DIFFERENT PERSPECTIVES: A LOOK AT CHARTING TECHNIQUES

By Richard L. Evans

A stock’s price at any point in time is the sum total of what all investors think about the stock. Whether an investor makes money or loses money depends on what others think about the stock, so keeping track of price, which is what technical analysis is all about, should be of interest to all investors.

There is, though, more than one way to plot a stock’s price, and these various plotting techniques afford different perspectives on a stock.

To demonstrate the different patterns, I’ve decided to use Intel as an example, because the stock is well-known and has made some interesting patterns.

BAR CHARTS

One of the first ways of plotting stock prices was line charts, based on closing prices. Among the first line charts were the closing prices of the Dow Jones industrial and rail indexes. In 1928, high and low prices were added, and the utilities average was started. And, as a note for history buffs, the charts covered six days a week, since trading on the New York Stock Exchange included Saturdays—not until June 1952 was trading cut back to five days a week.

Today, the most common price plotting technique combines the three prices—the high-low-close bar chart, illustrated in Figure 1. At first only the closing prices were considered important, as that represents the “final” price. However, high and low prices became more popular, and open price is increasingly appearing in databases.

Most bar charts also indicate volume, usually below the chart, since it is a key component that indicates which prices are most important.

The number one resource for bar charting is still Technical Analysis of Stock Trends (for more information, see reference sources at the end of the article). There are many newer books on technical analysis, but readers should start with the “bible.”

POINT & FIGURE

Another method of price plotting that is enjoying some renaissance of popularity is point and figure, illustrated in Figure 2.

Point and figure uses only closing prices, and it uses only price changes; time is not depicted. Thus, if a security is unchanged price-wise for a period of say, six weeks, no entry is made. It is only when there is a certain specified price change that an entry is made.

In point and figure, each box represents a specified price change; an “X” is entered when prices are rising by the specified price changes, and an “O” is entered when prices are falling by the specified price change.

The box size is generally $1. However, Mike Burke of Chartcraft, whom I

consider to be the keeper of the point and figure “flame,” so to speak, increases the box size to $2 for stocks over $100 and reduces the box size to $0.50 for stocks under $20 a share.

One purpose of most systems of technical analysis, including point and figure, is to identify reversals, to enable investors to either buy or sell, depending on where the reversal is developing. The “3-box” method is the standard, so for a stock to move either from the “X” column to the “O” column, or vice versa, a stock must change in price by at least three box sizes.

Of course, this article covers only general aspects of point and figure. The box at the end of the article provides additional references you can go to for more in-depth discussions on the use of point and figure charting.

CANDLESTICKS

Figure 3 illustrates a candlestick chart, a price plot that has gained greater visibility in recent years. Interestingly, the candlestick system, dating back to the 1600s, was used by the Japanese to analyze the price of rice contracts.

The candlestick system uses open, high, low, and closing prices. How the stock closes relative to the other prices largely determines the shape and color of the candlestick: The body of the candlestick represents the range between the session’s open and close; if the body is black, then the close was lower than the open, and if the body is white, the close was higher than the open. The thin lines above and below the body represent the highs and lows.

A series of candlesticks will then lend itself to pattern analysis.

Candlestick charting has gained some popularity no doubt due to some of the catchy names of different pattern formations, such as Bearish and Bullish Haramis; Dark Cloud Cover; Morning, Evening and Gravestone Dojis; Engulfing Bearish and Bullish Lines; Evening Star; Hanging Man; Shaven Head; Three Black Crows; and Tweezer Bottoms and Tops, to just name a few.

Steve Nison is the “guru” of candlesticks. His latest book is listed at the end of the article.

EQUIVOLUME

Figure 4 illustrates equivolume, which incorporates both volume and pricing into a single chart. The high and low lines are determined by the price; the width of the box is determined by trading volume. You can see in the Intel...
example that some of the larger boxes are associated with the panics in late May 1997 and early February 1998.

Richard Arms created equivolume. His book “Volume Cycles in the Stock Market,” is listed at the end of the article.

INTEL PATTERNS

Intel was used to illustrate the various charting methods because it has been showing interesting patterns. The formations are illustrated in Figure 1 in the traditional bar chart, but they can be more clearly detected in the other charts.

Intel at the start of 1997 had been moving higher in a nearly perfect uptrend for six months, up from a low of 32 1/16 in July 1996. It advanced to an early February high of 82 1/2 in just about a straight line. At the time, 82 1/2 just seemed like one more new high. However, subsequent price pattern development would make 82 a key price level as it related to future trading in Intel.

Generally speaking, the longer the current trend, the more important the eventual break. In the second half of February, Intel’s six-month uptrend was broken. The correction to 62 1/8 through late March was normal, but after a test of the lows in mid-April, Intel was off and running once again. In early May Intel approached the prior highs, but was thrown back. In late May, however, Intel had broken out, which is where the charts in Figures 1 through 4 pick up.

One problem with such widely held and highly publicized stocks is that sentiment and trend can change quickly. In any case, following an “apparent” breakout in late May to 84 7/8, the stock got blindsided as Wall Street turned jittery on the stock.

The stock closed out May 29 at 81 7/8. The following day, Intel gapped to the downside as the stock opened at 70 1/16. The stock closed near the high of the day, at 75 1/4. Volume on the day surged to nearly 115 million shares, perhaps best illustrated in the equivolume chart in Figure 4.

The selling was short-lived, however. Intel tested the lows in late June, and by early July the stock was headed right back up. Note that in mid-July, as the stock moved through the May 30 gap, the stock could rise relatively free as there was a lack of resistance. Figure 2 illustrates this well, with a long line of Xs, as does Figure 3, with a series of rising open candlesticks. Then, as the stock moved above the
resistance at 82, the stock gapped again, a breakaway gap.

During the second half of July, Intel formed what might be considered a rising pennant, which by its own formation is bullish. The stock broke out at the end of July and then rose sharply to new highs in August. The stock would hit 102 by August 6. A stock never looks more bullish than at the very top.

For the next 2½ months Intel developed a descending triangle, which has bearish implications. When the stock dropped below clear-cut support at 90, it gapped lower: Intel closed October 14 at 91 1/8; on October 15 the stock opened at 85 9/16, closing at 86 11/16, on volume of 66.2 million shares, and while the stock found some support at 82, it then continued to drop quickly. The selling ended in a selling climax on October 28, with the stock hitting a low of 69, on volume of 51.5 million shares; again this is well-illustrated by the Figure 4 equivolume chart. After the typical rebound rally, the stock would then again sink lower, to a low of 67 3/8 on December 19.

Most often in a test of the lows, the stock will hold above those lows. Sometimes, especially following panics, a stock will edge somewhat lower during a test of the lows. The latter situation is especially bullish as the stock is marked down, but there is no follow-through selling. The market is denuded of stock.

By late December, it is clear from the “big” picture on all four charts that 67-70 is an important support for the stock. Following the mid-December lows, Intel began to be marked up once again. However, an interesting development occurred on its march to new highs—the stock ran into resistance as associated with the August-September-October 1997 descending triangle. After one last rally effort to a high of 95 3/8 in late February, down went the stock. As the stock broke through support at 82, another gap panic followed. The selling would eventually taper off at 71 5/16 in April.

Intel would once again rally on the support at 70, but the rally would once again stall as the stock moved into the resistance above the 82 level—and down went the stock.

Which direction Intel eventually takes will be interesting. The 67–70 price level has often been support for Intel. The stock may well just be undergoing an extensive “correction.” Moves first through 82, then through 90, would suggest that the correction has run its course and that the stock is on its way to bettering its prior all-time highs of 102. All will be well.

However, Intel not only has considerable overhead resistance to overcome, but on relative strength (the movement of the stock’s price relative to the overall market) the stock has been losing ground in a strong Nasdaq market.

Sooner or later, support levels fail. If the entire formation, from the start of 1997 to mid-1998, is something akin to a massive head-and-shoulders, with support at 70 representing the neckline, the neckline-to-head difference (30 points to the high of 102) implies that if there were a break below 70, a 30-point drop to the 40 level could occur. Time will tell, but the Intel patterns are not especially favorable.

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<th>TECHNICAL ANALYSIS CHARTING REFERENCES</th>
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<tr>
<td><strong>Chartcraft</strong></td>
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<tr>
<td>30 Church Street</td>
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<td>New Rochelle, NY 10801</td>
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<td>(914) 632-0422</td>
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<td><strong>Technical Analysis of Stock Trends</strong>, by Robert D. Edwards and John Magee; Amacom (American Management Association); (800) 262-9699; <a href="http://www.amanet.org">www.amanet.org</a>; 721 pages; $75.00.</td>
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<td><strong>Point and Figure Charting: The Essential Application for Forecasting and Tracking Market Prices</strong>, by Thomas J. Dorsey; John Wiley &amp; Sons; (800) 225-5945; <a href="http://www.wiley.com">www.wiley.com</a>; 256 pages; $59.95.</td>
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<td><strong>Beyond Candlesticks</strong>, by Steven Nison; John Wiley &amp; Sons; (800) 225-5945; <a href="http://www.wiley.com">www.wiley.com</a>; 282 pages; $65.00.</td>
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The vendor of the stock charts used in this article, Equis Int’l., also offers a very informative users manual which gives brief explanations to price plotting techniques, along with a host of other informative technical analysis methods. Information on MetaStock by Equis is available at (800) 882-3040.