<u>DO YOU USE ELLIOTT WAVE?</u>

By Alexander O'Malley

I am often asked about Elliott Wave analysis. It is not an analysis technique that I use. It's not an analysis technique I find particularly useful because it seems to me it has several major failings.

- It confuses coincidence with correlation
- It uses complexity and confusion to cover-up mistakes in analysis
- It is very subjective in its application.

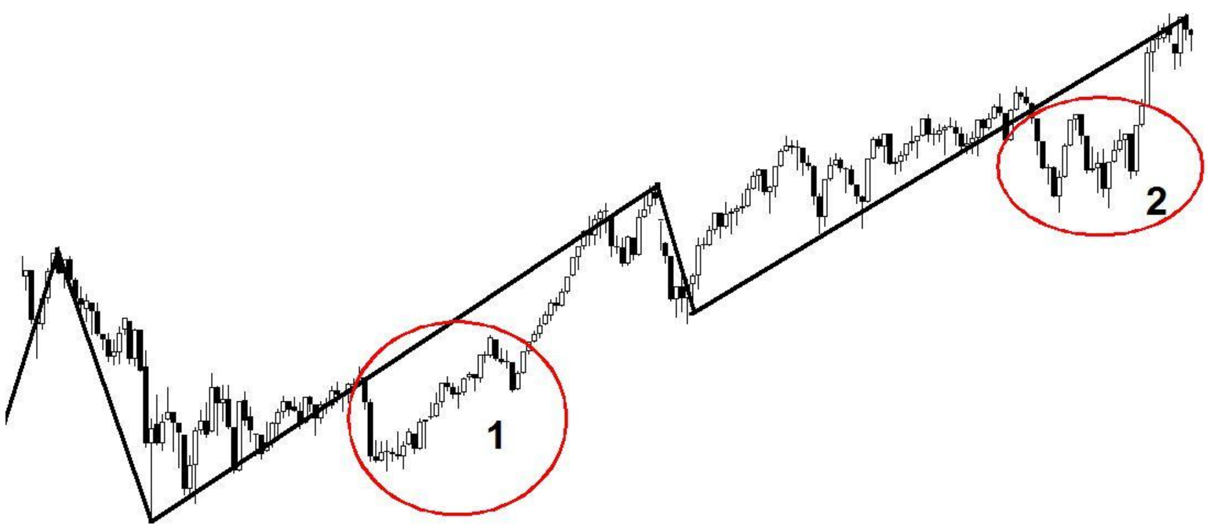
Look at any chart for long enough, and analyse it with enough indicators, and you will find correlated patterns and signals. Many of these are coincidental relationships. You establish this by looking a charts with similar price patterns to see if the same <co-incidental> relationships appear. If they appear consistently then we can talk of a correlated relationship. If they do not, then it's just coincidence.

Often complexity and confusion is used to cover up mistakes in analysis. The analysis is incorrect because the position of wave A was incorrect. The analysis is incorrect because you didn't properly understand the application of the wave calculation. The solution is always more learning rather than an examination of the trading analysis methodology.

We prefer analysis methods that provide a robust probability framework and which make no pretences at prediction.

But its most significant problem is its subjectivity and this includes the convenient exclusion of chart features which don't fit into the neat pattern or lead to rathe preferred conclusion.

The weekly chart above is an example. It was presented by a skilled Elliott Wave technician. At first glance it looks very convincing. The chart below shows the problems.



Some simple questions.

- Why was the pullback and trend correction in area 1 ignored in the calculation of waves and sub waves?
- Why was the pullback and trend correction in area 2 ignored in the calculation of waves and sub waves?

I invite readers who use Elliott wave to suggest answer to these questions.

For us the exclusion of these significant trend reversal points suggests <curve fitting> analysis. A significant trend reversal is one that triggers closing long positions and opening short positions. Remember, this is a weekly chart. When these reversals are excluded then we need sound reasons for this decision.

Applying the same wave line principles as in the early segments of the chart then the chart looks like this.

The pattern of waves is very different, and the Elliott Wave count is also very different. The trading strategy and conclusion are very different from the first chart. The truth is out there but it’s difficult to see how it can be found using this type of analysis.

When we have an audience and an Elliott wave teacher arguing about if a feature is wave A or B then it strongly suggests that the analysis method is very subjective.

We avoid it for that reason. We know many people who use Elliott Wave analysis for trading and some are successful. It’s not a method we use, and the objective in these notes is to explain why we don't use this style of analysis. We prefer a robust indicator that can be applied to all charts and deliver the same analysis conclusions no matter who is applying the method. The position of a moving average crossover is beyond dispute on all charts for all users. The interpretation of robust indicators is the same no matter who applies them.

Beauty may be in the eye of the beholder, but trading success depends on objectively verifiable signals.