

THE TYPE 1 TRADE

by Steve Griffiths

As explained in last month's issue of *The Technical Analyst*, one lesson learnt over years of trading is that the simple approach to analysis is often all that is needed to uncover excellent trading opportunities. Arguably, one of the clearest trade set-ups for a professional trader should be the simple ABC correction.

The last article outlined not only how this clean ABC correction can yield profitable trade opportunities, but also how simple and easy-to-recognise it could be. Taking this a stage further, when the basic ABC correction occurs at a certain juncture in a market, it can produce one of the most profitable trades available. This happens when the simple ABC correction develops as part of the first correction to the first move off an important high or low. In Elliott Wave terms, this is a Wave 2 or B correction. When this correction is complete, it can lead into a Wave 3 type move, which is usually the strongest and longest swing in a typical 5-wave sequence. This swing has the largest profit potential in any Elliott Wave pattern.

Figure 1 presents a simple ABC correction on the UK equity ICI. The most important point is that this ABC correction unfolded as part of the first correction to the initial swing off an important low.

ICI made a major low in March 2003, which was followed by an initial rally off the low. The simple ABC pattern then appeared during the correction to this initial rally (Figure 2). This is referred to as a Type 1 trade set-up in MTPredictor.

Why is this set-up so important? Very often this initial correction is the springboard for an extremely strong move. Moving forward in time we can see how, once this particular corrective ABC was complete, ICI proceeded to rally by over 75%, from a price of 124 to approximately 220 (Figure 3).

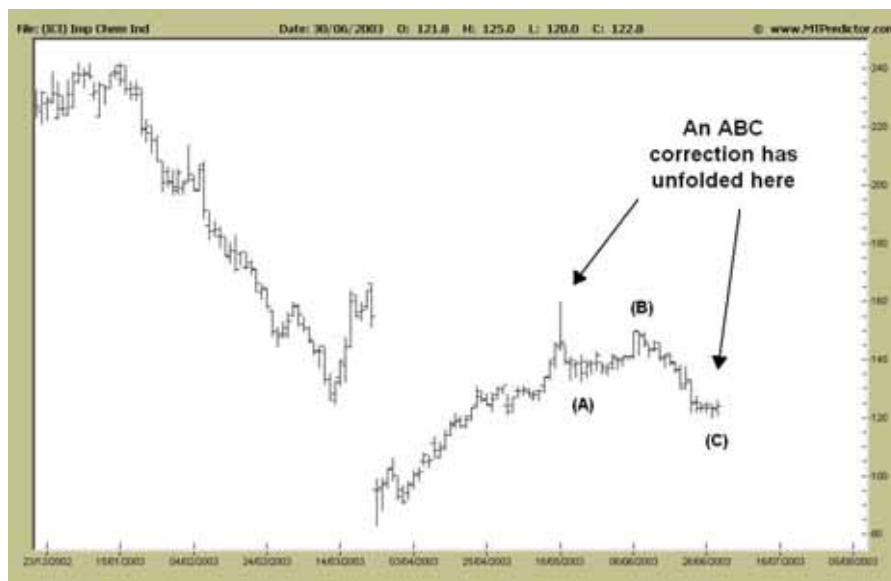


Figure 1.

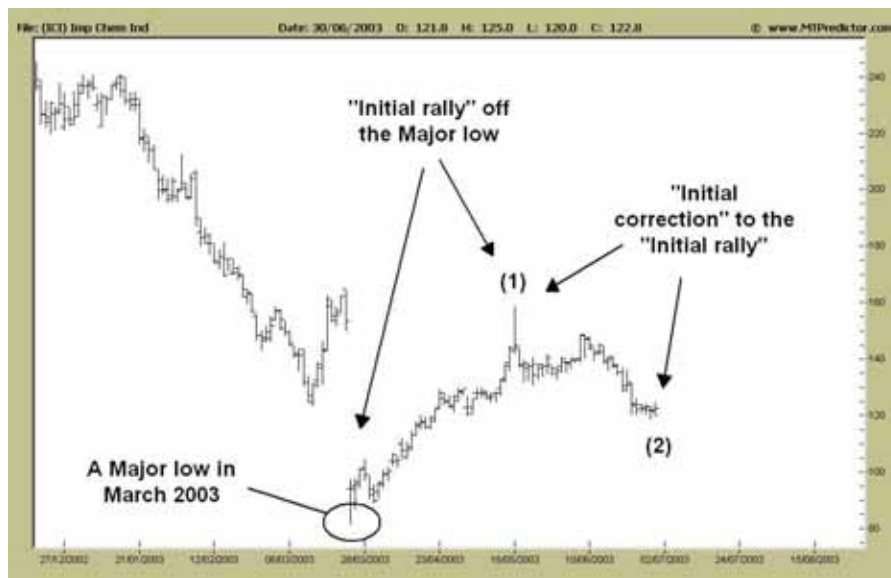


Figure 2.

Clearly, identifying these set-ups can result in enormously profitable trades. This is why the Type 1 trade is the principal trade set-up sought out of the three ABC corrective variants. More importantly, this set-up is

straightforward to identify, with its mathematical simplicity - a simple ABC correction that unfolds as part of the first correction to the first move off an important high or low.

In the example shown in Figure 4, being able to identify the end of the correction enabled the trader to enter a very profitable trade precisely at the start of the strong move. This has the major advantage of reducing the initial risk on the trade, particularly compared with the potential profit from these Type 1 set-ups.

Expanding on this theme, Figure 4 shows how the ABC correction developed exactly at the Typical Wave C Wave Price Target support zone. (This support/resistance zone was covered in last month's article). Anticipating that the market was reversing at this zone enabled the trader to go long from 124 (ignoring slippage and commission) with an initial protective stop loss at 118 - an initial risk of only 6 points.

Now compare this with the potential profit as ICI rallied to approximately 220, a profit of 96 points. Given the initial risk of only 6 points needed to take the trade, this is a spectacular risk/reward ratio. Over time, this can result in a track record where the losses are kept small relative to the profits - a prerequisite for low risk/high return trading.

This particular trade set-up can unfold in any market and on any timeframe (from weekly charts to five minute charts), so whether you trade UK equities, US equities, futures or currencies, the identification of this set-up arguably should be a major part of your trading plan.

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Figure 3.



Figure 4.