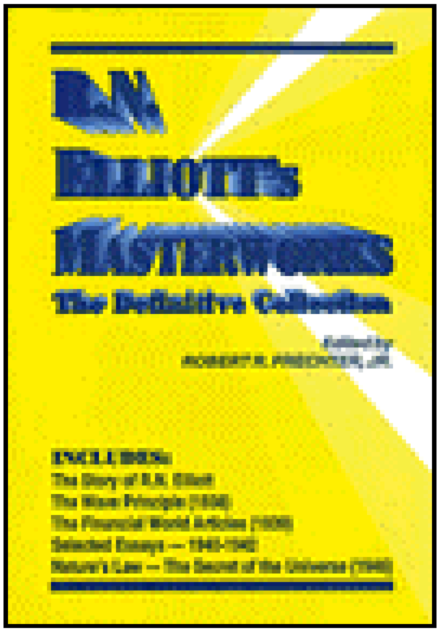

R. N. Elliot's Masterworks: The Definitive Collection (1994), Robert Prechter.

Science reveals order. Cycles are all around us in the world in which we live. Day and night. Summer and winter. Rain and vaporization. And yet we are told that markets random, and therefore, we cannot anticipate their direction. Is this true? Or are there patterns that can teach us more about risk?

Marconi saw cycles in electrical waves, Bell in sound waves, and Edison in light waves. These great scientist and their discoveries of wave patterns trace their roots back to Leonardo Fibonnaci in the 1200's. Fibonnaci discovered mathematical patterns throughout nature. His Fibonnaci Sequence relates closely to the Golden Ratio and Phi.

We have seen that markets do not follow the normal bell curve distribution. Let us now look to see if there is some sort of pattern in the markets. I find the commonalities between the findings of Fibonnaci, Elliot, and Mandelbrot to be fascinating.

What was a time of great pain for Elliot, suffering a debilitating illness and an almost total loss of financial resources, became a time of great discovery that he would leave for future investors. Initially provoked to study the markets by the crash of 1929, Ralph Elliot found recurring market patterns and expanded his search, examining over 75 years of data. Ironically, he would read Robert Rhea's (the leading Dow Theorist of the time who called the end of the stock market decline in 1932) book on Dow Theory in 1932.

His discovery of wave patterns became widely known by the late 1930's. In fact, by 1938 he had an office in New York where he began managing money and writing *"The Wave Principle"*, a newsletter based on his findings. In the simplest of explanations, the theory goes as follows. All markets and individual securities move in wave patterns with five parts. Impulse waves (1,3, and 5) move in a primary direction while corrective waves (2 and 4) move counter to the primary trend. This 5 wave movement is then followed by a larger corrective movement of 3 waves (A, B, and C). Each pattern contains a smaller pattern within it and is part of a larger pattern itself, much the same way as nine small squares can be arranged to make one large square. This repeating pattern is called a fractal.

Though the 2002 Investment Planning textbook of the College for Financial Planning makes no mention of Wave Theory (and only cursory mention of Dow Theory), it has been used since the 1930's. Even the *"Bank Credit Analyst"*, an institutional research publication that still is highly regarded today, studied Elliot's Wave Principle and published an Elliot Wave Supplement each year for over a decade.

While there will always be a lot of criticism for Wave Theory and Dow Theory, there can be no argument that the writings have had a major influence on the world of trading for decades. Though traders may use other tools and indicators, most remain conscience of Fibonnaci retracement levels and Dow Theory trend indicators. It is my opinion that they greatly assist in understanding risk in the overall markets; something that indexing does not.

Doug Wakefield

Digitally signed by Doug Wakefield
DN: CN = Doug Wakefield, C = US, O = Best Minds, Inc.
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