

Elliott Wave — Market Psychology & Trading Mindset

Elliott Wave patterns are a visual representation of collective human emotion — fear, greed, optimism, despair. Understanding the psychology behind each wave helps you confirm your count AND master your own emotions as a trader.

Psychology of Each Wave

Wave 1 — Early Optimism / Smart Money Enters

Market mood: Cautious, skeptical. Coming off a bearish phase. Only the most informed traders (institutional, smart money) are buying based on improving fundamentals or technical signals. The broader market hasn't caught on.

What you see: Low volume, tentative rally. Most participants still feel bearish. When you go long, the majority will think you're wrong.

Your psychology:

- Trust your analysis — if the chart says buy, buy. Don't wait for others to confirm
- Use small position sizes and scale in gradually
- Going against the crowd feels uncomfortable. That discomfort is often a good sign
- You can always add to your position as the trade establishes itself

Wave 2 — Profit Taking / "Is It Real?"

Market mood: Early buyers take profits. The market is still predominantly bearish. Many believe the rally was just a temporary bounce — "another lower high." Big battle between real trend change and false breakout.

What you see: Significant retracement (50-78.6% of wave 1). Skepticism increases. People sell expecting further declines.

Your psychology:

- Markets zig and zag — pullbacks are normal. As long as price bounces off key zones, the thesis holds
- Stick to your stop loss strategy. Don't make emotional decisions
- Use Fibonacci retracement levels to identify potential re-entry points
- If you missed wave 1, wave 2 is your second chance to enter

Wave 3 — FOMO / Herd Mentality

Market mood: Dramatic psychological shift from skepticism to full optimism. Previous resistance levels break. FOMO becomes prevalent. Optimism snowballs.

What you see: Substantial volume increase. Mainstream media starts reporting the rally. Retail investors and latecomers pile in. Strong economic/fundamental data reinforces the narrative. "Bitcoin is going to \$1M because BlackRock..." "Uranium is taking off because nuclear plants..."

Your psychology:

- Don't get carried away — stick to position sizing and risk management
- Don't chase the market. If you missed the early part, wait for a zag (pullback) instead of buying up 50%
- Plan your exit NOW. This may be wave 3, or it may only be wave C. Have a plan for both
- Take partial profits as the market rises

Wave 4 — Caution / "Where Am I?"

Market mood: Cautious optimism. Some traders take profits after the wave 3 explosion. Confusion — many traders aren't sure if the trend is continuing or ending. Wave 4 is typically the wave where "if you don't know where you are, you're probably in wave 4."

What you see: Reduced momentum, consolidation, shallow pullback. Lower volume. Triangles, flags, sideways chop. People sitting on phenomenal gains locking some in.

Your psychology:

- Patience is key — wave 4 is corrective before the final push

- Don't be too quick to close everything — wave 5 may still come
- Watch for consolidation patterns (triangles, flags) that indicate trend continuation
- Manage risk with stop losses but remain open to further upside

Wave 5 — Euphoria / Overconfidence

Market mood: Extreme bullishness. Greed and euphoria dominate. Even fundamentals may not support the continued rise — price climbs because everyone is confident it will. Mania phase. Irrational exuberance.

What you see: Speculative buying. Retail investors who missed everything buying aggressively. Fear & Greed Index at extreme greed. Sentiment indicators maxed. Divergence on RSI and OBV — momentum is weakening while price makes new highs. Rockets and moon emojis everywhere.

Your psychology:

- Watch for exhaustion — this wave typically marks the trend's end
- Lock in profits gradually. Don't get greedy
- Divergence on momentum indicators (RSI, MACD) + declining volume = the rally is losing strength
- Mentally and strategically prepare for a significant correction

Wave A — "Just a Dip" / Initial Disbelief

Market mood: The decline is seen as a normal pullback. Most participants still believe the uptrend is intact. Sentiment is still bullish. "Buy the dip" mentality in full force — because every other time, buying the dip worked.

What you see: Moderate selling pressure. Many still hold positions. No change of market structure yet.

Your psychology:

- Accept that the rally has likely ended if market structure changes
- Don't fight the data — follow it
- Use stop losses. Protect capital
- "The dippity dip dip dip" — it keeps dipping because this time buying the dip doesn't work

Wave B — Bull Trap / False Hope

Market mood: Counter-trend rally. Investors start buying again thinking the market is resuming its bullish trend. Hope and optimism that the correction was just a temporary blip. "I told you so, you idiot bears!"

What you see: Briefly bullish sentiment. Weaker rally than previous waves. Lower volume. Technical indicators fail to confirm strength. This is the right shoulder of a head & shoulders pattern.

Your psychology:

- Understand wave B is a temporary rebound — nothing goes down in a straight line either
- Don't get caught in the bull trap — don't buy just because it bounced
- Wait for change of market structure before re-entering. Buy because of confirmed trend change, not because of a bounce

Wave C — Capitulation / "It's Over"

Market mood: Pessimism at its peak. Traders capitulate, selling at a loss. Everyone who held through A and B finally panics. "The market is done." Blood on the streets.

What you see: Impulsive five-wave decline. Sharp and rapid. Volume picks up. Fear dominates sentiment.

Your psychology:

- Stay disciplined — if you didn't exit earlier, stick to your stop loss and plan
 - Don't panic sell at the worst time — that's exactly what capitulation is
 - Wave C often presents the best buying opportunities for the next cycle
 - "Be fearful when others are greedy, and greedy when others are fearful"
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Five Principles for Trading Psychology

1. Trust the Process

Markets move in cycles. Elliott Waves are a visual map of collective emotion — fear, greed, optimism, despair. Every rally has a correction. Every crash has its end.

- Wave 2 and wave 4 corrections are opportunities, not threats
- Don't abandon your analysis because of temporary market noise
- See beyond immediate price movements — the market is cyclical
- Stay calm during corrections. Remain detached during euphoria

2. Use Confirmations — Trade Triggers, Not Signals

The most common mistake: acting too early based on a hunch. Without confirming a wave's end through market structure, support levels, reversal patterns, and momentum indicators, you risk entering prematurely.

- **Never enter without change of market structure** — the trigger, not the signal
- Use multiple indicators: Fibonacci levels + divergence + volume + price support + index confirmation
- Confirmation adds objectivity and reduces emotional decisions
- Patience might mean watching the market rise without you — but it prevents the greater pain of entering prematurely
- "It's like surfing — you can't expect perfect waves every single day"

3. Stay Flexible

Elliott Waves aren't perfect. Markets don't always behave predictably. What looks like a clear wave 3 could become an extended wave 1. A C wave could extend into a WXY.

- Always run multiple scenarios: plan A, plan B, plan C
- Re-evaluate regularly as new data unfolds — "as more data comes, we may have to evolve what we thought"
- A rigid mind blocks success — the educator expected Bitcoin rejection at \$30K, adapted when the data changed, and rode the bull run instead
- The best traders combine Elliott Wave (predictive) with foundational TA (reactive) — the reactive data tells you which scenario is playing out
- Accept that no wave count is 100% guaranteed. Certainty doesn't exist. It's all about high probabilities
- **"We are always trying to be the casino. Stack the chips in our favour. It becomes a numbers game."**

4. Self-Awareness — Journal Your Emotions

Elliott Waves mirror not just market psychology but YOUR psychology. Track your emotions to spot patterns that sabotage your trading.

What to journal for every trade:

- Your mood when entering
- Your confidence level (1-10)
- Your reasoning (data-driven or emotional?)
- Notes on what you were feeling

What you might discover:

- Times when you felt least confident (buying wave 2 dips) might be your best trades
- Times when you felt most confident (wave 5 euphoria breakouts) might be your worst
- You might tend to panic sell during wave C corrections → set predefined stop losses BEFORE emotions hit
- You might over-trade during wave 3 due to FOMO → set position sizing rules in advance

The three pillars of trading: Skills + Risk Management + Psychology. If you're not tracking all three, you're not doing it right.

5. Reflection Is the Key to Growth

After every trade: what worked well? What didn't? Pick ONE thing to improve next time. Small steps lead to great success.

- You can't fix everything at once — focus on one weakness per trading period
- If you don't know what to fix, you can't get better
- Mindfulness practices (meditation, focused breathing) improve emotional control in high-stress moments
- Some professional traders won't go out on weekends before big trading days — they know clouded judgment costs money
- Make sure you're in a good headspace before making trading decisions

The Synergy

Understanding how collective emotions drive market movements lets you ANTICIPATE future patterns. Mastering your personal psychology gives you the internal tools to NAVIGATE those patterns without self-destructing.

Technical mastery + psychological mastery = consistent long-term success.

Elliott Wave provides the roadmap. Your psychology determines whether you follow it or panic off course.

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