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G91-1059 Point-and-Figure Analysis

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Point-and-Figure Analysis

This is the ninth and final NebGuide providing an overview for producers using technical analysis in marketing decisions. It covers point-and-figure analysis.

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The *point-and-figure* chart is one kind of chart commonly used by people tracking prices in the futures market.

To construct this type of chart you need graph paper, a pencil, price information, and a little time to learn the technique. Charting services also offer point-and-figure charts for a fee.

Point-and-figure charts provide producers with general price trends. They also create short-term buy and sell signals.

This kind of chart records reversals in commodity prices. The sensitivity of the chart depends upon the scale the producer chooses. It can chart every price fluctuation in a given time period. The point-and-figure concept is based on the assumption that no plotting is necessary unless the price move exceeds the values the producer considers significant.

Prices are plotted on the vertical axis, and the boxes represent prices. The producer uses Xs and Os to record a commodity's reversals in prices. Upward moving prices are recorded as an X; downward moving prices are recorded as an O in the appropriate boxes.

The point-and-figure chart shows change without regard to time, so no calendar is shown on the bottom axis. The user determines the value of each box and its significance.

	3 x 1				
3.20	X				
3.10	X				
3.0	X	O			
2.90	X	O			
2.80		O			

¢ bushel -- Price represented by each box

3 x 1 -- number of boxes required in one direction for a reversal

X -- represents upward price movement

O -- represents downward price movement

The most difficult factor for a producer to determine is when such movement is significant. Two critical values can help determine significance. They are:

1. The size of each box or the amount of price change it represents.
2. How far the price must move to constitute a reversal.

The producer should continue to mark his or her chart with Xs and Os until the pattern determines a significant price reversal is occurring. Ultimately, the producer still decides what is significant.

Before beginning to chart prices, the user must choose the box size and reversal number. The box size is the amount of price change each box represents. Producers normally use two to four cents for the box size.

The reversal number indicates how far the price must move opposite to the present trend to become a reversal. The producer changes from Xs to Os or Os to Xs at this point.

To begin charting, choose a day when the spread between the high and low represents the reversal. If the close is above the midpoint for the day, the first column is an X. The first column is an O if the close is below the day's midpoint.

For example, assume a two-cent box size and a three-box reversal number.

When prices are moving up, add an X for each two-cent increase in price. If prices are moving down, add an O for each two-cent decrease in price. The trend is reversed when the price moves at least three boxes, or six cents, in the opposite direction.

If the previous trend had been downward and there is a reversal, the next column to the right will have at least three Xs in it, moving upward. More than three Xs may be required, depending upon the price change.

If the previous trend had been upward, the next column to the right will contain at least three descending Os. Again, the number of Os depends upon the price movement.

The amount chosen for the box size and reversal number determines the sensitivity of the point-and-figure chart. The smaller the box size, the more sensitive the chart to price change.

Smaller reversal numbers also create a more sensitive chart because less price movement is necessary for a reversal. Producers should select the box size and reversal number that fits their marketing plans, time constraints and relevant commodities.

A simple "buy" signal sounds when the current column of Xs rises one box higher than the top X in the prior column of Xs. The simple "sell" signal sounds when the current column of Os dips one box lower than the lowest O in the prior column of Os.

An Example of Simple "Buy" and "Sell" Signals

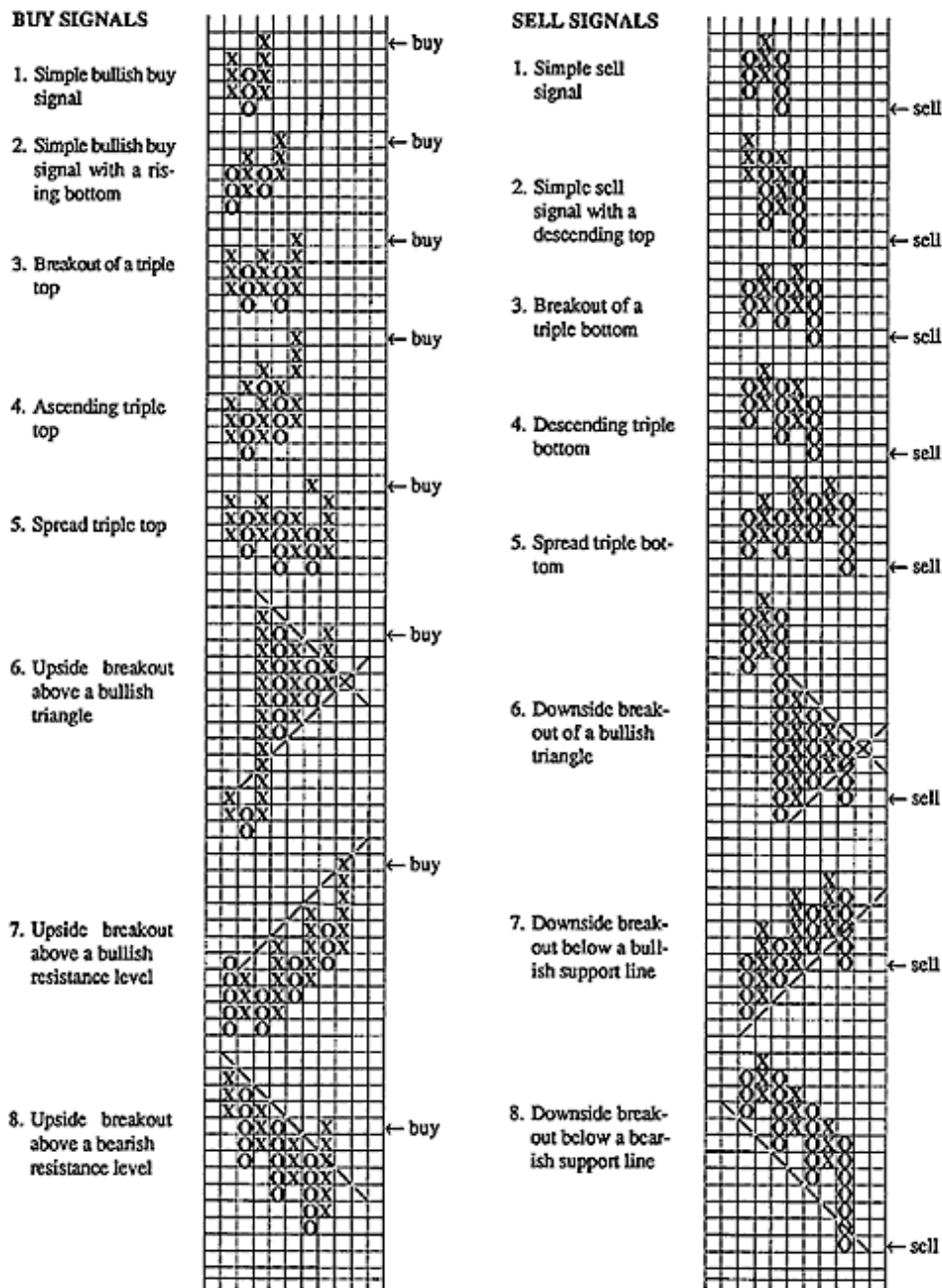


Figure 2. Samples of point-and-figure charts.

The person using the chart needs to consider what other market indicators they are using, and how the point-and-figure enters into the long-term plan.

If the purpose is to signal only major market swings, a large box and reversal number should be chosen. However, the day trader probably desires a much more sensitive chart with both a smaller box size and reversal number. The type of commodity in which the trader is dealing also gives direction to box size.

What is appropriate for corn is meaningless for cattle.

Conclusion

Various chart formations, some sophisticated or exotic, can be found using point-and-figure charts. They are similar to the formations formed on bar charts and can be useful by predicting market trends.

Trend lines can be drawn at a 45-degree angle on the point-and-figure charts to find major market trends. If a producer has the time and enjoys the challenge, there are triple tops and bottoms, bullish and bearish triangles, ascending triple tops and descending triple bottoms.

It is beyond the scope of this NebGuide to explore these approaches in any depth, but they are illustrated. Support and resistance lines are used by some producers, and again are shown but not explained in depth.

More information can be found in various books and in information provided by brokers.

Two suggested sources for further reading are the *Commodity Trading Manual*, published by the Education and Marketing Service Department of the Chicago Board of Trade, and Jake Bernstein's *Facts on Futures*, © 1987.

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