Market Dynamics

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Performance Management System

The Mystique Of Point And Figure

Portfolios heavy with under-performing stocks almost never outperform the market. Ignat's Law

Persistent, long-term up trends are not accidental. Neither are persistent long-term, downtrends.

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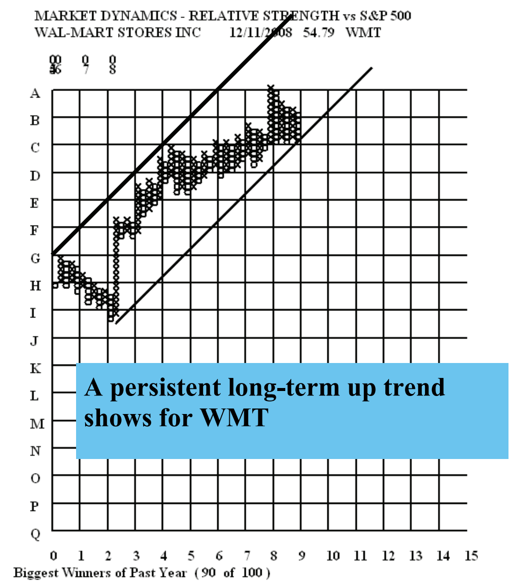
Many, if not most, investors are confused and "put off" by the appearance of a point and figure chart. The construction of the PnF chart is simply the result of applying a simple set of rules for recording the price of a stock over time in order to compress the data into a small space and to remove the erratic daily price fluctuations which often mask the more important long-term trend.

Investors are usually confused by the fact that the PnF chart does not record price against time. They are used to looking at charts of price against time and the idea of recording price against some other quantity takes some "getting used to."

The PnF chart is made up of alternating columns of Xs and Os where the Xs represent price movement up and Os represent price movement down. These columns of Xs and Os are based on a simple set of rules that consist of two parts; only the whole numbers of price are recorded and fractions are ignored, and as long as the trend proceeds in the established direction, Xs or Os are added to the column as the price moves up or down.

The next rule defines what has to happen to establish a new column of Xs or Os. This is the 3-box reversal rule. When the price moves in the direction opposite to the current trend by an amount of 3 points or more from the last posting, a new column of Xs or Os is started with at least 3 boxes recorded in that column The 3-box reversal rule acts like a filter on the price data and it reduces the impact of short-term, minor fluctuations on the chart. The 3-box rule is very important because it places an emphasis on the intermediate trends of the price of the stock. This eliminates the influence of short-term minor fluctuations in the price of the stock and lets the long-term trend show through. This 3-box reversal rule is



what makes long-term PnF charts so useful to long-term investors.

The determination of the long-term trend depends upon the alignment of the extremes of the intermediate columns of Xs and Os as the chart moves across the page. A pattern of higher highs and higher lows by these alternating columns of Xs and Os defines an up trend. Conversely, a pattern of lower lows and lower highs characterizes a downtrend.

A long-term up trend should be considered valid as long as the pattern of higher highs and higher lows remains in place. The reverse is true for a trend down. The 45-degree bullish support lines will help gauge an up trend. Bullish support lines can be drawn on the Market Dynamics main chart by clicking the Bullish Support Line button. Bullish trend channels can also be constructed by using two upward sloping bullish support lines.

It is my belief that the long-term trend on the chart will be readily visible and complicated decision rules are not required. Long-term trends are not accidental and while we can't predict their turning points with any degree of accuracy, we can recognize when they change direction.

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