Wyckoff method of trading stocks part 6

Figure charts

by Jack K Hutson

Thus far in this series we've concentrated on the price volume information supplied by vertical charts, which are the mainstay of Richard D. Wyckoff's technical analysis. But as an adjunct to vertical charts, most Wyckoff analysts also employ figure charts, which record only price movement.

Figure charting allows the analyst to quickly see where and how strongly supply or support is building and to actually calculate the distance a price should rise or fall. Therefore with a vertical chart pointing out direction, the figure chart shows just how far that direction should travel.

Figure charts are useful for market averages, group averages and individual stocks. One-point figure charts ignore fractional price changes and record only full-figure price changes during a day's tradingÑ for example, from 57 to 58 to 59. Three point figure charts record only changes of three points or moreÑ from 57 to 60 to 63. Five-point and 10-point charts follow the same pattern.

A one-point figure chart for a stock can be built from its vertical chart or from the daily newspaper listings of opening, highest, lowest, and closing prices. Figure charts are usually constructed as each vertical chart is constructed, although veteran Wyckoff analysts will watch for interesting developments in their figure charts before constructing the more detailed vertical chart.

Taking a quick look at how a figure chart is developed, suppose your stock closed at 50 on Monday. On Tuesday, it opened at 50 3/4, went as high as 51 7/8, as low as 45 3/4, and closed at 48 1/4.

Your one-point figure chart for the two days looks like this:

Tuesday's high —51	
Monday's close —50	50
	49
	48 48— Tuesday's close
	47 47
	46— Tuesday's low

A three-point figure chart would condense the one-point chart by discarding all changes of less than three points. In our example, the only three-point move occurs between Tuesday's high and Tuesday's low. The three-point chart would look like:

One-point chart	Three-point chart
Tuesday's high- 51	
Monday's close —50 50	50— Monday's open
49	49
48 48	48
47 47	47
Tuesday's low —46	46— Tuesday's low

A figure chart's most valuable feature is its *horizontal formations*—horizontal price lines that show where and how strongly the forces of demand and supply are gathering. Horizontal formations are easiest to discern when you step back, take in the entire figure chart and notice where rallies and reactions begin growing.

In this hypothetical one-point figure chart, horizontal formations clearly unfold at the 60 and 61 price levels:

64	
63 63 63	
6262 626262	
616161 61 61616161	— horizontal formation
606060606060606060	— horizontal formation
5959 59	

You can think of a horizontal formation as a kind of foundation or baseline on which significant activity builds. Without this horizontal baseline, there isn't much chance of prolonged price increase or decrease because either demand or supply are missing.

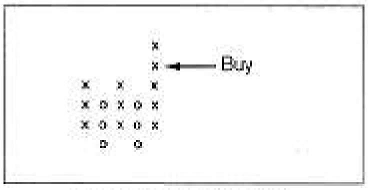
Experience says the number of times a figure is repeated in a horizontal formation is the number of points a stock, group, or the market average will advance from its deepest low or decline from its peak high. Counting the width of a horizontal formation includes both numbers and blank spaces between numbers. In the example above, the horizontal formation at 61 is 10 figures wide—eight numbers and two spaces.

A horizontal formation after a decline indicates that operators are willing to support the stock and stem the decline. After a rally, a horizontal formation uncovers the supply that's being offered and signals a downturn in prices as soon as the supply satiates demand.

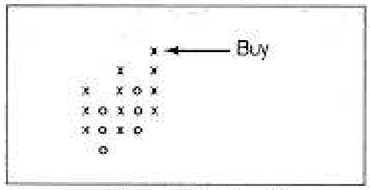
If the stock in our previous example had already been through a markdown, we'd assume the horizontal formations at 60 and 61 were demand lines and heralded a rise. To calculate how far the price could rise, we would add the horizontal formation's width of 10 to the bottom price of 59 and expect the price to ultimately hit **69**. Of course, we would continue to test the accuracy of this calculation as further activity was recorded on the figure chart—particularly if other, wider horizontal formations became evident that would increase our estimate of decline.

This horizontal formation calculation is an obvious advantage in deciding whether the magnitude of a potential price movement is worth your trading time and trouble, as well as anticipating where a stock's next climax or turning point should appear.

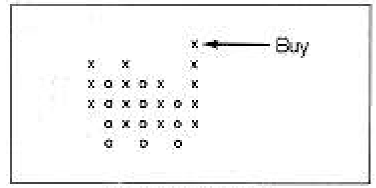
Figure charts also make the calculation of technical strength and weakness easier. With price movements so clearly displayed, it's a simple matter on a figure chart to determine whether a correction or reaction moves a price halfway from its starting point.



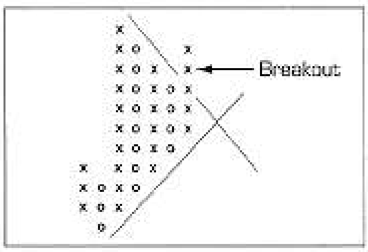
Breakout of a triple top



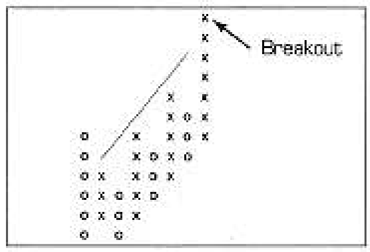
Ascending triple top



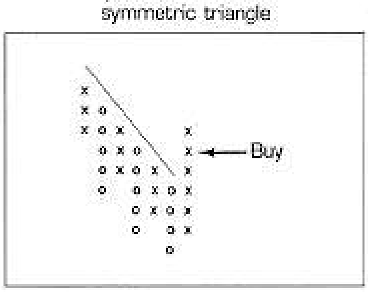
Spread triple top



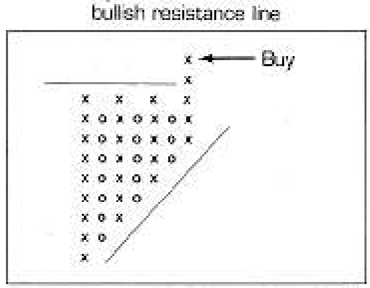
Upside breakout of a symmetric triangle



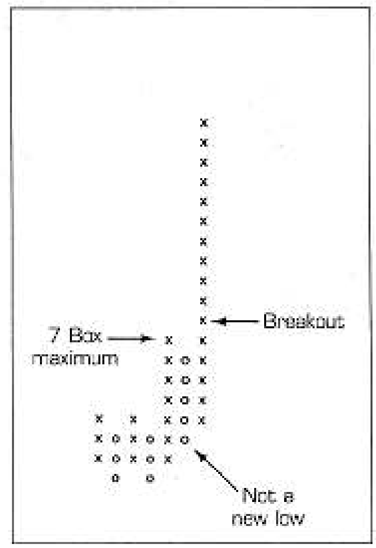
Upside breakout of a bullish resistance line



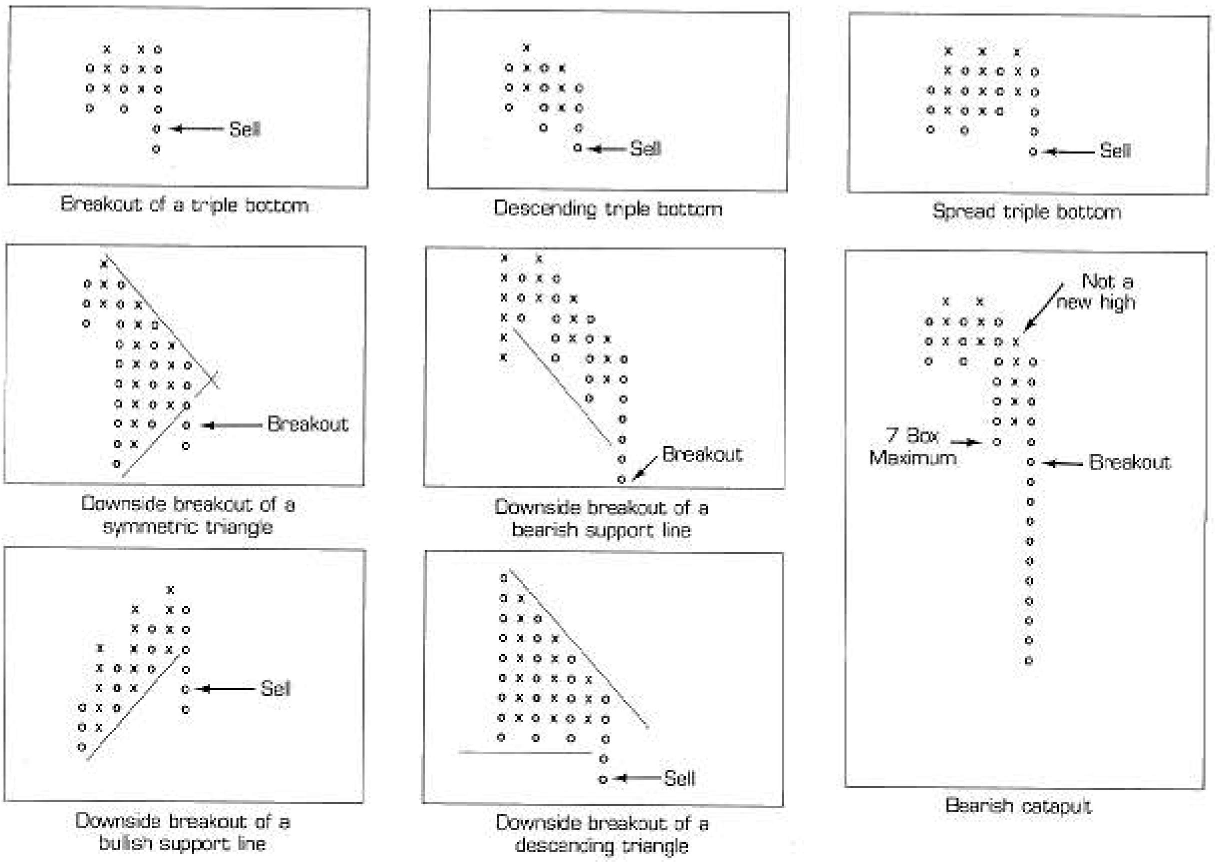
Upside breakout of a bearish resistance line



Upside breakout of an ascending triangle



Bullish catapult



Breakout of a triple bottom

Descending triple bottom

Spread triple bottom

Downside breakout of a symmetric triangle

Downside breakout of a bearish support line

Bearish catapult

Downside breakout of a bullish support line

Downside breakout of a descending triangle

Aside from the arithmetic, the general shape of figure charts also spotlights activity that might be clouded by the details of a vertical chart. An upward thrust that breaks the angle of a decline is an eyecatcher on a figure chart. Price oscillations that narrow to a trading range's dead center, the "hinge" of a springboard, are quickly detected on a figure chart. Likewise, an oversold condition shows up on a figure chart as a perpendicular column of prices unbroken by rallies or plateaus.

Seeing a figure chart in action is the best way to understand its usefulness. The hypothetical stock in the following example contains a number of clearly defined manipulative movements, with considerable forecasting value.

When you understand what a figure chart is telling you, it becomes a simple matter to integrate it into your vertical chart analysis. At first, you may run into instances where you think you're getting contradictory signals from the two charts: But with practice and experience, you'll find these apparent contradictions are simply early warning signals and that one chart's information does not supercede the other's.

