**There will be rallies during this phase, just as there are reactions during the markup phase.** At certain points, supply will be withdrawn or demand will overpower what's available, perhaps due to elephants trying to shore up prices. For whichever reason, the bleeding will be stanched and the stock (and the investor who's watching his life savings go down the toilet) will be given a break. **As with all rallies and reactions, watch the relationship between price and volume.** Does the volume suddenly disappear during the rally? If and when the first rally attempt fails and the next reacton follows, does it exceed the previous low? If there's another rally attempt, does it exceed the previous rally high or fall short? Is volume stronger on the downsides or the upsides? **If rallies consistently stop short of supply, and up volume is consistently weaker than down volume, don't be shocked when your stock re-accelerates to the downside.**

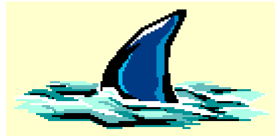
As with the journey up, the road will not be a smooth one. In fact, it'll be downright nauseating. What makes this particular road tricky is the perennially bullish outlook of the average investor (if he weren't bullish, he wouldn't be in the market in the first place). Whereas fear will generally keep him from jumping into overextended stocks (though an overabundance of hope may cause him to do just that), hope will induce him to try to buy in at the bottom (buy low, sell high, right?), even to the point of trying "catch a falling knife". When the rally attempt fails and the stock continues to fall, he panics, dumps his shares and adds fuel to the downside slide (this is referred to as "**capitulation**"), assuming he's not one of the truly clueless mentioned earlier who will continue to buy all the way down to what eventually does become the bottom (this is referred to as "ignorance" the first time it happens, "stupidity" thereafter).

Most stocks do not hit the bottom with a thud. **Even if there is a "selling climax" with a precipitous drop on high volume, the true bottom may not be reached until days or even weeks later.** If a bottom (though perhaps not *the* bottom) is reached quickly, there will usually be at least one rally off of it, given the colorful name of "**dead cat bounce**", meaning that it will go nowhere except, eventually, south. This is referred to as a "**technical rally**", as opposed to a legitimate rally attempt, because of the reasons for its occurrence, and it is not to be trusted. This sort of rally occurs not because there's a mad rush of people who are desperate to own this stock and who plan to bequeath it to their children, but because elephants are instituting buy programs to stop the decline, short-sellers are covering their positions, amateurs are attempting to catch the bottom, shareholders are averaging down, and/or daytraders are anticipating (thus helping to create) the rally and want to play whatever points it turns out to be worth. Professionals expect these rallies. They are, after all, helping to create them. And they don't pay much attention to them. They may, in fact, use them as further opportunities to sell, just in case they still have some accumulated stock left over in the fridge. **The volume clues mentioned above will help you to determine if this is what's going on.** If the "rally" does fail, you may find yourself looking at the world-famous double bottom, or W pattern.

Under the right conditions, however, such as those of October '98, stocks will do what's least expected, shatter all fondly-held notions of "how markets (and stocks) behave" and make what is called a **"V" bottom**. In highly volatile markets such as those we've seen this summer and fall (1998, that is), stocks may rebound off these V bottoms without pause, and recover much of their losses before reaching equilibrium and forming the kinds of bases or handles in which at least some accumulation can take place. Conventional wisdom says that **one shouldn't buy if the stock has regained 50% of the loss because it may retrace 50% of the just-achieved gain** (you'll often see this in a W formation in which the low of the second leg doesn't exceed the low of the first). This is why one wants to see a base or handle of at least minimal length to indicate that some agreement has been reached between bulls and bears as to the value of the stock, at least at that time (if the stock bases long enough to reach its trendline, so much the better). Without that, the stock is just as likely to collapse as it is to take off again, taking into consideration all the factors of price and volume, demand and supply, accumulation and distribution that I've delved into here.

There are signs to look for if one is irremediably aggressive and wants to try to buy these bottoms. If you have a cast-iron stomach, a will of iron, and are willing and able to remain glued to your monitor, you may want to try buying these bottoms as well. Otherwise, wait for at least some confirmation of strong demand before writing any checks.

**The first, most-rewarding, and far riskiest opportunity to enter or re-enter a position in a stock that's being marked down is immediately after the selling climax.** Making assumptions is never a good idea. Far better to let the chart tell you what's happening rather than some preconception, talking head, or message board post. But in this case, break the rule and **assume that whatever rally ensues will be a technical one leading to a double bottom.** Prepare to use what you've learned about price and volume clues and demand and supply to get out fast if this rally *does* turn out to be technical and *does* collapse just as it's supposed to. If the "technical" rally defies all expectations, turns out to be a legitimate rally after all, and results in a V pattern, you may not be in the clear but you will be able to see light ahead. Never lose sight of the fact, however, that **the many V bottoms that were evident this fall were the result of market activity, not news or anything fundamental pertaining to a particular stock.** Typically, buying V bottoms is a recipe for disaster, is only for the most risk-tolerant, and should never be attempted by those who are new to the markets and to investing.



If the rally does turn out to be technical after all, **watch to see if the ensuing reaction falls below the level of the first reaction or holds above it.** Also carefully watch volume throughout. **If the previous low cannot hold, and particularly if volume picks up,** expect a resumption of the decline as those who bought during the rally or were holding *before* the rally began now throw their shares onto the market. If the amount of this supply is large enough, and whatever demand there may be is not sufficient to absorb it, prices will fall. On the bright side, however, if volume is substantial, there may be less supply to slog through if and when the stock resumes its advance. **If volume subsides and the previous low *does* hold,** you will be given your **second chance to buy,** though it's best to wait until the advance actually resumes. You may also choose to wait for the market's "follow-through day"* if the market as a whole is also going through one of these cycles. **If volume subsides and the previous low does *not* hold,** this will indicate that those who are holding are mostly still holding. They may be waiting for the stock to rally to the midpoint of the W, in which case they'll get the hell out, or they may consider the stock to be a hold and have no intention of selling at all (or they may all be on the same cruise ship). Anticipate the behavior of both.

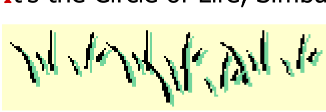
*(for those who haven't read O'Neil, the follow-through day is characterized by [1] a minimum 2% increase in whatever major market average you're following concurrent with [2] volume which is greater than the volume the day before and which [3] falls within a window of 3 to 10 days after what seems to be the bottom has been reached).

**Your third opportunity to buy** is the point at which the stock exceeds the high of the first rally attempt, the "midpoint" of the W, though there is always the possibility that a "handle" may form here. This does not necessarily mean that you should wait for one, but be prepared for the possibility that one may form (this midpoint is important resistance as it represents all those suckers who bought the first rally attempt; therefore, getting past it is an important achievement). If a handle does form and you don't want to wait for the breakout, you have the option of moving on to something else. If you choose to stay, monitor price and volume rigorously, as there is always the possibility of a further retest and a triple bottom. Just as the midpoint signifies important resistance, the low of the first leg down represents important support. If it's broken, pay very close attention to volume. Or get out altogether until volume and price show that buyers are clearly in charge once again.

V and W bottoms, however, are not the most common resolutions of the markdown phase. Typically, **volume will subside as selling pressure lets up, spreads will narrow, a line of support will be found, and price will begin to bob up on relatively light volume,** indicating that supply is becoming more scarce, the waters are subsiding, the sun is emerging from behind the clouds, the birds are singing, and a new accumulation phase has begun. It may take a while. There are a lot of burned-out and battle-weary investors out there, many of whom still don't quite understand what just happened. But these are exactly the conditions under which the elephants are most likely to begin buying up all those cheap shares.

And how do you know that your stock is being accumulated? Accumulation takes place in what is called a congestion area . . .

It's the Circle of Life, Simba.



I'm sure it has occurred to at least some readers that if the accumulation-distribution pattern I've described here were dependable in all circumstances under all conditions, then all stocks would have a pattern of up, across, down, across, up, across, ad infinitum. This is clearly not the case. **The markets are not represented by a straight and narrow highway.** A far better metaphor would be a roiling sea of rallies, reactions, markups, markdowns, shakeouts, thrusts, buying and selling climaxes, turning points, all happening all at once in timeframes varying from minutes to years and with all the accompanying eddies, currents, inversions, and undertows. This is the primary reason why I haven't provided graphic examples here of the concepts I've presented. **The point is not to find**

**some stock somewhere that typifies accumulation or a shakeout and use it as a template for all future investigations of manifestations of changes in demand and supply, but to understand at a deeper level how the threads of demand and supply, accumulation and distribution, and the relationship between price and volume all intertwine.** What I've provided here is only the beginning of an exploration, not an exhaustive treatment of the subject.

Each chart you look at, instead of being "typical", will instead be unique. **Each movement of price and volume in a chart has meaning only within the context of what has gone before in that particular chart.** Therefore, solving the puzzle of the dynamics of demand and supply will be a new challenge with each chart. Achieving mastery of this skill will take time, if mastery is ever achieved at all. But applying even the most basic of the principles outlined above will result in an almost immediate payback, if not in money gained, then in money saved.