

VOLUME

2

HARMONIC TRADING

ADVANCED STRATEGIES FOR PROFITING FROM
THE NATURAL ORDER OF THE FINANCIAL MARKETS



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Introduction

After years of research, Harmonic Trading has evolved into a distinct and comprehensive methodology that effectively analyzes the financial markets. The basic tenets of pattern recognition as quantified by harmonic ratios define a system that provides immensely pertinent technical information and identifies trading opportunities unlike any other methodology. It is important to consider the substantial advancement of Harmonic Trading since its inception.

The release of my first book, *The Harmonic Trader*, marked the beginning of the entire methodology. The new measurement techniques presented in this book quantified price action in a unique manner. These new ideas created the framework of an unprecedented Fibonacci measurement and price pattern recognition system that consistently defined profitable trading opportunities. Although it was not my intention to formulate such a system, these strategies were the result of extensive research to discover the most effective relationships that were encompassed by these measurement tools. Through it all, I precisely refined many general concepts and publicly divulged many “secret” strategies that comprised the fundamentals of the Harmonic Trading approach.

The unprecedented combinations of specific ratios that differentiated similar price structures as exact patterns defined an effective trading methodology, yielding relevant technical information in an unprecedented fashion. Although others years before me have utilized Fibonacci ratios within the realm of Technical Analysis, the concept of exact ratio alignments presented a new means to define M-type and W-type price structures. These precise patterns offered greater accuracy in the often vague discipline of pattern recognition for many traders.

Although the rules that define harmonic patterns seem to be common knowledge today, it wasn't too long ago that these strategies were practically considered avant-garde within the field of Technical Analysis. This new application of Fibonacci ratios created a system of rules that defined price patterns in an unprecedented fashion. For example, the common definition for the Gartley pattern—requiring a 0.618 retracement and a 0.786 retracement at the B and D points, respectively—which was originally outlined in *The Harmonic Trader*, has become the standard within the technical community.

These strategies have proven themselves effective through the years, but this success has engendered many Harmonic Trading-related systems that have skewed the basic tenets of the approach. These outfits have espoused the mystical charm of Fibonacci ratios to present more

of a “secret code” to the financial markets than a proven system of measurement strategies within the discipline of Technical Analysis. Although I will address the problem of misinformation and unscrupulous “gurus” a little later in this Introduction, there are two critical concepts to be mindful of while studying this material:

- **Harmonic Trading is more than Fibonacci.** Anyone somewhat familiar with this methodology understands that Harmonic Trading is much more than general Fibonacci analysis. The entire Harmonic Trading approach comprises a variety of tools that include more than simple Fibonacci measurement techniques and integrates a complex system of execution and management strategies. Moreover, the new ideas presented in this book incorporate an even wider gamut of unprecedented trading tools.
- **Harmonic Trading is still evolving.** In my first book, I presented a number of technical measurement strategies that quantified price patterns with respect to their alignment of Fibonacci ratios. *The Harmonic Trader* was unprecedented in that it was the first material to emphasize the importance of exact alignments and to employ specific ratio combinations that differentiated a variety of patterns. Although *The Harmonic Trader* outlined the framework of this methodology, *Harmonic Trading: Volume One* represented a substantial advancement to the basic approach. Those two books represent more than 500 pages of some of the most comprehensive pattern strategies within the field of Technical Analysis and dedicate a considerable portion of the material to identification techniques, outlining the strict rules that validate structures as patterns. This book builds upon that foundation and improves upon the entire methodology to outline effective trading strategies from start to finish.

Since its release in 1999, many have tried to lay claim to the ideas that were first espoused in *The Harmonic Trader*. Despite other interpretations, *Harmonic Trading: Volume One* truly distinguished this approach from the often misguided and misappropriated use of basic Fibonacci strategies. Meanwhile, this book advances the basic tenets of Harmonic Trading offering greater “standardization” of pattern structures and improved confirmation strategies that optimize trading decisions.

As these strategies evolve, there will continue to be a need for more thorough statistical validation to improve the application of these methods and to enhance the overall accuracy of the approach. In fact, this is a driving principle behind the entire Harmonic Trading system—always improve upon what works. Although this may challenge the old adage: “If it ain’t broke, don’t fix it,” the effectiveness of this approach (and of any trading methodology) depends upon continual improvement. I offer comprehensive case studies throughout this material. I will continue to compile research to validate the effectiveness of the Harmonic Trading approach. Furthermore, new concepts such as the RSI BMM and the 5-0 pattern represent substantial improvements upon the initial foundation of this methodology.

New Ideas in Harmonic Trading

The strategies outlined in this book are entirely new concepts that build upon the prior material presented within the Harmonic Trading approach. Many new topics will be presented with particular emphasis on the Harmonic Impulse Waves, patterns within established trends, and

BAMM Theory. In particular, the entire RSI BAMM strategy will be outlined. I will present new patterns such as the 5-0, the Reciprocal AB=CD, and the Alternate Bat. Although *Volume Two* references many of the basic tenets of the Harmonic Trading approach, this material consists of mostly new ideas and trading strategies. The new patterns and expanded measurement techniques significantly advance the primary identification tools established within this approach. For example, the 5-0, the Alternate Bat, and the Reciprocal AB=CD are important new structures within the existing array of harmonic patterns. Furthermore, these new structures also comprise the basic framework of more advanced techniques. Hence, *Volume Two* represents a significant evolutionary step and an essential new direction that enhances the existing methodology immensely.

The most significant concept presented in this book and the most profound advancement of the entire Harmonic Trading methodology is outlined in the RSI BAMM methodology. This new complex system incorporates a standard technical indicator—the Relative Strength Indicator (RSI)—with advanced Harmonic Trading measurement techniques. The RSI BAMM employs precise ratio measurements and exact structural pattern specification to identify critical technical price levels. All of the material in *Volume Two*—especially the RSI BAMM—offers unprecedented strategies that identify the areas where overall trend divergence and harmonic pattern completions define the most critical technical levels. In addition, the new ideas presented in this material advance the basic theory of price pattern recognition by requiring other technical conditions to exist to validate potential opportunities with improved accuracy. Specifically, the advancement of the RSI BAMM separates the minor reactive moves from the more substantial trading opportunities and provides extensive technical information regarding the future potential direction of the price action. Although this material will take some time to digest, I believe these advanced concepts dramatically enhance the entire Harmonic Trading system, furthering its efficacy in pinpointing the best trading opportunities.

Technical Entities Continued...

In *Harmonic Trading: Volume One*, I discussed the importance of specific pattern alignments as defined “technical entities.” It is important to note that the prescribed set of harmonic ratios that define these structural entities has been differentiated, analyzed, and refined to develop pattern-specific strategies for each situation. Although I covered it extensively in *Volume One*, it is important to remember that “The Great Gartley Controversy” emphasized the necessity of pattern differentiation and underscored the essential argument that not all patterns (Gartleys) are the same. New “technical entities” in the form of unprecedented harmonic price patterns outlined in this book, such as the 5-0, the Alternate Bat, and the Reciprocal AB=CD, further the basic identification strategies of M-type and W-type price structures. These new patterns adhere to the primary principle of defining specific technical situations based upon their respective ratio alignments. Clearly, the material presented in *Volume Two* furthers the specification of the Harmonic Trading methodology by offering a new level of strategic analysis. The improved measuring techniques enhance the precision and the overall accuracy of this approach in its ability to define the most critical turning points in the financial markets.

Harmonic Trading: Volume One was a major advancement of the principles of the primary pattern identification theory. The addition of unprecedented measurement techniques such as new harmonic ratios, new patterns, and other comprehensive strategies, expanded the existing array of effective trading tools and substantially bolstered the overall Harmonic Trading discipline. *Volume One* presented a step-by-step approach with effective strategies for the entire trading process. From initial identification to trade execution to money management, a comprehensive plan was presented with each aspect thoroughly considered. In this regard, I have been pleased that this material provides a solid decision-making framework of probable answers for all possible questions that might arise during the trading process. From pattern identification to the eventual execution of a trade, all possible actions have been outlined to facilitate decisions, especially when unexpected real-time considerations can affect the outcome.

The material in *The Harmonic Trader* and *Harmonic Trading: Volume One* effectively defined this system. However, through the years, I have continually strived to improve the Harmonic Trading approach and build upon this foundation. Hence, I present *Volume Two*. It is important to note that the material within this book takes Harmonic Trading into new territory. Most of the ideas outlined in *Harmonic Trading: Volume Two* are unprecedented, and they have not been released previously in any other material. *Volume Two* advances the comprehensive methodology of pattern identification presented in *Volume One* to incorporate new technical measures that refine and filter the best trading opportunities. Advanced techniques, such as the RSI BAMM, represent my most sophisticated trading techniques to date. It is my desire to distinguish Harmonic Trading as a serious discipline within the field of Technical Analysis. Such distinction has become increasingly important to me in recent years, as certain individuals have attempted to capitalize on the burgeoning popularity of Fibonacci-related trading strategies, while tarnishing the inherent principles of Harmonic Trading.

Imitators and Agitators

I am compelled to discuss the importance of ethical and accurate reference information regarding these techniques and for that matter, much of the educational material regarding trading the financial markets available today. I have been disappointed with the misinformation and blatant misuse of the concepts first espoused within the Harmonic Trading approach. I'm willing to accept this risk in exchange for the advancement of trading knowledge and for the positive contribution to help others in search of the answers to the financial markets.

When I first began discussing Harmonic Trading on various websites in the 1990s, I was admittedly naive. I openly shared strategies that advanced the basic Fibonacci trading mantra of that era. It was my desire to share with others in the hope that they would provide feedback ultimately furthering this discipline. Although I received a fantastic response from an overwhelming number of traders, I realized that other Fibonacci-related "educators" were picking up on the ideas, as well. I welcomed their response and actively sought to "talk shop" with these traders. Unfortunately, I quickly learned that most of these so-called educators were

just teaching basic and somewhat vague Fibonacci strategies. These people promoted their products by making absurd and controversial statements of phenomenal success. In fact, most of these outfits were only in the business of selling products and not really trading. In some instances, certain research of mine was presented as their own. I realized that I needed to exercise greater discretion and to strive to establish Harmonic Trading as a distinct methodology apart from basic Fibonacci analysis.

Harmonic Trading is a distinct approach to the financial markets within the field of Technical Analysis. The main problem relates more to the misinformation or blatant manipulation of the intrigue and mystery that anything related to Fibonacci ratios inherently possesses. With the recent popularity of books such as *The Da Vinci Code*, the subject of mystical conspiracy-type stories that possess a secret order based upon the “golden proportions” of divine numbers has opened a Pandora’s box of P. T. Barnums in the investment industry. Their ability to flourish and to attract the general public’s attention proves that the inherent curiosity regarding this subject matter can be an easy sell. It seems apparent that harmonic-related trading strategies have become an increasingly popular marketing slogan. Again, I must emphasize that the entire “harmonic concept” of pattern recognition based upon *exact* Fibonacci ratio alignments did not exist until *The Harmonic Trader* was released in the late 1990s. In addition, the entire subject of Fibonacci was a minor niche within the field of Technical Analysis. Harmonic Trading techniques have impacted the technical community and contributed to this recent popularity while others have jumped on the coattails of this approach.

For me, the degree of misinformation spewed to the public with catch phrases such as “market-harmonics, trading in harmony, harmonic secrets” have lumped a great deal of less-than-credible information with the strategies that truly work. It is important for me to take a little time to show some of the troublesome examples that have been offered to the public. I strongly urge people to be cautious regarding outrageous claims of the effectiveness of any system that will make “quick riches” in the financial market, whether it is Fibonacci ratios or fundamentals.

The problem with such claims, especially when the subject of Fibonacci is involved, is that it is simply exploited for its marketing value. In this business, marketing is the key to selling your financial products, as I have unfortunately realized. Unlike many of the financial product vendors, I am not dependent on book sales to make my living. I do this because I am passionate about trading the financial markets and the strategies that unlock its secrets.

I strongly recommend that you perform thorough due diligence before signing up for seminars, purchasing software, or spending substantial money for educational products and services that make outlandish claims. Believe me, Harmonic Trading possesses some of the most effective trading strategies available, but success still depends upon diligent and dedicated work to turn patterns into profits.

Market Gurus Again

These concerns lead into another discussion regarding my disdain for so-called market gurus. Anyone who purports to be a market guru must be cautiously regarded. Simply stated, there

are *no market gurus*. Let me repeat: There are *no market gurus!* In fact, many of these gurus are just people who have failed to be successful traders and have resorted to selling products to make their living. It's such a shame. It is so easy to believe these people and their hype. My question is if they were really making money trading the markets with their methodology, why would they spend the majority of their time selling products? In addition, it's amazing to me that these guys have so much time to dedicate to the marketing of their financial products when the market consumes so much time as a full-time trader. It can be difficult to know the real deal from the jokers selling their products just to make money. In my experience, after thoroughly investigating many of these professionals—either going to their seminars or reading their books and talking with them personally—you quickly realize who's really trading and who is not. It's unbelievable that many of these individuals get so much exposure in the media yet they rarely trade and derive most of their income from selling products. If you want to find the most pertinent material on successfully trading the markets, you must seek out the people who have been or are in the business of trading.

Even more incredulous is the number of people who have come to me after spending thousands—if not tens of thousands of dollars—trying to learn how to trade from self-proclaimed gurus like these. Many of these people have been swindled out of their money while not learning any meaningful trading strategies. I believe that this is one of the greatest pitfalls as a beginner. Engulfed in a sea of (mis)information, it is easy to bounce from one system to the next looking for the answers to the financial markets. I have been there—searching for the answers to the market. Years ago, I struggled to find the best systems, spent thousands of dollars on books and software, and lost even more money attempting to trade these fantastic systems that held no real trading value. Sitting in front of my computer screen, I spent countless hours researching the best techniques. I was willing to look at any approach that proclaimed to have the answers to the market. Unfortunately, most of this research yielded strategies that failed to be reliable techniques in real trading situations.

From a general perspective, I must emphasize that searching for the Holy Grail to the financial markets is just not a realistic approach to achieve consistent success. What is realistic is discovering the order within the chaos in the financial markets, defining that order and being willing to take some risk in return for financial reward. I've dedicated a substantial portion of my life to the intensive study of the financial markets in an attempt to discover the best techniques that are consistently profitable. Through my years of research, I have put together a series of books and a software program that is sufficient to help anyone learn the dynamics of harmonic price action and provide a comprehensive method for effectively trading the financial markets. Whether you are a hedge fund manager with a billion in assets, a retiree trying to maximize your IRA, or a novice trader just beginning, I'm confident that these tools will help you decipher price action better than any other system. In my opinion, the Harmonic Trading methodology offers some of the most reliable and pertinent technical information to identify profitable opportunities and interpret price action.

Then Why Give It Away?

Why give it away? I could simply retain these techniques for my own research and trading. However, I firmly believe that knowledge not shared is worthless. It does not matter that I have taken the necessary legal precautions to protect my intellectual property. Although I am bothered by blatant plagiarism, it is my greatest desire to encourage an open and frank discussion of this material, while freely sharing this information with the public. The most important reason why I'm releasing this book is that I truly want to set Harmonic Trading apart from all of the other Fibonacci-related strategies that have sprouted up in recent years. I believe that the advanced concepts within *Volume Two* demonstrate that Harmonic Trading is one of the most effective and reliable methods to understand the complex dynamics of the financial markets. The material in this book advances the entire system to a new level of accuracy and provides even more effective trading strategies to achieve consistent success.

It's Still Up to You...

I can share these strategies, but the overall success is still dependent upon your dedication and determination to work diligently to follow the markets, analyze price action, and adhere to this methodology. You must be willing to do the work. Although it can be easier to relinquish control to an advisor or professional money management outfit, the ultimate responsibility for success in the financial markets is still up to each individual. The pursuit of market knowledge can be daunting. But it is essential to refuse to allow anyone to deter you from the success that you seek.

The ability to succeed in trading is 100% self-directed. You must find the opportunities, determine which trades to execute, and remain focused on your goals, as no outside element can distract you from your objective. Although this can seem overwhelming at first, Harmonic Trading does possess a comprehensive, start-to-finish methodology to successfully guide you throughout the decision-making process. Despite sharing my most advanced research, it is still entirely up to you to dedicate yourself to this endeavor to realize success.

Although trading can be a solitary pursuit, it is important to remember that you know what's best for yourself—regardless of your level of experience. Many experts and their “immensely successful systems” can be intimidating at first. It can be easy during the early stages of learning any trading system to relinquish control of your own decision-making process to others because they seemingly have better answers or appear to know more than you. Again, the truth is that only you know what's best for yourself, and you must make your own assessments regarding any trading methodology. I encourage questions and welcome any comments and/or criticism to extend an open debate regarding this material. Despite my own beliefs and personal success, I truly encourage you to evaluate this material for yourself.

The Benefits of Advanced Harmonic Trading Techniques

I have always said that Harmonic Trading and the pattern identification techniques in particular within this approach are merely a starting point. These techniques serve as a comprehensive framework that accurately measures and analyzes price action. The ultimate objective of this book attempts to outline specific technical situations within the course of trading that will yield a high degree of reward while minimizing risk. Advanced Harmonic Trading techniques can offer information regarding the potential state of price action unlike any other methodology. When combined with other technical studies and analyzed within the predominant trend, Harmonic Trading strategies can pinpoint the potential “hot spots” where reversals may complete or important continuations of the prevailing direction may develop.

The combination of pattern identification techniques and the utilization of Fibonacci ratios to quantify price action is the greatest asset within the Harmonic Trading approach. As this methodology has become more refined, I’ve realized that there are many other technical indicators that form repetitive patterns in the same manner as price action. In the past, I tended to be exclusive in the application of other technical measurement tools with harmonic price patterns. However, I began to notice over time how frequently many of these indicators were acting as valid confirmation signals in conjunction with the basic pattern recognition techniques. Although many of these integrative strategies are simple applications of standard indicators, the combination of these existing measures with the Harmonic Trading approach yielded more accurate technical information.

The advanced Harmonic Trading strategies offer immense confirmation signals, and they have led to more precise executions within a pattern’s Potential Reversal Zone (PRZ). Essentially, the integration of other measures has resulted in even more accurate projected reversal points for trade executions and hence, more reliable technical information regarding the state of potential price action. At first, the simple integration of many of these indicator readings was generally beneficial. However, as I expanded the use of other technical indicators, I noticed many similar harmonic traits that formed in the indicator readings as did in the actual price action itself. Once I began to see these relationships, I thoroughly explored a variety of indicators to find those that correlated best with the Harmonic Trading techniques and provided the most accurate confirmation signals to validate patterns.

The Best of the Best

This book like the others has been years in the making, and it represents a collection of my best ideas. I’m proud of this book because the techniques that I present in this material are truly original within the field of Technical Analysis. While combining the basic approach of several established technical methodologies, I believe the new ideas in this material integrate the existing unprecedented strategies of Harmonic Trading to create one of the most comprehensive and effective trading systems available today.

It is important to note that I only release strategies that I have tested thoroughly in real trading situations that have produced consistently successful results for me. In my opinion, successful strategies must stand up in real market conditions that reflect the realities of trading and not just shine in well-chosen examples at a weekend trading seminar. I understand that many products and services, especially Fibonacci-related ones, make absurd claims of fortune and success if you spend “only 15 minutes a day.” NO! I make no false promises of quick riches. I offer effective trading tools that help those people who are looking for the answers to the financial markets, as long as they are willing to study and apply themselves through diligent work to achieve consistent success.

My goal in this book is to present a significant advancement of the Harmonic Trading approach that integrates new applications of existing technical measures beyond their standard interpretation. In fact, the extent of new ideas and concepts practically doubles the existing amount of material on the subject. The advanced techniques outlined in this book incorporate only the most pertinent technical measures that substantially increase the accuracy of harmonic patterns to identify the critical turning points in the financial markets. In particular, the RSI BMM exemplifies the effectiveness of these advanced techniques to identify unique technical situations where the completion of harmonic patterns has even greater importance and serves to filter the more meaningful setups from those that possess less significance.

In closing, I want to thank you for taking time to read my material. I want you to know that I’m using these techniques every day to make financial decisions for my clients and myself. I have a responsibility to serve their best interests to the best of my ability. I extend this level of dedication and commitment to all career endeavors. This book reflects such dedication and commitment. I just want you to know that you are getting the real deal here and that I’m grateful to share this information with you. Let’s get started!

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