

BEHAVIORAL FINANCE

The Future Is Now

The 21st-Century Technician

A transition to a new paradigm for market analysis and action may be under way — and it may be a century old.

by Henry “Hank” Pruden, PhD



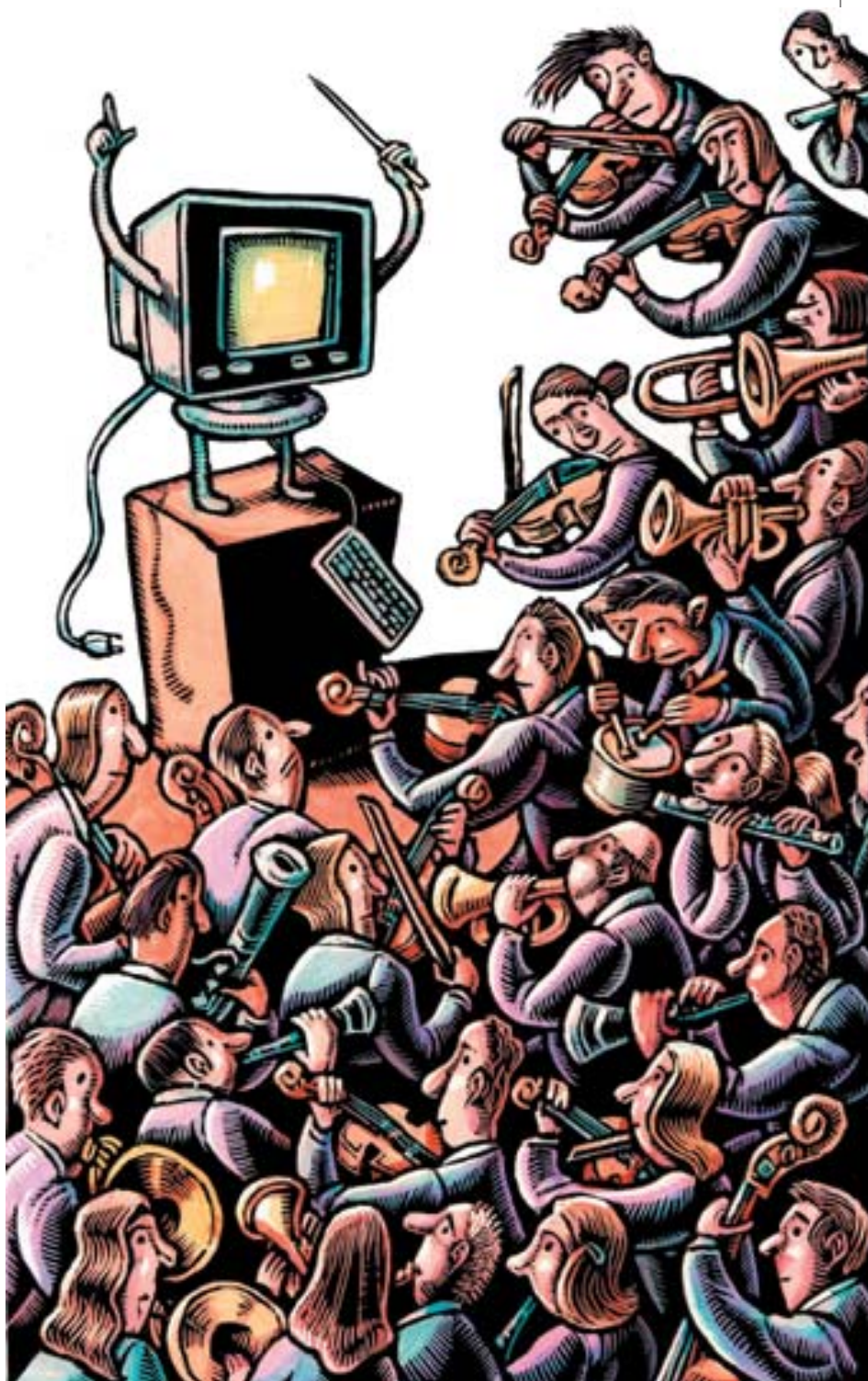
Expect the professional technician of the 21st century to acquire many of the attributes of the Wall Street technicians and traders from 100 years ago. Pattern recognition, intuition, judgment, and a feel for markets and people will become the distinguishing attributes that the technician may cultivate in order to secure an edge in 21st-century trading.

The theme of “pattern, intuition, judgment, and feel” may clash with the scientific information technology approach to technical analysis that is currently in vogue. But there are reasons to believe that a transition to a new paradigm for market analysis and action is under way. Anthony Tabell and Daniel Pink are on the forefront of those who believe this.

VIEWS OF TONY TABELL

During an address to the Society for the Investigation of Recurring Events (SIRE) in the early 1990s, Tony Tabell, a third-generation technician, concluded that with the arrival of new thinking on Wall Street (for example, the rise of behavioral finance and chaos theory), the technician of the new era will hearken back to the old-time technicians who worked on Wall Street in the early part of the 20th century. Tabell went on to define several important characteristics of the old-time technicians that can be used as instructive guides for today’s professional technical analyst: intuitive, deterministic, contrary, apocalyptic (Figure 1).

A lifelong student of the market, Tabell followed in the footsteps of his father as well as his great uncle, the legendary Richard D. Wyckoff. For Tabell, the beauty of behavioral finance was its compatibility with the world of the old-time



technicians and traders. He anticipated that as the field of behavioral finance developed, it would ultimately result in a view of the market similar to the way technicians and traders saw things back in the early days of the 20th century. According to Tabell, the early technicians could be characterized as being intuitive, deterministic, contrary, and apocalyptic.

| ATTRIBUTES (Of The “Old-Time Technician”) | SKILLS & KNOWLEDGE (For Modern Technical Analytical Pros) |
|--|---|
| Intuitive | Buying and selling on intuition resulted from skill and experience. It was a judgmental approach the trader and technician applied to his tape reading and to his chart analysis. Like having a sixth sense, the <i>intuitive</i> approach was a prized possession. |
| Deterministic | Certain that there were larger “forces” at work in the market and that though he could not control them, he could detect them; he was <i>deterministic</i> . |
| Contrary | A product of the era of the trading “pool” in which the fix was always in, he was <i>contrarian</i> —the crowd, which was subject to the “forces” of the market, had to be wrong. |
| Apocalyptic | You can tell a lot about a person by what he or she reads, and the old-time trader-technician <i>apocalyptic</i> view of the world was betrayed by his book of choice: <i>Extraordinary Popular Delusions And The Madness Of Crowds</i> , by Charles Mackay. |

Tony Tabell explained that the old-time technician had a world view that led him to buy and sell on the only thing he could trust — his intuition. Certain that there were larger forces at work in the market (what Richard Wyckoff termed the “composite man,” the sum of the interests that have an effect on the market) and that, though he could not *control* them, he could *detect* them (he was deterministic). He was a product of the era of the trading pool when the fix was always in. He was a contrarian — the crowd, which was subject to the forces of the market, ultimately had to be wrong. Finally, he had an apocalyptic world view — no surprise, given the economic climate that eventually gave way to the crash of 1929.

These distinguishing attributes of the old-time technicians are benchmark principles for adoption by modern technical professionals. Figure 1 lists the four distinguishing attributes and their descriptions.

Buying and selling on intuition resulted from skill and experience. It was a judgmental approach that the trader and technician applied to his tape reading and to his chart analysis. Like having a sixth sense, the intuitive approach was a prized possession. Indeed, Tabell observed that an archetype of the old-time trader was James Keene, a New York Stock Exchange floor trader who claimed to have no rules for trading, only to buy and sell by intuition. Keene’s skill at detecting market manipulation and his capacity to lead a pool of operators like him were sought by Richard Wyckoff, who observed and codified their best practices, which eventually became woven into Wyckoff’s method of technical analysis and the art of speculation.

With respect to the old-timer’s intuitive, deterministic, and contrarian attributes, Tabell reported that these were largely spawned by the “pools” of the pre-1929 era. Those pools consisted of investors who would find an “operator” (for instance, Keene), who would enlist the help of “customers’ men,” willing brokers who would put out that a stock was on the decline. Then, when the value of the stock depreciated, the pool would scoop it up, running the stock price up again. They would then turn to their brokers (or the press) with doomsday news that would depress the stock anew, and the pool would purchase at

FIGURE 1: THE MODERN TECHNICAL PRO. Here you see the skills and knowledge of the modern TA pro matched to the attributes of the old-time technician.

bottom again (Figure 2).

“Then you could start a rumor that the company was going to cut its dividend — if your pool was close to the company itself, you might get them to actually cut their dividend!” related Tabell. “Finally, when you had accumulated all the stock you could possibly accumulate came the phase known as the ‘markup,’ following the ‘breakout,’ before the pool liquidated at tremendous profit.” Not surprisingly, this atmosphere prompted trader Humphrey Neill to coin the term “contrarian.”

You can tell a lot about a person by what he or she reads, and the old-time trader-technician’s apocalyptic view of the world was betrayed by his adoption of Charles Mackay’s book, *Extraordinary Popular Delusions And The Madness of Crowds*.

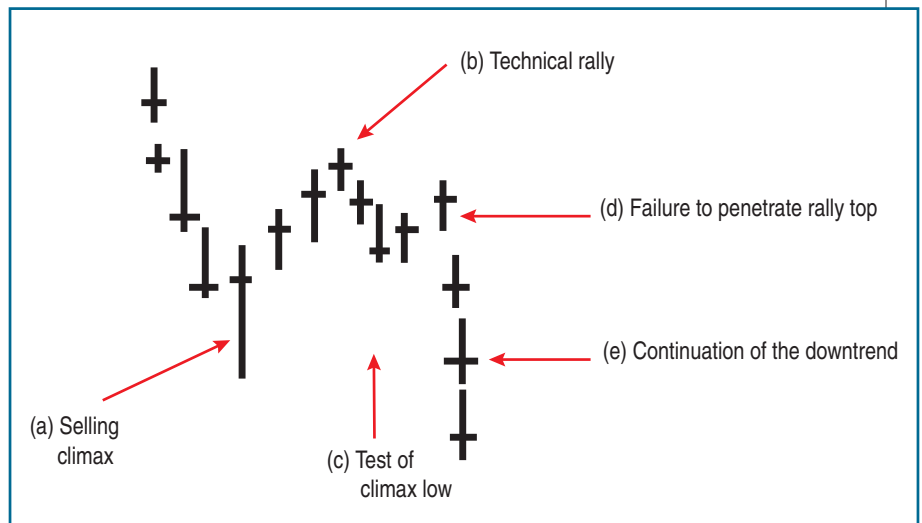


FIGURE 2: BEING DETERMINISTIC. Here you see (a) climax, (b) technical rally, or often a 50% countermove reaction, (c) test of the climax juncture, followed by a (d) reversal or (e) continuation of trend. The technician determines this through incremental wave comparisons.

BEHAVIORAL FINANCE**PATTERN RECOGNITION**

The Wyckoff method is a classic pattern-recognition system. It relies on bar charts and point & figure charts to judge the relationships of price spread and volume between comparative waves of buying and selling.

From his many observations of behind-the-scenes manipulations by the large operators on Wall Street, Richard D. Wyckoff discovered time and again by reading the stock market ticker tape and the charts of stocks that the best indicator of the future price of a security was the relationship between supply and demand. In 1910, under the pen name "Rollo Tape," he wrote the pioneering book *Studies In Tape Reading*, in which he revealed how to read the market and conduct speculative operations. In this classic, Wyckoff covered such basics as stop orders, volume indications, dull markets and their opportunities, and other market techniques that would one day be incorporated into his method, which first appeared around 1931.

Wyckoff placed prime importance on the analyst's ability to judge the relative power of the buying and selling waves, and thus to comprehend the dominant forces behind a market move. This pattern recognition approach predated what Pink referred to as the "information age." The talents Wyckoff deemed important for effective stock market diagnosis, prognosis, and trading foreshadowed the now-emerging "conceptual age" that Pink asserted would soon become the dominant way of thinking in the 21st century. Thus, Wyckoff was both quintessentially classic and utterly modern.

In the classic *Extraordinary Popular Delusions*, Charles Mackay reported historical incidents "while communities suddenly fix their minds on one object and go mad in its pursuit... until their attention is caught by some new folly, more captivating than the last." Mackay's book, first published in 1841, together with Gustav LeBon's book, *The Crowd*, were antecedents to my own analytical framework, *The Life Cycle Model Of Crowd Behavior*.

Tabell concluded his address thus. "If there is one concept that has fascinated technicians recently, it is the newly emerging science of chaos-fractal structures... that says that stock movements are not, in fact, linear. ... There is no such thing as 'supply' and 'demand' — these occur when human beings are *willing* to buy or sell," he emphasized. Chaos theory supports the notion that higher prices can produce more demand because of the herd mentality that leads people to follow a trend. Even in the madness of crowds, there are forces at work, and you can detect them.

But to Tabell, the true elegance of chaos theory was in its correlation and compatibility with the qualities of the old-time technicians. "You almost have to be intuitive because there are so many possibilities," Tabell asserted. "You almost have to be deterministic because the new model tells you there are, indeed, forces out there that, through positive feedback, will gain its own momentum. You almost have to be contrarian, because under the new market mathematics ... the best possible outcome — the perfect price — is not always the actual outcome. Finally, you have to be apocalyptic,

Whatever we have lost, forgotten, or been stripped of, can be reclaimed, revived, and perpetuated. And that remains true with technical analysis.

because 1929 is the sort of thing that can happen in a chaotic market structure."

As Tabell concluded, "I think the ultimate result [of chaos theory developing] will be a view of the market that is very similar to the way the old-time technicians perceived things back in the early days of [the 20th] century."

NEW VISTAS FOR THE 21ST CENTURY

Daniel H. Pink's *A Whole New Mind* further deepens our understanding of the nature of the trading and investment challenges that will face us in this new century and the tools we will need to meet those challenges. Pink argues that we are leaving the era of information technology behind and entering the age he dubs "high concept/high touch."

Pink captured the essence of this new age and its implications for professional technicians by citing from a study of industry executives. "Just one cognitive ability distinguished star performers from the average: Pattern recognition, the big picture thinking that allows leaders to pick meaningful trends from a welter of information around them and to think strategically into the future. ... These star performers ... relied less on deductive, if-then reasoning and more on intuitive, contextual reasoning."

HIGH CONCEPT, HIGH TOUCH

The science and art of technical analysis and trading have progressed since the days of the old-time traders — the technicians described by Anthony Tabell. The technical trader who seeks success in the 21st century must absorb the best lessons from the past while embracing the newest thinking in the present. In *The Three Skills Of Top Trading*, I attempt to help the technical trader reach those objectives by teaching the knowledge and judgment of the Wyckoff method of technical analysis and the art of speculation together with systems based on new thinking from behavioral finance.

To further deepen your understanding of the nature of the trading challenges that you will face in this new century and equip you with additional tools to deal with them, let me expose you to the ground-breaking thinking found in Pink's book. The following introduction to the work reveals why his "big picture, pattern recognition" attribute is so essential for the technician who wishes to cultivate a competitive edge in the 21st century:

[T]he Conceptual Age also demands the ability to grasp the relationships between relationships. This meta-ability goes by many names — systems thinking, gestalt thinking, holistic thinking. I prefer to think of it as simply seeing the big picture.

Seeing the big picture is fast becoming a killer app in business. While knowledge workers of the past typically performed piecemeal assignments and spent their days tending their own patch of a larger garden, such work is now

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moving overseas or being reduced to instructions in powerful software. As a result, what has become more valuable is what fast computers and low-paid overseas specialists cannot do nearly as well: integrating and imagining how the pieces fit together. This has become evident among entrepreneurs and other successful businesspeople.

The narrowly focused bean-counter specialists emphasize the L-directed or left-hemisphere part of their brain, while the pattern-recognition, big-picture entrepreneur trader relies on the right-hemisphere (R-oriented) part of their brains.

Pink’s “new age” thinking creates some high-caliber ammunition for the trader-technician to use for gaining the upper hand. Pink encapsulates this new thinking into “six senses” for the trader-technician to adopt — design, story, symphony, empathy, play, and meaning — that he believes will increasingly “guide our lives and shape our world.”

INTRODUCING THE SIX SENSES

Pink argues that in the conceptual age, you will need to complement your L-directed reasoning ability with R-directed aptitudes. In the following exploration I suggest how these right-hemisphere aptitudes can affect the trader-technician. Together, these six high-concept and high-touch senses can help you develop the whole new mind-set that this new era demands. Figure 3 provides a correlation between these senses and technical analysis tools:

■ **Design** — Pink contends that the new age calls for systems that are not only functional but also arresting, even beautiful. In technical analysis and trading, designing your systems to transcend function and engage the user will lead to personal rewards, both emotional and financial. One approach found in *The Three Skills* is to build dual systems that have both a visual/chart, right-brained, component and an analytical/checklist, left-brained component. These two approaches help capture the full benefit available from the whole mind.

■ **Story** — J. Welles Wilder, the creator of many technical indicators in use today, once said that you have to have a “story” to get a technical analysis message communicated and appreciated. Pink’s philosophy says that persuasion, communication, and the ability to understand yourself hinge on your capacity to understand and tell a compelling narrative.

■ **Symphony** — Pattern recognition, the old-fashioned way to read charts, is at a premium. Pink argues that now more than ever, in a global economy where specialists can be found all over the world, the real demand is for the individual who can put it all together. Nowadays, the real need is the ability to see the big picture, to perceive the interconnections of market themes — to take different pieces of the

market puzzle and put them together in much the same way that a conductor pulls together the players and instruments to create the arresting sounds of a beautiful symphony.

■ **Empathy** — According to Pink, logic alone will soon be insufficient; we must be able to “feel” others, to intuit what motivates them. Assume that behind the stock screens on your computer, there dwells a market genie called the “composite man.” To understand him, you’ll need to walk in his footsteps, and to do so, you’ll need to cultivate empathy.

■ **Play** — You need to enjoy playing the game to extract the essence from the market. Pink points out that both the health and professional benefits of laughter and games are well documented, and he contends that too much sobriety can damage one’s career and well-being.

■ **Meaning** — Pink points out that the conveniences of modern life have freed us to pursue fulfillment on a more profound level. To get the most out of your life as a trader, you need some greater purpose and meaning for yourself and your trading. This important attribute identified by Pink is addressed in the final section of this article, “The symbol of Sankofa.”

| NEW AGE CONCEPTS: The Six Senses | TRADER’S NEW EDGE TOOLS |
|---|---|
| Design: Both right-brained and left-brained appeals | Schematics and checklists (for example, The adoption diffusion curves and the checklist of price, volume, time, and sentiment) |
| Symphony | Interactive and independent systems (for example, S-shaped and bell-shaped curves of crowd behavior showing the interactions of price, volume, time, and sentiment). |
| Story | The market tells its own story through the comparison of buying and selling waves. Chart reading and pattern recognition are important. |
| Empathy | Play the role of the composite man. A trader should see — feel — hear the market from the composite man’s vantage point. |
| Play | Build skills through guided repetitions of market analysis. Gain empathy and enhance decision-making. |
| Meaning | Discern your purpose and gain a deeper meaning for your trading with practices inspired by a deeper meaning of “back to the future” (see Sankofa at the end of this article). |

FIGURE 3: TRADER’S NEW EDGE TOOLS MATCHED TO PINK’S NEW AGE CONCEPTS. Here you see the six senses matched to concepts that are important for trading.

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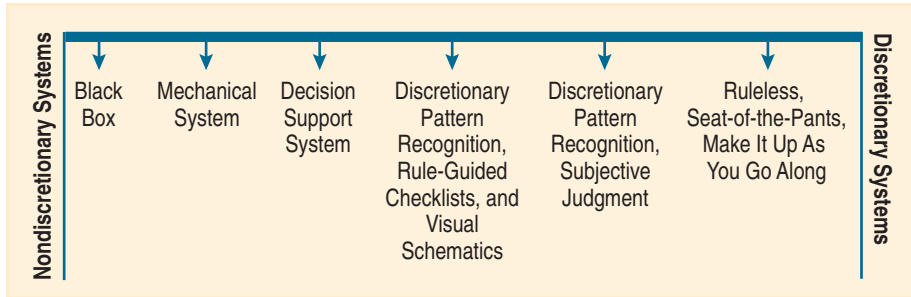


FIGURE 4: A SYSTEMS-BUILDING SPECTRUM FOR TECHNICAL TRADERS. Here you see the range of systems from nondiscretionary to discretionary.

BACK TO THE FUTURE: SANKOFA

Sankofa: A symbol of wisdom and learning from the past to build for the future (literally, “Go back to fetch it”). The concept is derived from King Adinkera of the Akan people of West Africa. Sankofa teaches us that we must go back to our roots in order to move forward — that is, we should reach back and gather the best of what our past has to teach us so that we can achieve our full potential as we move forward. Whatever we have lost, forgotten, forgone, or been stripped of, can be reclaimed, revived, preserved, and perpetuated. And that remains true with technical analysis.

Hank Pruden is a leading technical analyst with more than 20 years of active trading experience. Currently, he is the executive director of the Institute of Technical Market Analysis and

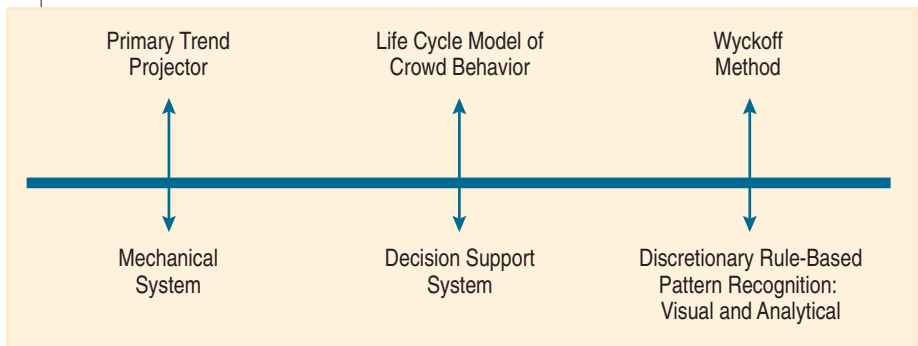


FIGURE 5: SYSTEMS BUILDING FOR TECHNICAL TRADERS. Here you see specific technical trading systems for the three skills of top trading.

president of the Technical Securities Analysts Association of San Francisco, and a professor at Golden Gate University, where he has taught technical analysis for 30 years. He may be reached at hpruden@ggu.edu.

SUGGESTED READING

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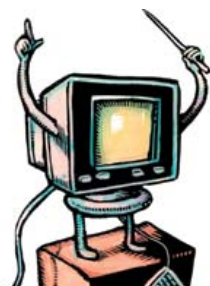
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Although some of these concepts may seem foreign, they are attributes that humans have possessed since they were cave dwellers. To this day, we can see evidence of story and empathy in their drawings, of design in their tools. To some degree, Pink is encouraging us to return to the past in order to move into the future, a theme echoed by Tabell and evident in the technical analysts’ return to Richard Wyckoff and the composite man. As in the market, timing is everything. To paraphrase Pink, anyone can master the six conceptual age senses. But those who master them first will gain an advantage.



SYSTEMS BUILDING FOR THE 21ST CENTURY

Figure 4 shows a spectrum of trading systems available to the trader that range from nondiscretionary systems to discretionary ones. In my years, I have had ample opportunity to appraise the strengths and weakness of the various types of trading systems. I grew dubious of the reliability and accountability of the seat-of-your-pants, no-system approach, and equally skeptical of relying on an automatic black box that crunches mounds of data, often in a uniformed manner.

Between the extremes of mechanical and discretionary systems, the trader–analyst can find a system that matches his cognitive-emotional makeup and that fits his goals and philosophy of trading as well. (See Figure 5.)