GENERAL

technical analysis of financial markets by john murphy

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Introduction

In the ever evolving world of financial markets, traders and investors constantly seek reliable tools to predict price movements and make informed decisions. While fundamental analysis examines a company's intrinsic value through financial statements and macroeconomic factors, another powerful discipline focuses on price action itself: technical analysis. Among the many scholars who have shaped this field, **John Murphy** stands out as a leading authority. His comprehensive methodologies—often referred to as the *technical analysis of financial markets by John Murphy*—blend classic charting techniques with modern statistical insights, providing a systematic approach to market interpretation.

Whether you are a novice looking to understand the basics or a seasoned trader aiming to refine your strategy, this article will walk you through the core concepts, tools, and practical applications that define John Murphy's approach. By the end, you'll have a solid foundation for incorporating his techniques into your own trading routine.

Who Is John Murphy?

John J. Murphy, born in 1941, is a renowned financial analyst, author, and educator who has spent over four decades studying market behavior. He earned his Bachelor of Science in Finance from the University of Illinois and later became a Certified Financial Planner. Murphy's most significant contribution to the trading community is his seminal book, *Technical Analysis of the Financial Markets*, first published in 1999. The text quickly became a bible for traders worldwide, offering a detailed roadmap for interpreting price charts and applying a wide array of indicators.

Beyond authorship, Murphy has served as a senior analyst for major brokerage firms and has taught at several universities. His reputation for clarity and rigor stems from his insistence that technical analysis is not an art but a disciplined science grounded in observable market patterns. As a result, his methodologies have been adopted by professionals across equities, futures, currencies, and commodities.

Core Principles of Technical Analysis

At its heart, technical analysis rests on three foundational principles:

1. Price Discounts Everything – All known information, from macroeconomic data to corporate earnings, is already reflected in the market price. Traders, therefore, need only study price movements.
2. Price Moves in Trends – Markets tend to move in discernible directions—upward, downward, or sideways. Identifying these trends early allows traders to align their positions with prevailing momentum.
3. History Tends to Repeat Itself – Market psychology drives price patterns to recur. By recognizing familiar formations, traders can anticipate future price action.

John Murphy's teachings amplify these principles by integrating them with a structured framework that emphasizes chart patterns, trendlines, and a suite of technical indicators.

John Murphy's Approach to Technical Analysis

Murphy’s methodology can be broken down into three interrelated components:

- Charting and Pattern Recognition – Identifying classic formations such as head and shoulders, double tops, and triangles.
- Trend Analysis – Using trendlines, moving averages, and channels to determine market direction.
- Oscillators and Volume Analysis – Applying tools like the Relative Strength Index (RSI), Moving Average Convergence Divergence (MACD), and on balance volume (OBV) to gauge momentum and confirm signals.

Murphy’s approach is systematic: he first establishes the primary trend, then identifies potential reversal points, and finally uses confirmation indicators to validate entries and exits. This layered process reduces the probability of false signals and enhances trade reliability.

Key Tools & Indicators

Trendlines and Support/Resistance

Trendlines are the simplest yet most powerful tool. A bullish trendline connects a series of higher lows, while a bearish trendline links lower highs. When the price tests these lines, they often act as dynamic support or resistance zones. Murphy stresses the importance of allowing a trendline to be broken only when it is accompanied by a substantial price move, such as a gap or a large candlestick.

Moving Averages

Moving averages smooth out price noise, revealing underlying momentum. The most common are the 20 period, 50 period, and 200 period averages. Murphy recommends using a combination of short term and long term averages to spot trend changes. For example, a bullish crossover occurs when the 20 period average crosses above the 50 period average, signaling a potential upward shift.

Elliott Wave Theory

Murphy is a staunch advocate of Elliott Wave Theory, which posits that markets move in repetitive cycles driven by investor sentiment. The theory identifies five impulse waves followed by three corrective waves. By applying wave counts to price charts, traders can forecast potential turning points. While Elliott Wave analysis can be complex, Murphy provides a step by step method for beginners, emphasizing the importance of wave completion before making trade decisions.

Candlestick Patterns

Candlestick charts offer granular insight into intraday price dynamics. Murphy highlights classic formations such as engulfing patterns, hammer, doji, and shooting star. These patterns often signal immediate reversals or continuations, especially when confirmed by volume or other indicators.

Oscillators

Oscillators measure relative strength and momentum, helping traders identify overbought or oversold conditions. Murphy frequently uses the RSI, Stochastic Oscillator, and MACD:

- RSI (Relative Strength Index) – A 14 period RSI above 70 indicates overbought territory, while below 30 suggests oversold conditions.
- Stochastic Oscillator – Compares closing price to a price range over a set period, generating %K and %D lines.
- MACD (Moving Average Convergence Divergence) – Tracks the difference between two exponential moving averages, producing signal lines and histogram bars.

Volume Analysis

Volume confirms price movements. A price breakout accompanied by high volume is more likely to sustain, whereas a breakout on thin volume may reverse quickly. Murphy recommends pairing volume indicators, such as On Balance Volume (OBV) and Chaikin Money Flow, with price patterns to validate trade signals.

Channels and Rectangles

Channels are formed by drawing parallel trendlines around a price range. Rectangles, or trading ranges, consist of horizontal support and resistance levels. Murphy advises traders to monitor price behavior at the channel or rectangle edges, as breakouts often precede significant trend shifts.

Fibonacci Retracement

Fibonacci levels (23.6%, 38.2%, 50%, 61.8%) help identify potential support and resistance zones during a correction. Murphy recommends using these levels in conjunction with other tools, such as trendlines or moving averages, to strengthen entry points.

Case Studies

Case Study 1: Bullish Trend Confirmation in the S&P 500

During the 2017 rally, a trader applied Murphy's framework to the S&P 500 daily chart. The 50 period moving average was above the 200 period average, confirming a bullish trend. A bullish engulfing candlestick formed at the 50 period line, and the RSI dipped below 30 before rebounding to 55. Volume spiked, validating the breakout. The trader entered a long position at 2,500 points, set a stop loss below the 50 period line, and exited at 2,750 points, achieving a 10% return.

Case Study 2: Bearish Reversal in the Gold Futures

In early 2020, gold futures experienced a sharp decline. Using Murphy's methodology, a trader identified a head and shoulders pattern on the weekly chart, with the neckline at $1,650. A bearish engulfing pattern confirmed the reversal. The RSI moved above 70, indicating overbought conditions. The trader shorted gold futures at $1,640, placing a stop loss above the neckline. The price fell to $1,480, yielding a 9% profit.

Integrating Technical Analysis with Fundamental Analysis

While Murphy's teachings emphasize price action, many traders find value in combining technical and fundamental insights. For instance, a company's earnings announcement may cause a temporary price spike. A technical analyst can use trendlines and support/resistance levels to determine whether the spike represents a genuine trend shift or a short term reaction. By overlaying key fundamentals—such as earnings per share, revenue growth, and macroeconomic indicators—traders can filter out noise and focus on high probability setups.

Common Pitfalls & How to Avoid Them

1. Over reliance on a Single Indicator – Technical analysis thrives on confirmation. Relying solely on one tool, like the RSI, can lead to false signals. Combine multiple indicators for validation.
2. Ignoring Market Context – A bullish trend in a bearish market may still present risks. Always assess the broader market environment.
3. Failing to Adjust Position Size – Even the best signals can fail. Use proper risk management, limiting each trade to 1–2% of your portfolio.
4. Chasing the Market – Entering trades after a breakout has already occurred increases the probability of a

reversal. Wait for confirmation signals before committing.

5. Neglecting Stop Losses – Stops protect against unexpected volatility. Place them strategically, based on support/resistance levels or ATR (Average True Range).

Resources & Further Reading

- Books – Technical Analysis of the Financial Markets by John J. Murphy; Elliott Wave Principle by A.J. Frost and Robert Prechter.
- Online Courses – Investopedia Academy's Technical Analysis Course; Coursera's Financial Markets by Yale University.
- Software – TradingView, MetaTrader 4/5, and Thinkorswim offer robust charting tools and indicator libraries.
- Communities – r/ChartSchool on Reddit, Elite Trader forums, and the TradingView community provide peer feedback and real time analysis.

Conclusion

John Murphy's *technical analysis of financial markets*offers a pragmatic, evidence based framework that blends chart patterns, trend analysis, and momentum indicators. By mastering these tools and applying them with disciplined risk management, traders can navigate market complexities with greater confidence. Whether you're charting equities, commodities, or currencies, Murphy's principles provide a solid foundation for turning price action into actionable insight.

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