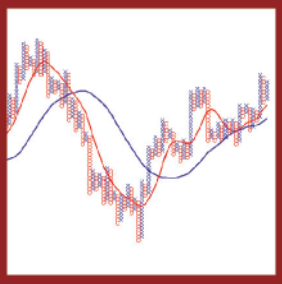
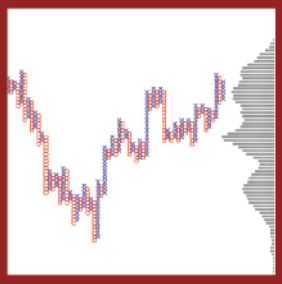
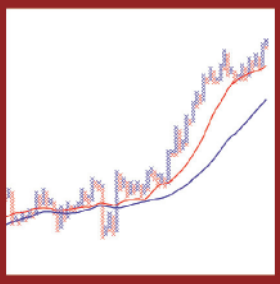
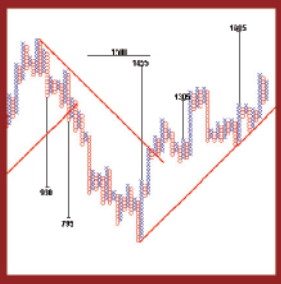
"I expect that du Plessis' book will not only become the definitive book on point and figure, but will also become a classic in the field of technical analysis."
John Murphy CMT, author of Technical Analysis of the Financial Markets

JEREMY DU PLESSIS

THE DEFINITIVE GUIDE TO POINT AND FIGURE

A Comprehensive Guide to the Theory and Practical Use of the Point and Figure Charting Method

FULLY REVISED AND UPDATED 2ND EDITION

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The Definitive Guide to Point and Figure

A Comprehensive Guide to the Theory and Practical Use of the Point and Figure Charting Method

Jeremy du Plessis

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HARRIMAN HOUSE LTD

3A Penns Road
Petersfield
Hampshire
GU32 2EW
GREAT BRITAIN

Tel: +44 (0)1730 233870
Fax: +44 (0)1730 233880
Email: enquiries@harriman-house.com
Website: www.harriman-house.com

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To Lynne

Contents

Praise for The Definitive Guide to Point and Figure Charting

"Rarely does a book live up to its claim of being the 'definitive' guide to something. Jeremy du Plessis' new book lives up to that claim and more. It's almost impossible to imagine a more definitive treatment of point and figure charting. The author pays homage to its early development and the pioneers who first wrote about it. He gives extensive coverage to the original 1-point reversal method before moving on to the more modern methods. The subject is examined from every conceivable angle. I'm not aware of anyone who has even attempted to combine p&f charting with so many modern technical indicators. I expect that du Plessis' book will not only become the definitive book on point and figure, but will also become a classic in the field of technical analysis."

– John Murphy CMT, author of *Technical Analysis of the Financial Markets*

"Not only does Mr. du Plessis plumb the history and elucidate the present state of point and figure analysis, he looks at a craft many regard as passé and sees a vibrant future. This eye-opener is a welcome addition to the literature of technical analysis."

– John Bollinger, CFA, CMT, President, Bollinger Capital Management

"If you had to go to a desert island and were only allowed to take one investment tool with you, then it should be the Point and Figure chart. If you were also allowed to take only one book, other than the Bible and the works of Shakespeare, then make it this Definitive Guide by Jeremy du Plessis.

The whole subject is covered from its early historical beginnings as a way of noting the noise of the ticker tape in the days of Charles Dow, then called the Book method, through its evolution to become the 'Voice of the market'.

How to construct and use the charts and their unequivocally clear buy and sell signals, revelation of trend, reversal, support and resistance levels are all revealed and well illustrated. The subject is explained as an evidence-gathering procedure, that leads to a successful trading method, with accurate entry, stop loss, and targets. It is also brought right up to date with some new thinking involving indicators such as OBV, Bollinger bands, and parabolic stop and reverse signals.

You will have such a great time working through it on your desert island that you might not want to come home."

– Robin Griffiths FSTA, Technical Strategist for Cazenove Capital

"Even though point and figure charting is 120 years old, Mr. du Plessis has brought a truly fresh and authoritative approach to a subject that is central to technical analysis. Bravo!"

– Bruce M. Kamich, CMT, Adjunct Professor of Finance at Baruch College, Past President of the Market Technicians Association

"A superbly comprehensive book on this powerful technique from one of the world's leading experts on the subject. A must read for all serious technicians and investors."

– Adam Sorab, Chairman, UK Society of Technical Analysts

About the Author

Jeremy du Plessis CMT, FSTA

Jeremy trained as an automotive engineer, then an economist, but gave them both up to become a Technical Analyst. In 1983 he founded Indexia Research and pioneered the development of PC-based Technical Analysis software with the Indexia range of Technical Analysis systems. During the 1980s he developed a number of technical tools and indicators under the banner of Indexia, such as the Indexia Market Tracker and Indexia moving averages, which are still used in software to this day.

He is an expert on Point and Figure charts, and the Indexia software was the first PC-based system to draw them correctly and clearly in the early 1980s. He lectures the Point and Figure module for the Society of Technical Analysts and sets the Point and Figure syllabus for the International Federation of Technical Analysts. He has taught Technical Analysis, and in particular Point and Figure, to thousands of professional traders and investors over the last 20 years. In 2001, after running Indexia Research for nearly 20 years, he agreed to merge the company with Updata plc, where he is now head of Technical Analysis and Product Development, and the designer of the Updata PC and SmartPhone Technical Analysis software.

He is a Fellow of the Society of Technical Analysts (FSTA) in the UK, and a member of the American Market Technicians Association (MTA) as well as the American Association of Professional Technical Analysts (AAPTA). He is a holder of the Chartered Market Technician (CMT) designation awarded by the MTA.

Preface to the Second Edition

Any author waits apprehensively for the first reviews of their book to come in. It was no different for me, but I have been extremely fortunate to have had numerous good reviews and have been honoured with many emails congratulating me on the first edition. It has been comforting to hear that readers have learnt this powerful technique from me and are profiting from it. I am delighted that the Market Technicians Association in the U.S. has chosen my book for the reading list for Chartered Market Technician CMT levels I, II and III. Point and Figure is an essential tool that all Technical Analysts must be familiar with. In fact if you speak to any Technical Analyst who started in the 1960s and 1970s, they will all tell you they used to plot Point and Figure by hand.

When I was approached to produce a second edition, I knew exactly what had to be done. Over the last six years I have received many emails asking for clarification on one aspect or another, so my first task was to rewrite those sections. In addition, I have added some new techniques.

While writing the first edition I had been experimenting with some new construction techniques and have added two of these, the low/high and ohlc methods, to the book. I have extensively revised the section *Analysing Point and Figure charts* and spent more time on explaining the parameters required to draw a Point and Figure chart and then how to choose the correct ones. I have also discussed the implications of showing gaps on Point and Figure charts and how this can provide more information about any column. I have introduced two new Market Breadth indicators based on Point and Figure, Bullish Trend Percent and X-column Percent, both of which give a different perspective to Market Breadth measurement and analysis. Finally, I have introduced horizontal Activity histograms based on price activity and volume at each box level. These give additional information about the strength of support or resistance at any level.

The Point and Figure charts used throughout this book are taken from the earlier Updata Technical Analyst and current Updata Professional software. Both do what every Point and Figure analyst requires in a clear and, most importantly, accurate way. For example, it is vital to be able to change parameters instantly to see how the chart is affected and both sets of software enable this. More information may be obtained from www.UpdataTA.com in the USA or www.Updata.co.uk in the rest of the world, from where you can download a trial. You will find that being able to draw and analyse Point and Figure charts while you are reading this book will help your understanding immensely.

I hope that you will learn from this book and enjoy reading it.

Jeremy du Plessis CMT, FSTA

Berkhamsted, United Kingdom 2012

Preface to the First Edition

This book is about Point and Figure charts; anyone wishing to practise Technical Analysis of the markets should be fully conversant with them. They may be the oldest method of charting the market in the Western world, but that does not mean they should be ignored in our modern world. On the contrary, once you understand more about them, you will wonder how you survived without them.

I have written this book so that it can be used and enjoyed by all levels of reader. Newcomers may find that they do not need another text, as this book starts with the basics and covers everything that they need to get a grip of Point and Figure Charts. Expert Technical Analysts who are familiar with Point and Figure charts are likely to find that the book covers things they may not be aware of, at the same time as reminding them of things they may have forgotten. I have tried to include as many examples from real charts as possible throughout.

The first thing you will notice about Point and Figure charts is that they look completely different from any other type of chart you may be familiar with; the main reason being that there is no time-scale along the horizontal axis. To understand why this is the case, it is essential that you read Chapter 1, *Introduction to Point and Figure charts*. Thereafter it is suggested that you read the book sequentially because each new chapter builds on the chapters before and assumes that you have accumulated that knowledge.

If you are new to Technical Analysis, you should read the *Introduction to Technical Analysis*, which explains what Technical Analysis is all about, and why and how charts are used. If you are an experienced Technical Analyst, you may skip the chapter and go straight to Chapter 1, *Introduction to Point and Figure charts*.

A summary of each chapter is given below.

Chapter 1 – Introduction to Point and Figure Charts

Chapter 1 explains the history and development of Point and Figure charts and how they came to get their name. It is essential that you read this chapter as it sets the scene and explains why Point and Figure charts look the way they do, and helps you understand more about them. You will find with this knowledge that all other aspects of Point and Figure charts become clearer.

Chapter 2 – Characteristics and Construction

Chapter 2 follows on directly from Chapter 1 and starts by explaining the characteristics that describe a Point and Figure chart. It then explains in detail how to construct one. You may be surprised to learn that there are quite a few different ways – all valid – to construct a Point and Figure chart. Even if you have software drawing the charts for you, it is important to understand the various methods of chart construction and the implications of using them. Some software,

unfortunately, does not draw charts correctly and unless you know what is right, you may be using charts that are incorrect without knowing it. Full details of arithmetic as well as log scale construction methods are provided, as well as the difference between using tick-by-tick data and end-of-day data.

Chapter 3 – Understanding Patterns and Signals

Chapter 3 is about understanding Point and Figure charts and the patterns associated with them. Instead of listing dozens of theoretical patterns, you are encouraged to understand how the patterns develop and what happens when they do. There are differences in the pattern make-up depending on the construction method. Chapter 3 explains those differences and compares and contrasts them. The chapter explains how Point and Figure charts generate buy and sell signals, and when signals should be ignored.

Chapter 4 – Understanding and Using Trend Lines

Chapter 4 covers the use of trend lines on Point and Figure charts which is different from other types of charts. It deals with subjective trend lines as well as a special Point and Figure version, which is drawn objectively.

Chapter 5 – Projecting Price Targets

Chapter 5 covers one of the unique features of Point and Figure charts; the ability to project price targets using both the vertical and horizontal count methods. A full explanation of the calculations, as well as where and how to apply the counts, is given. Once again, different construction methods result in different ways of calculating the targets. The implications of targets being exceeded or not achieved is explained and also how this adds to the analysis of the chart as a whole. There is a full explanation of risk:reward ratios and how they can be established on a Point and Figure chart.

Chapter 6 – Analysing Point and Figure Charts

Chapter 6 takes you through the thought process required to draw a Point and Figure chart. It explains the implications of changing the construction parameters and then how to choose them. You are then taken through an exhaustive step-by-step analysis of the FTSE 100 Index and the NASDAQ Composite using two construction methods. Finally, there is an explanation of how to use stoplosses on a Point and Figure chart.

Chapter 7 – Point and Figure Charts of Indicators

Chapter 7 describes the benefits of drawing Point and Figure charts of indicators – calculated lines – such as relative strength, on-balance volume and oscillators. It explains that Point and

Figure is simply a method of charting data and it should be used for drawing charts other than just price charts.

Chapter 8 – Optimisation of Point and Figure Charts

Chapter 8 discusses the case for and against optimisation, how Point and Figure parameters may be optimised and what the benefits or disadvantages are of doing so. A number of examples of optimised parameters are given and it is shown how these can be used to assist analysis.

Chapter 9 – Point and Figure's Contribution to Market Breadth

Chapter 9 covers Point and Figure's contribution to Market Breadth, firstly with the well-known Bullish Percent indicator, and then introduces two other breadth indicators based on Point and Figure, Bullish Trend Percent and X-Column Percent.

Chapter 10 – Advanced Point and Figure Techniques

Chapter 10 covers advanced Point and Figure techniques such as the use of moving averages, Parabolic SAR and Bollinger Bands on Point and Figure charts. It explains how using these techniques can enhance the readability of the charts. Finally it covers the use of horizontal histograms which show price and volume activity.

Chapter 11 – Chart Examples

Chapter 11 is the answer to the complaint so often levelled at authors that there are not enough real-life examples in their books. Chapter 11 contains a number of chart examples from a number of markets with a brief explanation of each to help you understand how to approach a Point and Figure chart.

Chapter 12 – Dividing your Stocks into Bullish and Bearish

Chapter 12 explains how you can use the power of objective Point and Figure signals and trends to scan universes of stocks to find those giving buy signals or sell signals and therefore dividing your universe into bullish and bearish. It explains how Point and Figure of relative strength can be used to enhance the signals.

Conclusion

Chapter 12 concludes the book with a summary of the major points made in the text.

References and Further Reading

There are many fine texts that preceded this one. Many have been used as references and you are encouraged to read as many as possible.

Figures and charts in the book

Throughout the book you will see references to figures as well as charts.

- *Figures* are diagrams drawn to illustrate a particular aspect of Point and Figure charts.
- *Charts* are actual Point and Figure charts of indices, equities (stocks), exchange rates and commodities from a number of international markets.

The colour used throughout the book makes reading the charts so much easier.

The name and origin of the instrument used in any chart is not important. A chart is a chart, no matter which market and which country it has come from. When looking at the charts, try to ignore the instrument name. Do not assume that if you do not trade the particular instrument, the chart is of no use to you. Point and Figure techniques apply across all instrument types in the same way.

Introduction

The question I ask myself before reading a book such as this is: what qualifies the author to write on the subject?

I am not going to pretend that I started trading stocks when I was at junior school. I can't even pretend that it was at high school; there were many more exciting things to do at that age. I confess that I did not pay my way through university from the proceeds of trading either. In fact, I graduated in 1975 and settled down to the life of an automotive engineer in South Africa, blissfully unaware that the stock market even existed. I was 27 before I became aware of financial markets, when I returned to university in Britain to take an economics degree.

Some may therefore regard me as a relative novice. I only have 25 years of Technical Analysis behind me. It was in 1979 that I was first introduced to the subject and in 1980 I bought a copy of *How Charts Can Help You in the Stock Market* by William Jiler, which I read many times over. I tinkered with charts without really understanding too much about them, but I knew enough to tell me that this was what I wanted to do for the rest of my life.

After graduating in economics, I returned to South Africa and joined my brother who was coincidentally in partnership with a South African Technical Analyst, Tony Henfrey, publishing a Technical Analysis newsletter on gold and gold shares. It was there that I was introduced to Point and Figure charts and I have been intrigued by them ever since. We had a team drawing and updating Point and Figure charts as well as bar charts by hand in large chart books every day. We also used basic arithmetic and exponential moving averages as well as momentum indicators, all of which were calculated by hand and logged in large journals from which the charts were drawn. It took more than half of the day to produce the charts, leaving the balance of the day for analysis. Eventually we bought a very basic computer (pre-IBM) that we used to generate some of the calculations for our hand-drawn charts.

I learnt a lot about Technical Analysis and how markets worked during that time. We had a stockbroker two floors above us with a Reuters Ticker or Telex machine, as well as a number of Reuters Stockmasters. I would run up the stairs a number of times a day to record the latest prices so we could update our charts – in pencil, because the market had not yet closed – to see what the latest position was. The stockbroker was typical of the time; tea was served to anyone in reception. It was a gathering place, a place to chat about the markets. The same faces were there day after day. We called them the 'old boys'. They sat there watching the ticker; some of them updating a few hand-drawn charts. Very often, those charts were Point and Figure charts. These old boys had been around a long time and I learned so much from them.

At the time, we also had a very good relationship with a broker on the floor of the exchange and seeing and experiencing the live open-outcry trading taught me a lot about how markets worked. We were able to speak directly to the floor and get a feel for what was happening. They liked the chartists because our information combined with the floor intuition could give them a head start.

Commodities were big then as well, especially metals. Trading LME (London Metal Exchange) silver was an exhausting and very emotional experience. To be called up at 8pm, when you had a long position, only to be told that silver was nearly limit down in New York was chilling to say the least. The decision was to either ignore the outside LME trading or try to open a contrary position in the US market. It was bracing stuff.

Our intra-day charts were mostly Point and Figure charts because they were easy to update and it didn't matter if you missed the occasional price. Although manually updating charts tells you more about the emotions of the market than electronically-drawn charts, I realised that the only way forward for the company was to computerise. The IBM PC had just been released and it seemed a good use for the computer, although not everyone thought so, and I was told that charting could never be computerised. I didn't believe it and decided to spin off a separate company, Indexia Research, with the specific aim of computerising Technical Analysis for our internal use. Together with a brilliant computer programmer, John Johnson, we worked on the first program and, in early 1983, we saw the first chart drawn. It was a revelation. The chart took 12 seconds to draw! We were so excited that we took the rest of the day off because we couldn't believe how quick it was. Although 12 seconds is laughable now, remember that to produce the same chart by hand would have taken an hour. Being able to change the periods of moving averages in seconds convinced us that we were on the right track and soon all Technical Analysis would be done by computer.

We used the software we had written for our own analysis and produced charts and advisory reports from the PC. Word soon spread that we had produced a Technical Analysis system and we started to see a demand from other market analysts for a similar program. So we decided to give it a name, Indexia Research Market Analyser, IRMA for short, and start selling it. But how? We had no experience of producing and selling software. What about a manual? How did we stop the program from being copied? All these things crossed our minds but, being young and naïve, we forged ahead.

Our first system was written for a German designed MS-DOS-based PC, the NCR DecisionMate V, mainly because it had a 640x400 full colour resolution compared to only 320x200 for the IBM. The problem was that we had to sell a PC as well as the software and that was not easy. There was a big demand from brokers and banks who were fitted with IBM PCs and were not prepared to go down the NCR route. So, we produced a monochrome IBM version (I refused to allow anyone to see our charts in low resolution IBM colour). Soon every broker and bank in South Africa had an Indexia program, together with a band of private users that quickly grew into thousands.

In 1986, we released a new version of the program called INDEXIA II at an investment show in Johannesburg. Nothing like it had been seen before. It had many innovative features as well as a number of Indexia indicators I had developed, the Indexia Market Tracker being one of them. It was very successful and proved to be just what the market wanted. In order to expand the business, we opened up agencies in the UK and Australia, but neither of these markets matched the sales of South Africa. The UK, in the 1980s, was behind South Africa in terms of Technical Analysis and we struggled to make it acceptable to the British investor.

I eventually decided that the only way to make Indexia and Technical Analysis acceptable in the UK was to move; so John and I moved the company and our families to the UK. The strategy worked and soon we had released a more powerful version – INDEXIA II Plus.

Throughout the 1990s Indexia software was regarded as the best Technical Analysis software available and, in 2001, Indexia won the first *Shares* magazine annual award for the best investment software.

Then in 2001 I agreed that Indexia join forces with a public company, Updata plc. It was a difficult decision to make, but having weighed up all the options, I realised that together we would be more progressive; Updata's programming resources combined with Indexia's reputation and Technical Analysis knowledge would make a formidable team and indeed it has. As head of Technical Analysis at Updata plc I was able to design an all-new Technical Analysis program, Updata Technical Analyst, which many regard as the leading Technical Analysis software. Its compatibility with major services such as Bloomberg has brought me into contact with some of the world's leading Technical Analysts, from whom I have continued to learn.

Another book on Point and Figure?

You could be excused for asking why there is a need for yet another book on Point and Figure charts. I have read many excellent texts and there are some yet unread. This book has been over 20 years in the making for no other reason than that it was easier to put off today what could easily be accomplished tomorrow. If I had finished it 20 years ago, it would have been one of a handful. Now there are dozens. The interesting thing is that, no matter how many times I read about the same technique in different books, I pick up something new each time due to the way the author is able to articulate it. I hope that the same will apply to this book. I have consciously, and no doubt subconsciously, used information I have gained from reading other books. I have listed these in the References section at the end and thank the authors for their assistance.

I am, however, disappointed that of the many fine Point and Figure books available today, none cover the original 1-box reversal charts in any detail. These are where Point and Figure charts began and they still have a place today. This book goes into more depth on traditional Point and Figure charts than any other book I have read. The aim is to ensure that you understand the history, development, calculations and the analysis of Point and Figure charts. You really need these basics to fully appreciate and apply this technique. Given all the facts, you, as the reader, may go out and apply every technique and assess for yourself whether it is of any benefit to you. Many believe that no knowledge of the construction and make-up is required because we all have computers to draw the charts. This is wrong. If you do not understand what is behind a Point and Figure chart you should not use them.

Do not presume that this book can replace all the other fine books on Point and Figure charts. It cannot. It can only supplement them. Although I believe this to be a complete work, you will gain further knowledge by reading some or all of those books listed in the References section at the back of this book.

Desert island charts

I have often described Point and Figure charts as my *desert island* charts. This has nothing to do with a special pattern I have discovered – as a student on a course once thought – but more to do with their usefulness. In the UK there is a radio programme called *Desert Island Discs* where celebrities nominate the songs they would most like to hear if stranded on a desert island. So just like we all have our favourite book, or our favourite song, I have my favourite chart. If I were ever shipwrecked on a desert island with only one chart to guide me through the markets, it would have to be a Point and Figure chart. No other single chart has the ability to cut through the chaff and show what is really going on.

Technical Analysis software

Although at the start of my Technical Analysis career I drew Point and Figure charts by hand, I no longer think it is necessary – unless of course you draw one just to 'keep your hand in'. I believe that computers can draw them with more flexibility and certainly a lot more quickly. However, that does not mean that you can ignore the chapter on chart construction. If you do not know how to construct a Point and Figure chart, you won't know if the computer-drawn chart you are looking at is correct. Many are not.

As the designer and project manager of the Updata's Technical Analysis software, I can recommend no other. Updata does what every Point and Figure analyst requires in a clear and, most importantly, accurate way. Speed and flexibility is key to good Point and Figure analysis, as you will see, and good PC software can do this so much better than an internet-based system can.

Acknowledgements and thanks

I would not be at this point in my career today without the help of many people: my wife Lynne, who has given me so much support over the years; my daughter Angelique and son Daryl, who encouraged me to finish this book; my late brother Dennis, who introduced me to a career in Technical Analysis and encouraged me through it during good times and bad; John Johnson, who was my business partner for over 20 years, and whose creative genius was behind the range of Indexia Technical Analysis software systems and most especially Point and Figure charts, long before Technical Analysis software was generally available for the PC; Tony Henfrey, who taught me the basics of Technical Analysis and how to understand charts; David Linton, Chief Executive of Updata Ltd, who gave me a free hand to create the Technical Analysis program of my dreams without any restrictions and gave me time to complete this book; Sami Khan of Updata, whose brilliant mathematical mind turned much of my theoretical ramblings into the best computerised Point and Figure charts available today, and Nigel Shaw and Andrew McKendrick who helped him to create the world's best Technical Analysis software system; John Cameron whose advice and encouragement helped me to keep going; the many authors over the last 100 years or more, whose writings I have digested and which have helped me to

write a book on Point and Figure charts; finally the thousands of nameless individuals who supported me, the Indexia Technical Analysis software and then the Updata Technical Analyst software for over 20 years, and whose suggestions I have noted, and in many cases have unashamedly used in the software and this book. Without all these people, I would not be in this very exciting business today and would certainly not have written this book.

Most especially, I would also like to thank Sami Khan, David Linton and Tony Smith for patiently and studiously reading through the text to see if it made sense and giving valuable comment and advice.

Finally, any errors, omissions and plain incompetence are entirely my own.

Jeremy du Plessis CMT, FSTA

Berkhamsted, United Kingdom, 2005

Any comments on the book will be gratefully received at **PointandFigure@updata.co.uk**.

Introduction to Technical Analysis

In order to fully understand Point and Figure charts, it is essential that the reader understands the basics of Technical Analysis. This brief introduction lays the foundations of Technical Analysis and explains the philosophy behind it. If you are new to Technical Analysis, it is essential that you also read one or more of the excellent texts on the subject, such as those by Murphy, Pring, or Kirkpatrick & Dahlquist (these are all listed in the References section).

Experienced readers may skip this section and go straight to Chapter 1 – *Introduction to Point and Figure Charts*.

Technical Analysis of markets has been around for well over a hundred years, but what really popularised it was the advent of the IBM PC and the Technical Analysis software that followed in the early 1980s. This allowed private investors to start doing their own analysis and compete on equal or better terms with the professionals. Societies and associations of Technical Analysts[1] gained popularity and met regularly to discuss the subject and publish journals. Most countries now have their own organisations and there is an International Federation of Technical Analysts, which holds a worldwide conference once a year. Many universities also now embrace and teach Technical Analysis. But anyone thinking that Technical Analysis is a short-cut to riches should think again; it is not. Technical Analysis is a method that requires time and effort to be spent on it for it to be profitable.

Technical Analysis and the 'F' word

Technical Analysts are not normally appreciative of the 'F' word being used in their presence, however there are some who tolerate it and indeed some who embrace it. This author believes that there is no place for 'fundamental' analysis if Technical Analysis is used, but there are those who use both methods. Either way, they are very different methods and although this is a book on Technical Analysis, it is important to understand the difference.

Fundamental Analysts look at macroeconomic, microeconomic and business factors in order to determine the direction of the market and the prospects for a particular share, commodity or exchange rate. The objects of their research include company reports and economic statistics.

Technical Analysts, on the other hand, look at price and volume changes to deduce from these the direction of the market and the prospects for the price of any instrument; the only measure that truly counts if you are an investor.

Technical Analysts argue that all these known and less known factors are reflected in the price and, if good, the price will rise, and if they are bad, the price will fall. Technical Analysts argue that fundamental analysis lags the market by too much for it to be of any use.

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[1] Websites: Society of Technical Analysts (STA) **www.sta-uk.org**, Market Technicians Association (MTA) **www.mta.org**, International Federation of Technical Analysts (IFTA) **www.ifta.org**.

There are, of course, stories that Technical Analysts love to tell. There is the one about the Technical Analyst and the Fundamental Analyst having lunch one day. Accidentally, the Fundamental Analyst knocks his steak knife off the table and it goes straight into his foot. The Technical Analyst looks at him and says, "That must have hurt, why didn't you move your foot?" The Fundamental Analyst replies, "I thought the knife would go back up again". No matter how good the fundamentals are, a price in a strong downtrend is unlikely to reverse back up again without demand behind it.

Another is told about a broker who phones his client and says, "Hi, Bob, I have some good news and some bad news". Bob replies, "Oh dear, give me the bad news first". The broker says, "You know that share I told you to buy yesterday? Well, it has halved in price this morning". "Oh no," says Bob, "What's the good news?" "The fundamentals are still good", replies the broker.

Well, he's probably right. The fundamentals most likely are still good because they have not had time to change. As John Maynard Keynes once remarked, when criticised for altering his position, "When the facts change, I change my mind. What do you do, Sir?" For a Technical Analyst, the facts are the price. If the price breaks up through a price level, a Technical Analyst may recommend buying. However, if for some reason the price pulls back again and goes in the other direction, Technical Analysts will change their view and recommend selling – unlike our broker above, who, despite the change in direction, tells his client that the fundamentals are still good. Technical Analysts are often criticised for changing their view, but in fact a speedy adaptation to a movement in the price is the strength of Technical Analysis.

What is Technical Analysis?

Technical Analysts have never been very good at explaining what Technical Analysis is, so it is not surprising that it is often misunderstood. Technical Analysis in the Western world goes back to the 19th century, when Charles Dow, of Dow Jones fame, laid some of the foundations for the subject. Since then its history has been well-documented and books from the first half of the 20th century are excellent reading for anyone wishing to understand more about the subject and its rich history.

So what is Technical Analysis and why is it is the best way to analyse markets?

When asked, most people will tell you that Technical Analysis is about charts, but it is likely that they don't know why. A book by Robert Edwards and John Magee, one of the definitive Technical Analysis texts, describes Technical Analysis as follows:

"Technical Analysis is the Science of recording, usually in graphic form, the actual history of trading (meaning price changes, volumes etc.) in a certain share, or commodity etc. and then deducing from that pictured history, the probable future trend."

The definition is correct, but it doesn't explain what Technical Analysis actually is. It's a bit like explaining that a car is a pile of steel, glass and rubber that gets you from A to B. A car

may be made of these things, but the definition does not communicate what a car really is; a mode of transport.

Technical Analysis is the art of recognising repetitive shapes and patterns within a data series represented by charts. It is the understanding that these patterns are created by price changes which are in turn created by the market participants like you and me. The patterns created by the market participants repeat themselves because human nature is constant; just like fashions repeat, so market action repeats itself.

The important point to remember is that it's people that create the price; their fear and greed, their hopes and prayers, and their opinions. The price, and therefore the chart, is the weighted average sum of everyone's feeling or opinion about a particular share, future or commodity. It's better than an opinion poll, because everyone with the slightest interest in the share makes their mark by participating in the buying or selling thus making the price go up or down. A chart, therefore, is a study of human behaviour, and that is the key to Technical Analysis.

Technical Analysis is a bit like trying to cross the Champs Elysées in Paris. The safe way to do it is to wait on the pavement for a few people to gather. Someone will take a step off the pavement and step back as a car rushes past. And so it will continue. Individuals test the road until the small group on the pavement becomes more powerful than the cars and start holding up the traffic. Then, and only then, will the Technical Analyst step out and walk across the road. Technical Analysts need some indication that things are now in their favour before they act.

But why do Technical Analysts draw charts? The reason is that they can't interview all the market participants every day. All they can do is take the price and accept that at the end of the day – when all the 'fighting' has stopped – the price represents the best estimate as to the value that day. It is then far easier and more informative to draw a chart of this price on a day-to-day basis than to just write it down. A chart can show things that the numbers cannot. For example, charts can show trends and in 90% of cases markets do trend.

So, charts represent price movement, but what causes the price to move? It's simple. If there are more buyers than sellers, the price will go up. If there are more sellers than buyers, the price will go down. These are the simple laws of demand and supply that we all understand. The markets are driven by the constant fight between the buyers and the sellers. It has little to do with PE ratios, what a government minister has just said, or who a company's directors are. It is the interaction of the market participants and how they feel about all the available information that drives the price.

Trend

Trend is vital to good Technical Analysis. There is nothing unusual about that. You will hear economists, company analysts and accountants using the word 'trend' – trend in earnings, trend in the sales, trend in the inflation rate. Following trends is part of human nature. Anyone who has read *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds* by Charles Mackay will have read about trends that have occurred in human behaviour, such madness of

the price of tulip bulbs or the schemes thought up by people like John Law or the South Sea Company which caught the people's imagination and dragged them in. Trends do exist and are an integral part of human nature, because the fear of being left out is a strong motivation to follow a trend.

James Dines, in his 1972 book, *How the Average Investor can use Technical Analysis for Stock Profits*, placed trends into four psychological phases:

1. Cognitive or awareness stage

This is where the public are aware that a trend exists, but they are hesitant to get involved for one reason or another. It's like the start of a new fashion trend. You see it in the street, but wouldn't wear it yourself. You need to see confirmation that it exists and is not a one-off. You are aware that the market has been rising but, having been caught out before, you are hesitant to get involved again.

2. Mobilisation stage

This is when the public start moving with the trend or the fashion and even the most hesitant get involved. Having seen the trend, they want to be part of it. They see others wearing the latest fashion and start to do so themselves. Having continually heard about profits that others are making in the market, you overcome your hesitation and get involved yourself.

3. Confirmation stage

This occurs when, having become involved, the public see confirmation that the trend exists and are now convinced by it. It's the "things are different this time, the old rules no longer apply" stage and complacency sets in. This stage was evident in the internet boom of the late 1990s. It's when you have taken up the fashion yourself and see others wearing it as well. Having become involved with the market you start to make the gains that others have been making. You feel secure.

4. Equilibrium stage

This occurs when the expectations are no longer met and the trend has to retreat dramatically to bring back equilibrium again. These expectations could be profit-related. Investors used to making 20% a month become disappointed with only 10%! It's when the fashion you have been wearing doesn't look that good anymore and when you step out you feel like a fool. During this phase, the stock market can retreat significantly, as it did in the years following the technology boom top in March 2000.

Think how these phases apply to the analogy of crossing the road. The pioneers start, the crowd follows and everyone is happy, except the motorists, who, after waiting for a while, get impatient and start moving forward to prevent the pedestrian trend from continuing.

Technical Analysts are therefore most concerned with trends and trend lines. You just have to look at any chart and you will see that prices do move in trends. Human beings are trend followers. Technical Analysts observe these trends and act when important trends are broken.

Support and resistance

In addition to studying trends, Technical Analysts also look for support and resistance levels. Support occurs at a level at which the market participants believe the price will rise and, consequently, where the demand is. Resistance occurs at a level at which the market participants believe that price cannot rise further and, consequently, where the supply is. Technical Analysts don't look for fundamental reasons why certain areas are support and resistance areas, they simply observe that they are. In fact, they occur mostly for psychological reasons. Let's have a look at how it might work. Figure 1 shows a hypothetical price on the decline.

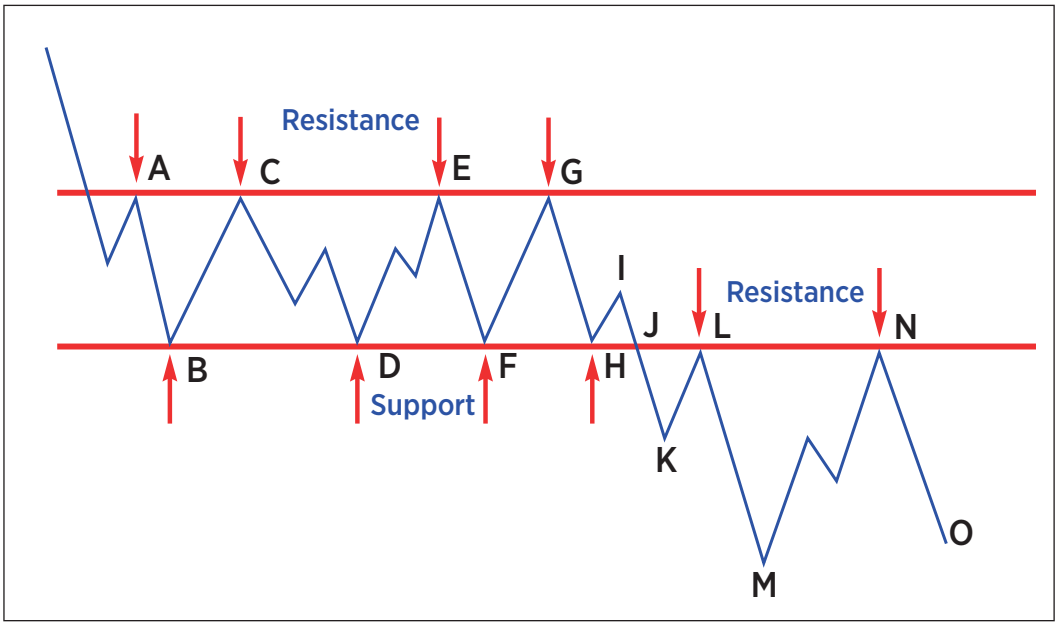


FIGURE 1: SUPPORT AND RESISTANCE

The price is in a downtrend. It pauses, reacts back up to point A, and then falls to point B. Technical Analysts do not reason why it did this; it is simply understood that supply and demand caused the price to move in this way. At point A, buyers were not prepared to pay any more and so the price declined to B, where the buyers were prepared to start buying again.

You have to remember that the market is made up of lots of participants with differing views and objectives. Buyers who bought at point B may take profits at point C. However, there is

another group who bought at point A, are pleased that the price has risen back to the same level at point C, and are pleased to get out of their position. This collective view results in a resistance level at point C and causes the price to move down from point C.

Remember, buyers at point B made a good gain when they sold at point C, and so when it gets down to point D they start buying again. This creates a support level, where buyers are prepared to take an interest again. This demand pushes the price back up again. Once again, at point E, they start selling, reinforcing the resistance level at this price. This causes the price to decline again until it reaches support at point F, where the same short-term traders, who have bought at B and D before, start buying again.

Point G is as far as the price gets again because the short-term traders have become confident that it will not go higher, and so the resistance at that level gets stronger. It declines again to point H and, once again, the buyers come back again, creating support for the price. The price bounces to point I and then falls back to point J. The same buyers who bought at point H are pleased that they now have a second chance to buy at the same price at point J, but this time the sellers are in charge and force the price below point J. It is important to consider how the participants feel about this. Buyers had become confident buying at the same level and making a profit, so much so that they were probably buying increasingly more each time. For the first time, they are in a losing position.

Some will sell their positions immediately, creating a selling frenzy that pushes the price down. Others will, however, hope and pray that the price will rise back to the price they paid. Point K is the point where the price has become oversold. That is, it has fallen too far too quickly and short-term traders looking for a quick profit start buying. This forces the price back up to point L briefly, where the new buyers take a quick profit and some of the B, D, F, H and J buyers sell to break even. The move to point L is short-lived as so many sellers appear. So, the level at point L, which was a support level, now becomes a resistance level. The price falls to point M.

There is no reason why the price stops at point M. It could be at any level. It is just a point where demand exceeds supply and the price is driven back up again. It is important to pause and consider the psychological make-up of the participants. There will be a large group who bought at the B, D, F, H and J levels and are still holding their positions. What is going through their minds is 'if only the price can reach the price I paid, I will sell out and never buy another thing again'! This creates even more resistance at the L level, which is the same level as the previous support. So, when the price does eventually rise back to that level, those who have been praying start selling at point N, reinforcing the resistance level and forcing the price down again to point O or lower. The level at points L and N will remain a strong resistance until there are no sellers left at that level.

The important point about this scenario is to understand that levels of support and resistance do occur on charts and that they occur for psychological, not fundamental, reasons. When support is broken, it is important to recognise that support becomes resistance to any up movement and that this also occurs for psychological reasons. Although not shown in the

diagram, resistance, once broken, becomes support to any down movement. So support and resistance alternate. This is not just a theory – it actually happens in real life, as the chart of Whitbread plc (a FTSE 100 company) shown in Chart 1 testifies.

Notice how resistance areas become support areas once the price breaks above the resistance, and support areas become resistance areas once support is broken. As explained, these are created by the emotions of fear and greed that influence market players. There are thousands of private scenarios being played out. There is no point in trying to analyse each and every one. Simply observe and predict where the price will be supported and where it will be resisted. You can see that there is support for the price around the 780 mark and resistance around the 850 mark. Should the resistance break, then the next resistance is at around 1130, a price tested twice several years ago.

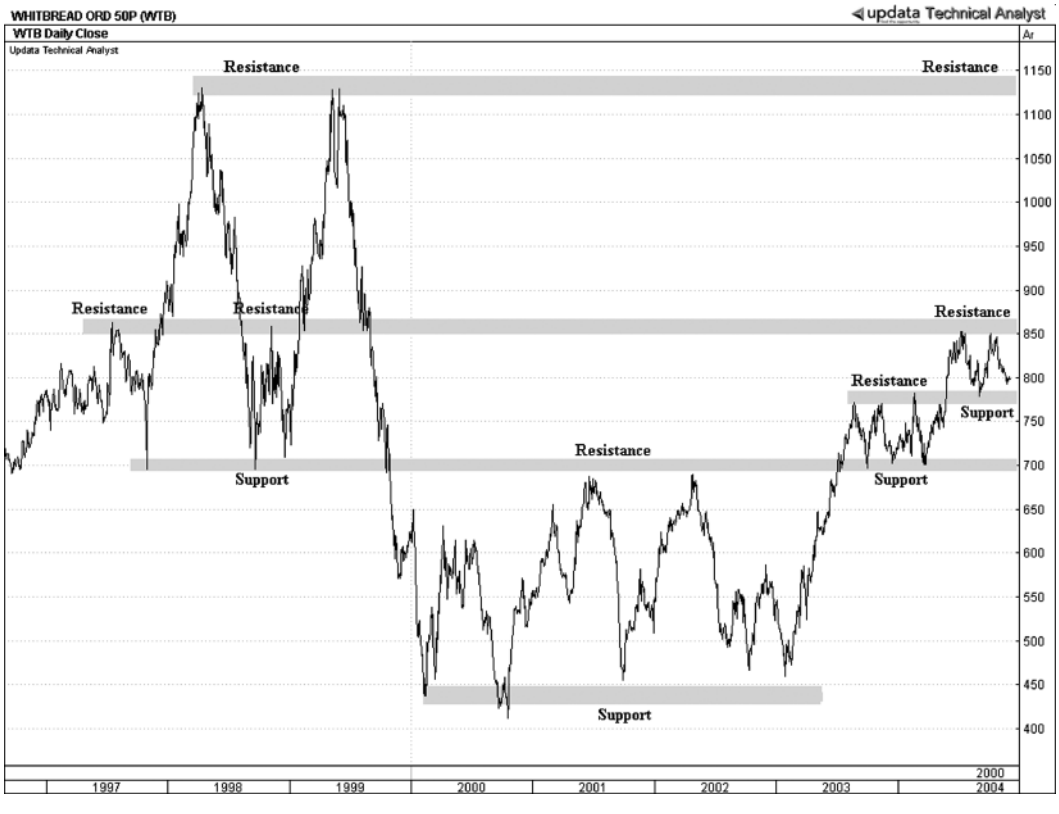


CHART 1: WHITBREAD PLC SHOWING SUPPORT AND RESISTANCE LEVELS

Price patterns

In addition to looking at trends, and support and resistance, Technical Analysts also look for price patterns. These patterns help us to predict whether a trend has reversed or whether it will continue. They are not rigid patterns and perhaps Technical Analysts made a mistake when they

decided to give them names, like double-tops and head and shoulders, because then the uninformed take hold of them and recite them without understanding how and why they are created. These patterns are created by crowd psychology as well.

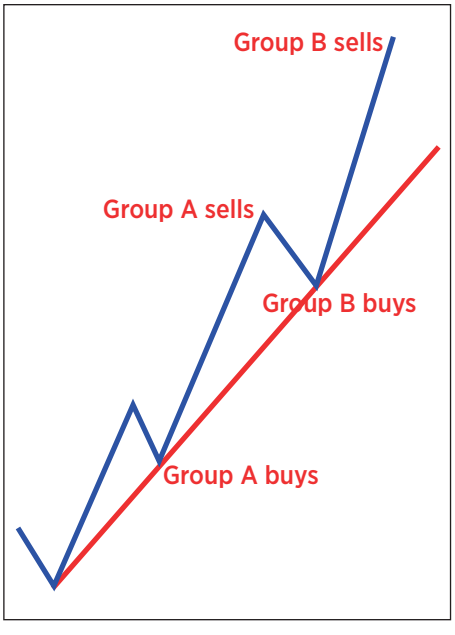


FIGURE 2: HOW PRICE PATTERNS ARE FORMED

Let's see how it happens, referring to Figure 2.

The price finds a level where it starts to move up. Very few people get on the first leg up. After the first move up, profit-taking forces the price back and Group A buys. The point where Group A buys allows a trend line to be drawn from the bottom to this point. The price runs up and Group A, who are then showing a good profit, sell, causing the price to fall back again. When they think the price is at bargain levels, Group B, who missed out before, buys. The price runs back up again and Group B eventually sells for a profit and are pleased with themselves.

The price falls back to the psychological trend – the red trend line – in Figure 3. Group C, the largest group, usually small players, who have missed the whole move from the bottom, buy in the circled area. Instead of rising, however, the price continues down, breaking the uptrend line. Remember, however, that none of these participants are consciously aware that the trend line exists. Consider the psychological state that members of Group C are in. Their first foray into the market has left them holding a paper loss. Many will be praying that the price gets back to the level they paid so they can get out at breakeven.

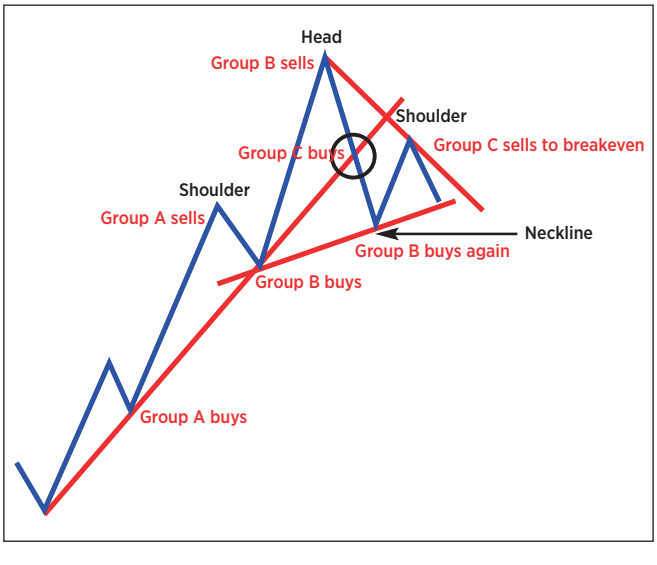


FIGURE 3: HOW PRICE PATTERNS ARE FORMED

The 'cheapness' of the price, however, attracts the attention of Group B, who notice that the price is in the same area that they had made a profit from before. Group B therefore buys as well and the price moves up again allowing a new trend line

to be drawn. It is the line where there is currently demand. As the price reaches the level paid by Group C, it is held back by selling from Group C, who have just suffered the trauma of the price falling below the level they bought at. So, Group C sells to break even, placing resistance on any further up move, and the price falls back again. This allows a downtrend line to be drawn from the top. It is the line where there is currently supply. Look at Figure 3. The price is trapped in a triangular pattern bounded by the neckline and the downtrend line. It is a point of resolve, where either the demand from buyers or supply by sellers must take the upper hand. Also notice that a head and shoulders pattern has been traced out by the antics of the various groups. There is a head and two clear shoulders supported by a neckline.

Figure 4 shows what happens next. Instead of rising, the price falls, breaking the neckline in the circled area, indicating that the supply is greater than the demand. The price falls back and a new group who have not yet participated, Group D, buy. Again the price moves up slightly, hitting the downtrend line where Group B, thankful that they can break even, sell. This selling pressure forces the price to fall again and another new group, Group E, buys. Once again, the demand, this time by Group E, drives the price back up and Group D, who have seen paper losses, use the opportunity to sell at a small loss, thankful to get out. This halts any further up movement and the price falls further until another new group, Group F, finds it cheap enough to buy. It is likely that Group F will consist of many members of Group A, who have seen the price come back to the level where they bought and made profits previously.

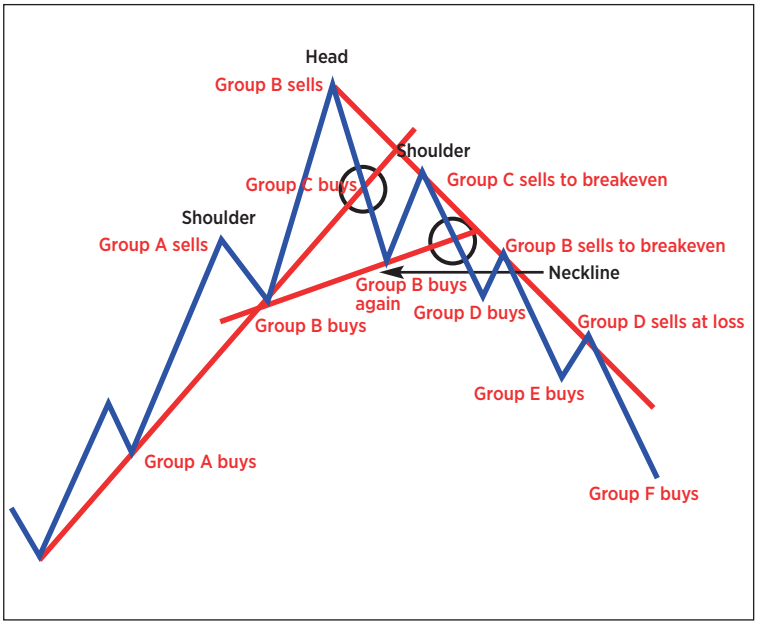


FIGURE 4: HOW PRICE PATTERNS ARE FORMED

The process continues in Figure 5. The price moves up and Group E, thankful to get out at breakeven, sell, forcing it down again. As this happens, Group F, who can't believe their luck, come in and support it by buying more at the same level they bought before. The price moves up again. Group F, who are now aware of previous levels where the price had turned down, sell for a profit, and the cycle starts all over again.

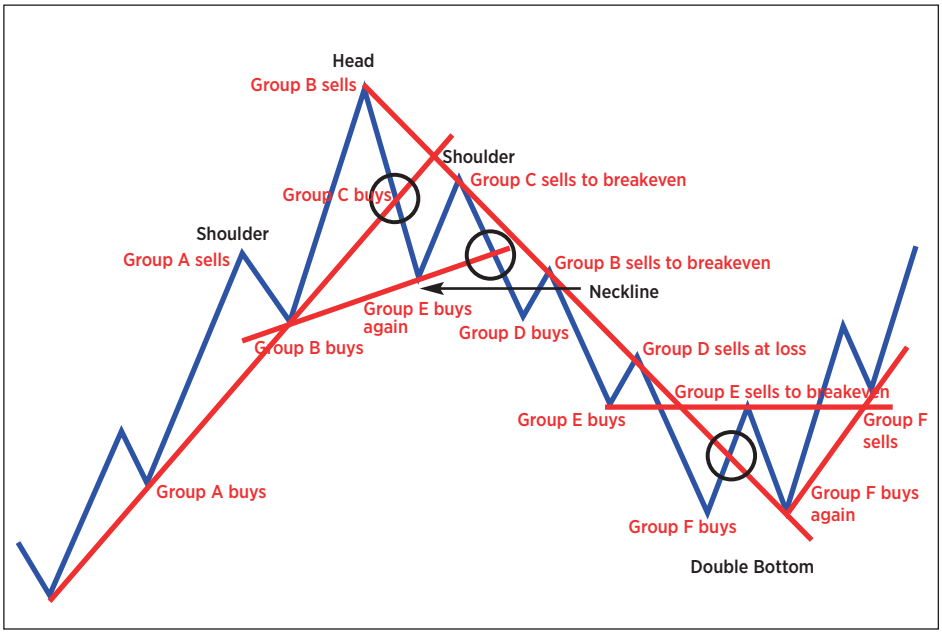


FIGURE 5: HOW PRICE PATTERNS ARE FORMED

Notice that in constructing this scenario two very important patterns are created, namely a head and shoulders top and a double-bottom.

Don't expect every scenario to play out in this form. There are thousands of permutations, but remember that patterns chartists observed 100 years ago still present themselves to this day. Why? Because people with the same habits and the same emotions are still behind the price moves. As you become more involved with charts and the technical analysis of them, so you will subconsciously read them as if they are a picture of the emotions of the players in the market.

Finally

The unique thing about Technical Analysis that makes it so much more powerful than any other analysis method is that you can change your analysis time horizon by changing the time frame of data you use, switching to weekly, monthly or even 1 minute price changes. Try asking a Fundamental Analyst for a short-term and medium-term view.

Technical Analysis is the best method of analysis because:

- It is based on fact, the price, not estimates.
- Real people with real emotions drive the price.
- It keeps you on the right side of the trend, long in an uptrend and short in a downtrend.
- It lets you know when you are wrong and allows you to change your mind.
- It allows you to change your analysis time horizon by changing the time frame of the chart.

Technical Analysis is a vast subject. It is therefore not the intention of this book to cover every aspect, but rather just the Point and Figure method.

Emotion – the (Technical) Analyst's greatest enemy

Without doubt, the greatest cause of bad decisions is emotion and unfortunately, like everyone else, Technical Analysts are subject to emotion when making their decisions. How many times have you spent an hour deciding which share to buy, only to be told that the fundamentals are poor? You change your mind about buying, only to see the price rise in the weeks following. How many times have you decided to sell your shares and then seen a glowing report in the newspapers predicting on ongoing bull run? You decide not to sell and, within days, the price falls dramatically.

These are the sorts of emotions that any investor is subjected to constantly. If you are a Technical Analyst in the corporate world, you may have additional pressure from your superiors who are not believers in Technical Analysis. Your advice may therefore be unpopular. Stick to your guns, however much pressure you come under. In the end, it will pay off – you will be right and they will be wrong. Above all, do not listen to market gossip and rumour. So often, rumours are started by those who have a vested interest.

Finally, trading, and investing, isn't easy. If it were, it wouldn't be profitable.

Chapter 1

Introduction to Point and Figure Charts

Point and Figure charts are unique to Technical Analysis. It is not often that a discipline can claim complete ownership of a technique, with the knowledge that other disciplines could not use it even if they wanted to. Economists, engineers and sales analysts use all sorts of charts but none use anything like a Point and Figure chart. The roots of Point and Figure are in the stock and commodity markets and have fascinated Technical Analysts for well over a hundred years. Chart 1-1 below shows a Point and Figure chart of Whitbread plc, the same company shown in Chart 1 in the Introduction to Technical Analysis above.

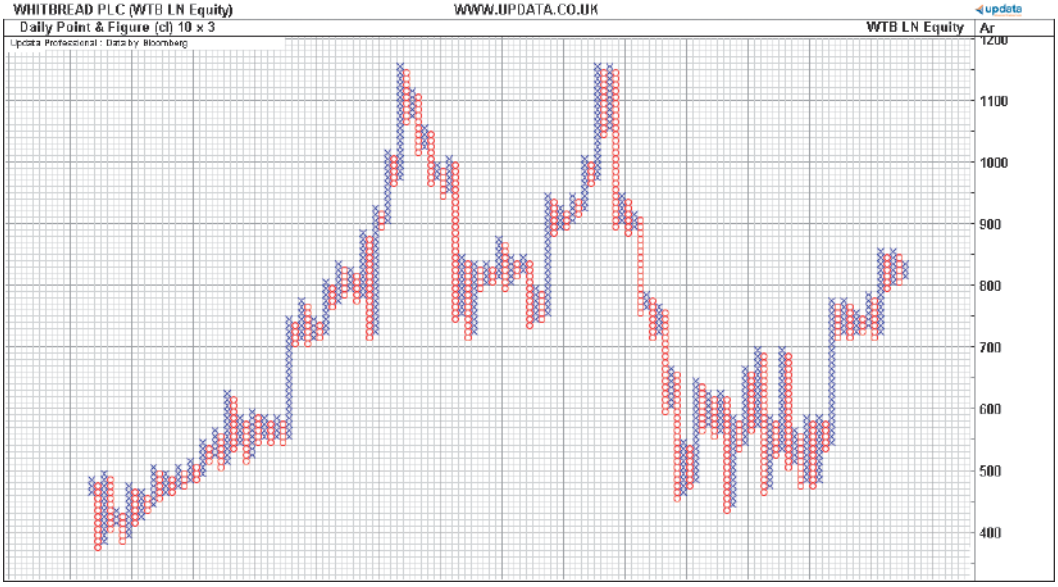


CHART 1-1: POINT AND FIGURE CHART OF WHITBREAD PLC

Look at the chart. It is different from every other chart you have ever seen. It uses Xs and Os instead of lines and bars and it doesn't appear to have a time-scale.

So unusual are Point and Figure charts that most students of Technical Analysis avoid them completely. This author has dedicated over 30 years to educating and encouraging the wider use of Point and Figure chart analysis. One thing that makes them clearer to students is an understanding of where they came from and how they developed.

HISTORY AND DEVELOPMENT

No one really knows precisely where the Point and Figure charts came from, or who invented them. They weren't always called Point and Figure charts, as you will see. Writing in 1933, Victor De Villiers and Owen Taylor state that the Point and Figure Method is over 60 years old. Some have therefore attributed them to Charles Dow, which seems to be the easy option, as Dow is regarded by many as the father of Technical Analysis.

It is unlikely that any one person invented Point and Figure charts. In fact they probably weren't invented at all. It is more likely that they were born out of necessity – a need to be able to record price movement quickly and efficiently whilst on the move. 'On the move' being not at your desk, but standing on the trading floor or in front of the ticker tape machine in the broker's office, as most private traders would have been. What the trader wanted was a general idea of what the share price was doing. The most obvious way therefore was to simply write down the prices on the back of a cigarette packet or notebook as the share traded, for example as follows:

9¾ 10¼ 11½ 11¼ 12½ 12¼ 13¼ 15 16½ 15 14¼ 13½ 12

10¼ 10 11¾ 11½ 14 15 16 17 19½ 20 21¾ 19 18¾ 19½ 20

It was not long before he[2] realised that there was no point in writing down all the fractions[3], because firstly it took more time, and secondly the fractional changes were irrelevant to the general trend, which is what he was trying to see. He therefore left out the ¼s, the ½s and the ¾s, so his record of the day's trading started to look like this:

9 10 11 11 12 12 13 15 16 15 14 13 12 10 10 11 11 14 15 16 17 19 20 21 19 18 19 20

He now had a record of what the share was doing, but this is what it would look like at the end of a busy trading session:

9 10 11 11 12 12 13 15 16 15 14 13 12 10 10 11 11 14 15 16 17 19 20 21
19 18 19 20 21 19 18 19 20 20 21 23 20 19 16 15 13 12 10 10 8 9
11 11 14 15 16 17 15 11 12 12 13 12 12 13 15 16 15 13 12 10 10 11 11
14 15 16 17 19 20 21 19 20 20 23 24 21 22 22 20 19 19 20 22
20 21 20 21 20 19 19 20 19 20 20 21 22 21 20 20 21 21 22 21
20 19 19 18 19 19 20 19 20 19 19 18 18 17 18 17 16

[2] 'he' has been used for convenience, because firstly it is unlikely that any 'she's' were trading on the floor 120 years ago and secondly writing 'he or she' interrupts the flow of the text. Many of the world's best Technical Analysts are women and the author hopes that they do not take offence.

[3] U.S. markets have always traded using fractions rather than decimals.

It would have been a mass of numbers. The only thing he could glean from it was the first price of the day, 9, and the last price of the day, 16. He could not see, at a glance, how it had traded during the day; what the high or low was; or where most of the trading had taken place. So, he had to come up with a better way of recording the prices. How about writing down the numbers in columns so that the highest and lowest price could easily be seen? Logically, he decided on a rising column for rising prices and a falling column for falling prices. Taking the first few prices from our series, his tabulation would have looked something like this:

16
15
13
12
12
11
11
10
9

It didn't take him long to work out that it was unnecessary to write down a price twice if it traded at the same price in succession. So, the double 11s and 12s disappeared. He also realised very quickly that when the price changed direction he would have to move across to the next column and write the number in the next free space. So, having written '10 11 12 13 15 16' in the first column as the price was rising, when the price fell back to 15, he realised he would have to move to the next column to write '15' and then '13 12 10' as the price fell further. See Figure 1-2.

FIGURE 1-1: TABLE OF RISING PRICES

16
15 15
13 13
12 12
11
10 10
9

This immediately showed a flaw in the method. In the first column, he initially missed out 14 because the price had not traded at 14, but that meant there was nowhere to put 14 in the second down-column as the price traded at 14 on the way down. So, he had to ensure that all price levels were recorded even though the price never traded at that level and hence one of the basic tenets of the method was established – the charts take no account of gaps. See Figure 1-3, which shows the construction of the first three columns.

FIGURE 1-2: TABLE OF RISING AND FALLING PRICES

		17
16		16
15	15	15
14	14	14
13	13	13
12	12	12
11	11	11
10	10	
9		

As the columns grew longer and more columns appeared as the price changed direction, he realised that squared paper would assist in keeping the tables neat and regular and so his record (remember it was not intended to be a chart) started to look like Figure 1-4. The figures written into squares brought the word 'box' into the language, although he had no idea at this stage that, firstly, he was drawing a chart and, secondly, that it would one day be called Point and Figure, he would refer to the 14 box, or that the price had increased by, say, two boxes.

FIGURE 1-3: TABLE OF RISING AND FALLING PRICES

Figure 1-4 shows how a Figure chart was born. It is important to note that it was not started as a method of charting, but more as a sequential price recording method.

															24																
							23								23	23															
							22	22							22	22	22	22					22		22						
			21		21		21	21						21		21	21	21	21	21	21	21		21	21	21	21					
			20	20	20	20	20	20						20	20	20		20	20	20	20	20	20	20	20		20	20	20			
			19	19	19	19	19	19						19	19			19				19	19				19		19	19		
			18	18		18		18						18													18			18	18	
			17					17	17					17																17	17	
	16		16					16	16	16		16		16																	16	
	15	15	15					15	15	15		15	15	15																		
	14	14	14					14	14	14		14	14	14																		
	13	13	13					13	13	13	13	13	13	13																		
	12	12	12					12	12	12	12	12	12	12																		
	11	11	11					11	11	11			11	11																		
	10	10						10	10				10																			
	9							9	9																							
								8																							

FIGURE 1-4: EARLY RECORD OF PRICES

Traders now had a way of recording price movements that had a number of benefits:

1. They could trace what the price had done during the day by following the columns.
2. They could easily see what the high of the day was (24).
3. They could easily see the low (8).
4. They could see where it closed on the day (16).
5. They could see where most of the trading had taken place by looking at the most filled in row (20).
6. It was a portable system that could be written on the back of an envelope and did not require the plotting rigours and precise time and price scaling of a line or bar chart. Thus, time is not an ingredient of the method.

In an editorial in the *Wall Street Journal* in 1901, Charles Dow described what we have seen above as the *Book* method because it was plotted from the ticker, often referred to as the market book.

Once traders realised that they were, in fact, drawing charts, the name 'Figure Chart' began to be used. Perhaps the best printed example of exactly how a trader would have drawn a Figure Chart[4] is shown by George Cole in his 1936 book. See Figure 1-5.

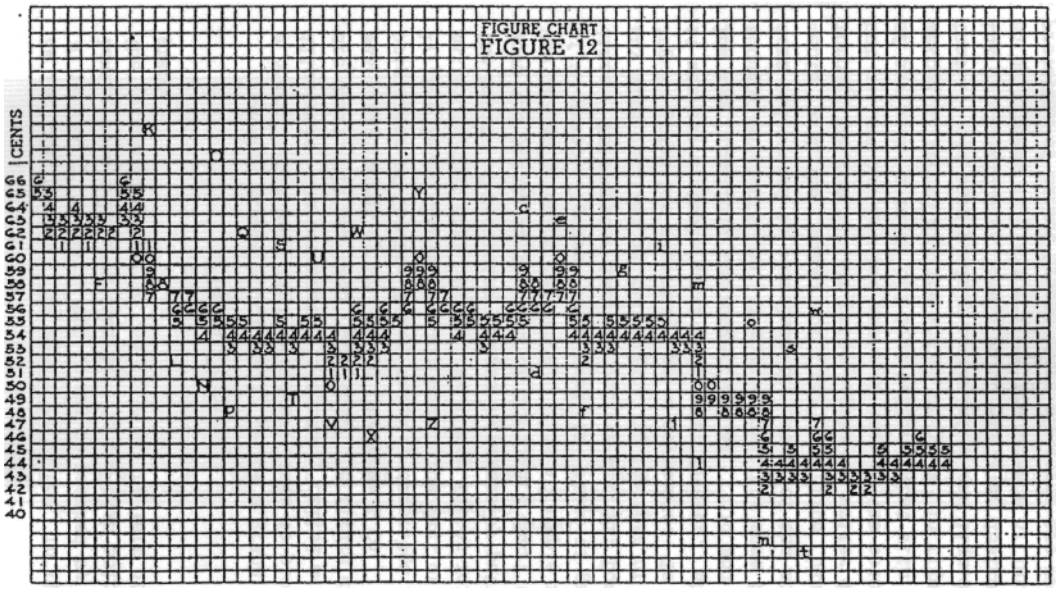


FIGURE 1-5: EARLY FIGURE CHART
Source: Cole, Geo W., Graphs and the Application to Speculation, Peoria 1936

[4] In fact George Cole made some plotting errors in this chart. Once you become familiar with Point and Figure construction, see if you can spot where he went wrong.

Note that he had a vertical scale, choosing to write down the price units only. Note also that he entitled it 'Figure Chart'[5].

Some traders would have found it tedious to write down the price all the time, preferring instead to 'tick off' or 'mark off' the price with a dot, a tick or cross as it hit a particular price level (Figure 1-6). These charts constructed with ticks or crosses started to appear towards the end of the 19th century and into the 20th. It is almost as if there were several groups developing the charts to their own specification, often not realising that others were doing the same.

24															X																
23							X								X	X															
22							X	X							X	X	X	X					X		X						
21			X		X		X	X						X		X	X	X	X	X	X	X		X	X	X	X				
20			X	X	X	X	X	X						X	X	X		X	X	X	X	X	X	X	X		X	X	X		
19			X	X	X	X	X	X						X	X			X				X	X				X		X	X	
18			X	X		X		X						X													X			X	X
17			X					X	X					X																X	X
16	X		X					X	X	X		X		X																	X
15	X	X	X					X	X	X		X	X	X																	
14	X	X	X					X	X	X		X	X	X																	
13	X	X	X					X	X	X	X	X	X	X																	
12	X	X	X					X	X	X	X	X	X	X																	
11	X	X	X					X	X	X			X	X																	
10	X	X						X	X				X																		
9	X							X	X																						
8								X																							

FIGURE 1-6: CHART CONSTRUCTED WITH CROSSES

In 1898 an anonymous writer calling himself 'Hoyle'[6] published what he termed a 'pamphlet' entitled *The Game in Wall Street and How to Play it Successfully*. In it, he described and demonstrated *'the method of keeping records of the fluctuation in the price of stocks'*. His method shown in Figure 1-7 is exactly the Figure method described above.

[5] The inserted letters above and below the chart are reference points in Cole's text and have no relevance here.
[6] Many believe that 'Hoyle' was indeed Richard Wyckoff writing under a pseudonym.

The method of keeping the records of the fluctuations in the price of stocks as shown on the charts in this book is as follows :

Suppose St. Paul sells at 85 then goes to 86 and to 87. Then the price turns and reacts to 85 again. Then it turns again and goes to 86, 87, 88, 89. Then reacts to 87. Then goes up to 90 and down to 89. The record should be made each day in the order in which the changes occur,

				90	
		89		89	89
		88	88	88	
87		87	87		
86	86	86			
85	85				

the corresponding quotations should always be on the same horizontal line.

FIGURE 1-7: FLUCTUATION CHART
Source: Hoyle, The Game in Wall Street, J.S., reprinted by Fraser Publishing

Although he described the Figure method in detail, Hoyle's charts were actually drawn with price scales and, instead of numbers, he had 'ticks' as if he was ticking off the prices as they occurred. Figure 1-8 is an example of a Fluctuation chart from Hoyle's booklet. The fact that this appeared in a book suggests that it must have been in common usage at that time.

Hoyle states that the "*study of fluctuations or records of daily ups and downs in prices of stocks furnishes a key to an understanding of this whole business*". They are "*the smoke and dust of battle that hides the plans of the general from the men in the thick of the fight*".

Although there is no evidence to support the theory, one can imagine that these charts could have been referred to as tick charts, a name that lives on to this day in describing any chart that records prices as they occur, rather than in equal time intervals.

The method of ticking off the price with ticks did not, however, seem to be that widespread. There is more evidence of the use of the letter X, but this did not mean the demise of Figure charts. Richard Wyckoff, writing under the name 'Rollo' in 1910, clearly shows a chart constructed with figures, showing the Amalgamated Copper panic of 1903 (Figure 1-9). There is no mention of using Xs or ticks.

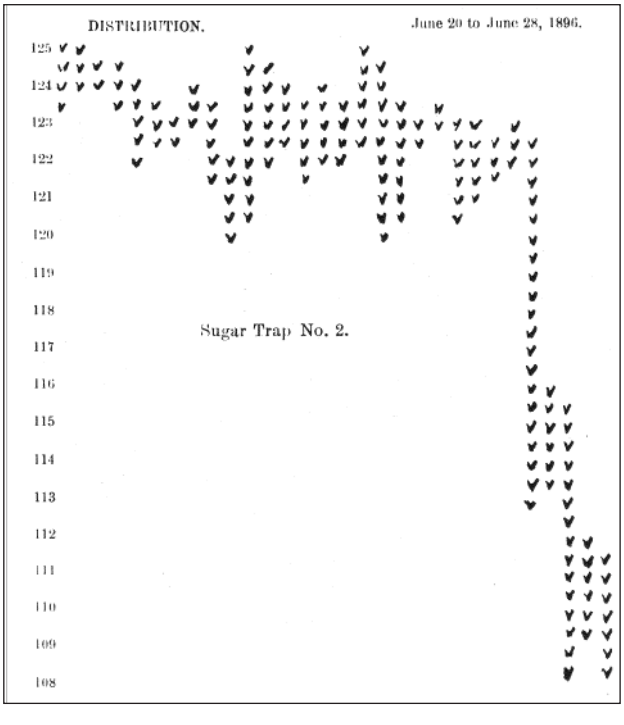


FIGURE 1-8: FLUCTUATION CHART
Source: Hoyle, The Game in Wall Street, J.S., reprinted by Fraser Publishing

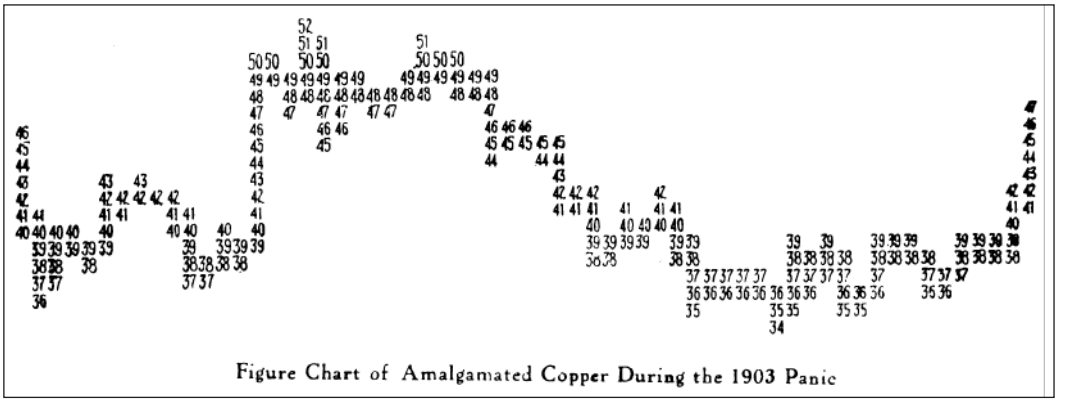


FIGURE 1-9: EARLY FIGURE CHART
Source: Rollo Tape, Studies in Tape Reading and the Application to Speculation, 1910, reprinted Fraser Publishing

The next mention of Point and Figure charts was in 1932, when Richard Schabacker published his Technical Analysis epic, entitled, *Technical Analysis and Stock Market Profits*. Although the book is mainly about Bar and Line charts, he included a short section headed 'Point and Figure charts', which he referred to as a "*corruption of the ticker chart"*. A ticker chart was one where the prices were not grouped by time. This type of chart is referred to as a Tick chart nowadays. Schabacker also states that Point and Figure charts are similar to minor move charts, where a vertical line continued to be drawn until the price reversed by a prescribed amount. At that point, a short horizontal line was drawn and another vertical line was drawn in the other direction. Although he does not show one, these appear to be similar to Manhattan swing charts and are related to Point and Figure charts because they take no account of time.

Interestingly, Schabacker states that "*this type of chart has many names, but it is usually known as the Figure or the Point chart"*. He concluded the section by saying that Point or Figure charts "*offer the practical trader no advantages over the ordinary vertical line chart"* [bar chart].

In 1933, Richard Wyckoff mentioned and showed a Figure chart (Figure 1-10) in his book *Stock Market Technique Number One* and challenged the reader to interpret it. When you compare the charts you can see that the construction method is exactly the same as that in his 1910 book. He made no mention of any chart constructed with ticks or crosses.

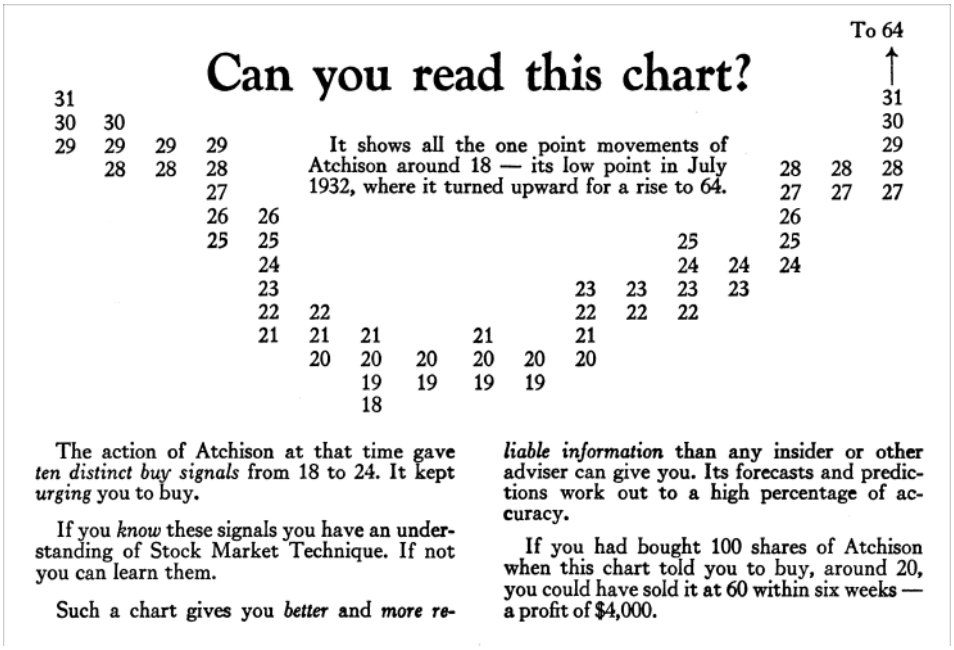


FIGURE 1-10: FIGURE CHART CONSTRUCTION EXAMPLE
Source: Wyckoff, R.D, Stock Market Technique Number One, reprinted by Fraser Publishing

Also in 1933, the first book dedicated to Point and Figure charts appeared. De Villiers' booklet, entitled *The Point and Figure Method of Anticipating Stock Price Movements – Complete Theory and Practice*, appears to be the first text dedicated to the method, indicating that it was by then widespread enough to sell a book describing it. In the book, De Villiers shows an example of a chart constructed with figures, which he calls the Figure Method, as well as one constructed with Xs and numbers at key levels, which he calls the Point Method (Figure 1-11).

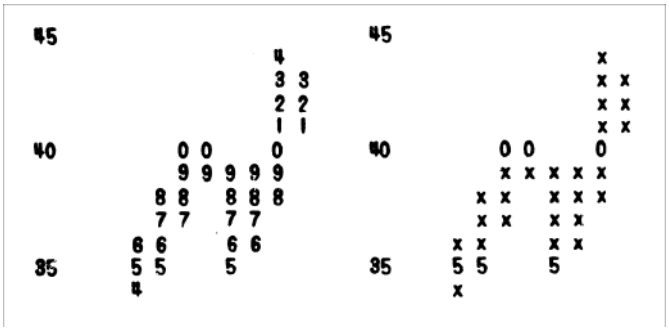


FIGURE 1-11: EARLY FIGURE CHART AND EARLY POINT CHART
Source: De Villiers, V, The Point and Figure Method of Anticipating Stock Price Movements, 1933, Reprinted by Windsor Books

He states that he prefers the Point Method, but does say that Figure charts do have the advantage that the analyst can see the repetition of the figures at a particular level more easily than in Point charts. He goes on to say that Figure charts are "*old fashioned*", so, by 1933, Point charts – as De Villiers calls them – were starting to replace Figure charts, but it does show that even into the 1930s Figure charts were still being used. There is no doubt, however, that Point charts were becoming more widespread, reinforced by the fact that throughout De Villiers' book the charts he shows are those constructed with Xs instead of Figures.

In doing away with figures written in each square, Point and Figure chartists had to have another way of seeing what the price level was. They introduced a vertical price scale so that the price could be marked off quickly as it moved, but they also considered the 5 and 10 levels so important that they wrote the numbers five (5) and zero (0) in the squares at these levels. See Figure 1-11.

The original price series, used here as an example, started off as rows of numbers, then the trader started to use columns of numbers, then the columns became Figure charts, then Tick charts and finally Xs replaced the numbers and the ticks, which resulted in Point charts where Xs, 5s and 0s were used instead of figures.

Writing again in 1933, this time with Owen Taylor in a much more comprehensive work, De Villiers does not refer to, or show, Figure charts at all. All the charts shown in the book are constructed with Xs, 5s and 0s as shown in Figure 1-12.

																X															
							X									X	X														
							X	X								X	X	X	X					X		X					
			X		X		X	X						X		X	X	X	X	X	X	X		X	X	X	X				
20			0	0	0	0	0	0						0	0	0		0	0	0	0	0	0	0	0		0	0	0		
			X	X	X	X	X	X						X	X			X				X	X				X	X	X	X	
			X	X		X		X						X													X			X	X
			X					X	X					X																X	X
	X		X					X	X	X		X		X																	X
15	5	5	5					5	5	5		5	5	5																	
	X	X	X					X	X	X		X	X	X																	
	X	X	X					X	X	X	X	X	X	X																	
	X	X	X					X	X	X	X	X	X	X																	
	X	X	X					X	X	X			X	X																	
10	0	0						0	0				0																		
	X							X	X																						
								X																							

FIGURE 1-12: POINT CHART EXAMPLE

In Wyckoff's 1934 work, *Stock Market Technique Number Two*, he showed the charts constructed with Xs, 5s and 0s (Figure 1-13), just as De Villiers and Taylor had done in 1933, which was a complete change from Wyckoff's book, written a year earlier. So, with Wyckoff persuaded to move to crosses, we can conclude that Figure charts had virtually ceased to exist.

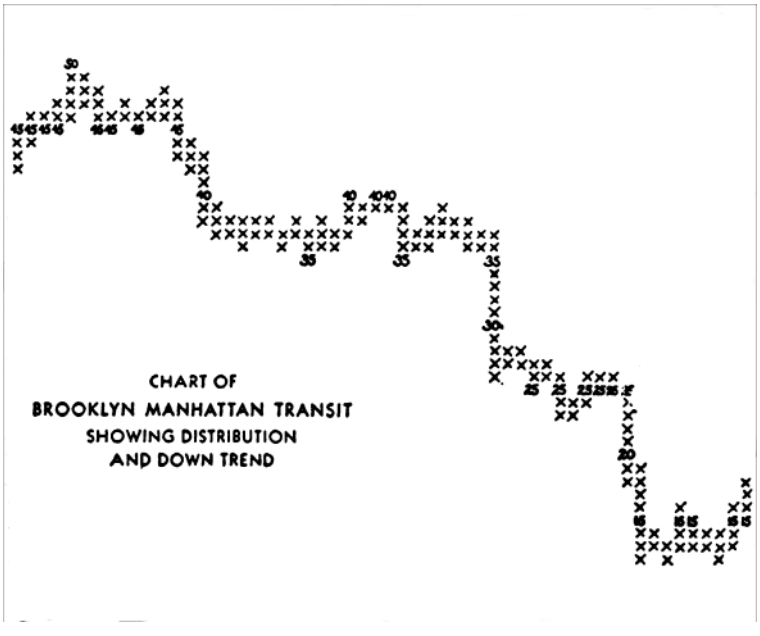


FIGURE 1-13: EARLY POINT CHART
Source: Wyckoff, R.D, Stock Market Technique Number Two, reprinted by Fraser Publishing

In 1936, George Cole's pioneering work, *Graphs and the Application to Speculation*, refers to, and shows, a hand-written Figure chart, shown in Figure 1-5 on page 7. He states, however, that some practitioners prefer a chart constructed with Xs instead of Figures and shows an example of a chart constructed with Xs, where each X is half a point. See Figure 1-14[7]. What is interesting however is that he did *not* include 5s and 0s at the 5 and 10 levels on the chart. Cole does not refer to De Villiers or Taylor, but does say the method of Figure charts was originated by Charles Dow.

[7] Once again, the letters above and below the chart are irrelevant.

FIGURE 1-14: EARLY POINT CHART
Source: Cole, Geo W., Graphs and the Application to Speculation, Peoria 1936

It is safe to assume that Figure charts gave way to Point charts constructed with Xs for two reasons:

1. Writing down numbers had become tedious.
2. If a fractional chart was required like a half point chart in Figure 1-14, it would have been necessary to write down all the ½s as well, which would have made the chart unreadable.

There appears to have been another lull in writing until two very important works appeared: A.W. Cohen's 1947 work, entitled *Stock Market Timing*, later re-titled as *The Chartcraft Method of Point & Figure Trading* and re-titled again as *How to use the Three Point Reversal Method of Point and Figure Stock Market Trading*; as well as Alexander Wheelan's 1954 booklet, *Study Helps in Point and Figure Technique*.

The two books could not have been more different if they had tried. Cohen's was the very first occurrence of a completely new plotting method which will be discussed in a later chapter. Significantly, the traditional chart constructed with Xs – and sometimes 5s and 0s at key levels – was dispensed with, in favour of a chart constructed with the letters X and O[8], where Xs designated up-moves and Os designated down moves. It gave a completely new meaning to Point and Figure charts and their interpretation. Figure 1-15 shows our original price series constructed with Xs and Os.

[8] For readability, Xs and Os should be read as Ex's and Oh's rather than crosses and noughts. So an X is an 'Ex' rather than a cross, and an O is an 'Oh' rather than a nought.

															X															
						X									X	O														
						X	O								X	O	X	X					X		X					
			X		X	X	O						X		X	O	O	X	O	X	X		X	O	X	O				
20			X	O	X	O	X	O					X	O	X		O	X	O	O	O	X	X	O		O	X	X		
			X	O	X	O	X	O					X	O			O				O	O				O	X	O	O	
			X	O		O		O					X													O			O	X
			X					O	X				X																O	O
	X		X					O	X	O		X		X																O
15	X	O	X					O	X	O		X	O	X																
	X	O	X					O	X	O		X	O	X																
	X	O	X					O	X	O	X	X	O	X																
	X	O	X					O	X	O	X	O	O	X																
	X	O	X					O	X	O			O	X																
10	X	O						O	X				O																	
	X							O	X																					
								O																						

FIGURE 1-15: POINT AND FIGURE CHART EXAMPLE

It is easy to see why Cohen preferred charts constructed with Xs and Os. Charts constructed with Xs, 5s (fives) and 0s (zeros) suffer from two problems:

1. It is confusing, having Xs going up as well as down. Anyone looking at the chart has to work out whether the first column is a rising or falling one, before analysis can take place. This is a waste of time and prone to mistakes.

2. It is also somewhat off-putting to see rows of 0s and 5s amongst the Xs as they can be mistaken for support and resistance levels – which they are not – leading to incorrect interpretation.

Although the X and O method was clearer, some authors, namely Alexander Wheelan in 1954, still used charts with Xs, 5s and 0s. Nowhere did he use the X and O method. In fact, to this day, the X-only method is still the best method when a certain type of Point and Figure chart – called a 1-box chart – is drawn. The X-only method (without the 5s and 0s) makes the 1-box chart clearer than the X and O method does. The X and O method is, however, the clearest for all other types of Point and Figure chart.

Books on Point and Figure charts have continued to appear over the last 20 years, from authors such as Markstein (1972), Blumenthal (1975), Burke (1990), Aby (1996), Zieg (1997), Dorsey (2001), and others. Their excellent texts are listed in the References section on page 459. Most have, however, ignored the history and therefore the original methods of construction, leading newcomers to Point and Figure to believe that there is only one type of Point and Figure chart, constructed in only one way. This book will address that issue.

So, that is the history and development of Point and Figure charts. You may find it useful to read it again, because no other method has such a clear development path. It is the understanding of the psychology that caused this development path that is important when it comes to interpreting Point and Figure charts. It is almost as if it is the mouthpiece or the voice of the market. The chart moves only when the market moves and only when there is significant movement in the price. It is like watching a ticker tape or the trading of a particular stock on the floor, which sadly does not exist in most major markets anymore. It is a graphic representation of the supply and demand, and the fear and greed, that is part of the market.

WHERE DID POINT AND FIGURE CHARTS GET THEIR NAME?

There has been much discussion and speculation about the origin of the name Point and Figure, and, although it is not that important, it is worth looking at the written evidence.

Charles Dow described the early charts constructed with figures as the 'Book Method'. They were so called because the charts were plotted from the ticker, also known as the market book, in a sequential process.

As stated earlier, Hoyle did not give the method a name, other than to describe them as 'fluctuation records'. Although he described the recording of figures, Hoyle's charts were drawn with price scales and instead of numbers he used 'ticks', as if he was ticking off the prices as they occurred.

Richard Wyckoff describes and shows a Figure chart of Amalgamated Copper during the 1903 panic, but says nothing about Points. So, by 1903 the Book Method had become known as Figure charts.

It is clear, therefore, where the word 'Figure' came from. Figures were used to plot the prices as they occurred. There is, however, some confusion and speculation as to where the word 'Point' originated.

Wyckoff referred to one-point Figure charts in 1933, where the lower case 'p' and upper case 'F' were deliberate. The charts were Figure charts, plotting 1 point.

In his 1933 book, entitled *Point and Figure Charts*, De Villiers states that although he uses Point charts exclusively, Figure charts do have the advantage that the analyst can see the repetition of the figures at a particular level more easily than in Point charts. This implies that there were two types of chart: Figure charts constructed with figures; and Point charts where the figures are replaced by Xs. Throughout the book, De Villiers refers to the Point and Figure method, but when referring to charts he refers to them as Points and Figures (note the plural). This implies that the words 'Point' and 'Figure' relate to the two methods – the Point method and the Figure method. It is likely, therefore, that when referring to his charts the analyst

referred to his Points and Figures charts and possibly the combination of the two, using Xs with 5s and 0s, was referred to as Point and Figure.

In an apparent complete contradiction, however, writing with Owen Taylor in 1933, De Villiers clearly states that the name, Point and Figure, came from plotting 1 point in figures. This is confusing, since in the same year he had earlier referred to Figure charts or Point charts in a book with the same title. In De Villiers and Taylor, they refer to Point and Figure (singular) charts and do not refer to them as separate Point charts or Figure charts. This could have been Taylor's influence, but it does seem that this was the earliest joining of the two methods into one name and then searching for a reason for doing so. De Villiers and Taylor chose to explain the name as plotting 1 point in figures. On the evidence this does not seem a good explanation.

In the first of his *Stock Market Technique* books, also published in 1933, Wyckoff discusses Figure charts constructed with Figures and states that the "*one point figure chart"* is the standard for stocks.

Although it was clear from a number of sources that Figure charts were losing favour to Point charts, it still does not explain the name Point and Figure.

George Cole refers to, and shows, a Figure chart similar to De Villiers'. He also states that some practitioners prefer a chart constructed with Xs instead of Figures and shows an example of a Figure chart constructed with Xs where each X is half a point. He calls this chart a "*One half point Figure Chart"*. One presumes that if each X had been worth 1 point he would have referred to it as a "*One point Figure chart"*. This is a similar naming convention to that used by Wyckoff in 1933. It is possible, therefore, that Point and Figure got its name in one or all of three ways:

1. As De Villiers and Taylor explained in 1933, the charts got their name by plotting 1 point in figures. This is, however, a flawed reason because it does not explain what the chart would have been called if each X were half a point, as many were.

2. The name came from a distortion of the full name '*One point Figure chart*' where each X represents 1 point, or the '*Half point Figure chart',* where each X represents half a point, as Cole and Wyckoff seem to suggest, although neither of them ever referred to their charts as Point and Figure charts.

3. Writers and practitioners referred to their '*Point or Figure charts*' or their *Point and Figure charts* meaning their Point charts and/or their Figure charts, which represented the same thing, and this became distorted to Point and Figure charts. This theory is supported by the fact that De Villiers entitled his 1933 book *Point and Figure Charts* but never actually referred to them as Point and Figure in the book, but rather as Point charts and Figure charts as separate types of chart. However, the final piece of conclusive evidence comes from Point and Figure sceptic, Richard Schabacker, who heads a section in his 1932 book as 'Limitations of Point or Figure charts'. Note the use of the word 'or'. All the way through the section, he refers to Point or Figure charts as if the analyst had the choice of one or the other but probably kept both. As you have read earlier, he headed another section 'Point

and Figure charts', but said that this type of chart is usually known as the Figure chart or the Point chart.

The evidence, therefore, suggests the third way. Of course, it does not really matter where and how it got its name, because the method we know today is called the Point and Figure method and the charts we draw and analyse are called Point and Figure charts. It is interesting however to show that it was an evolving technique that may well keep evolving. Towards the end of this book, some new Point and Figure techniques, such as moving averages on Point and Figure charts as well as Point and Figure charts of indicators, are covered.

THE USE OF POINT AND FIGURE CHARTS OVER THE YEARS

Point and Figure charts were plotted by hand and used extensively by every working Technical Analyst throughout the 20th century until the early 1980s, when everything changed. The launch of personal computers such as the Apple II and the IBM meant that computer-drawn charts were within the reach of everyone. But those early programs didn't have Point and Figure and when they did get it, they were very poor. So, reluctant to continue drawing their charts by hand, many Technical Analysts stopped using Point and Figure altogether. And the lack of computer-drawn Point and Figure charts meant that newcomers to the world of technical analysis didn't know that Point and Figure existed at all. Although there were some sophisticated programs drawing Point and Figure charts in the early 1980s, like Indexia, there being no internet meant the word did not spread quickly throughout the technical analysis community. It was not until the mid-1990s that there was a revival in Point and Figure charts, when analysts realised the power they had been missing. And in the last ten years no serious Technical Analyst or trader would have been without them.

THE *VOICE* OF THE MARKET

Point and Figure charts are the *voice of the market*. They are the only charts that come directly from the trading floor and are plotted as and when the price changes. Of course, all technical analysis charts come from the market, but remember that Point and Figure charts only change when the price changes. All other charts having time-scales must move forward as time passes, whether the price is changing or not. When the market is quiet, Point and Figure charts do not move. When the market is busy and the price is moving up and down, Point and Figure charts show that movement.

Point and Figure charts plot every price tick by tick, telling you exactly what is going on. It's like the market talking to you. When analysing Point and Figure charts, that's exactly what

you get from the charts – your own squawk box. Each minor and major battle between bulls and bears is played out on the chart and is there for you to see and analyse. If the market doesn't move, the chart falls silent.

Some chart examples

Before moving to the next chapter on Point and Figure construction, here are a few examples of what Point and Figure charts look like. Remember they work just as well for stocks, indices, futures, commodities, bonds and currencies – in fact any financial instrument. Don't worry about trying to understand the charts at this stage; they will be explained in later sections. The purpose is to get a 'feel' for the charts.

Chart 1-2 is a traditional Point chart of Intel Corporation, where Xs are used for up- and down-columns. It is drawn in the early De Villiers style of showing 5s and 0s at the 5 and 10 levels. You can see how having these rows of numbers can make the chart confusing.

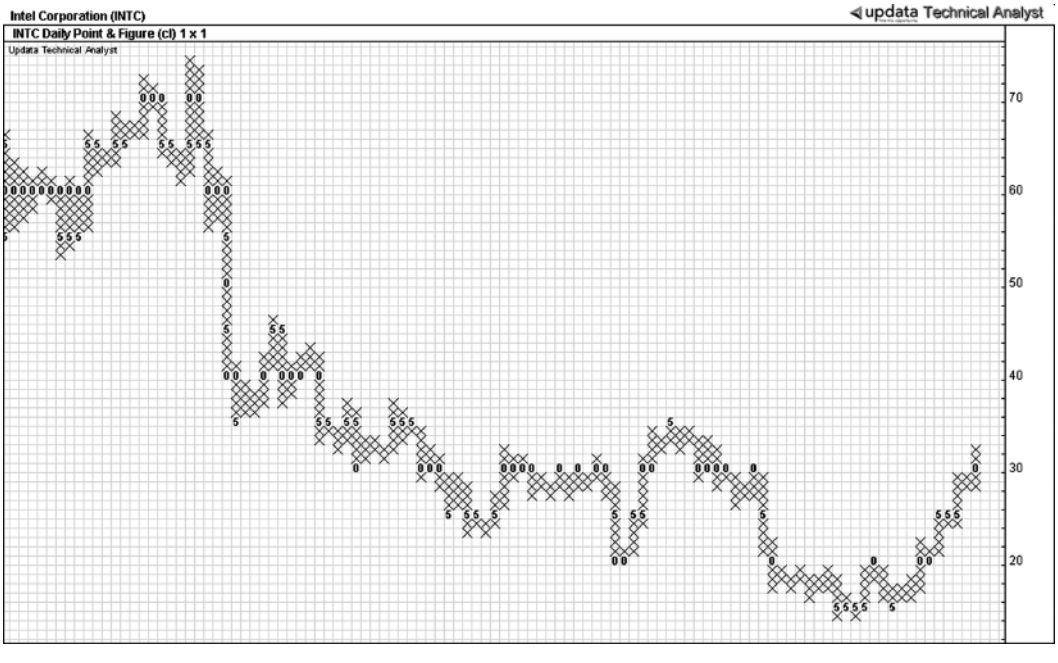


CHART 1-2: COMPUTER DRAWN POINT CHART WITH 5S AND 0S OF INTEL CORPORATION

Chart 1-3 is a traditional Point chart of Euro Dollar, where Xs are used for up- as well as down-columns. This version is favoured for 1-box charts, which you will learn about later.

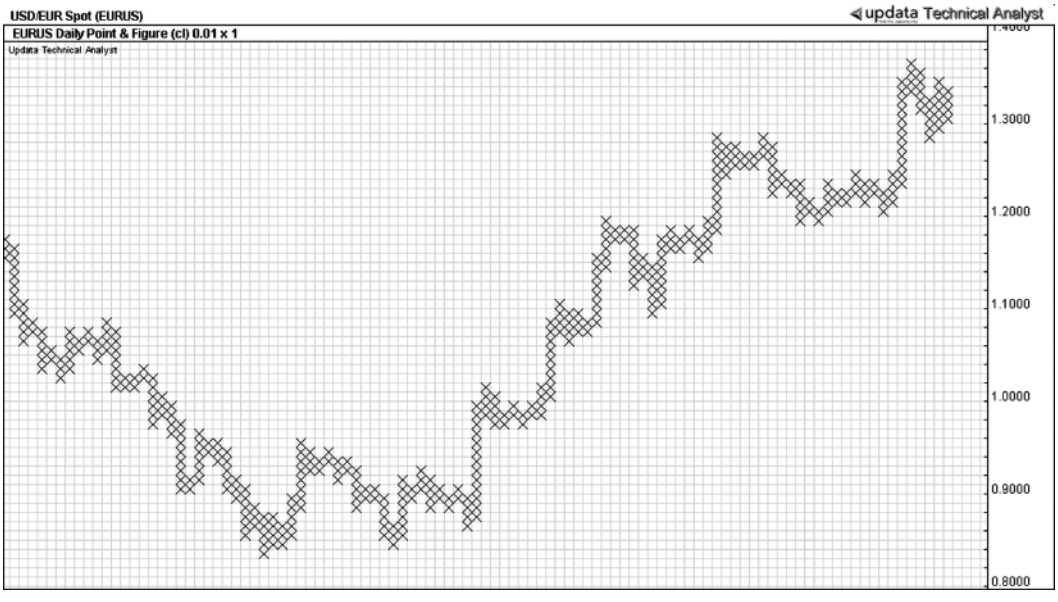


CHART 1-3: COMPUTER DRAWN POINT CHART OF EURO DOLLAR

Chart 1-4 is a Point and Figure chart of the Gold price, constructed using the Cohen method of Xs and Os. Notice, however, that some of the Xs and Os are replaced by numbers. Because Point and Figure charts don't have a time-scale, some analysts use a number to show the start of each month instead of an X or O. A, B and C are used for October, November and December.

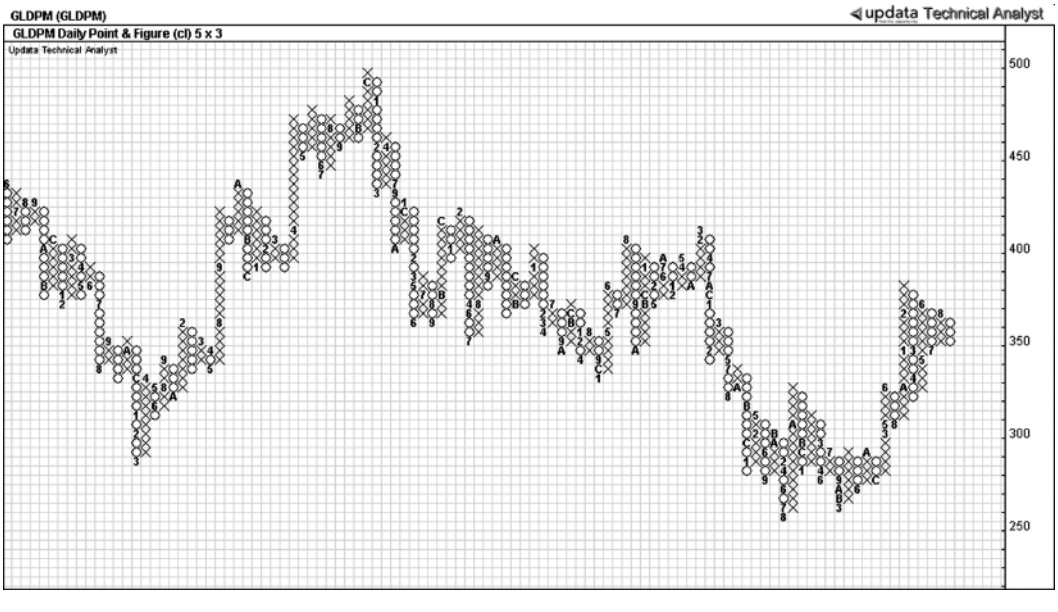


CHART 1-4: COMPUTER DRAWN POINT AND FIGURE CHART OF GOLD PM FIX SHOWING MONTH NUMBERS

Finally, Chart 1-5 shows a Point and Figure chart of Reckitt Benckiser plc constructed with Xs and Os which are coloured blue and red to identify the columns and make the chart easier to read.

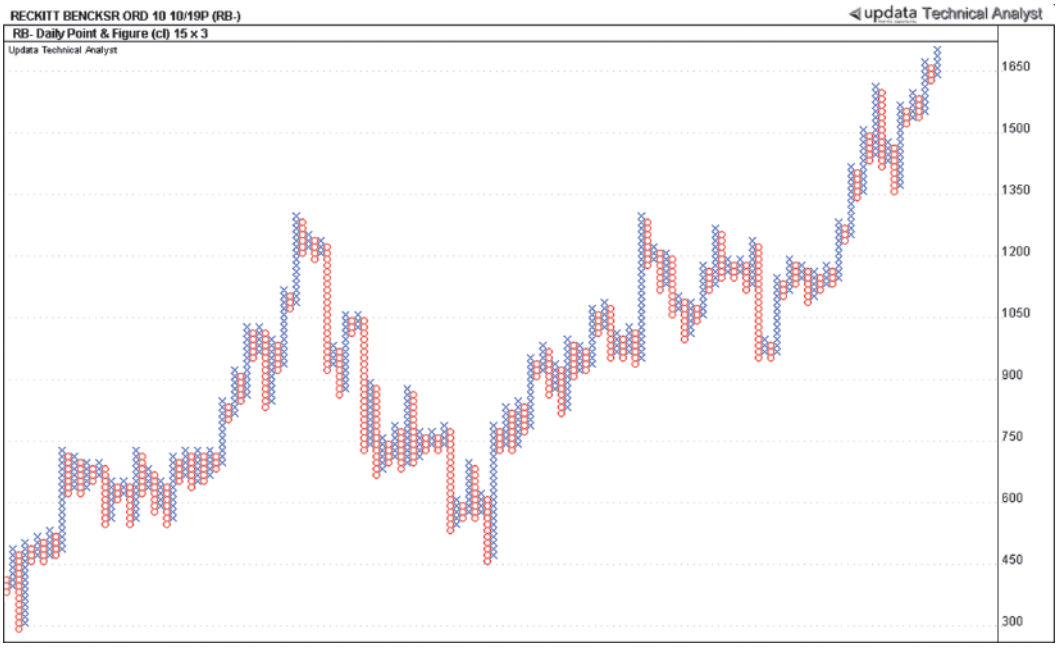
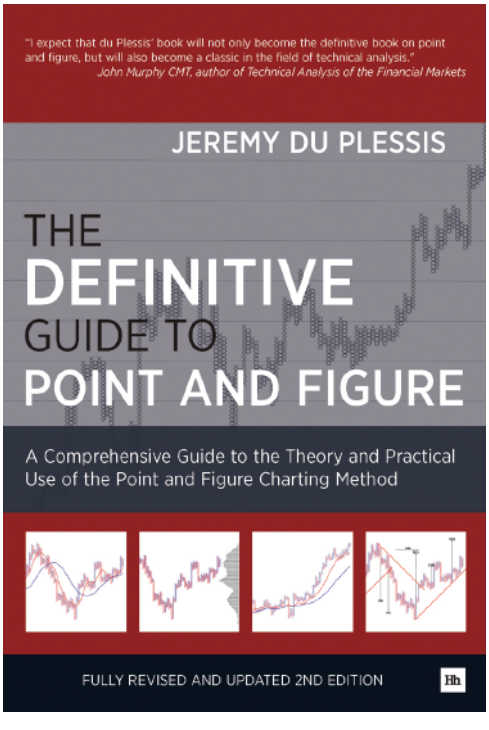


CHART 1-5: COMPUTER DRAWN POINT AND FIGURE CHART OF RECKITT BENCKISER PLC

The Definitive Guide to Point and Figure

A Comprehensive Guide to the Theory and Practical Use of the Point and Figure Charting Method

Jeremy du Plessis



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