

## An Alternative To Elliott Goodman Wave Theory

*Logical and easy to apply, this wave theory can complement your own approach to technical trading.*

*by Michael Duane Archer*

**C**harles B. Goodman devised two trading theories, the Goodman wave (GWT) and market environments (ME), and used them effectively in trading equities and commodity futures. I have further developed his work, codifying much of it. Even though I have written complex computer trading programs, GWT and ME are still my “go-to” trading methods. I have used them successfully in equities as a registered investment advisor, in futures as a commodities

trading advisor (CTA), and in forex as a private trader.

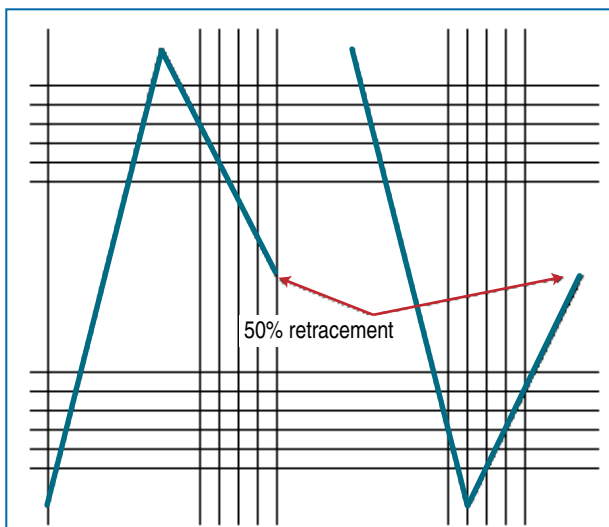
Here, I will discuss the three principles of the GWT: propagation, intersection, and 3-C. These will also show how Goodman differs from other wave and swing theories. Finally, I provide a useful trade setup, the propagation trade setup (PTS), derived from GWT principles.

### THE 50% RETRACEMENT AND MEASURED MOVE

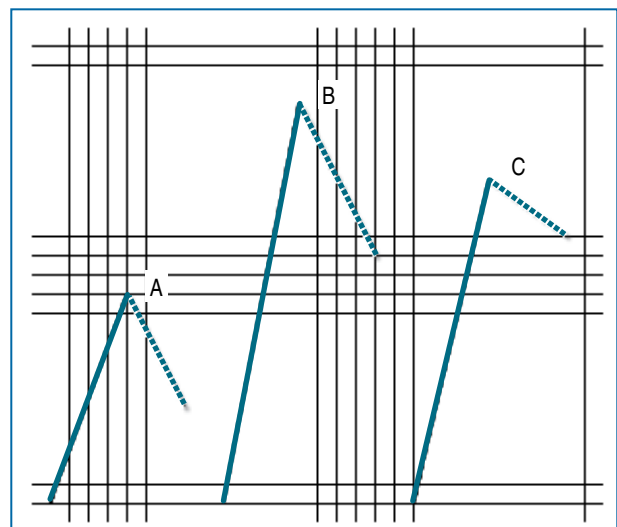
The Goodman wave theory begins with the 50% return and measured move rules and constructs a complete trading approach from the ideal 1-2-3 wave.

The 50% rule, an old but very sound one, states that prices will find support or resistance at the 50% retracement of a price swing (Figure 1). The logic is easy enough to understand. At the 50% point all the buyers and sellers in the swing are basically even. Half of the buyers and half of the sellers have profits; half of the buyers and half of the sellers have losses. Goodman taught me the importance of being able to detect the underlying logic in any chart formation or indicator tool. The relative strength index (RSI) is, after all, a flavor of the slope-intercept equation from high school algebra:

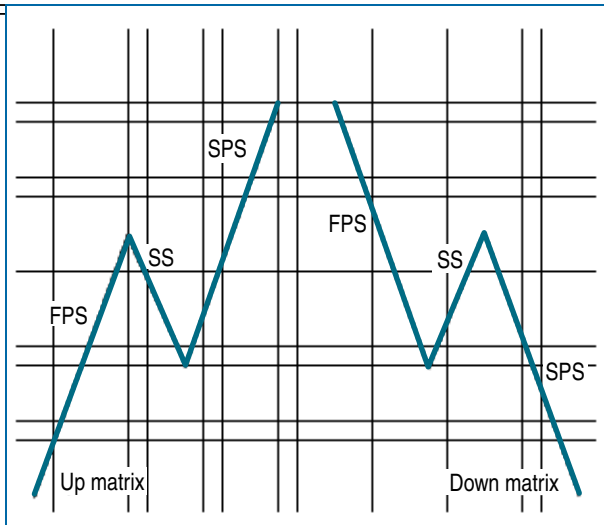
$$y = mx + b$$



**FIGURE 1: THE 50% RETRACEMENT.** The Goodman wave theory begins with the 50% return and measured move rules. The 50% rule simply states prices will find support or resistance at the 50% retracement of a price swing.



**FIGURE 2: THE SWING.** In GWT, a swing is a price trend without more than a 25% retracement. The dotted lines in A and B are swings.



**FIGURE 3: THE MATRIX.** A matrix is composed of three swings, two primary ones — first primary swing (FPS) and secondary primary swing (SPS) — and a secondary swing (SS).

In GWT, a swing is a price trend without more than a 25% retracement. In Figure 2 the dotted lines in A and B are swings. When these buyers and sellers unwind, it will create a measured move at which price point, assuming all else is constant, either all buyers have profits and all sellers have losses (up swing) or all sellers have profits and all buyers have losses (down swing).

This 1-2-3 measured move is the ideal building block and a matrix composed of three swings: two primary (first primary swing [FPS] and second primary swing [SPS]) and one secondary (secondary swing [SS]). The diagram in Figure 3 displays an up matrix and a down matrix. A matrix need not conform to the ideal measurements as long as the SS is a swing.

### THE PROPAGATION PRINCIPLE

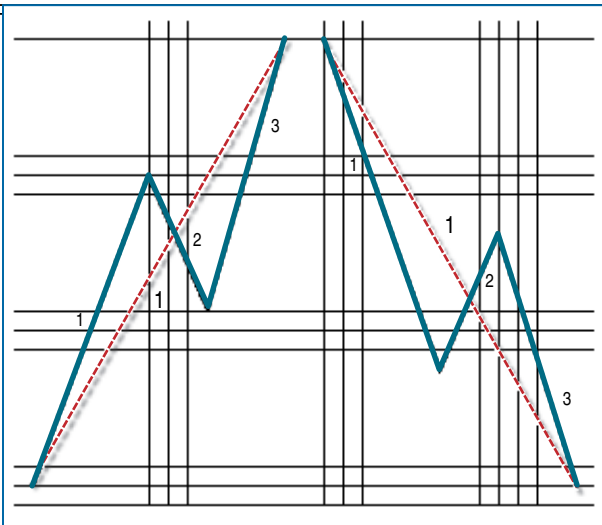
Matrixes are said to *propagate*, or multiply; once a matrix is formed, it has the potential to become an FPS in a larger 1-2-3 wave (Figure 4). Markets that propagate with four, five, or even six propagations, from very small to very large, are not uncommon.

In GWT, every matrix is composed of smaller matrixes, and every matrix is itself part of a larger one. Looking at it from the first perspective, matrixes are nested in larger matrixes (Figure 5). Looking at it from the second perspective, matrixes are said to multiply, or propagate.

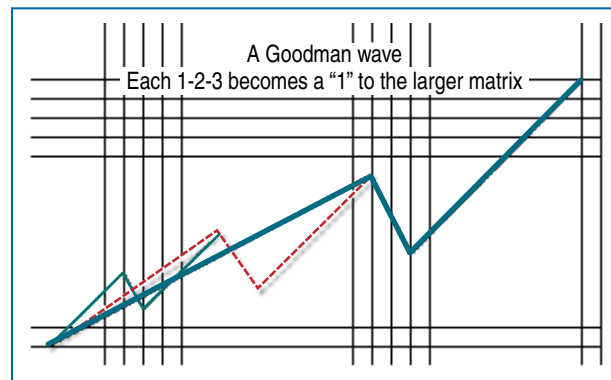
In GWT, a propagated matrix is a Goodman wave. Here's a common and useful corollary: If primary swing 1 is itself a 1-2-3, then primary swing 2 will usually be a simple swing with no secondary components. If primary swing 1 is a simple swing with no secondary retracement, primary swing 2 will usually be a 1-2-3. This is called the *flat-complex principle* (Figure 6).

### GOODMAN VERSUS ELLIOTT

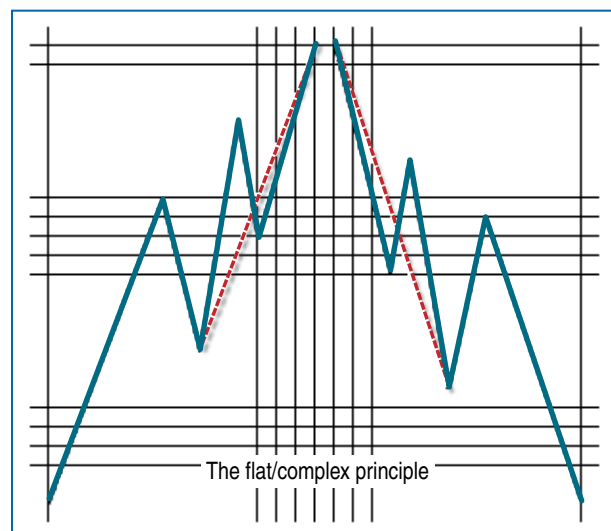
GWT has some factors in common with the Elliott wave theory but there are quite a few differences, the most important of which is that GWT sees a 1-2-3 as the primary building block, whereas Elliott sees a 1-2-3-4-5 as primary. This is the first of three major differences between Goodman and Elliott.



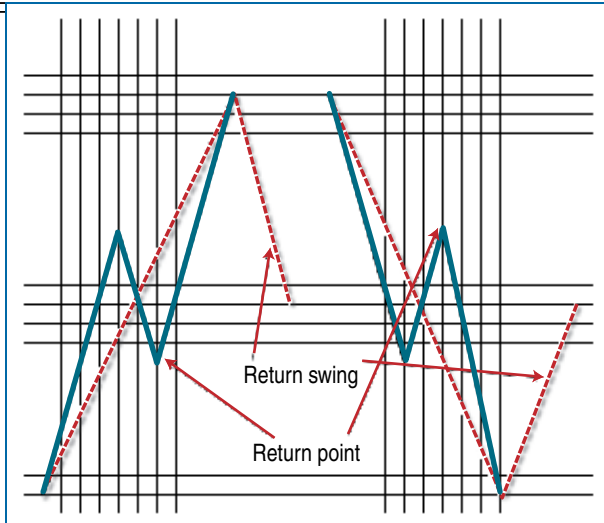
**FIGURE 4: THE PROPAGATION PRINCIPLE.** Matrixes are said to propagate. Once a matrix is formed, it has the potential to become a 1 in a larger 1-2-3. Markets with four, five, or six propagations from very small to very large are not uncommon.



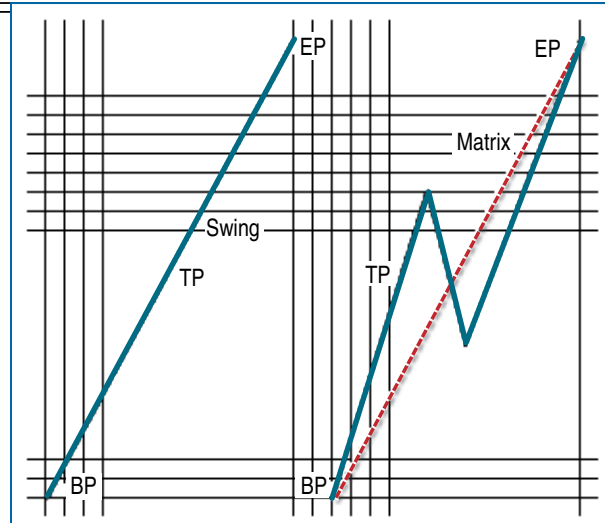
**FIGURE 5: NESTING OF MATRIXES.** In GWT every matrix is composed of smaller matrixes and every matrix is itself part of a larger one. Looking at it from the first perspective, matrixes are nested in larger matrixes (Figure 5). Looking at it from the second perspective, matrixes are said to “propagate.”



**FIGURE 6: FLAT/COMPLEX PRINCIPLE.** In GWT a propagated matrix is a Goodman wave. Note a very common and useful corollary of Goodman wave: If primary swing 1 is itself a 1-2-3, then primary swing 2 will usually be a simple swing with no secondary components. If primary swing 1 is a simple swing with no secondary retracement, primary swing 2 will usually be a 1-2-3.



**FIGURE 7: RETURN OR RETURN SWING.** The end point (EP) of the previous secondary swing is the return point. The price area between the return and return point is very strong and often results in a reversal or at least a powerful bounce in prices.



**FIGURE 8: THREE KEY POINTS.** Every swing or matrix has three key points. Remember, in GWT a matrix becomes a swing for purposes of analysis once it forms. These points are: 1) the beginning point of the swing or matrix (BP), 2) the end point (EP), and the 3) 50% point (TP).

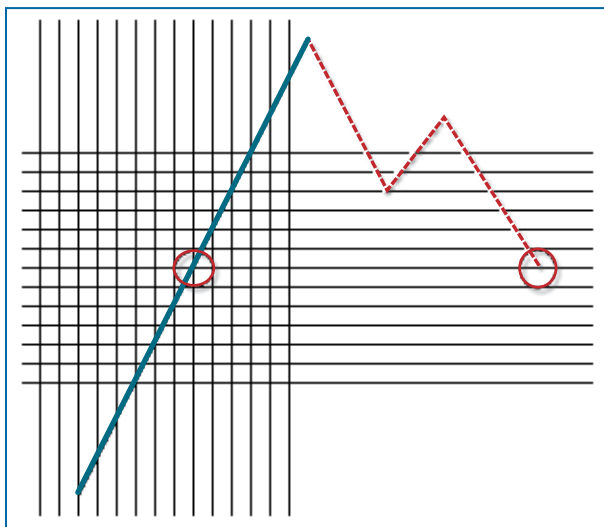
This is not simply syntax. Since matrixes propagate, there is a key difference in the 4 swing. In Elliott, the 4 swing is related to the 3 swing. In the Goodman wave theory (GWT), the 4 swing is the beginning of a propagation and is related to the entire 1-2-3 matrix.

In GWT, the 4 swing is called the *return swing*. The end point (EP) of the previous secondary swing is the return point (Figure 7). The price area between the return and return point is very strong and often results in a reversal or at least a powerful bounce in prices.

If you have studied Elliott, you may have discovered that problems — usually resulting in multiple forecasts — begin with that key 4 swing. According to GWT, the 4 is not related to just 3 but to the entire 1-2-3, which has become a 1 in propagation.

### THE INTERSECTION PRINCIPLE

Every swing or matrix has three key points (Figure 8). Remember, in GWT a matrix becomes a swing once it forms.



**FIGURE 9: THE INTERSECTION PRINCIPLE.** Here you see a double intersection. The EP of the secondary swing matrix intersects the TP of the primary swing. This is a 3 template in Goodman wave theory.

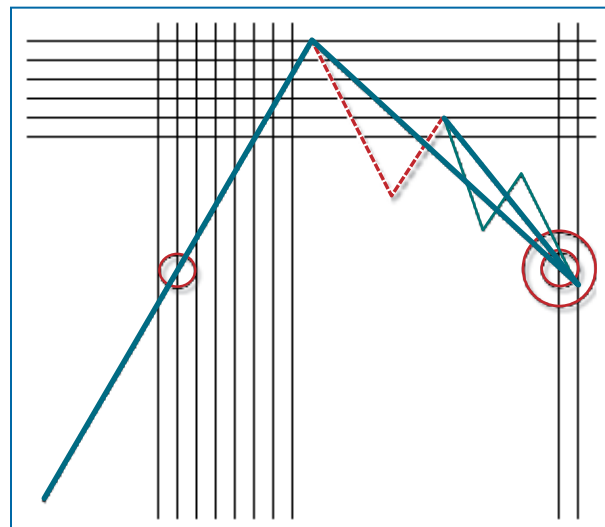
These points are the beginning point of the swing or matrix (BP), the end point (EP), and the 50% point (TP).

In GWT, an *intersection* is a price where the points of two or more matrixes meet. The TP is an important equilibrium point. In the standard 50% component of two swings, the EP of the secondary swing intersects the TP of the primary swing (Figure 1). The Goodman wave theory takes this a step further: If more swing and/or matrix points meet at the same price, the equilibrium should be even stronger and more worthy of attention!

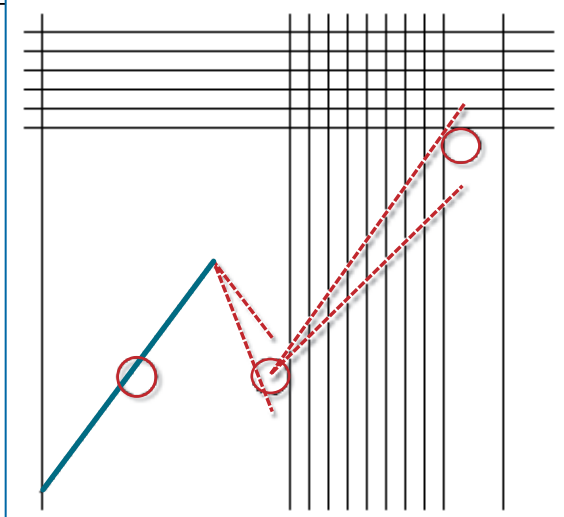
In Figure 9, you see a double intersection. The EP of the secondary swing matrix intersects the TP of the primary swing. This is an example of a standard intersection form — a template — and it is a “3” in the GWT.

In Figure 10 you see a triple intersection. Here, the SPS of the secondary swing matrix is itself a matrix. Its EP intersects with the entire secondary swing matrix and the TP of the primary swing.

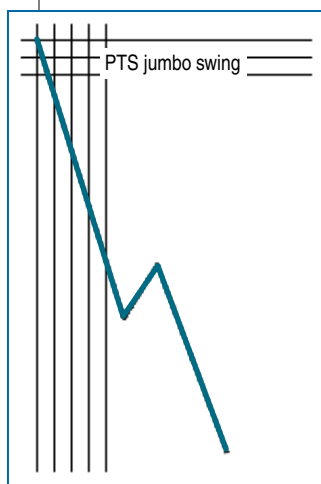
GWT has identified a number of standard intersection forms,



**FIGURE 10: TRIPLE INTERSECTION.** Here, the SPS of the secondary swing matrix is itself a matrix. Its EP intersects with the entire secondary swing matrix and the TP of the primary swing.



**FIGURE 11: THE 3-C PRINCIPLE.** “3-C” stands for compensation, carryover, and cancellation. In GWT if prices miss the 50% retracement, either by going too far or not far enough, that amount will be made up on the next swing, the second primary swing of the measured move, or matrix 1-2-3.



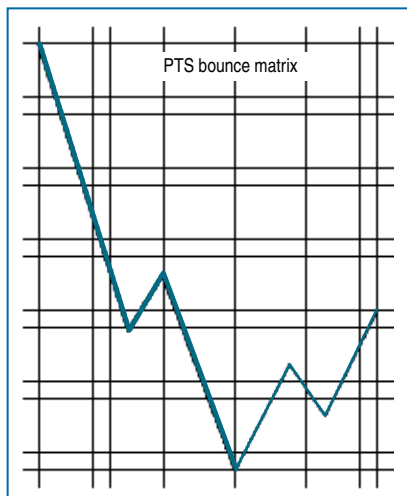
**FIGURE 12: JUMBO SWING.** First locate the EP of a relatively long and straight swing. You may wish to follow a swing occurring on a four-hour chart, waiting for its EP to stop floating.

templates, in price action. From what I’ve seen, nearly 90% of all charts may be reduced to one of six such templates. And this is the second difference between GWT and EWT. All wave theories have some level of indeterminacy. In Goodman, intersections and templates lower the level of indeterminacy.

### THE 3-C PRINCIPLE

Another difference between Elliott and the Goodman swing count system: the latter provides a built-in counting scheme to make forecasts more accurate and to cut down on the number of possible forecasts. In the years I have mentored traders on GWT, the 3-C principle, which stands for “compensation, carryover, and cancellation,” is typically received as the most fascinating.

In GWT, if prices miss the 50% retracement by going too far or not far enough in the SS, that amount will be made up on the next swing, the second primary swing of the measured move or matrix 1-2-3 (Figure 11). Prices will be over or under the measured move by that amount. The logic is similar to that of the



**FIGURE 13: THE NEXT STEP.** The next step is to wait for a small matrix or 1-2-3 to form.

## The Goodman wave theory is logical, transparent, and easy to apply.

measured move: any imbalance will need to be compensated at some point.

Here’s an example: The FPS is 12 units. One secondary swing is two units short of the primary swing 50% point (TP) and the other SS is two units long of the primary swing TP. The target value where the matrix cancels will either be two units short of 12 (10 units) or two units long of 12 (14 units) as measured from the FPS TP. The “over” or “under” will reestablish buyer–seller equilibrium.

This is the primary count. If prices have not canceled, a secondary count is made to the next swing. By offering target price zones, GWT further responds to indeterminacy. Prices will compensate for missing the 50% retracement. That amount will carry over until it cancels.

### THE PROPAGATION TRADE SETUP

From GWT it is possible to derive a number of useful tactical trade setups. The templates are the major source of setups. Trading the return — anticipating at least a bounce reaction from between the return swing end point (EP) and the return point — is yet another. But my personal favorite is the propagation trade setup (PTS). It is easy to use and the formation itself is common on all time frames of charts in equities, commodities, and currencies. Here’s how it works:

**Step 1:** Locate the EP of a relatively long and straight swing. You may wish to follow a swing occurring on a four-hour chart, waiting for its EP to stop floating. I call this the *jumbo* swing (Figure 12).

**Step 2:** Wait for a small matrix or 1-2-3 to form (Figure 13).

If you found the jumbo on a four-hour chart, you may want to watch for the PTS matrix on a one-hour chart.

**Step 3:** Watch for the 4 return swing to form (Figure 14).

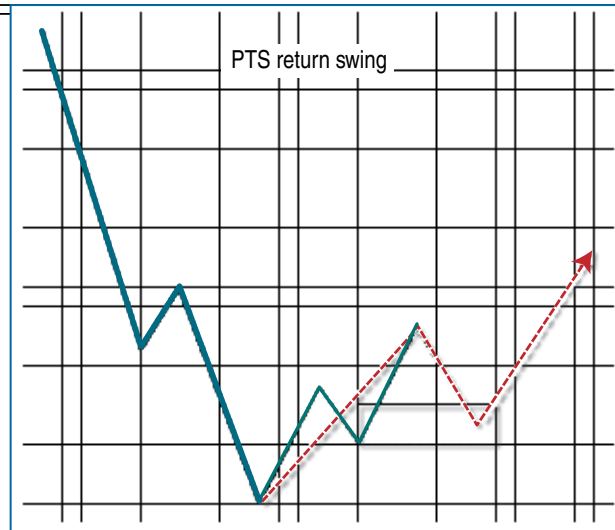
Ideally, the EP of the return swing should be between the 50% point of the matrix and the EP of the matrix secondary swing EP. The PTS is said to be “in the zone.”

Remember, in GWT the 4 swing is connected to the entire previous 1-2-3 swing. A 50% retracement is for the entire 1-2-3. The 1-2-3 swing becomes a larger 1 and the 4 becomes a 2.

**Step 4:** Wait for price to move back in the direction of the matrix and buy or sell with a stop-loss below the formation. You can use an even smaller (15-minute chart) 1-2-3 formation or an indicator such as a moving average to determine the short-term reversal of prices. Your target is the measured move, adjusted



**FIGURE 14: STEP 3.** Watch for the 4 return swing to form.



**FIGURE 15: THE TARGET.** Wait for price to move back in the direction of the matrix and buy or sell with a stop-loss below the formation. Your target is the measured move, adjusted for the 3-C, of the propagated second primary swing. Here the target is also the TP of the jumbo swing.



**FIGURE 16: PROPAGATION TRADE SETUP.** Here you see an example of a PTS trading the GBP/USD pair. Keep in mind that this is just the basic paradigm.

for the 3-C of the propagated second primary swing. In Figure 15 the target is also the TP of the jumbo swing.

In Figure 16 you see an example of a propagation trade setup trading the British pound/US dollar pair. There is more to the PTS; this is just the basic paradigm.

### ADVANCED CONCEPTS

There are a number of other GWT principles as well as several key concepts such as overlay, dominance, breakaway, Siamese swing, and the Goodman knot. But perhaps most interesting is the time-based parallel to GWT's price-based forecasting. Charles Goodman considered his wave theory to be composed of two components, SCS for prices, which has been the main topic of this article, and the cycle count system (CCS) for time. Whereas

SCS gives vertical price ranges for points and intersections, CCS generates horizontal time ranges. Together, they form price-time box targets on a chart called *landing areas*.

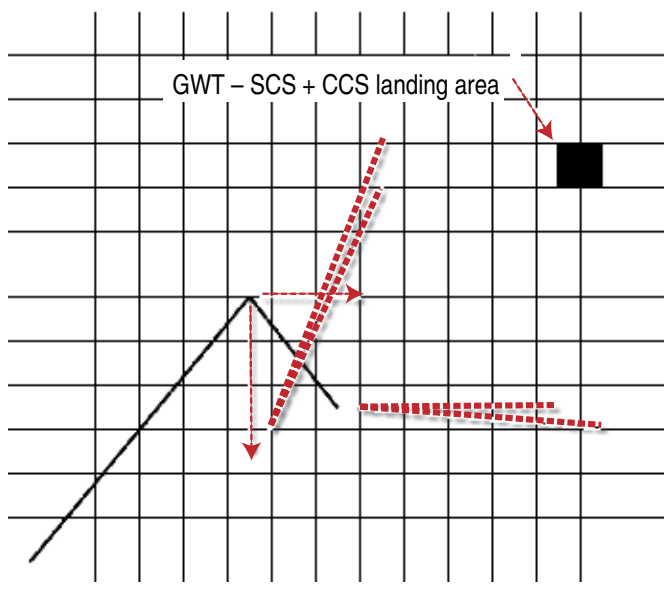
In the example shown in Figure 17, the solid lines refer to FPS-SS component. The vertical dotted lines refer to GWT/SCS price counts and the horizontal dotted lines to the GWT/CCS time counts. I leave it to the reader to map the principles of SCS (price) to CCS (time) with the caveat that they are nearly identical.

### CONCLUSION

No technical analysis method works in all situations. At best, GWT is a more accurate way to analyze swing movements than Elliott; at worst, it offers an alternative and complementary tool.

The Goodman wave theory is logical, transparent, and





**FIGURE 17: GOODMAN WAVE THEORY.** The solid lines refer to FPS-SS component. The vertical dotted lines refer to GWT/SCS price counts and the horizontal dotted lines to the GWT/CCS time counts.

easy to apply. It is a comprehensive trading approach built from two intuitive ideas or axioms — the 50% rule and the measured move. A detailed exposition would require more space. Nevertheless, you now have enough to work with it and decide if it complements your own approach to technical trading in equities, commodities, and currencies.

*Michael Duane Archer has been an equities, futures, and forex trader for more 30 years. He has authored or coauthored a number of books on forex trading, including Getting Started In Currency. He writes The Goodman Theory Letter and The PTS Trader. His website is [www.goodmanworks.com](http://www.goodmanworks.com).*

**The Goodman wave theory is logical, transparent, and easy to apply.**

#### RELATED READING

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