Stock Markets Guides

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Wolfe Wave Trading Strategy Guide

If there is one thing every trader wishes for, it's that they could predict the future with complete certainty. If they could, making money in the markets would be a foregone conclusion.

Unfortunately, except for Nostradamus (and perhaps a few of the writers on the Simpsons), human beings are unable to predict the future with any real certainty.

Since they are unable to predict the future, technical traders are forced to rely on various data points and indicators to identify trading opportunities in the markets and aid their decision-making whilst trading.

This post will examine a specific chart pattern known as the Wolfe Wave.

We discuss both Wolfe Waves and the strategies that traders can use to trade this chart pattern effectively.

What is the Wolfe Wave?

The Wolfe Wave was discovered by an S&P trader named Bill Wolfe over 20 years ago. Mr. Wolfe suggested that this pattern occurred naturally and could be consistently found in the financial chart of any security. This is because the same laws of supply and demand that generate support and resistance levels also suggest that prices will regain their equilibrium after a break-out.

Technical traders who seek out the Wolfe Wave are essentially attempting to profit from a break-out in the price of that security.

The Wolfe Wave is a chart pattern consisting of further five-wave patterns analyzing an underlying equilibrium in price.

These price patterns are then used to assist traders in predicting either bullish or bearish trends in the markets. It should be noted that this pattern can appear within any time frame.

Simply put, the Wolfe Wave is a naturally occurring rhythm in financial markets. It consists of waves of supply and demand that ultimately form their own equilibrium.

Properly identifying these waves is crucial to the Wolfe Wave's accuracy because these waves provide for the proper balance of equilibrium. So what does a Wolfe Wave actually do?

A Wolfe Wave will ultimately do two things:

1. Predict where a price is going;
2. Predict when the price will get there.

There are generally three places where a Wolfe Wave can be found. These are:

1. An uptrend (lookout for a bearish Wolfe Wave);
2. A downtrend (look out for a bullish Wolfe Wave);
3. Securities whose prices are consolidating.

To be considered a Wolfe Wave, there are a series of rules that need to be observed. Let's examine those now.

Wolfe Wave Rules

To be considered a Wolfe Wave, the following five rules must be observed;

1. The first rule is that waves 3-4 must stay within the channels created by 1-2.
2. Waves 1-2 must show symmetry with waves 3-4.
3. Wave 4 is within the channel created by waves 1-2.
4. There is a regular interval between all of the waves. This means that the time it takes from low to low or high to high should be equal. For example, the time between waves 1-3-5 is the same.
5. Wave 5 is the break-out. It exceeds the trend line created by waves 1 and 3 and serves as the trader's entry point. Waves 3 and 5 are usually 127% or 162% (Fibonacci) extensions of the previous channel point.

Look at the chart below to see if you can follow the rules above to identify the Wolfe Wave.

Bearish Wolfe Wave

The bearish Wolfe Wave is a [chart pattern]() preceded by an upward move in the price action of a security.

It is bearish because the final wave leads to a breakout in which the price of the security falls.

Bullish Wolf Wave

A bullish Wolfe Wave is the opposite of its bearish counterpart. It is a chart pattern preceded by a downward move in the price action of a security.

It is bullish because the final wave leads to a breakout in which the price of the security rises.

Wolfe Wave Trading Strategy

Traders using this strategy first need to identify their profit target line. This can be done by drawing a line between the first and fourth points. This profit line will show traders where the price of the security is likely to go.

If the wave is bullish, then the fifth wave is where a trader will enter a long position. If the wave is bearish, then the fifth wave is where a trader will enter a short position. Traders will then close their positions when the price of the security hits the profit target line they drew earlier in the trade.

Wolfe Wave Indicator

Although identifying a Wolfe Wave is not a particularly difficult task, some brokerages and trading platforms provide traders with a Wolfe Wave indicator. Wolfe Wave indicators automatically detect a Wolfe Wave. This makes the job of identifying a Wolfe Wave that much easier.

There are several suitable platforms on which traders can find a Wolfe Wave indicator.

Below you will find links to download the Wolfe Wave indicators of MetaTrader4 and TradingView.

Wolf Wave Indicator for MT4

Wolf Wave Indicator for TradingView

Wolfe Wave Scanner

Similar to the indicators listed above, the Wolfe Wave scanner scans for possible reversal signals based on the Wolfe Waves chart trading system. There are also several suitable platforms where traders can utilize these tools. Below are two links to Wolfe Wave scanners for both MetaTrader 4 and Trading View.

Wolfe Wave Scanner for TradingView

Wolf Wave Scanner for MT4

Lastly

The Wolfe Wave provides traders with a way of predicting breakouts and trading them successfully. However, traders must observe the five rules detailed earlier in this post to ensure a bona fide Wolfe Wave. Without these rules being observed, the pattern is formed may be a product of random price oscillations.

Lastly, when studying charting patterns, traders need to remember that it is a straightforward task to look over these patterns in hindsight and detail exactly when entering and exiting a trade.

Doing this in real-time, with the risk of losing real money, is a far more challenging activity. Individuals learning to trade should not begin trading with large amounts of money until they have sufficient experience in trading with smaller amounts.

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