Point and Figure Charts

Point-and-figure (P&F) chart is a special type of graphical analysis, which lays stress to prediction of medium-term and long-term trends.

Conclusion

Let’s single out advantages and disadvantages of Point and Figure charts.

Point and Figure Advantages

1. P&F charts send only clear buy or sell signals without any dual nature.
2. P&F charts take into account only “important” price changes and filter out market noise. This being said, the “importance” of changes is set by a trader.
3. P&F charts are not affected by time effect, which sometimes introduces additional element of uncertainty on general charts.
4. P&F charts allow to identify support and resistance levels, and also trend lines.
5. P&F charts are very intelligible.

Point and Figure Disadvantages

1. P&F charts send clear signals only for medium-term and long-term periods and are almost not intended for short-term trade.

Building Point and Figure Charts

The majority of the most popular charts, used for technical analysis, are built in accordance with opening price, closing price, maximum or minimum for a definite period. Only closing price for a period is used for building Point and Figure charts.

Point and Figure charts consist of X and O columns, which reflect the filtered price changes. Increase in prices is shown by “X” boxes, and drop in prices is shown by “O” boxes. New boxes are created only in case of price change by the size of a box or more in one of directions.

As a result, each chart has a setting called “box size” – conventional unit of price movement direction, which is shown on a chart. Box size is an amount of pips, on which price should move above the current X box (or below the current O box) for a new X (or O) box to be created and added to the chart. For example, if price increased by three conventional box sizes, it will be displayed on a chart like three X boxes.

If there is a reverse of price movement, a new column of O boxes will be displayed on a chart. This being said, X and O boxes never appear in one and the same column.

Besides, each chart has a setting called “reversal threshold”, which defines the amount of pips, necessary for a new column to be created and a chart to start moving in the opposite direction (downwards, if a previous column was the column of Xs, or upwards, if a previous column was the column of Os). When a reversal threshold is crossed by price, a new column, which moves in the opposite direction, will be created next to a previous column.

Thereby, if securities move, for example, in ascending trend, a chart will show the growing column of Xs until these securities move downwards for a distance more that a reversal threshold (as a rule, several boxes represent a reversal threshold, for example, 3 boxes). The same situation occurs in case of appearance of a column of Os.

It is necessary to remember two important specific points:

1. There is no linear time scale on Point-and-figure charts, so each column can represent several minutes or several days depending on price movement patterns.
2. There is no definite price value in a box on Point-and-figure charts. On the contrary, a certain range of price values is displayed, which is situated within the limits of the box size.

Point and Figure Charts Signals

- **Reversal pattern signals**

Appearance of a new column of Os is a signal to sell.
Appearance of a new column of Xs is a signal to buy.

- **Support and resistance levels**

Support and resistance levels are always horizontal lines because of specifics of Point and Figure charts. Support level appears on Point and Figure charts if there is a row of successive O columns, which minima are situated on a level. Resistance level appears on Point and Figure charts if there is a row of successive X columns, which maxima are situated on a level.

You should remember that the XO chart doesn’t point to a specific level, but to a support zone (equal in size to the box size), because arrangement of minima of several successive O columns on a level doesn’t mean that prices have stopped exactly on this level, but indicates that prices simply haven’t passed below more than one box. The same is true of resistance levels.

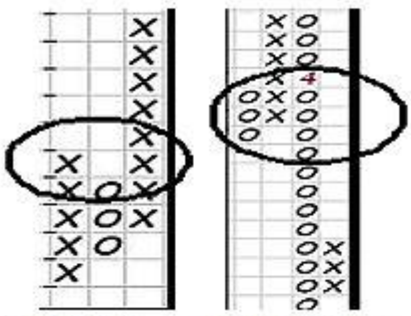
- **Trend lines**

Support and resistance levels are always lines with 45-degree slope because of specifics of Point and Figure charts.

It should be noted that in most cases the current position of a trend line on a Point and Figure chart is not match the position of the same line on a bar and candle chart in point of price. There are two reasons: firstly, Point and Figure chart doesn’t reflect the real minima and maxima of the market, but only points to their position in the diapason of a box; secondly, time scale is non-linear.

Point and Figure Charts Patterns

Double Top and Double Bottom Patterns



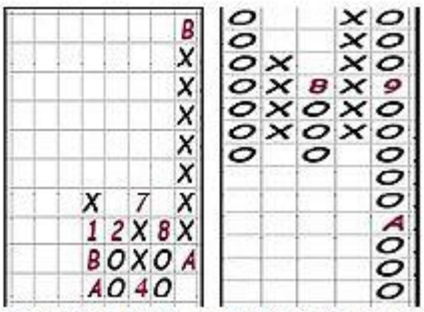
Double Top Double Bottom

These two patterns are the simplest trading signals on a Point and Figure chart. A double top signal is a signal for buying, which appears when a column of Xs goes beyond the top of the previous column of Xs. A double bottom signal is a signal for selling, which appears when a column of Os goes below the bottom of the previous column of Os.

In order to identify double top or double bottom patterns you should single out three columns, and it would be enough. Double top or double bottom patterns only help you to understand when a price reaches a position higher or lower than the previous one. These patterns also indicate that price movement is likely to continue in the direction of the breakout. You can use double top and double bottom patterns for identifying short-term trends.

Simple identification of stop-loss points should be specially singled out among many useful features of Point and Figure charts. For example, a trader can identify the price, where the breakout occurs, and place a stop a bit lower this price. In case of a false breakout the market will go back to the congestion zone right away, taking position above the new minimum, marked by double bottom, or below the new maximum, marked by double top. If there is a real breakout, your loss will make no more than a few pips.

The Triple Top/Bottom Patterns



Triple Top Buy   Triple Bottom Sell

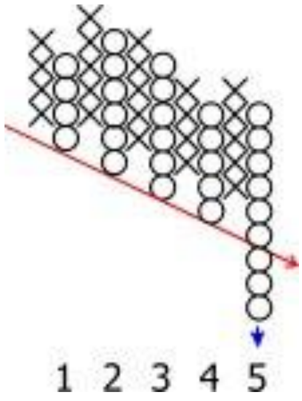
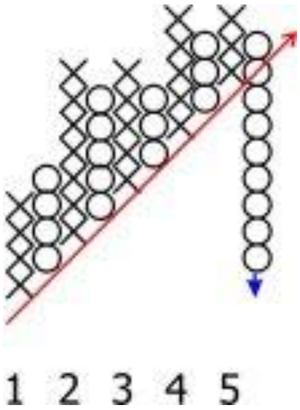
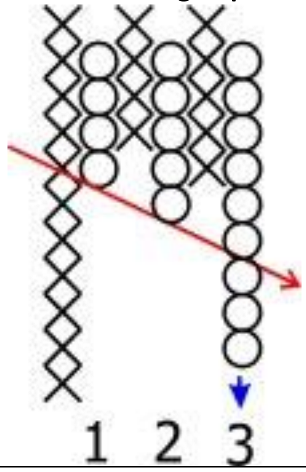
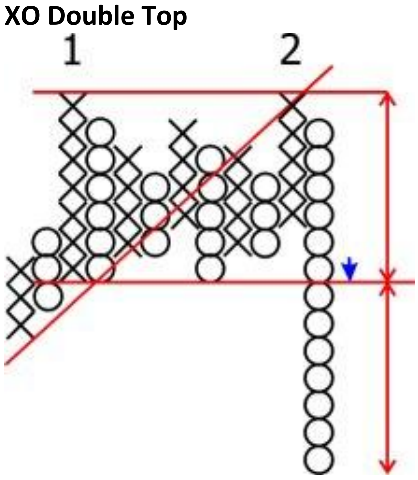
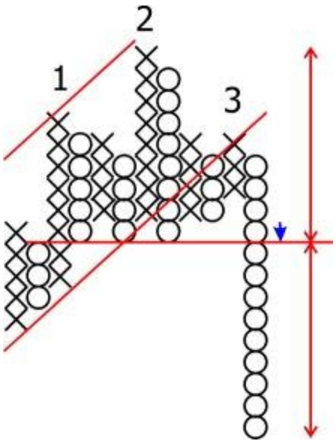
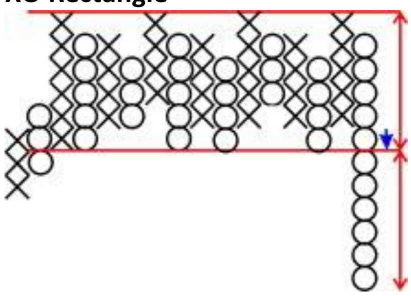
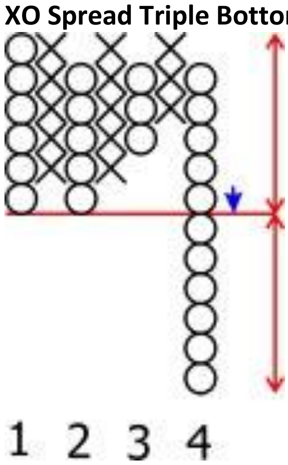
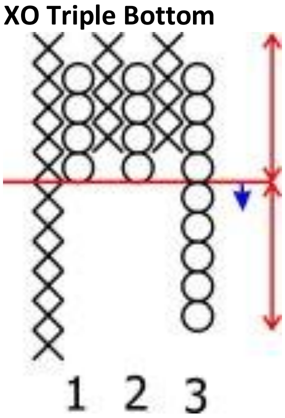
A triple top pattern is a more complex signal for buying. In this case one column of Xs should go above the top of two columns of Xs. The Triple Top signal means that the momentum is strong. It also indicates that bulls couldn’t to push the price above a certain price level two times in the past. A triple bottom pattern is a more complex signal for selling. In this case one column of Os should fall below the bottom of two columns of Os.

In order to form the Triple Top/Bottom pattern there must be at least five columns. The more columns are in Point and Figure patterns, the larger price targets are and the more dramatic the breakouts are.

When the triple top pattern or the triple bottom pattern signals you about possibility to buy or to sell, you should determine a strategic price target. It is usually done by means of multiplying the number of columns within the pattern by the box size. For instance, if a pattern is six columns wide and the box size is 0.5, then the $3 target in this case exceeds the risk by a factor 3/1, thus making this trade very attractive.

Look at the Picture 3 and you will see how Point and Figure patterns can be used as trading strategies. The double bottom sell signal is placed near $18. There are three possible decisions in this case: buying put options, closing long positions or selling short. At least, it would be wise to think about closing long positions in case of Point and Figure chart showing a sell signal. Point and Figure chart is created to filter out market noise, i.e. it takes into account only important price changes. Thus, Point and Figure chart should reliably show changes in the trend.

Point and Figure Charts Patterns - Summary Table

XO Bearish Support  	**XO Bullish Support**  	**XO Descending Triple Bottom** 
XO Double Top  	**XO Head-Shoulders**  	**XO Rectangle** 
XO Spread Triple Bottom  	**XO Triple Bottom**  	

Short Selling to Profit

It happens that traders try to sell the stock short. In this case traders simply sell a stock they do not own. In order to do this, traders have to use a margin account, and it is a very risky initiative. In case of placing a short position traders borrow the stock with a view to make profit from price declines. The borrowed stock should be repaid later on. Moreover, traders must pay borrowing cost and other redemption fees. In case price goes higher traders will need to cover losing positions by buying the stock back. Thereby, there is a very high percentage of risk of suffering losses, while the gain is limited.

Buying a Put Option

Buying a put option is a more moderate strategy. In this case, you can make profit from price declines, but at the same time you will be protected by limited risk. So you won't lose more that you've spent on purchasing the option.

Point and Figure Chart is a Very Useful Tool

No matter what strategy you have chosen, because all three of them would have been successful in the scenario, which you can see on the Picture 3. Let's consider this case: as you see, the double bottom sell signal had occurred, and then the stock went straight down and fell more than 50% during the next month. In case of buying put option and selling short traders would have profited, but the amount of profit would have depended on time of closing their positions. In case of closing long position a trader would have sold almost 10% from the highest price reached in the previous rally.

XO Metatrader Indicator

Click to view [More information about XO (Point and Figure) Indicator]

Risk Warning
Before deciding to participate in the Forex market, you should carefully consider your investment objectives, level of experience and risk appetite. Most importantly, do not invest money you cannot afford to lose. There is considerable exposure to risk in any off-exchange foreign exchange transaction, including, but not limited to, leverage, creditworthiness, limited regulatory protection and market volatility that may substantially affect the price, or liquidity of a currency or currency pair.