

Introduction To Elliott Wave Theory

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My Trading and Forecasting background

Hello, myself, Muhammad Azeem, an Elliott Wave Practitioner since 2004 is a certified Elliott Wave Analyst Level 1 with 93% score (2012). You can find more about my related learning & experience by visiting my professional website: <http://www.readyforex.com>

My own struggle in Forex trading

Back in the beginning of year 2004, I was searching for technical indicators, which could earn me significant money via Forex market. Over the time, I have realized that still most of the traders think that if some how they manage to find a “Fancy” and secret “Technical Indicator” then, their all Forex trading problems will vanish forever! Let me confess the same that like all other inexperienced and newbie Forex traders, I was looking for the same magical ‘Indicator’ to solve my Forex trading problems 😊

Time flew and it was during my struggle to discover the above mentioned 'Indicator', under the guidance of my senior co-workers at a brokerage firm, I started gaining interest in day trading systems to trade Spot Forex EUR/USD currency pair. At that time, I heard that it is possible to project the price movement of a currency pair, before price actually reaches a specific level; with pinpoint accuracy.

Some traders use fundamental analysis (NEWS trading) and some use technical analysis to forecast an upcoming price action. So, like any other novice currency trader, I was not keen to learn an effective forecasting method or trading tool. Rather, I was only interested to learn a Forex trading system enough to make easy and fast money!

Forecasting the market as accurate as possible was something that never appealed me enough to learn more. I was naïve and eager enough to generate buy and sell trading signals just by using a trading formula. Honestly, I did not care about Forex jargons, market trend, money management, trading psychology, price patterns and average daily trading range, etc.

All I cared about is how to make easy and fast money by trading the Spot Forex currency pairs, every day. That's all!



Google Search

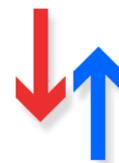
I'm Feeling Lucky

My extensive search on Google found me many Online Forex day trading systems. Just to try my luck, I purchased one Forex day trading system for just US\$ 199/- with simple to follow trading rules. After applying the custom designed technical indicators and chart setup, I got an arrow popup screen, which used to guide me; when to buy or sell currency pairs and when to stay out of the market. Just like that, it all seemed simple, easy and beautiful!

Well... to make my long story short, I have lost my Forex trading account worth US\$ 5,000/- within a week's time. It was quite a shock for me! Unfortunately, I was unable to figure out that what went wrong where and how, so fast? Wondered if was that even my mistake! All I did was just following an Easy Forex day trading system.



1. Just read pdf manual and apply indicators on charts.



2. Pull pips out of market by following buy/sell arrows.



3. Next, fill buckets of cash.

Above is what was mentioned on that website from where I purchased my first "Easy Forex Day Trading System". Not to mention, that website went offline within a few months; after selling non-profitable trading system to many currency traders. Again, I was directionless and all alone to face the music.

Sometimes, I wonder that why I never thought; how come any one could sell his profitable Forex day trading method for a ridiculously small price of US\$ 199!

Anyways, after facing the loss of US\$ 5,199/- in Forex trading, I mustered up courage again but unfortunately lost money again in Forex trading.

After continuous losses, I reached a point in my life that I was desperate enough to discover any kind of trading methodology to make profit in Forex trading. I wanted to earn back all my lost Pounds, Euros and Dollars; each and every penny of it.

Thus, instead of finding another "Easy Forex Day Trading System", I tried to contact Old currency traders with white hairs, Trading gurus, Fx instructors and Chartered market technicians.

I emailed each one of those asking to provide me with the name of their favorite "Books" on Forex trading, investment and trading psychology. Most of them did not reply and some of them offered me to buy their "Super Easy Forex Day Trading System".

Definitely, thanks to my past experience, I was not keen on buying or trying another "Easy Forex Day Trading System". Out of many currency trading experts and market analysts, only few replied me back with the names of their favorite Forex trading and investment books, available on Amazon.com. This is how I found Elliott Wave Theory.

It is important to understand that Elliott wave theory tells us that there is no need to listen to NEWS in trading. Accordingly, I only use pure technical analysis to trade and forecast the market. I do not care about any kind of news in my own Forex trading and still make big profit.

Introduction about the history and life of Mr. Ralph Nelson Elliott

Mr. Ralph Nelson Elliott (28 July 1871–15 January 1948) was a USA based accountant and an author. His study on stock market historical data led him to develop the Elliott Wave Principle. Elliott wave is kind of a technical analysis that identifies trends in the financial markets. Mr. Elliott proposed that market movement unfolded in specific patterns, which practitioners today call Elliott wave patterns.



Early life and career

Mr. Ralph Nelson Elliott was born in Marysville, Kansas, United States. After a few years, his family moved to San Antonio, Texas, USA. He entered the field of accounting in the middle of the 1890s and worked mainly in executive positions for railroad companies in Central America and Mexico.

In 1903, Mr. Ralph Elliott married Mary Elizabeth Fitzpatrick (1869–1941), who accompanied him during his extended time working as an expatriate in Mexico. After a civil unrest and riot in Mexico, they came back to the United States and eventually to a residence in New York City, where Mr. Elliott started a successful consulting business.

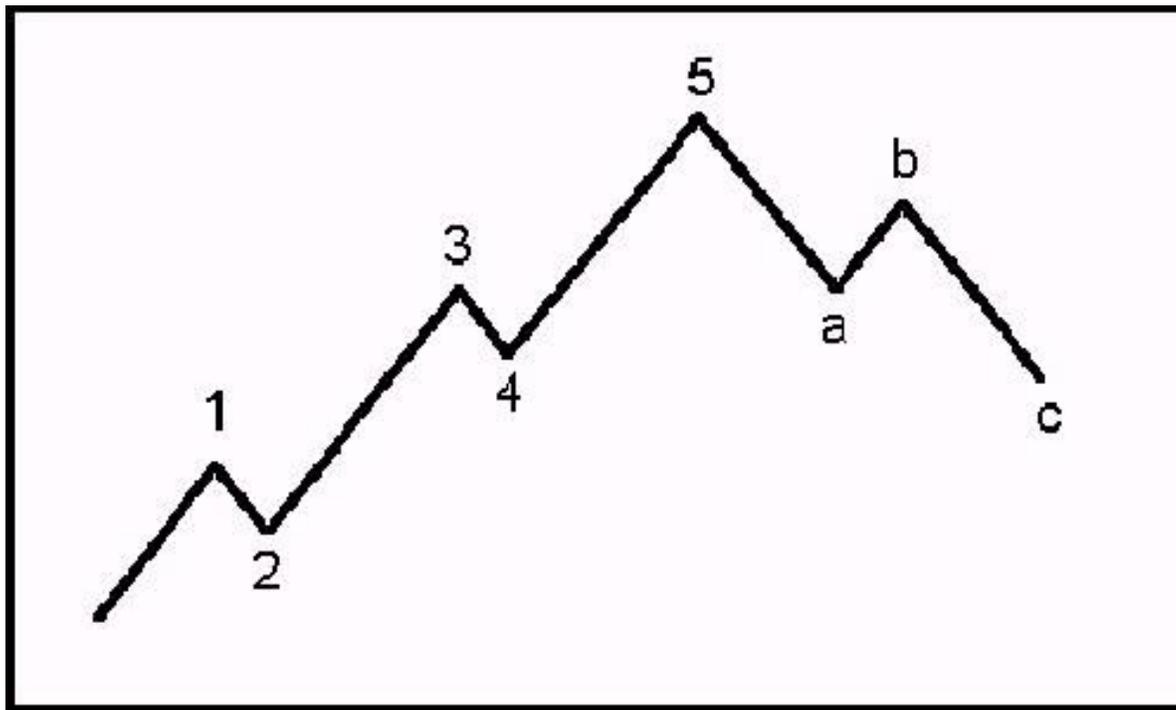
The USA Department of State appointed Mr. Ralph Elliott in 1924 to the post of Chief Accountant for Nicaragua (which at the time was under American control). During his time in Central America, Mr. Elliott got an intestinal sickness. Due to this reason, he was forced to retirement at the age 58. About this time, he decided to dedicate himself to the study of the behavior of the American stock market.

Elliott Wave Theory

Mr. Ralph Nelson Elliott started his systematic study of 75 years of stock market data in the year 1930. He also analyzed index charts

with increments ranging from yearly to hourly charts. In August 1938, Mr. Elliott elaborated the results of his studies in the form of several articles and letters.

At that time, Mr. Elliott stated that, while stock market prices may appear random and unpredictable, they actually follow foreseeable, natural laws and could be calculated and predict using the Fibonacci number. This means; it is possible to forecast the future price of a currency pair, in advance with some sort of probability!



In the years after Mr. Elliott's death, other Elliott wave practitioners such as Charles J. Collins, Richard Russell, Hamilton Bolton and A.J. Frost continued to use the Elliott wave principle and provide forecasts to investors.



Mr. A. J. Frost joined hands with Mr. Robert R. Prechter, Jr. They gather together all the past articles and letters of Mr. Ralph Nelson Elliott. Next, they consolidated and put together all the Elliott Wave rules and guidelines in one book. They published Elliott wave principle book in the year 1978.



Mr. Robert R. Prechter, Jr had come across Elliott's works when he was working as a market technician at Merrill Lynch Inc; his prominence as a forecaster during the bull market of the 1980s helped bring Elliott's wave theory its greatest exposure up to that time. Now-a-days, there are many other technical market analysts, which do not fully follow the rules of Elliott's wave theory. They only use it as a starting point to create their own forecasting methods.

Before I start discussing the rules and guidelines of Elliott Wave Theory, it is important to first address few common questions related to Elliott wave principle.

Question: What is the immediate learning from Elliott Wave?

Answer: You can forecast an upcoming price move of Spot Forex currency pairs with high probability. Next, look for trading opportunities, using Elliott wave patterns in the favor of your forecasts with high winning percentage.

Question: Anytime, it does not work?

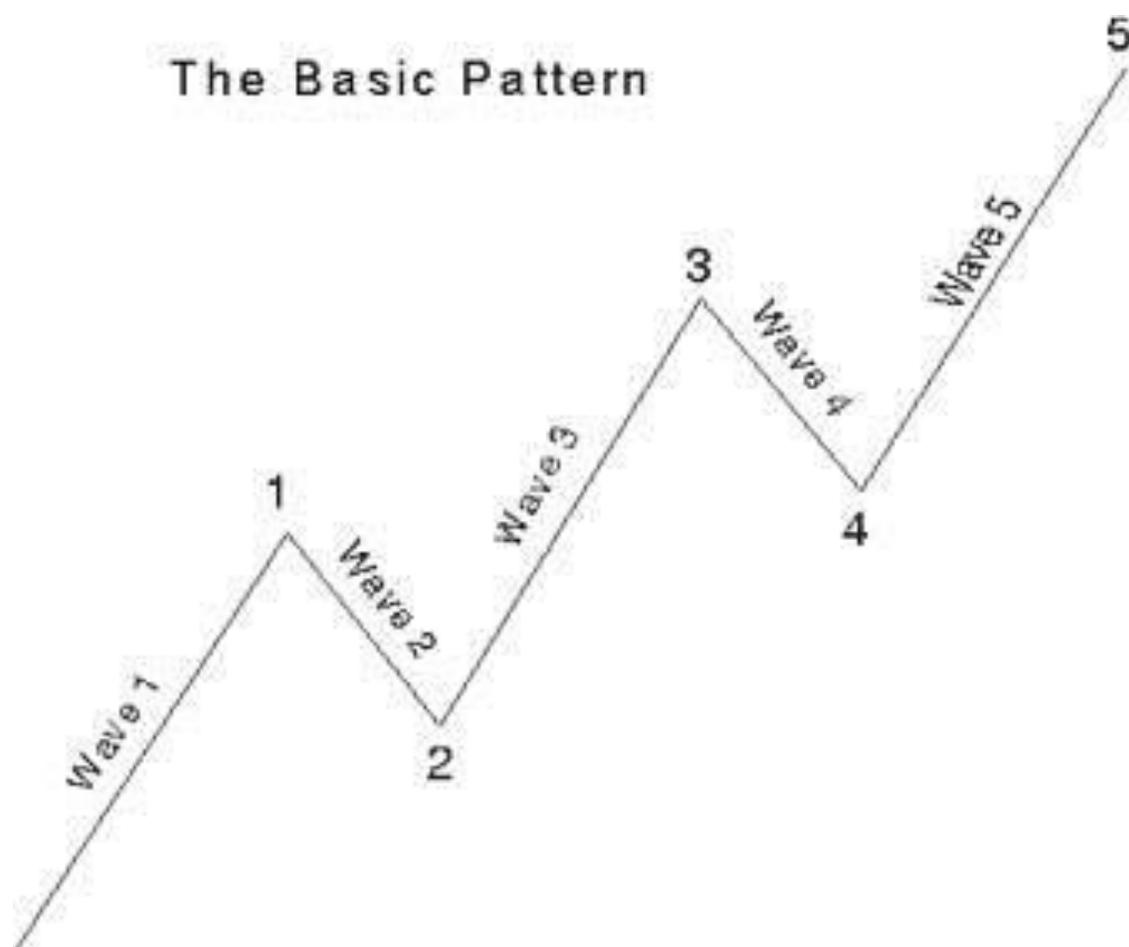
Answer: Like any other forecasting method, there are times when the Elliott wave forecasts do fail. However; mostly, it works quite well.

Question: Can I make big profit in my own Forex trading after learning and practicing Elliott Wave theory?

Answer: Elliott wave is a forecasting and trading tool. It does provide a framework; **a)** to enter in a market with buy or sell trade, **b)** where to place a stop loss to control the risk, **c)** what price level you should be looking forward to use as your take-profit level etc. However, it is not 100%, bulletproof moneymaking method, so you may lose trades, some times. I will suggest considering learning money management and trading psychology.

Basic Tenets

Mr. Ralph Nelson Elliott originally discovered wave principle by analyzing the stock market. However; the same rules and guideline of Elliott Wave Theory also work in the Spot Forex market. Elliott Wave Principle is governed by man's social nature. The human nature and mood are constant, in general. No one likes to see a losing trade, and everybody wants to make money in the Forex market. Thus, the collective behavior of traders commonly known as "Herding" along with buying and selling actions create patterns in the form of waves on price charts of currency pairs.



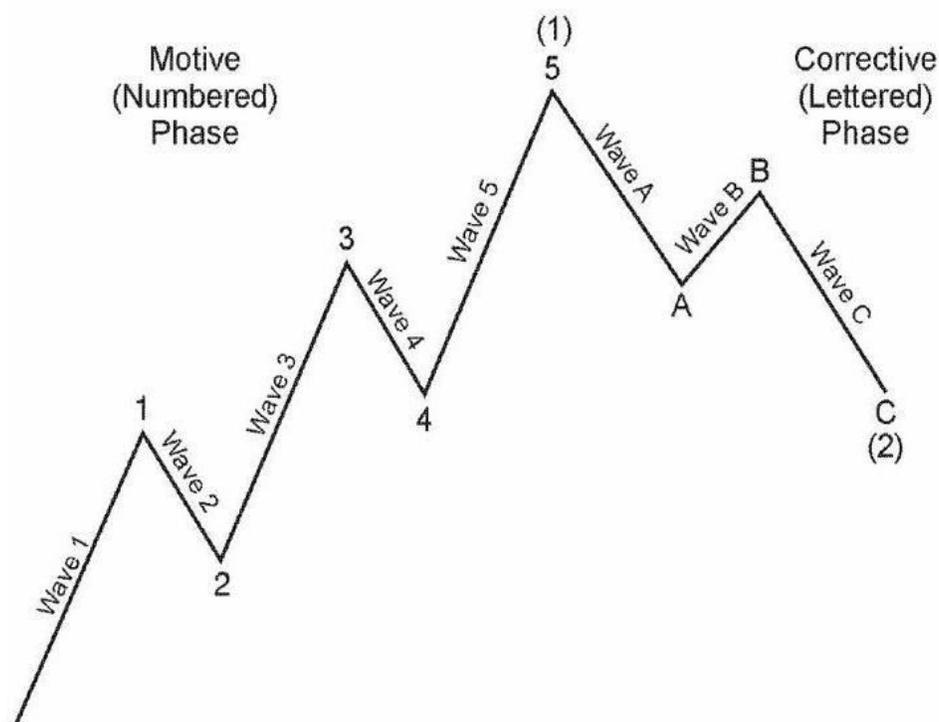
In markets, progress ultimately takes the form of five waves of a specific structure. Three of these waves, which are labeled 1, 3 and 5 moves in the favor of market trend. At the same time, we also get two counter trend waves, which are labeled as 2 and 4.

There are two main type of wave development. Motive waves and Corrective waves.

Motive Waves

What is a motive wave? Motive waves always move in the same direction as the trend of one higher time frame. They are straight forward and relatively easy to recognize and interpret. Wave 1, 3 and 5 are known as motive waves because they powerfully impel the market.

ELLIOT WAVE BASIC PATTERN



Price action of Motive waves usually shows consecutive bullish candlesticks in case of an up trend. Waves 1, 3 and 5 are also known as "Actionary Waves". The main objective of a motive wave is to make progress in the favor of market trend.

Mr. Ralph Elliott further discovered that in price terms, wave 3 is often the longest and never the shortest among the three actionary waves (1, 3 and 5) of a motive wave. As long as wave 3 undergoes a greater percentage movement than either wave 1 or 5, this rule is satisfied.

Motive waves further sub-divides into two types.

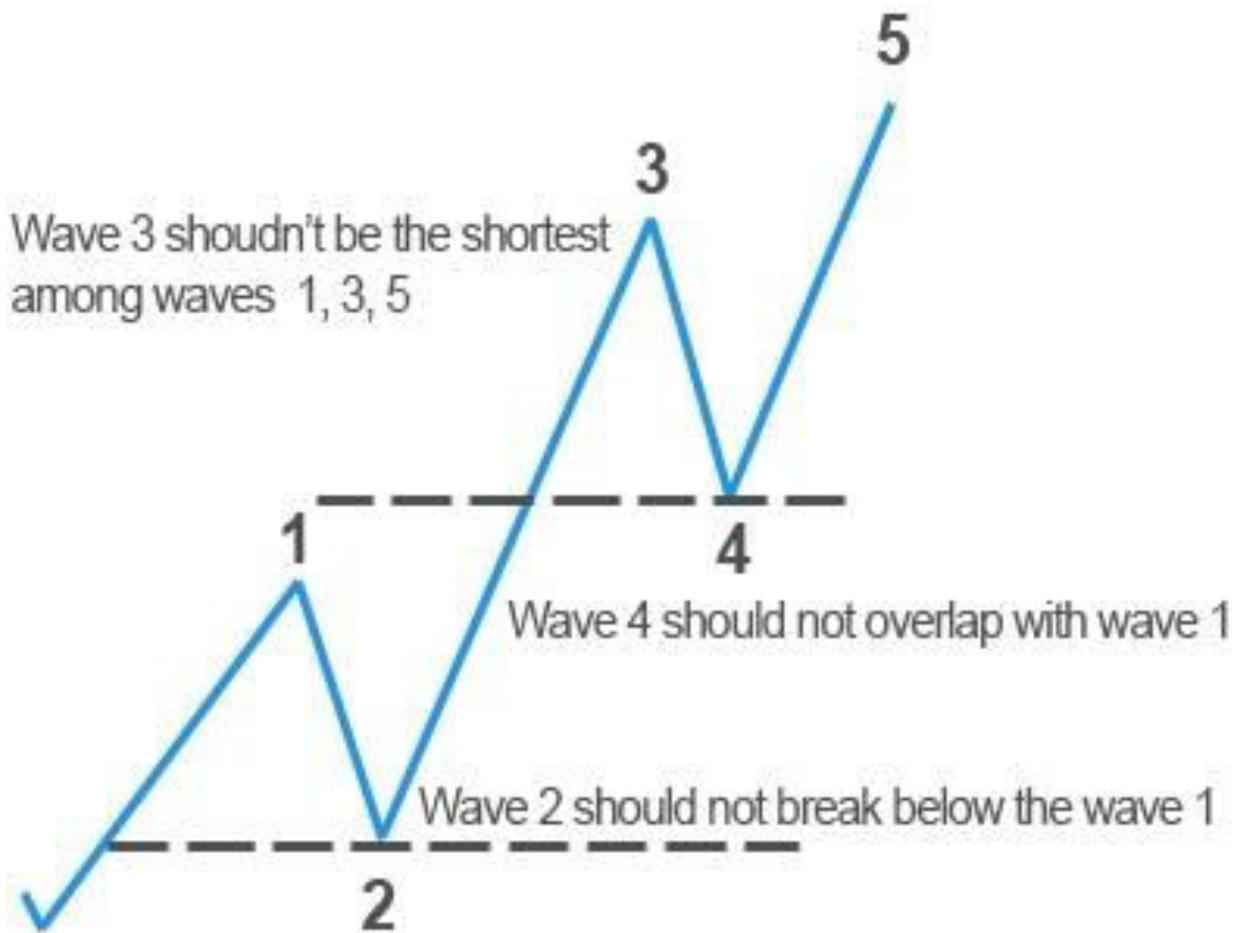
- i - Impulse wave
- ii - Diagonal (leading and ending)

i - Impulse Wave

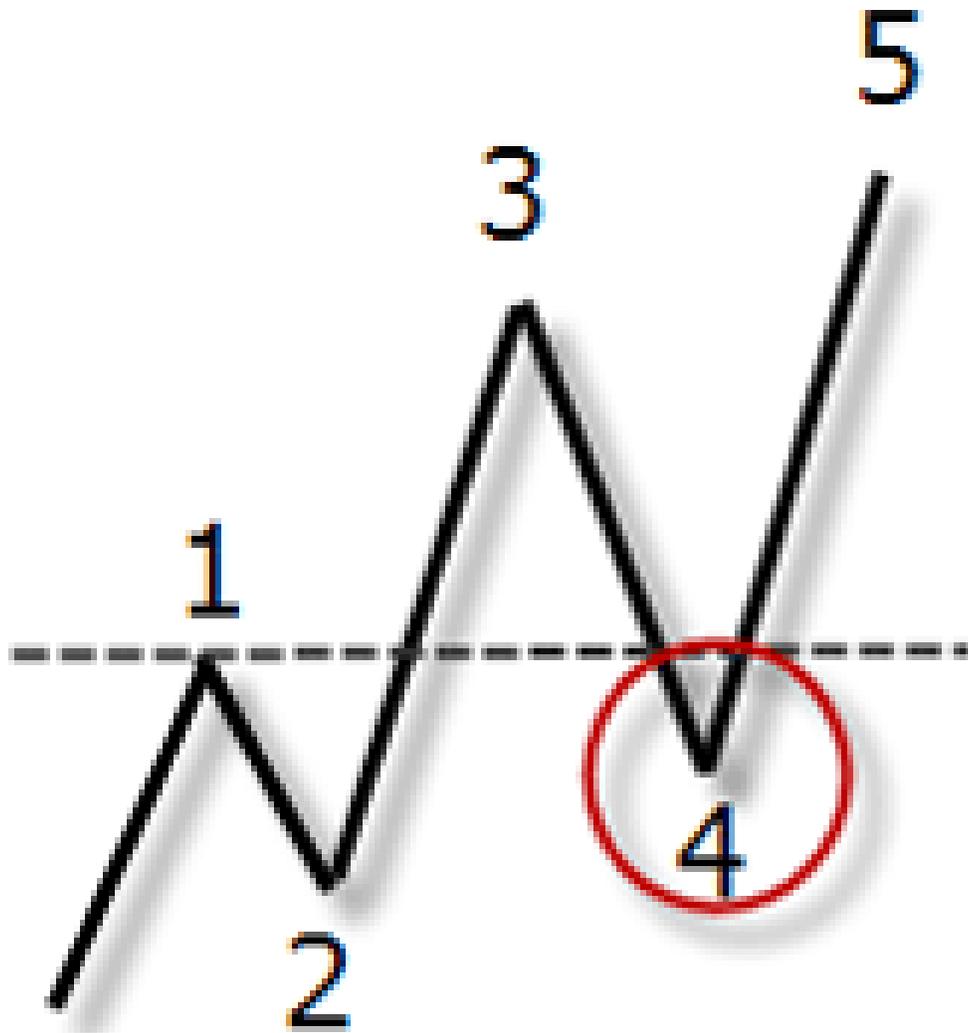
What is an impulse wave? Impulse wave moves in the favour of market trend. Impulse wave consists of 1, 2, 3, 4 and 5 waves pattern. This is usually straight forward and shows clear bullish and bearish price action. Impulse wave is the most common motive wave, regularly seen on all price charts of different currency pairs. Impulse wave does not show any kind of overlap in price. I will show an example of overlap in coming pages.

There are three main rules that every Elliott wave practitioner should learn by heart.

- 1) Wave 2 never moves beyond the start of wave 1.
- 2) Wave 3 is never the shortest wave.
- 3) Wave 4 never enters the price territory of wave one.

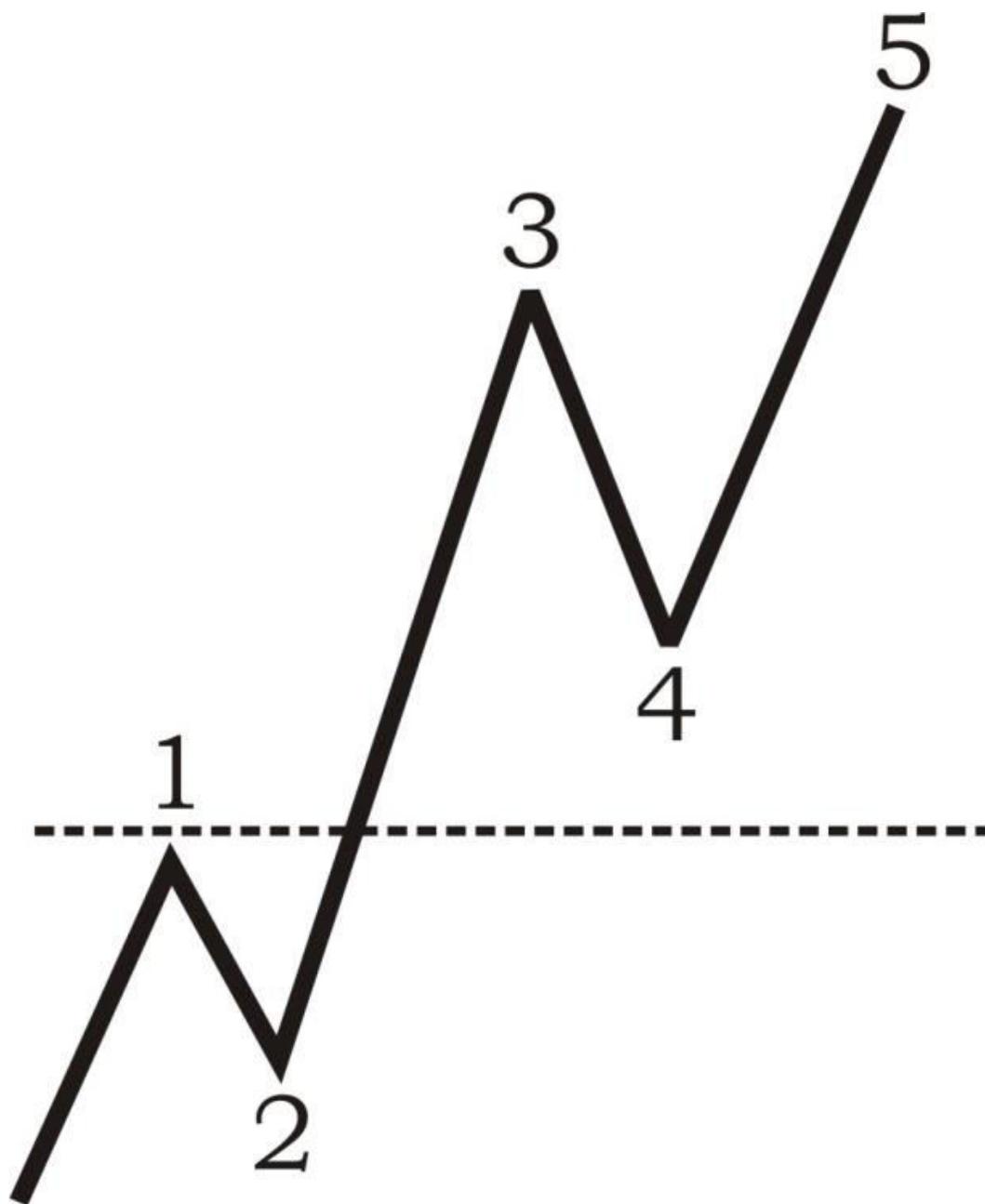


Note: Traders who are not following above rules are practicing something else, not Elliott wave principle.



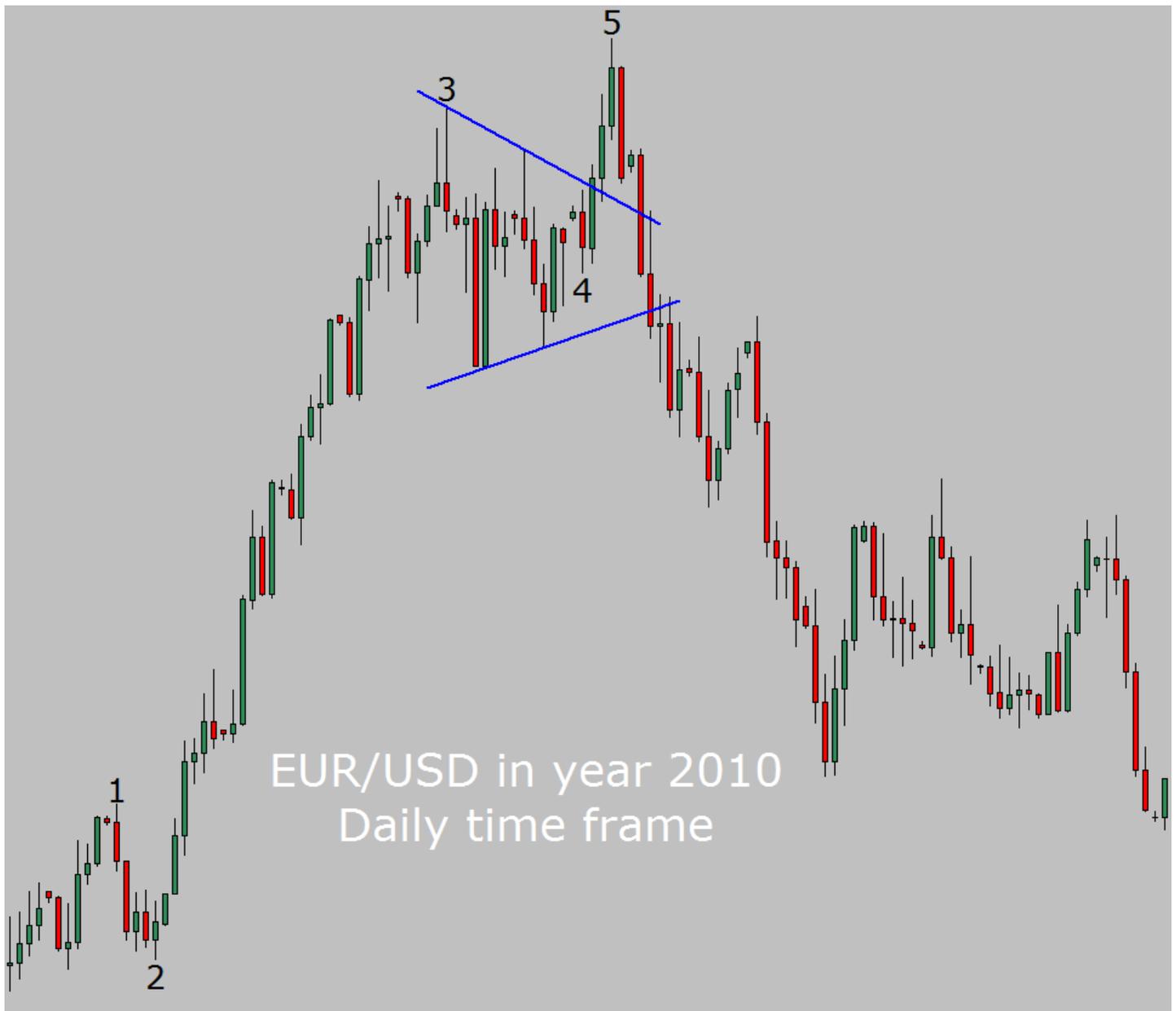
Above diagram is an in-correct impulse wave pattern. **"Overlap"** in price is not allowed!

In an impulse wave pattern, wave four does not enter the price territory of wave one. So, above diagram is an in-correct impulse wave pattern.



Correct impulse wave pattern. "Overlap" in wave four is not present. So, above diagram is a correct impulse wave pattern.

A real life bullish impulse wave example



Notice how EUR/USD price action followed the Elliott wave rules.

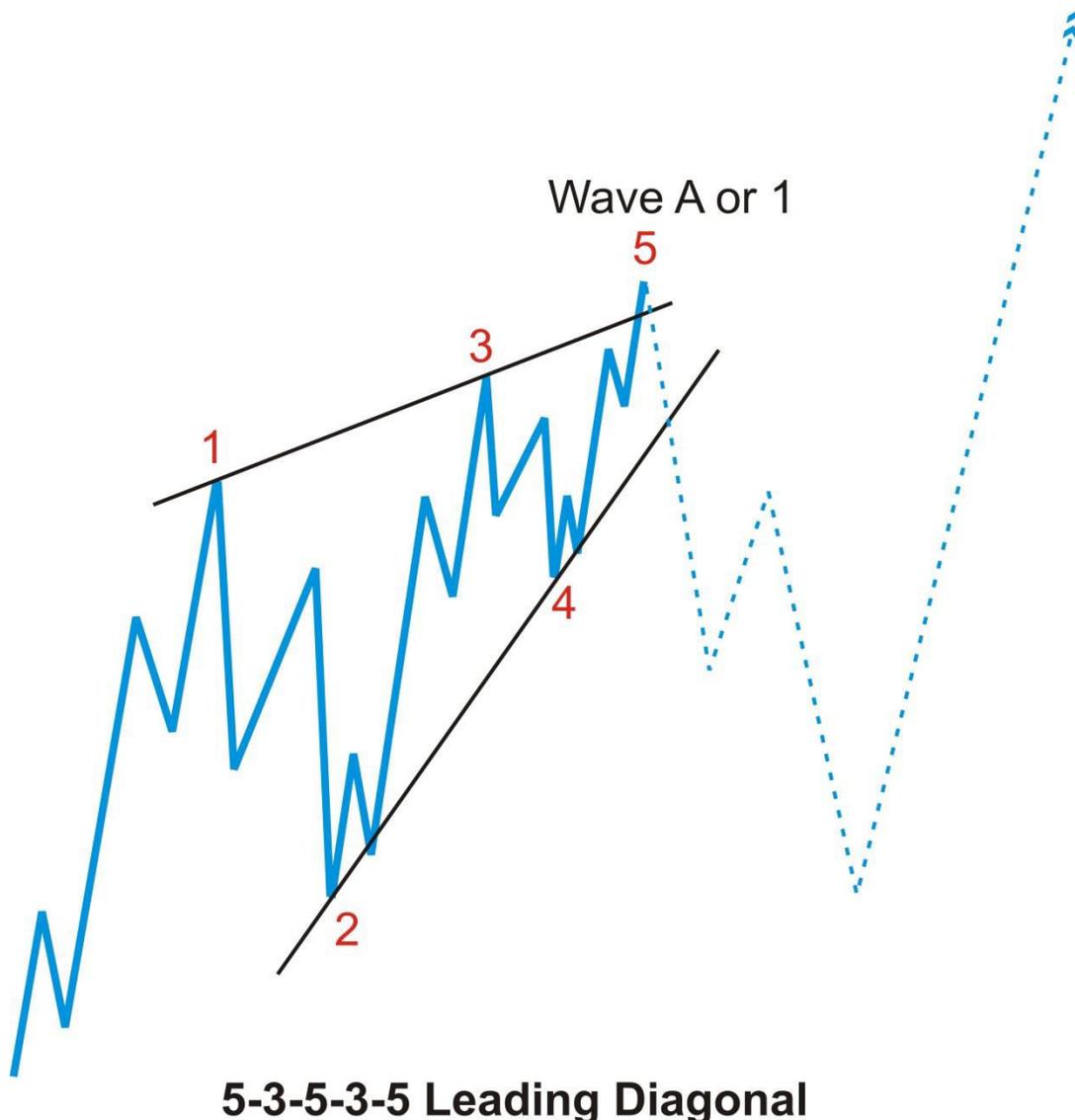
- 1) Wave 2 never moves beyond the start of wave 1.
- 2) Wave 3 is never the shortest wave.
- 3) Wave 4 never enters the price territory of wave one.

ii- Diagonal

What is a diagonal? A diagonal is a motive wave pattern yet not an impulse. A diagonal is the only 5 wave structure in the direction of the main trend within which wave four always move into the price territory of wave one (i.e., overlaps). There are two main types of Diagonal pattern.

1. Leading diagonal.
2. Ending diagonal.

Below is a picture of a leading diagonal pattern.



Notice the waves 1, 2, 3, 4 and 5 movements and subdivisions. Wave 1, 3 and 5 subdivided into five wave structure. Wave 2 and 4 subdivided into three wave structure. Now, look at wave 4 closely as wave 4 did enter the price territory of wave 1. In terms of Elliott wave we call it an overlapping price action. After the completion of wave 5 movement, expect a bearish pull back and then the resumption of up trend, based on above pattern. Leading diagonal pattern only appears at specific Wave A or Wave 1 position.

Now, let me show you a picture of an ending diagonal.



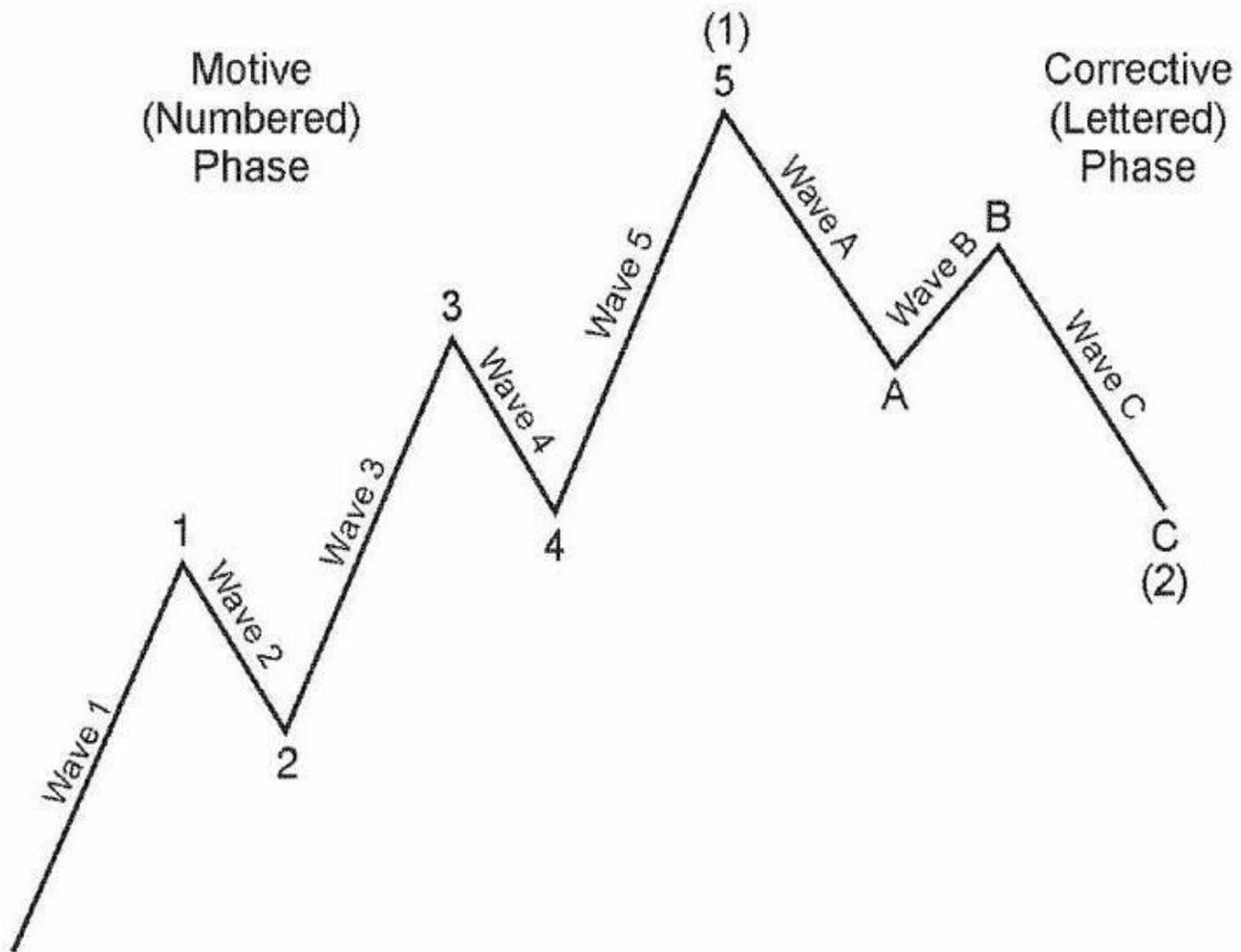
An Ending diagonal pattern occurs primarily in the fifth wave position of an impulse wave. Meaning wave number 5 becomes an ending diagonal and all the smaller sub-waves of wave number 5 sub-divides into 3 wave zig zag structure. On rare occasion, ending diagonal also appears in the C wave position of A, B and C formations. After the completion of wave 5 movement, expect a bearish reversal in price based on above pattern.

Important point note is that both leading and ending diagonal patterns show converging trend lines as shown inside above diagrams.

Corrective Waves

What are corrective wave? After impulse wave 1, 2, 3, 4 and 5, price creates a pull back which is known as corrective wave pattern or correction.

ELLIOT WAVE BASIC PATTERN



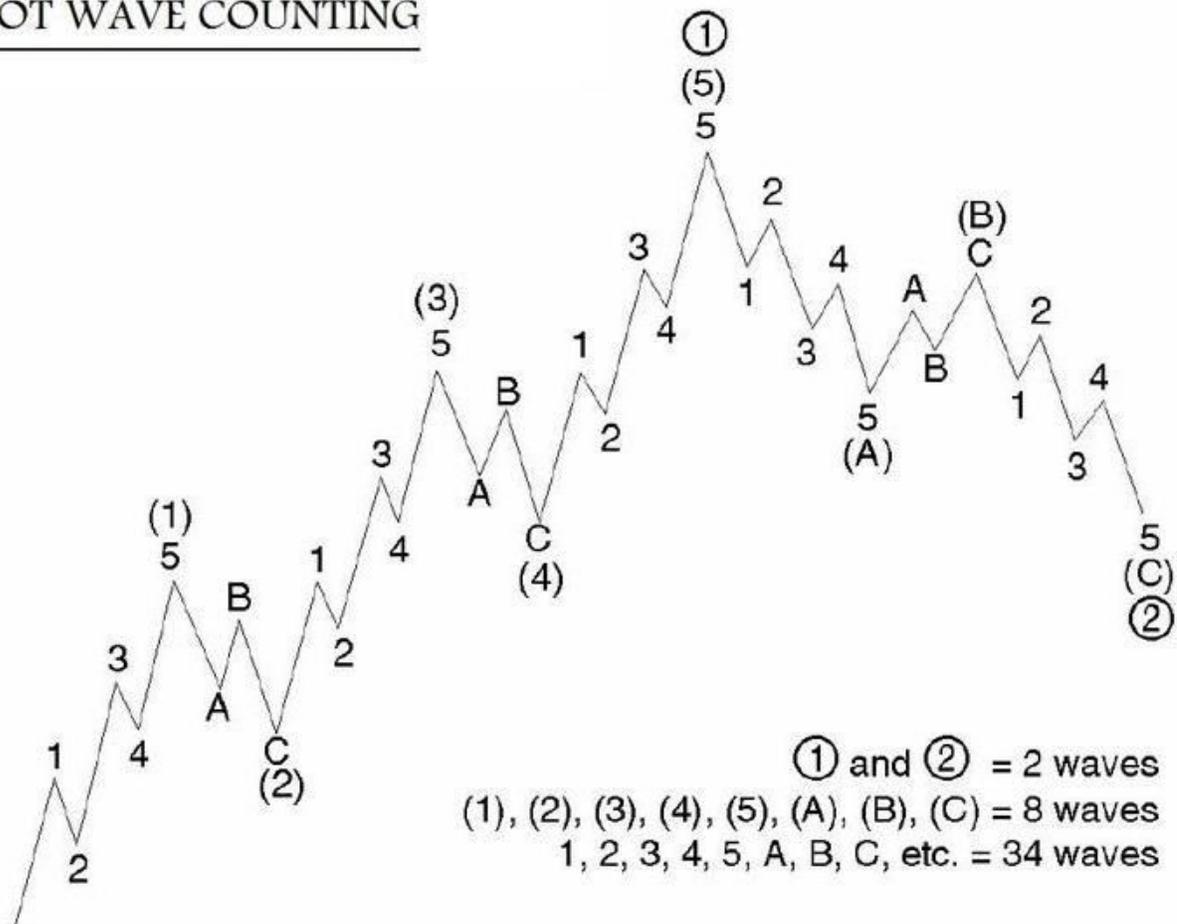
In terms of Elliott wave principle, this pullback corrects the previous price action. We use English language alphabets/letters to label the three waves pull back as Wave A, B and C. If you closely look at corrective letter phase, wave A and C are actionary

waves because these are moving in the favor of down trend to complete wave (2). Whereas, wave B corrects wave A and creates a pullback in price.

When an initial 8 waves cycle; wave (1) to wave (2) ends, a similar cycle ensues, which is then followed by another 5 waves bullish movement. In case of a downtrend, we get another five waves bearish movement. This entire development produces a five wave pattern of one degree larger than the wave of which it is composed.

There are different types of pullbacks. In Elliott wave, we call them corrective waves or three waves. Important point to note is that corrective wave patterns never sub-divide into five wave structure.

ELLIOT WAVE COUNTING



See the above diagram, which shows all the sub-divisions of bullish five wave impulse and after that three wave bearish corrective pattern. This five wave pattern of larger degree is later corrected by a three wave pattern of the same degree, completing a greater full cycle, as shown in above diagram.

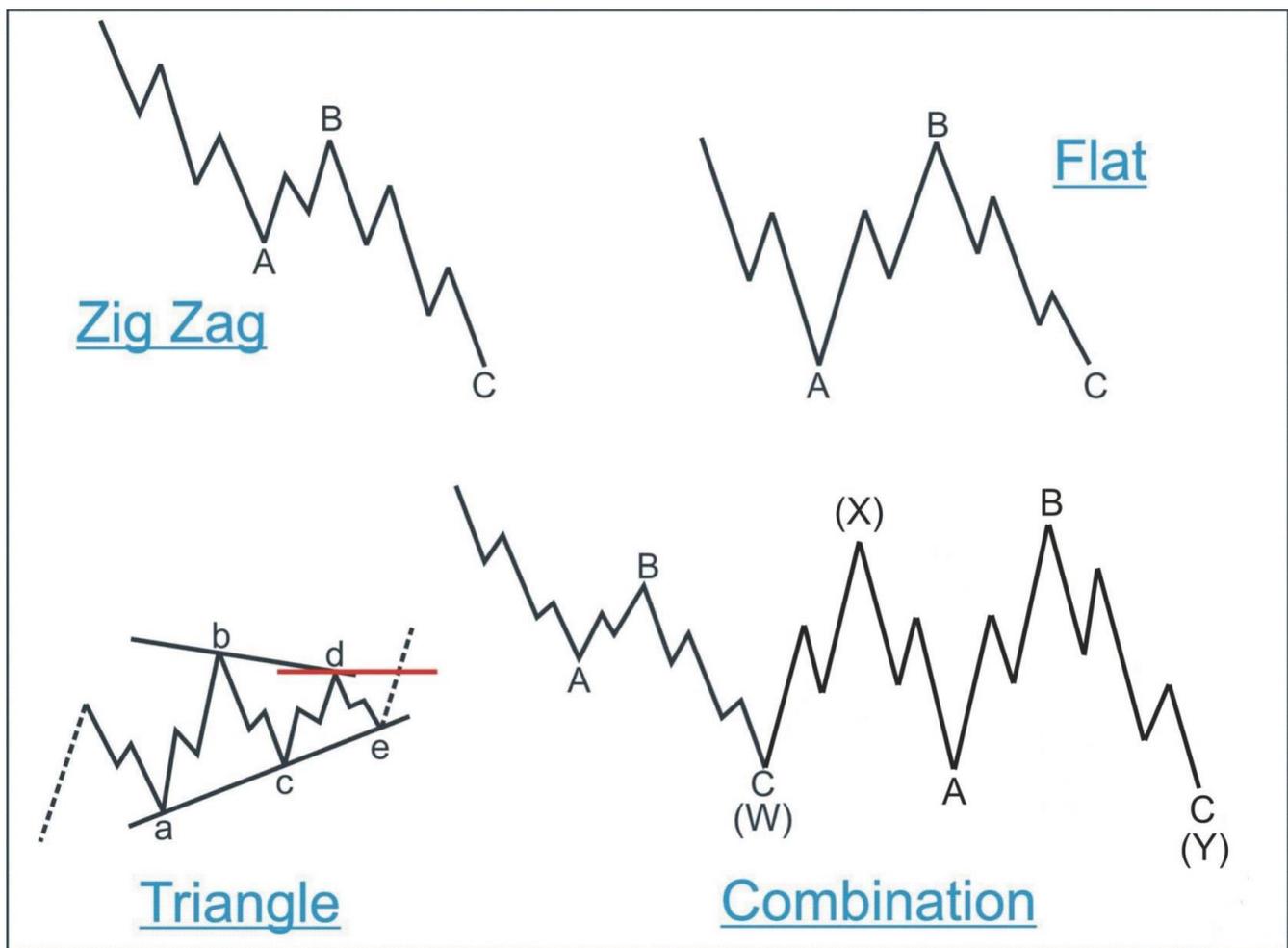
To summarize above points: trend moves occur in five wave impulse pattern. Within the trend moves, price creates corrective wave or pullback which corrects the trending moves.

Waves, 1, 3, 5, A and C moves in the favor of market trend of one higher time frame or higher degree. Waves 2, 4 and B moves against the market trend or creates a pull back.

There are four main types of corrective waves:

1. Zig Zag
2. Flat
3. Triangle
4. Combination

After an impulse wave pattern, expect a corrective wave pattern in the form of a pull back.



After the completion of a corrective wave pattern, expect another impulsive wave pattern. The pull back wave could be a Zig Zag or Flat or Triangle or combination of any of these corrective wave patterns.

So, the rhythm of market is five waves, followed by three waves. After three waves (corrective wave pattern) five waves appear again which moves in the favor of market trend.

You can say that price action shows sharp and quick moves (impulse wave) and then there is a pause (corrective wave). After a pause in price action, market resumes the price action and moves in the favour of original trend.

Elliott wave trading examples

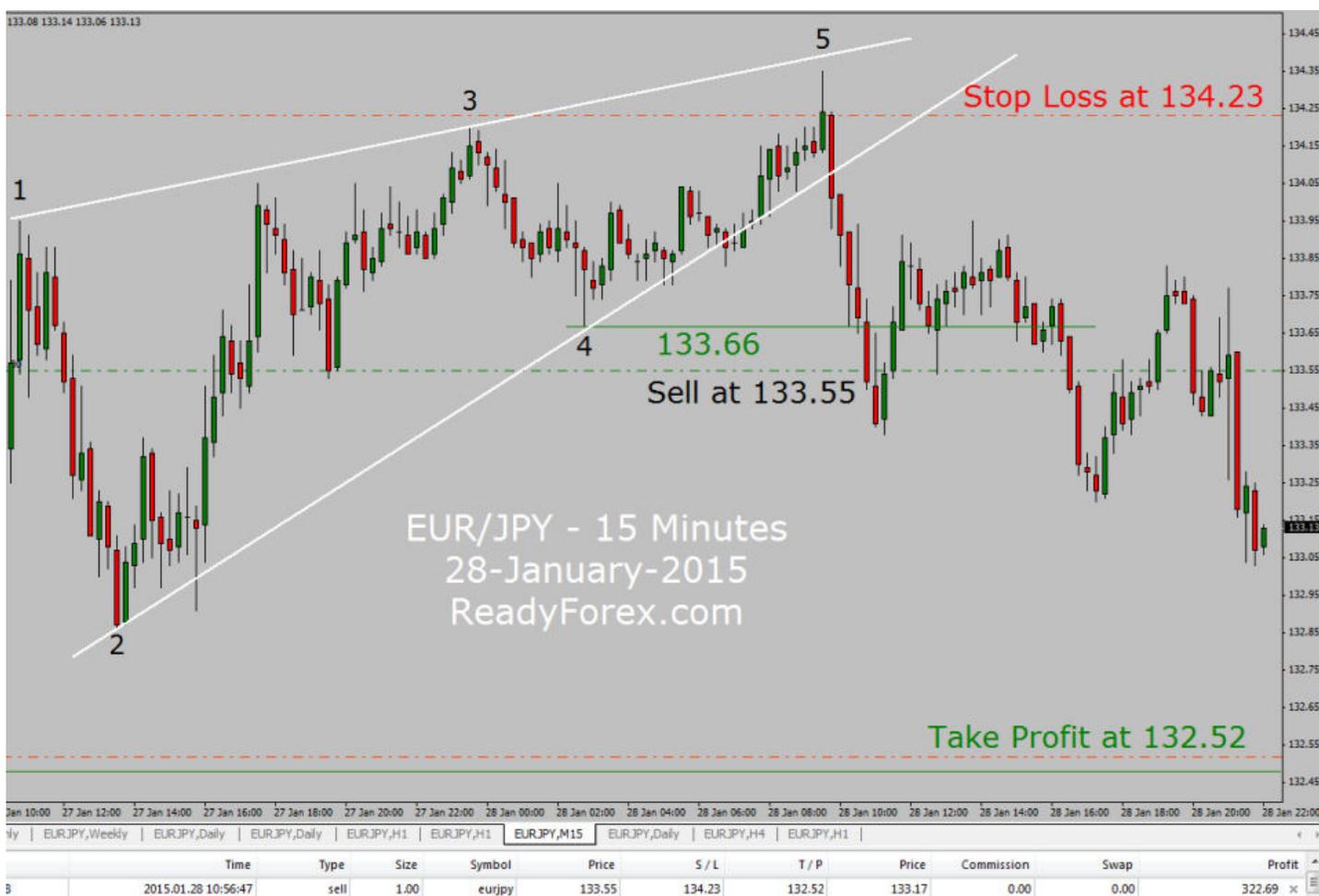
Example number: 1

Currency pair: EUR/JPY

Time frame: 15 minutes chart

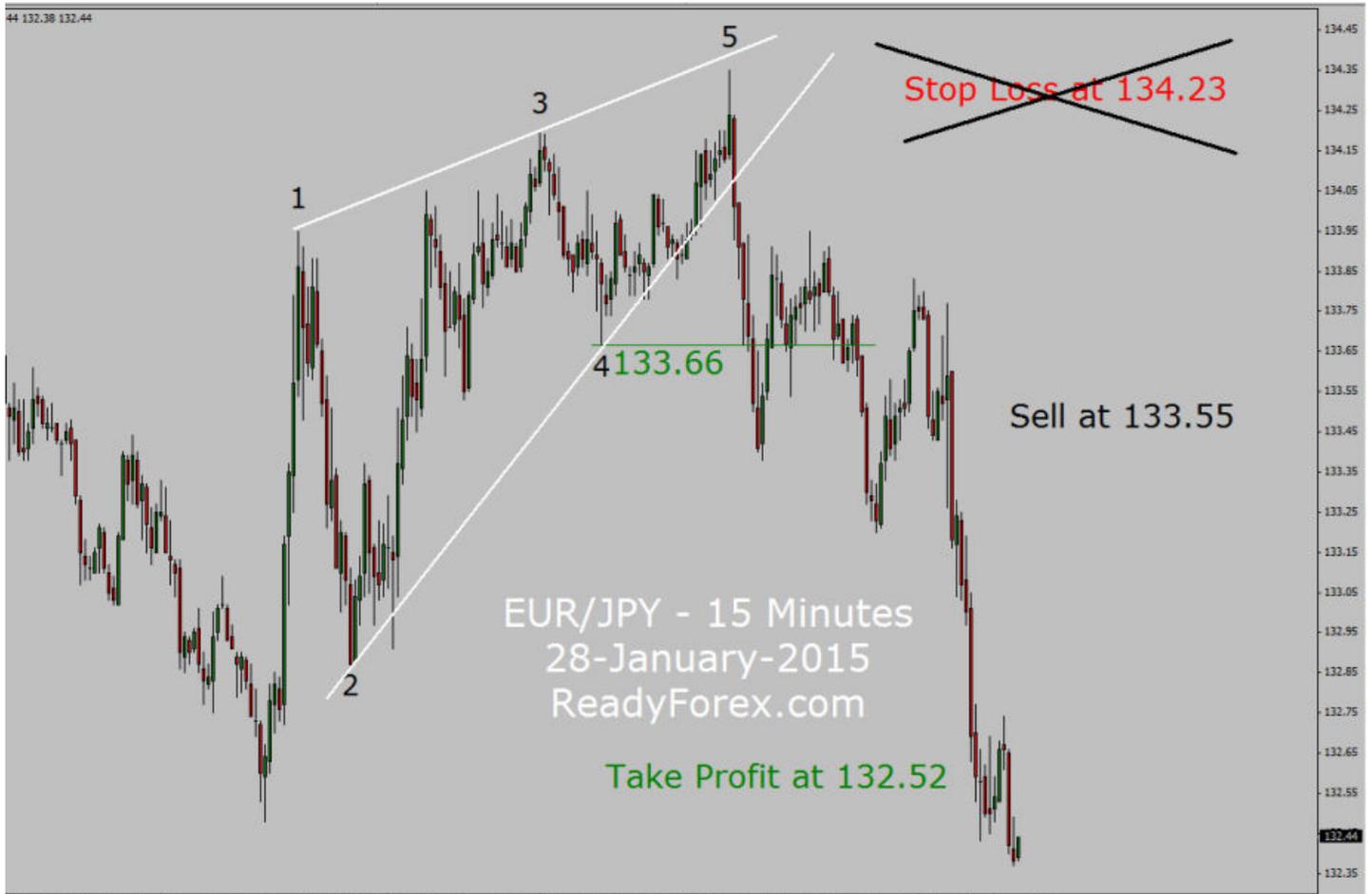
Date: 28-January-2015

Sell trade result: +103 pips profit.

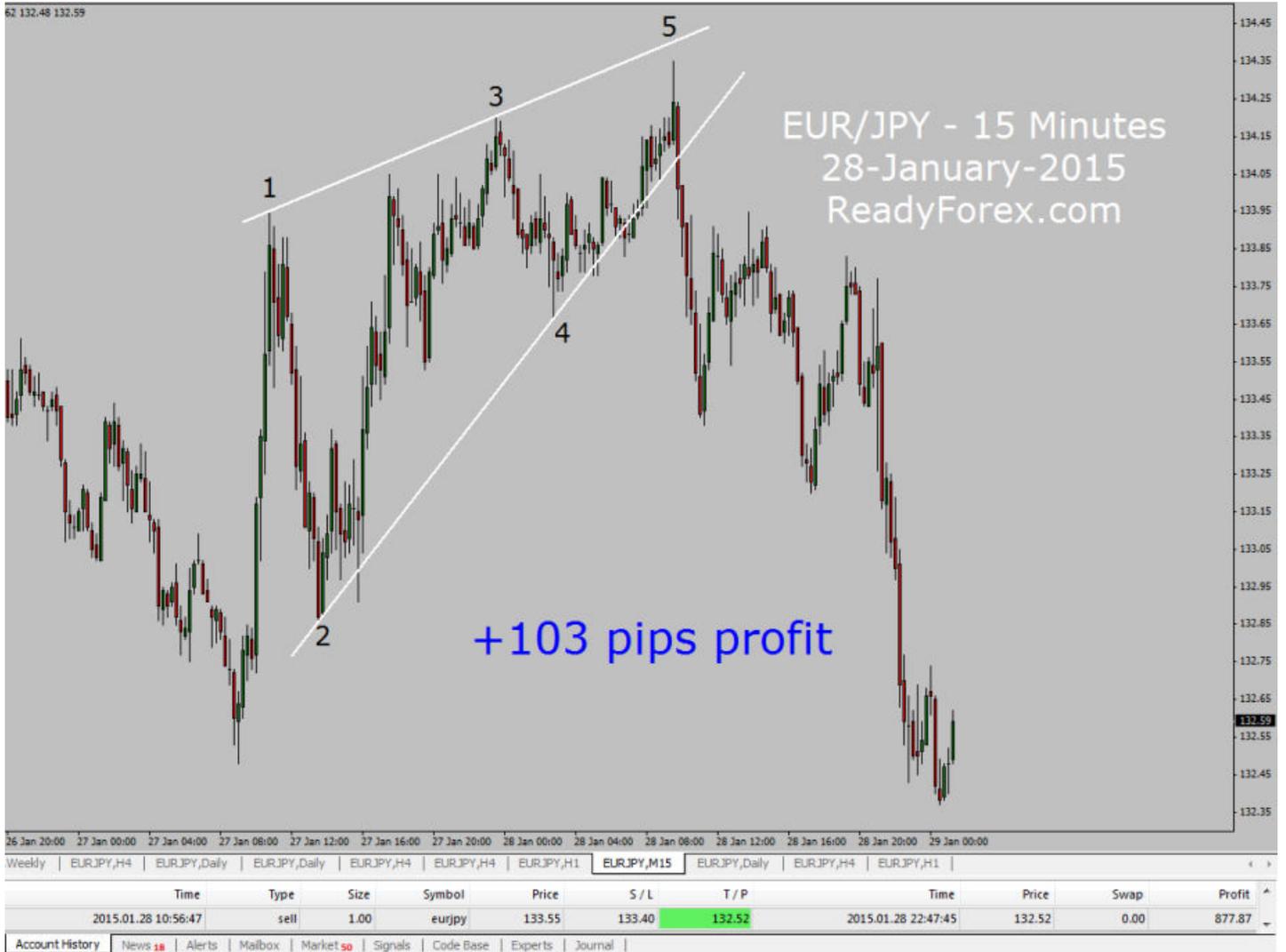








Time	Type	Size	Symbol	Price	S / L	T / P	Time	Price	Swap	Profit
2015.01.28 10:56:47	sell	1.00	eurjpy	133.55	133.40	132.52	2015.01.28 22:47:45	132.52	0.00	877.87



Example number: 2

Currency pair: GBP/USD

Time frame: 1 hour chart

Date: 4-March-2015

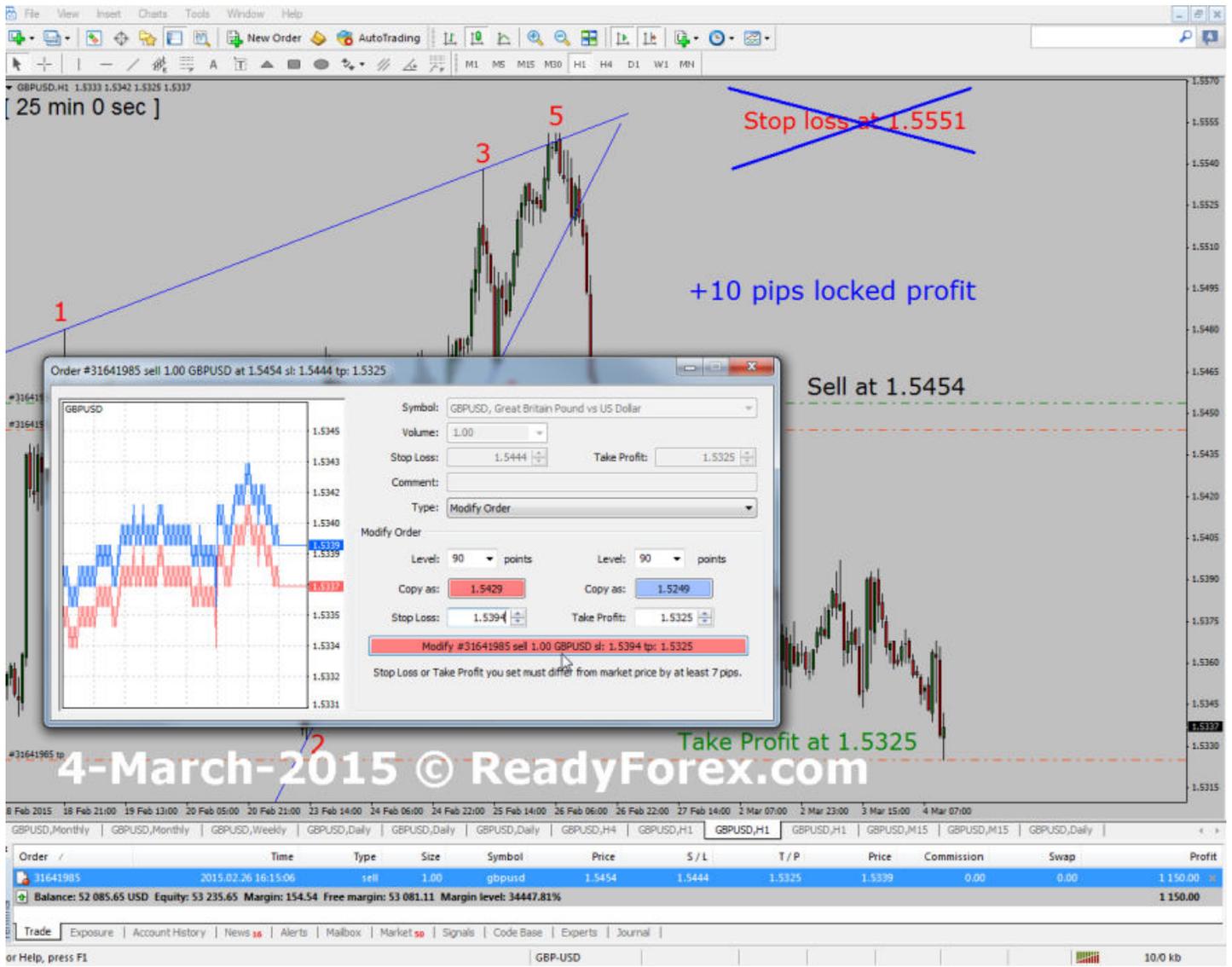
Sell trade result: +129 pips profit.

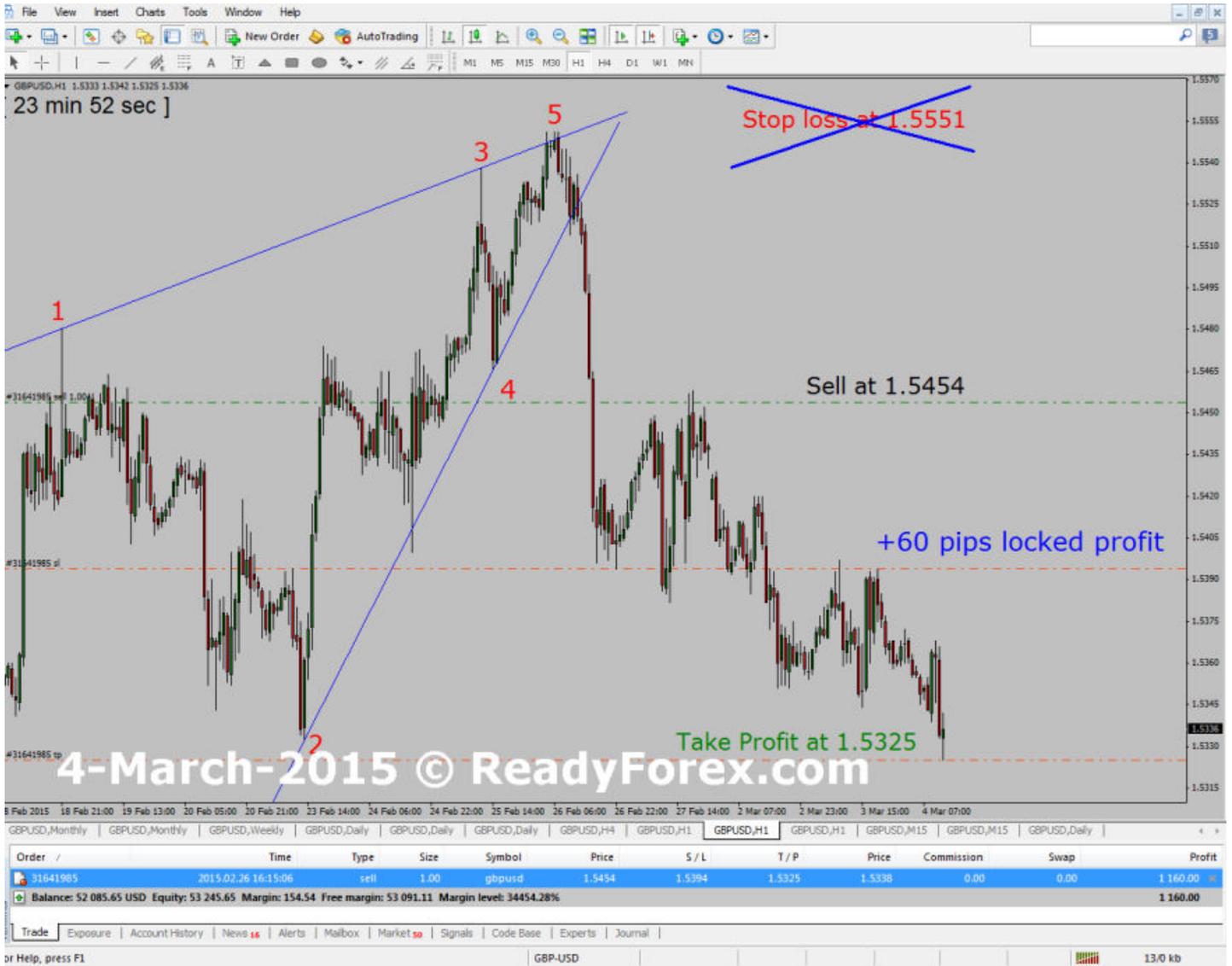


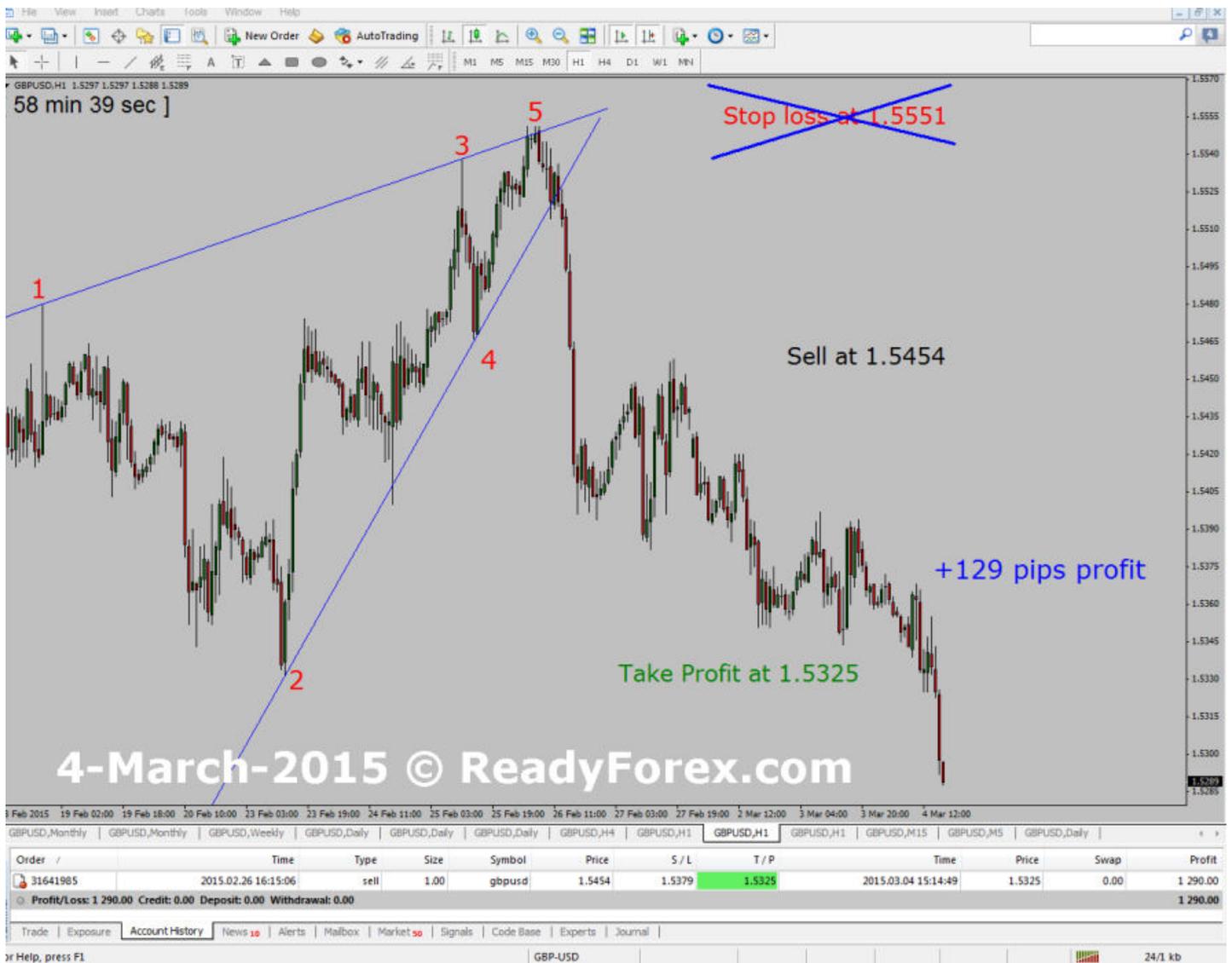












For more Elliott wave trading examples visit following link:

<http://www.readyforex.com/Trading-With-Elliott-Wave.php>

Summary

Elliott Wave Theory is a wide subject. It is not easy for beginners and novice traders. However; it will become easy for any Forex trader who invests his time, effort and money to learn Elliott wave patterns. In my judgement, traders need to learn Elliott wave under the guidance of an Elliott wave expert and experienced teacher. Next, practice trading to gain some experience in Forex market. Without proper education, practice and trading experience it is not easy to make money via Forex trading.

There are some important trading and investment factors, which I have not talked about in this e-book that are mandatory to make consistent profit in Forex trading business; such as money management, trading psychology, risk control, patience and discipline, which are out of scope of this e-book.

I call it freedom!

Elliott wave patterns work in almost all time frames and in all Spot Forex currency pairs with same forecasting and trading rules. It is like a universal trading formula and all you need to do is; just learn it once. Next thing you will know; you can forecast and trade Spot Forex currency pairs, Commodities, Indices, ETFs, CFDs and Options etc. Elliott wave theory helps you to trade your favorite trading instrument and any time frame of your choice!

How Elliott wave theory helped me?

Despite, losing money several times in past, I never forgot the lessons learnt during this tough journey. When I started learning Elliott wave and “Pure Technical Analysis” approach to trade Forex market, a lot of people called me crazy that how come I can possibly forecast future price direction of any currency pair. Many traders insisted on the importance of NEWS in trading but I chose the absolute opposite path. I did not care about any kind of NEWS in trading and succeeded in making big profits out of the Forex trading market.

It is been 11 years now, since I started learning forecasting and trading with Elliott wave. To me; Forex market was like a puzzle, which could reap me profits only, if I managed to solve it. I must mention that I seriously invested a lot of my time, money, effort and hard work to learn trading with Elliott wave and to solve my personal Forex trading issues.

I have written innumerable trading diaries and Forex journals to review my trading performance. I back tested and forward tested different bullish and bearish Elliott wave patterns to see which one works in favor and which proves otherwise. I have designed and created my very own proprietary Elliott wave calculator in Microsoft Excel. Not to forget that, I created many Elliott wave diagrams of buy and sell trade setups to remind myself about trading opportunities. Indeed, it is great to look back and cherish what I have accomplished so far!

For future, I hope to continue using Elliott wave patterns to trade and forecast Spot Forex currency pairs. My trading has proven to be profitable with the help of Elliott wave patterns and my Forex trading accounts have grown over the time.

To me, trading and money making opportunities are endless in the world of Forex market. Elliott wave trading patterns work in all time frames and are best suitable for Scalping, Day trading, Medium term trading and Position trading.

I have a lot of faith and confidence in trading with Elliott wave theory. It is the best forecasting and trading tool to analyze and trade Spot Forex currency pairs. I love what I do and hopeful that it will bring better Forex trading opportunities in time to come.

Hope this book guides you in the best possible right way and I wish you all the best of luck with your Forex trading endeavors!

Mr. Muhammad Azeem - Elliott Wave Analyst & Trader

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