in depicting the Composite Man's campaign when he first wrote it in 1931.

Wyckoff counseled investors and traders to treat the stock market like any other merchandising business. That means you should buy only when prices are low with the intention of selling when prices are high. Wyckoff further observed that the fluctuations in the market should be studied as if they were the result of one man's operations, those of the *Composite Man*. The Composite Man or Composite Operator sits behind the scenes and manipulates stocks to his own advantage. Your job as a chart reader is to detect his motives and follow his footsteps.

The Composite Man thinks and acts like a general. He prepares, executes, and concludes stock market campaigns.

Wyckoff based the Composite Man on his own trading philosophy, his observations, and his intimate understanding of such famous old-time professionals of the early 20th century as James R. Keene, Russell Sage, Edward H. Harriman, and Jesse Livermore. Indeed, Edwin LeFèvre's *Reminiscences Of A Stock Operator*, which was dedicated to Jesse Livermore, is an excellent model of the Composite

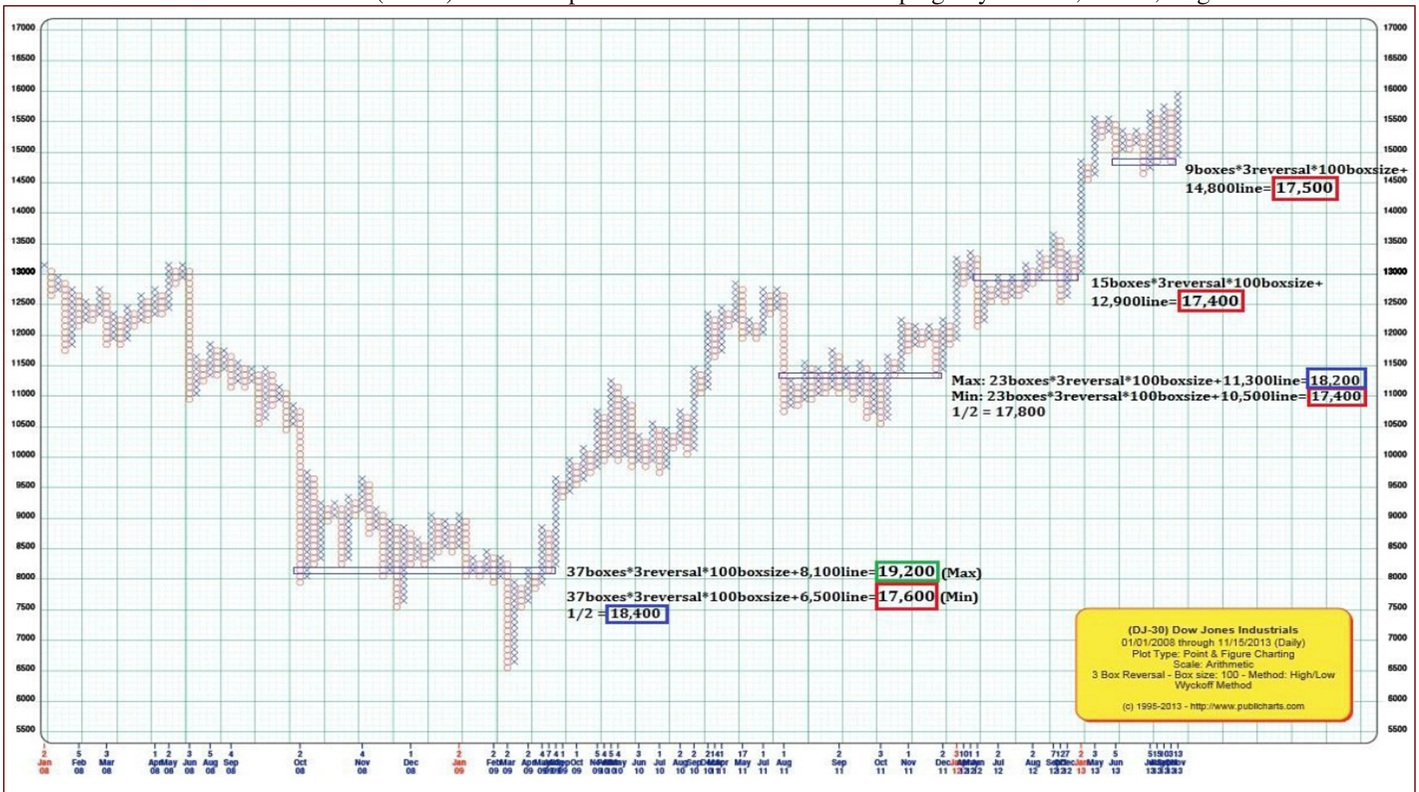


FIGURE 1: TYPICAL MARKET CAMPAIGN OF ACCUMULATION (2008–09). Here you see the price target zone where the distribution of long positions by the Composite Man could occur.

Man or Composite Operator.

The modern-day trader/technician should look upon the Composite Man as a useful fiction and helpful heuristic. Accept Wyckoff's advice that "If you learn to understand the market behavior of the so-called Composite Man, you can learn to make judgments, then conclusions, that should have a positive effect on your stock market operations."

The preparation for an important market campaign takes several weeks or months. During that time, the Composite Man accumulates a line of stocks while the market is weak, dull, and traders are depressed. Then, by making the stock active, he attracts a following of buyers from among the public. He will lend support to the price on the way up. Then, when the up move culminates on good news, he will sell out his position to a public who are eager to buy.

Market campaign of accumulation

Accumulation by the Composite Man can be seen to start with the stock market panic induced by the collapse of Lehman Brothers in October 2008. His buying stems the decline at around Dow Jones Industrial Average (DJIA) 8,000 as he buys stock at bargain prices from frightened and stressed sellers.

The Composite Man then helps to keep the stock market depressed and in a price trading range bounded by approximately 8,000 and 9,000 on the DJIA. He keeps a lid on prices by offering large amounts of stock on the bulges and then covering his short sales and buying his line on balance (that is, buying more than he sold over time, so he would accumulate his inventory of stock) throughout the trading range. Public sellers become tired and discouraged at around 8,000 or lower. They become fearful and dump their securities on the drive down to new lows around 7,000 DJIA. Meanwhile, the Composite Man enters buy orders on scaledown of, say, 8,800, 8,500, 8,200, 8,000, and 7,800. He then forces the price down by offering large blocks of stock, which in turn induces traders and others to follow his lead with sales and short sales.

By bringing the price down, the Composite Man, or "they," may sell 100,000 shares and buy 200,000 shares, resulting in a net accumulation of 100,000 shares of stock. By repeating this process of selling and buying and by helping to spread bad news, the Composite Man is able to buy on-balance and thus accumulate a sizable line of stock without putting the price up.

Finally, in March 2009, the Composite Man engineers a shakeout — a "terminal shakeout" — by driving prices all the way down to about DJIA 6,500. In so doing, he wipes out those who had protective sell stops below the prior lows in the trading range. By now, the Composite Man and those who follow him have absorbed most of the floating supply of stock.

The quick and almost vertical recovery of the market back to the upper level of the preceding trading range was a clear-cut sign of strength. Thus, the ensuing pullback to 8,100 would be a *last point of support* (LPS) and a vicinity for entering long positions in anticipation of a "markup" or bull market. The Composite Man has completed the accumulation of his line of stock.

The Wyckoff count guide for figure charts states that the potential that is built up in the base can be measured as the "cause" for a possible/probable "effect" of equal proportion to that cause (see sidebar "The Wyckoff Count Guide"). The count across that base from the last point of support sums up to 11,100 DJIA points for upside price projections of 17,600–19,200 DJIA (see Figure 1).

During the year 2011 and in the vicinity of DJIA 10,500–

THE WYCKOFF COUNT GUIDE

After seeing a sign of strength (SOS), locate the last point of support (LPS) on a reaction, and count from right to left. (See sidebar Figure 1.)

Detailed count guide: Up count

After having identified a sign of strength (SOS) on the vertical line chart, locate the last point at which support was met on a reaction — the last point of support (LPS). Locate this point on your figure chart as well and count from right to left, taking your most conservative count first and moving further to the left as the move progresses.

In moving to the left, turn to your vertical line chart and divide the area of accumulation into phases (sidebar Figure 1), adding one complete phase at a time. Never add only part of a phase to your count. Volume action will usually show where the phase began and ended.

As the move progresses, you will often see a lateral move forming at a higher level. Often, such a move will become a stepping stone confirming count of the original count. Thus, as such a level forms, you can often get a timing indication by watching the action of the stock as the potential count begins to confirm the original count. Resumption could begin at such a point.

For longer-term counts, you should add this count to the exact low or at a point about halfway between the low and the count line. You will thus be certain that the most conservative count is being used.

Counts are only points at which to stop, look, and listen. They should never be looked upon as exact points of stopping or turning. Use them as projected points where a turn could occur, and use the vertical line chart to show the action as these points are approached.

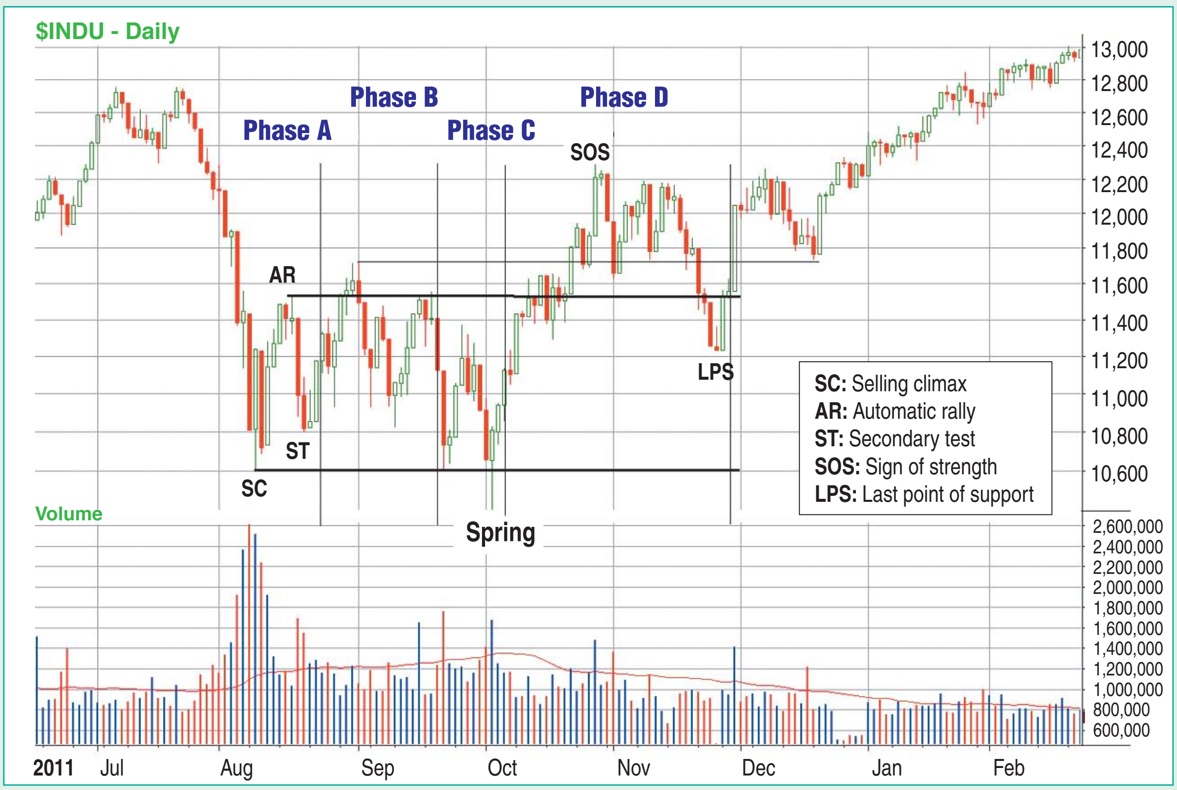
In the case of a longer-term count, often the last point of support (LPS) comes at the original level of climax, and this level should be looked at first in studying the longer-term count. The climax itself indicated a reversal, with the subsequent action being the forming of the cause for the next effect. If the last point of support (LPS) comes at such a level of climax, it usually makes it a more valid count. Often, the climax is preceded by preliminary support, and the last point of support often occurs at the same level as the preliminary support.

The spring, which in this case is a number 3 spring or the secondary-test of a number 2 spring, often constitutes the sign of strength and the last point of support in the same action that is reached at the same point and at the same time. Usually, a spring will be followed by a more important sign of strength, and the reaction following that sign of strength is also a valid last point of support.

Frequently, long-term counts on three- and five-point charts are confirmed by subsequent minor counts on the one point chart as the move progresses. Watch for this confirmation carefully, as it often indicates when a move will resume.

In the case of three-point or five-point charts, the same count line should be used as for the one-point chart.

—H. Pruden



SIDEBAR FIGURE 1: DJIA REACCUMULATION RANGE OF 2011. Here you see the various Wyckoff buying tests for reaccumulation.

Your job as a chart reader is to detect the Composite Man's motives and follow his footsteps.

11,000, the market experienced reaccumulation. (See sidebar "DJIA Reaccumulation Range Of 2011.") The LPS of this consolidation concludes at DJIA 11,400. There were 6,900 DJIA points generated during this reaccumulation phase in 2011 to provide upside counts to targets 17,400–18,300. Since these reaccumulation counts reached into the price range of

FIGURE 2: SPIKE-TOP SCHEMATIC. Here you see the support underneath a line of distribution at a top (ICE), the buying climax (BC), automatic reaction (AR), secondary test (ST), last point of supply (LPSY), sign of weakness (SOW), and the more important last point of supply (LPSY). On the cusp of this bear market, the Wyckoff nine selling tests have passed. You would go short, since the market is in the markdown phase.

the original accumulation base count (17,600–19,200), we can surmise that the requirements of a *stepping-stone confirming count* had been satisfied during the year 2011.

End Game: A Forked Road

During 2014, the Composite Man might induce a dramatic final rush upward to attract a broad public following. He could "lock up the shorts" and seemingly "lock out" the late-arriving bulls by restricting corrections to around 6% DJIA, or much less than the 10% correction hoped for by the sold-out bulls. A virtual parabolic price rise into a "buying climax" could occur, and the distribution of long positions by the Composite Man to the public could start somewhere within the price target zone shown in Figure 1. That scenario would bring his bull market campaign to a conclusion. That sort of spike-top alternative would be the "road less traveled," which would look something like the "spike top" scheme depicted in Figure 2.

The *classic crowning formation* could be the other "end

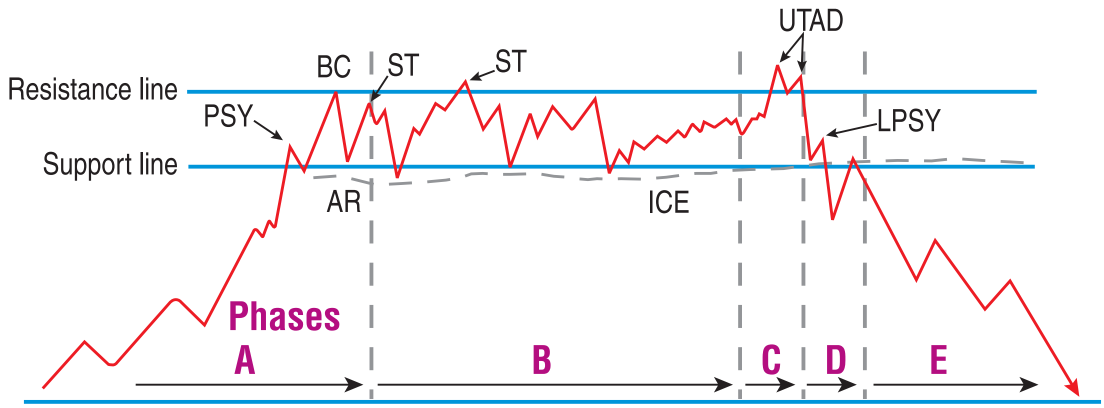
DJIA REACCUMULATION RANGE OF 2011

Here is an interpretation of the chart in sidebar Figure 1 based on Wyckoff principles.

1. Correction completed. The distribution count generated during late 2010 to mid-2011 was fulfilled by the correction in price down to the low in October 2011. Simultaneously, the selloff created a normal correction of approximately 0.37.
2. Volume on the upside ultimately outpaced volume on the downside on the right-hand side of the trading range or during the testing phase.
3. Higher highs were reached as the price broke out above resistance (a sign of strength).
4. A higher low was realized on the pullback to the last point of support (LPS).
5. A consolidation pattern of congestion/reaccumulation was evident. The pattern of triple ascending bottoms during the consolidation was indicative of reaccumulation.
6. A stepping stone confirming count was established.
7. A 3:1 reward-to-risk ratio existed at the LPS.
8. A horizontal resistance line was overcome and the creek of supply was surmounted during the transition from reaccumulation to markup.
9. Favorable relative strength or equal to the market.

Nine reaccumulation tests:

1. Resistance line broken (horizontal line across the top of the trading range)
2. Activity bullish (for example, volume expanding on rallies, shrinking on declines)
3. Higher lows (price)
4. Higher highs (price)
5. Favorable relative strength (equal to or stronger than the market)
6. Correction completed in price and/or time (for example, one-half retracement, support line reached)
7. Consolidation pattern formed (for example, triangular formation)
8. Stepping stone confirming count
9. 3:1 reward-to-risk ratio.



PSY—Preliminary supply, or first heavy selling by Composite Man.

BC—Buying climax. Huge offerings that stop the price advance.

AR—Automatic reaction; rapid, substantial decline suggesting that demand is exhausted.

ST—Rally on narrowing price spread and diminished volume that is stopped at or near the price level of BC. Confirms BC.

ST—Repeated secondary tests indicate supply offerings by Composite Man.

ICE—Line of price support along the low prices in the distribution trading range. Supporting price orders are given by Composite Man, who observes that there is still demand created by the laggard buyers.

UTAD—Upthrust after distribution; a false price breakout to new highs above the trading range catches early short sellers and last-minute upside breakout buyers. Demand is exhausted by the maneuver.

SOW—Sign of weakness; wide price spread and high volume on the downside gives evidence that supply is now most likely in control.

LPSY—More important last point of supply. It's the last rally to the ICE (line of price support). Since the Wyckoff nine selling tests are passed at this point, go short, as the market is in the markdown phase.

FIGURE 3: CROWNING FORMATION. During a classic crowning formation like this one, volume expands and prices oscillate between a support & resistance level. A few stocks record dramatic price gains.

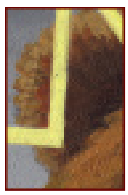
game" road pursued by the Composite Man (see the schematic in Figure 3). The Composite Man would keep a line of support — attracting the laggards, consisting of the odd-lot public — until demand is exhausted. Heavy selling by the Composite Man and his emulators will occur after he has canceled his buying orders under the market. The Composite Man's *bear market campaign* could then commence.

During a classic crowning formation, like that shown in Figure 3, volume expands and prices oscillate and a few stocks do record dramatic price gains. Traders should follow the path traveled by the Composite Man. Once long positions have been eliminated, they would wait for a *last point of supply* after a *sign of weakness* and sell short.

But what if…

A third scenario could end up tricking a large number of investors and traders. That third scenario would envision a more pronounced correction of around 20% within the current bull market (an equivalent to the 2011 shakeout). This would be followed by a phase of reaccumulation for a final rise to the maximum DJIA figure chart price projection of 19,200. This third scenario would allow the bull market more space and time to unfold.

Henry "Hank" Pruden, PhD, Bruce Fraser, and Roman Bogomazov are faculty members of the Ageno School of Business at the Golden Gate University in San Francisco.



Further reading & resources

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