Technical analysis of Cryptocurrencies

This is the fifth part of our training lessons on cryptocurrencies trading that gives insight about technical analysis of cryptocurrencies.

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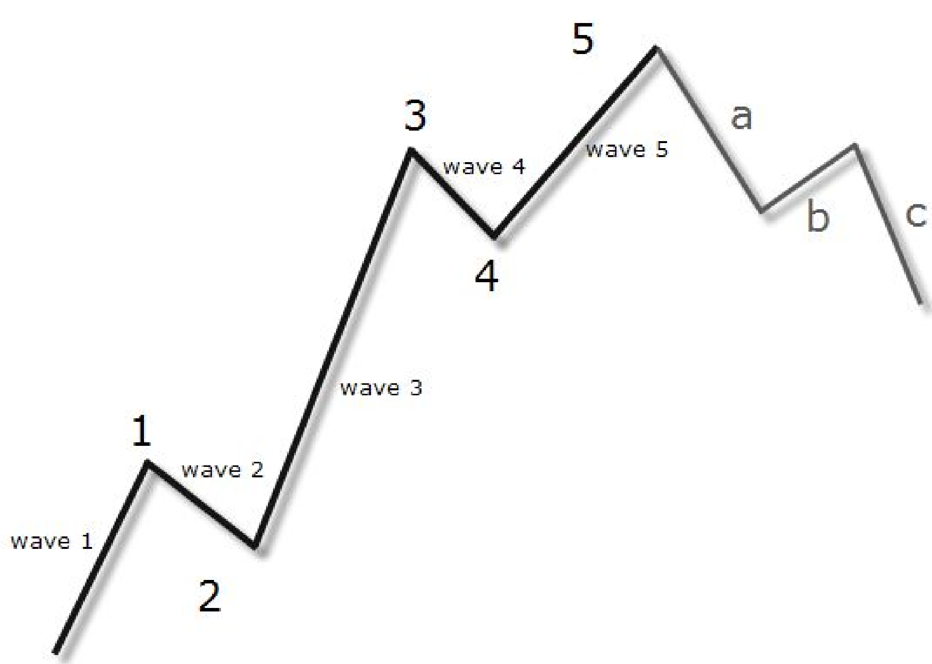
Elliott Wave Theory

Elliott wave theory was introduced by Ralph Nelson Elliott in 1938 in his book named "The Wave Principle". He was one of the best mathematicians of his time and he developed this theory after studying 75 years worth of stock data.

He is of the view that the market moves in a repetitive cycle based on the emotions of investors and external market influencers. He named upward and downward swings as waves and he is of the view that if you can identify the repeating patterns in the price of an asset, you can easily predict the future price.

His theory works best if used with Fibonacci levels that we have learned in the last training lesson. Elliott wave theory not only helps the traders to catch the top and bottom of an asset but also helps in predicting the profit targets of an asset.

Elliott wave theory consists of 5 impulsive waves and 3 corrective waves and theory explains that after 3rd corrective waves a new impulsive wave starts. Let's take a look at both waves in detail.



Impulsive waves

Impulsive waves consist of 5 waves. In an uptrend, out of those five impulsive waves, three waves are bullish while the other two are bearish.

- **Wave 1**

  Wave Elliott wave starts with a first bullish wave which may be the result of good news about the asset or a group of people might buy it for any other reason.

- **Wave 2**

  After a good move in the assets price, initial investors start booking profits which cause the second impulsive wave.

- **Wave 3**

  The third wave should be a bullish candle which is usually the biggest wave in the pattern. This wave's movement gets the attention of the general public and more people start buying in a fear of missing out even after its signature move.

- **Wave 4**

  After a strong third wave, people start selling the asset at some point to book profits which causes the fourth wave.

- **Wave 5**

  The last fifth wave is usually a small bullish candle which is driven by investors or traders who have a minor or little understanding of the market and still keep on buying it.

Corrective waves

As per Elliott wave theory when it completes the impulsive waves it is followed by three corrective waves. These three waves are denoted with alphabets A, B and C.

- **Wave A**

  First corrective wave is a bearish move in the price that can be from 50% to 161% of the size of the 5th impulsive wave.

- **Wave B**

  Wave B which is a bullish candle is usually half of the size of wave A.

- **Wave C**

  Wave C is usually more than double the size of wave B. When these corrective waves complete, then we again start the impulsive waves.

3 Rules of the Elliott Wave Theory

- Wave 3 can NEVER be the shortest impulse wave
- Wave 2 can NEVER go beyond the start of Wave 1
- Wave 4 can NEVER cross in the same price area as Wave 1

How to trade cryptocurrencies using Elliott wave theory

You can take a long trade during wave 3 and wave 4 but the most recommended point of trading an impulsive wave is to enter upon the completion of wave 2. Wave 2 is usually 50% to 76% the size of wave one. You can take a trade here and can find the profit taking points with the use of trend-based Fibonacci extension tools available in TradingView. A typical target for the 3rd wave of Elliott wave theory is 161% of the wave 1. You can also enter in a trade during the retracement after wave 3, wave 4, but the fifth wave is usually not the biggest wave so the risk is higher while taking a long trade there.