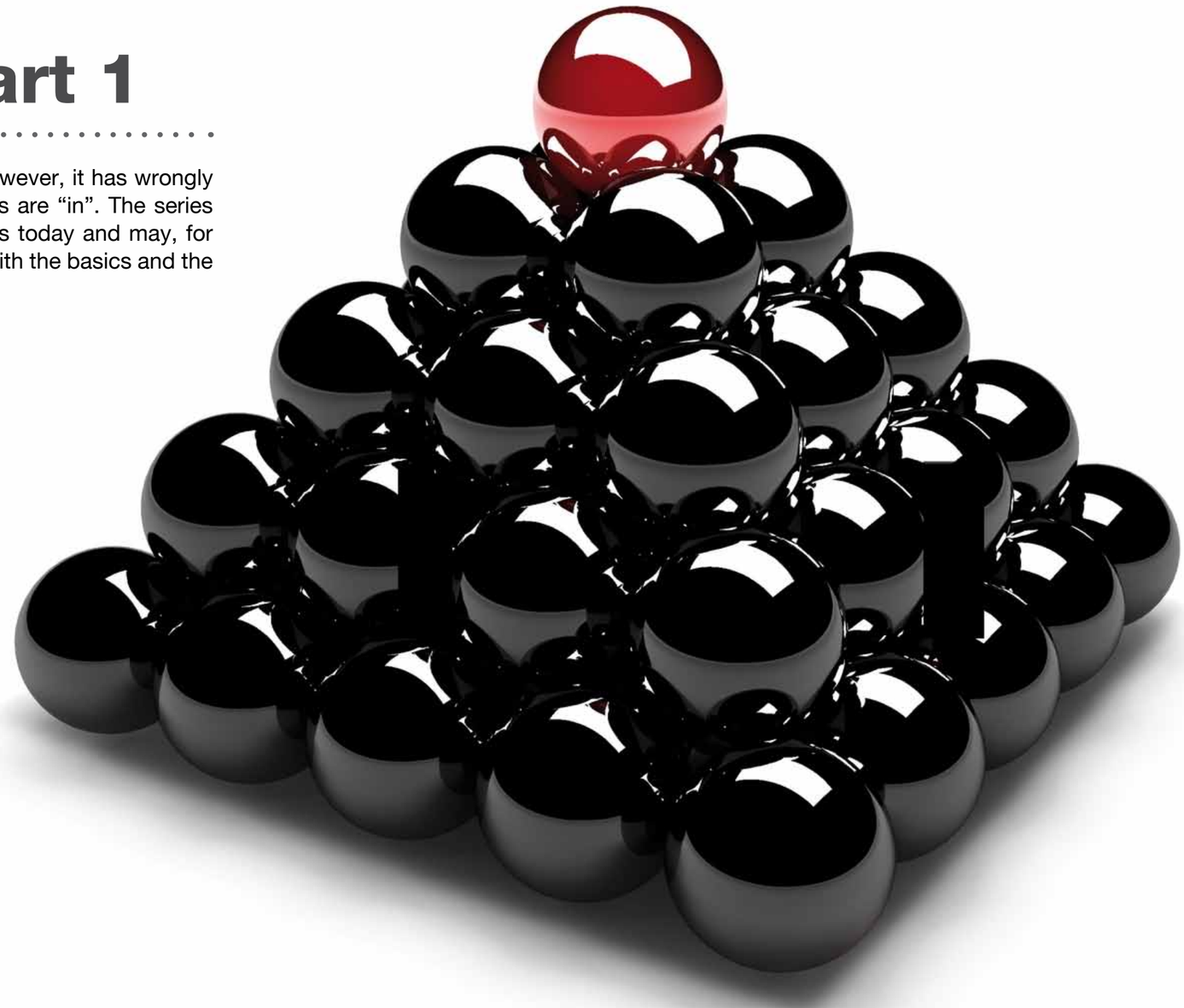
Discover the Benefits of this “Exotic” Charting Technique

Point & Figure Charts – Part 1

The point & figure charting technique has its origins in the late 19th century. By now, however, it has wrongly been forgotten by many traders. “New” types of charts like candlestick or Renko charts are “in”. The series starting with this article is intended to show how point & figure charts still offer benefits today and may, for example, represent the basis of a trend-following trading system. The first part will deal with the basics and the construction of the charts.



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At first sight, Point & Figure (P&F) charts appear to be unusual. Price development is shown in columns that are alternately stacked with the letters X and O. At the same time it should be noted that there is no explicit time axis. While modern P&F charts do indicate years, this is only done for orientation purposes. All this comes across as being rather exotic to the modern technical analyst. Although computers nowadays are taking over the preparation of the charts, it does make sense in light of the significant differences compared to other types of charts to first take a closer look at the construction of the P&F chart.

Construction

The P&F chart is composed of several columns that are alternately stacked with X and O. Generally speaking, the X represent rising and the O falling prices. Depending on the software used, you may – within the columns – come across the numbers one to nine and the letters A to C. Since P&F charts have no time axis, those numbers/letters serve to give a rough idea of when these price events occurred. The numbers represent the months of January to September and the letters A to C the months of October to December.

Scaling: Setting of the Box Size

The layout of a P&F chart is essentially that of a squared paper with the lines characteristically arranged vertically and horizontally. Each entry of an X or O on the chart is made in a so-called “box”. This includes a certain amount, the so-called “box size”, which needs to be set depending on the price level of the market to be analysed as well as on the time level. At the same time, the box size equals the minimum size of another entry on the chart. This means that you yourself can influence the sensitivity of the chart picture on the basis of your personal preferences. Suggestions for setting the box size on daily charts can be found in Table 1.

In this example, a stock is trading at 55 euros and is in an uptrend, i.e. in a column of X. The box size is one euro. If the stock rises to 56.99 euros on the following day, another X is only entered in the €56 box. A price rise of at least another cent would be necessary for an entry to be made in the €57 euro box.

Once a trend is reversed, a new column will be opened on the P&F chart. Since not any ever

T1) Scaling of the Box Size for Daily Charts

Price Level	Box Size
0.00 - 0.50	0.01
0.50 - 1.00	0.01
1.00 - 2.00	0.02
2.00 - 5.00	0.05
5.00 - 10.00	0.10
10.00 - 20.00	0.20
20.00 - 50.00	0.50
50.00 - 100.00	1
100.00 - 500.00	2
500.00 - 1000.00	5
1000.00 - 2000.00	10
2000.00 - 5000.00	20
5000.00 - 10,000.00	50
10,000.00 - 20,000.00	100

The box size describes the minimum size for another entry of an X or O on the chart. The size should be set according to your personal preferences with the table serving as a benchmark.

Source: TRADERS´ graphic

so slight correction results in a trend reversal, it is necessary to determine a reversal amount. This is indicated by the number of boxes. The so-called “3 box reversal“ is considered to be the standard, which means that there must be a market correction by at least three boxes before a new column can be opened. Just as is the case with the box size, you can of course also adjust the reversal amount to your individual needs.

In another example, a stock is quoted at 80 euros and is in an uptrend. The box size is one euro and the reversal amount three boxes. For a trend reversal to be considered a given and a column of O to be capable of being opened, the stock must fall by at least three euros (3 boxes x €1 box size) to 77 euros.

Updating the Chart

As a result of the above, updating a P&F chart is very simple. The investor already defines price levels ahead of time which when reached require an entry to be made.

An example will illustrate the procedure: A stock index is trading at 1200 points. The box size is 100 points and the reversal amount three boxes. The market is in an uptrend. An update of the chart will be necessary if

a) The upward trend continues and the index rises by at least another box, i.e. to at least 1300 points or
b) The trend reverses and the index falls by no fewer than three boxes at 100 points each, i.e. to at least 900 points.

Trade Signals

In general, a buy signal is generated by crossing the high of the last column of X. A sell signal is generated, however, when the price falls below the low of the last column of O. This clearly underlines the trend-following character of the P&F charting technique.

Trend Lines

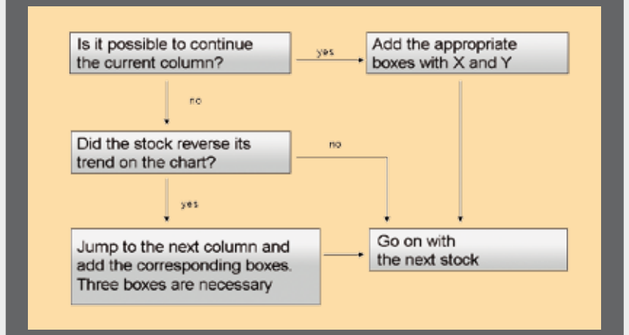
After you have come to know the construction of P&F charts, it is now time to address another feature of this type of chart. The trend line represents one of the most powerful instruments of technical analysis. While the analyst interconnects two or more swing points on traditional charts, trend lines on P&F charts generally run at an angle of 45 degrees (in an uptrend) or 135 degrees (in a downtrend). An uptrend line starts a box below the column of O and is called a bullish support line. If an uptrend channel is to be plotted, the bullish resistance line is additionally required. This line begins a box above the column of X, which follows the column of O.

A downtrend line starts a box above the column of X and is called a bearish resistance line. If a downtrend channel is to be plotted, the bearish support line is additionally required. This line begins a box below the column of O, which follows the column of X. In general, a break of a trend line can be interpreted just as it is in the traditional types of the techniques discussed in this article.

Conclusion

Point & Figure charts are far from being a thing of the past in technical analysis. Trend-following investors in particular should consider using them. Setting the box size and reversal amount can cause “non-significant” price fluctuations to be filtered out which are referred to as “noise” and are often responsible for false signals. Here each individual investor can determine on the basis of his personal preferences how quickly the chart is to react to price changes. So depending on the setting it may happen that no entries are made over longer periods of time. This has the advantage of P&F charts showing trends as well as support and resistance zones more impressively than other types of charts. At the same time clear trade signals are generated that require no interpretation.

F1) Updating the Chart



Setting the box size and reversal amount makes updating the chart easy. An entry will be made if one of these two levels is broken.

Source: TRADERS´ graphic

F2) P&F Chart S&P 500

In this chart (box size ten points, reversal size three boxes), all techniques which were discussed in this article were applied. The break of the bearish resistance line in combination with the buy signal shows a sustainable trend reversal.

Source: TRADERS´ graphic