13 Elliott Wave Patterns Trading Guide

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Elliott Wave Theory is a method of technical analysis used in stock market trading to predict market trends by identifying repetitive wave patterns.

The theory, developed by Ralph Nelson Elliott in the 1930s, posits that market prices unfold in specific patterns called waves.

These waves are divided into two main categories: motive waves (which move in the direction of the trend) and corrective waves (which move against the trend).

Elliott Wave Success Rate

While critics often claim that Elliott Wave Theory is ineffective, they rarely provide concrete evidence to support their arguments. In contrast, multiple studies have demonstrated the accuracy of this analytical approach.

For example, the study "Fibonacci Retracement and Elliott Waves to Predict Stock Market Prices: Evidence from Amman Stock Exchange Market" found that Elliott Wave Analysis effectively predicts price movements.

Similarly, the research "The Effectiveness of the Elliott Waves Theory to Forecast Financial Markets: Evidence from the Currency Market" reached the same conclusion.

When applied correctly, Elliott Wave analysis can forecast price movements with precision. However, the key to success is accurately identifying and labeling the wave patterns.

Poor analysis can lead to incorrect predictions, which might cause some to dismiss the theory as flawed.

In my view, the complexity of Elliott Wave Theory is likely why some traders believe it doesn't work. A deep understanding and proper pattern interpretation are essential for effectively leveraging this method.

Wave analysis helps traders identify potential price directions and provides a market overview. By understanding the current price position, you can set targets, define stop losses, and anticipate trends, which can significantly improve your investment decisions.

Elliott Wave Corrective Patterns

When applying Elliott Wave in your trading, you aim to identify a five-wave motive phase.

As shown in the chart below, during this motive phase, the price moves higher in three waves, with two shorter pullbacks.

These brief pullbacks are essential for the trend to build momentum, but the rules must be followed for the motive phase to be valid.

Corrective Waves

The corrective phase unfolds in three distinct moves, labeled as A, B, and C rather than numbered.

The corrective phase can be challenging to identify until it has fully played out and the price movements have occurred.

Leading Diagonal Elliott Wave

The leading diagonal pattern closely resembles the ending diagonal. It consists of five sub-waves labeled 1-2-3-4-5.

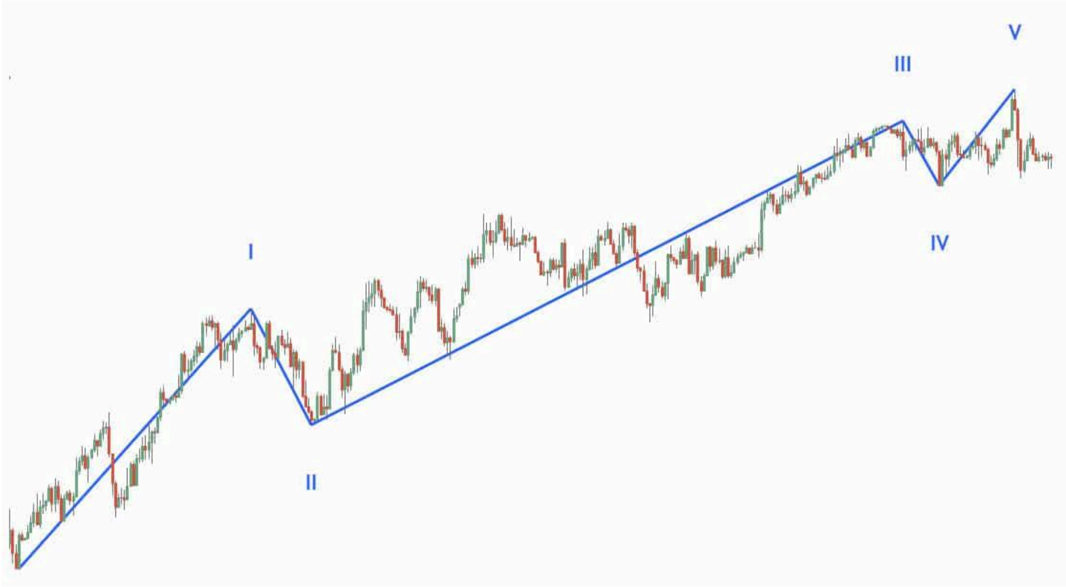
Typically, the first wave is the longest, while the third wave cannot be the shortest among waves 1, 3, and 5. Waves 2 and 4 are always corrective, and waves 1 and 4 should overlap. However, there are a few key exceptions. First, leading diagonals appear either as the first wave within a standard five-wave impulse or as wave A in a simple zig-zag correction.

Second, unlike ending diagonals, where all five waves are corrective, the three motive waves in a leading diagonal (1, 3, and 5) can be either corrective or impulsive. Let's explore some examples.

13 Elliot Wave Patterns

1. Impulsive Pattern

Numbers 1,2,3,4,5 are all impulses. Waves 1,3,5 are impulsive moves, and these three will be almost the same length.



2. Corrective Patterns

Labels 2 and 4 are corrective patterns. Wave 2 will not be longer than wave 1, and wave four will not overlap wave 1.

3. Extension Patterns

In the impulsive pattern, an extended pattern forms. For example, in the extension pattern, 1,3,5 waves will be extended. In most cases, this extension happens in the third wave.

The first wave extension is named extension 1.

The third wave extension is named extension 3.

The fifth wave extension is named extension 5.

4. Diagonal Triangle Type 1

The Elliott Wave Diagonal Triangle Type 1, or Leading Diagonal, is a pattern that typically appears at the start of a new trend, either as the first wave of a five-wave impulse or as wave A in a zigzag correction. It consists of five sub-waves labeled 1 through 5, with waves 1 and 4 often overlapping.

The first wave is usually the longest, and wave three cannot be the shortest among waves 1, 3, and 5.

The pattern can be contracting or expanding, signaling the beginning of a new trend or corrective move, making it a valuable tool for traders.

5. Diagonal Triangle Type 2

The Elliott Wave Diagonal Triangle Type 2, or Ending Diagonal, is a pattern that usually appears at the end of a trend, either as the final wave (Wave 5) of a five-wave impulse or as the last wave (Wave C) in a corrective sequence. This pattern, characterized by five sub-waves labeled 1 through 5, typically involves overlapping waves 1 and 4, forming a contracting wedge shape.

Unlike the Leading Diagonal, all five waves in an Ending Diagonal are generally corrective, signaling the exhaustion of the current trend. The appearance of this pattern often indicates an impending reversal, making it a valuable tool for traders looking to identify the end of a trend and prepare for potential market shifts.

6. Failure or Truncated 5th Pattern

This is one kind of impulsive pattern. The main feature of this pattern is that the fifth wave will not exceed the third wave. And as the fifth wave fails to exceed the third wave, its name is the failure pattern.

When this pattern occurs, pay close attention to the market. It indicates that the existing trend is weak now, and the market will accelerate in the opposite direction.

7. Zigzag Patterns

Zigzag is one kind of corrective pattern. So when we see any zigzag pattern in our chart, we can assume that a sharp reversal is coming.

8. Flat Pattern

In corrective patterns, the flat shape pattern is prevalent. We will observe this pattern in a sideways market where A and B are corrective patterns, and C are impulsive.

9. Expanded Flat Pattern

An expanded flat is an expanded form of a regular flat pattern. Here, wave B extends, and the robustness of B proves that the market wants to go in the direction of B.

10. Contracting Triangle

This is a corrective pattern. A contracting triangle is composed of five waves. In a contracting triangle, wave 1 is the most extended wave, and wave five is the shortest.

11. Expanding Triangle

There are three kinds of expanded triangle patterns. Ascending triangle, descending triangle, running triangle.

12. WXY or Combination Pattern

Combination patterns are formed by combining different wave patterns. These include the zigzag, flat, and triangle patterns to form a combination pattern. This pattern is observed mainly in a choppy market.

13. X wave pattern

Usually, this type of pattern is formed in a more complex way. This is a corrective wave and forms in many ways, such as zigzag, double zigzag, flat, expanded flat, and a combination of a triangle pattern.

Elliott Wave Examples

Bullish Impulse Wave:

- **Wave 1:** A stock starts to rise from a recent low.
- **Wave 2:** The stock pulls back slightly but does not retrace the entire upward move of Wave 1.
- **Wave 3:** The stock then rallies significantly, often breaking previous highs.
- **Wave 4:** A brief pullback occurs, but it's less severe than Wave 2.
- **Wave 5:** The stock makes another push upward, often culminating in a final peak.

Bearish Corrective Wave:

- After completing a five-wave bullish impulse, the market begins to correct.
- **Wave A:** The stock begins to decline, signaling the start of the correction.
- **Wave B:** A brief rally occurs but doesn't reach the previous high.
- **Wave C:** The stock declines again, often reaching or exceeding the level of Wave A.

Practical Example:

- **S&P 500 Index**: Imagine the S&P 500 is in a long-term uptrend. The market could form a five-wave pattern:
  - **Wave 1:** The S&P 500 rises from 3,200 to 3,400.
  - **Wave 2:** It then pulls back to 3,300.
  - **Wave 3:** The index rallies to 3,700.
  - **Wave 4:** A minor correction brings it back to 3,600.
  - **Wave 5:** Finally, the index pushes to 3,800 before entering a correction phase.
- **Corrective Phase**:
  - **Wave A:** The S&P 500 drops from 3,800 to 3,600.
  - **Wave B:** It briefly rallies to 3,700.

- ○ **Wave C:** The index then declines to 3,500, completing the correction.

Lastly

Elliott Wave patterns are fractal, meaning they can be observed on multiple timeframes.

While theory can be helpful, correctly applying it requires skill and practice. It also involves a degree of subjectivity in identifying waves.

Many traders combine Elliott Wave analysis with other technical analyses to improve the accuracy of their trading strategy.