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A Rare Phenomenon, Current Wave Pattern Creates Unpredictable Environment

Understanding why Today's Stock Market Is Unpredictable and the best Trading Strategies to Employ

By Glenn Neely, Founder, NEoWave Institute

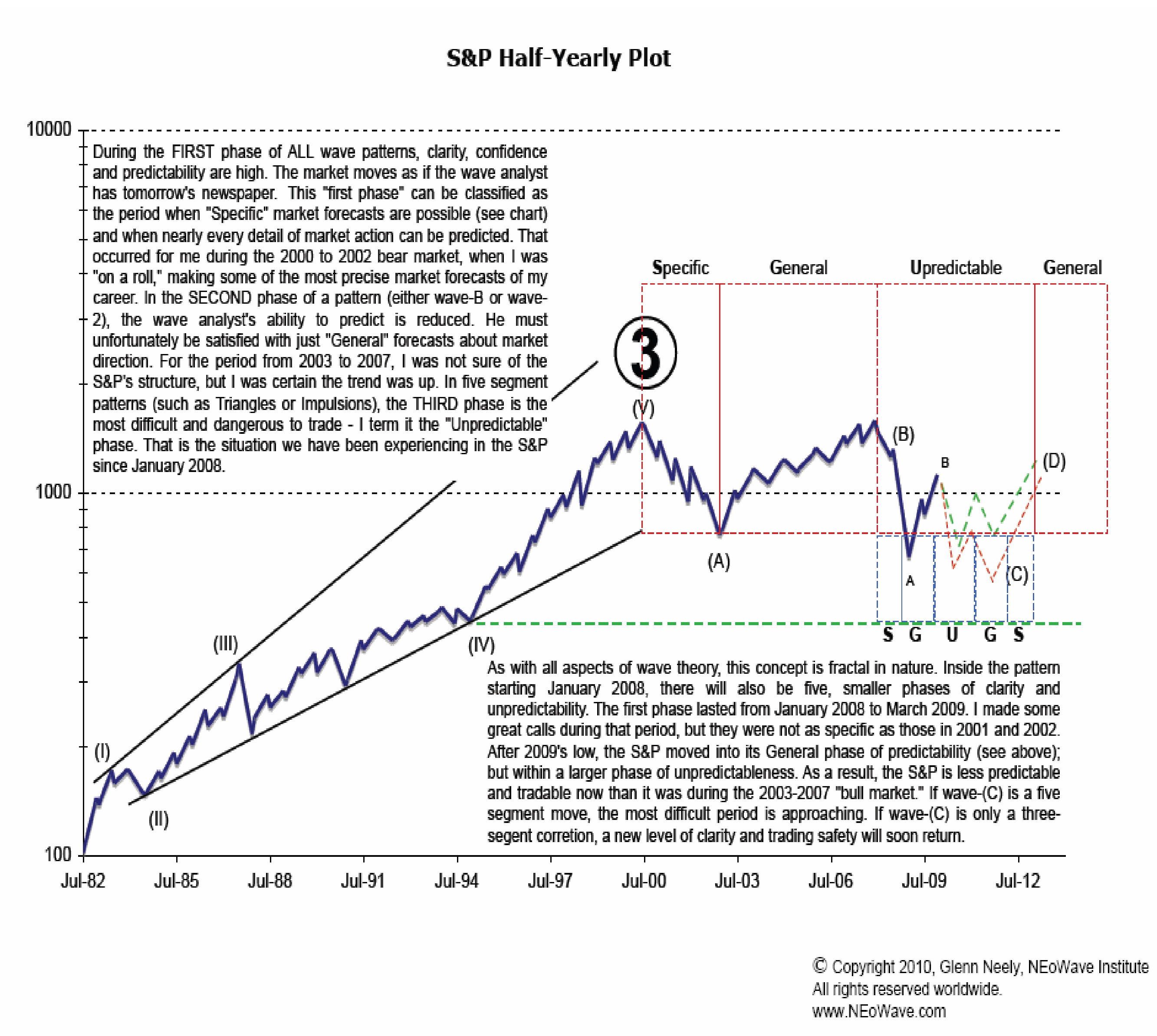
The U.S. stock market has entered the center of a 20-year correction and is currently in a highly unpredictable phase. In fact, stock market predictions in 2010 – and for the next several years – will continue to be extremely challenging. This is an unavoidable phenomenon, which makes trading at this time more difficult and dangerous than usual. In this article, I discuss the U.S. stock market's current

phase of pattern development – a strange Wave phenomenon – and how it impacts trading strategies and risk management, and what it means to traders and investors.

NEoWave's phases of market predictability

The current U.S. stock market environment is an interesting phenomenon related to Wave Theory. Most people who approach Wave analysis believe the stock market is predictable all the time – as long as you can figure out the Wave count. The reality is that Wave counts are predictable some of the time – along with market predictability – and sometimes they're not. Markets go through phases of predictability that I call Specific Predictability, General Predictability, and Unpredictability. This understanding of predictability is an important component of NEoWave technology, an advancement of Wave theory that presents logical concepts, structures, and rules. To be clear, the logical design of NEoWave is not present in the original Elliott Wave Theory.

What is the current Wave pattern, and why is the stock market so unpredictable right now? First, let's look at the chart below. This presents the high-low cash data for every six months of the S&P 500



between 1982 and early 2010. This chart illustrates the historical Waves – and shows my stock market predictions for 2010 and beyond.

As an aside, in my book, Mastering Elliott Wave, I specifically address how to plot charts. You should always plot the market on a cash basis, because cash prices don't deteriorate over time like futures data. Also, the highs and lows should be plotted in order – do not put the highs and lows on the same vertical plane – this helps you create a chart that actually shows Wave patterns. If you use bar charts, you're not really looking at Wave patterns, and it's difficult to decipher Wave structure.

Let's look at the chart, starting with the high in 2000. As you can see, this was the end of a multi-decade advance. Under Wave Theory, this is a five-way structure with a fifth-Wave extension. The pattern concluded, and we went into a bear market, which technically began on September 5, 2000. (The high was in February 2000, but the actual start of the bear market under Wave Theory was September 5, 2000.) The decline began with a strong directional move, which was extremely predictable because we were in the very early stages of a large, 20-year corrective formation.

My ability to predict stock market action for the next two years was truly stunning to many people. It was the most predictable market action I'd seen in nearly my entire career – because we were at the very beginning of a long-term formation. During this period of Specific Predictability, you can precisely forecast what will happen day-to-day, week-to-week, and month-to-month. My stock market predictions during this timeframe were extremely precise.

The center of a Wave is far more difficult to predict than the beginning

The beginning of a large formation offers a high degree of predictability, with extremely accurate stock market predictions. However, from January 2008 through 2012 (and possibly 2014), we will be in the Unpredictable phase of Wave pattern development. That's a long time to not be able to specifically predict what will happen. The interesting part of this Unpredictable phase that began in January 2008 is that it goes through a pattern of Specific Predictability, General Predictability, and Unpredictability. (On the chart, the S stands for Specific, G for General, and U for Unpredictable.)

We're in the center of a very large 20-year correction, and the center of a Wave pattern is the greatest period of uncertainty. Whenever you're in an environment of unpredictably, it opens up the market tremendously to outside influences, unexpected economic circumstances, and geopolitical events like the terrorist attacks of September 2001 (this was near the center of the 2000-to-2002 decline, which was a period of unpredictability). We're dealing with that kind of environment now, which means unexpected events, uncertainty, and fear will reign supreme for the next few years.

The center of an unpredictable environment presents a lot of uncertainty due to polarization of opinion. The market can swing in wild ways, because there's a lot of money either sitting on the sidelines or doing the opposite of what the other half is doing. If one group suddenly decides to join the other group, this can move the market dramatically and quickly.

This situation allows for randomness and unpredictability that you don't get near the beginning and end of patterns. It's like throwing an extra person on one end of a teeter-totter, which results in a sudden and dramatic shift.

Unfortunately, this unpredictable market environment will continue for several more years, certainly throughout 2010. The risk of violent, unexpected external events that could affect the stock market is very high for the entire year. Generally speaking, Wave Theory suggests that we're in a sideways or down trend, which began in January 2008. And I'm certain we'll be in this sideways or down trend for four to six years. This means the bear market will not finish until at least 2012 – and it could stretch out until 2014. At that point, the large Unpredictable phase will come to an end, and we'll move back into a General Predictability phase, like that of 2002 to 2007.

What are the best trading strategies for this unpredictable market?

This Unpredictable phase does make trading far more dangerous. As the market moves toward the center formation, our focus has to shift away from dependability on Wave structure and Wave patterns that you would expect to occur. Now, trading strategies must be based on bottom-line-oriented capital management strategies. Traders and investors need to look to market trading strategies that are outside the realm of Wave Theory.

The best way to deal with unpredictable stock markets is to use what I call second-tier technologies: strategies for trading, risk management, and capital management that are independent of Wave Theory. Clearly, when the stock market is harder to predict, it's harder to trade. Therefore, you need to be much more careful about risk management and protecting your capital. You need to minimize risk and maximize potential. In this unpredictable environment, you need to reduce the emphasis on predicting the stock market and place the emphasis on careful, strategic trading and on strategies to preserve capital.

In the next article in this series, I will introduce the fundamentals of my revolutionary Neely River Technology. This provides a behavioral framework for traders and investors to better deal with the randomness of price fluctuations in unpredictable market environments.

Founder of NEoWave Institute, Glenn Neely is internationally regarded as the premier Wave analyst. He has devoted more than 25 years to mastering Wave theory, stock market predictions, and successful trading. In 1990, Neely published his advanced Wave analysis process in his classic book, Mastering Elliott Wave. In the following decades, Neely continued to evolve Wave theory to make it objective, practical, and consistently accurate. This evolution produced NEoWave technology – a precise, step-by-step assessment of market structure, which results in low-risk, high-profit trading and investing. See for yourself: Subscribe to NEoWave's 2-week Trial Service. Learn more Glenn Neely and NEoWave Trading and Forecasting services at www.NEoWave.com.