

## The Elliott Wave Principle

This is a book by A. J. Frost and Robert Prechter Jr. published by New Classical Library, Gainesville, Georgia.

The theory behind this book is that the ever-changing stock market tended to reflect a basic harmony found in nature, the Fibonacci Sequence, and from this discovery developed a rational system of stock market analysis. Ralph Nelson postulated that the price movement of the DJIA (Dow Jones Industrial Average), formed discernable patterns which were repetitive in **form**, but not necessarily repetitive in time or amplitude. Elliott claimed predictive value for this and named it “The Elliott Wave Principle”.

The Fibonacci Sequence starts with any two numbers, usually stated as 1 and 1, but it could be any two numbers. The next number in the sequence is found by adding together the two numbers that appear before it. The formula could be written as :  **$t_1 = 1$ , and  $t_2 = 1$ , and for  $n > 2$ , we get  $t_n = t_{n-1} + t_{n-2}$** . For this formula  $t$  = term and  $n$  = term number.

Here is the result: 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, etc.

One of the neat things about the Fibonacci Series is that, no matter what two numbers you start with, if you divide any number by the number before it, the result always tends to 1.618 033989.. as “ $n$ ” gets larger. You have to be out about term 8 or 9 before this gets to happen, but it always does. And of course this number, 1.618 033989.., should be familiar to long time readers: it is the Golden Ratio, called Phi (symbol =  $\Phi$ ).

For more on the Fibonacci Sequence and the Golden Ratio see Monday to Saturday, May 18<sup>th</sup> to May 23<sup>rd</sup>, 2009, where we had a “theme week” of sequences, the Fibonacci Sequence and the Golden Ratio.

What Elliott has claimed is that the stock market Dow Jones Average follows ups and downs that mimic the Fibonacci Sequence. This does not surprise me, as the Fibonacci Sequence occurs in growth type of problems such as the number of rabbit pairs in succeeding generations. At the same time, the stock market is also involved with growth and decline as people “climb on board” a stock and “bail out of a stock”.

More on this can be found on the web at:

<http://www.elliottwave.com/club/Elliott-Wave-Video-Crash-Course/default.aspx?code=27997>

and

[http://en.wikipedia.org/wiki/Elliott\\_wave\\_principle](http://en.wikipedia.org/wiki/Elliott_wave_principle)

and

[http://stockcharts.com/help/doku.php?id=chart\\_school:market\\_analysis:elliott\\_wave\\_theory](http://stockcharts.com/help/doku.php?id=chart_school:market_analysis:elliott_wave_theory)

In now way, am I involved in the stock market or predicting the stock market. I just thought that this “theory”, that is still debated, is an interesting application of a mathematical principle.