

# **Dow Theory**

## **Unit 1-Topic 2**

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# Dow theory

- ▶ The Dow Theory has been around for almost 100 years, yet even in today's volatile and technology-driven markets, the basic components of Dow Theory still remains valid.
- ▶ Developed by Charles Dow, refined by William Hamilton and articulated by Robert Rhea, the Dow Theory addresses not only technical analysis and price action, but also market philosophy.

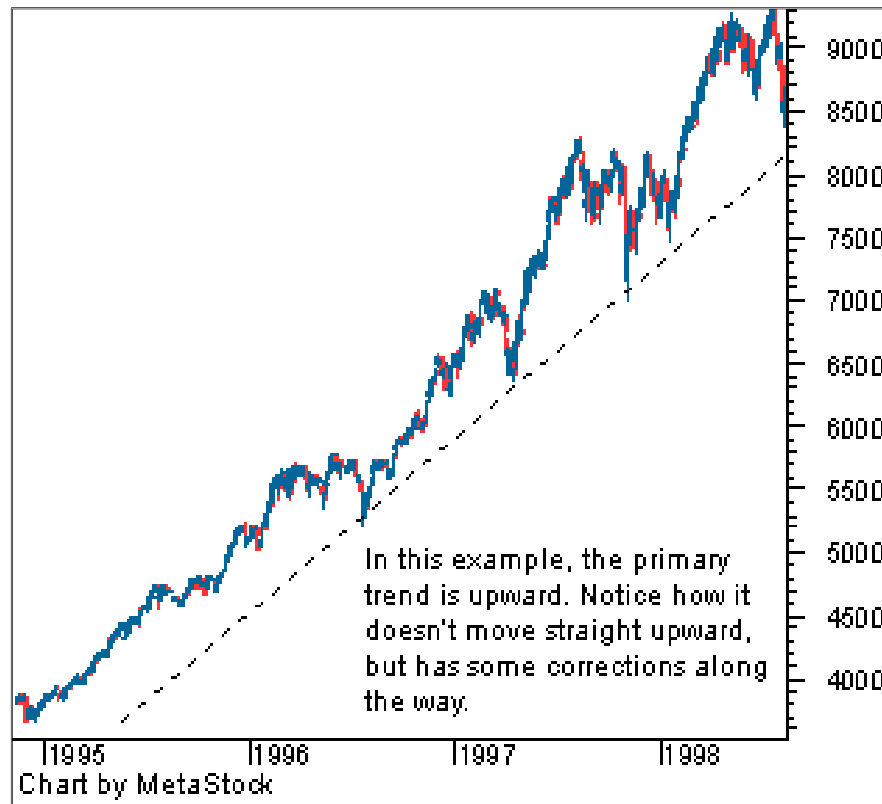
# Background

- ▶ Charles Dow developed the Dow Theory from his analysis of market price action in the late 19th century.
- ▶ Dow and Hamilton identified three types of price movements for the Dow Jones Industrial and Rail averages: **Primary Movements, Secondary Movements and Daily Fluctuations.**
- ▶ **Primary** moves last from a few months to many years and represent the broad underlying trend of the market.
- ▶ **Secondary** (or reaction) movements last from a few weeks to a few months and move counter to the primary trend.
- ▶ **Daily fluctuations** can move with or against the primary trend and last from a few hours to a few days, but usually not more than a week.

# Primary Movements

- ▶ Primary movements represent the broad underlying trend of the market and can last from a few months to many years. These movements are typically referred to as bull and bear markets. Once the primary trend has been identified, it will remain in effect until proven otherwise.
- ▶ The length and the duration of the trend were largely indeterminable.
- ▶ The objective of Dow Theory is to utilize what we do know, not to guess about what we don't know. Through a set of guidelines, Dow Theory enables investors to identify the primary trend and invest accordingly.
- ▶ Trying to predict the length and the duration of the trend is an exercise in futility. Success, according to Hamilton and Dow, is measured by the ability to identify the primary trend and stay with it.

## Primary Uptrend



## Primary Downtrend



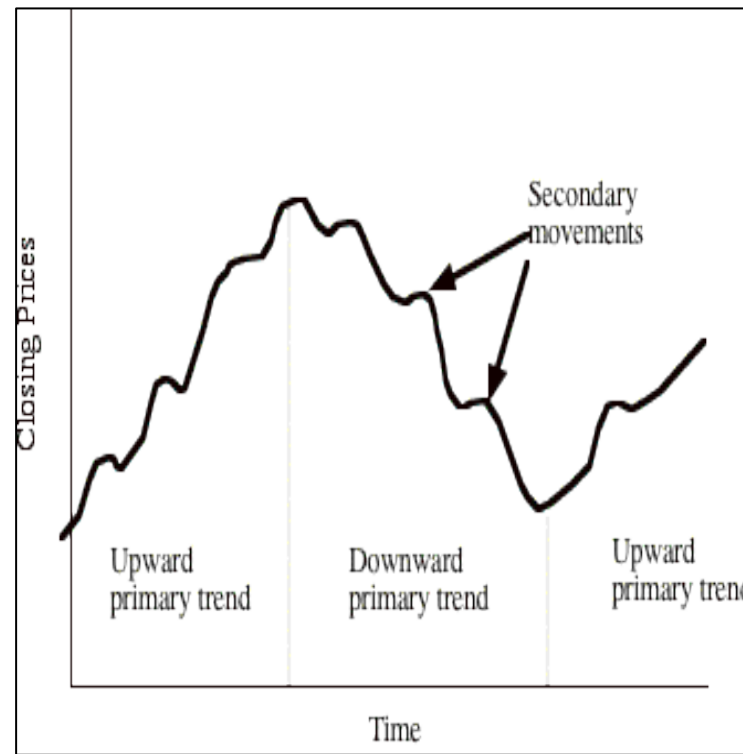
# Secondary Movements

- ▶ Secondary movements run counter to the primary trend and are reactionary in nature. In a bull market a secondary move is considered a correction. In a bear market, secondary moves are sometimes called reaction rallies.
- ▶ Based on historical observation, It is estimated that secondary movements retrace  $\frac{1}{3}$  to  $\frac{2}{3}$  of the primary move, with 50% being the typical amount.
- ▶ Secondary moves tend to be faster and sharper than the preceding primary move. Just with a visual comparison, we can see that the secondary move was sharper than the preceding primary advance.
- ▶ Investors often mistake a secondary move for the beginning of a new primary trend.

## Secondary Uptrend



## Secondary Downtrend

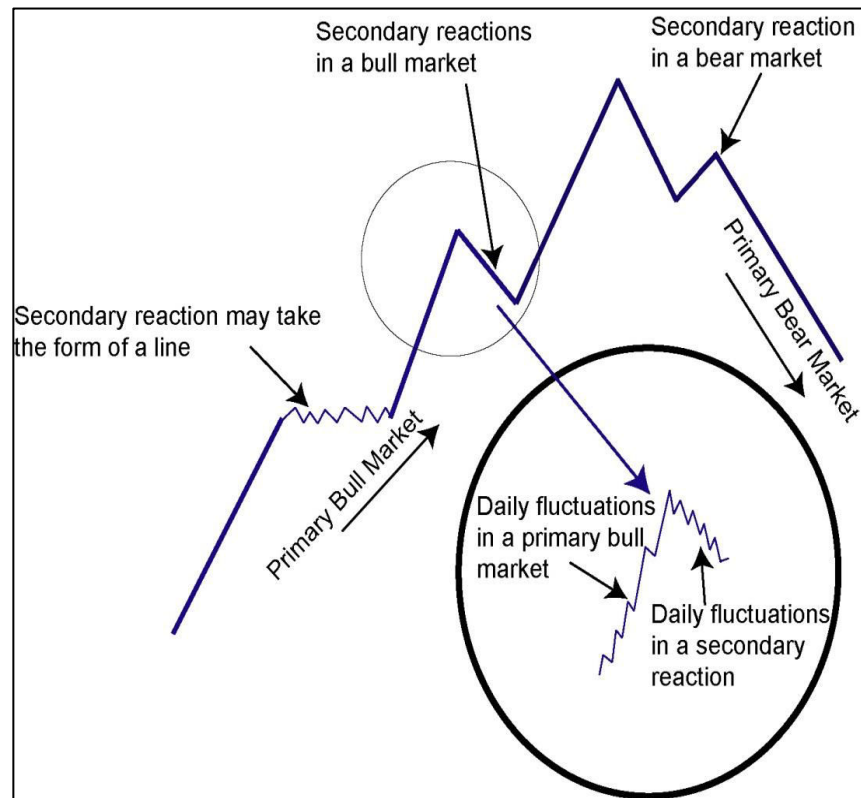


# Daily Fluctuations

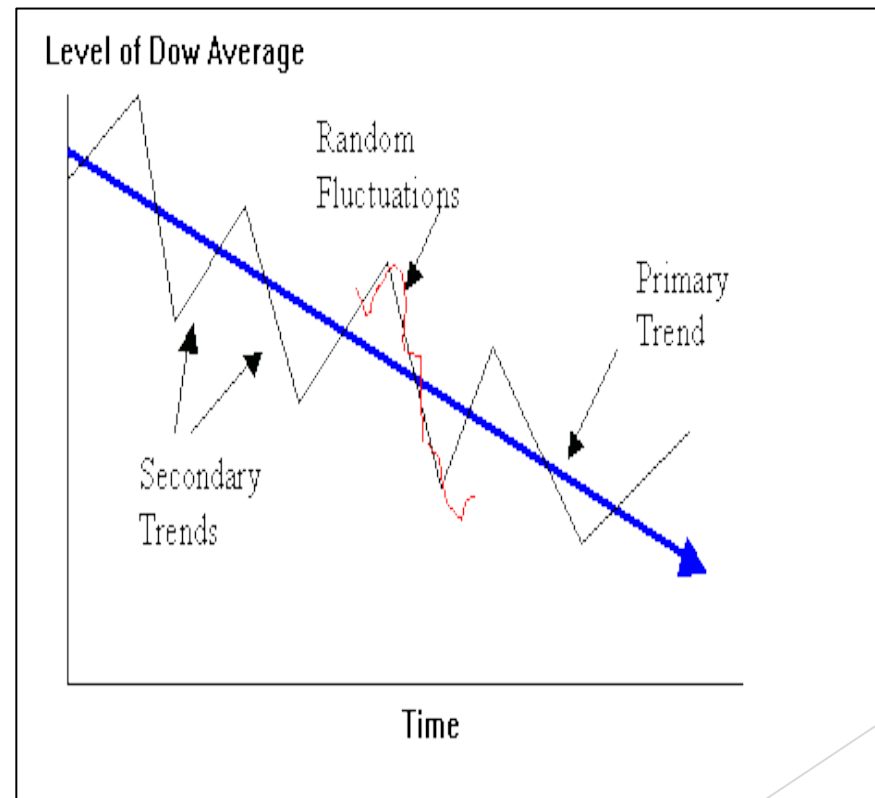
- ▶ Daily fluctuations can be dangerous and be unreliable individually.
- ▶ They are also called as Minor Movements or Tertiary Movement.
- ▶ Due to the randomness of the movements from day to day, the forecasting value of daily fluctuations is limited at best. At worst, too much emphasis on daily fluctuation will lead to forecasting errors and possibly losses.
- ▶ Daily price movements are important, but only when grouped with other days to form a pattern for analysis. The study of daily price action can add valuable insight, but only when taken in context of the larger picture.



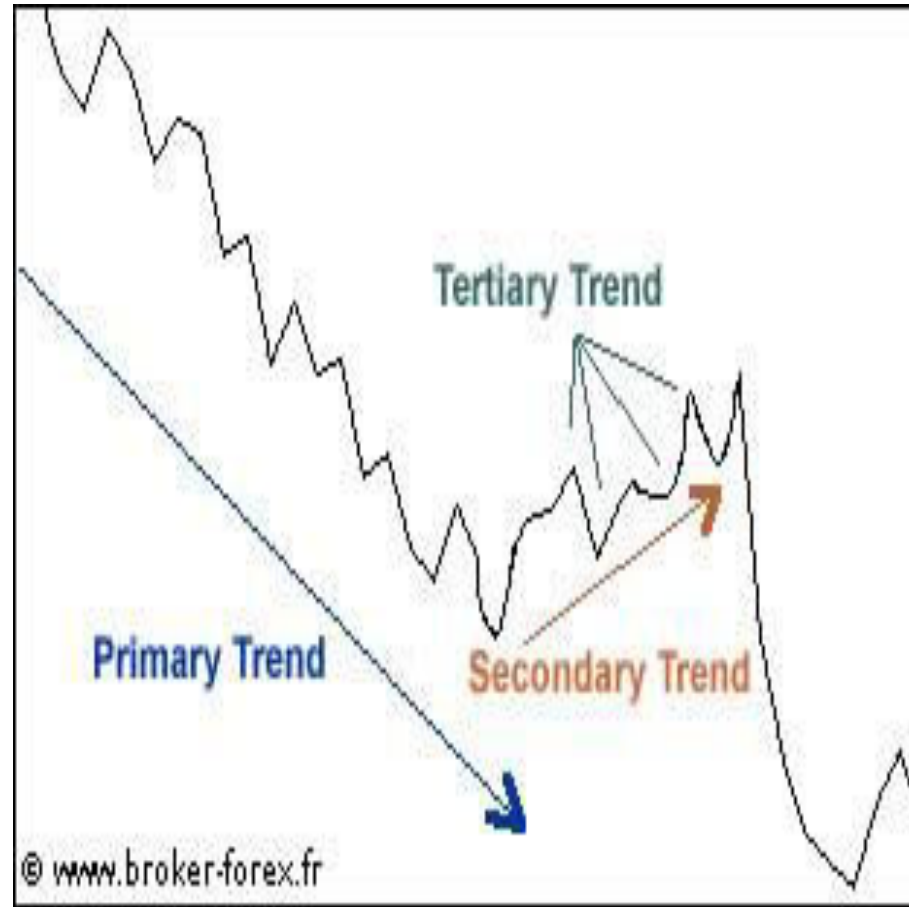
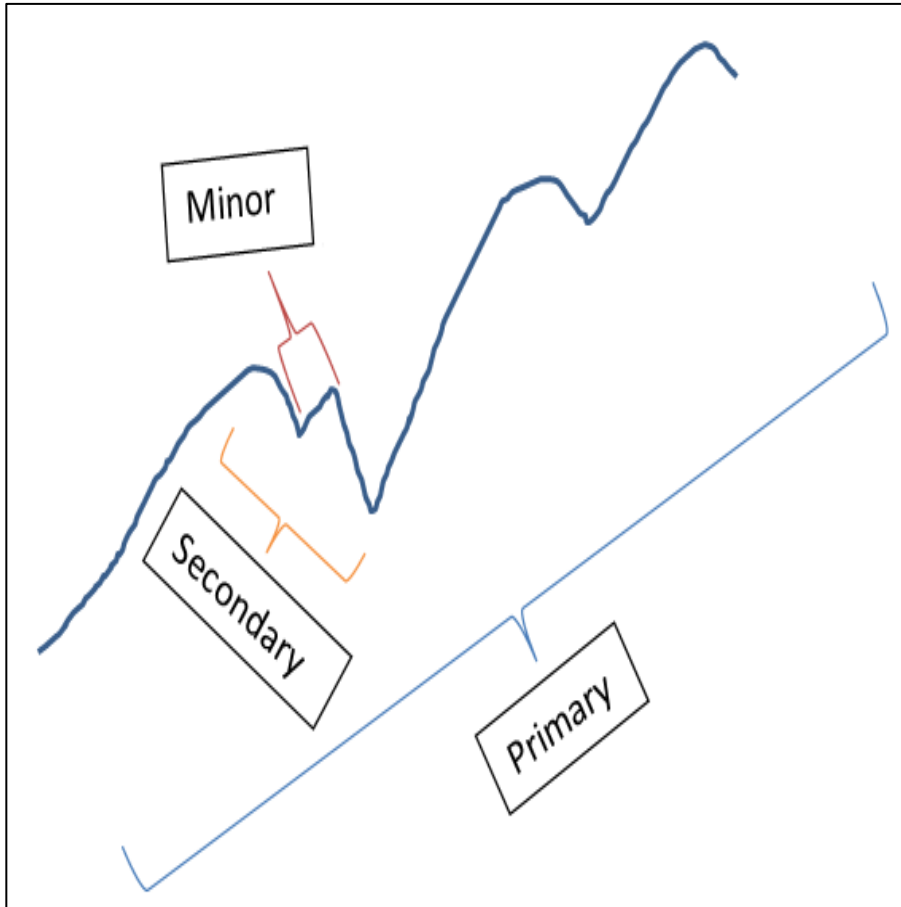
## Daily Fluctuations-Uptrend



## Daily Fluctuations-Downtrend



# Dow Theory





THANK YOU