

The Harmonic Trader

By Scott M. Carney

Library of Congress Cataloging-in-Publication Data

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

From a Declaration of Principles Jointly Adopted by a Committee of the American Bar Association and a Committee of Publishers and Associations.

Copyright HarmonicTrader.com, L.L.C. 1999

This material is protected under all copyright laws. This material may not be reprinted or reused in any manner without the express written consent of Scott M. Carney. All rights reserved!

Printed in the United States of America

HarmonicTrader.com, L.L.C.
P.O. Box 30088
Tucson, Arizona 85751-0088
[www. HarmonicTrader.com](http://www.HarmonicTrader.com)

Table of Contents

Author's Note.....	vii
Foreword.....	ix
Acknowledgements.....	xiii
Introduction.....	1
Part I. Harmonic Trading	
Chapter 1: Harmonic Trading.....	7
Chapter 2: The Potential Reversal Zone.....	11
Chapter 3: Gauging Price Action.....	15
Chapter 4: Invalid Harmonic Set-ups.....	27
Part II. The Fibonacci Numbers	
Chapter 5: The Fibonacci Sequence.....	37
Chapter 6: The Primary Numbers.....	41
Chapter 7: 0.618 Retracement.....	43
Chapter 8: 0.786 Retracement.....	59
Chapter 9: 1.27 Projection.....	67
Chapter 10: 1.618 Projection.....	85
Chapter 11: The Secondary Numbers.....	97

Part III: Patterns

Chapter 12: Patterns.....	113
Chapter 13: AB=CD.....	115
Chapter 14: Gartley 222.....	157
Chapter 15: Butterfly.....	189
Chapter 16: Three Drives.....	217

Part IV: Learning the System: Putting it All Together

Chapter 17: Potential Reversal Zone Confirmation.....	247
Chapter 18: Scanning for Stocks.....	257
Chapter 19: Tools for Trading.....	261
Chapter 20: Developing the Trading Plan.....	265
Chapter 21: Gauging the Profit Potential.....	269
Chapter 22: Sticking to the Plan.....	277
Conclusion.....	283
Appendix.....	285
Bibliography.....	303

Author's Note

This book presents a unique approach to the financial markets. These techniques are extremely effective in defining consistently profitable opportunities. I encourage you to share these ideas with others. However, I request that you not reproduce this book or any portion of it without my permission. In return, you may contact me at www.HarmonicTrader.com and ask any questions regarding this material. Thank you for your interest in this book and I wish everyone the best.

Best Regards,

Scott M. Carney

Foreword

Although many people will usually bypass this section of the book, I believe it is crucial to relate my general experience and education to elucidate the foundation for my work.

I have been involved with the stock market since approximately 1980. As a child, my father and I would look at the stock pages in our local newspaper and follow his stocks on a weekly basis. Although I did not understand all of the numbers located in the various columns of information, there was one number that I did understand – the price. If the stock was up, that was good for my dad and if it was down – well, my dad wasn't making money. The early eighties were a fascinating time due to the bullish trend that was developing.

It was during this time that my dad owned some stocks that really started to move. Watching the stocks rally really stimulated my interest in the stock market. I wanted to know why the stocks went up or down. It seemed as if some stocks just went straight up.

In 1987, however, I experienced my first real lesson of a market whacking. It was during “the Crash of 1987” that I learned that the market does not go straight up. On that one fateful day in October, twenty percent of everything was gone. Was this the end of the run? Was this another 1929?

Well, as we all know, that “Crash of ‘87” has become a mere blip on the long-term chart of the Dow Industrials. In fact, it was probably one of the greatest buying opportunities of the century. Most significantly, the action of 1987 compelled me to study the market in depth and to understand its dynamics.

I read started my market research with the most popular stock market books of the late 1980s, such as Peter Lynch's, One Up on Wall Street. I started reading the Wall Street Journal and Barron's Weekly. I researched financial statements in the Value Line Investment Survey. I watched FNN - now CNBC - constantly, trying to learn as much as I could about the market.

I learned a great deal about publicly traded companies and the stock market in those first few years of intensive study. I started trading for myself in 1992. Although I invested in the strongest companies, according to my fundamental research, I frequently was buying near the top. The stock would go against me and I endured a loss. Or, I usually waited a long time for a stock to turn around before I realized a profit.

There were times when I would sell my position at a loss, only to have the stock turn around shortly thereafter. In fact, this is exactly what happened to my first trade. I bought a hundred shares of Novellus (NVLS) at around \$12 a share. The stock dropped to \$8 and then bounced. I sold the stock around \$11 a share, only to have the stock rally several hundred percent in the next year. Although I did make money in the market when I initially traded, I still did not understand when to buy or sell.

My frustration with fundamental research led me to focus more on price action and the area of technical analysis. It wasn't really until I met life-long market technician and friend, Bill Sourbey that I realized the importance of this field of study. Bill is an extraordinary person, who has taught me a great deal about the markets. Bill's unique approach to the markets include hand-written charts and unique indicators that effectively analyze the state of the price action.

Over the years, Bill lent me a number of very rare books on technical analysis. Many of these books were over 50 years old. Also, he showed me the volumes of charts and personal studies that were incredibly insightful.

One day, Bill told me about a local trader whom utilized Fibonacci ratios to trade the markets that he saw speak at a meeting in Tucson, Arizona. I called the trader and asked to meet with him. I bought his books and reviewed his basic work with Fibonacci.

At first, the books were quite confusing to me. I did not understand the basis of Fibonacci ratios, and I resisted the notion that price action could form the patterns described in his book. Although I scrutinized the numerous chart examples, I still had difficulty discovering the harmonic patterns. Furthermore, the author failed to provide a thorough explanation of the application of Fibonacci measurement techniques other than a simple retracement or projection.

It took me several months before I accurately determined valid patterns and discovered profitable trading opportunities. I studied numerous charts of potential trade opportunities, or as I like to call them harmonic "set-ups". I remember being amazed when I first started to clearly recognize various patterns that seemed to "bounce" off Fibonacci calculations. I

would think, “Look at that Butterfly,” or “Check out this incredible Gartley.” It seemed as if the patterns were a work of art. But, once I realized the essence of Fibonacci measurement techniques with respect to price action, it turned on the light that helped me discover new relationships and measurement techniques that advanced the entire application of Fibonacci theory to the financial markets. After the light turned on, I was determined to refine these techniques to maximize their effectiveness and substantiate the overall success that pattern recognition and Fibonacci ratios inherently possess. This entire approach is what I have termed Harmonic Trading.

The harmonic methods taught me how to trade. I spent ten years studying financial statements and analysts’ reports, trying to discover profitable stock opportunities. But, I never really knew when to buy and sell. After my initial study of Fibonacci measurement techniques, I quickly learned the difference between researching fundamentally sound companies and trading.

Since I started utilizing these methods, my trading has improved immensely. I am consistently profitable, and I am able to determine opportunities in the stock market without being misguided by the media or analysts' reports. In fact, I am so convinced by these methods that I have dedicated my life to this field of study.

I would like to emphasize that I am a student of the market. I will be studying and learning about the market for the rest of my life. I do possess an extensive knowledge of the stock market and Harmonic Trading methods. Although I have studied tens of thousands of harmonic stock charts in my life, one of my fundamental beliefs is that there is always more that can be learned. One of the greatest technicians of all, W.D. Gann, once said: "I have studied and improved my methods every year for the past forty years. I am still learning. I hope to make greater discoveries in the future." (How to Make Profits in Commodities, Pomeroy, WA: Lambert-Gann, 1976, p. 2).

These words epitomize my attitude towards the stock market and life. I will continue to study harmonic price action and learn as much as I can for the rest of my life. I am currently researching new applications of these techniques that will define even greater trading opportunities. Perhaps, these will appear in my next book.

I have written this book to help people sort through the mass amount of information about the stock market and to learn how to trade profitably. I have an innate desire to help people. I am extremely passionate about my trading and there is nothing that I enjoy more as a career.

I have analyzed many trading systems in my time. I have studied popular technical measures such as moving averages, oscillators and trend lines. I have tried software systems that have "back-testing" capabilities to validate certain trading techniques. All of these methods have some merit. However, I believe that the harmonic techniques are the most effective means of being successful in the market.

I believe that this material is presented in such a simple manner that almost anyone could understand these techniques. There are more sophisticated technical methods that can identify profitable opportunities in the stock market. And, I encourage you to continue studying beyond these techniques. But, I believe that the harmonic methods are the fundamental basis to understand price action. After studying this material, you will realize the incredible significance of harmonic analysis and never look at the markets the same way again.

Acknowledgements

I would like to take this opportunity to thank the people whom have helped me achieve the success that I have in my life. In light of all that I have put them through, I could never thank my family enough. I dedicate this book to them - Mom, Dad, David, Steven and Mark. Without them, I would not have been able to achieve the success and happiness that I now enjoy.

I would like to thank those market technicians like W.D. Gann, J.M. Hurst, H.M. Gartley, R.N. Elliott and others who have share their insights into the financial markets, whom have enabled me to the phenomenon of price action. These individuals possess the mental acumen that separates them from the rest. They are the top technical market experts and I strongly urge you to study their work. They have provided me with the tools and understanding that will enable me to not only make a living in the stock market, but to truly lead a fulfilling life.

I would like to thank a personal friend, Bill Sourbey. Bill is truly a unique individual, who has taught me the value of the "old school" methods regarding the markets. His detailed studies have enabled me to understand the historical significance of the stock market. Bill has taught me that the market can be understood through thorough analysis of price action. Furthermore, his "proprietary indicators" have proven that the answers to the market are out there. We must be willing to do the work.

I would like to thank BigCharts.com for authorization to use their charts in this book. Their web site is an excellent resource for stock charts and investment information.