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## Point & Figure Technique

# It's Easier to Identify Support and Resistance Levels With Point & Figure Charting

By David Vomund

**L**ike the traditional bar charts, Point & Figure charts graph price activity. This lesser known charting form offers some unique advantages over the more traditional charting methods. The Point & Figure charting technique first became popular in 1948 when A.W. Cohen published *The Chartcraft Method of Point & Figure Trading*.

Unlike bar charts, where the vertical coordinate is based on price and the horizontal coordinate is based on time, the Point & Figure chart is only concerned with price. Although the year and months are reported on the horizontal axis, they are shown merely to establish a frame of reference. Since time is not a factor, small fluctuations in price are often not charted. Without these disturbances, it is easier to spot critical support and resistance levels. It is also easier to visually locate chart patterns.

*AIQ's Technical Indicators Reference*

*Manual* has a good explanation of the mechanics of Point & Figure charting (page 101). To give a short summary, Point & Figure charts are plotted with X's and O's. Vertical columns of X's represent increasing prices while O's represent



DAVID VOMUND

***“Unlike bar charts, the Point & Figure chart is only concerned with price...Since time is not a factor, small fluctuations in price are often not charted. Without these disturbances, it is easier to spot critical support and resistance levels.”***

decreasing prices. Each X or O represents a specific increment of change in price, which is called the box size.

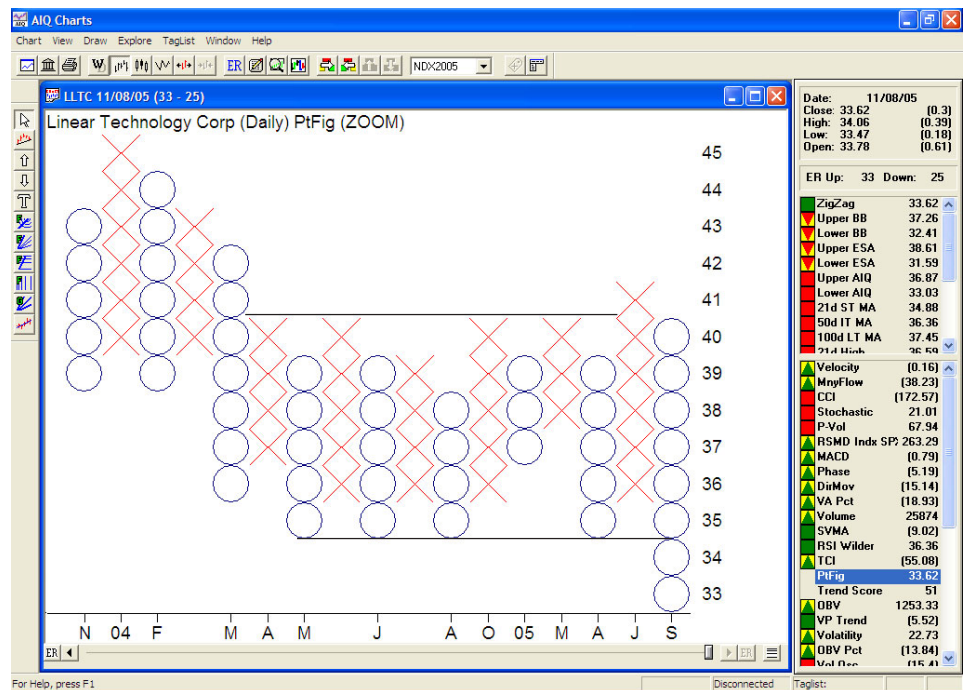
For example, each X may represent a \$2 increase in the price of the stock. Every time the stock increases by \$2, an X is plotted. Time is irrelevant so it

doesn't matter how long it takes for the security to make the \$2 advance.

When X's are being plotted, the stock is advancing. TradingExpert's present default values specify that a stock must fall by three times the box size before a new column of O's will appear to indicate a trend reversal. In our example of a \$2 box size, a stock must fall by \$6 (\$3 times \$2) before a new column of O's is plotted. The three box reversal is what eliminates all minor and sometimes confusing fluctuations.

To plot a security using the Point & Figure technique, first chart the security and click on the PtFig indicator on the Control Panel. The chart will initially appear very small so AIQ's Zoom feature must be used. Place your mouse cursor on the Point & Figure plot at the bottom of the screen and press the "Z" key. The plot will then fill the entire window. Pressing the "Z" key again restores the plot to its original size.

There are advantages and disadvantages to all charting methods. One advantage of using Point & Figure charting is that it makes it easier to identify support and resistance levels.



**Figure 1.** Daily Point & Figure chart of Linear Technology. Obvious on the chart are support (\$34) and resistance (\$41) levels as shown by trendlines.

*“Using this methodology, a lot of buy and sell signals occur...There are patterns that can be identified which point toward the more significant buy and sell signals.”*

For resistance levels, look for a level where several columns of X's end. For example, in **Figure 1** Linear Technology (LLTC) hit \$41 on four occasions and then barely pierced this level on the fifth try before retreating.

To find support levels, look for a level where several columns of O's end. In **Figure 1** notice \$34 was support until September when the column of O's fell below that level, although only by a small amount. There was also support at around \$38 at the start of the year.

*Editor's Note: We drew trendlines on the Point & Figure charts to help clarify the examples discussed in this article. TradingExpert does not have the ability to draw these trendlines.*

**Figure 2** shows another example. Cisco Systems (CSCO) shows resis-

tance at \$21, a level that five columns of X's hit without breaking. These two examples show how easy it is to spot support and resistance levels on a Point & Figure chart.

A buy signal is registered on a Point & Figure chart when one column of X's moves higher than the previous column of X's. The theory behind a buy signal is that the stock is able to rise above the previous level where sellers once appeared and drove prices lower. The stock then remains on a buy signal until a column of O's falls below a previous column of O's.

Using this methodology, a lot of buy and sell signals occur. Which are the best signals? There are patterns that can be identified which point toward the more significant buy and sell signals.

## AIQ Opening Bell Newsletter

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While the information in this newsletter is believed to be reliable, accuracy cannot be guaranteed. Past performance does not guarantee future results.

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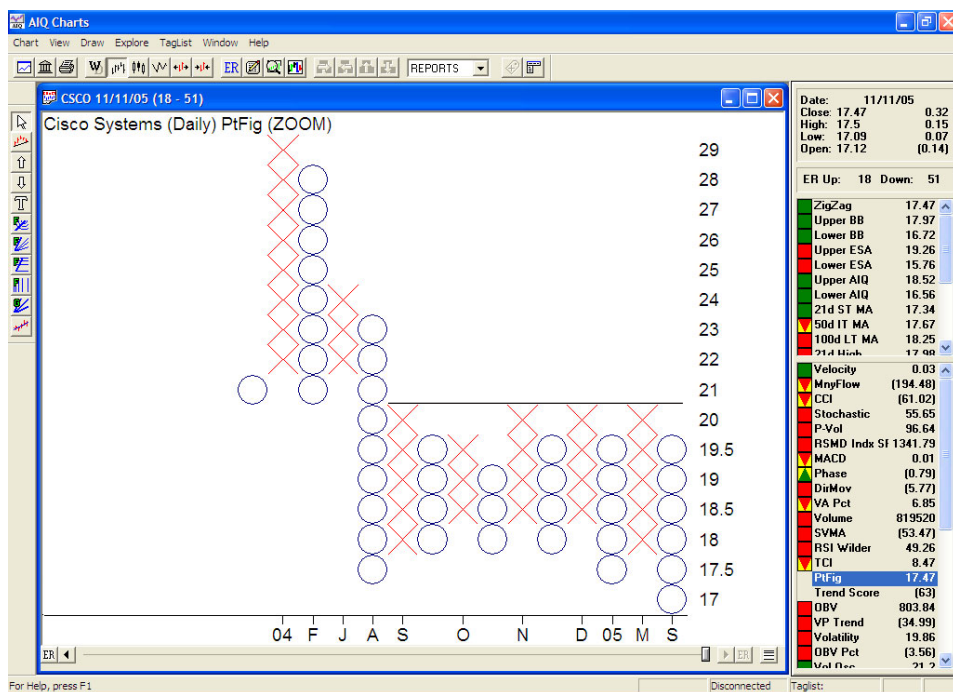
## Triple Top Buy and Triple Bottom Sell

The pattern that AIQ's Point & Figure report screens for is the Triple Top/Triple Bottom pattern. The Triple Top pattern is a bullish pattern where two rally attempts fail at the same level (i.e. two columns of X's that end at the same level) but on the next attempt the security rises above the resistance level.

The Triple Bottom pattern is just the opposite. The security falls but finds support at the same area. On the next attempt it falls below the previous lows, registering its sell signal.

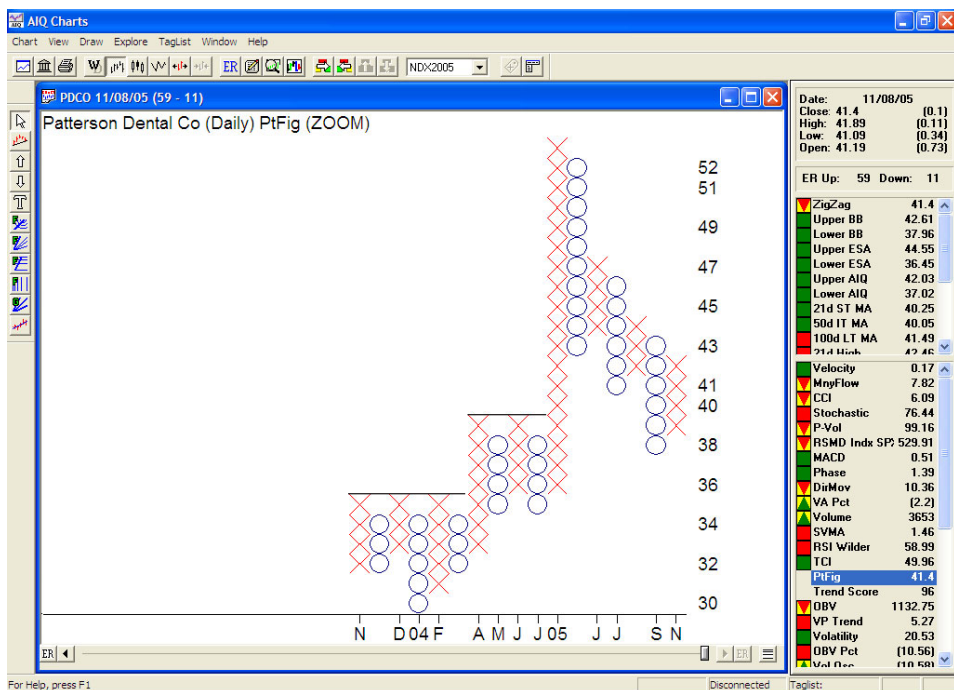
**Figure 3** shows two Triple Top buy signals. In late 2003, \$35 acted as resistance and it wasn't until the spring of 2004 that the resistance was broken, giving the first buy signal. Notice there were two columns of X's that ended at the same level before the breakout.

Then in the summer of 2004 another Triple Top buy signal was formed. Notice two level columns and then a breakout. Once resis-



**Figure 2.** Daily Point & Figure chart of Cisco Systems. Trendline shows resistance level at \$21.

***“We see that by using Point & Figure charts you won't buy at the lows or sell at the highs. It takes upward price movement before a buy signal is registered. With Point & Figure analysis, you don't guess the bottom—you wait for it to happen.”***



**Figure 3.** Daily Point & Figure chart of Patterson Dental. Trendlines are drawn to show resistance levels. The penetration of these trendlines resulted in Triple Top buy signals.

tance was broken the stock leaped above \$50.

In AIQ Reports, users can use the pre-built Point & Figure Breakout report to get a list of Triple Top and Triple Bottom signals.

### Symmetrical Triangle

Another popular pattern, and one that I believe is more effective, is the Symmetrical Triangle. This pattern requires at least five columns and there is a pattern of higher bottoms and lower tops. For a bullish pattern, the buy comes when the security rises above its pattern of lower tops and moves above the previous column of X's. The opposite is true for the bearish pattern.

**Figure 4** (next page) shows examples of bearish Symmetrical Triangles. With the aid of



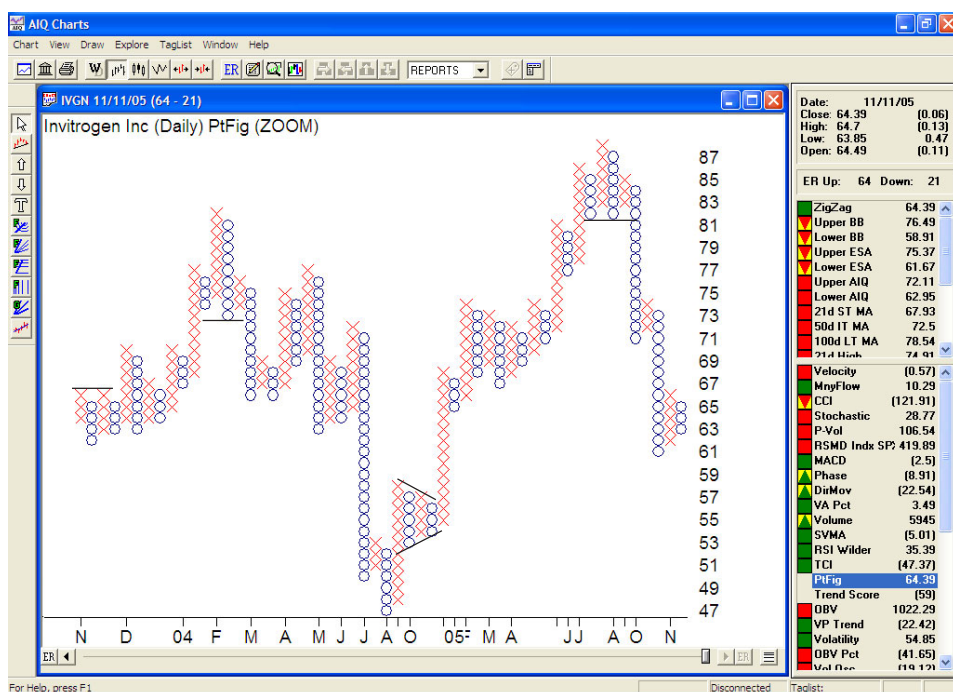
trendlines, notice how in the summer of 2004 each rally was less than the previous rally (i.e. lower columns of X's) and each drop was less than the previous drop (increasing columns of O's). Career Education dropped below the pattern, giving its sell signal. Notice that after the sell, a Triple Bottom pattern formed and then the stock plunged to \$27. Another bearish Symmetrical Triangle was formed at the start of 2005.

TradingExpert is not able to screen for Symmetrical Triangles.

### Summary

**Figure 5** shows Invitrogen Inc. (IVGN), which has examples of these patterns. The first is a Triple Top buy signal. After rallying into the \$80s, there is a Triple Bottom sell signal. In this pattern the first two columns of O's doesn't end at the same level so it won't show in AIQ's report, but it is technically a sell signal.

As the stock makes a low in October 2004 a Symmetrical Triangle is formed. It is resolved to the upside. Finally, near the top a Triple



**Figure 5.** Daily Point & Figure chart of Invitrogen. Trendlines are shown to define four P&F patterns that occurred on this chart and when penetrated resulted in buy or sell signals.

Bottom sell signal is registered. This time there are two level columns of O's before the breakdown.

Through these examples we see that by using Point & Figure you won't buy at the lows or sell at the highs. It takes upward price

movement before a buy signal is registered. With Point & Figure analysis, you don't guess the bottom—you wait for it to happen.

Point & Figure charting wasn't designed to eliminate bar charts. Each charting method has its advantages. Bar charts allow you to run indicators with the graph. With Point & Figure charting, you can more easily identify important chart patterns as well as support and resistance levels as they develop.

David Vomund publishes VIS Alert, a weekly investment newsletter. For a sample copy, go to [www.visalert.com](http://www.visalert.com).



### S&P 500 Changes

Changes to the S&P 500 Index and Industry Groups:

Patterson Cos. (PDCO) replaces Delphi Corp. (DPH). PDCO is added to the Health Care Distributors and Svcs. (HEALTHSS) group.



**Figure 4.** Daily Point & Figure chart of Career Education. Trendlines define two examples of bearish Symmetrical Triangle patterns.

## Market Review

# Very Bullish: Nasdaq Outperforming S&P 500

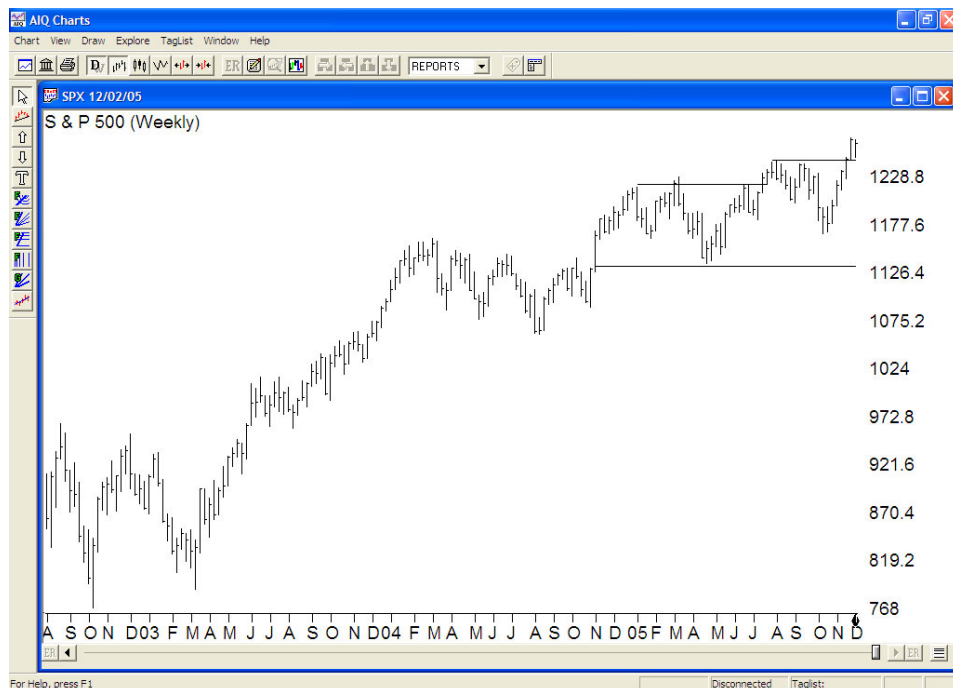
**N**ovember was a very strong month for the market. The S&P 500 rose 3.5% and the Nasdaq rose 5.3%.

With the advance from the October low one would expect a pullback but the S&P 500's weekly chart shows a normal bullish environment (**Figure 1**). In the graph there are several areas of mini-corrections and consolidations, but the breakouts are to the upside.

In Figure 1 we see the market broke above resistance the third week of the month. That breakout was re-tested on the last few days of the month but then rallied.

The Nasdaq can represent the stock market's mood ring. It was very bullish to see how well it outperformed the S&P 500 on up days and down. The Nasdaq's weekly relative strength indicator (RSMD SPX) has been trending higher since early November.

With the strength of the Nasdaq it isn't surprising that Electronics was the best performing group. Electronics rose 12% in November. Precious Metals also performed exceptionally well, gaining 10%.



**Figure 1.** Daily chart of S&P 500 Index shows the 2005 trendline breakouts have been to upside.

Conservative groups like Consumer Products and Utilities were the laggards in November, and they were about unchanged for the month.

In our articles we almost exclusively discuss domestic securities but with the growth of ETFs it is easy now easy to trade international markets as well, and most interna-

tional markets are very strong. The iShares EAFE (EFA), which owns securities from developed markets in Europe and Asia, is within pennies of recovering its entire 2000-03 bear market losses. A stronger performer is the more aggressive iShares Emerging Markets (EEM).

## STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date	Stock	Ticker	Split	Approx. Date
Aqua America	WTR	4:2	12/02/05	Cooper Cameron	CAM	2:1	12/16/05
Range Resources	RRC	3:2	12/03/05	Hyperion Solutions	HYSL	3:2	12/20/05
TXU Corp.	TXU	2:1	12/09/05	Jet Blue Airways	JBLU	3:2	12/24/05
Cal Drive Int'l	CDIS	2:1	12/09/05	Whole Foods Mkt	WFMI	2:1	12/28/05
RPC Inc.	RES	3:2	12/13/05	United Financial	UBMT	5:4	12/29/05
Joy Global Inc.	JOYG	3:2	12/13/05	AmerisourceBergen	ABC	2:1	12/29/05
Valero Energy	VLO	2:1	12/16/05				

### Trading Suspended:

Cadence Design Systems (CDN), 7-Eleven Inc. (SE), Silicon Graphics (SGI), Hibernia Corp. (HIB)

### Name Changes:

Tenneco Automotive (TEN) to Tenneco Inc. (TEN), YDI Wireless Inc. (YDIW) to Terabeam Inc. (TRBM)

# An Update on the 'Efficient Stock Strategy' Featured in AIQ TradingExpert Pro

By Van K. Tharp, Ph.D.

One of four featured built-in trading strategies in AIQ TradingExpert Pro is Dr. Van K. Tharp's Efficient Stocks Strategy. The Efficient Stock Strategy can be run at any time on all the tickers in the database.

In this article, Dr Tharp shares his insights on Efficient Stock trading with AIQ users. This complete article is reproduced from the Tharp's Thoughts newsletter available at [www.vantharp.com](http://www.vantharp.com)

**A** number of you have been making comments on efficient stocks lately. And to me, most of the comments show how careful I need to be even just talking about it. Let me give you some examples, although these are not exact quotes.

- Can anyone tell me what I need to know to follow Van's strategy for the efficient scans?
- Is a 25% trailing stop the only exit strategy (as mentioned in *Safe Strategies for Financial Freedom*)? And with that exit, what's the expectancy?
- I am unable to test the strategy with my analytical software. What changes have you made to it since you wrote *Safe Strategy for Financial Freedom* because you seem to be making good money with it?
- I don't understand how Van trades negative efficiency stocks. Can you help?
- And though the following client wrote to say thanks for the information, you'll be surprised when I explain below how this information is not designed to be USED as recommendations.
- On November 2nd, you indicated that ENG is a negative efficiency

stock. I had just bought it and was up over the round turn commission. With this information, I sold it and was glad I did. ENG has been retreating ever since. Thank you.

First, let me talk about the strategy. *Safe Strategies for Financial Freedom* was written with the idea of giving you a framework to develop strategies that you could use within in the current big picture (i.e., a secular bear market). One of the key statements made in that book was "use the efficient market strategy (as described) only when we are in green light mode or yellow light mode." In fact, by mid 2002 at the end of the last major downleg of the secular bear, I could not find a single stock that would pass my efficiency screen. There were no stocks that scored above +10 and the hundreds of stocks that scored below -10 had such low prices that it wasn't worth shorting them. With that information as a guideline, remember that we've been in red light mode since July 2004.

I also didn't talk about shorting negative efficiency stocks in *Safe Strategies for Financial Freedom*. We recommended several criteria for shorting stocks, but negative efficiency was not one of them.

Secondly, one of the key principles that I've always advocated is that to be a good trader, you need to develop strategies that fit you and your personality. This is what the whole book, *Trade Your Way to Financial Freedom* is about. Many of you have decided that because I'm trading efficient stocks, you should be doing so as well. That doesn't mean that you should not do it, but it does mean that if you do use this type of strategy, then you should



Van K. Tharp, Ph.D.

adapt the strategy to fit you using the techniques we talk about in our systems course and workshop.

Third, the Efficient Stock strategy given in *Safe Strategies for Financial Freedom* was a simple strategy that was meant to be a substitute for buy and hold. It gets you in when stocks are going up (i.e., they are efficient). Furthermore, rather than buying and holding the stock, it protects from a downfall by having a 25% tra+op. And the strategy has built in risk control in that you should not take more than 1% risk in each position.

However, I want to stress again that this strategy was designed for you to use in a bull market (such as most of 1982 through 1999) or in a major up move (i.e., a correction) in a secular bear market, such as the one we had in 2003. It was not designed for the conditions we are in now. Again, we've been in red light mode since April 2004.

Yes, I currently trade efficient stocks on both the long and short side. However, I have not taught my strategy in any of my books. I've briefly mentioned it in the last systems workshop just to give



people an idea of how I constructed the system from my beliefs – not to suggest that they trade that way. Let me again stress the message given in *How to Develop a System that Fits You* (both the workshop and the home study course) and in *Trade Your Way to Financial Freedom*:

**If you want success in the market, don't trade someone else's system. Instead, you must develop a system that FITS YOU.**

As a result, even though I trade efficient stocks, if you decide that the idea of efficient stocks is right for you, then you must develop your own version of it. Otherwise, you just will not be able to trade it successfully. You must develop your own rules instead of saying, "How does Van trade it?"

In addition, if I were to give you all the specific details of how I trade it, then you'd want to test it thoroughly and then compare your results with my results. "What expectancy did you get, Dr. Tharp? I only got 1.49 and you got 1.89. What did I do wrong?" "Why did you use this efficiency rating and not that one?" As a result, I'd be spending a lot of my time on things that were not that productive for me. (By the way, those expectancy numbers were just PFA – plucked from air.)

The bottom line is that I like my system. It fits me and my beliefs. I make nice profits trading it. But the way I've developed it, it is right for me! I like trading it because it fits me. At the same time, it's probably not right for you. And even if you like the concept, you'd probably feel much more comfortable trading it differently than I do.

Lastly, my trading with efficient stocks — both positive and negative — is very discretionary. Any of the stocks my scans show me as being efficient are really junky looking stocks. The efficiency scans just make it so that I only have to look through about 100 stocks to find the

nice charts that reflect the stocks that I like. However, I still have to sort through the junk. I've tried to filter them out, but I haven't been able to do so. As a result, the system has to be quite discretionary if I am to use it.

So why do I report on some of the most and least efficient stocks in my monthly market commentary in *Tharp's Thoughts*? Well, first of all I found it very useful to look at the percentage of positive and negative efficiency stocks as a market barometer. And the results have been quite wild.

- At the end of September the market was about 60% positive and making money wasn't too difficult on the long side.
- By the end of October, the market was about 60% negative and it was much easier to make money on the short side.
- And already, by mid November, the market has turned back to nearly 60% positive.

For example, I first discovered MOVI as a negative efficiency stock in September and it was just under \$18 per share – down from a high of \$33.54. The dark line going up is a trending that was broken. It was moving straight down. In two and a half months MOVI has lost about 75% of its value (since I pointed it out) and is now selling below \$5 where it is dropped from my negative efficiency screens. It's been a very

profitable ride down and I still have a short position on it because my feeling is this one could go to \$1 or \$2. However, I'll be out quickly if it reverses.

Also it's important to me that you understand that positive efficiency stocks can exist in bear markets. For example, Deluxe Checking was a smooth line up throughout most of 2001. It was easy to make money from that stock even though the overall market was down. And I recently found a stock that's been going up steadily since 2000 and accelerated into 2005 which is why it started showing up on my scans. That stock was INGR. It's only gone up about 30 points during that five year period, but that's still a 300% gain.

I make two strong cautions in each market commentary of *Tharp's*



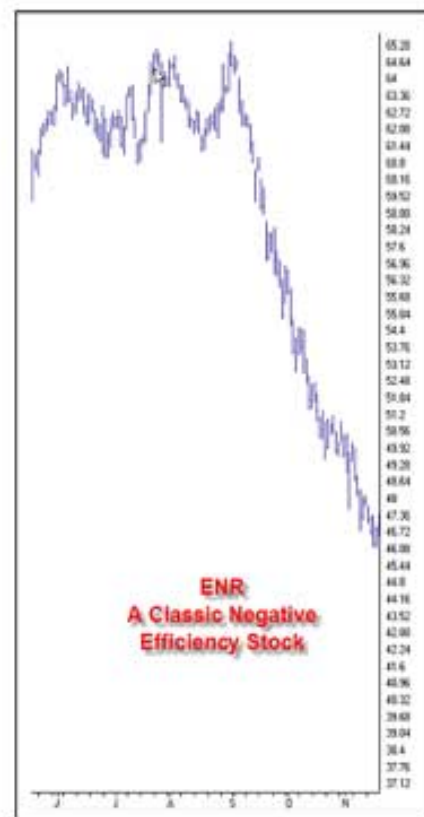
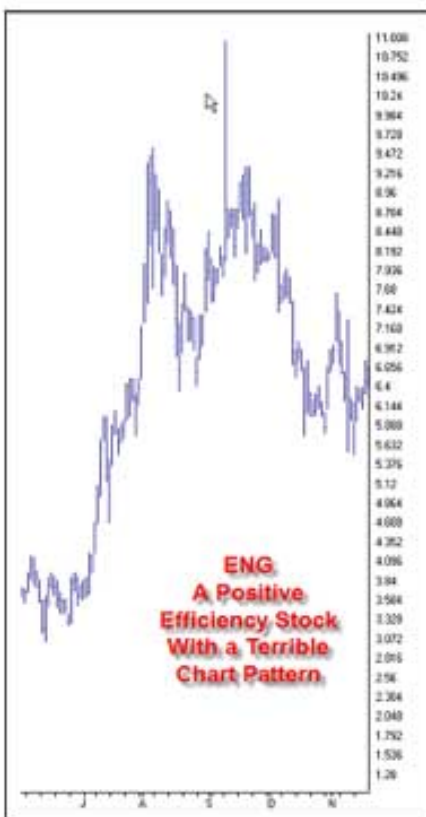
*Thoughts* and I'd like to repeat them here.

- The first is that if you happen to like any of the stocks I mention (or dislike some for that matter) that you should still do your own due diligence on them before you take action. Ask yourself, "Does this action make sense to me and fit within my rules?" *Tharp's Thoughts* is a FREE educational service; it's not meant to be a recommendation of stocks you should buy, sell, or short.
- The second comment is that we occasionally have typos in the newsletter.

When Mr. X mentioned that he'd sold ENG because I reported it to be a negative efficiency stock, I was happy that it saved him money, but also a bit shocked that he'd used it like a recommendation. I then looked up ENG and found that it had an efficiency rating of about +6 (not good enough for me to buy it, but certainly not a good shorting stock). The chart on the left (this page) shows ENG.

Ironically, it wasn't what I remember as a classic negative efficiency stock at all. The stock I remembered had been at about \$60 a share and had had a significant drop. I also believe that I sold that stock short and bought it back rather quickly because it wasn't behaving properly. And it didn't look like the chart of ENG. Now here's the irony.

I went back through my scans and discovered that ENG was NOT the stock I had intended to give as a good negative efficiency example. Yes, it was a classic typo – and the kind of typo that none my staff would be likely to catch. The stock



that was a great example of a negative efficiency stock was ENR shown in the chart on the right. Notice the difference between the stocks. ENR is at about \$46 with plenty of room to fall. While ENG is already at 6, just looks choppy, and it is certainly in a downtrend.

It's somewhat ironic that I probably would have sold ENG (had I owned it) as well. It's a terrible looking stock, despite having a positive efficiency. However, it hasn't been in a downturn long enough for me to call it a negative efficiency stock like MOVI.

This example perfectly illustrates my point of why it is important to DO YOUR OWN DUE DILIGENCE

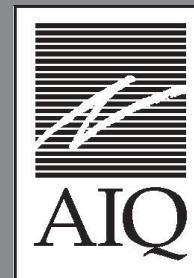
if you decide to do anything with any of the stocks I happen to mention as examples. Just think, we might have even made a typo when we gave you the symbol – they do happen.

About Dr. Van K. Tharp: World-renowned trading coach, author and psychologist Dr. Van K Tharp is widely recognized for his best-selling book *Trade Your Way to Financial Freedom* and his outstanding Peak Performance Home Study program - a highly regarded classic that is suitable for all levels of traders and investors.



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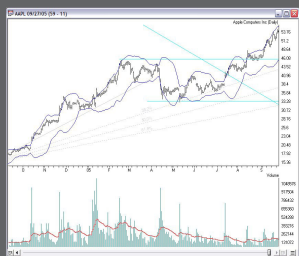
Here's what previous attendees had to say

*"Palmquist was great! A nice combination of good systems and good methodology clearly presented in an engaging manner"*

*"David Vomund. Very knowledgeable, very good speaker, extremely practical advice-a great asset to AIQ!!"*

## VENUES

San Diego	2/25/2006
Tampa	3/25/2006
Manchester	4/22/2006
Denver	6/17/2006



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In this session Steve will be sharing one of his favorite short term trading techniques for trading both Long and Short positions. This is not a theoretical approach, but one Steve uses every day with his own money. He will discuss the specific system, show how it was developed and tested, and provide tips and techniques for using it based on his nearly 20 years of market experience.

### Market Truths *by David Vomund*

David Vomund will reveal important market truths that he has learned from actively studying and trading the market for nearly 20 years. These are the truths that experienced investors learn over time. New investors learn these truths the hard way – by losing money. Topics include market behavior, position sizing, and trading psychology.

### Market Adaptive Trading *by Steve Palmquist*

Steve has developed a Market Adaptive Trading Technique that he uses to determine when to trade specific systems and when to stand aside. Successfully analyzing current market conditions is one of the keys to trading success. Learn when to focus on Longs, when to trade Shorts, and when to stay in cash. Just trading a single system all the time without a careful analysis of the market conditions can give you a lot of practice at taking draw downs. Learn from Steve's experience and take your trading to the next level.

### Getting Started Right With AIQ *by David Vomund*

David Vomund will cover the features within TradingExpert that every AIQ user should know. Basic features such as charting, report generation, and exploring will be discussed. Advanced features such as industry group creation and the use of Expert Design Studio will also be covered.

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- Room rate \$129/night
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- Guest parking \$12/day
- Day parking \$7.00/day

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New Hampshire  
700 Elm Street  
Manchester NH 03101  
Reservations 800-333-3333

- Room rate \$109/night
- Complimentary airport shuttle
- Guest parking \$2/day
- Day parking \$1



**David Vomund**  
*Chief Analyst*  
*AIQ Systems*



**Steve Palmquist**  
*Founder*  
*Daisydogger.com*

## Tampa, FL Saturday 3/25/2006

Tampa Westshore Marriott  
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Tampa FL 33607  
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- Room rate \$179/night
- Complimentary airport shuttle
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