Wyckoff Schematics: Visual templates for market timing decisions

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Introduction

This article will explain and discuss applications of the Three Schematics used in the Wyckoff Method of Technical Analysis. It will build upon and extend the "Wyckoff Laws and Tests" article that appeared in the STA's journal in November 2004 (Issue No 51). That article examined the first part of the Wyckoff Equation — the analytical, digital half which consists of "check lists" for the "three laws" and "nine tests". The Wyckoff Schematics will complete the Wyckoff picture by introducing students of technical analysis to the visual half of the Wyckoff equation.

For each of the three Schematics — one for accumulation and two for distribution — there will be an idealised representation of the Schematic. On top of each Schematic there will appear alphabetical and numerical annotations that refer to Wyckoff's interpretations of key phases and junctures found during the evolution of accumulation or distribution. Many of these annotations reflect the work of Mr. Robert G. Evans. It was Mr. Evans who carried on the teaching of the Wyckoff Method after the death of Mr. Wyckoff in 1934. Mr. Evans was a creative teacher who was a master at explaining Wyckoff via analogies. The Schematic principles will then be applied to charts of Nokia. (These were real-time charts used by the authors during conferences in Stockholm, Sweden in October 2004 and in Malmo, Sweden during June 2005.

Finally, this article will explain how the use of Wyckoff Schematics may be extended. The authors have long observed that an accumulation schematic had been missing. This missing schematic would be the accumulation counterpart of the distribution schematic of declining types within a trading range. A new schematic for accumulation has, therefore, been developed to fill the gap in Wyckoff schematics.

1. ACCUMULATION and DISTRIBUTION

An objective of the Wyckoff Method of technical analysis is to improve market timing when establishing a speculative position in anticipation of a coming move where a favourable reward/risk ratio exists to justify taking that position. Trading Ranges (TRs) are places where the previous move has been halted and there is relative equilibrium between supply and demand. It is here within the TR that campaigns of accumulation or distribution develop in preparation for the coming move. It is this force of accumulation or distribution that can be said to build a base which unfolds in the subsequent move. The building up of the necessary force takes time and because during this period the price action is well defined, trading ranges present particularly good trading opportunities with potentially very favourable reward/risk parameters. To be successful, however, we must be able to correctly anticipate the direction and magnitude of the coming move out of the trading range. Fortunately, Wyckoff offers us some guidelines and models by which we can examine a trading range.

ACCUMULATION

Schematic 1 is a basic Wyckoff model for accumulation. While this basic model does not offer a schematic for all the possible variations in the anatomy of the TR, it does provide a representation of the important Wyckoff principles, often evident in an area of accumulation, and the identifiable phases used to guide our analysis through the TR toward our taking of a speculative position.

Phase A

In Phase A, supply has been dominant and it appears that finally the exhaustion of supply is becoming evident. This is illustrated in Preliminary

SCHEMATIC 1

Accumulation Schematic

Phases A through E: Phases through which the Trading Range passes as conceptualised by the Wyckoff method and explained in the text.

Lines A and B... define support of the Trading Range.

Lines C and D... define resistance of the Trading Range.

(PS) preliminary Support is where substantial buying begins to provided pronounced support after a prolonged downmove Volume and spread widen and provide a signal that the downmove may be approaching its end.

(SC) Selling Climax... the point at which widening spread and selling pressure usually climaxes and heavy or panicky selling by the public is being absorbed by larger professional interests at prices near a bottom.

(AR) Automatic Rally... selling pressure has been pretty much exhausted. A wave of buying can now easily push up prices which is further fuelled by short covering. The high of this rally will help define the top of the trading range.

(STs) Secondary Test(s)... revisit the area of the Selling Climax to test the supply demand balance at these price levels. If a bottom is to be confirmed, significant supply should not resurface, and volume and price spread should be significantly diminished as the market approaches support in the area of the SC.

The "CREEK" is an analogy to a wavey line of resistance drawn loosely across rally peaks within the trading range. There are of course minor lines of resistance and more significant ones that will have to be crossed before the market's journey can continue onward and upward.

Springs or Shakesouth usually occur late within the trading range and allow the market and its dominant players to make a definitive test of available supply before a markup campaign will unfold. If the amount of supply that surfaces on a break of support is very light (low volume), it will be an indication that the way is clear for a sustained advance. Heavy supply here will usually mean a renewed decline. Moderate volume here may mean more testing of support and to proceed with caution. The spring or shakeout also serves the purpose of providing dominant interests with additional supply from weak holders at low prices.

Jump Across the Creek (JAC) is a continuation of the creek analogy of jumping resistance and is a good sign if done on good spread and volume — a sign of strength (SOS). Sign of Strength (SOS)... an advance on good (increasing) spread and volume. Back Up (BU) to a Last Point of Support (LPS) — a pull back to support (that was resistance) on diminished spread and volume after a SOS. This is good place to initiate long positions or to add to profitable ones.

Note: A series of SOS’s and LPS’s is good evidence that a bottom is in place and Price Markup has begun.


Support (PS) and the Selling Climax (SC) where widening spread often climaxes and where heavy volume or panicky selling by the public is being absorbed by larger professional interests. Once selling pressure is exhausted, an Automatic Rally (AR) ensues the selling climax. A Secondary Test on the downside usually involves less selling than on the SC and with a narrowing of spread and decreased volume. The lows of the Selling Climax (SC) and the Secondary Test, and the high of the Automatic Rally (AR) initially set the boundaries of the trading range. Horizontal lines may be drawn here to help to focus attention on market behaviour in and around these areas.

It is also possible that Phase A can end without dramatic changes in spread and volume. However, it is usually better if it does, in that more
dramatic selling will generally clear out all the sellers and pave the way for a more pronounced and sustained markup.

Where a TR represents a Reaccumulation (a trading range within a continuing upmove), we will not have evidence of PS, a SC, and ST as illustrated in phase A of ????

Schematic 1
Phase A will instead look more like Phase A of the basic Wyckoff distribution schematic (described later in the article under Schematic 2 or 3) but, nonetheless, Phase A still represents the area of the stopping of the previous move. The analysis of Phase B through E would generally proceed in the same way as within an initial base area of accumulation.

Phase B
In Phase B, Supply and Demand on a major basis are in equilibrium and there is no decisive trend. The clues to the future course of the market are usually more mixed and elusive, however here are some useful generalisations.

In the early stages of Phase B, the price swings tend to be rather wide, and volume is usually greater and more erratic. As the TR unfolds, supply becomes weaker and demand stronger as professionals are absorbing supply. The closer you get to the end or to leaving the TR, volume tends to diminish. Support and resistance lines, (shown as horizontal lines A, B, C, and D on the Accumulation Schematic 1) usually contain the price action in Phase B and will help define the testing process that is to come in Phase C. The penetrations or lack of penetrations of the TR enable us to judge the quantity and quality of supply and demand.

Phase C
In Phase C, the stock goes through a testing process. The stock may begin to come out of the TR on the upside with higher tops and bottoms or it may go through a downside spring or shakeout, breaking previous supports. This latter test is preferred, given that it does a better job of cleaning out remaining supply from weak holders and creates a false impression as to the direction of the ultimate move. Schematic 1 shows us an example of this latter alternative.

A spring is a price move below the support level of a trading range that quickly reverses and moves back into the range. A spring is an example of a "bear trap" because the drop below support appears to signal resumption of the downtrend. In reality, though, the drop marks the end of the downtrend, thus "trapping" the late sellers, or bears. The extent of supply, or the strength of the sellers, can be judged by the depth of the price move to new lows and the relative level of volume on that penetration.

Until this testing process, we cannot be sure the TR is accumulation and must wait to take a position until there is sufficient evidence that mark-up is about to begin. If we have waited and followed the unfolding TR closely, we have arrived at the point where we can be quite confident of the probable upward move. With supply apparently exhausted and our danger point pinpointed, our likelihood of success is good and our reward/risk ratio favourable.

The shakeout at point 8 on our Schematic 1 represents our first prescribed place to initiate a long position. The secondary test at point 10 is better, since a low volume pullback and a specific low risk stop or danger point at point 8 gives us greater evidence and more confidence to act. A sign of strength (SOS) here will bring us into Phase D.

Phase D
If we are correct in our analysis and our timing, what should follow here is a consistent dominance of demand over supply as evidenced by a pattern of advances (SOSs) on widening spreads and increasing volume, and reactions (LPSs) on smaller spreads and diminished volumes. If this pattern does not occur, then we are advised not to add to our position and to look to close our original position until we have more conclusive evidence that markup is beginning. If the market or stock progresses as stated above, then we have additional opportunities to add to our position.

Our aim here is to initiate a position or add to our position as the stock or commodity is about to leave the trading range. At this point, the force of accumulation has built a good potential and could be projected by using the Wyckoff point and figure method.

We have waited until this point to initiate or add to our positions in an effort to increase our likelihood of success and maximise the use of our trading capital. In Schematic 1, this opportunity comes at point 12 on the "pullback to support" after "jumping resistance" (in Wyckoff terms this is known as "Backing Up to the Edge of the Creek" after "Jumping Across the Creek"). Another similar opportunity comes at point 14, a more important point of support and resistance. (See Side Bar).

In Phase D, the mark-up phase blossoms as professionals begin to move into the stock. It is here that our best opportunities to add to our position exist, before the stock leaves the TR.

Phase E
In Phase E, the stock leaves the TR and demand is in control. Setbacks are unpronounced and short lived. Having taken our positions, our job here is to monitor the stock's progress as it works out its force of accumulation. At each of points 8, 10, 12, and 14 we may take positions and use point and figure counts from these points to calculate price projections and help us to determine our reward/risk prior to establishing our speculative position. These projections will also be useful later in helping us target areas for closing or adjusting our position.

Remember that Schematic 1 shows us just one idealised model or anatomy of a trading range encompassing the accumulation process. There are many variations of this accumulation anatomy and we addressed some of these considerations earlier. The presence of a Wyckoff principle like a selling climax (SC) doesn't confirm that accumulation is occurring in the TR, but it does strengthen the case for it. However, it may be accumulation, redistribution or nothing. The use of Wyckoff principles and phases identifies and defines some of the key considerations for evaluating most trading ranges and helps us determine whether it is supply or demand that is becoming dominant and when the stock appears ready to leave the trading range.

THE “JUMP” ACROSS THE CREEK* ANALOGY

The term "jump" was first used by Robert G. Evans, who piloted the Wyckoff Associates educational enterprise for numerous years after the death of Richard D. Wyckoff. One of his more captivating analogies was the "jump across the creek" (JAC) story he used to explain how a market would break out of a trading range. In the story, the market is symbolised by a Boy Scout, and the trading range by a meandering creek, with its "upper resistance line" defined by the rally peaks within the range. After probing the edge of the creek and discovering that the flow of supply was starting to dry up, the Boy Scout would retreat in order to get a running start to "jump across the creek." The power of the movement by the Boy Scout would be measured by price spread and volume.

Defining the Jump
A jump is a relatively wider price-spread move made on comparatively higher volume that penetrates outer resistance or support. A backup is a test that immediately follows the jump – a relatively narrow price-spread reaction or rally on comparatively lighter volume that tests and confirms the legitimacy of the preceding jump action.

The Wyckoff method instructs you to buy after a backup following an upward jump (a sign of strength) or to sell short after a backup following a downward jump (a sign of weakness). Also according to Wyckoff, you should not buy breakouts because that would leave you vulnerable to swift moves in the opposite direction if the breakout turned out to be false. Hence, at first glance, the Wyckoff method appears to be telling you to buy into weakness and sell into strength.

DISTRIBUTION

Schematics 2 and 3 represent two variations of the Wyckoff model for distribution. While these models only represent two variations of the many possible variations in the patterns of a distribution TR, they do provide us with the important Wyckoff principles often evident in the area of distribution and the phases of a trading range that can lead us toward taking a speculative position.

Much of the analysis of the principles and phases of a TR preceding distribution are the inverse of a TR of accumulation, in that the roles of supply and demand are reversed.

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Here, the force of “jumping the creek” (resistance) is replaced by the force of “falling through the ice” (support). It is useful to remember that distribution is generally accomplished in a shorter time period than accumulation.

**Phase B**

In Phase A, demand has been dominant and the first significant evidence of demand becoming exhausted comes at point 1 at Preliminary Supply (PSY) and at point 2 at the Buying Climax (BC). (See Schematic 2 and 3.) It often occurs on wide spread and climatic volume. This is usually followed by an Automatic Reaction (AR) and then a Secondary Test (ST) of the BC, usually on diminished volume. This is essentially the inverse of Phase A in accumulation.

As with accumulation, Phase A in distribution may also end without climatic action and the only evidence of exhaustion of demand is diminishing spread and volume.

Where **Redistribution** is concerned (a TR within a larger continuing downmove), we will see the stopping of a downmove with or without climatic action in Phase A. However, in the remainder of the TR the guiding principles and analysis within Phases B through E will be the climactic action in Phase A. However, in the remainder of the TR the guiding principles and analysis within Phases B through E will be the same as within a TR of a Distribution market top.

In Phase B, we are also given more evidence of the probable direction of the market and the opportunity to take our first or additional short positions. Our best opportunities are at points 13, 15, and 17 as presented on our Initial Positions chart. In Phase D, the evidence of supply becoming dominant increases either with a break through the “ice” or with a further SOW into the TR after an upthrust.

In phase B within Accumulation, except clues may begin to surface here of the supply/demand balance moving toward supply instead of demand.

**Phase C**

One of the ways Phase C reveals itself after the standoff in Phase B is by the “sign of weakness” (SOW) shown at point 10 on Schematic 2. This SOW is usually accompanied by significantly increased spread and volume to the downside that seems to break the standoff in Phase B. The SOW may or may not “fall through the ice,” but the subsequent rally back to point 11, a “last point of supply” (LPSY) is usually unconvincing and is likely to be accompanied by less spread and/or volume.

**Point 11 on both distribution Schematics 2 and 3 give us our last opportunity to cover any remaining longs and our first inviting opportunity to take a short position.** An even better place would be on the rally testing point 11, because it may give us more evidence (diminished spread and volume) and/or a more tightly defined danger point.

An upthrust is the opposite of a spring. It is a price move above the resistance level of a trading range that quickly reverses itself and moves back into the trading range. An upthrust is a “bull trap” – it appears to signal a start of an up trend but in reality marks the end of the up move. The magnitude of the upthrust can be determined by the extent of the price move to new highs and the relative level of volume on that movement.
Rallies are usually feeble. Having taken our positions, we must monitor the stock's progress as it works out its force of distribution.

Successful understanding and analysis of a trading range enables traders to identify special trading opportunities with potentially very favourable reward/risk parameters. When analysing a TR, we are first seeking to uncover what the law of supply and demand is revealing to us. However, when individual movements, rallies or reactions are not revealing with respect to supply and demand, it is important to remember the law of "effort versus result." By comparing rallies and reactions within the trading range to each other in terms of spread, volume, velocity and price, additional clues may be given as to the stock's strength, position and probable course.

It will also be useful to employ the law of "cause and effect". Within the dynamics of a TR, the force of accumulation or distribution gives us the cause and the potential opportunity for substantial trading profits. It will also give us the ability, with the use of point and figure charts, to project the extent of the eventual move out of the TR and help us to determine if those trading opportunities favourably meet or exceed our reward/risk parameters.

**“The Ice Story.”**

We imagine the market in the person of a Boy Scout walking over a frozen river in the midst of winter. If support, the ice, is strong the river covered with ice has no difficulty in supporting the weight of the Boy Scout. That support is seen as a wiggly line connecting the lows, the supports, in a trading range.

A failure by the Boy Scout to reach the upper resistance level of the Trading Range would be a warning of potential weakness. Weakness of the ice would be signalled by the Boy Scout breaking support or falling through the ice.

The Boy Scout has two chances to get back above the ice (i.e., creating a bullish “Spring” situation). On the first upward rally the Boy Scout may fail to regain a footing above the ice. If so, then he will sink lower into the river in order to gather strength to try and rally once and crack the ice. If on this second attempt, the Boy Scout again fails to penetrate above the ice, he would be most likely to sink downward and drown (i.e., a Bear Market/Market phase would occur).

2. Wyckoff Schematics Applied to Charts of Nokia

Weekly Charts of Nokia display the overall cyclic progress of Nokia from Markup to Distribution to Decline to Accumulation and finally to the commencement of a Markup phase. Schematic # 4 provides a visual conceptual scheme depicting these four phases of market action. The Weekly Charts of Nokia suffice as an application of this Conception of Primary Market Phases. The Weekly charts also furnish a bigger picture backdrop for the detailed applications of the Schematics 2, 3 and then 1 for Distribution and then Accumulation. The “jump across the creek” and “ice” analogies will be used to help explain the important junctures of distribution and accumulation illustrated on the Daily Charts of Nokia (See Side Bar #2 and Figures 2 and 4).

Nokia’s bull market advance was stopped during the year 2000 around the 500 level by the entry into the market of a dominant force of supply. This force of supply first appeared around March 2000, where it created a sharp sell-off down to the vicinity of 350 on the Nokia chart. The demand that came to market to staunch this sell-off marked the point at which the “Ice Story” commenced. (See Schematic #2). We can see that support occurring at points (1), (2), (3), and (4). The rallies from these support levels were becoming increasingly feeble as witnessed by the progressive diminution in volume coupled with the halting of the price advances at a resistance level near 540. Then from point (4) there was a rally that failed to reach the horizontal resistance line. Here the volume shrank appreciably. Moreover, the price level stopped in July near the same 500 level as did the earlier preliminary supply (PSY) in March-April. Hence, this juncture is annotated as a last point of supply for the possible completion of a line of important distribution.

The failure to reach the upper resistance level was a warning of potential weakness. Indeed, a sign of weakness ensued on the next sell-off. It is here that we witness support breaking around the 425 level in August 2000. Note the extremely wide price spread and the enormous increase in volume as the Nokia plunged through the meandering support line drawn across the previous lows.

![Nokia Chart 1](image1)

![Nokia Chart 2](image2)

The significance of the price breaks below the support levels of this trading range in Nokia will be confirmed by the subsequent tests. In the ice analogy the Boy Scout has two chances to get back above the ice (i.e., creating a bullish “Spring” situation). As can be seen on Nokia chart #2, there were two such rallies. The first attempt stopped at LPSY (2) while the second attempt was halted at about the same level as PSY and LPSY (1). It can also be seen that the ice, which had provided support, has now reversed roles and is acting as resistance against attempt to move higher. These latter LPSY’s (2) and (3) also expand the possible extent of the distribution (supply) pattern, thus generating the potential for a greater decent in price. Nokia ultimately declined to under 100 in year 2004.
Nokia's decline was stopped by the Selling Climax (SC), Automatic Rally (AR) and Secondary Test (ST) during July and August 2004. This sequence of stopping actions helped to form a small base of accumulation that in turn helped to propel Nokia upward to the resistance level around 110. Thereafter there was a prolonged period of backing and filling on the chart. Bearish forces remained in control as seen by the line of floating supply around the 110 levels. However, another, lesser branch of the creek was formulated by the dominance of supply over demand during the intermediate down channel that occurred during late 2004 when Nokia's stock price declined from about 115 down to under 100 in early 2005. The "Boy Scout" was cognizant of these developments as he would have been following along the edge of the creek around the 110 level so as to judge best the relative powers of supply and demand. Earlier he would have been following the minor creek as it flowed downward under the weight of supply from 115 to below 100. Then near the end of the year 2004 and early 2005, the Boy Scout would have sensed that the floating supply was drying up. He would have noticed the narrowing price range, the diminishing volume and the absence of material price movement on the downside. It was at this point that he said to himself, "Now if I back way up to make a good run for it, I bet I can jump across the creek". In the process of backing up, he causes price to drop below minor support around 105. Also in this process the remaining bears (floating supply) are flushed out of the market as evidenced by the downward gap in price that exhaust the supply. A Wyckoff "spring" thus occurs.

Note the wide price spread of about 10 points as Nokia climbs from around 98 to 108. More significantly, note the very significant expansion in volume that accompanied that 10 point upward move in price. That large volume day is where the "jump" occurred. Thus we also know that is where the edge of the meandering (minor) creek occurred. In other words, this successful JAC was also a sign of strength (SOS). A long position could have been initiated during the pull back test following JAC at around 104 with a protective stop loss order entered below the support level, around 95. In practice, such a long is not typically entered by a student of the Wyckoff Method, because it is evident that the major branch of the creek still lies ahead.

After jumping the lower and lesser branch of the creek, the Boy Scout continues upward to the vicinity around 115 where earlier he had found the flow of supply too fast and too deep to jump across. Here again in early 2005 around the 115 price level, the creek creates a squiggly-wiggly line of resistance, along the peak prices of the recovery rally, or slightly above the 110 price level of Nokia. However, this time things are different. The Boy Scout observes that the volume is shrinking and the price level is narrowing. The Boy Scout is witness to a drying up of the floating supply creating the edge of the major creek/ major resistance level just above 110.

As in the instance of his earlier preparation to jump across the (Minor) creek, the Boy Scout again creates a "Spring" as he backs up to the 100 level. A relative increase in upward price spread coupled with a notable expansion in the level of volume mark where the Boy Scout jumped the major creek. But by the time the propulsion of the jump had dissipated the Boy Scout would have been temporarily tired out by his exertion in jumping across the creek. Hence we would logically anticipate that he would rest and consolidate his strength. He does so by backing up to the edge of the creek (BUEC). At this point we observe further confirmation that supply has been exhausted and demand is in control. The pullback comes on a relatively smaller price spread and shrinkage of volume, thus showing that supply cannot regain control. Consequently, it is now safe for the trader or the investor to enter a long position in the vicinity of 110-115 and to place a sell stop order just below the 100 level.

### 3. NEW SCHEMATIC: ACCUMULATION

#### Gradient of Ascending Bottoms

The chart below depicts a new or added schematic for accumulation that we wish to name "The Accumulation Gradient of Rising Bottoms." This new Schematic is an attempt to fill an obvious gap in the conceptual body of the Wyckoff Method. In brief, there are currently two Schematics for distribution, but only one Schematic for accumulation.

The new Schematic for Accumulation is a counterpart to the Schematic for Distribution that features descending price peaks. Richard D. Wyckoff and his Associates time and again pointed out the power of ascending bottoms in a base of accumulation or re-accumulation. They also underscored on numerous occasions the efficiency of a pattern distribution composed of descending price peaks (current Schematic #2).

The logic for ascending bottoms amid descending peaks is rooted in the concept of the Composite operator. Within a trading range the composite man is seen to accumulate a line of stock from the public who become especially frightened during the downthrusts. The composite man is willing to play the short side of the market as well during the trading range of accumulation so long as he can abstract a public following of sellers. But as the trading range proceeds, the new schematic reveals that fewer and fewer sellers remain to propel stocks downward in price. As a consequence, the downwaves become shorter and shorter in length (the bottoms rise) and the Composite Man as a result accumulates an increasing line of stock. Ultimately there is little left of sellers to coax to the downside and so the composite man reverses his attention and spurs prices upward and out of the trading range. A markup campaign now gets underway led by the composite man.

Elsewhere Pruden has conducted studies of Market behaviour with the aid of the Cusp Catastrophe Theory from Mathematics/ behavioural finance. That theory shows accumulation dissipative gradients and accumulation gradients that occur within a trading range just prior to buying stampede or a selling panic. Our label of "Accumulation Gradient" for the new Schematic was in large part inspired by the Cusp Catastrophe model of market behaviour. Moreover, the literature of Catastrophe Theory describes how the "managers" of an unstable situation will keep things in a close proximity until all the marginal, regional support has been exhausted. This phenomenon is known as the Delay Rule and the Maxwell Rule followed by the Maxwell Principle.
Thus the observations of Wyckoff, the logic behind the Composite Man and the Models from Catastrophe Theory combine to buttress our addition of a new Schematic for accumulation to complete the Conceptual body of the Wyckoff Method in regard to Schematics, a powerful visual tool for Wyckoff Analysis.

BIBLIOGRAPHY


Schematics, Courtesy of Wyckoff/Stock Market Institute, Phoenix, A.Z.


