Section 1: Chapter 7:

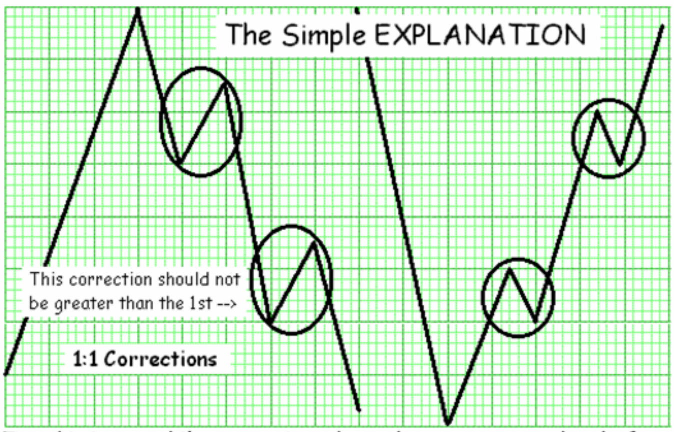
The 1:1 Overbalancing Rule:

The 1:1 overbalancing rule is possibly the most important trading rule I have when it comes to determining where the market will go in the short term. I use it primarily on the 5-minute chart for intra-day swings but it can also be a great tool in larger time frames.

The 1st rule is: -

Corrective waves of similar degree in progressive market impulse movements should not be greater than the preceding corrective wave of similar degree if the trend is going to remain intact within that degree.

So let's start with the smaller wave degree example first; this type of progression is more likely on a daily 5-minute chart when a new trend gets into progress. The corrections could be around 3-4 points on an E-Mini continuation move.

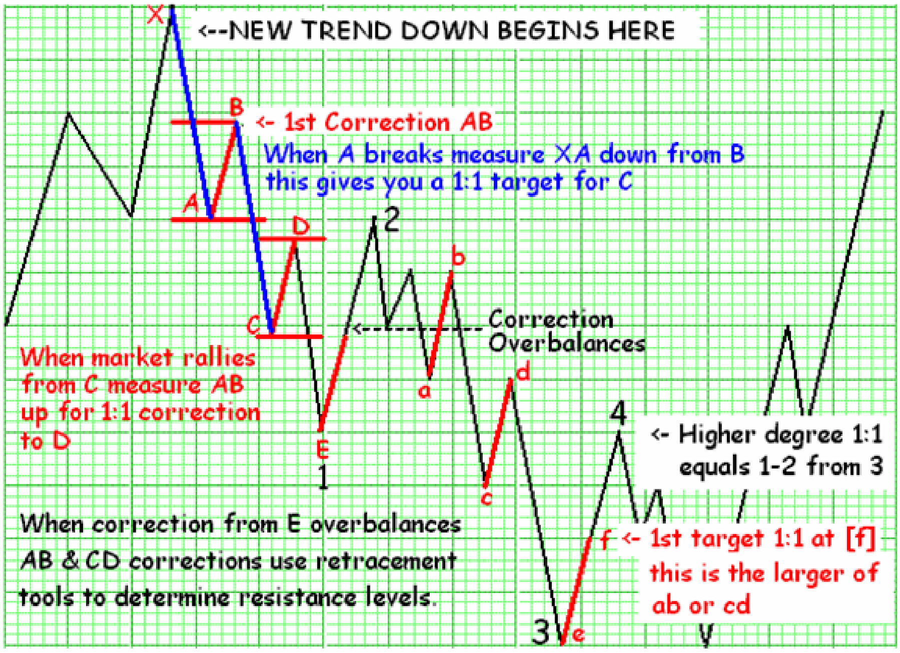


Trend is intact while corrections do not become greater than before.

Once a move of some substance begins it always starts from a market reversal of some larger degree movement that has been in force for a series of waves. If it didn't then the market would have been going sideways without any directional tendencies.

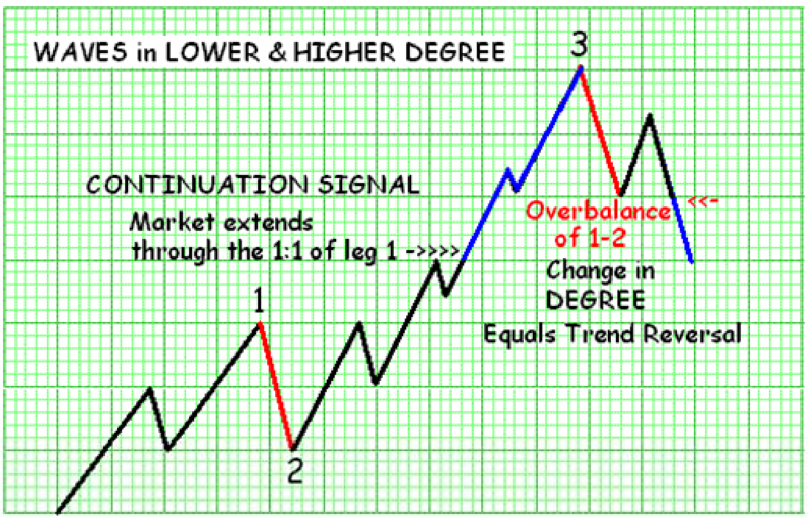
The first thing to remember when you are applying this rule is that the market must look like it is heading in the intended direction with some conviction, i.e., if the market is going down it must look impulsive and then the next correction comes back to a 1:1 with the 1st hits resistance and gives you the confirmation that it cannot rally any higher. This is a sign to re-enter the existing trend down. The reverse also applies to a market move heading up.

WAVES of LOWER & HIGHER DEGREE:

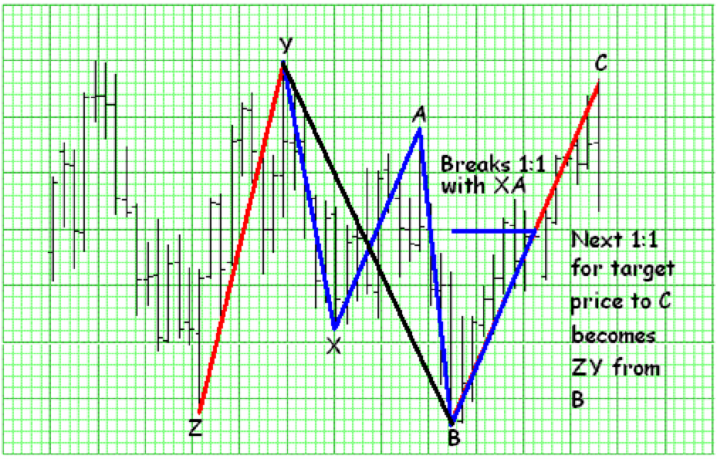


Market waves unfold 1st as waves of smaller degree and then they extrapolate into waves of higher degree as the smaller degree waves combine to form the waves of higher degree.

The 1:1 rule can be used for determining support or resistance levels in all degrees of market waves. You must determine if the market has moved from a lower degree into a higher degree to use this tool correctly.



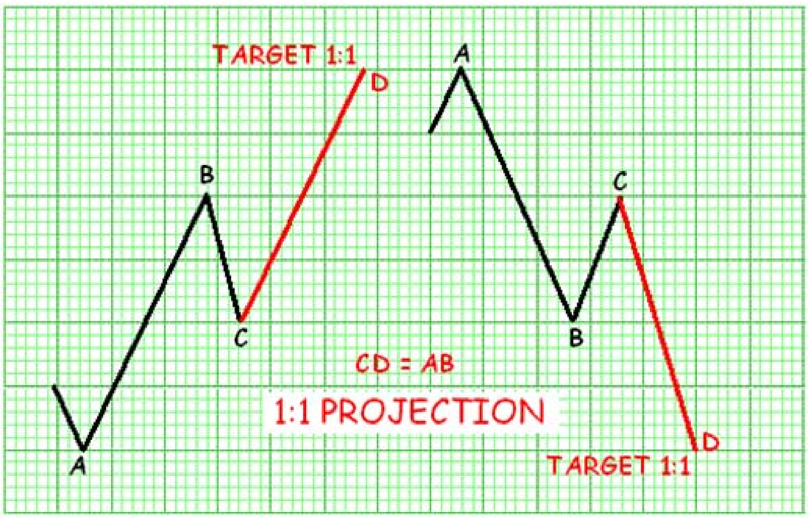
COMPLEX RANGE DEGREES:



In this example when the market reversed trend at (point B) the correct 1:1 calculation for the overbalancing rule becomes XA from B. Once this degree has been exceeded the next 1:1 becomes ZY from B.

I only ever look backwards TWO DEGREE LEVELS when I am calculating market targets on any given trading day. If you start trying to work out to many targets you will just confuse the issue. Unless the current market is within range of making it to a 1:1 I am not interested in it.

PROJECTING AN IMPULSE WAVE TARGET PRICE USING THE 1:1 RULE:

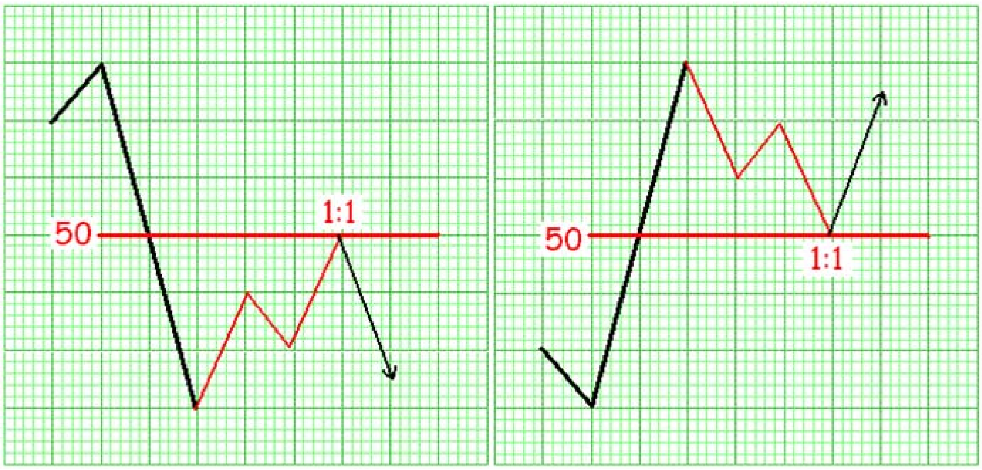


The benefit of the 1:1 projection tool is that it can give you a profit target to aim for. If the market reaches the 1:1 target and continues on then it is telling you that the current trend in progress is strong.

In contrast if the new thrust does not reach the 1:1 target and reverses trend beforehand it is telling you the trend is weak.

I don't consider reversing position when the market arrives at a 1:1 impulse projection unless the target price coincides with something else important.

For instance when a market is advancing from a low price in a retracement of a previous range of larger degree a 1:1 projection may terminate on a 38.2, 50 or 61.8 of the range it is retracing. This could be a good reason to reverse position at the target price.



Situations like these are especially important to you because the other technicians in the market will see them and be prepared to attack the market at the time.

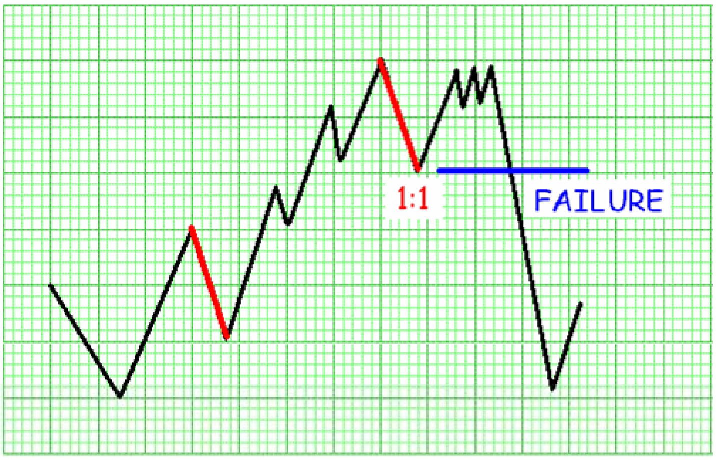
You will have to remember as I move along that many of the technical tools I am teaching you are well known to the top traders – when I say top traders I mean the guys who trade 1000's of contracts a week. The public have no chance at all when it is said and done.

The longer you watch the unfolding market each day you will realise that most of the things I am teaching you become self fulfilling due to the professional traders participation.

To become a successful trader is not just a matter of knowing technical analysis it is a matter of knowing what everyone else is up to. Understanding the potential strength of technical support or resistance levels on any particular day comes down to how the traders are reacting at those levels.

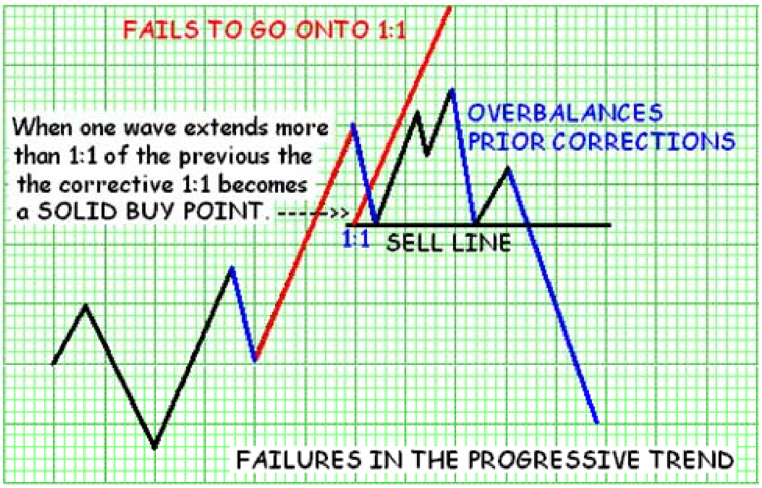
1:1 CORRECTION FAILURE:

It is amazing the little things that can provide SIGNS of what is likely to come as the day progresses.



This is a situation that could occur on a regular basis. The 1:1 correction has you believing the market will take out the current days high but something changes the minds of the players and the market can't do it. A break back through the 1:1 low is a SELL SIGN.

1:1 PROJECTION FAILURE:



Every little thing that happens on the day is important to observe in this business. You could call this example an UNDERBALANCING MOVE in the next progression. The breakout of the high fails and the market returns to the prior support. This only holds temporally and then breaks for a SELL.

WHAT CONSTITUTES A LEGITIMATE 1:1 CALCULATION:

1. The 1:1 must be a correction in an existing trend in waves of similar degree.
2. The 1:1 must be an expansion in an existing trend in waves of similar degree.

In the example below you will see that I don't consider example [2] as a legitimate 1:1 calculation. The reason is the market was going up prior to the BC correction and the 1:1 being calculated is supposed to represent resistance for a correction level when the AB wave it is being measured off is expansionary. The two don't mix in my book.

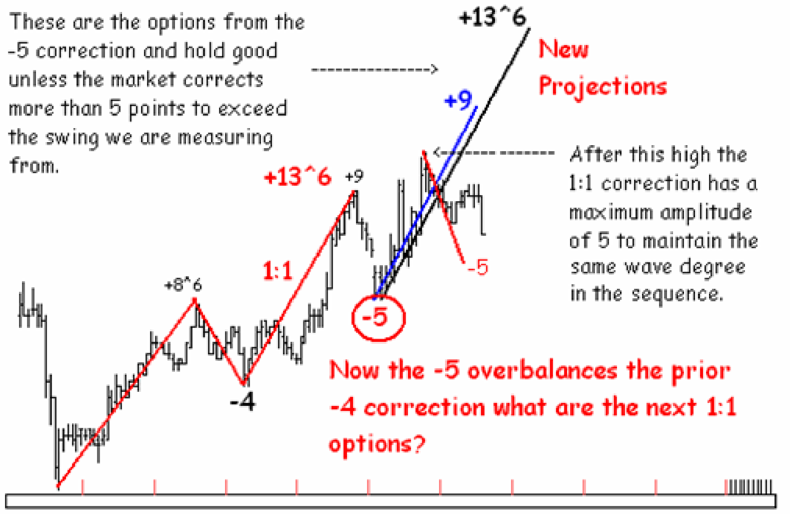
This view of mine may not make sense to some of you and I know that it certainly has a few of my students confused. In my opinion D could terminate on any ratio of AB in context of the XABCD relationships. A 1:1 is only one of the possibilities.

If you still don't understand the logic just take my word for it and don't use 1:1 calculations as shown in example [2] as it only adds another complication to your analysis and our best policy is to always eliminate what doesn't work for us.

Now I will show you some things in the lesser degree wave activity that occurred in the leg up that is projected as **[3]** in the example above.

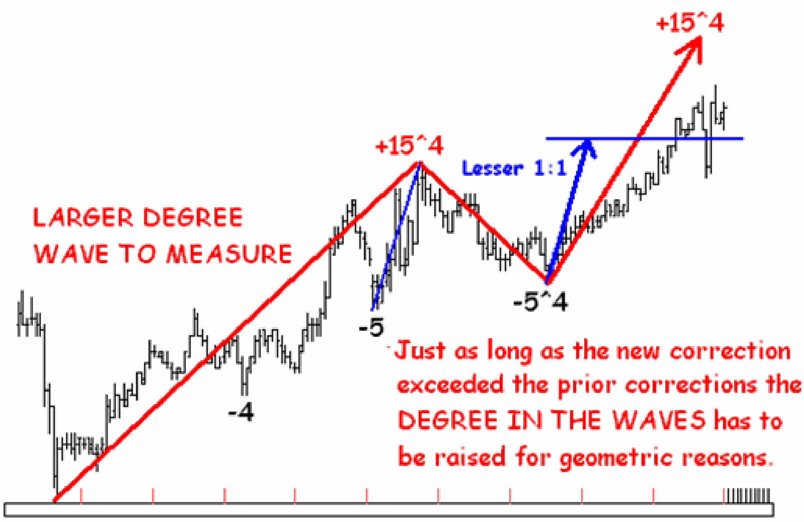
At the time this happened in the market some of my students were a little confused as to which waves remained in the same degree and what actually constituted a valid price projection using the 1:1 rules.

All you have to remember is that as soon as a correction overbalances a prior correction the wave degree moves up a level. You can start another lesser degree 1:1 wave series but you need to also calculate the higher degree wave 1:1's as well.



This is what threw the spanner in the works. The correction in progress in the chart above invalidated the –5 by declining –5^4 (two ticks more).

The correct way to handle this situation is this:



Just go with the FLOW one step at a time and don't confuse the issue anymore than you have to. Stick to the rules – some are easier to see than others but these examples are the way I do it.