

TECHNICAL ANALYSIS of STOCK TRENDS

TENTH EDITION

Robert D. Edwards · John Magee
W.H.C. Bassetti



CRC Press

Taylor & Francis Group

Boca Raton London New York

CRC Press is an imprint of the
Taylor & Francis Group, an **informa** business

Contents

Preface to the tenth edition.....	xv
Preface to the ninth edition.....	xix
Preface to the eighth edition.....	xxiii
In memoriam.....	xxxiii
Preface to the seventh edition.....	xxxv
Preface to the fifth edition.....	xxxix
Preface to the fourth edition.....	xli
Preface to the second edition.....	xlili
Foreword.....	xlv

Section I: Technical theory

Chapter 1 The technical approach to trading and investing.....	3
Definition of technical analysis.....	4
Chapter 2 Charts.....	7
Different types of scales.....	8
Chapter 3 The Dow Theory.....	11
The Dow Averages.....	12
Basic tenets.....	12
Tide, wave, and ripple.....	14
Major trend phases.....	14
Principle of confirmation.....	16
Chapter 4 The Dow Theory's defects.....	21
The Dow Theory is too late.....	21
The Dow Theory is not infallible.....	23
The Dow Theory frequently leaves the investor in doubt.....	23
The Dow Theory does not help the Intermediate Trend investor.....	23
The Dow Theory in the 20th and 21st centuries.....	24
Chapter 5 Replacing Dow Theory with John Magee's Basing Points Procedure.....	31
The fractal nature of the market.....	31
Chapter 6 Important Reversal Patterns.....	41
Important Reversal Patterns.....	42

Time required to reverse a trend	43
The Head and Shoulders	44
Volume is important	45
Breaking the neckline	47
Variations in Head-and-Shoulders Tops	49
Price action following confirmation: the measuring formula	53
Relation of Head and Shoulders to Dow Theory	55
Chapter 7 Important Reversal Patterns: continued	57
Head-and-Shoulders (EN: or Kilroy) Bottoms	57
Multiple Head-and-Shoulders Patterns	59
Tendency to symmetry	61
A leisurely pattern	65
Rounding Tops and Bottoms	66
How Rounding Turns affect trading activity	70
The Dormant Bottom variation	73
Volume pattern at Tops	75
Chapter 8 Important Reversal Patterns: the Triangles	77
Symmetrical Triangles	78
Some cautions about Symmetrical Triangles	80
How prices break out of a Symmetrical Triangle	80
A typical Triangle development	82
Reversal or Consolidation	86
The Right-Angle Triangles	92
A planned distribution	92
Descending Triangles	94
Volume characteristics same as the Symmetrical type	95
Measuring implications of Triangles	98
Triangles on weekly and monthly charts	99
Other Triangular formations	100
Chapter 9 Important Reversal Patterns: continued	103
The Rectangles, Double and Triple Tops	103
Pool operations	105
Relation of rectangle to Dow Line	108
Rectangles from Right-Angle Triangles	109
Double and Triple Tops and Bottoms	111
Distinguishing characteristics	113
Double Bottoms	116
Triple Tops and Bottoms	117
Chapter 10 Other Reversal phenomena	121
The Broadening Formations	121
Volume during Broadening Formations	122
A typical example	123
The Orthodox Broadening Top	124
Why no Broadening Bottoms?	126
Right-Angled Broadening Formations	128

The Diamond	129
Wedge Formations	130
The Falling Wedge	134
Wedges on weekly and monthly charts.....	135
Rising Wedges common in Bear Market Rallies.....	136
The One-Day Reversal.....	136
The Selling Climax.....	140
Short-term phenomena of potential importance	144
Spikes.....	145
Runaway Days.....	147
Key Reversal Days	148
Chapter 11 Consolidation Formations.....	151
Flags and Pennants	151
The Pennant: a pointed Flag.....	153
The measuring formula.....	154
Reliability of Flags and Pennants	156
Where they may be expected	157
Flag pictures on weekly and monthly charts.....	158
Rectangular Consolidations: an early phase phenomenon	159
Head-and-Shoulders Consolidations	160
Scallops: repeated Saucers	162
Modern versus old-style markets.....	166
Chapter 12 Gaps.....	171
Which gaps are significant?	171
Closing the gap.....	171
Ex-dividend gaps	172
The common or area gap.....	173
Breakaway gaps.....	174
Continuation or runaway gaps and the measuring rule.....	177
Two or more runaway gaps.....	179
Exhaustion gaps	181
The Island Reversal.....	184
Gaps in the Averages	186
Chapter 13 Support and Resistance	189
Normal trend development.....	190
The explanation.....	191
Estimating Support-Resistance potential.....	193
Locating precise levels.....	196
Significance of Support failure	197
Popular misconceptions	198
The round figures.....	200
Repeating historical levels	200
Pattern Resistance	202
Volume on breaks through Support	205
Support and Resistance in the Averages.....	206

Chapter 14 Trendlines and Channels	207
The Trendline.....	207
How Trendlines are drawn.....	208
Arithmetic versus logarithmic scale.....	211
Tests of authority.....	211
Validity of penetration.....	214
Amendment of Trendlines.....	216
Double Trendlines and trend ranges.....	216
Trend Channels.....	218
Experimental Lines.....	219
Consequences of Trendline penetration: Throwbacks.....	220
Intermediate Downtrends.....	221
Corrective trends: the Fan Principle.....	225
Chapter 15 Major Trendlines	229
Major Downtrends.....	237
Major Trend Channels.....	238
Trendlines in the Averages.....	244
Trading the Averages in the 21st century.....	244
Chapter 16 Technical analysis of commodity charts	247
Technical analysis of commodity charts, part 2: A 21st-century perspective.....	251
Rocket scientists.....	252
Turtles?.....	253
The application of Edwards and Magee's methods to 21st-century futures markets.....	254
Stops.....	258
A variety of methods.....	261
Everything you need to know as a chart analyst trading futures.....	261
The return of the great markets of the 1970s.....	262
Chapter 17 A summary and concluding comments	263
Technical analysis and technology in the 21st century: the computer and the Internet: tools of the investment/information revolution.....	267
The importance of computer technology.....	269
Summary 1.....	270
Other technological developments of importance to the technical Magee analyst and all investors.....	270
The Internet: the eighth wonder of the modern world (EN9: Appendix B, Resources, for the ninth edition has been enormously expanded and is of paramount importance to modern investors.).....	270
Marking-to-market.....	271
Separating the wheat from the chaff.....	272
Chaff.....	272
Summary 2.....	272
Advancements in investment technology, part 1: Developments in finance theory and practice.....	273
Options.....	273
Quantitative analysis.....	274
Options pricing models and their importance.....	275

Futures on indexes	275
Options on futures and indexes	276
Modern Portfolio Theory	277
The wonders and joys of investment technology	277
Advancements in investment technology, part 2: futures and options on futures on the Dow–Jones Industrial Index at the CBOT	277
Investment and hedging strategies using the CBOT® DJIA SM futures contract	278
Settlement of futures contracts	278
Marking-to-market	278
Fungibility	278
Differences between cash and futures	279
Dow Index futures	279
Using stock index futures to control exposure to the market	279
Investment uses of Dow Index futures	281
Situation 1: Portfolio protection	281
Situation 2: Increasing exposure with futures	282
Situation 3: Using bond and index futures for asset allocation	282
Perspective	284
Options on Dow Index futures	284
Option premiums	285
Volatility	285
Exercising the option	286
Using futures options to participate in market movements	286
Profits in rising markets	286
Exploiting market reversals	287
Using puts to protect profits in an appreciated portfolio	287
Situation 1	287
Improving portfolio yields	287
Situation 2	287
Using option spreads in high- or low-volatility markets	288
Situation 3	288
Situation 4	289
Perspective	289
Recommended further study	289
 Section II: Trading tactics	
Midword	291
 Chapter 18 The tactical problem	295
Strategy and tactics for the long-term investor. What’s a speculator, what’s an investor?	299
One definition of the long-term investor	301
The strategy of the long-term investor	301
Rhythmic investing	302
Summary	304
 Chapter 19: The all-important details	305
The simplest and most direct way to use a computer for charting analysis	306
Summary	307

Chapter 20 The kind of stocks we want: the speculator's viewpoint	309
The kind of stocks we want: the long-term investor's viewpoint	310
Changing opinions about conservative investing	310
The kinds of stocks long-term investors want: The long-term investor's viewpoint	311
Construction of the Index Shares and similar instruments	312
An outline of instruments available for trading and investing	313
The importance of these instruments: diversification, dampened risks, tax, and, most important, technical regularity	314
Summary	316
Chapter 21 Selection of stocks to chart	317
Chapter 22 Selection of stocks to chart: continued.....	321
Chapter 23 Choosing and managing high-risk stocks: tulip stocks, Internet sector, and speculative frenzies	327
Managing tulipomanias and Internet frenzies	328
Detailed techniques for management of the runaway issues.....	330
Hope springs eternal and there is one born every second.....	334
Chapter 24 The probable moves of your stocks.....	343
Chapter 25 Two touchy questions	347
The use of margin.....	347
Short selling	348
Chapter 26 Round lots or odd lots?	353
Chapter 27 Stop orders	355
The progressive stop.....	357
Stop systems and methods	359
A brief survey of stop methods.....	360
Some other stop methods.....	360
Average True Range.....	360
Parabolic stop and reverse	361
Target stops	361
A natural method used by the Turtles.....	361
Chapter 28 What is a bottom, what is a top?	363
Basing Points.....	364
Basing Points: a case analyzed	366
The Basing Points paradigm.....	367
Key to Figure 28.2 analysis	368
A narrative of the events in the chart.....	369
The complete Basing Points Procedure: taking into consideration the setting of Basing Points on both wave lows and new highs	370
The complete Basing Points procedure	371
Two charts giving a long-view perspective on the complete (Variant 2) procedure....	372
The representative case fully analyzed using wave lows and new highs.....	372
A narrative of the events in the chart.....	373

Chapter 29 Trendlines in action.....	375
Buying stock, "going long"	376
Liquidating, or selling a long position.....	377
Selling stock short	380
Covering short sales	381
Additional suggestions	381
General outline of policy for trading in the Major Trend.....	382
 Chapter 30 Use of Support and Resistance.....	 385
 Chapter 31 Not all in one basket	 391
EN: diversification and costs.....	392
 Chapter 32 Measuring implications in technical chart patterns	 393
 Chapter 33 Tactical review of chart action	 395
The Dow Theory.....	395
Head-and-Shoulders Top.....	402
Head-and-Shoulders Bottom.....	403
Complex or multiple Head-and-Shoulders.....	405
Rounding Tops and Bottoms	405
Symmetrical Triangles	408
Right-Angle Triangles.....	410
Broadening Tops.....	410
Rectangles.....	410
Double Tops and Bottoms.....	411
Right-Angled Broadening Formations.....	411
The Diamond	411
Wedges.....	412
One-Day Reversals.....	412
Flags and Pennants	412
Gaps	413
Support and Resistance.....	416
Trendlines.....	416
 Chapter 34 A quick summation of tactical methods	 419
Get out of present commitments	419
Make new commitments.....	420
 Chapter 35 Effect of technical trading on market action.....	 421
 Chapter 36 Automated trendline: The Moving Average	 423
Sensitizing Moving Averages.....	424
Crossovers and penetrations.....	424
The PENTAD Moving Average system from Formula Research.....	426
 Chapter 37 The same old patterns.....	 429
Not all the same.....	430

Chapter 38 Balanced and diversified	483
September 28, 1985: an oversold market	488
Chapter 39 Trial and error.....	489
Chapter 40 How much capital to use in trading.....	491
Chapter 41 Application of capital in practice.....	493
Put and call options	495
Chapter 42 Portfolio risk management	497
Overtrading: and a paradox	498
Risk of a single stock	500
Risk of a portfolio	501
EN9: Risk and trend	501
Value-at-Risk Procedure.....	501
Pragmatic Portfolio Theory (and practice)	502
Pragmatic portfolio risk measurement	502
Determining the risk of one stock	502
Determining the risk for a portfolio	503
Measuring maximum drawdown, or maximum retracement	504
Pragmatic portfolio analysis: measuring the risk	504
Portfolio Ordinary or Operational Risk.....	504
Portfolio risk over time.....	505
Portfolio extraordinary or catastrophic risk.....	505
Controlling the Risk	505
Summary of Risk and Money Management Procedures	505
Infinitely more sophisticated risk and money management procedures—Ralph Vince and optimal f.....	506
Chapter 43 Stick to your guns.....	507
Appendix A The Dow Theory in practice.....	509
Five years of Dow interpretation.....	509
The first severe test	510
Failure to confirm.....	512
Signs of Major Turn.....	513
The Bull signal	515
The first correction	516
Bull Trend reaffirmed	517
The Rails falter.....	518
The spring of 1946.....	519
Final Up-Thrust.....	521
The Bear Market signal.....	521
Appendix B Resources.....	525
Section 1: important and indispensable sites	525
Section 2: references for further study	526
On risk	526

On candlesticks	526
On futures	526
On portfolio management	526
Section 3: investment-oriented sites	526
Brokerage Houses.....	528
Section 4: the Sharpe Ratio.....	529
Section 5: calculating volatility.....	529
Section 6: the essence of fundamental analysis	530
The Elliott Wave Theory: perspective and comments	530
Section 7: software packages and Internet technical analysis sites.....	533
AIQ: TRADING EXPERT PRO	533
METASTOCK 9.0	533
Tradestation 2000i and Tradestation 8.....	534
The Internet: prophet (http://www.thinkorswim.com)	534
The Internet: http://www.stockcharts.com	534
A brief summary	534
Section 8: the Leverage Space Portfolio Model.....	534
Glossary.....	539
Bibliography.....	565
Index	567