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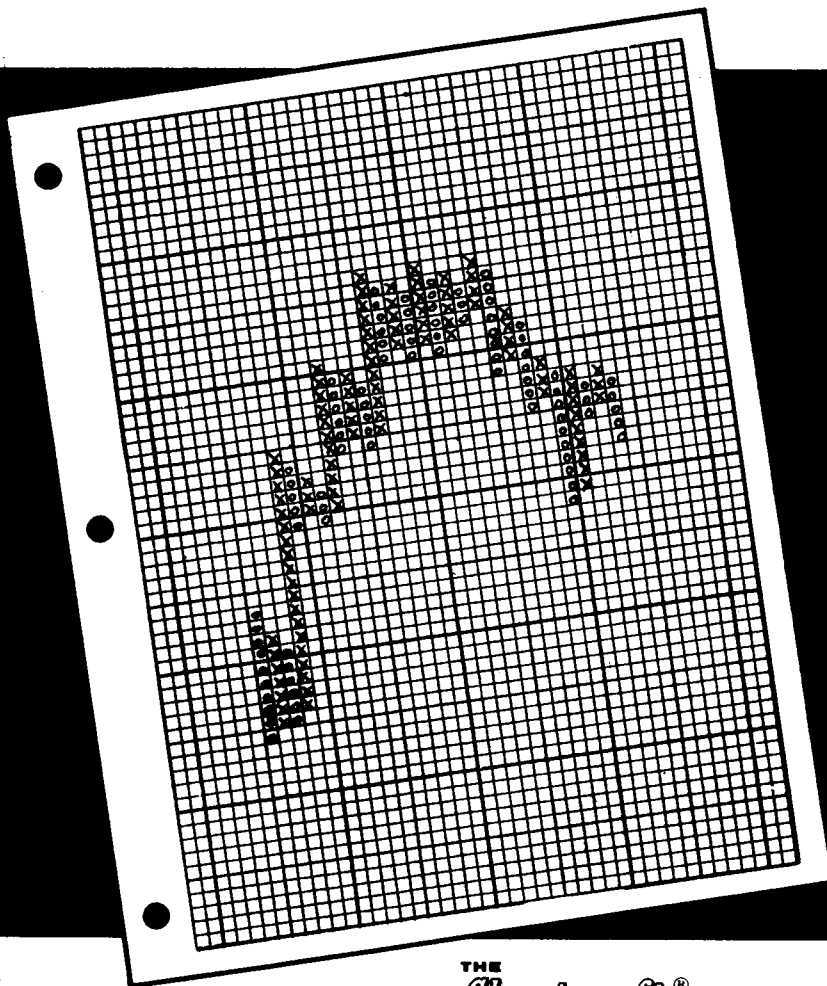
**HOW TO USE THE**

***Three-Point Reversal Method of***

***Point & Figure***

***Stock Market Trading***

**BY A. W. COHEN**



- A TECHNICAL APPROACH TO STOCK MARKET TRADING
- A SIMPLIFICATION OF POINT AND FIGURE CHARTING & INTERPRETATION
- CHART PATTERNS, TREND LINES, PRICE OBJECTIVES, RELATIVE STRENGTH, INDUSTRY GROUPS, TECHNICAL INDICATORS
- A NEW APPROACH FOR THE BEGINNER
- AN ADVANCED TOOL FOR THE PROFESSIONAL
- INCLUDES CONVERTIBLE BONDS, PUTS & CALLS, OTC STOCKS AND COMMODITY FUTURES

**ORIGINAL TITLE ►**

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METHOD OF POINT  
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***Three-Point Reversal Method of***  
***Point & Figure***  
***Stock Market Trading***

**BY A. W. COHEN**

A TECHNICAL APPROACH TO STOCK MARKET TRADING



**PUBLISHED BY CHARTCRAFT INC., LARCHMONT, N. Y. 10538**

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EIGHTH REVISED EDITION

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## FORWARD

The basic principles of "*How to Use the Three-Point Reversal Method of Point & Figure Stock Market Trading*" were first published in 1947 under the title "*Stock Market Timing*." When the Chartcraft Weekly Service was started in 1948, the name of the book was changed to "*The Chartcraft Method of Point & Figure Trading*." In August 1978, we published the sixth revised edition of this book which included revised chapters dealing with the Dow-Jones Industrial Average, Over-The-Counter Stocks, and Technical Indicators. In March 1980, the Seventh edition was published containing a revised chapter on Option Trading.

This is the eighth revised edition. It contains revised sections on Price Objective, Relative Strength, Technical Indicators, Options, and Commodities.

Although future editions are constantly in the planning, the basic principles remain the same.

Special acknowledgment is made to Professor Robert Earl Davis of Purdue University. He was kind enough to let us read his lengthy manuscript, "*Profit and Probability—Technical Analysis of the Price Fluctuations of Common Stocks*," and has permitted us to use his figures on the profit potential of the various trading formations contained in this book. All the formations were programmed for an IBM 7094 computer and the results were obtained on the basis of trading from buy signal to sell signal, and sell signal to buy signal, with trend lines taken into account.

A. W. Cohen  
July 1982

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## INTRODUCTION - THE TWO APPROACHES

The problem of the purchase of stock in any particular company can be approached in either of two ways. One way is to pose the problem as: "Should I buy the stock of the XYZ Company?" The other is to pose the problem as: "When shall I buy the stock of the XYZ Company?"

The person who asks the question "Should I?" is taking the fundamental approach to the stock market analysis. The person who asks the question "When shall I?" is taking the technical approach to stock market analysis.

The fundamental analyst concerns himself with financial statements, history, quality of management, earnings, dividends, popularity of products, relative position in the industry, etc.

The technical analyst concerns himself with supply and demand, accumulation and distribution. Practically all stocks have substantial moves at one time or another. Fluctuation in price is as true of a "blue chip" as of a "cat and dog." No stock goes up in price of its own accord. Before a stock goes up it goes through a period of accumulation by "insiders," it is passing from "weak hands" into "strong hands" until demand is greater than supply and the upward move is on its way. Before a stock drops in price, it goes through a period of distribution by the same "insiders." It is passing from "strong hands" into "weak hands." When support is withdrawn, supply overcomes demand and the panicky downward move is on. The technical analyst is concerned with the right time to buy and the right time to sell short. He attempts to determine the moment when either supply or demand has taken control of the situation. He is an "outsider" making use of various techniques to determine what the "insiders" are doing.

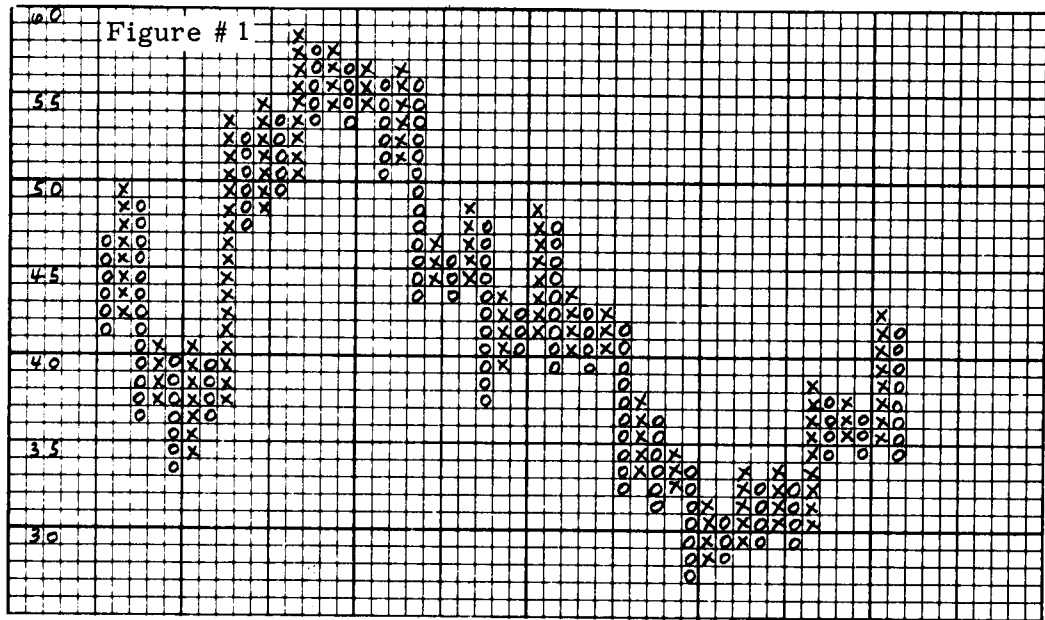
When should a stock be bought? The broad answer to this question is that a stock should be bought only when (1) the general market is in an uptrend, (2) the industry group of which it is a member is in an uptrend, and (3) the stock itself is in an uptrend. Uptrend, as used herein, refers to price - the price of a market average, the price of the industry group index, the price of the stock. It does not refer to earnings, cash flow, growth, etc.; such factors may answer the question what to buy but never the question when to buy.

When should a stock be sold short? The broad answer to this question is that a stock should be sold short only when (1) the general market is in a downtrend, (2) the industry group of which it is a member is in a downtrend, and (3) the stock itself is in a downtrend. The trader or investor who does not like the short side of the market should at least be out of stocks in such a situation. Here again, downtrend refers only to price and nothing else.

The tools used by the technical analyst in making such determinations are primarily charts - charts of a particular stock, charts of an industry group, charts of a market Average or Index. There are three types of charts: line, bar, and Point and Figure. This book is devoted to Point and Figure charting and interpretation. It is the oldest form of charting used in the stock market, it is indigenous to and grew out of the stock market, and once mastered and understood it is also the simplest and clearest method of determining the right time to buy and the right time to sell. The Point and Figure chart shouts where other charts merely stutter.

SECTION ONE

THE POINT AND FIGURE CHART AND ITS CONSTRUCTION



In Figure # 1, we have a Point and Figure chart "under the aspect of eternity." By this, we mean that both vertical and horizontal coordinates are based on price changes. In the usual line or bar chart, the vertical coordinate is based on price and the horizontal coordinate is based on time (day, week, or month). This is not the case in a Point and Figure chart. Chronology has no significance in it. The only thing it concerns itself with is a stock's price changes independent of the time in which these changes take place. The chart patterns that this chart develops are independent of the time it takes for their coming into being, whether it is a matter of days, weeks, months, or years. Their significance for the future remains the same.

Although we will include chronological data in the body of the Point and Figure chart, as will be seen in the ensuing pages, this will be done merely to establish a frame of reference.

## THE POINT AND FIGURE CHART

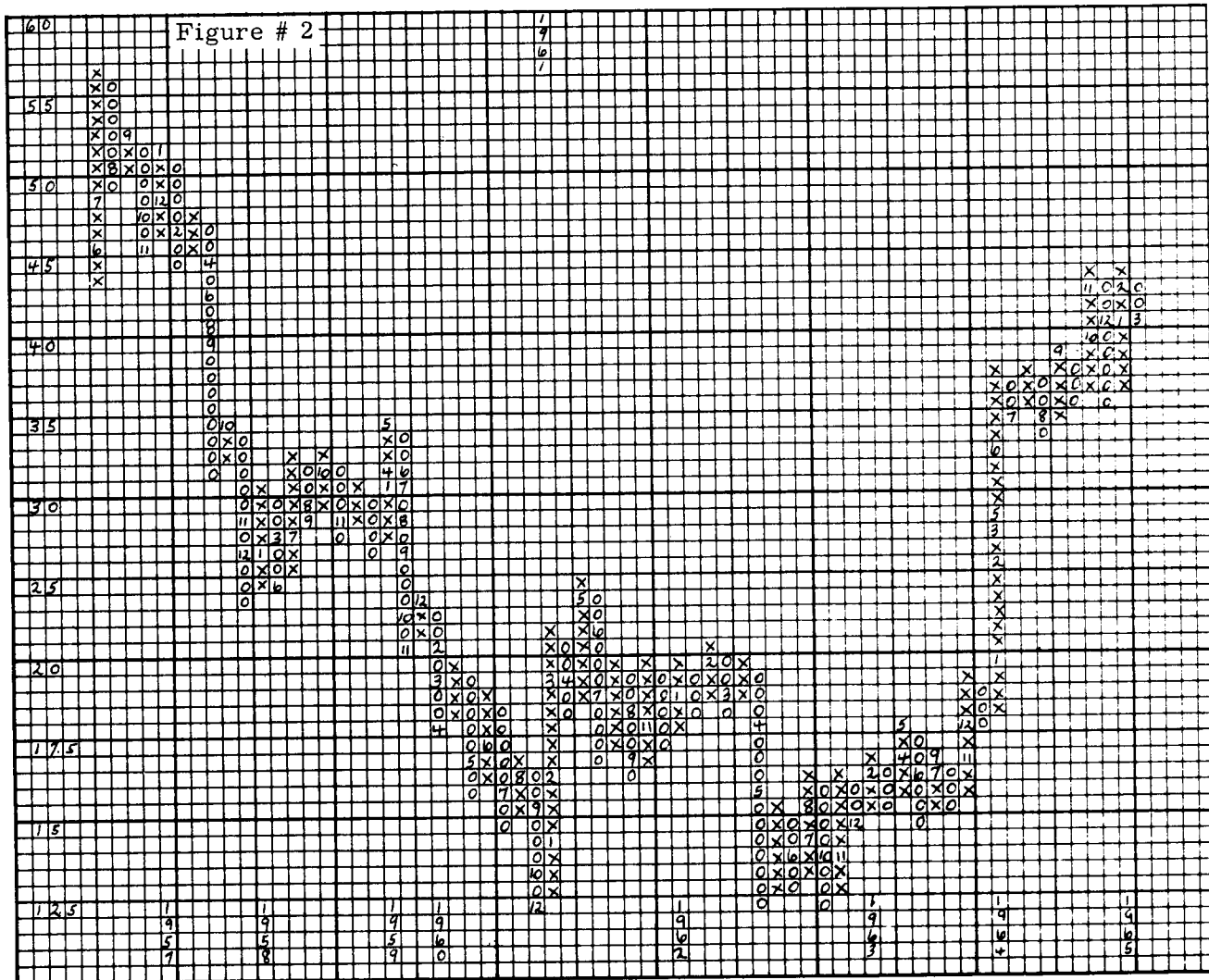


Figure # 2 is a reproduction of a Point and Figure chart of Bucyrus-Erie. Let us examine it closely and learn how it is constructed.

Each square (not line) on the chart represents a unit of price.

Under 20, each square stands for  $\frac{1}{2}$ -point or one-half dollar.

From 20 to 100, each square stands for 1-point or one dollar.

When the price of a stock is going up, we use Xs to indicate the price changes.

When the price of a stock is going down, we use Os to indicate the price changes.

Vertical columns of Xs and Os alternate. We move one column to the right each time there is a change in direction - from up to down or from down to up. Xs and Os never appear in the same column. Each column represents either an upmove or a downmove, it cannot represent both. (Daily highs and lows are used for determining upmoves and downmoves and not closing prices).

In no vertical column are there ever less than 3 squares of Xs or 3 squares of Os. This means that in order to record a change in direction from an upmove to a downmove, or vice versa, there must first be a price change equal to at least 3 squares.

Over 20, therefore, a price change of 3 points or three dollars would be necessary for a trend reversal. If the price of a stock has gone up to 50, it must go down to 47 before we can record the Os in the next vertical column.

Under 20, a reversal of  $1\frac{1}{2}$  points or one-and-one-half dollars would be necessary. If the price of a stock has gone down to 14, it must go up to  $15\frac{1}{2}$  before we can record the Xs in the next vertical column.

At the borderline of 20, 3 squares may represent only 2 or  $2\frac{1}{2}$  points, but a reversal occupying 3 squares is always necessary.

In the same trend, however, each point or  $\frac{1}{2}$ -point is added as the stock continues on its way up or down.

Over the 20 price square, we have no fractions at all on our chart. If a stock has gone up from 32 to  $39\frac{7}{8}$ , the highest X in our column will be in the 39 square. If a stock has gone down from 57 to  $43\frac{1}{8}$  the lowest 0 in our column will be in the 44th square (it never made an even 43).

Under the 20 price square, the only fractions we have are in  $\frac{1}{2}$ -point units. If a stock has gone up from  $10\frac{1}{2}$  to  $13\frac{7}{8}$ , the highest X will be in the  $13\frac{1}{2}$  square; and if it has gone down from 16 to  $13\frac{5}{8}$ , the lowest 0 will be in the 14 square (it never made an even  $13\frac{1}{2}$ ).

Over 100, each square should represent 2 points or two dollars. The 3 squares necessary for a trend reversal will therefore stand for 6 points or six dollars except, of course, at the borderline of 100.

It is very important to indicate that a Point and Figure chart is a one-dimensional chart. In the usual stock market chart, whether bar or line, the vertical axis represents price and the horizontal axis records time. In the Point and Figure chart both the vertical and horizontal axis record price. The chronological data that it may contain is of no importance either to its construction or interpretation. It is used only as a matter of convenience. In the chart of Bucyrus-Erie, we have indicated the passage of time by the numerals 1 to 12 (1 representing January, 2 representing February, etc.). The appropriate numeral has been substituted for an X or an 0 the first time a price change is entered in a new month. When this coincides with a 3-box price reversal, the numeral is entered in the third square up or down as the case may be. Years are indicated at the foot of the chart. If all this chronological data were omitted, the chart would be just as valid. The Point and Figure chart is indigenous to the stock market; it was used to graphically record price changes, perhaps as far back as the 1880s. It is the oldest type of chart used in stock market trading.

The Point and Figure chart, as we have constructed it, because of the 3-box reversal necessary for a change in direction, eliminates all minor and confusing moves. It is simple, clear and concise. It lends itself easily to correct interpretation. It is simple to construct and maintain.

Note: Charts compiled by Electronic Computer substitute A, B and C for 10, 11 and 12 as symbols for the months October, November and December.

Figure # 3

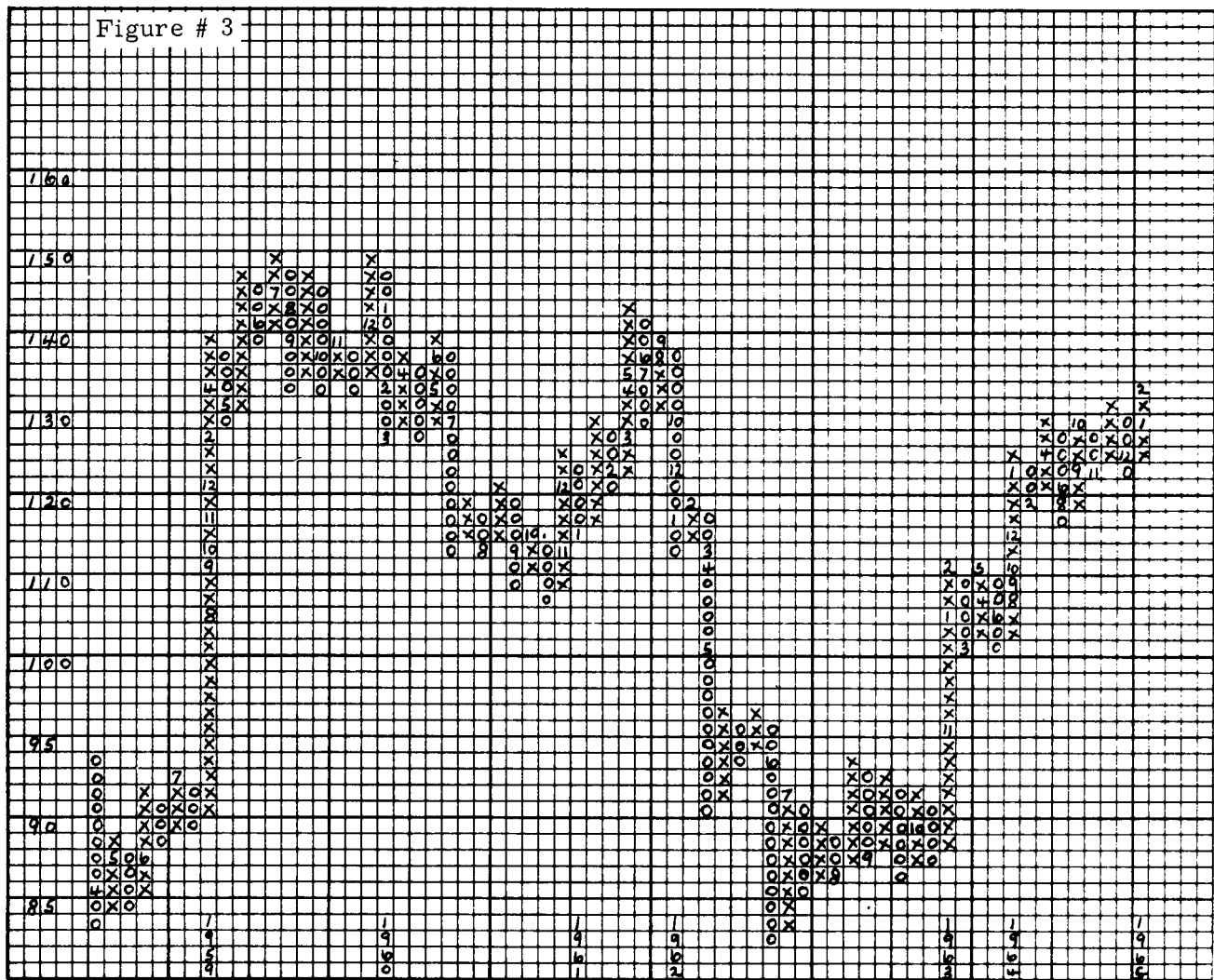


Figure # 3 is a Point and Figure chart of Union Carbide. It illustrates the units of charting when the price of a stock rises and falls above 100.

Below 100, each square stands for 1-point or one dollar.

Above 100, each square stands for 2-points or two dollars.

A 3-box reversal below 100, would be equal to 3-boxes or three dollars.

A 3-box reversal above 100, would be equal to 6-points or six dollars.

At the borderline of 100, the 3-box reversal may sometimes equal 4 dollars and at other times 5 dollars.

The important fact to keep in mind is that above 100 we have only even units and no odd units. Thus if a stock goes up to 115, the high on our chart would be 114; if a stock goes down to 107, the low on our chart would be 108.

In all other respects, the chart is basically the same as that of Bucyrus-Erie, in Figure # 2.





## CHART CONSTRUCTION

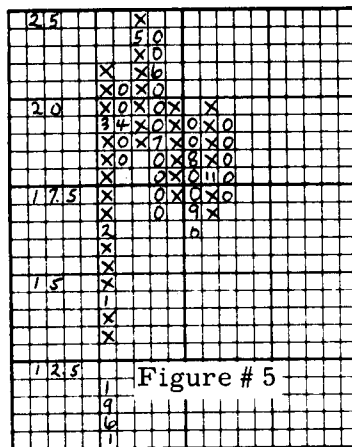
The Point and Figure chart of Bucyrus-Erie was constructed from the daily stock tables appearing in the Wall Street Journal. Any newspaper reporting the daily highs and lows may be used. Because the 3-box reversal eliminates the minor and insignificant price changes, there is no need to subscribe to any special price change service in order to construct and maintain a chart of this type.

We are appending below the daily high and low figures of Bucyrus-Erie for the year 1961. We have also added a column showing the chart entries to be made from these figures. This will enable you to practice making a chart. We suggest that you cover the column marked chart entries and only use it to check your own postings. The figure after the colon represents eighths of a point; the figure in parenthesis represents the month, i. e., (1) January, (2) February, etc.

<u>Date</u>	<u>High</u>	<u>Low</u>	<u>Chart Entries</u>	<u>Date</u>	<u>High</u>	<u>Low</u>	<u>Chart Entries</u>
Jan. 3	14	13:4	13½-14	21	19	18:5	
4	14:7	13:7	(1)14½	23	18:6	18:1	
5	15:4	14:7	15-15½	24	18:4	17:7	
6	15:5	14:7		27	18:6	18:1	
9	15:6	15:5		28	18:4	18:1	
10	15:7	15:1		Mar. 1	18:2	18	
11	15:4	15:2		2	18:4	18	
12	15:2	15		3	18:3	17:6	
13	15:2	15		6	19:7	17:5	(3)19½
16	15:2	14:7		7	20:3	19:2	20
17	15	14:6		8	20	19:4	
18	15:4	15:1		9	20:3	20	
19	16:1	15:4	16	10	20:7	20:2	
20	15:7	15:5		13	22	21:2	21-22
23	16:2	15:7		14	21:7	20:5	
24	16:2	16		15	20:7	19:7	
25	16:1	15:7		16	21:3	20:6	
26	15:7	15:4		17	21:2	20:2	
27	15:5	15:4		20	21:2	20:3	
30	15:7	15:4		21	21	20:4	
31	15:6	15:2		22	21	20:3	
Feb. 1	15:2	15		23	21:3	20:4	
2	15:6	15:3		24	21:6	21:1	
3	15:4	15:2		27	22:2	21:7	
6	15:3	15:1		28	22:1	21:6	
7	15:2	14:7		29	21:7	21:3	
8	15:3	14:7		30	21:7	21:3	
9	15:3	15		April 3	21:7	21:3	
10	15:2	15:1		4	21:3	21	
13	15:3	15:1		5	21:1	20:4	
14	15:7	15:1		6	20:1	19:6	
15	16:2	15:6		7	19:7	18:4	21-20-(4)19½-19-
16	17:4	16:3	(2)16½-17-17½				18½
17	18:3	17:5	18	10	20:3	19:5	19-19½-20
20	19	18	18½-19	11	20:5	20:1	

<u>Date</u>	<u>High</u>	<u>Low</u>	<u>Chart Entries</u>	<u>Date</u>	<u>High</u>	<u>Low</u>	<u>Chart Entries</u>		
April	12	20:3	19:6		26	20:6	20		
	13	20	19:5		27	20:2	19:6		
	14	19:7	19:4		28	20:7	20		
	17	19:7	19:1		29	20:6	20		
	18	19:1	18:5		30	20:7	20:6		
	19	20:2	19:2						
	20	22:1	21:4	21-22	July	3	20:5	20:2	
	21	23	22:3	23		5	20:6	20:1	
	24	22:7	21:5			6	20:3	20:1	
	25	22:5	21:6			7	20:2	20	
	26	23:4	22:3		10	20:1	19:3		
	27	23:1	22:1		11	19:3	19	(7)19	
	28	22:7	22:1		12	19:2	19		
May	1	23:1	22:6		13	19:6	18:7		
	2	23:1	22:5		14	19:5	19:2		
	3	22:7	22:3		17	19:3	18:5		
	4	22:6	22:5		18	18:5	17:4	18½-18-17½	
	5	22:6	22:3		19	17:6	17	17	
	8	24	22:7	(5)24	20	18	17:5		
	9	25	24	25	21	18	17:4		
	10	24:6	24:1		24	18:3	18:1		
	11	24:3	23:5		25	19:4	18:5	17½-18-18½-19-19½	
	12	24:2	23:7						
	15	24:2	23:7		26	19:7	19:1		
	16	24:6	24		27	20	19:1	20	
	17	24:2	24		28	20	19:4		
	18	24:1	23:6		31	19:7	19:4		
	19	23:7	23:4		Aug.	1	19:6	19:4	
	22	24	23:6			2	19:7	19:4	
	23	24:1	23:4			3	19:4	18:6	
	24	23:7	23:4			4	19:4	19	
	25	23:3	23:1			7	19:4	19:2	
	26	23:4	23:1			8	19:3	18:6	
	31	23:4	23:2			9	18:5	17:5	19½-19-(8)18½-18
June	1	23:2	23		10	18	17:6		
	2	23:1	22:6		11	18:2	17:7		
	5	23:1	22:5		14	18:2	18		
	6	22:5	22:1		15	18:4	18:2		
	7	22:2	21:5	24-23-(6)22	16	18:5	18:3		
	8	21:7	21:1		17	18:4	17:7		
	9	21:7	21	21	18	18:3	18		
	12	21:6	21:2		21	18:3	18:1		
	13	21:6	20:7		22	18:2	17:7		
	14	21:2	20:5		23	18	17:5		
	15	20:3	19:7	20	24	17:6	17:4	17½	
	16	20:5	20:1		25	17:7	17:4		
	19	20:4	19:2	19½	28	17:6	17:5		
	20	20:4	19:6		29	17:6	17:4		
	21	20:5	20:3		30	17:5	17:1		
	22	20:4	20		31	17:5	17:2		
	23	20:4	20						

Date	High	Low	Chart Entries	Date	High	Low	Chart Entries
Sept. 1	17:3	17:2		Nov. 1	16:6	16:2	
5	17:3	17:1		2	17:2	16:4	
6	17:1	16:7	(9)17	3	17:3	17	
7	17:1	16:6		6	17:2	16:7	
8	17:2	16:6		8	18	17:2	17-17½-(11)18
11	16:6	16:2	16½	9	18:3	18	
12	16:5	16:1		10	19:5	18:2	18½-19-19½
13	17:2	16:4		13	20:1	19:6	20
14	17:6	17:1		14	19:7	19:2	
15	17:5	17:3		15	19:7	18:5	
18	17:4	16:7		16	18:4	18	19½-19-18½-18
19	17:1	16:5		17	18:6	18:2	
20	16:5	16:4		20	18:6	18:3	
21	17:3	16:6		21	18:4	18:2	
22	17:2	17		22	18:2	17:6	
25	17:3	16:6		24	18	17:6	
26	17:3	16:5		27	17:7	17:4	17½
27	17:1	16:7		28	17:7	17:4	
28	17:1	17:1		29	17:6	17:3	
29	17:1	16:7		30	17:5	17:3	
Oct. 2	17:1	16:6		Dec. 1	17:5	17:3	
3	16:6	16:5		4	18:4	17:5	
4	16:7	16:5		5	18:4	17:5	
5	17:1	16:6		6	17:6	17:4	
6	17:1	17		7	17:3	17:2	
9	17	17		8	18:1	17:2	
10	17	17		11	18:4	18:2	
11	17:1	16:7		12	18:6	18:2	
12	17:1	16:7		13	18:4	18:2	
13	17:2	17:1		14	18:4	18:3	
16	17:6	17:3		15	18:4	18	
17	17:6	17:2		18	18:1	17:5	
18	17:4	17:1		19	17:5	17:5	
19	17:2	17		20	18	17:5	
20	17:2	16:5		21	18	17:6	
23	16:7	16:5		22	17:7	17:6	
24	17:1	16:5		26	18	17:6	
25	17	16:4		27	17:7	17:5	
26	16:6	16:4		28	17:7	17:4	
27	16:5	16:4		29	17:5	17:2	
30	16:7	16:3					
31	16:4	16:3					

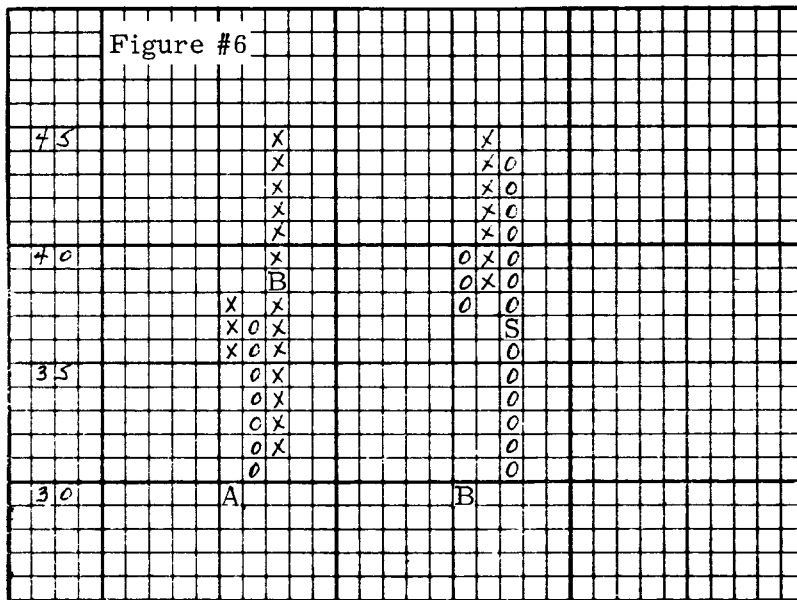


This method of charting is based on the elimination of the minor and insignificant intra-day moves.

If your last chart entry is an X, then look at the daily high. If the stock has gone up enter the additional X or Xs and forget about the lows. If the stock has not gone up then look at the low for a 3-box reversal.

If your last chart entry is an O, then look at the daily low. If the stock has gone lower enter the additional Os and forget about the highs. If the stock has not gone lower then look at the daily high for a 3-box reversal.

THE DOUBLE TOP AND DOUBLE BOTTOM FORMATION (#1)



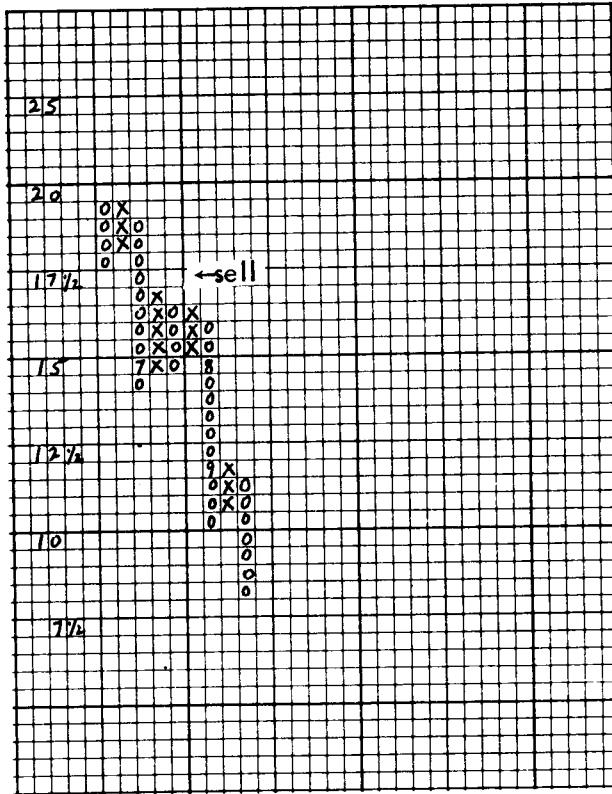
Example A is an illustration of the Double Top formation (#1). It is the basic chart pattern in a bull market. Chart picture shows a first top at 38. This is followed by a decline to 31, which in turn is again followed by a rally to 38. The two tops at 38 comprise the double top. A breakout above this double top to 39 registers a buy signal. This point is indicated on the chart by the letter B.

Example B is an illustration of the Double Bottom formation (#1). It is the basic chart pattern in a bear market. Chart picture shows a first bottom at 38. This is followed by a rally to 45, which in turn is again followed by a decline to 38. The two bottoms at 38 comprise the double bottom. A breakout below this double bottom to 37 registers a sell signal. On the chart, this point is indicated by the letter S.

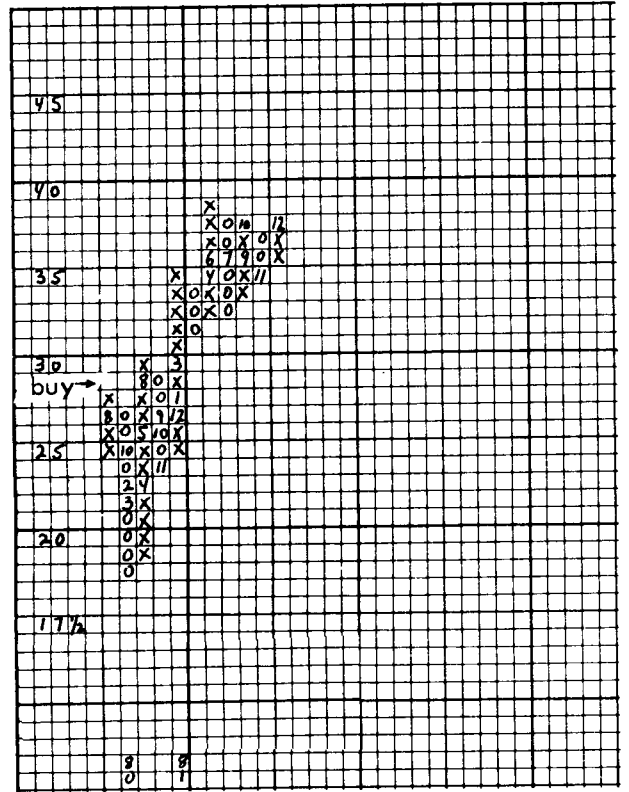
These two basic formations consist of three vertical columns. It is impossible to have a chart pattern that consists of less than three columns. All other chart patterns are derivations from and combinations of these two basic patterns. As will be seen in the following pages, they necessarily consist of more than three vertical columns.

Since all other formations are derived from these two basic formations they may contain the Double Top or the Double Bottom formation as part of their chart patterns. The trader will then have a choice to act on the original breakouts or on those occurring later in the more complex formations.

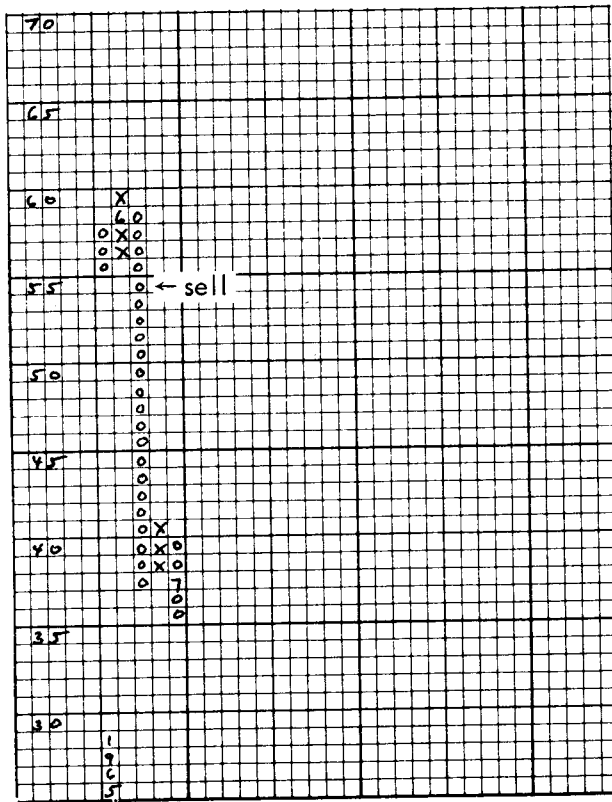
Genisco Tech. (GES)



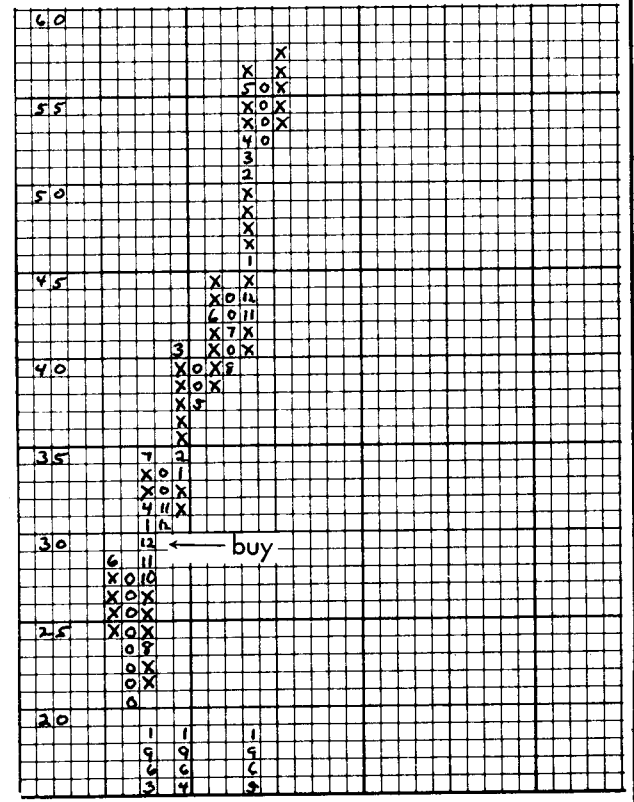
General Mills (GIS)



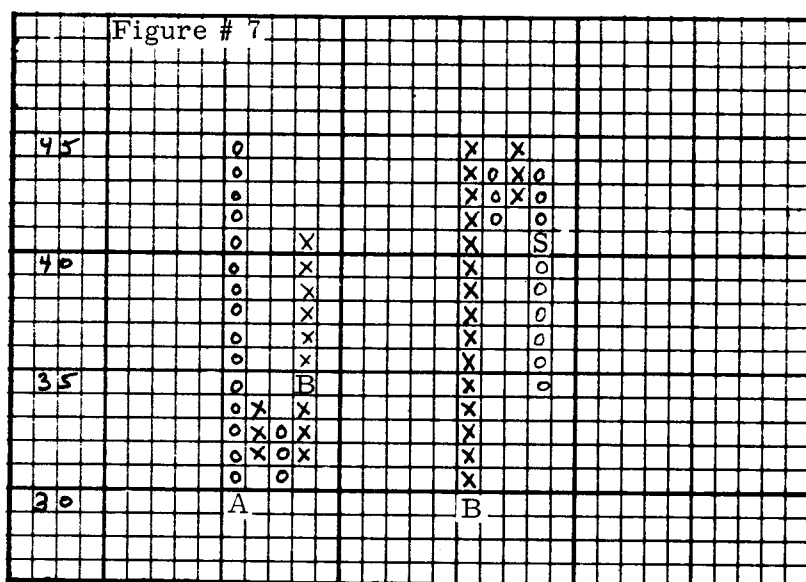
Control Data (CDA)



Harcourt Brace (HBJ)



THE DOUBLE TOP AND DOUBLE BOTTOM FORMATIONS (#2)



The formations illustrated above are variations on the Double Top and Double Bottom formations #1 in Figure #6.

In example A, the breakout at 35 takes place after two bottoms have been made at the same level instead of merely one bottom. The first bottom at 31 was retested and held. Then came the rally for the breakout on the Double Top formation. This type of Double Top formation is more common than a straight upmove from a single bottom.

In example B, the breakout at 41 occurs after two tops have been made at the same level instead of merely one top. The first top at 45 was retested and held. Then came the decline for the breakout on the Double Bottom formation. This type of Double Bottom formation is more common than a straight downmove from a single top.

These patterns usually appear at market tops and market bottoms.

In these #2 formations four vertical columns are required for their completion. These chart patterns may also appear as integral parts of more complex formations and the trader or investor has the choice of acting on these breakouts or on the breakouts that occur in the more complex formations.

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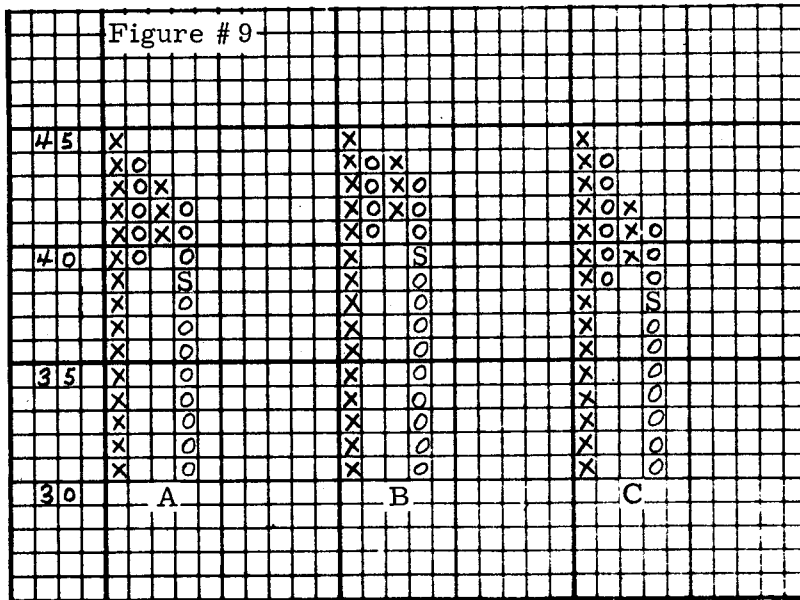








## THE BEARISH SIGNAL FORMATION



The Bearish Signal formation is one of two classic chart patterns used in timing a stock sale. The significant feature of this chart is a lower top and a lower bottom. As long as a stock continues to make lower tops and lower bottoms it is bearish. The first time it makes a lower bottom after making a lower top is the signal that the stock may be sold. It is telling us that Supply has overcome Demand and that the stock, which hitherto may have been bullish and in an uptrend, is now ready to make a downward move. Distribution by those in the know has been completed.

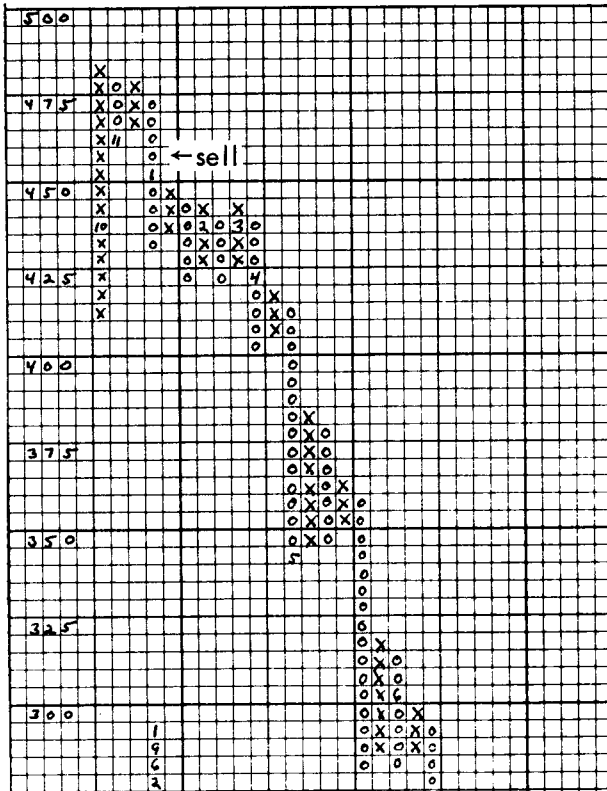
For the three most common patterns of the Bearish Signal formation see Figure # 9. In example A, we have a top at 45 and then a lower top at 43; it also has one bottom at 40 and then a lower bottom at 39. When the lower bottom is made at 39, the stock, in technical parlance, has had a downside breakout and has given a sell signal. In all three examples, the point at which the sell signal is given is indicated by the letter S.

In example B, we have a top at 45 and then a lower top at 44; we also have a bottom at 41 and then a lower bottom at 40. The lower bottom at 40 is the signal that the stock may be sold. In this case, it took place at a higher level than in the first example, although both chart patterns started from the same high at 45.

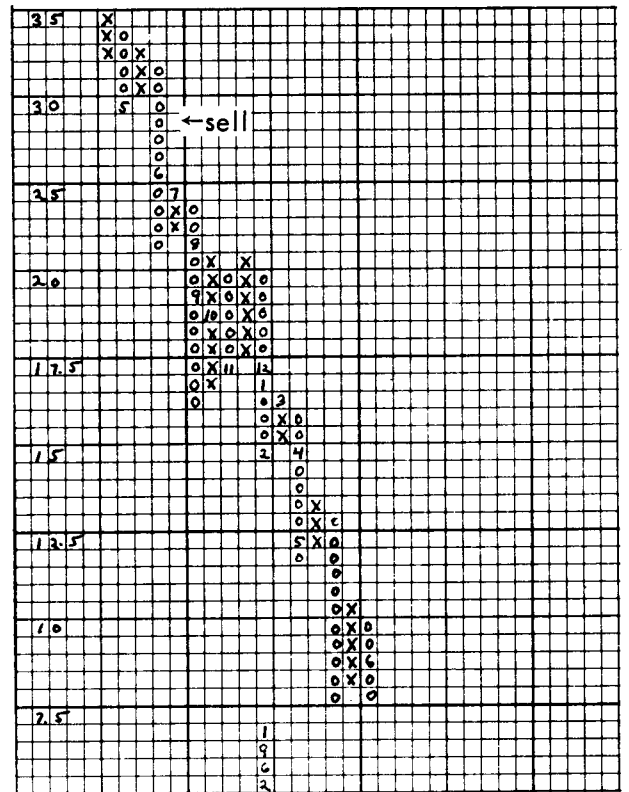
In example C, we again have a top at 45 and then a lower top at 42; we also see a first bottom at 39 and then a lower bottom at 38. The lower bottom at 38 is the signal that the stock may be sold. In this example, the sell signal took place at a lower level than in the two previous ones, although all three chart patterns started with a high at 45.

Four vertical columns are required for the Bearish Signal formation.

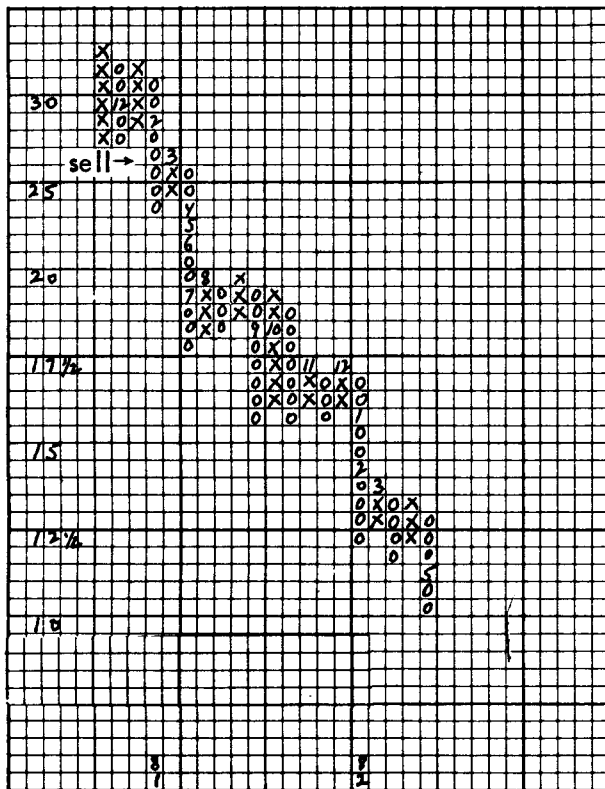
### International Business Machines (IBM)



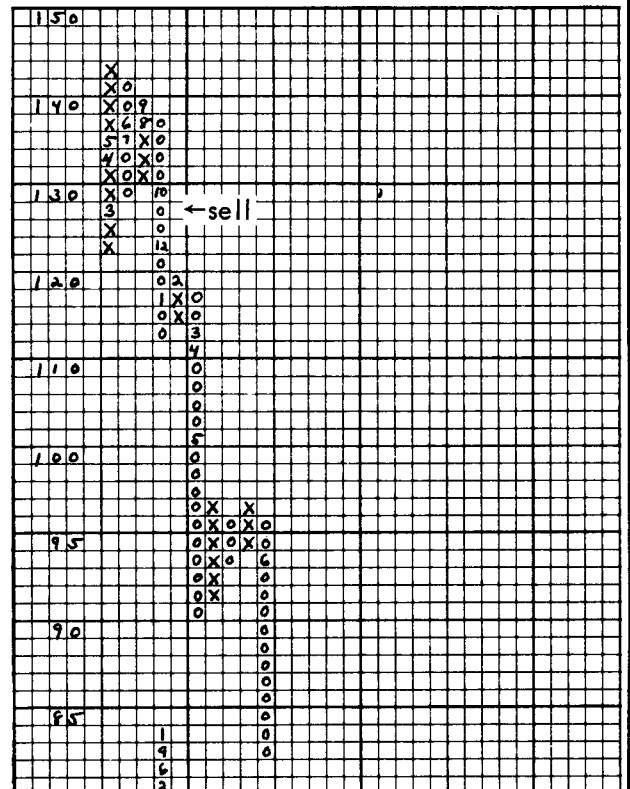
### International Rectifier (IRF)



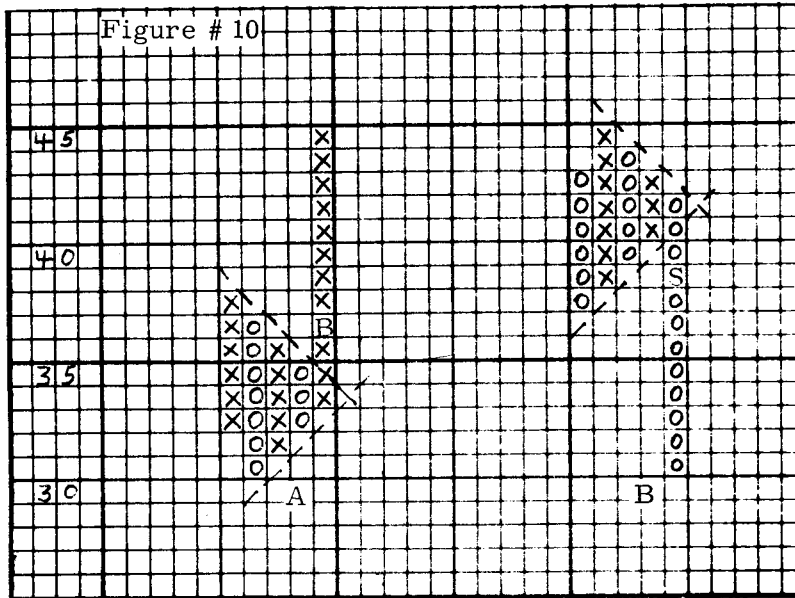
### Dravo Corp. (DRV)



### Union Carbide Corporation (UK)



## THE BULLISH AND BEARISH SYMMETRICAL TRIANGLES



The Bullish and Bearish Symmetrical Triangles are basically mere variations on the Bullish and Bearish Signal formations. However, since triangles have always occupied an important role in technical analysis, we have decided to deal with these two formations separately.

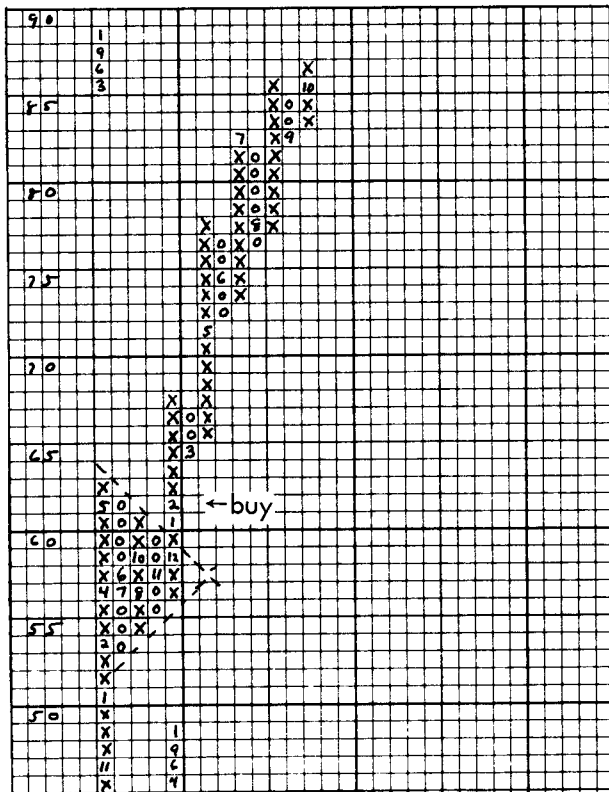
In example A, we have the Bullish Symmetrical Triangle formation. First, we should note the standard Bullish Signal formation of higher bottoms and higher tops. We see the bottom at 31 then a higher bottom at 33. We see a top at 36 then a higher top at 37. This higher top at 37, indicated by the letter B, gives the buy signal. The additional factor that makes a triangle out of this formation is the top at 38 and the lower top at 36. When trend lines are drawn from the bottom at 30 and from the top at 38, they form a symmetrical triangle.

In example B, we have the Bearish Symmetrical Triangle formation. Here, too, we should first note the regular Bearish Signal formation of lower tops and lower bottoms. We have a top at 45 then a lower top at 43. We have a bottom at 40 then a lower bottom at 39. The lower bottom at 39 gives the sell signal and is indicated by the letter S. The feature that makes this formation a triangle is the bottom at 38 and the higher bottom at 40. If trend lines are drawn from the bottom of 38 and the top of 45 they form a Symmetrical Triangle.

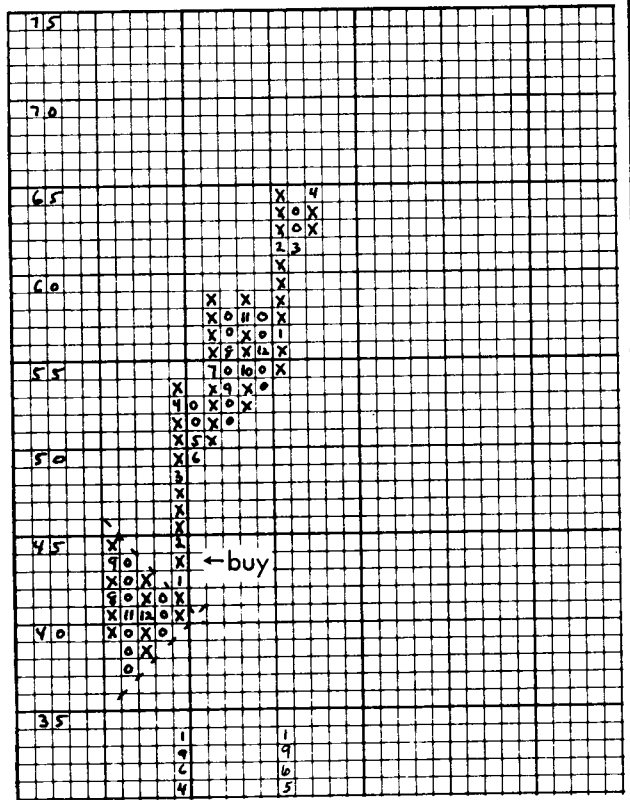
These Symmetrical Triangle formations require a minimum of five vertical columns. Variations can be worked out where they have seven vertical columns, nine vertical columns, or even more.

The Bullish Triangle formation is profitable 71.4% of the time for an average gain of 30.9%. The average time for the gain is 5.4 months. The Bearish Triangle formation is profitable 87.5% of the time for an average gain of 33.3%; the average time for the gain is 2.5 months.

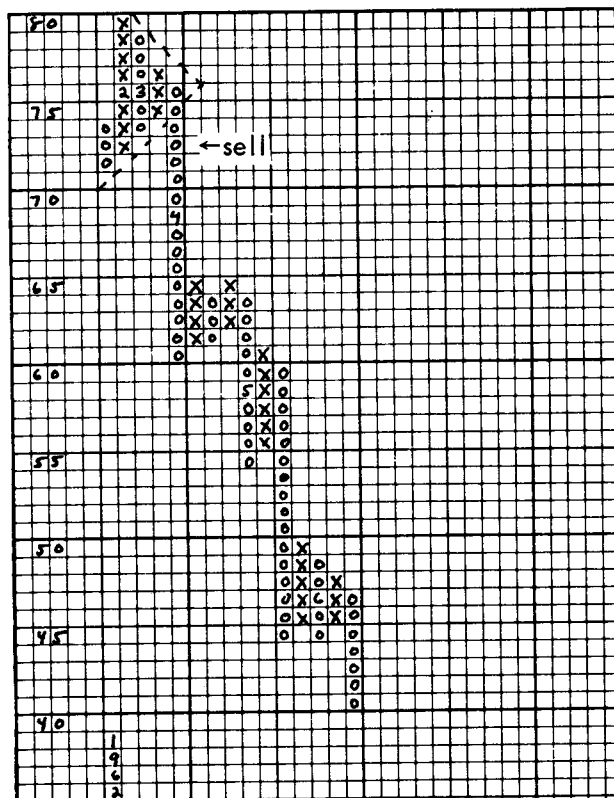
International Harvester (HR)



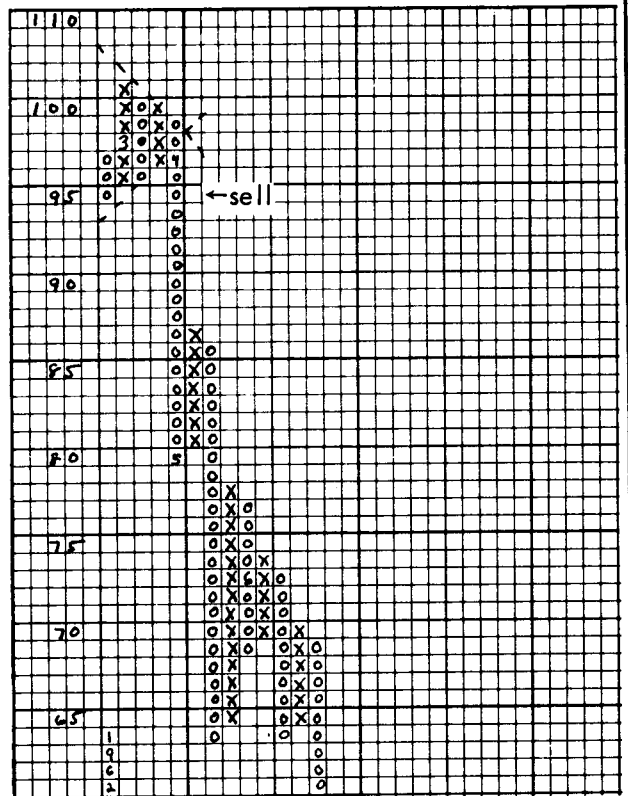
Georgia-Pacific Corp. (GP)



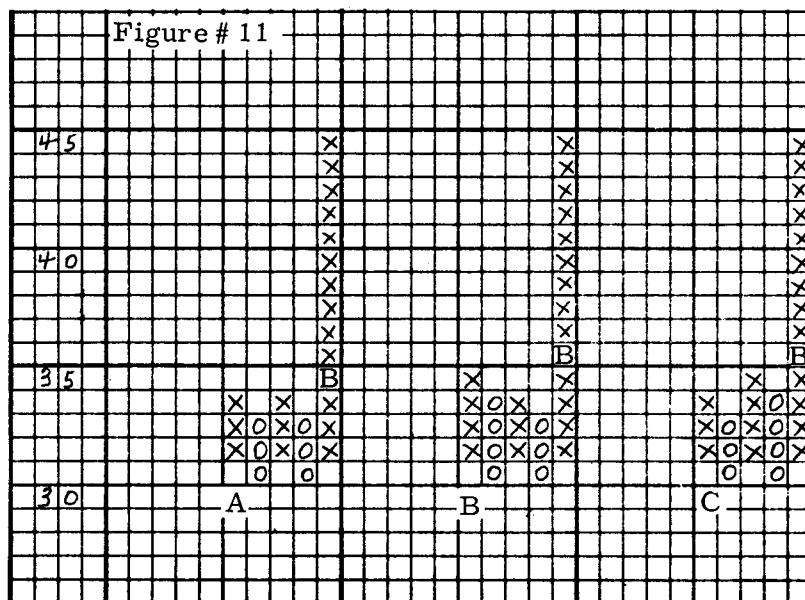
Reynolds (R.J.) Tobacco (RJR)



Richardson-Merrell (RXM)



## THE TRIPLE TOP FORMATION



The Triple Top formation is the second of the two classic chart patterns used in timing a stock purchase. Unlike the Bullish Signal formation, it is only the action of the stock at previous tops that is important, not at bottoms. No higher bottoms are necessary in this formation. All that is necessary is the penetration of two previous tops. The penetration of two previous tops by a third top compensates for the fact that the chart formation has no higher bottom. Because of the higher bottom in the Bullish Signal formation, the penetration of only one previous top was necessary. This formation must have a minimum of five vertical columns.

In example A, we see a base of accumulation between 31 and 34. There are two level tops at 34. The buy signal was given at 35 when these two tops had been penetrated. At this point Demand has overcome Supply and the extension of the upmove is to be expected.

In example B, we have a base of accumulation between 31 and 35. The first top is at 35 and the second top at 34. The buy signal was given at 36 when these two tops had been exceeded.

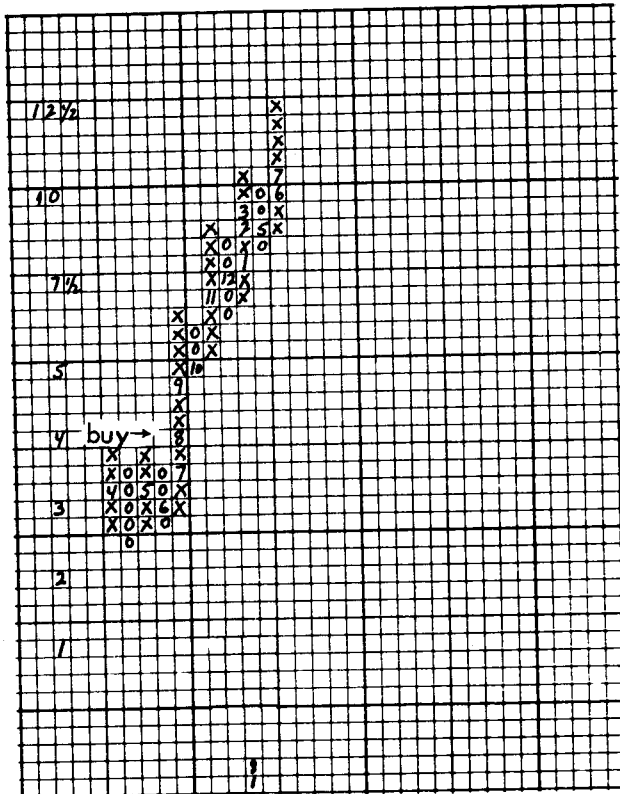
In example C, we have another base of accumulation between 31 and 35. However, here the first top is at 34 and the second top at 35. The buy signal was given at 36 when these two tops had been exceeded.

In none of the above examples have we higher bottoms. All of these formations have level bottoms at 31. We compensate for the lack of a higher bottom by waiting for the penetration of two previous tops.

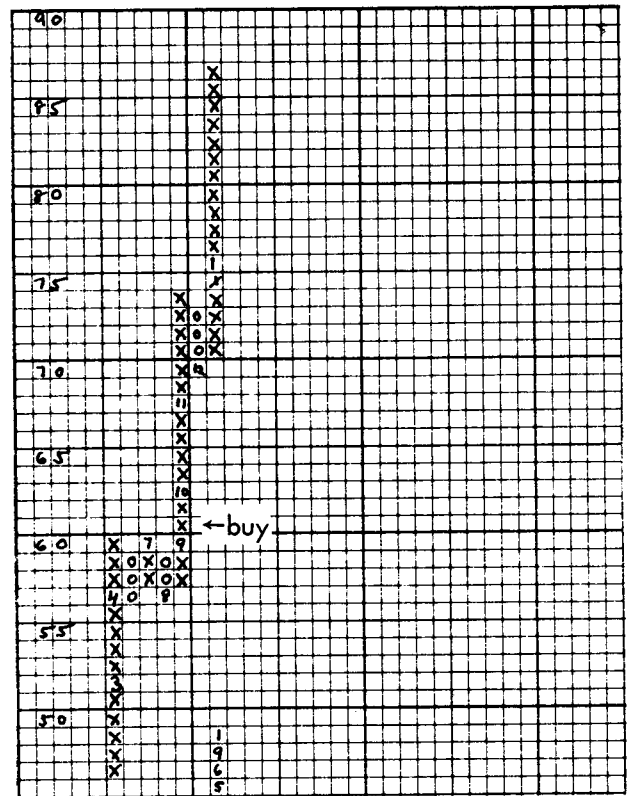
Examples B and C contain Double Top formations within them, but many traders wait for the Triple Top breakout.



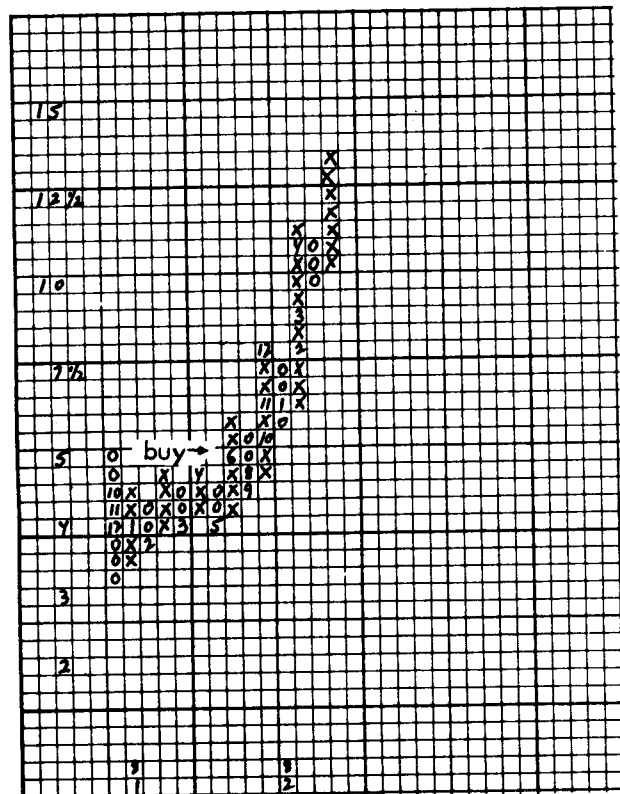
Hiller Aviation (HIL)



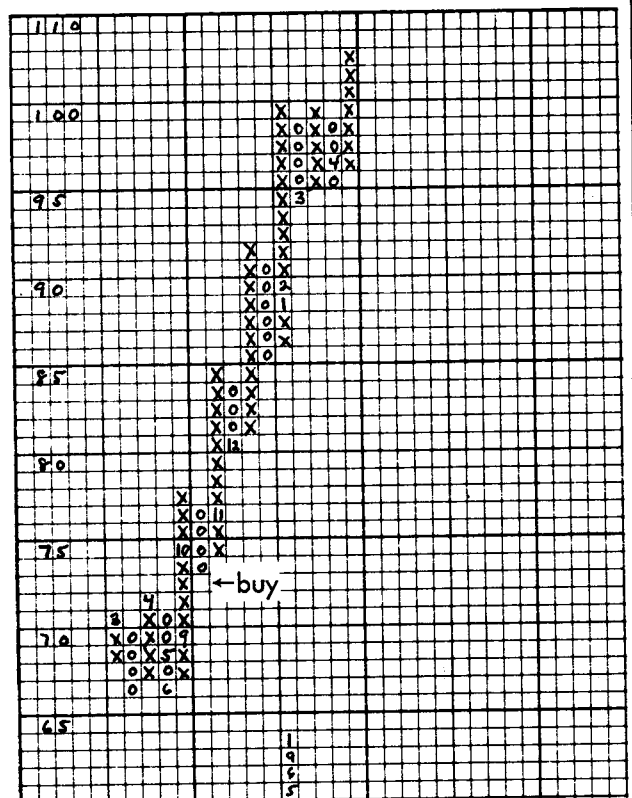
Howard Johnson (HJ)



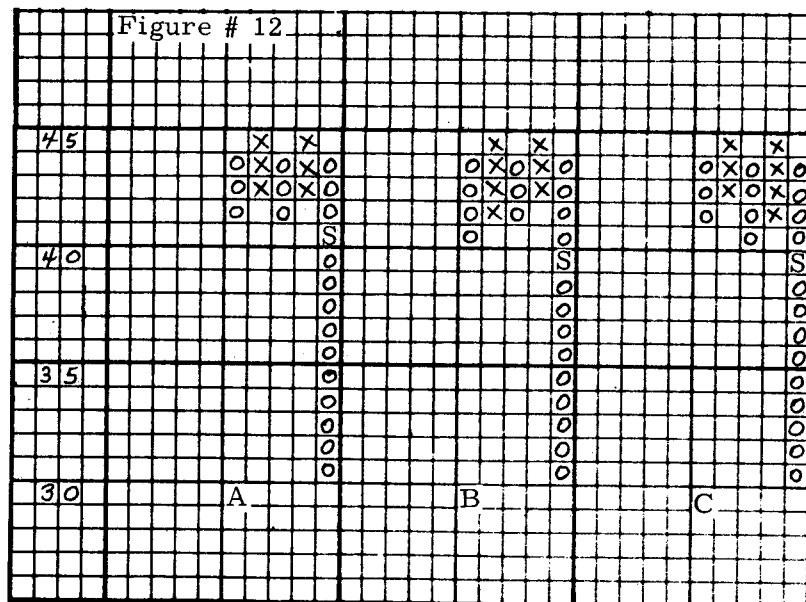
Ideal Toy Co. (ID)



Eastern Gas & Fuel (EFU)



## THE TRIPLE BOTTOM FORMATION



The Triple Bottom formation is the second classic chart pattern used in timing a stock sale. Unlike the Bearish Signal formation, it is only the action of the stock at previous bottoms that is important, not at tops. No lower tops are necessary in this formation. All that is necessary is the penetration of two previous bottoms. The penetration of two previous bottoms by a third bottom compensates for the fact that chart formation has no lower tops. Because of the lower top in the Bearish Signal formation, the penetration of only one previous bottom was necessary. This formation must have a minimum of five vertical columns.

In example A, we see a top distribution between 45 and 42. There are two level tops at 45. The sell signal was given at 41 when these two bottoms had been penetrated. At this point Supply has overcome Demand and an extension of the downmove is to be expected.

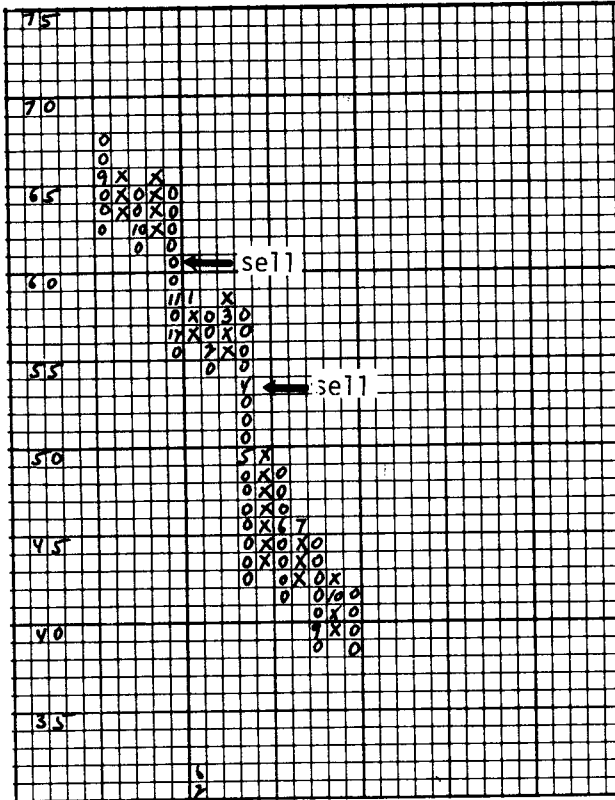
In example B, we have a top of distribution between 45 and 41. The first bottom is at 41 and the second bottom at 42. The sell signal was given at 40 when these two bottoms had been exceeded.

In example C, we have another top of distribution between 45 and 41. However, here the first bottom is at 42 and the second bottom at 41. The sell signal was given at 40 when these two bottoms had been exceeded.

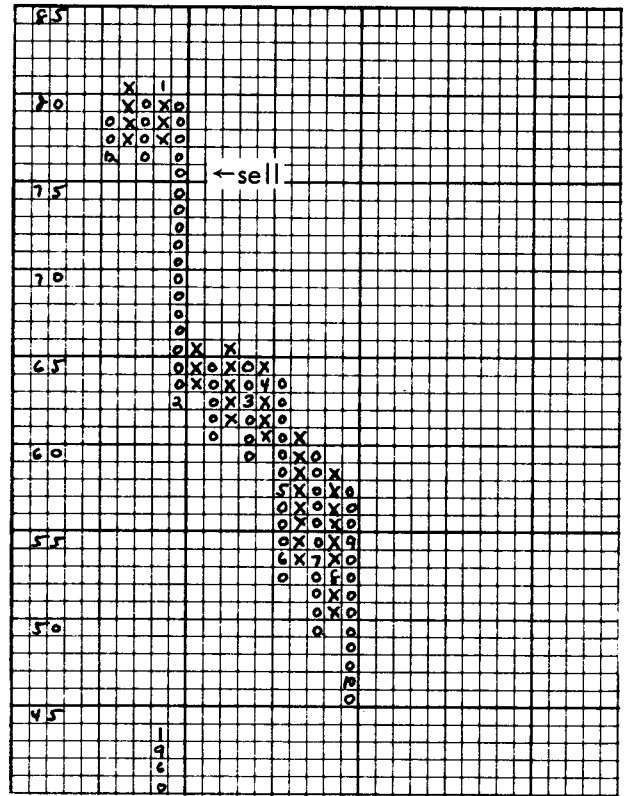
In none of the above examples have we lower tops. All of these formations have level tops at 45. We compensate for the lack of a lower top by waiting for the penetration of two previous bottoms.

Examples B and C contain Double Bottom formations within them, but many traders wait for the Triple Bottom breakout.

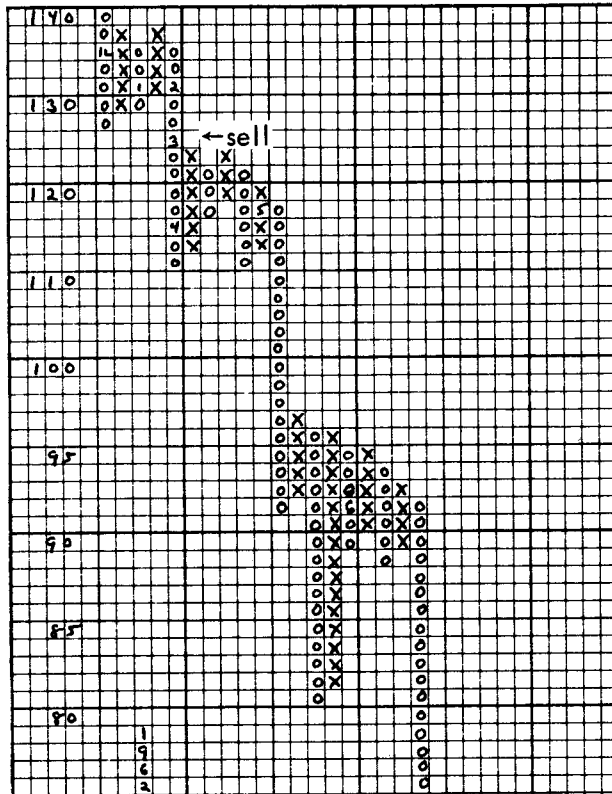
Manville Corp. (MAN)



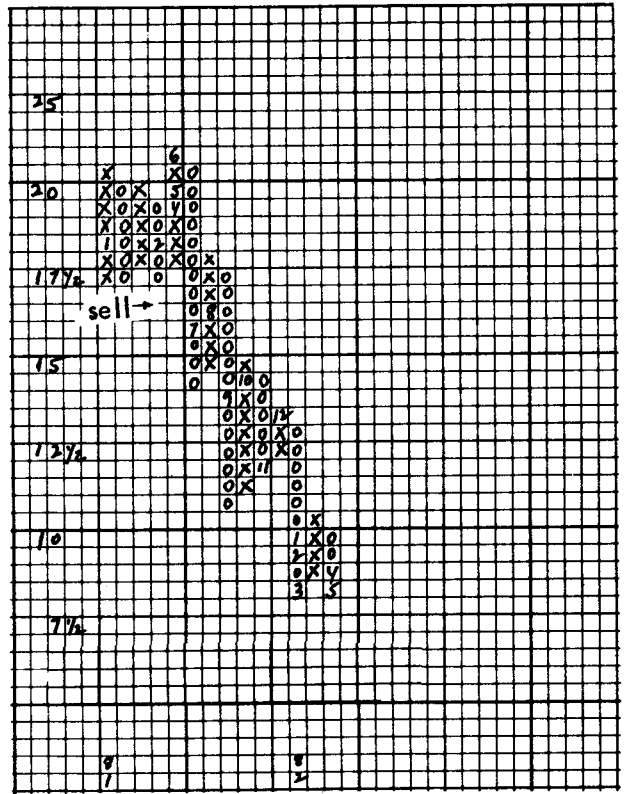
Pittston Company (PCO)



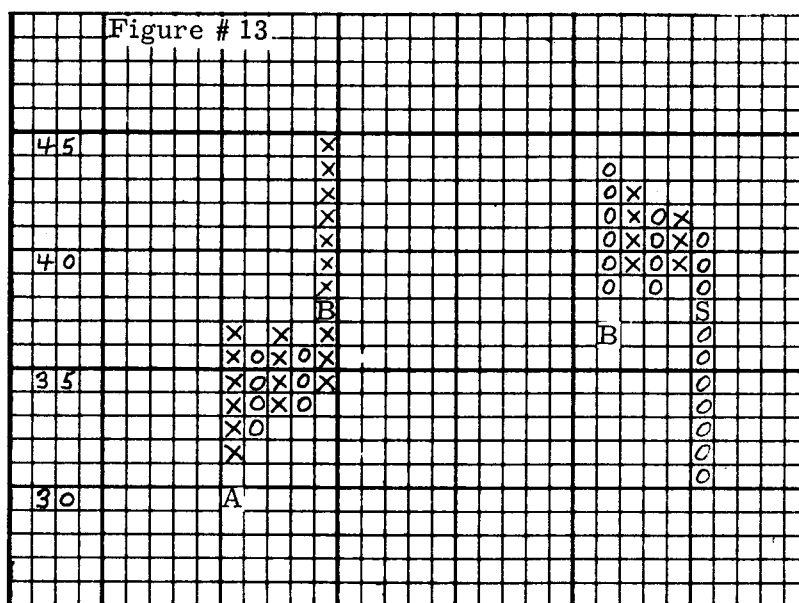
Rohm & Haas (ROH)



Mark Controls (MK)



## FORMATIONS IN COMBINATION

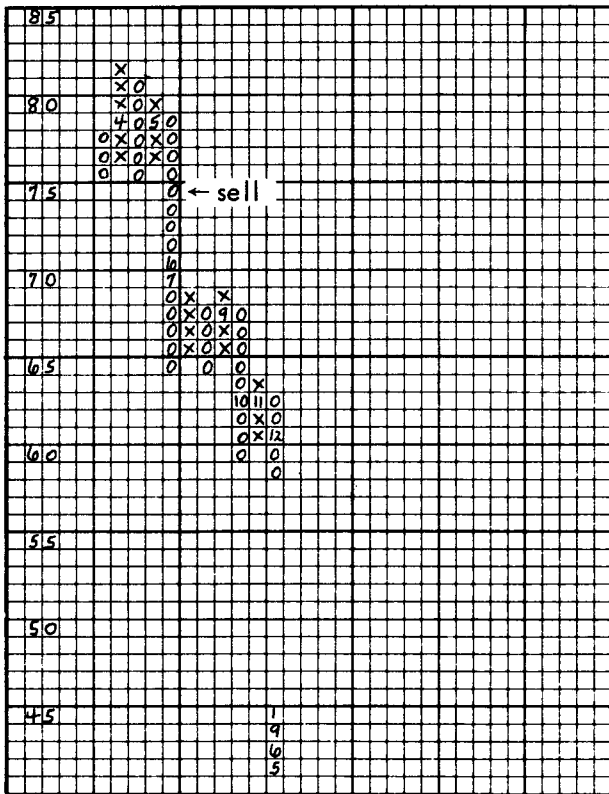


Example A is an illustration of both the Bullish Signal formation and the Triple Top formation combined into one. It contains the essential elements of both formations. It has both higher bottoms and higher tops plus the penetration of three tops. The buy signal which takes place at 38 (indicated by the letter B) is both a buy signal on a Bullish Signal formation and a Triple Top formation. This chart pattern occurs less frequently than either of the two separately, but when it does occur it is usually a very strong buy signal. This formation is profitable 79.5% of the time for an average gain of 36%. The average time for such gain is 8 months.

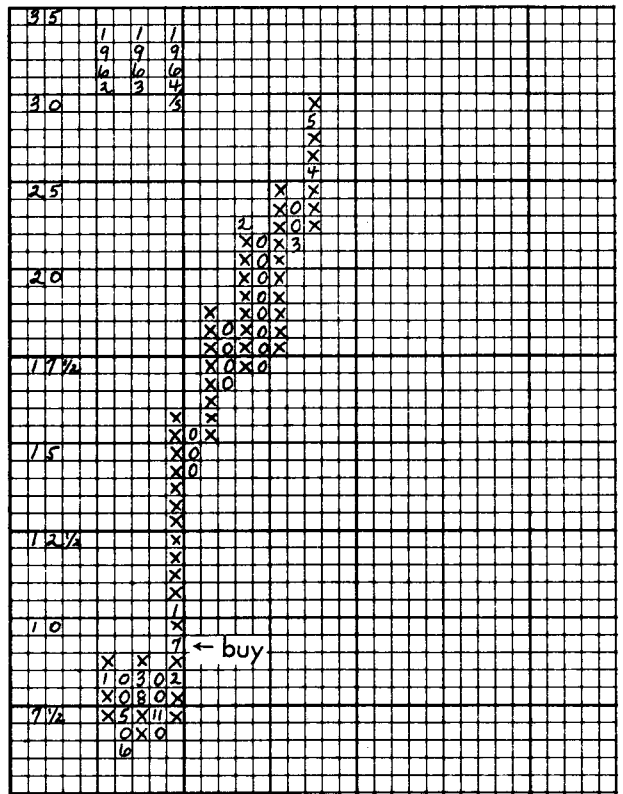
Example B is an illustration of both the Bearish Signal formation and the Triple Bottom formation combined into one. It contains the essential elements of both formations. It has both lower tops and lower bottoms plus the penetration of three bottoms. The sell signal which takes place at 38 (indicated by the letter S) is both the sell signal on a Bearish Signal formation and a Triple Bottom formation. This chart pattern occurs less frequently than either of the two separately, but when it does occur it is usually a very strong sell signal. It is profitable 83.3% of the time for an average gain of 22.9%. The average time for such gain is 3.4 months.

In both examples of this formation, a minimum of five vertical columns is necessary for its completion.

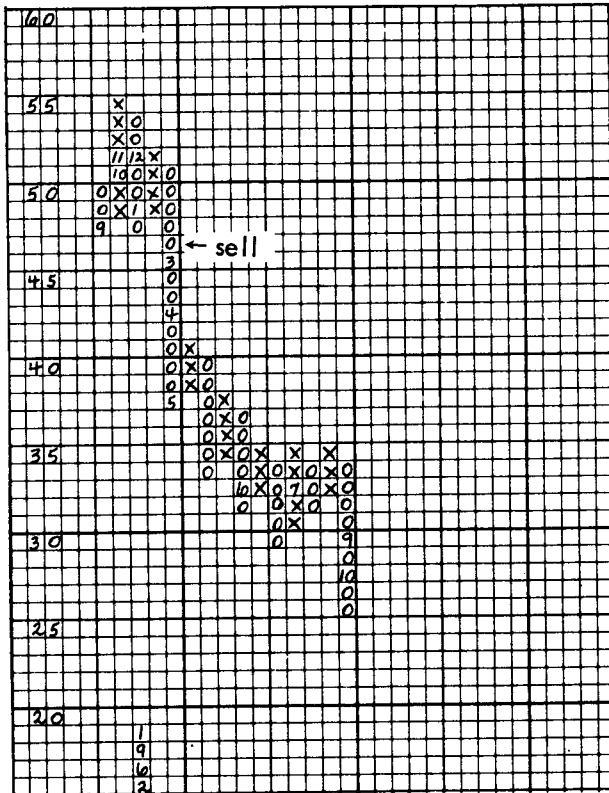
Allied Products (ADP)



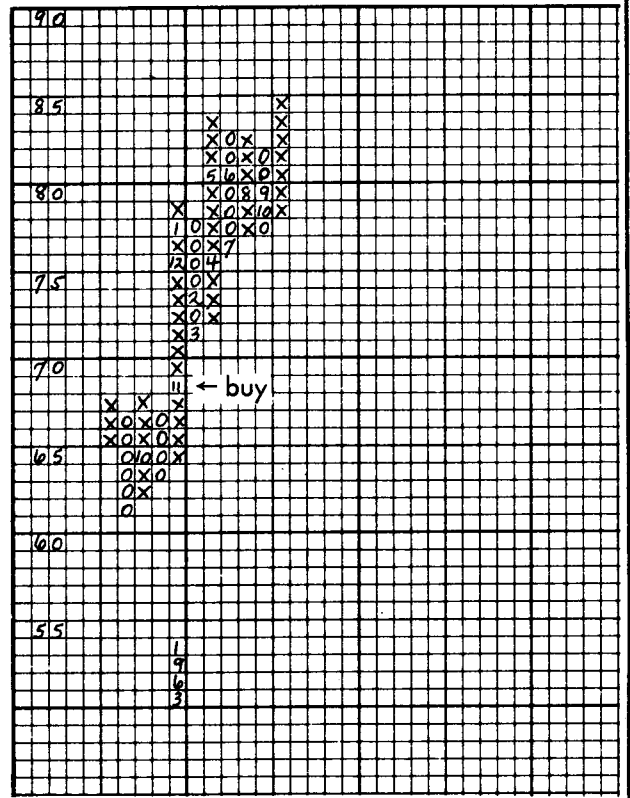
Aluminum Company of America (AA)



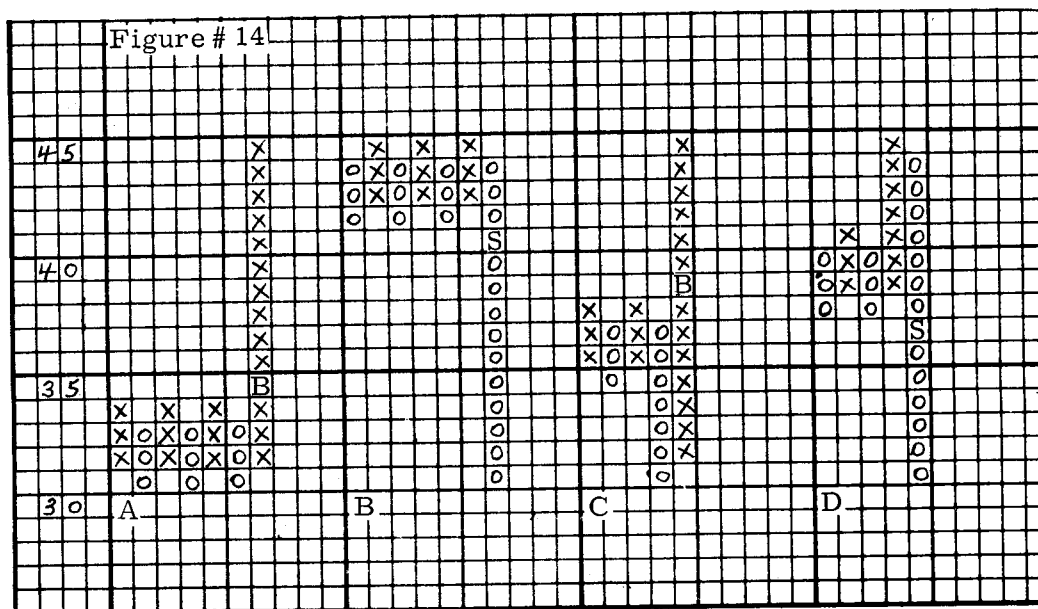
American Brand (AMB)



General Electric (GE)



## VARIATIONS ON THE TRIPLE TOP AND BOTTOM FORMATIONS



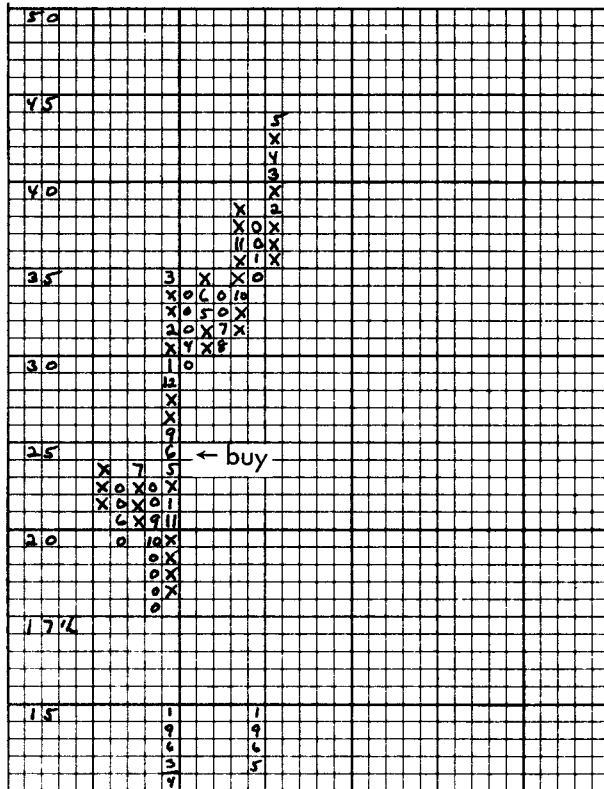
Example A shows the upside penetration of not merely three tops but actually four tops. Sometimes you may have a penetration of five or more tops. From a timing point of view, this has no more significance than the penetration of merely three tops. The stock cannot be bought until the penetration occurs and it occurs at the same point no matter how many previous tops are penetrated. The difference in the formation is important when trying to estimate the extent of the subsequent move. We will deal with this more fully when we discuss the various "counts" to estimate the probable extent of the move. But brief mention should be made of this here. Since you have more vertical columns in this variation of the Triple Top formation, any horizontal count across the formation will necessarily show a greater potential upmove.

Example B shows the penetration of not merely three bottoms, but actually four bottoms. Everything we said above about example A applies to example B, but in reverse, of course.

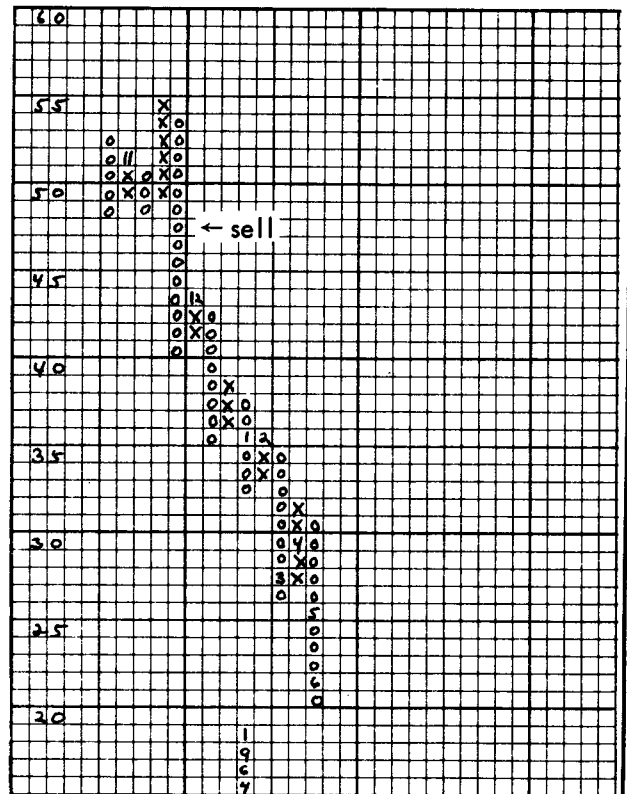
Example C shows a Triple Top formation with a long "tail" down. Note the downmove in the fourth vertical column before the final upmove in the fifth column to give the buy signal on the penetration of the Triple Top. This formation also occurs frequently in chart patterns. It is an unusually strong formation. The reason for this is that what at first appears to be a heavy overhanging supply of stock (between 35 and 38) was not actually so. There actually was no supply of stock to interrupt the upward move towards the breakout. The long "tail" down was not due to an overhead supply but, perhaps, to some news factor that was interpreted incorrectly (or sometimes even to some misleading news), or to some dramatic international or national event also incorrectly interpreted for the moment. The move up after such a happening is usually very dynamic and profitable.

Example D shows a Triple Bottom formation, with a long "tail" up. Everything that was said about example C applies to this example as well but in reverse, of course.

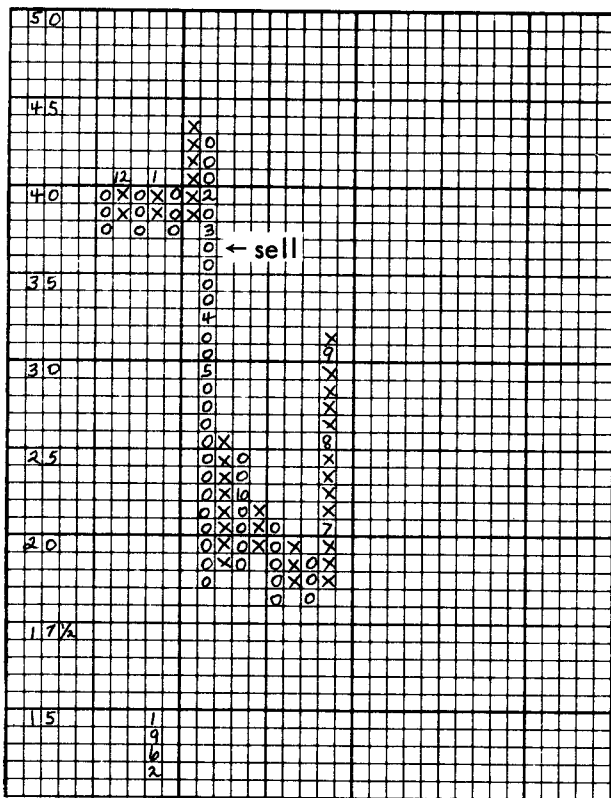
Beaunit Corp. (BEM)



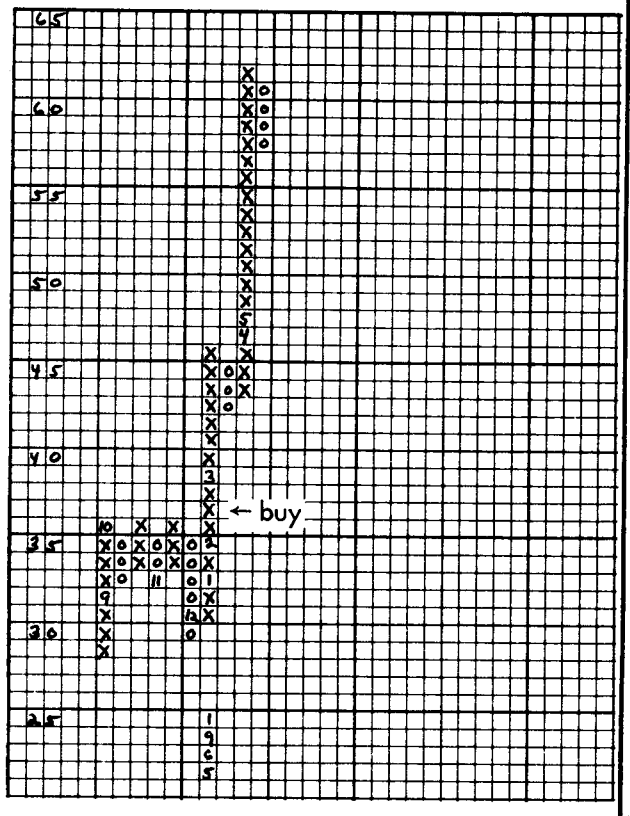
Fairchild Camera & Instrument (FCI)



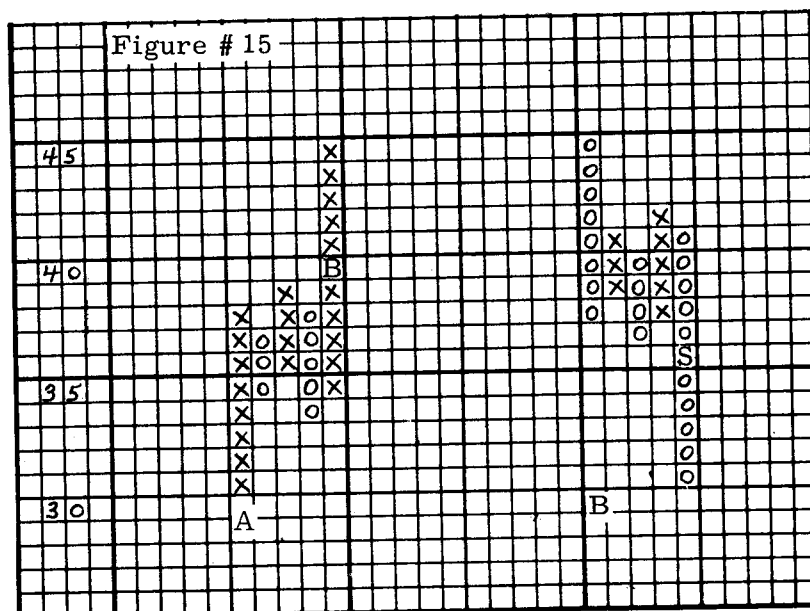
Thiokol Chemical Corp. (THI)



Vornado (VNO)



## THE BROADENING FORMATION



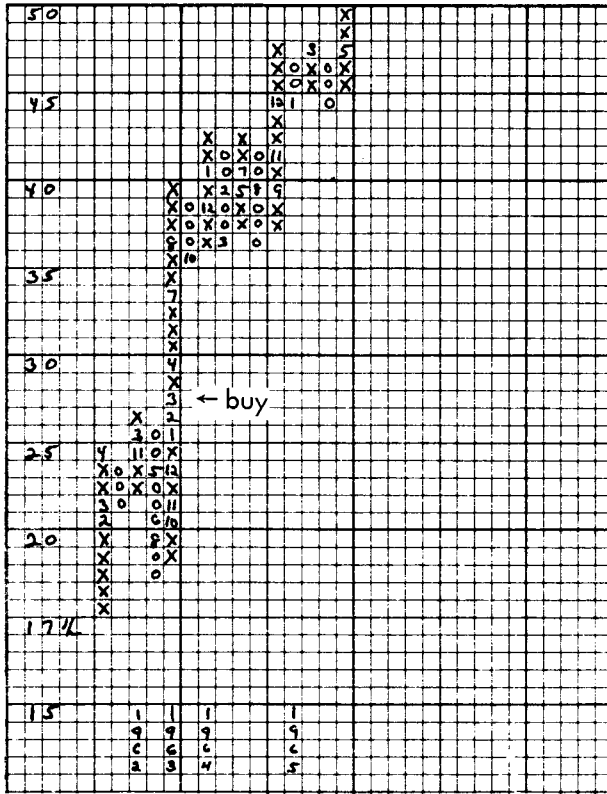
The chart patterns in Figure # 15 are actually a Triple Top formation in example A and a Triple Bottom formation in example B. In example A, we have the penetration of three tops with the buy signal at 40. In example B, we have the penetration of three bottoms with a sell signal at 36. But they have a certain characteristic about them which singles them out for special attention.

In example A, the breakthrough on the Triple Top takes place as follows: 1) We have the first top at 38. 2) Then we have the first bottom at 35. 3) The second top takes place at 39, at a higher level than the first top. 4) The second bottom takes place at 34, at a lower level than the first bottom. 5) And finally we have the breakout at a higher top at 40. We have a broadening price pattern: a top followed by a bottom, then a higher top and a lower bottom, and finally the upside breakout on a still higher top. These five points must be kept in mind in distinguishing this Triple Top formation from the usual Triple Top formation. It occurs most frequently not at the bottom of an up-move, but during an upmove which already may have gone a long way. This type of formation is usually classified as a "blow-off" formation by bar-chartists and, therefore, bearish. In Point and Figure charting, however, it has always proved to be very bullish as the so-called "blow-off" usually occurs at a much, much higher level and thus allows for a handsome profit. This variation on the Triple Top formation does not occur too frequently. It should be watched for very carefully and taken advantage of when it does occur. This broadening bullish pattern and the Triple Top with the long "tail" down can be classified as the best of the Triple Top formation.

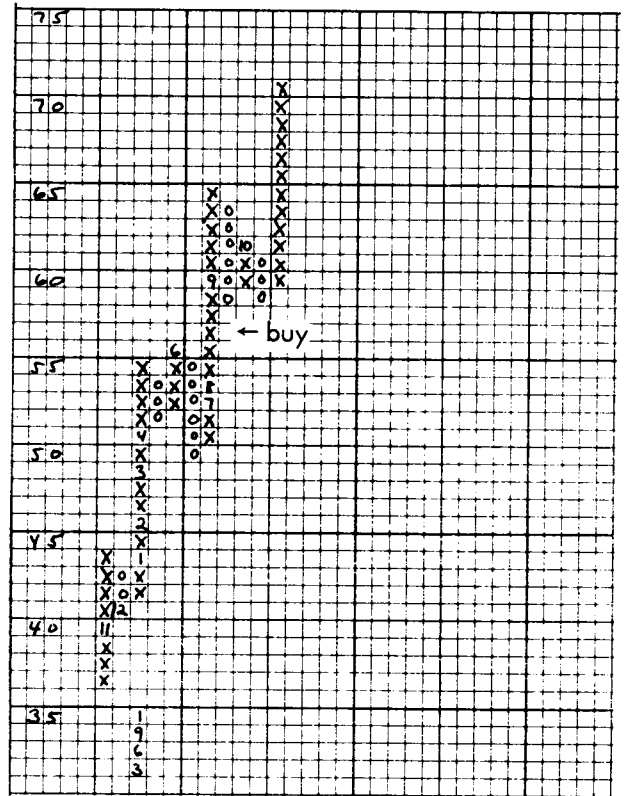
Example B is the same broadening type of formation with the breakout on the downside. It goes from a bottom at 38 to a top at 41, then a lower bottom at 37, and a higher top at 42, then the final breakdown on the third lower bottom at 36. This bearish formation occurs so infrequently that it is not worthwhile looking for. In a bear market, the ordinary Triple Bottom formation serves the purpose very well (here, too, the best of the Triple Bottom formations, is the one with the long "tail" up).



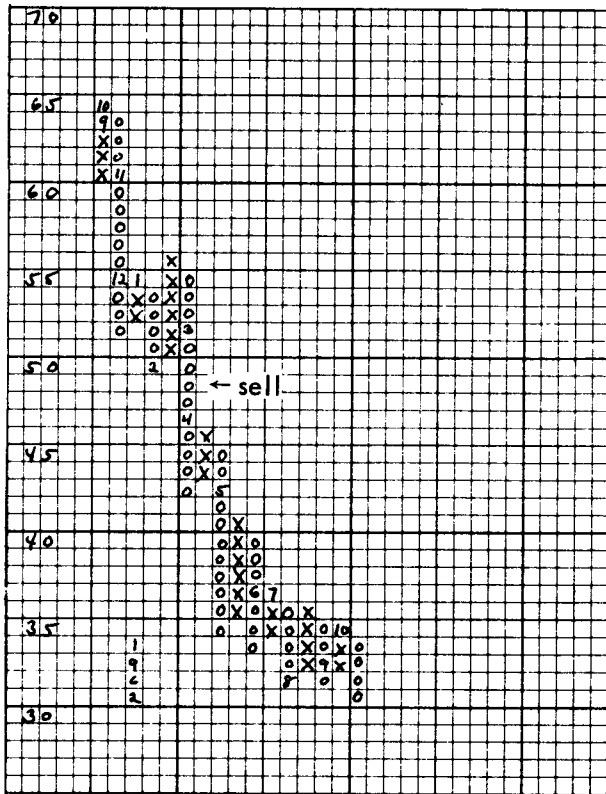
Abbott Laboratories, Inc. (ABT)



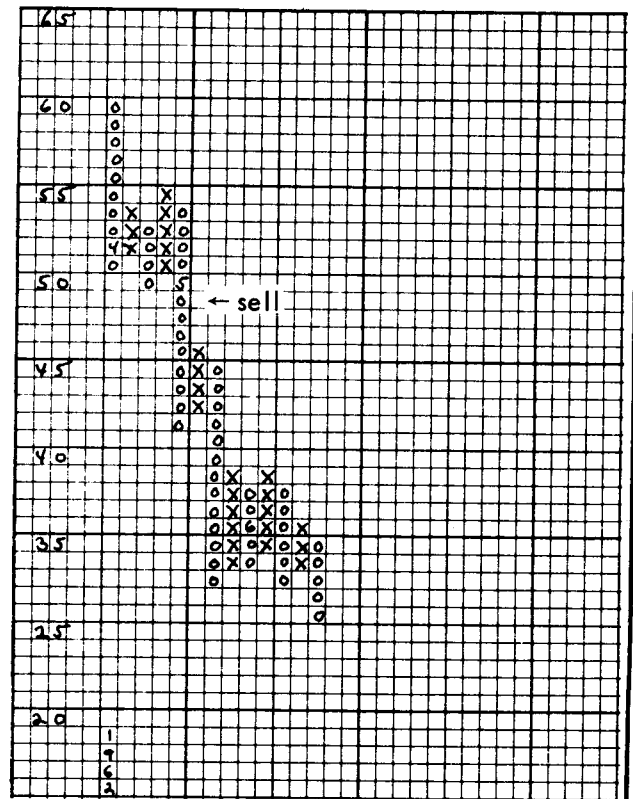
Honeywell, Inc. (HON)



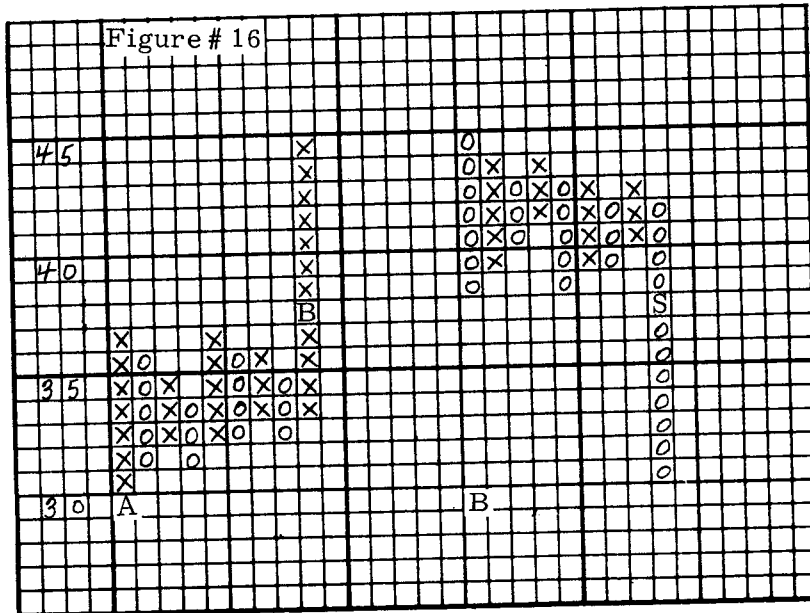
Marquette Cement Mfg. (MQC)



Universal Oil Products (UOP)



THE SPREAD TRIPLE TOP AND BOTTOM FORMATIONS



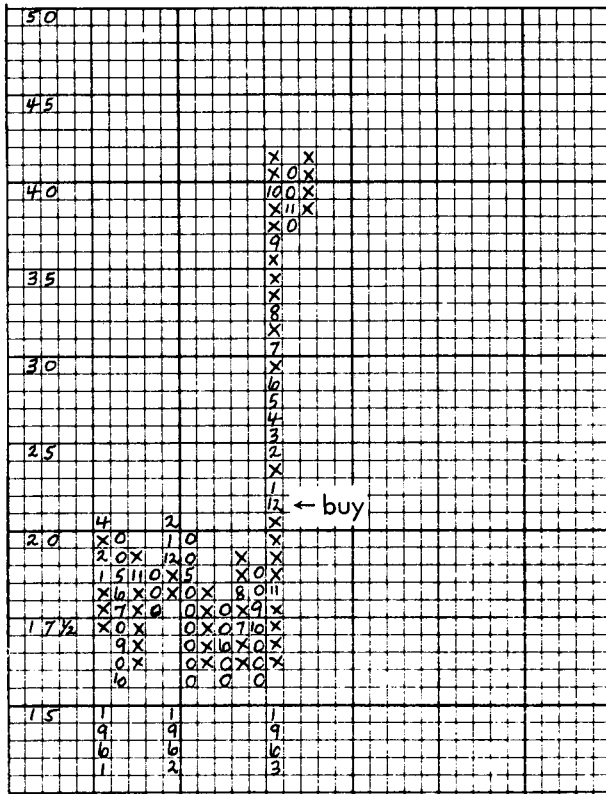
Example A illustrates the Spread Triple Top formation. This is a very broad formation and can have any number of vertical columns in it, from six up. The buy signal takes place on the penetration of three level tops. These tops are not consecutive but have intervening moves between them. In the example above the three tops are at 37 and the buy signal is at 38 (indicated by the letter B).

Example B illustrates the Spread Triple Bottom formation. This is a very broad formation and can have any number of vertical columns in it, from six up. The sell signal takes place on the penetration of three level bottoms. These bottoms are not consecutive but have intervening moves between them. In the example above, the three bottoms are at 39 and the sell signal is at 38 (indicated by the letter S).

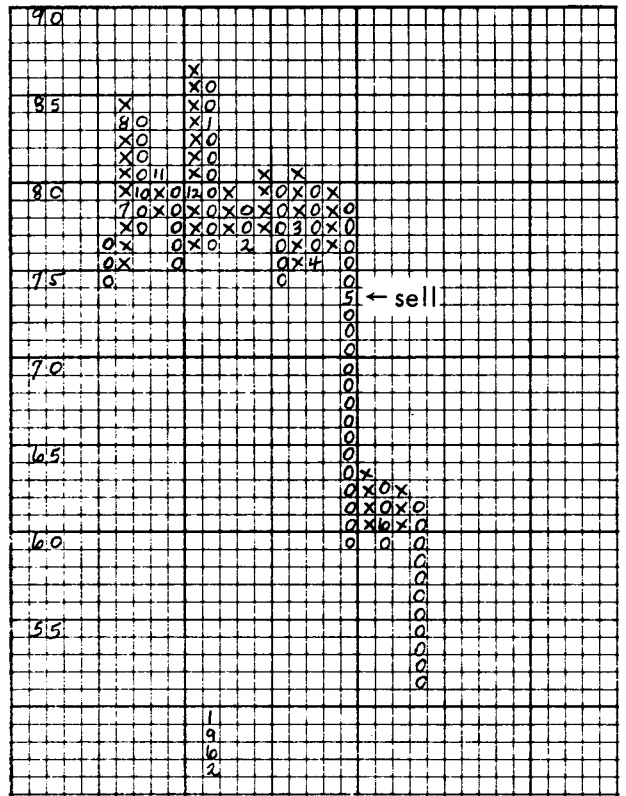
In both of these formations buy and sell signals on other formations may have occurred during the building of the chart patterns. The time involved in building a Spread Triple Top or Bottom formation is usually much longer than in the chart formations heretofore discussed. It may take from several months to several years. (See charts on facing page.) In the chart of Columbia Broadcasting the first top took place in April 1961 and the buy signal in December 1962. In the chart of J. C. Penney, the time elapsed was from February 1962 to March 1964. On the sell side of the market, a lesser period of time is usually involved.

Both of the above formations, contain Double Top and Double Bottom patterns within them. However, many traders prefer to wait for the final breakout.

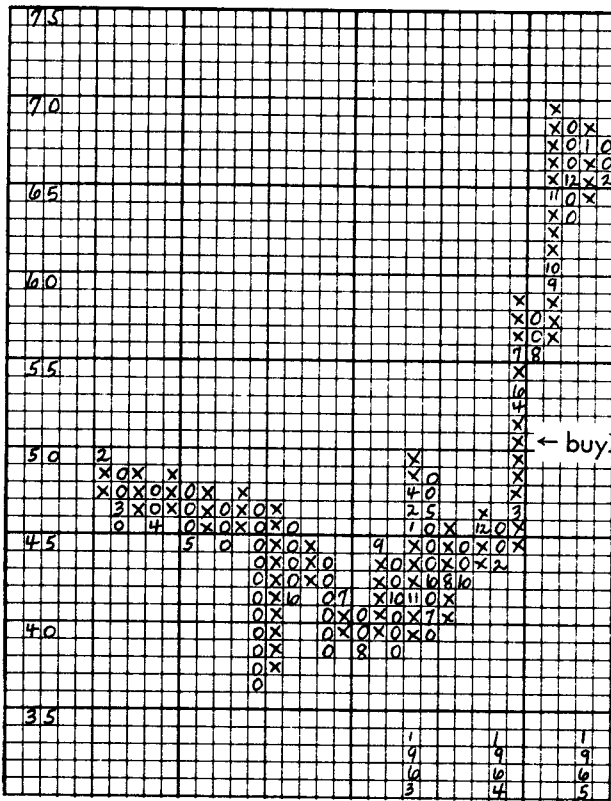
Columbia Broadcasting System (CBS)



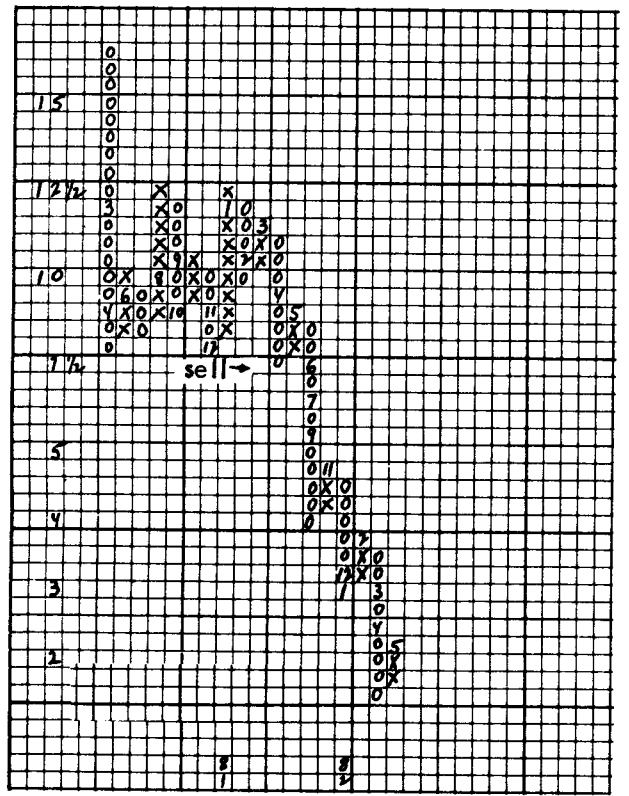
Inco Ltd. (N)



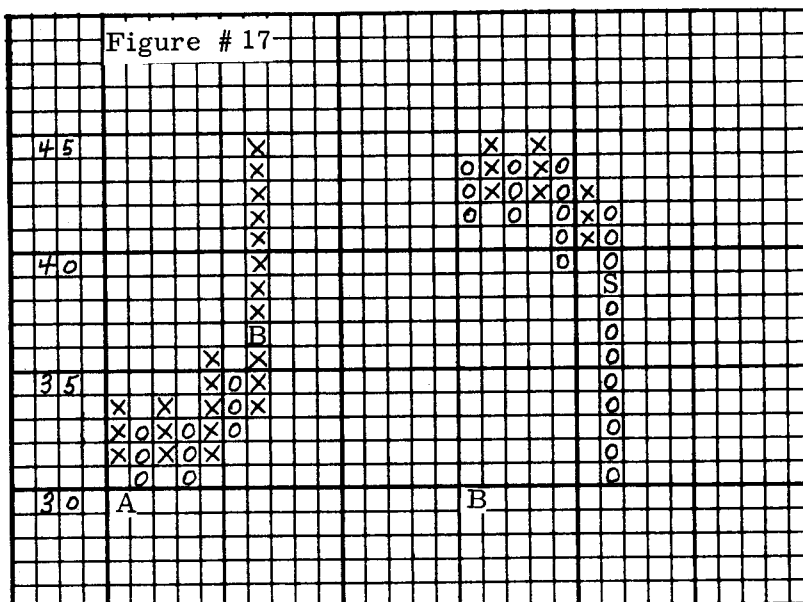
J. C. Penney (JCP)



Telecom Corp. (TEL)



## BULLISH AND BEARISH CATAPULT FORMATIONS



Example A is an illustration of the Bullish Catapult formation. This formation starts with the classical Triple Top formation. Note the original buy signal at 35 on a Triple Top formation. Instead of proceeding straight upwards, it only rallied to 36 and then pulled back three points. The stock then proceeded to rally once more and exceeded its previous high at 36. When it does this, it registers a new buy signal (indicated by the letter B at 37).

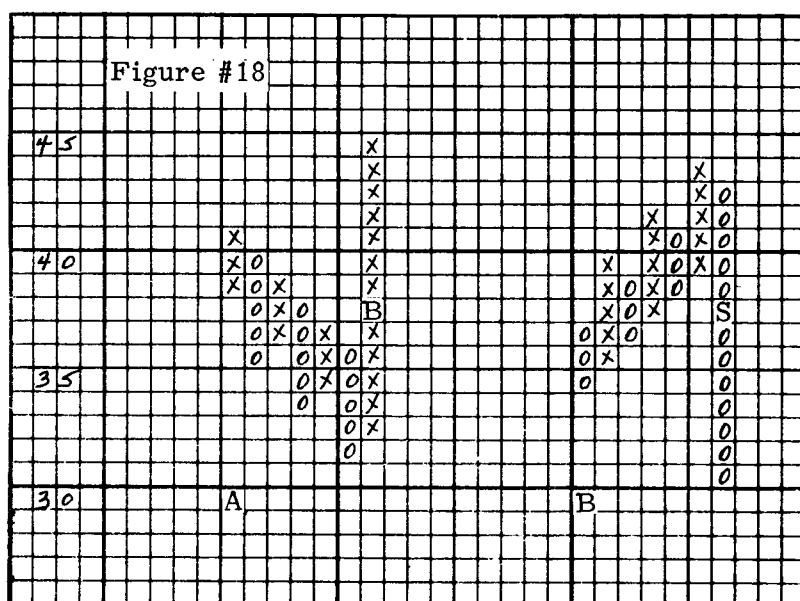
Example B is an illustration of the Bearish Catapult formation. This formation starts with the classical Triple Bottom formation. Note the original sell signal at 41 on a Triple Bottom formation. Instead of proceeding straight downwards, it only declines to 40 and then pulls back three points. The stock then proceeded to decline once more and penetrated its previous bottom at 40. When it does this, it registers a new sell signal (indicated by the letter S at 39).

To qualify as a Bullish or Bearish Catapult formation the move from the original breakout, whether up or down, cannot exceed seven points. Neither can the pullback from the original breakout decline below a previous bottom in the Bullish Catapult formation or exceed a previous top in the Bearish Catapult formation. If either of these two happen, then there is no possibility of this type of formation.

These formations occur about 50% of the time after an original Triple Top or Triple Bottom formation. It is often worthwhile to wait for such a chart pattern to save time that may elapse in waiting out a pullback. It is sometimes better to sacrifice a number of points for the sake of better timing and less risk.



THE BEARISH AND BULLISH SIGNAL REVERSED FORMATIONS

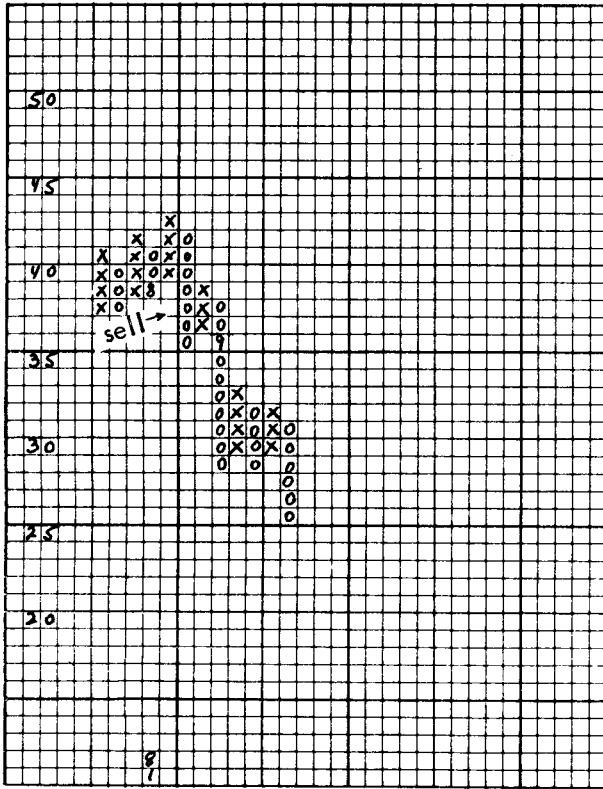


In example A, the Bearish Signal Reversed formation, we start with a perfect Bearish Signal formation. However, instead of consisting of merely four vertical columns, it contains seven vertical columns. The first six columns give us the classic pattern of lower tops and lower bottoms. The seventh column, however, shows a price reversal by a steady influx of demand without forming any sort of a base of accumulation. Because of this unexpected reversal, the buy signal takes place at 38, the first time the price penetrated a previous top. The momentum of this straight upward reversal in the seventh column usually carries far enough in the same direction to yield a substantial profit.

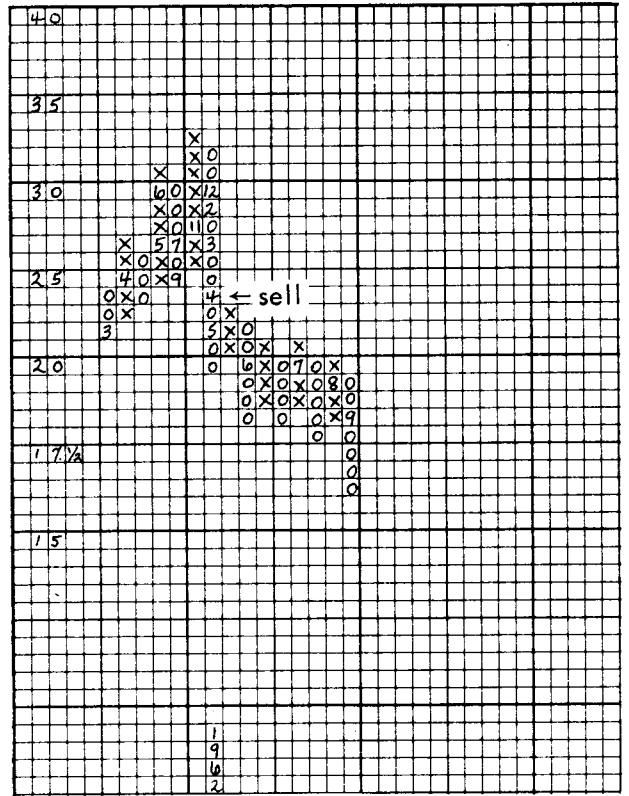
In example B, the Bullish Signal Reversed formation, we start with a perfect Bullish Signal formation. However, instead of consisting of merely four vertical columns, it contains seven vertical columns. The first six columns give us the classic pattern of higher bottoms and higher tops. The seventh column, however, shows a price reversal by a steady influx of supply without first forming a top of distribution. Because of this unexpected reversal, the sell short signal takes place at 38, the first time the price penetrated a previous bottom. The momentum of this straight downward reversal in the seventh column usually carries far enough in the same direction to yield a substantial profit.

Both of these formations usually prove most profitable. They do not occur too often, but they should be taken advantage of when they do happen.

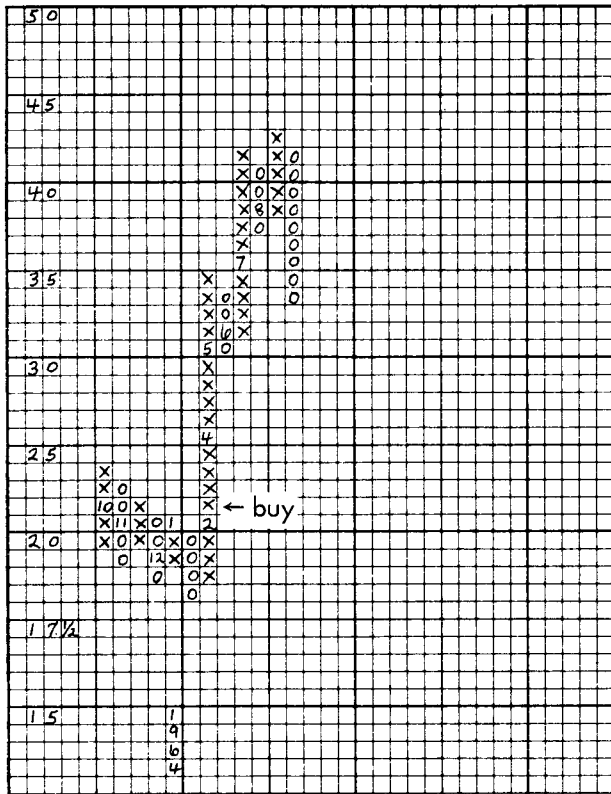
GCA Corp. (GCA)



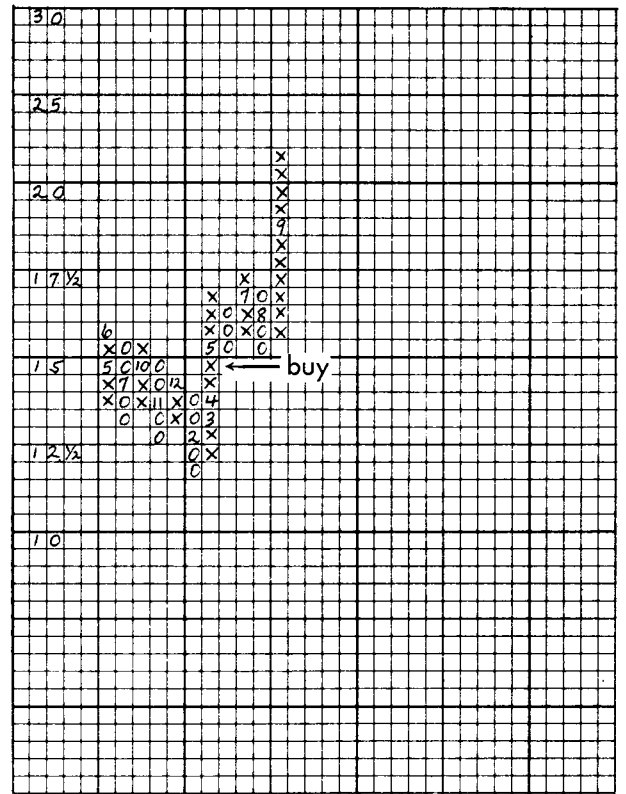
Kendall Company (KEN)



United Artists (UNA)



Warner Brothers Pictures (WB)



In the previous pages, we have dealt with the most common trading formations that occur both in bull and bear markets. We have by no means exhausted all their possible combinations and permutations. Recognizing trading formations is just a matter of study and practice. The more you study charts the more formations you will discover. Some may prove to be more profitable than others. You will probably find some new chart patterns on your own. If you chart enough stocks, you may be able to limit your own trading to one or two formations that you think best.

We must warn you, however, that chart patterns are not always in themselves guarantees of successful trades. You have probably heard of "false" breakouts. A breakout from a base of accumulation does not automatically guarantee a profit on the long side of the market; nor does a breakout from a top of distribution automatically guarantee a profit on the short side of the market. There are other technical factors that have to be taken into consideration.

In the next section of this book we deal with one of these factors, namely, trend lines. The importance of trend lines cannot be overemphasized. It is one of the most important tools that can be used in recognizing and avoiding "false" breakouts.



## SECTION THREE

### TREND LINES

The chart patterns discussed in Section Two are but the first step in deciding whether a stock should be bought or sold. The next step is to determine whether or not the signals they are giving are in agreement with the basic trend in the stock. And this is where trend lines assume their importance.

The two most important trend lines to watch are:

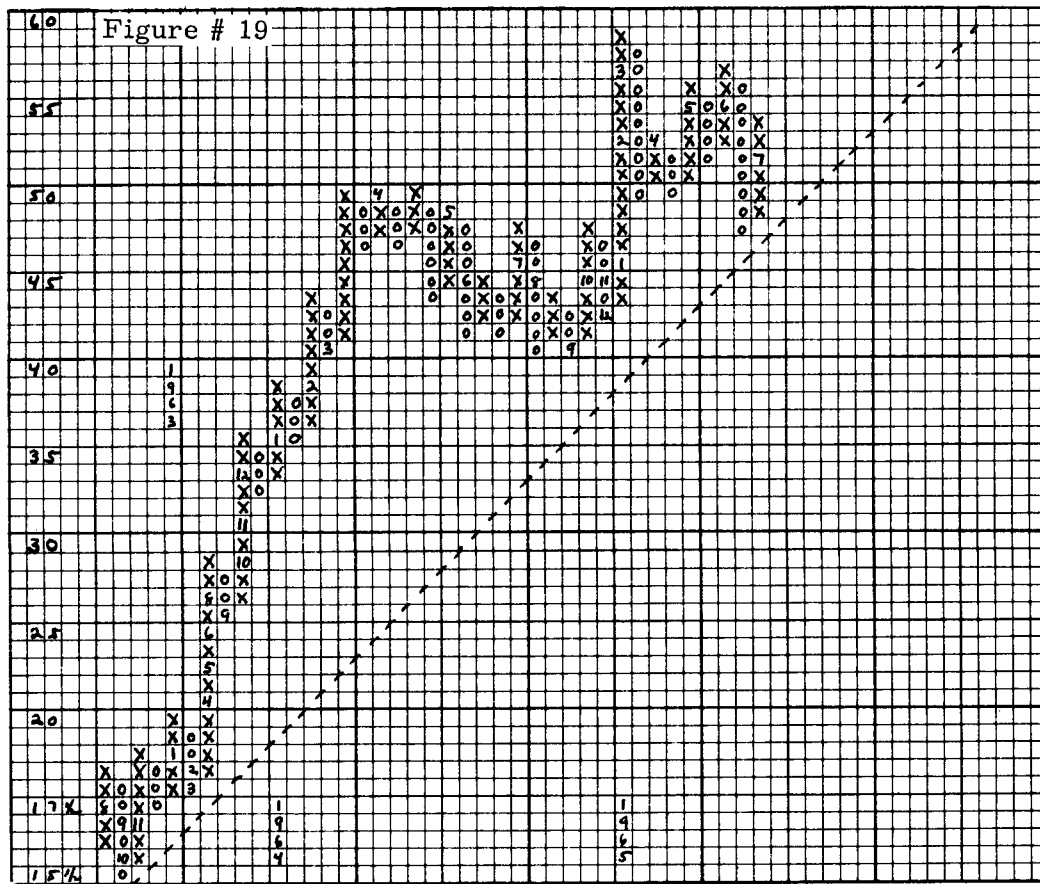
- 1) The basic Bullish Support Line
- 2) The basic Bearish Resistance Line

The subsidiary trend lines are:

- 1) The minor Bullish Resistance Line
- 2) The minor Bearish Support Line

The following pages are devoted to a discussion of the importance of these trend lines and their proper functions will be illustrated in actual stock charts.

## THE BULLISH SUPPORT LINE

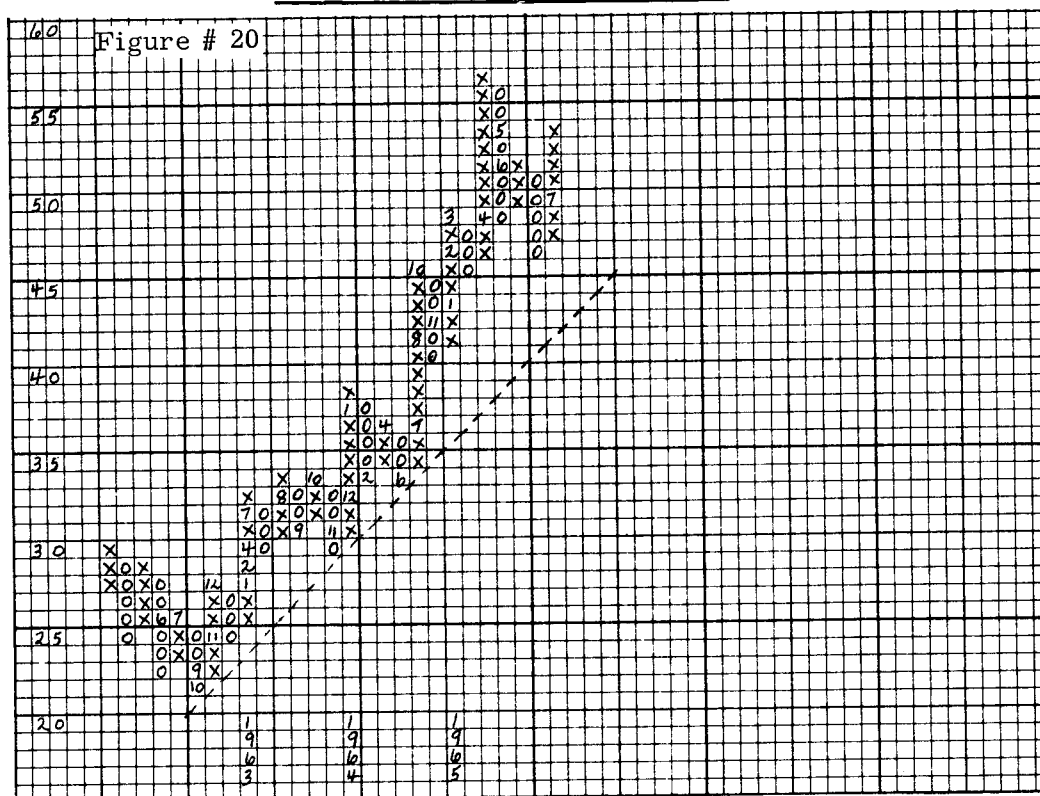


The chart of American Airlines shows a low of  $15\frac{1}{2}$  in October 1962. Its first buy signal was given in November at 19 on a Double Top formation and its second in January 1963 at  $19\frac{1}{2}$  on a Bullish Signal formation. A Bullish Support Line may now be drawn. It is indicated by the broken line on the chart. It is drawn from the square below the October low and is extended as far to the right as the chart paper will allow.

This line does not connect points. It is a line drawn from the lowest point made after the completion of a bear market or a significant downmove. It intersects successive ascending corners of the squares on the chart. It is a predictive line because it can be drawn immediately when an uptrend begins and one does not have to wait to connect bottoms. This line rarely has to be changed. A line connecting points constantly has to be revised as its points change. There is no rationale either behind a trend line connecting points or one drawn in this manner. Both are different methods of drawing a straight line. In a 3-box reversal point and figure chart, this type of line gives better results than a line connecting points.

As you can see in the above chart, the Bullish Support Line was not changed once. As long as the chart pattern remains above this line, the stock is long term bullish. Once this line is finally penetrated on the downside all bullish positions in the stock should be closed out. A long term trader can stay with a stock as long as the Bullish Support Line is not violated. Any sell signals given above this line are apt to prove false, especially if given close to the line. It is best not to take any short positions as long as the chart pattern remains above this line. This rule can only be violated by a "scalper" who goes for a point or two.

## THE BULLISH SUPPORT LINE



In the above chart of Bausch & Lomb we have an October 1962 low at 22 followed by higher tops and higher bottoms with a buy signal at 29 in February 1963. We are now ready to draw the Bullish Support Line. Again it is drawn connecting each successive corner of the square above from the lowest point.

The Bullish Support Line in this illustration shows how, on several occasions, the price came down to the line and then bounced right off it. This happened in November 1963 and in June 1964. (In January 1963, it actually gave a false sell signal on a Double Bottom formation).

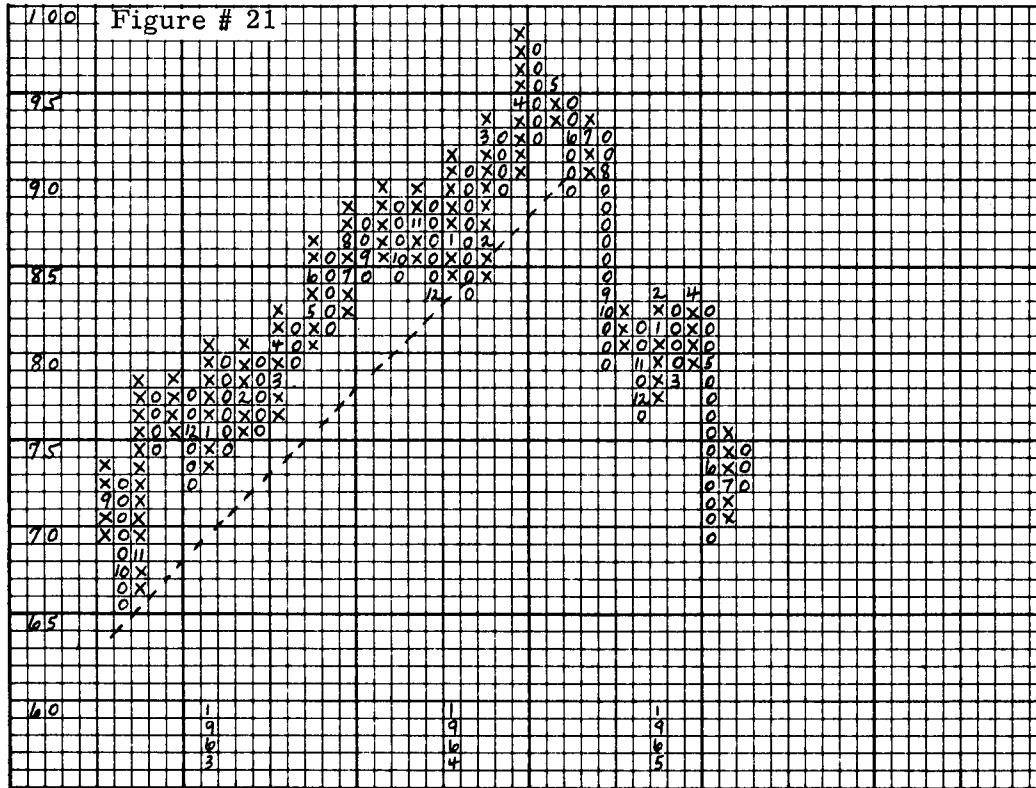
This chart points out two important factors: 1) don't take a sell signal close to the Bullish Support Line and, 2) the touching of the Bullish Support Line can, if one so desires, be used as an additional buy point. If one uses such action as an indication of an additional buy point, then one should place a stoploss order immediately beneath the trend line.

In this case, too, the long investor can keep his long position as long as the price action of the stock remains above the Bullish Support Line.

The chart of Bausch & Lomb shows three main buy signals; the first one at 29 in February 1963 on a Bullish Signal formation, the next one at 35 in December 1963 on a Triple Top formation, and another one at 40 in July 1964 on a Triple Top formation. They were all successful formations and money would have been made on any of them, but it is always advisable to get in on the first formation. This assures you the greatest possible profit and protects you against a sudden change in trend.

You don't need any special tool to draw the trend line. You just draw the line through each higher corner of a square as you move to the right.

## THE BULLISH SUPPORT LINE



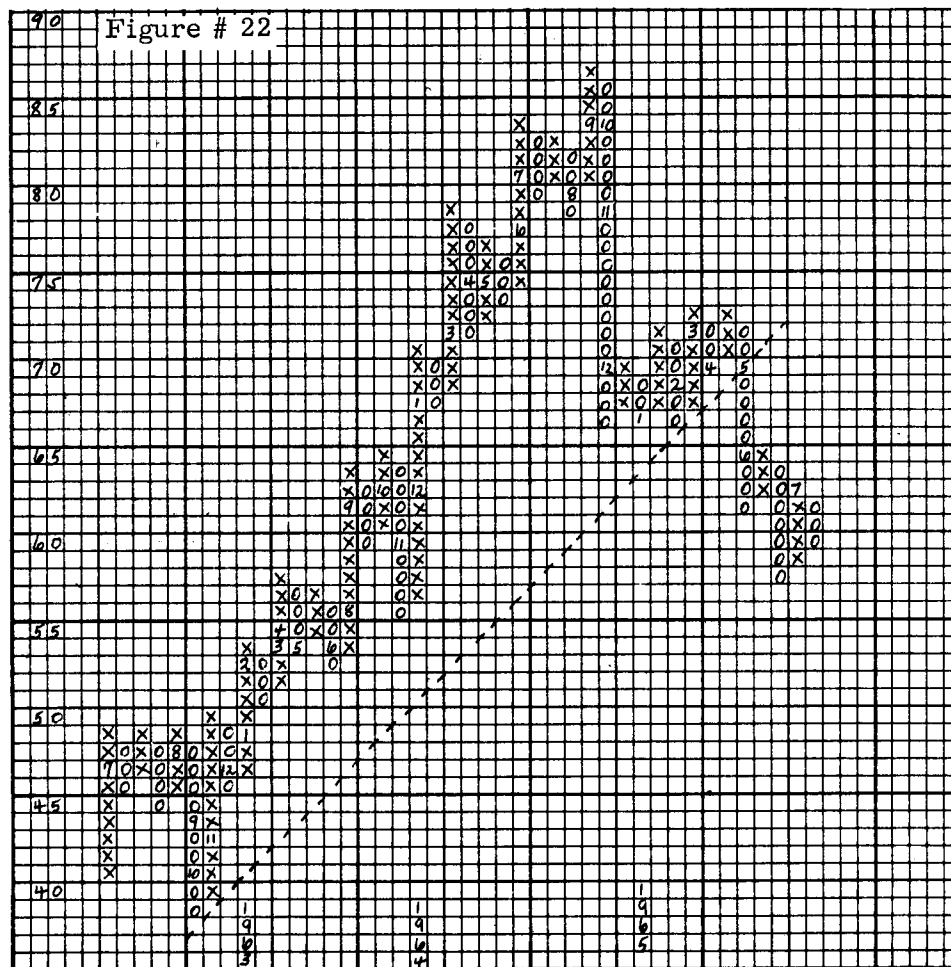
The chart of U. S. Gypsum illustrates both the ostensible and the true penetration of a major support line.

The Bullish Support Line was drawn from the low at 66 made in October 1962. This was the final bear market for this stock.

In January 1964, this trend line was ostensibly penetrated by one point when the price declined to 84. The trend line passed through the 85 square. The reason we classify this as only an ostensible but not a true penetration of the trend line is based on the chart pattern at that juncture. At that particular time, based on the chart formation alone, the stock did not turn bearish. The buy signal given at 91 on a Triple Top formation was still in effect. The decline to 84 did not in any way change the pattern from bullish to bearish - a bearish signal could only have been given by a decline to 83, the penetration of a previous bottom. Since the chart formation was still bullish, the penetration of the Bullish Support Line by only one point did not change the trend of the stock. A penetration of this kind is not valid and should be disregarded.

On the other hand, in June 1964, we have a true penetration of the Bullish Support Line. When this line was penetrated at 90, the chart pattern was already bearish; it had already given a sell signal at 92 on a Bearish Signal formation. The penetration this time was valid and confirmed the sell signal given previously. Such a penetration must be heeded for, as was subsequently borne out by the chart, a downmove was under way.

## THE BULLISH SUPPORT LINE



The above chart of Jones & Laughlin illustrates a possible exception to the general rule never to make a short sale above a Bullish Support Line.

Here, too, the main Bullish Support Line was drawn to connect each higher corner as you move to the right from the October low of 39.

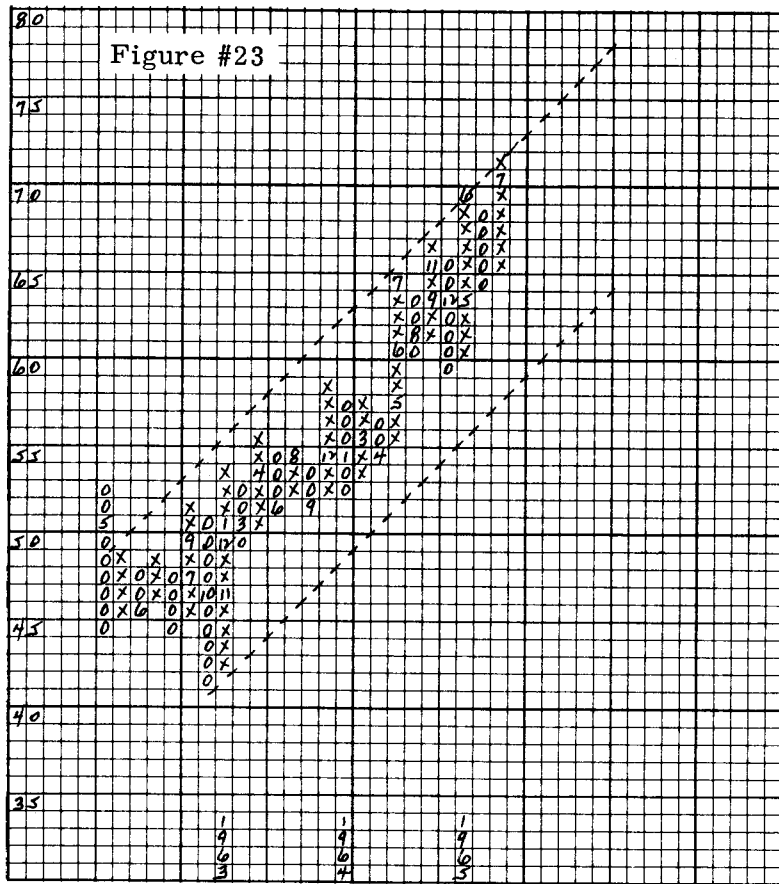
On the way up, four sell signals were given above the bullish trend line. The first one was in June 1963 at 53, seven points above the trend line. The second one was in November 1963 at 59, nine points above the trend line. The third one was in August 1964 at 79, nineteen points above the trend line. And the fourth one was in November 1964 at 78, 16 points above the trend line.

If we were following our general rule never to sell short above the Bullish Support Line, then all of these sell signals should have been disregarded.

The first two signals should have been disregarded even if we wanted to make an exception to this rule because they were too close to the bullish trend line. They did not warrant a short sale because the profit potential was not commensurable with the risk involved. However, the sell signals given later might have warranted the risk because of the greater profit potential. But even here, only the fourth sell signal turned out to be profitable.

The rule to be gleaned from the above is, therefore, that at times where a signal is given at a considerable distance from the main Bullish Support Line, a sell short signal may sometimes be profitable. But if undertaken, the risk involved should always be borne in mind and allowed for.

## THE BULLISH RESISTANCE LINE



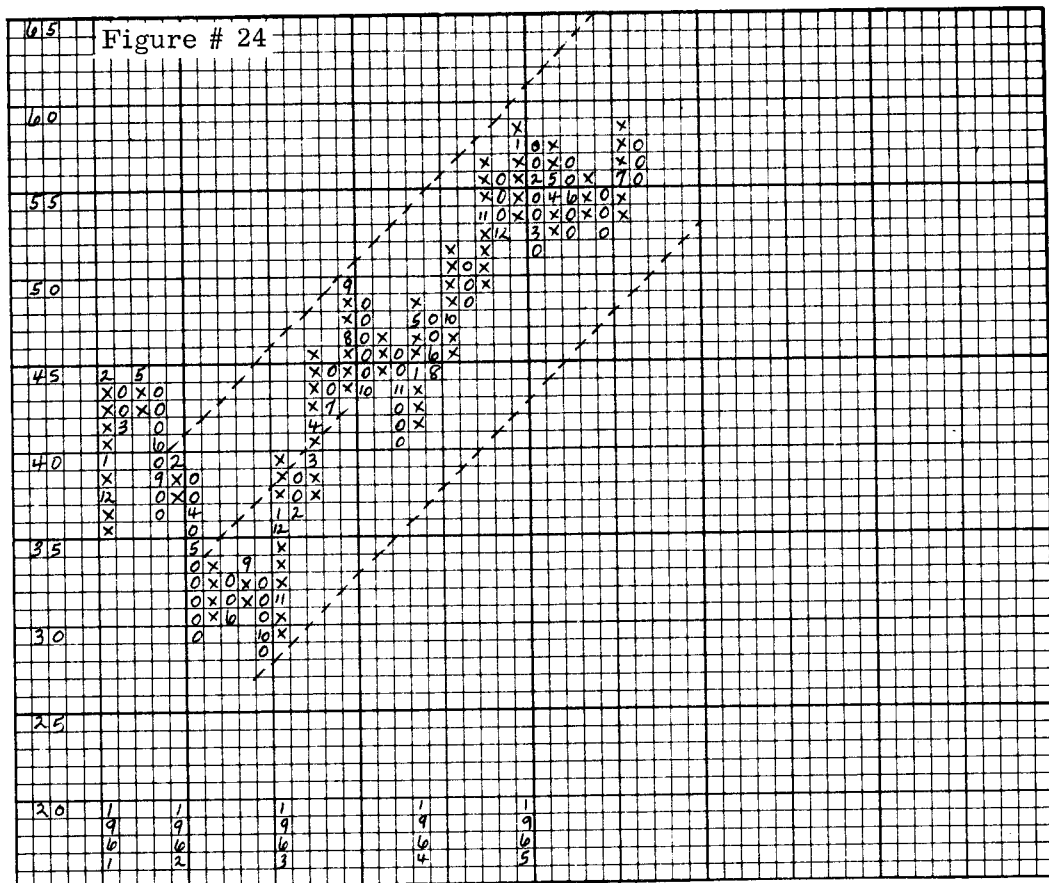
The chart of Atlantic Refining illustrates two bullish lines - a Bullish Support Line with which we are already familiar and a Bullish Resistance Line, which we are introducing for the first time.

The lower line on the chart is, of course, the Bullish Support Line. The upper line is the Bullish Resistance Line. This trend line is drawn in the same manner as the Bullish Support Line. It is a bullish line because its trend is upward. It is a resistance line, because there is a tendency on the part of the price pattern to stop or meet resistance at this line.

When and how is it drawn? It is drawn after a break out from a bullish chart pattern. In the chart illustrated above, there was a breakout on a Triple Top formation at 50 in September 1962. When this happened, the Bullish Resistance Line was drawn. Where was it drawn from? It was drawn from the extreme left of the formation where it runs into a sort of wall of Os. It is always drawn from the top of the highest X next to the "wall."

If you will study the chart, you will see that eight upmoves stopped near or at this Bullish Resistance Line. This does not mean that the long term trader need step out of his position every time this line is approached. He should hold his position as long as the Bullish Support Line remains intact. The short term trader, however, may at times use this line for in-and-out trading or scalping - selling when the Bullish Resistance Line is approached and buying when the price falls back near the Bullish Support Line.

## THE BULLISH RESISTANCE LINE



The chart of Sinclair Oil illustrates the fact that the Bullish Resistance Line is not as immune to penetration as is the Bullish Support Line.

The Bullish Support Line, which was drawn from the October 1962 low, is still intact.

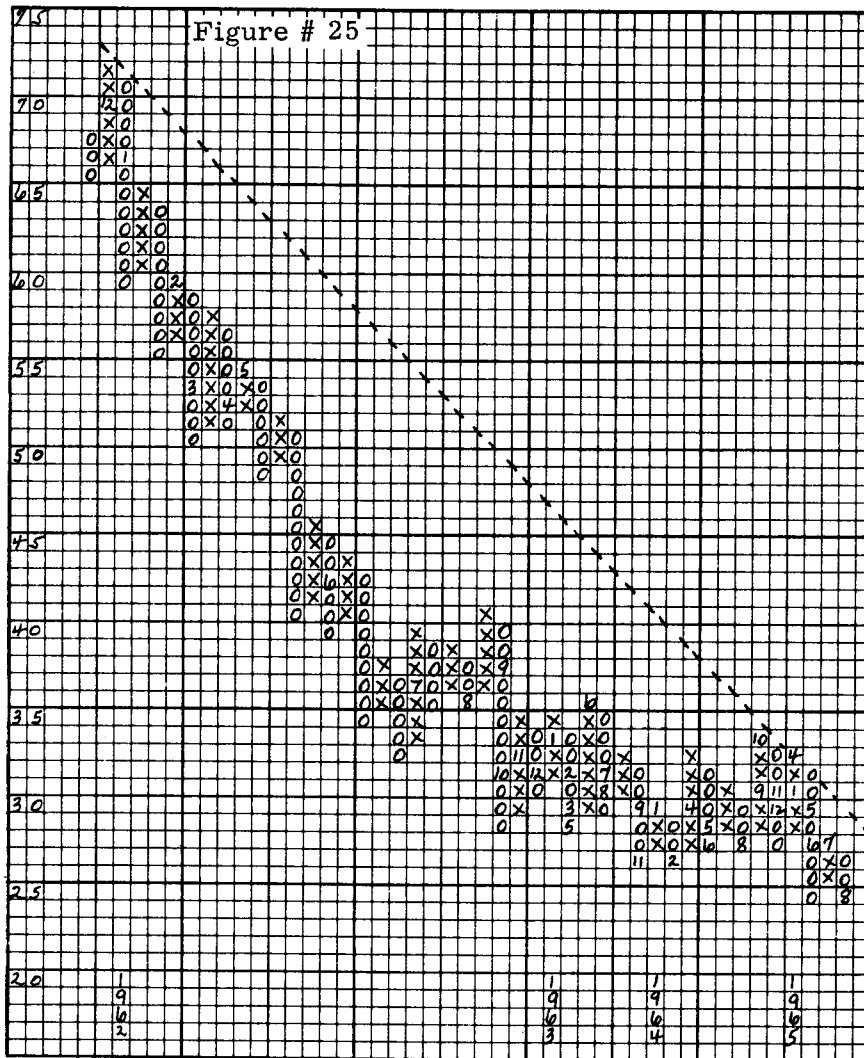
The first Bullish Resistance Line was penetrated within a couple of months after it was drawn. In November 1962, stock gave a buy signal at 35 on a Triple Top formation. The first Bullish Resistance Line was drawn by going to the extreme left of the formation to the wall of 0s. It crossed through the 39 square; this was penetrated on the upside in January.

A second buy signal took place in March 1963 at 41 on a Spread Triple Top formation. This new signal, plus the fact that the first Bullish Resistance Line was penetrated, necessitated the drawing of a second Bullish Resistance Line. This was again done by going to the extreme left of the formation to a wall of 0s. This second Bullish Resistance Line is still in effect and has not been penetrated.

A penetration of a first Bullish Resistance Line may be used as a new buy signal. This is an optional procedure; we prefer relying on the standard chart patterns described in Section Two.

There is one other important feature in this chart that should be studied, and that is the double top at 45 in February and May of 1961. A double top in Point and Figure work is not necessarily interpreted bearishly. It may be bearish for the immediate future but it also acts as a magnet for the next upward move in the stock. Thus, when Sinclair Oil gave its first buy signal at 35 in November 1962, an intermediate term price objective of 45 could have been set for the stock. This was reached by April 1963.

## THE BEARISH RESISTANCE LINE



The chart of Hunt Foods illustrates the Bearish Resistance Line. It should be compared with Figure # 19, the chart of American Airlines, which illustrates the Bullish Support Line. One is the exact opposite of the other.

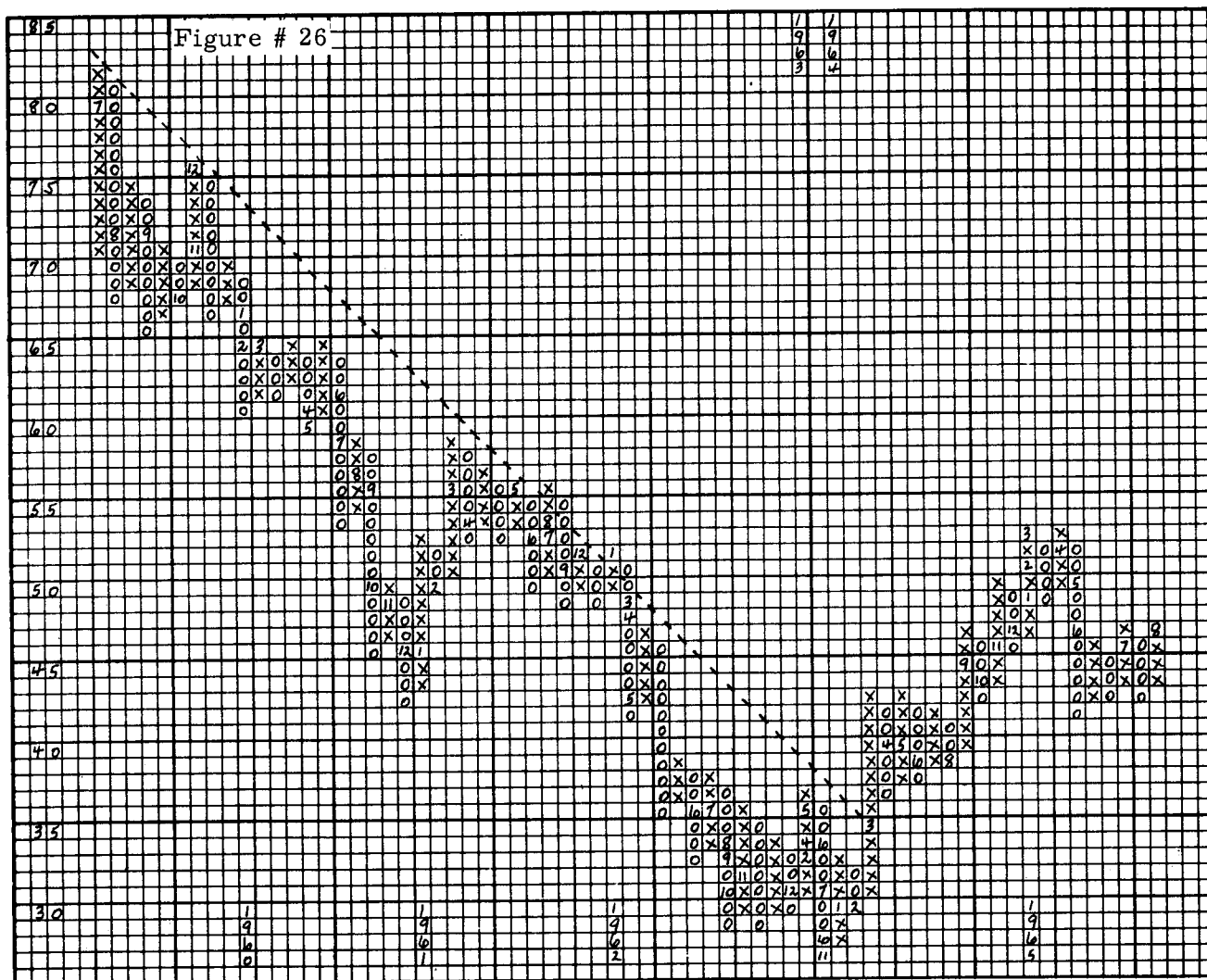
Hunt Foods gave a sell signal in January 1962 at 65 on a Double Bottom formation and a second signal at 59 on a Bearish Signal formation.

A trend line - in this case a Bearish Resistance Line - was drawn from the high of 72. It is a line intersecting the corner of each successive lower square as you move to the right.

It is important to point out that this line was not penetrated during the entire rise of the market from June 1962 to May 1965. At no time should this stock have been bought. The few buy signals that appeared below this line should have been ignored. This illustrates the value of the trend line - whether up or down. In the case of Hunt Foods, you were alerted to the fact that buy formations below the Bearish Resistance Line would probably prove false and should not be acted upon. This was a stock to avoid. If you wanted to buy a stock, then you should have bought one that had penetrated its Bearish Resistance Line.



## THE BEARISH RESISTANCE LINE



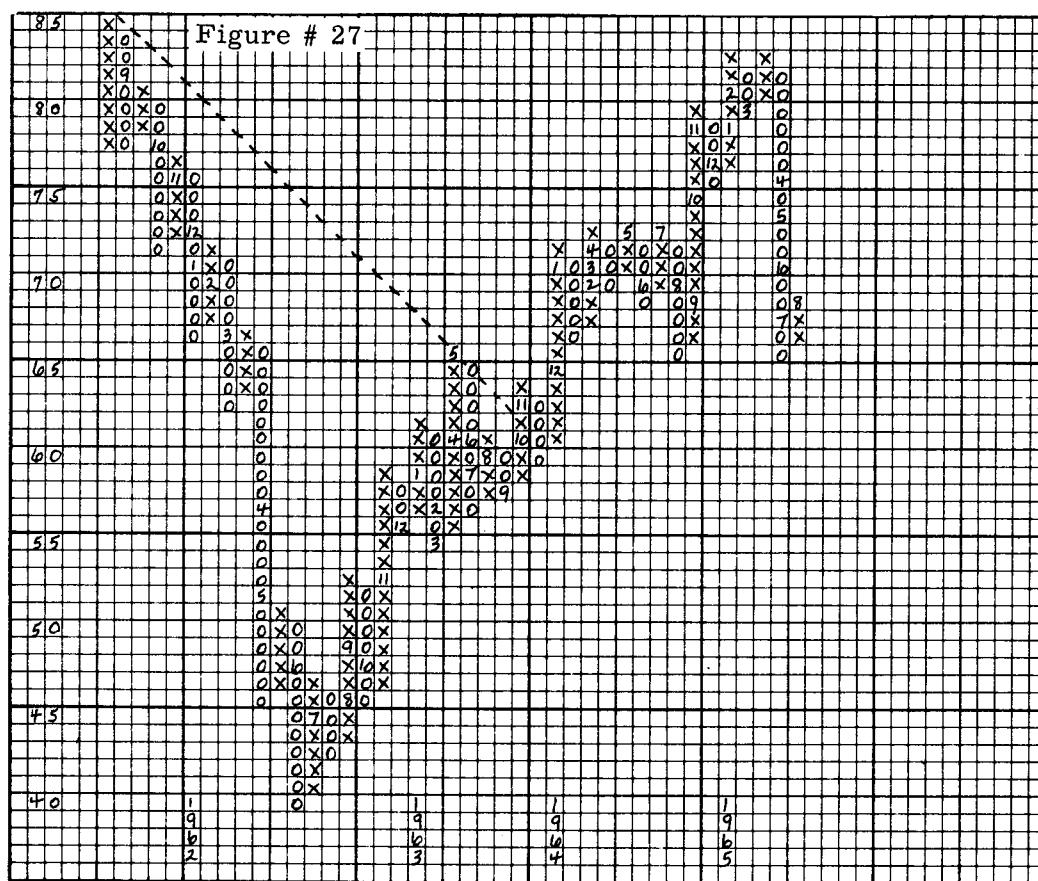
The above chart of Mesta Machine should be compared to the chart of U. S. Gypsum (Figure #21). It illustrates the same basic principle, but in reverse.

The Bearish Resistance Line was drawn from the high of 82 made in July 1959. This was the final bull market high made by this stock.

There were two ostensible penetrations of this line, the first at 56 in August 1961, and the second at 52 in January 1962. In neither of these cases was the previous high exceeded when this penetration took place. These penetrations were, therefore, not valid and should have been disregarded. The chart patterns remained bearish during both these penetrations.

It should be pointed out that in the bull market of 1961, the price just about reached the Bearish Resistance Line. Any buy position taken in January 1961 at 51 on a Double Top formation was limited by the Bearish Resistance Line. A trader or investor who realized this might have looked for another stock in which to take a buy position.

## THE BEARISH RESISTANCE LINE

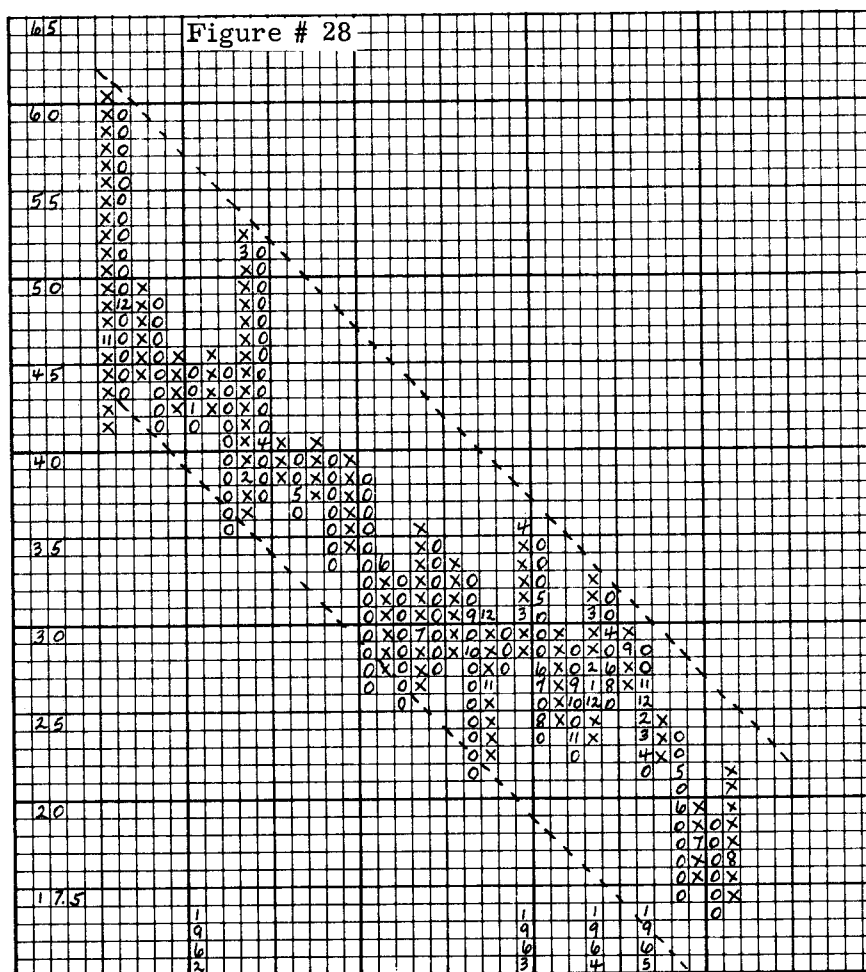


The above chart of Dow Chemical should be compared to the chart of Jones & Laughlin (Figure #22). It illustrates the same principle, but in reverse.

The Bearish Resistance Line is a trend line drawn from the high of 85 in August 1961. This stock gave a sell signal in October 1961 at 77 on a Bearish Signal formation. It made its final low at 40 in June 1962.

In August 1962, the chart pattern shows a buy signal at 48 on a Bullish Signal formation. Should this buy signal have been taken? Was it valid? The general rule is that it should have been disregarded because it took place below the Bearish Resistance Line. The long term investor should adhere to this rule under all circumstances. He can find buy signals in other stocks that take place after the penetration of the Bearish Resistance Line. An exception can, however, be made in favor of the short term trader. Because the Bearish Resistance Line is so far above the point where the buy signal is given, he might step in and buy the stock - always bearing in mind that the downward line will limit the upward move. The stock may move to the line, may actually reach it, or fall far short of it. In this case, the price of Dow Chemical came up to the line and the trade would have been very profitable. This type of trade can only be recommended to the short term trader who fully realizes the basic risk involved.

## THE BEARISH SUPPORT LINE



In the above chart of Gibraltar Financial, we have two bearish or downward trend lines. The top line is the Bearish Resistance Line which has already been discussed. The bottom line is the Bearish Support Line.

If you will refer to Figure # 23, you will see that the Bearish Support Line is the converse of the Bullish Resistance Line. The Bullish Resistance Line gave us an indication as to where the upward move might encounter temporary resistance. The Bearish Support Line gave us an indication as to where the downward move might meet with temporary support.

The Bearish Support Line is drawn in the same manner as the Bearish Resistance Line. It is drawn, in the above illustration, after a sell signal is given on a Bearish Signal formation. It is drawn from the extreme left of the formation where it encounters a "wall" of Xs.

Since a downmove is usually sharper and of shorter duration than an upmove, the move does not usually stop exactly at the line but may penetrate it by a point or more. This happened four times in the chart of Gibraltar Financial. However, this support line still serves as a guide that can be used to determine where buying support might come in to temporarily halt the downmove. The short-term trader can use this guide to cover his short position and to reinstate it, once more, when the price moves closer to the Bearish Resistance Line. The long term trader may disregard it and stay with his position as long as the price pattern remains below the upper Bearish Resistance Line.

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## SECTION FOUR

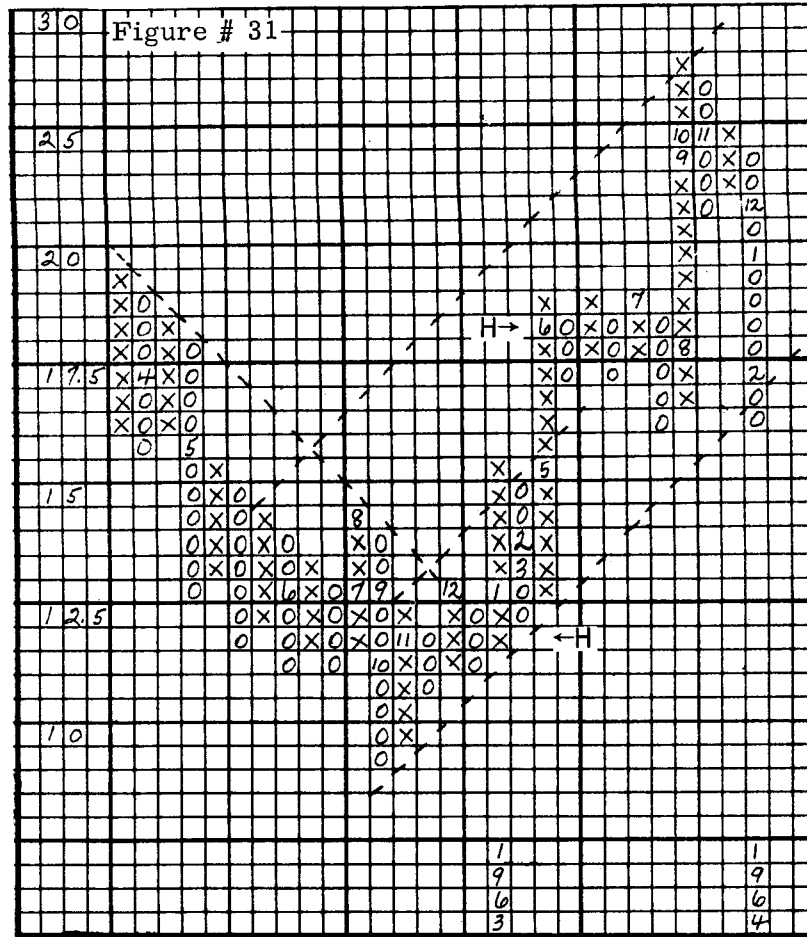
### PRICE OBJECTIVES

Section Two and Three were devoted to the problem of timing - when a stock should be bought and when a stock should be sold short. The next logical question is, having bought the stock at the right time, how much of an upside move can be expected? And, conversely, having sold a stock short at the right time, how much of a downside move can be expected? This section will attempt to answer these questions. It will deal with:

1. Trend Lines
2. The Horizontal Count
3. The Vertical Count



THE HORIZONTAL COUNT



The chart of Admiral Corporation, reproduced above, illustrates the horizontal count in a stock under twenty dollars.

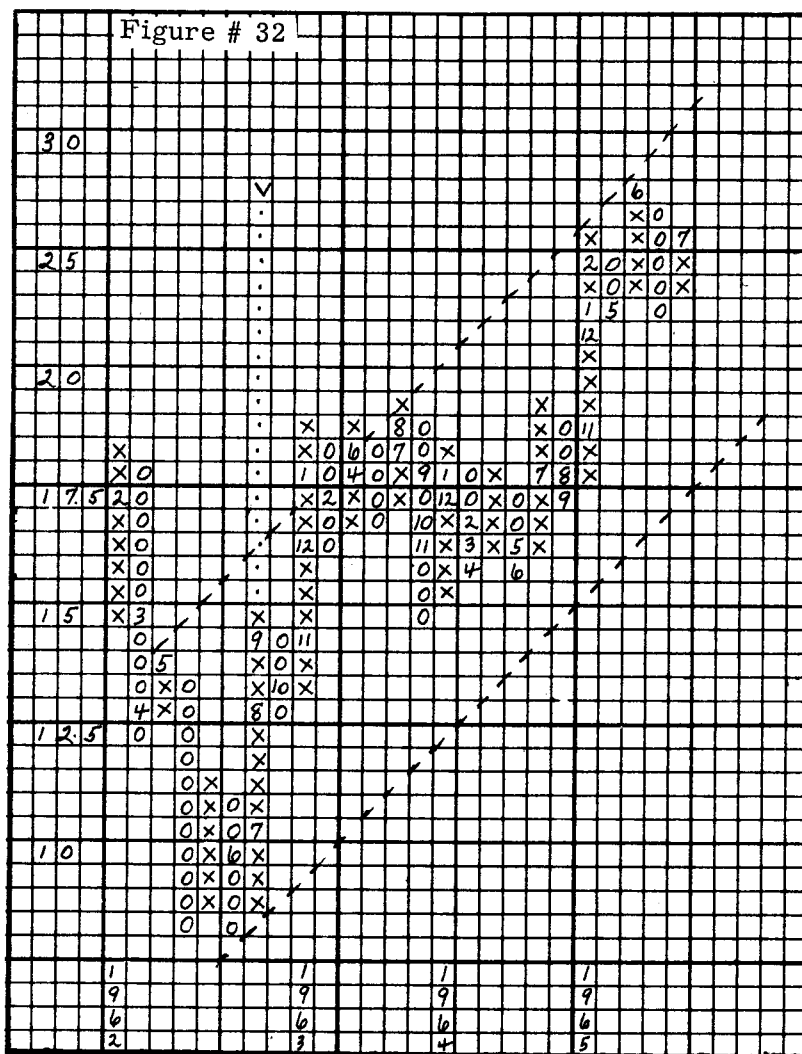
As in the case of American Telephone & Telegraph, we first draw our trend lines. The lowest line is the basic Bullish Support Line. Then we have two Bullish Resistance Lines, the first of which is usually penetrated and the second of which usually holds. Both resistance lines indicate where supply might come in to check the upmove, first temporarily, and then permanently.

Admiral Corporation gave a buy signal in January 1963 at  $13\frac{1}{2}$  on a combination Bullish Signal and Triple Top formation. If the stock was then bought, the purchaser would naturally be interested to know how high the price of the stock might go. To determine this we take a horizontal count. We start with the column where the buy signal was given and count across to the left to determine the width of the base of accumulation. We find that there are twelve horizontal squares in this base. This can be seen either on the  $12\frac{1}{2}$  or 12th line. Since this is a  $1\frac{1}{2}$ -point reversal chart, we multiply twelve by  $1\frac{1}{2}$  and get a product of 18. We add the eighteen to the low of  $9\frac{1}{2}$  and get a Price Objective of  $27\frac{1}{2}$ . The stock reached 28 by October 1963.

There was another buy signal on a Triple Top formation at  $19\frac{1}{2}$  in Aug. 1963. Here is another place where we can get a horizontal count. The base is seven squares wide. We multiply this by  $1\frac{1}{2}$  and get  $10\frac{1}{2}$ . This is added to the lowest point of the formation at  $16\frac{1}{2}$  and we get a Price Objective of 28. At times, you might get a higher Price Objective on the second horizontal count, but in this case the original Price Objective was confirmed.



## THE VERTICAL COUNT



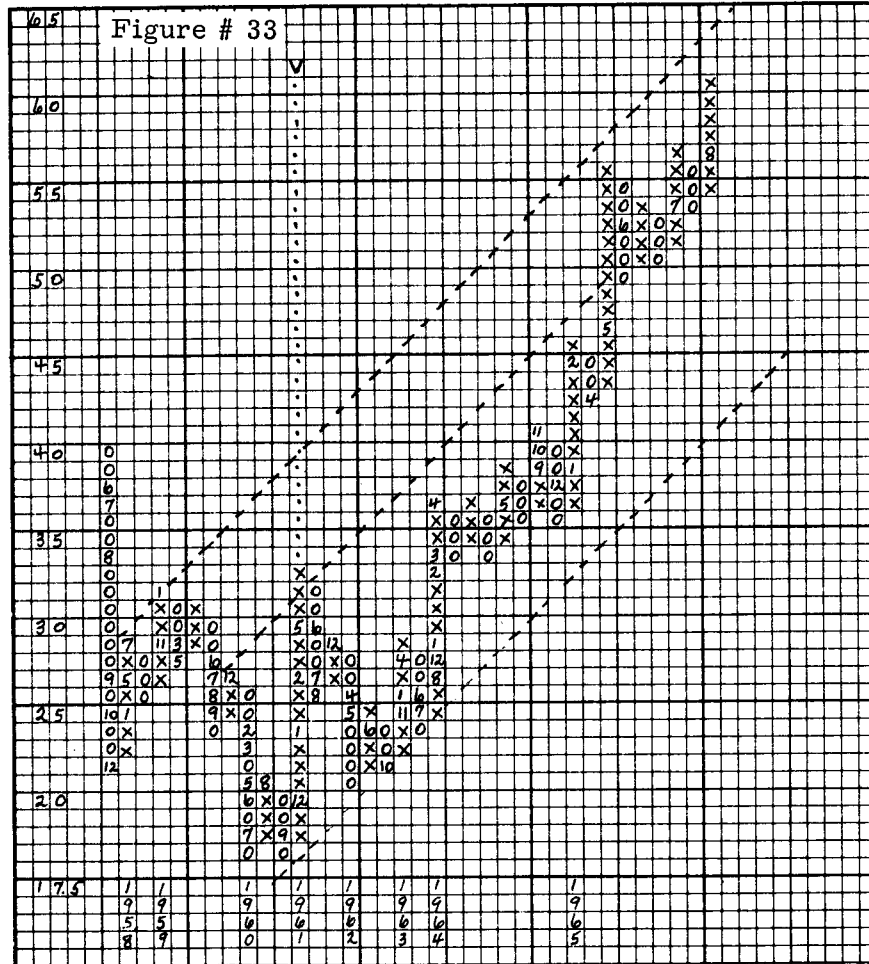
The above chart of B. V. D. Company illustrates the vertical count in a bull market, just as the two previous charts illustrated the horizontal count in a bull market.

The Bullish Support Line remained intact since the low made in June 1962. The basic trend of the stock was bullish. The Bullish Resistance Line also held up fairly well giving us a good idea as to where the price of the stock might go, and where it might meet with resistance as the chart pattern moved to the right.

The vertical count is taken after the double bottom at  $8\frac{1}{2}$ . If there are two bottoms at the same level, the count is taken after the second bottom. The first upmove after the final bottom was 13 squares. Since these squares were below 20 and, therefore, in  $\frac{1}{2}$ -point units, we multiply 13 by  $1\frac{1}{2}$  (since the 3 squares needed for a reversal amount to  $1\frac{1}{2}$ -points). This gives us a product of  $19\frac{1}{2}$ . We then add the  $19\frac{1}{2}$  to the low of  $8\frac{1}{2}$  and get a Price Objective of 28. This Price Objective was made in June 1965.

There is no time limit within which a Price Objective has to be reached. In the case of B. V. D. the vertical count was taken from the bottom of the 1962 bear market and the Price Objective was reached three years later.

## THE VERTICAL COUNT



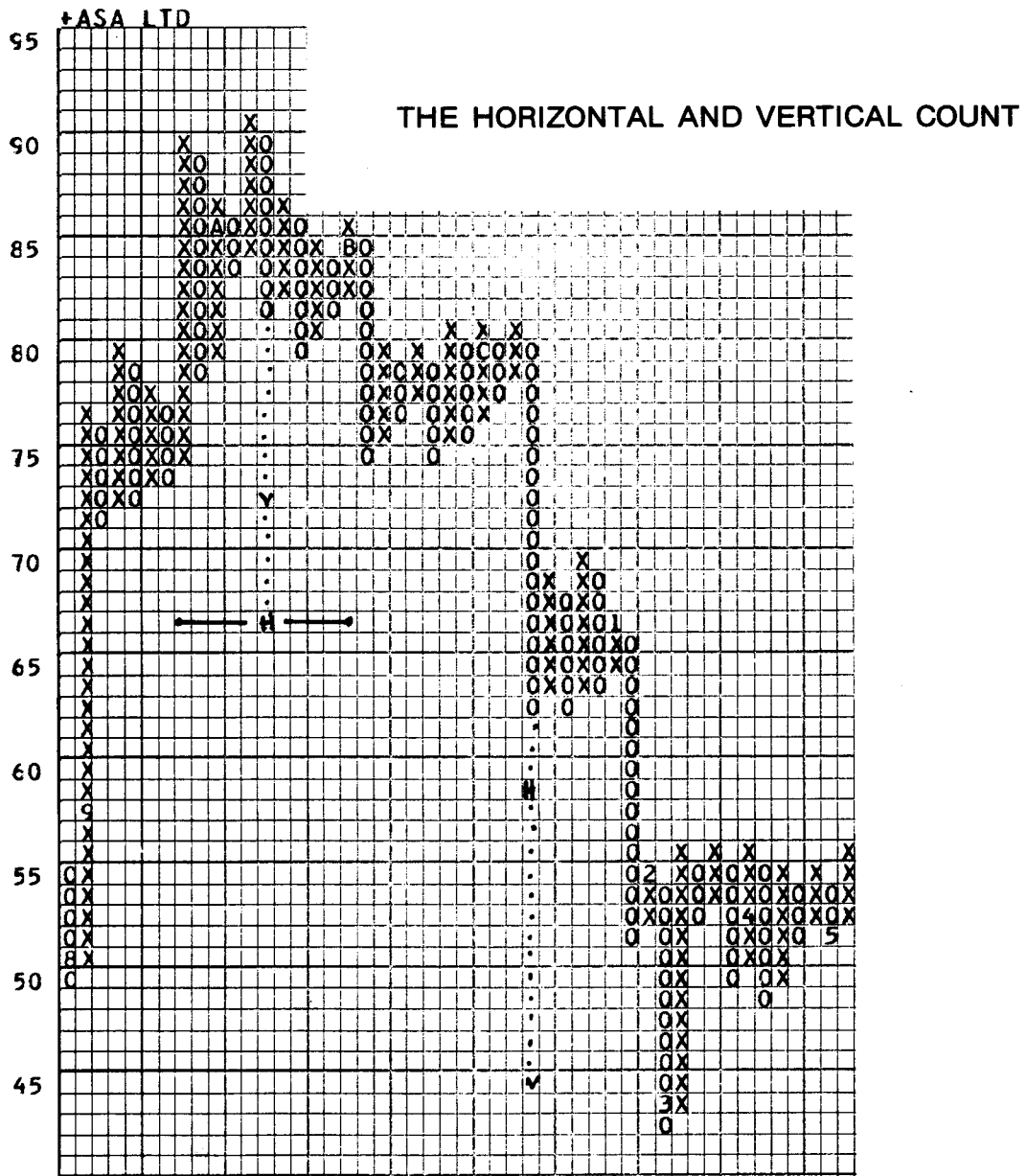
The above chart of Carrier Corporation also illustrates a vertical count in a bull market.

The Bullish Support Line was drawn from the September 1960 low at 18½. This line even remained intact during the 1962 bear market. The Bullish Resistance Line also gave one a good idea of how high the price of the stock would go as the chart pattern developed.

The first upward move after the September 1960 low consisted of 16 squares. However, these squares were both above and below the 20 price so that they had different values. This naturally would affect the vertical count and the method to be used in taking it.

From 20 and below, we have 3 squares in ½-point units. These we multiply by 1½ and get a product of 4½. Above 20, we have 13 squares in 1-point units. These we multiply by 3 and get a product of 39. 39 and 4½ gives us a total of 43½. 43½ added to the low point of 18½ gives us a Price Objective of 62. It should be borne in mind that this count was made in June 1961 after the first upmove of 16 squares had been completed in May. In August 1965, the price of Carrier Corporation was 61. Here we have a Price Objective that was practically reached after a period of about 4½ years.

The length of time it takes a Price Objective to be reached depends on how high it is and what kind of a market is taking place. It will be reached in a matter of weeks or months or years. Short term counts may be taken during the progress of the move. For example, in May 1964, the chart shows a buy signal at 38 on a Triple Top formation. A horizontal count on this formation would be 5 x 3 added to 34, giving a Price Objective of 49. This was reached by May 1965.



The chart of ASE, reproduced above, illustrates both horizontal and vertical counts in a bear market.

A top of distribution formed after the stock reached its all-time high at 91. After the sell signal at 79, we were able to determine both horizontal and vertical price objectives.

Vertical count: The first downmove after the 91 high consists of 9 squares. Multiplying this by 2\* gives us a product of 18 which we subtract from the top, giving us a count of 73.

Horizontal count: The top of distribution is 12 squares wide. Again we multiply this by 2\* and subtract it from the top at 91, which gives us a count of 67.

As the top broadened in the 75-81 area, it became possible to compute additional counts. A vertical count from the 81 high worked out to 45 while the 11 horizontal squares in this formation multiplied by 2 and subtracted from 81 was 59.

\* This was a change from previous editions in which we multiplied by 3. We still multiply upside price objectives by 3 as well as the DJIA.

## SECTION FIVE

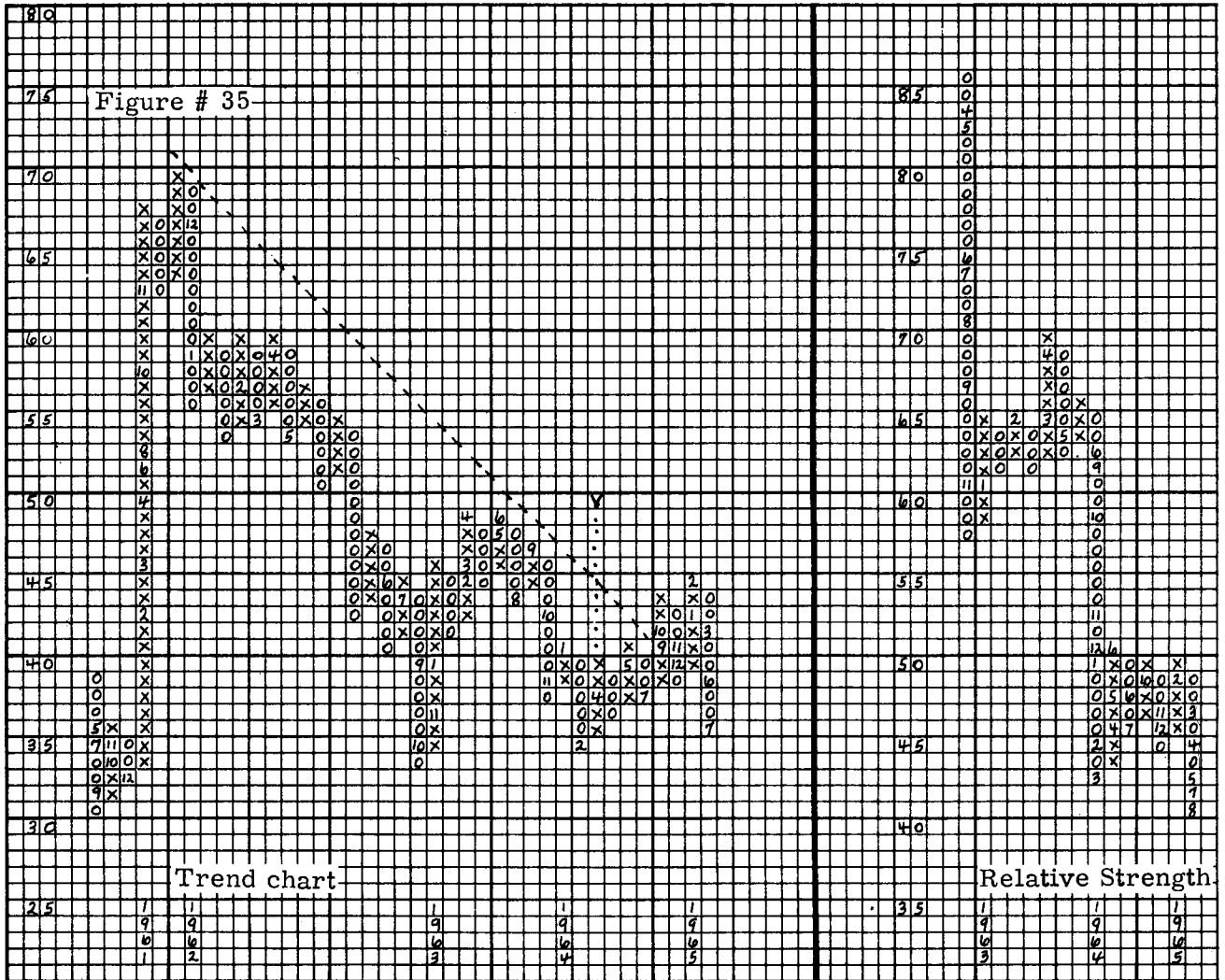
### RELATIVE STRENGTH

Relative strength measures the price action of a stock in relation to a market average. To determine an individual stock's relative strength, we divide the price of the stock using Tuesday's close by Tuesday's closing DJIA and plot the resulting figure on a P&F sheet.

As an example, if a stock is \$80 while the DJIA is 1000, we divide 80 by 1000 and get .0800. To make the RS figure comparable to that of a stock, we move the decimal 3 places to the right and get 80.0. If the DJIA now falls to 800 and the stock to 72, we divide 72 by 800 and get .0900, or 90.0 after moving the decimal. Posting the Trend Chart for the stock would now show Os from 80 to 72, while posting the RS Chart would show Xs from 80 to 90.

This tells us that this stock is much stronger than the DJIA and is a strong candidate for an advance when the market turns around.

Relative strength eliminates "the market" as a factor in the price of a stock.

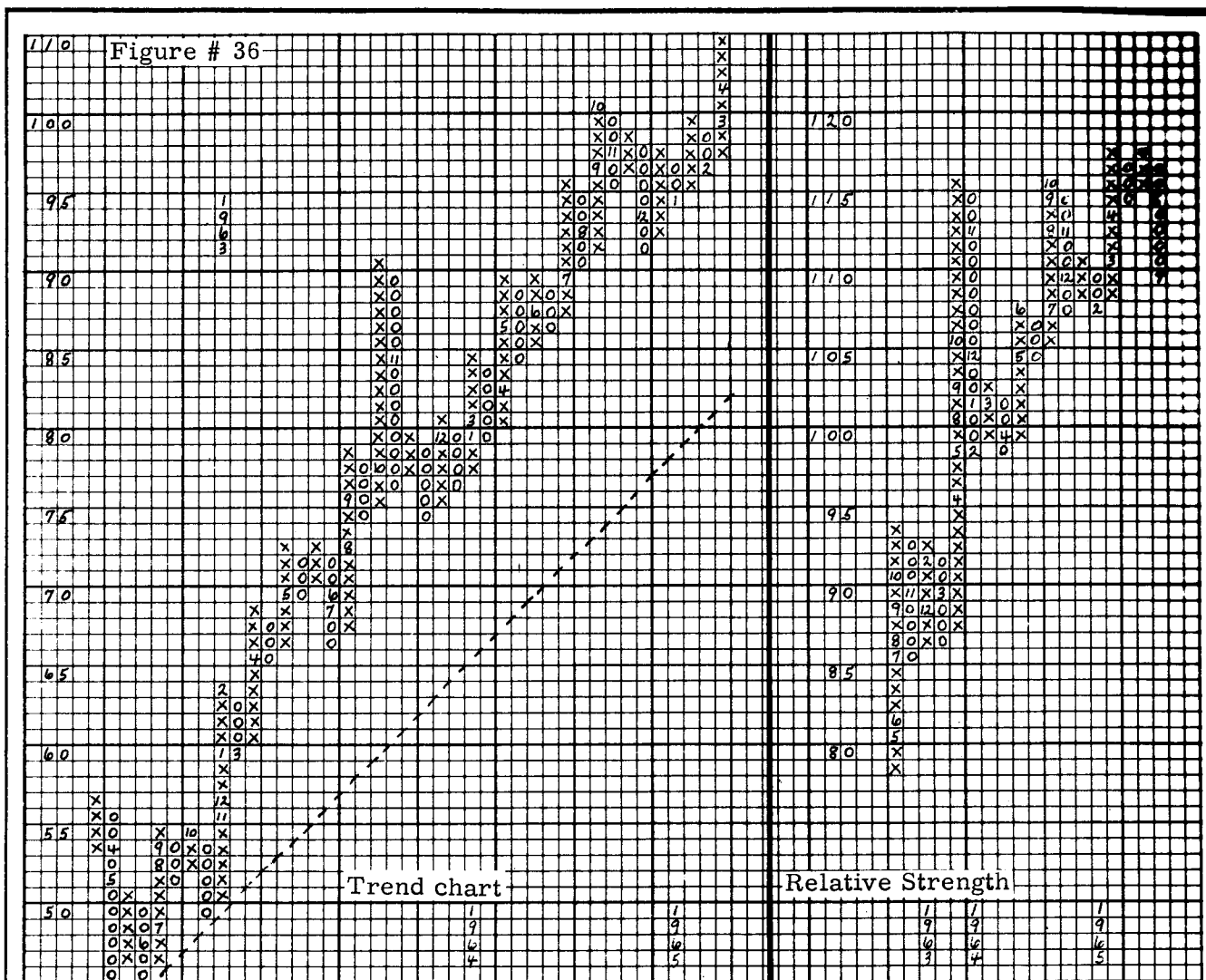


The relative strength chart of Great Atlantic & Pacific Tea Company, reproduced above, illustrates how such a chart may, at times, caution you against buying a stock which may look good technically from every other angle.

In October 1964, Great A. & P. gave a buy signal at 42 on a Spread Triple Top formation. At that point, the price pattern had also penetrated the Bearish Resistance Line. A vertical count yielded a Price Objective of 50, and on a horizontal count one of 59. On the basis of the trend chart alone, buying the stock at 42 would have been technically correct.

However, an examination of the relative strength chart for the same period would have shown that the stock was acting weaker than the Dow-Jones Industrial Average. It had not penetrated a previous top and, therefore, had not given any buy signal on the relative strength chart. This was additional technical information that could have been used in deciding whether or not to buy the stock. Since it was an adverse technical factor, one could have concluded that there were better stocks in which to invest one's funds at that particular time.

The relative strength chart is derived by dividing the closing price of the stock by the closing price of the Dow-Jones Industrial Average. Doing this once a week is sufficient. The resulting ratio figure is then plotted on a regular Point and Figure chart. The decimal point may be ignored.



In Figure # 36, we have the trend and relative strength chart of General Motors. The relative strength chart plots the ratio figure obtained by dividing the closing price of General Motors by the closing price of the Dow-Jones Industrial Average. This is done once a week.

A relative strength chart is most useful at market turning points, either from bearish to bullish or bullish to bearish.

An examination of the trend chart of General Motors shows that during April, May and June of 1962, the price of the stock was going down. On the other hand, on the relative strength chart we have an upmove during May and June of 1962. In other words, although the price of GM was actually dropping during that period, it was, nevertheless, acting stronger than the Dow-Jones Industrial Average.

This contrary action of the trend and relative strength charts was putting us on notice to watch General Motors. It was pointing to the possibility that once the bear market was over, General Motors would be a very good stock to buy. The trend chart did finally give its first buy signal at 51 in July 1962 on a Double Top formation and another buy signal in November at 56 on a Triple Top formation. During all this time the relative strength chart had never turned bearish. In March 1963 it began almost a vertical upward move showing extraordinary strength when compared to the Dow-Jones Industrial Average.

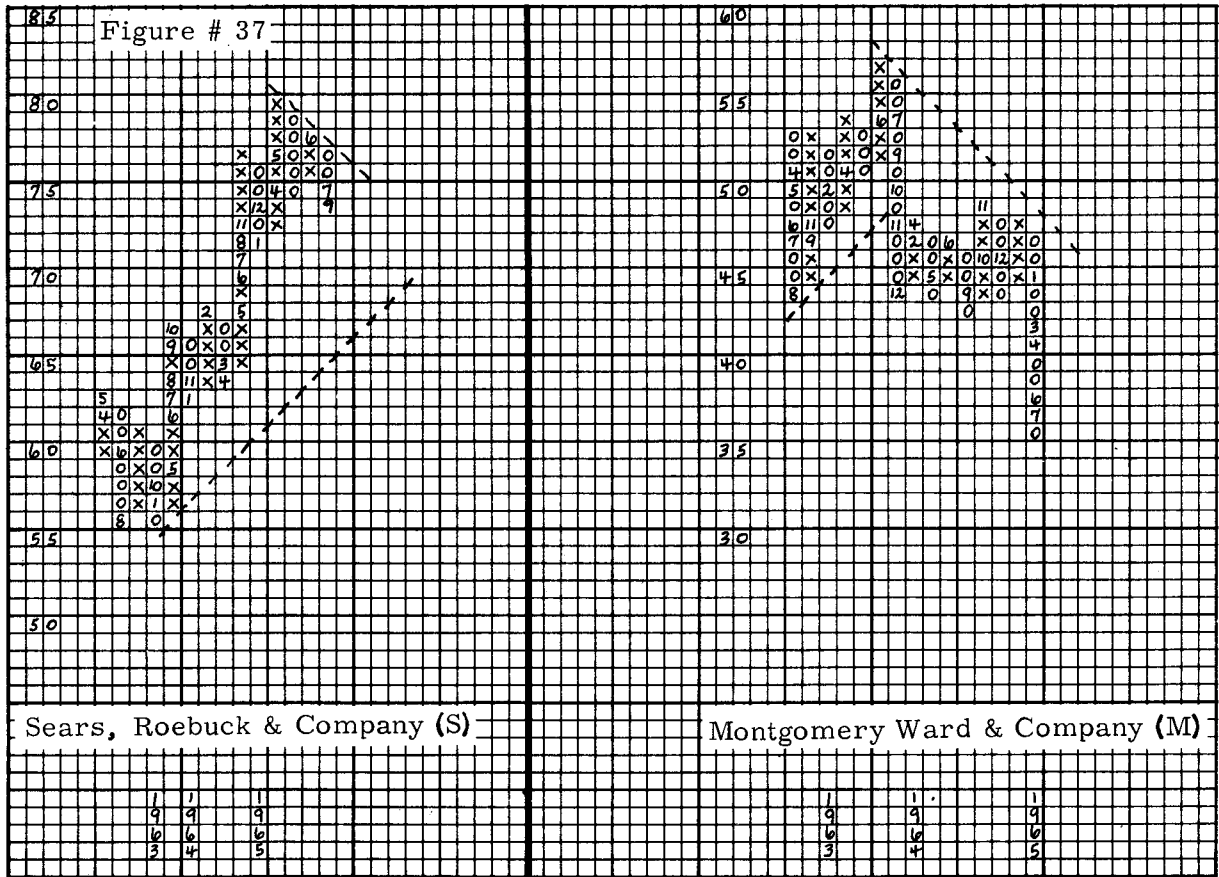


Figure # 37 illustrates another use that may be made of relative strength charts. Here we have two relative strength charts, one of Sears, Roebuck and the other of Montgomery Ward.

A comparison of the charts of the two companies can answer the question as to which stock should be bought and sold at any specified time.

Montgomery Ward started out as the better of the two. It started acting stronger than the Dow-Jones Industrial Average in September 1962, while Sears, Roebuck only started acting stronger than the Dow-Jones Industrial Average in May 1963. Thus, immediately after the bear market of 1962, Montgomery Ward was a preferable buy when compared to Sears, Roebuck.

However, Montgomery Ward stopped acting stronger than the Dow-Jones Industrial Average in June 1963 and was definitely out of the running by October. Sears, Roebuck on the other hand continued to show more strength. At this time, then, it would have been wise to switch out of Montgomery Ward into Sears, Roebuck. As a matter of fact, Sears, Roebuck continued to act better until May 1965 and did not turn bearish until September. Montgomery Ward, on the other hand, has continued its weaker action and is still in a downtrend.

Trend lines and trading formations should be used in interpreting relative strength charts. But it should always be borne in mind that a column of Xs means that the stock is acting stronger than the DJIA and a column of 0s means that it is acting weaker.

## SECTION SIX

### INDUSTRY GROUPS

Thus far we have used the following criteria in determining when to buy or sell a stock: 1) Breakouts from trading formations, 2) Trend Lines, 3) Price Objectives, and 4) Relative Strength.

We now subject our discussion, thus arrived, to Industry Groups. The stock we buy should be in an Industry Group analysis. The stock we buy should be in an Industry Group that is bullish and that is acting better than the rest of the market.

Standard & Poor's supplies index figures on 92 Industry groups. These are the figures and groups we use in our analysis. Barron's Industry Groups could probably be used as satisfactorily, but it has only about 35 groups.





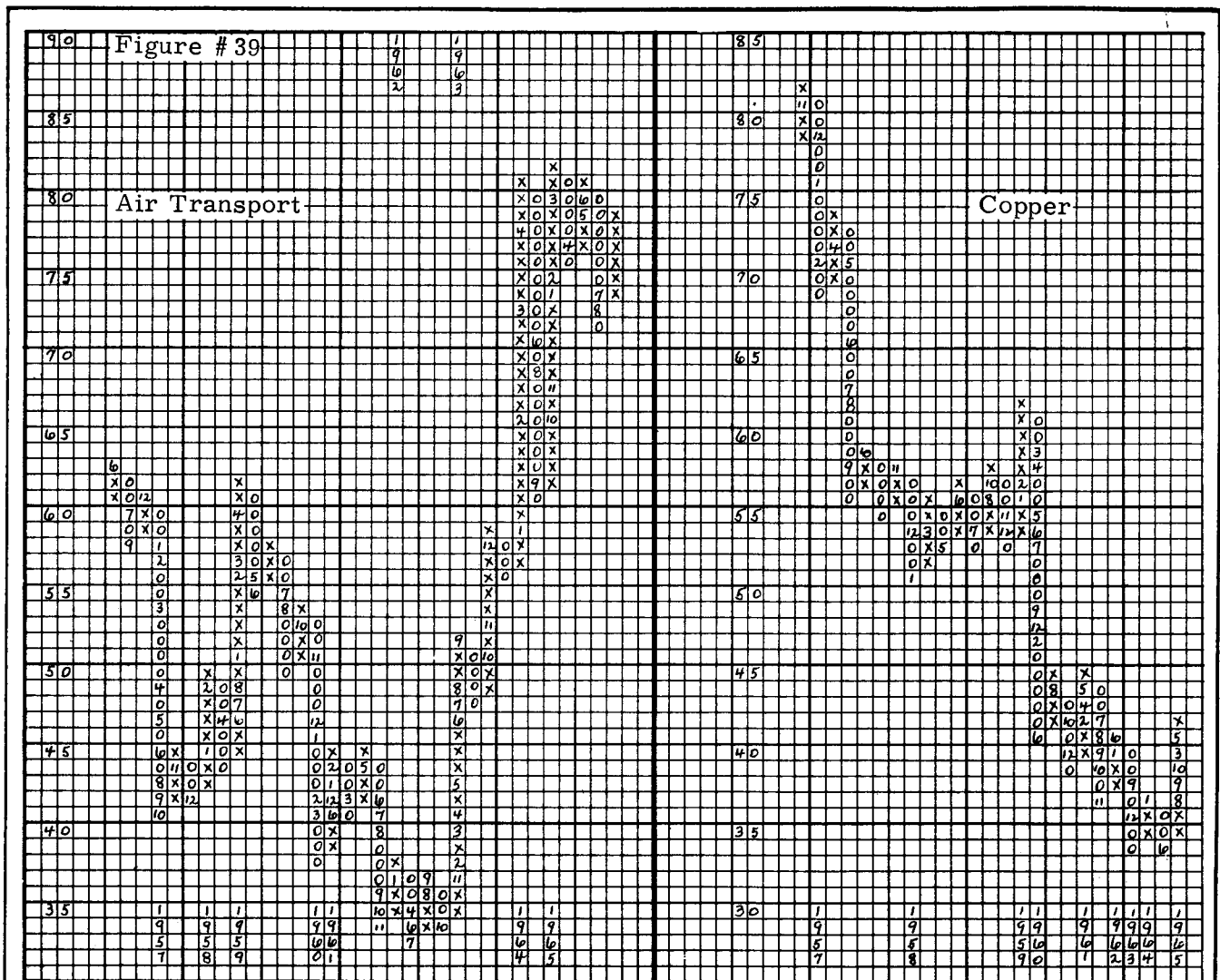
In Figure # 38, we have two Industry Group charts, one of Drugs and the other of Vending Machines. The purpose of this illustration is to point out the importance of selecting a stock in the right Industry Group.

It will be sufficient, for our purpose, to examine both charts since the end of the bear market in 1962.

The Drug stocks made their bottom in September 1962 and then gave a buy signal in November. This was the go ahead signal, which meant that individual stocks in this group could now be bought. The next step to be taken is to examine the individual stock charts in the group in accordance with all the principles laid down previously - trading formations, trend lines, price objective, relative strength - and to pick the best technically situated stocks for possible purchase.

The Vending Machines stocks made their bottom in October 1962. However, the group chart did not give any buy signal immediately thereafter. There was no point then in taking any position in any of the stocks comprising this group. A trader or investor is always confronted by a choice. And if he had to choose between the Drug stocks and the Vending Machine stocks, an analysis of the group charts made his choice obvious.

The Vending Machine Industry Group did not turn bullish until October 1964. This was the first time that a trader or investor was confronted with the problem of whether or not he should buy Vending Machines stocks.



In Figure # 39, we illustrate how relative strength charts can be used in choosing between different industry groups (assuming that the trend charts in the same groups have given buy signals).

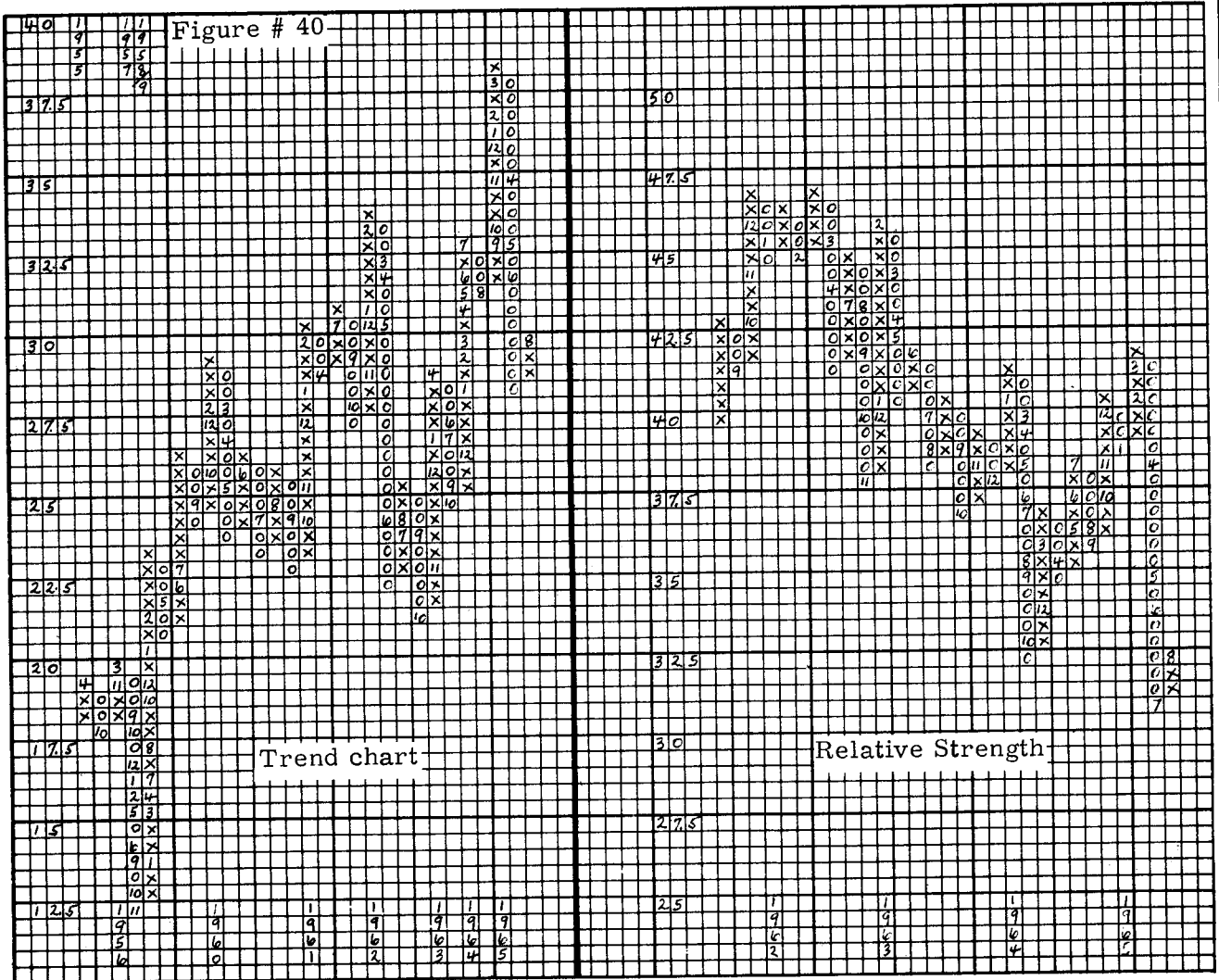
The relative strength chart of the Air Transport group shows a buy signal in February 1963. The relative strength chart of the Copper group does not show a buy signal until September 1964.

If in February 1963, we had to choose between these two groups for the investment of funds, there would have been no question that the right group would have been the Airlines. This group started to act better than the market at that time and continued to do so until March 1965, a period of over two years. Remaining invested in this group during this entire period brought extraordinary profits.

The relative strength chart of the Copper group shows that it started to act worse than the market as a whole in March 1960 and continued to do so until September 1964. It also indicates that it would not have been worthwhile to take positions in stocks in this group during the entire bull market of 1961. The relative strength chart was saying that there were much better groups for the commitment of funds even though some Copper stocks may have been rising. It was not until September 1964 that the Copper group signalled that it was starting to act better than the rest of the market. Not until this signal took place should investments have been made in Copper stocks.

The relative strength figure for an Industry Group is obtained by dividing Standard & Poor's Index figure for the group by Standard & Poor's 425 Industrials.

MEAT PACKING



In Figure # 40, we have both a trend and a relative strength chart of the Meat Packing Industry Group. The figures for the relative strength chart are obtained by dividing the group index figure by Standard & Poor's 425 Industrials.

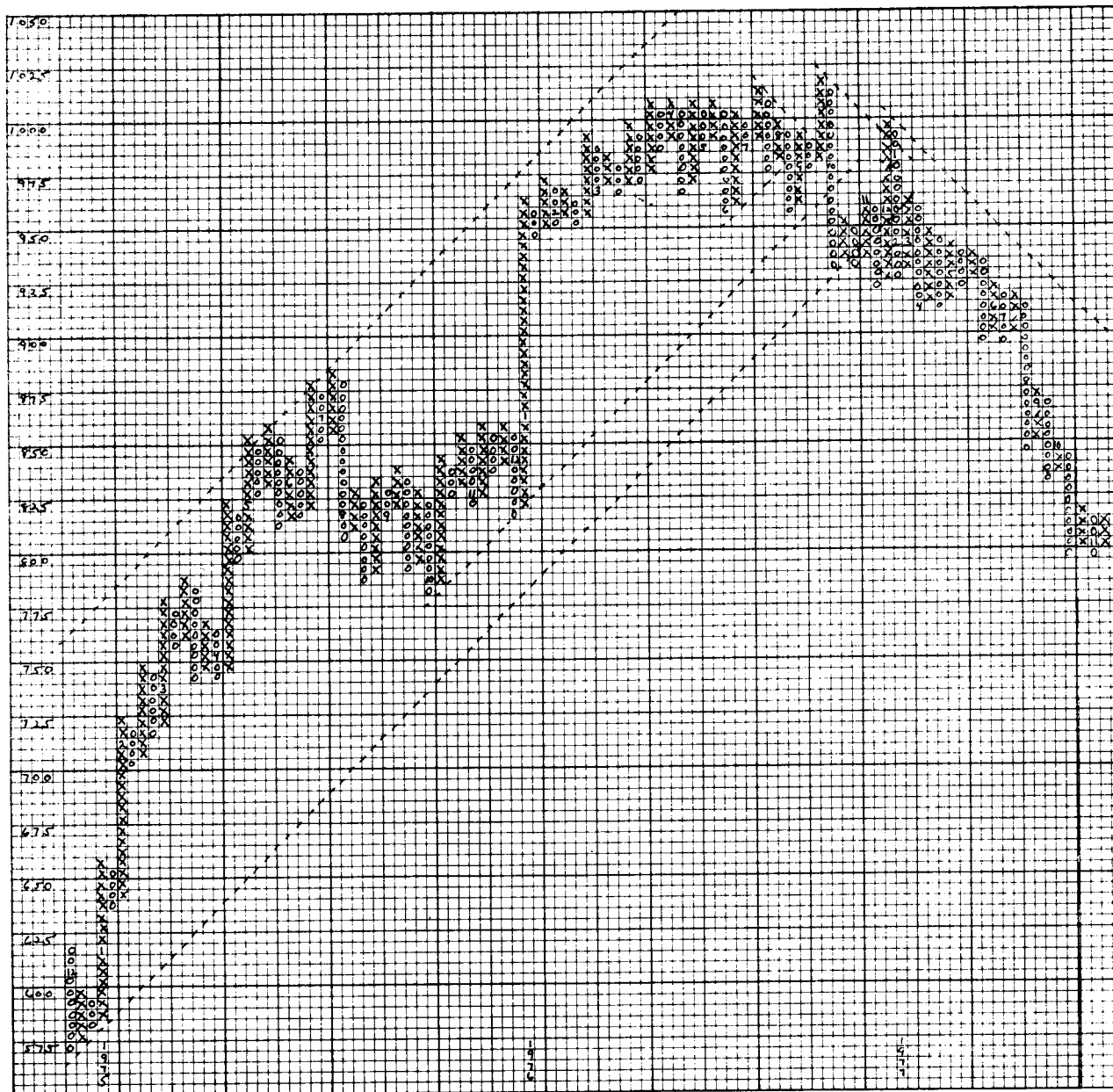
These charts illustrate the possibility of discovering seasonal patterns in certain industry groups.

In the Meat Packing group, highs are usually made in February and lows in October. In the trend chart we see a high in March 1956, a low in November 1957, a high in February 1960, a low in September 1960, a high in February 1962, a low in October 1963, and a high in March 1965. Even some of the minor moves make highs and lows according to this seasonal pattern - a high in February 1959, February 1961, April 1963, and lows in October 1961, and October 1964.

The trend chart is the most important for determining the seasonal pattern. The relative strength chart may be used as a check. It shows highs in February 1962, February 1963, January 1964, and March 1965. The lows appear in November 1962, October 1963, and October 1964.



DOW-JONES INDUSTRIAL AVERAGE (5 × 15)

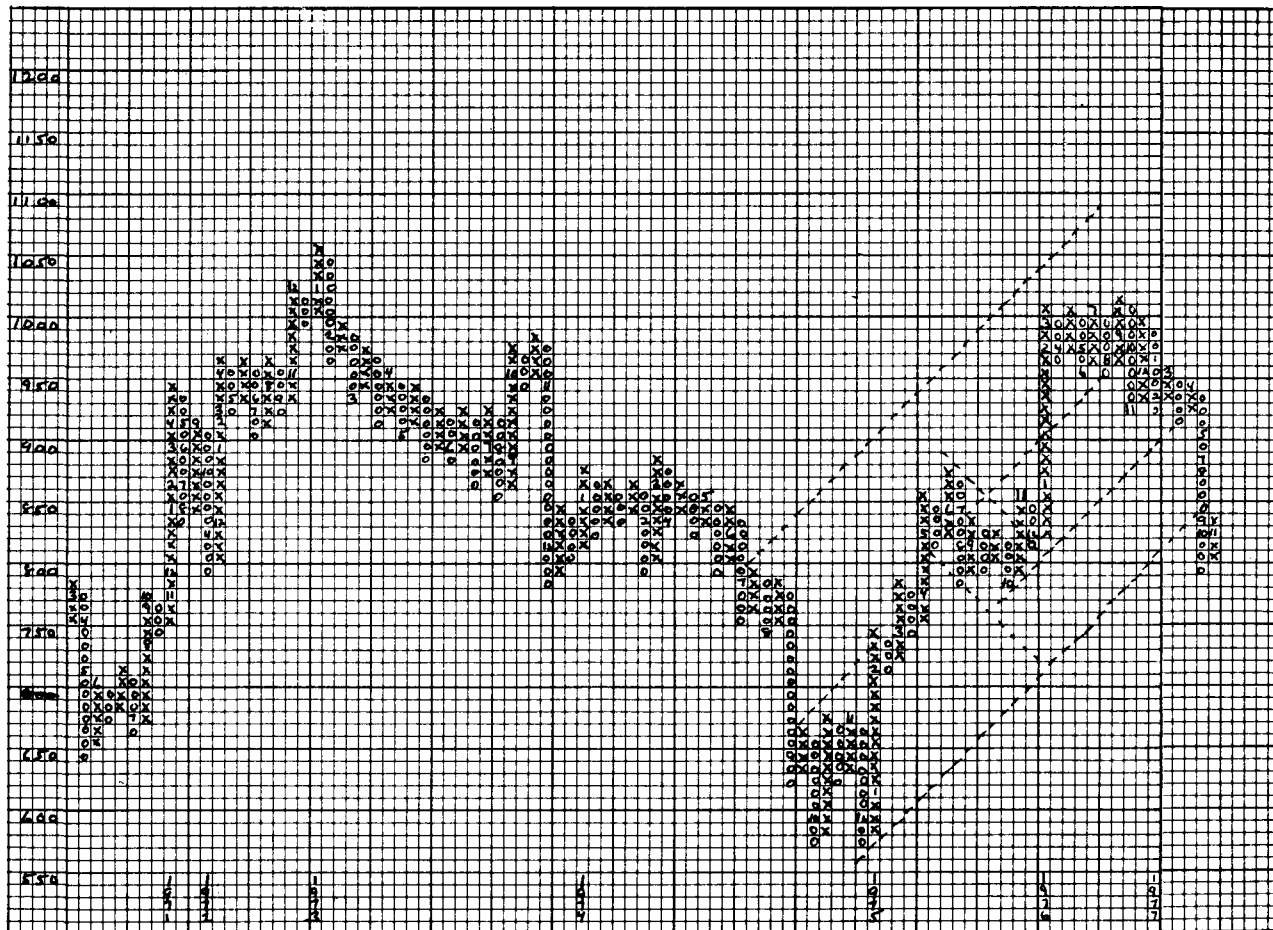


Our basic chart of the DJIA is a 5 × 15 point reversal chart. The readings are based on the hourly figures at 11, 12, 1, 2, 3 and close. Each square represents 5 points, and 3 squares or 15 points are necessary for a change in direction. The 3 o'clock was added October 1, 1974, when trading hours were extended to 4 pm.

This chart of the DJIA should be used as you would a chart of an individual stock. It is bullish when its chart pattern shows a penetration of a previous top; it is bearish when its chart pattern shows the penetration of a previous bottom. Bullish Support Lines and Bearish Resistance Lines are also of primary importance. These lines show where an upmove may run into resistance and a downmove may encounter support. The types of chart formations, whether triple tops, triple bottoms, bullish triangles, bearish triangles, etc., are also of significance. Vertical counts and horizontal counts to determine price objective may also be used.

Although the DJIA may sometimes lag behind other technical indicators at market tops, it usually leads all indicators at market bottoms. In the few cases where it does not lead another technical indicator, it is coincident with it. It is not a laggard at market bottoms. This may be true because blue chip stocks are usually the last to fall at the end of a bull market and the first to turn up at the end of a bear market.

DOW-JONES INDUSTRIAL AVERAGE (10 × 30)



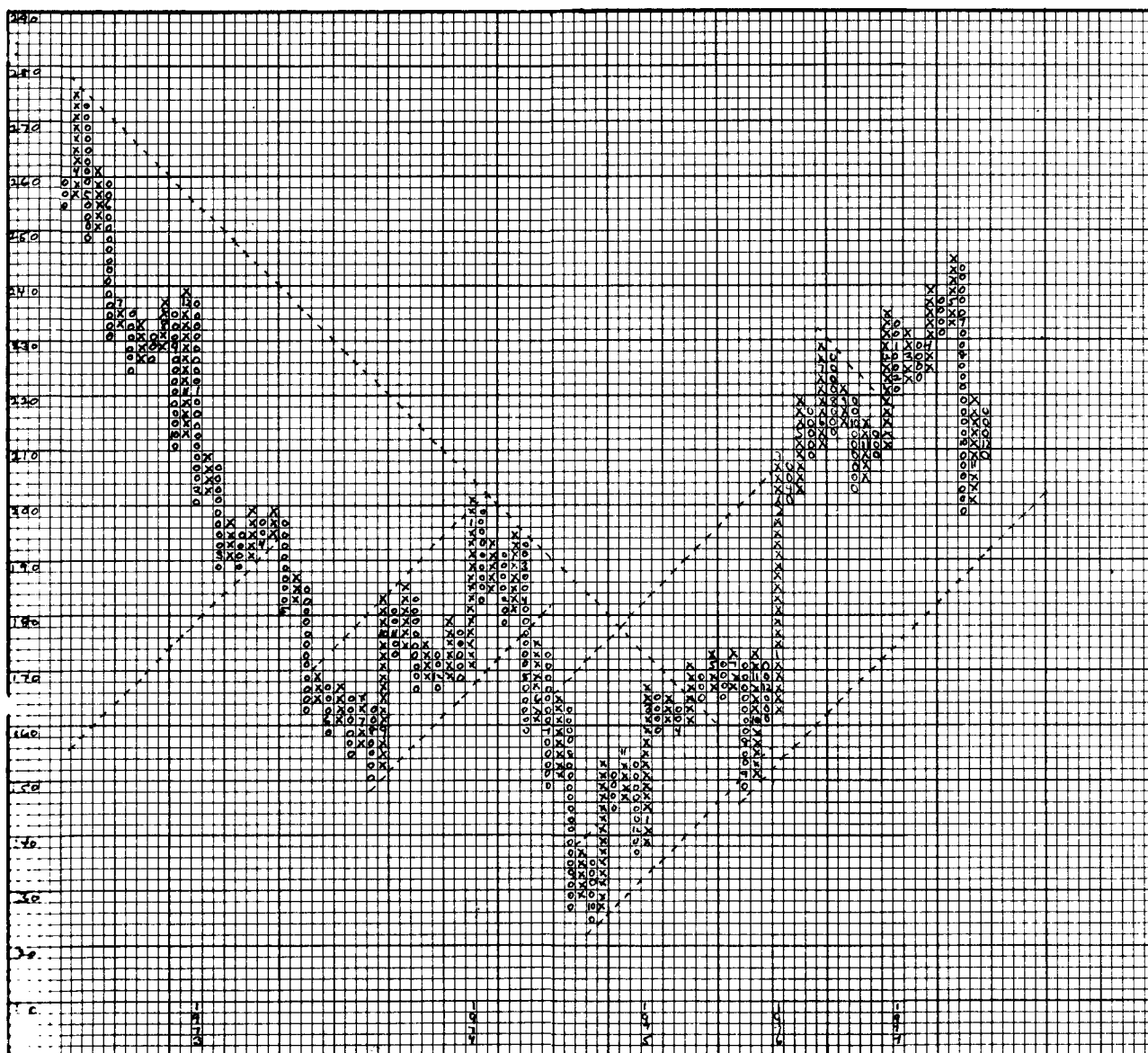
Last time we analyzed our basic 5 × 15 point reversal chart of the Dow-Jones Industrial Average. This week we are dealing with the 10 × 30 point reversal chart of the same Average. Each square on this chart represents 10 points, and 3 squares or 30 points are necessary for a change in direction. The readings are based on the figures at 11, 12, 1, 2, 3 o'clock and close.

This chart of the DJIA shows the longer term trends. It avoids many of the minor buy and sell signals which show up on the 5 × 15 point chart. The buy and sell signals on this chart are, therefore, more significant and important to the longer term trader and investor. A comparison of both charts will show how signals may differ or confirm each other.

Besides signals, Bearish Resistance Lines and Bullish Support Lines may also differ on the two charts. The 10 × 30 chart will show longer term trend lines and major support and resistance lines.

Signals and trend lines that coincide on both charts are of practical significance.

## DOW-JONES TRANSPORTATION AVERAGE



On January 1, 1970, Dow-Jones replaced its Rail Average by a new Transportation Average. Eleven of the original railroad stocks have been retained. Six airline stocks and three trucking stocks replaced the nine railroad stocks which were dropped. Dow Theorists, in the past, used the Rails to confirm the action of the Industrials. Both averages had to be bullish for a confirmed bull market and both had to be bearish for a confirmed bear market. They have continued to use the new Transportation Average in the same manner.

Each square on this chart represents 2 full points and 3 squares, or 6 points, are necessary for a change in direction. The readings are based on the hourly figures at 11, 12, 1, 2, 3 and close. The 3 o'clock price was added on October 1, 1974, when trading was extended to 4 pm.

This chart of the DJTA should be used in the same way as the chart of an individual stock or the chart of the Dow-Jones Industrial Average. It is bullish when its chart pattern shows the penetration of a previous top and bearish when it shows the penetration of a previous bottom. Bullish Support Lines and Bearish Resistance Lines are important for longer term trends. When both the DJIA and DJTA are in bullish trends, the market as a whole is bullish; when both are in bearish trends, a bear market is in progress. A divergence in trend between the DJIA and DJTA may signal a coming change in trend.

## SECTION EIGHT

### TRADING TACTICS

The foregoing sections of the book were devoted to trading strategy - the overall picture of when to buy a stock and when to sell a stock.

This section will deal briefly with trading tactics, such as:

1. Establishing the trade
2. The pullback
3. The use of stoploss orders
4. Taking profits
5. Stocks with a high short interest
6. Volume



During a bull market, with the proper use of chart patterns, trend lines, price objective, etc. the following average results might be achieved:

<u>Formation</u>	<u>% of Time Profitable</u>	<u>Average % Gain</u>	<u>Average Time</u>
Double Top	80.3%	38.7%	11.5 months
Bullish Signal	80.4%	26.5%	8.6 months
Bullish Triangle	71.4%	30.9%	5.4 months
Triple Top	87.9%	28.7%	6.8 months
Combinations	79.5%	36.0%	8.0 months
Spread Triple Top	85.7%	22.9%	7.7 months
Bearish Signal Reversed	92.0%	23.2%	2.5 months

As can readily be seen, there is a great variation in these formations; in percentage of times profitable, in average gain, and in the time necessary for such gain. All the different elements are important. Some traders might regard the time element as most important, as this allows a greater turn over of capital. Other traders might place emphasis on the amount of gain, and still others on the degree of risk.

An average of all these formations shows: 1) a profitability ratio of 83.7%, 2) an average gain of 29.5%, and 3) 7.2 months as the average time for such gain. We will assume that the trading formations on which we have no statistics will fall into this average pattern.

Conversely, during a bear market, the following results might be achieved:

<u>Formation</u>	<u>% of Time Profitable</u>	<u>Average % Gain</u>	<u>Average Time</u>
Double Bottom	82.1%	22.7%	4.7 months
Bearish Signal	88.6%	21.9%	4.9 months
Bearish Triangle	87.5%	33.3%	2.5 months
Triple Bottom	93.5%	23.0%	3.4 months
Combination	83.3%	22.9%	3.4 months
Spread Triple Bottom	86.5%	24.9%	4.6 months

An average of these bearish formations shows: 1) a profitability ratio of 86.9%, 2) an average gain of 24.8%, and 3) 3.9 months as the average time for such gain.

Now, if we put the average figures side-by-side we get the following:

<u>Formations</u>	<u>% of Time Profitable</u>	<u>Average % Gain</u>	<u>Average Time</u>
Bull Market	83.7%	29.5%	7.2 months
Bear Market	86.9%	24.8%	3.9 months

The conclusion to be drawn from this comparison is that there is less risk in selling short in a bear market than in buying long in a bull market. The average gain in a bear market is 4.7% less than in a bull market, but this is more than compensated by the fact that the average time for the gain in a bear market is 3.3 months shorter than for a bull market. A trader, therefore, who does not sell short in a bear market is acting contrary to his best interests. In a lesser period of time, at a lesser risk, if he

sells short in a bear market, he will actually make more money than when he buys long in a bull market. His bull market profit is at the rate of 4.09% per month while his bear market profit is at the rate of 6.36% per month. A trader cannot afford to lose such a profitable opportunity. He must learn to adjust his thinking and actions to both bull and bear markets.

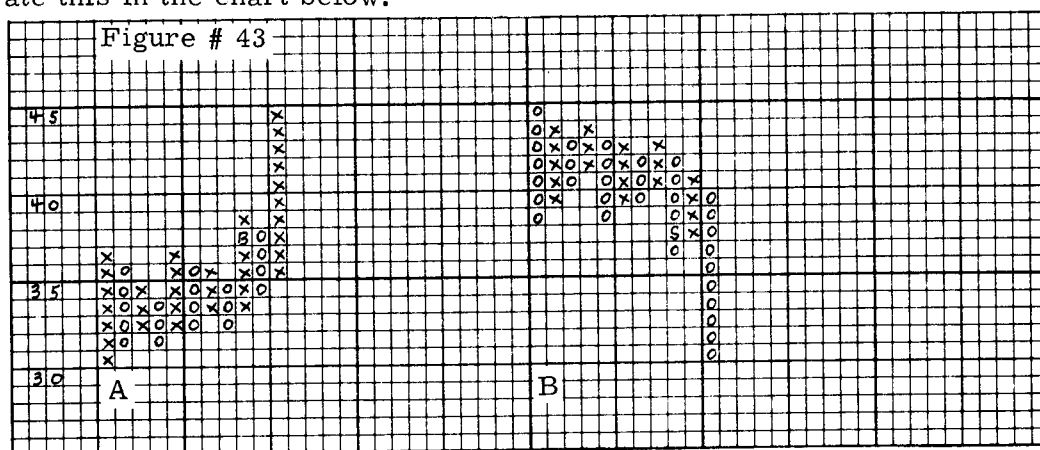
Although statistically the profit probabilities are on the side of the trader and investor who follows the market strategy laid down in the previous pages, like any other method, it can in no way lay claim to certainty. What we have thus far outlined may be the Truth but, this in itself does not guarantee Certainty or a profit. We still have the twofold problem of making the statistics and probabilities more certain when we establish a trade (although 100% certainty will never be reached) and how to handle our trades when they are not successful. It must always be borne in mind that 17% of the bullish trades end in losses and that about 13% of the bearish trades are also unsuccessful.

On the first problem of the degree of certainty we can perhaps lay down the following rules:

1. Never buy long unless the price is above both a Bullish Support Line and a Bearish Resistance Line. Make sure that a vertical or a horizontal count allows for a profit of at least 30% (average profit being 29.5%). Rely on vertical more than on the horizontal count, where possible. If the Price Objective obtained by a count is more than the 30%, then it is still better. Select your trade with the highest Price Objective in mind. Make sure that the channel created by the Bullish Support Line and the Bullish Resistance Line also allows for a move to at least 30%.

2. Never sell short unless the price is below both a Bearish Resistance Line and a Bullish Support Line. Make sure that a vertical or a horizontal count allows for a profit of at least 25% (average profit being 24.8%). On a downmove, trend lines may be even more important than vertical and horizontal counts. Make sure that the channel created by the Bearish Resistance Line and the Bullish Support Line allows for a move of at least 25%.

3. Another tactic that can be used to increase the profit percentage is to buy long or sell short, not on the original breakout, but to establish the trade on a pullback. Let us illustrate this in the chart below.



In example A, we have the Spread Triple Top formation with the buy signal at 38. After the signal, the price rose to only 39 and then pulled back to 35. This "pullback" enabled one to buy the stock at a "discount," 3-points lower than where the original

buy signal took place. Since the average percent gain in the preceding tables was based on buying at the point of the signal, buying on a pullback will increase the percentage of gain. A pullback takes place at least 50% of the time in all trading formations and if one has enough patience and keeps enough charts trading opportunities of this kind will be plentiful.

In example B, we have the Spread Triple Bottom formation with a sell short signal at 38. After the signal, the price declined only to 37 and then pulled back to 41. Here again, the pullback enables one to sell the stock short at a better price. In the case of a short sale, the pullback should always be looked for. A stock cannot be sold short when it continues to fall uninterruptedly - it must be sold short at an up tick of at least 1/8 of a point. The pullback assures you of establishing your short sale.

4. What about losses? The trading formations described above, with all the ramifications of the proper conditions under which a trade should be established, still do not guarantee a profit every time a trade is made. The trader and investor should also consider the probability of losses and how they should be handled. The loss probabilities are as follows:

<u>Formation</u>	<u>% of Time Unprofitable</u>	<u>Average % Loss</u>	<u>Average Time</u>
Double Top	15.3%	13.1%	4.6 months
Bullish Signal	16.9%	10.4%	4.9 months
Bullish Triangle	24.6%	5.4%	3.0 months
Triple Top	12.1%	8.3%	2.2 months
Combination	15.4%	8.1%	3.8 months
Spread Triple Top	14.3%	7.3%	2.5 months
Bearish Signal Reversed	8.0%	10.0%	1.5 months

Taking an average, these bullish formations are unprofitable 15.2% of the time, for an average loss of 9%; the average time for this loss is 3 months.

The probabilities of losses when establishing short sales are as follows:

<u>Formation</u>	<u>% of Time Unprofitable</u>	<u>Average % Loss</u>	<u>Average Time</u>
Double Bottom	17.9%	9.7%	5.5 months
Bearish Signal	10.7%	10.4%	3.5 months
Bearish Triangle	12.5%	5.4%	4.1 months
Triple Bottom	6.5%	8.7%	3.4 months
Combination	16.7%	10.8%	3.0 months
Spread Triple Bottom	13.0%	9.5%	3.0 months

On average, then, short sales are unprofitable 13% of the time for an average loss of 9.1%; the average time for this loss is 3.8 months.

We can summarize these statistics thus:

<u>Bull Market Formations</u>		<u>Bear Market Formations</u>	
% of Time Profitable	84.2%	% of Time Profitable	86.9%
% of Time Unprofitable	15.2%	% of Time Unprofitable	13.0%

Bull Market Formations

Average % Gain	29.5%
Average % Loss	9.0%
Average Time for Gain	6.5 months
Average Time for Loss	3.0 months

Bear Market Formations

Average % Gain	24.8%
Average % Loss	9.1%
Average Time for Gain	3.9 months
Average Time for Loss	3.8 months

Two rules can be deduced from the above statistics: 1) Never let your loss go beyond 10%, and 2) give your trade a little over three months to start working in your favor - if it doesn't do it by that time, close it out. These are general rules for cutting losses short and switching to trades that might prove more profitable. The use of stop-loss orders will be discussed below.

5. Another way to increase average profits and keep losses as low as possible is to take positions only in the most profitable trading formations. Taking into consideration the percentage of time a formation is profitable and unprofitable, its average gain and loss, and the average time for such gain and loss, the best trading formation is the TRIPLE TOP formation in a bull market and the TRIPLE BOTTOM formation in a bear market.

The statistics on this formation are:

<u>Triple Top</u>		<u>Triple Bottom</u>	
% of Time Profitable	87.9%	% of Time Profitable	93.5%
% of Time Unprofitable	12.1%	% of Time Unprofitable	6.5%
Average % Gain	28.7%	Average % Gain	23.0%
Average % Loss	8.3%	Average % Loss	8.7%
Average Time for Gain	6.8 months	Average Time for Gain	3.4 months
Average Time for Loss	2.2 months	Average Time for Loss	3.4 months

By restricting one's trading to this formation, average profit should be increased and the average loss should be smaller. The time factor in this formation is also very important as it can lead to a more rapid turnover of capital - less money will do more work.

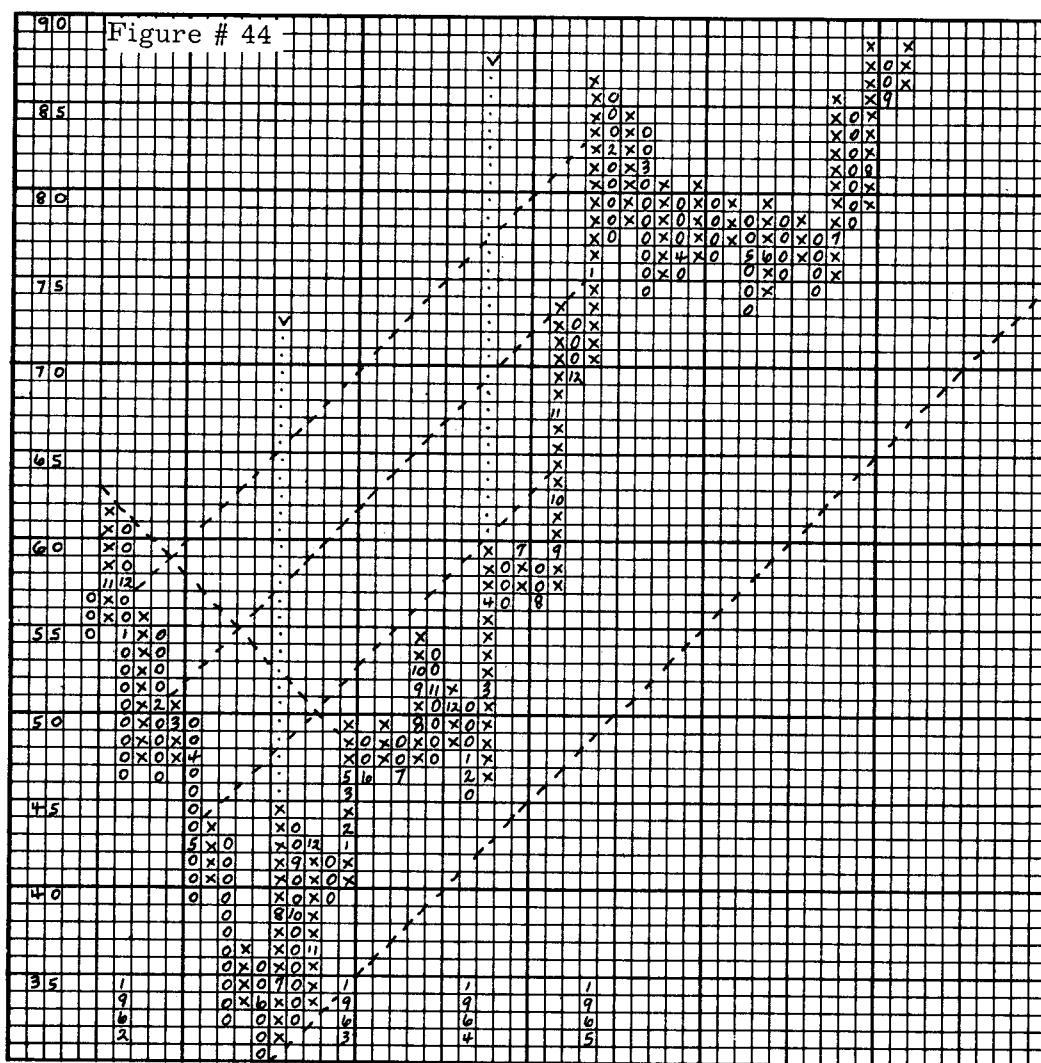
6. What about stoploss orders? Stoploss orders are criticized on the grounds that they often lead to abandonment of positions which ultimately turn out to be very profitable or to "whipsaws" - the getting in and out of positions at a loss or lesser profit until the right positions is established. This may be true but one should consider stop-loss orders as the insurance one pays against being completely wrong. In reviewing our trading formations, a buy signal, of some sort, is always given when the chart pattern shows the penetration of a previous high, and a sell signal when the chart pattern shows the penetration of a previous low. If you are long of a stock, the logical point for a stoploss order would be one square below the previous bottom; if you are short of a stock, the logical point for a stoploss order would be one square above a previous top. This will cut your losses short - and all the statistics referred to above are based on just such stoploss orders, which is in effect, trading from signal to signal.

There may, however, be occasions when a stoploss order does not have to be used as mechanically as outlined above. This is especially true for the long term trader and investor. If you are long of a stock and its price pattern continues to fluctuate above the Bullish Support Line, you may disregard any sell signal that takes place above this trend line. It is only when this Bullish Support Line is penetrated that a stoploss

order should be placed or the trade closed out. It is also important that the industry group of which the stock is a member and the market as a whole be bullish. The converse is true when you are short of a stock. No stoploss order need be kept as long as the price pattern fluctuates below the Bearish Resistance Line. It is only when this trend line is penetrated that a stoploss order should be used or the trade closed out. Also, make sure that the industry group of which the stock is a member and the market as a whole is also bearish. When not using a stoploss order, the exercise of careful judgment is required and emotions kept under control. If you feel you cannot do this, then use a stoploss order.

7. When should profits be taken? We have two guides on this point: 1) the Price Objective, and 2) the average profit based on probabilities outlined in this section. When establishing a trade, make sure that your Price Objective ( on a vertical or horizontal count ) is above the 29.5% profit probability in a bull market, and above the 24.8% profit probability in a bear market. Once your profit is above the average, stay with your trade to see whether the higher Price Objective will be reached. Here you might use stoploss orders arbitrarily to clinch at least the average profit. When the price reaches the Price Objective ( which is above the average profit ) you might close out your positions and be satisfied or continue to hold with arbitrary close stoploss orders.

HOWARD JOHNSON (HJ)



## CHART ILLUSTRATION OF THE ABOVE PRINCIPLES

In Figure # 44, (on page 78) we have a chart of Howard Johnson. We will use this chart to illustrate some of the principles outlined in this Section.

Howard Johnson made a low of 31 in June 1962 and gave its first buy signal in July at 38 on a Double Top formation. We would not have recommended a purchase at that point because it was still below a Bearish Resistance Line.

A Bullish Support Line was drawn from the June low.

The first time Howard Johnson gave a buy signal after penetrating the Bearish Resistance Line was at 50 on a Triple Top formation in August 1963. This buy signal took place above both the Bullish Support Line and the Bearish Resistance Line. The stock could have been bought on this breakout or one could have exercised patience and waited for a pullback to increase his profit percentage. After going to 55, the price pulled back to 48 giving us the opportunity to do just this in November 1963.

Before establishing our buy position, however, we would have to determine how high the stock might go. A vertical count on the first up-column after the June 1962 low gave us a Price Objective of 73 (  $14 \times 3$  added to 31 ). With the breakout taking place at 55, this gave a possible profit of 18 points or 32.7%. This was higher than the average percentage gain of 29.5% on a bullish formation. This met another qualification necessary for establishing the trade. If we bought on the pullback to 48 we could even expect a profit of 37.5%.

Since the price pattern continued to fluctuate above the Bullish Support Line we did not need any stoploss order and could proceed to wait patiently for our Price Objective to be reached. We did not have to accept the sell signal given in February 1964 which was just above the Bullish Support Line.

While waiting for our Price Objective of 73 to be reached, we got another buy signal at 61 in September 1964 on a Triple Top formation. This would have given us more confidence that the price of 73 would be reached. It was reached two months later in November.

Having reached our original Price Objective we could have taken our profit and have been quite satisfied with it. Or we could have elected to remain with the stock and follow it up with stoploss orders. This would stop us out of our position on the next sell signal. This would have occurred at 77 in March 1965. The few additional points that would have been gained did not actually warrant the additional time involved in holding on to our position. Taking profit at our Price Objective of 73 would have proven more satisfactory and we would have looked for another trading opportunity for the employment of our funds - using the same principles over again in the new situation.

The chart also shows three Bullish Resistance Lines creating possible channels within which the price might move. We could expect the first Resistance Line to be penetrated, and even the second might have been broken on the upside. But waiting for the third Resistance Line to be penetrated would be too optimistic, although it may happen in a few cases.

There is one other important fact that should be pointed out on this chart. At times more than one vertical count can be taken to determine a Price Objective. The

first vertical count was taken from the June 1962 low which was the lowest point reached after the sell signal at 54 in January 1962 on a Double Bottom formation. A new vertical count may be taken after another sell signal is given and the final low made. Such a sell signal was given in February 1964 at 47 on a Bearish Signal formation. The low was made the same month at 46. A vertical count, therefore, taken on the first upmove ( or next column of Xs ): 14 x 3 added to the low of 46 gives another Price Objective of 88. In January 1965 the price reached 87. It ultimately reached 88 in August.

One more rule that might be of use - be content with a profit one point below your Price Objective. In many cases, the Price Objective is missed by just one point.

8. Stocks with a high short interest. Once a month, both the Wall Street Journal and Barron's publish a comprehensive list of stocks with the number of shares that have been sold short during the previous month. A similar list of the American Stock Exchange may be obtained free of charge directly from the American Stock Exchange. A short sale is accomplished by borrowing a stock from an owner (your broker does this for you) and selling it. The short seller hopes to make a profit by buying the stock later at a lower price and returning the stock to the lender.

There is a general rule that a stock with a rising short interest is bullish and a stock with a falling short interest is bearish. The reasoning behind this is that the greater the short interest the greater the number of people that will be compelled to buy the stock at some future date.

We would not recommend using the rule as a technical tool for trading in stocks. There have been too many instances when a stock has had a rising short interest for months and the stock, nevertheless, continued to decline. Brunswick Corporation (BC), during 1961 and 1962 is a good example of this.

Furthermore, a rising short interest is more important in a bull market than in a bear market. A rising short interest during a bull market usually leads to "panic" buying as shorts rush to buy stocks in order to cut their losses.

There is one use, however, that can be made of the short interest in stocks. Make a list of those stocks that have a short interest of 1% or more of their outstanding shares. There are usually about two dozen of such stocks. Never sell these stocks short. Use these stocks for buy positions with our Bearish Signal Reversed formation (see page 40). Such stocks can provide the opportunity for substantial and fast profits.

9. Volume - We have not dealt with the question of volume in any of the preceding pages. The Point and Figure analyst has always maintained that price makes volume and volume does not make price. The price of a stock will both attract and repel volume. Other technical analysts pay a good deal of attention to volume and have devised many systems on how to use volume, such as on-balance volume, ultra high volume, large lot volume, etc. Applying these techniques to individual stocks requires a great deal of work. Assuming that they had some merit, we still do not feel that the difference in results obtained by their use, when compared to the simple Point and Figure chart, would warrant the extra work involved. The time could be more beneficially spent in keeping more Point and Figure charts.

## SECTION NINE

### CONVERTIBLE BONDS

A convertible bond can be converted into the related common stock at a specified share-to-share ratio, either indefinitely or up to a specified date.

A convertible bond, bought at the right price and at the right time, combines most of the safety of a bond, the yield of an ordinary bond, and the appreciation potential of a common stock. A convertible bond has an approximate price floor but no price ceiling.

Because of the relative safety of certain convertible bonds, banks will often lend up to 85% of the market price of a convertible. With only a 15% margin required, the gain potential on a cash investment may thus be larger than on the related common stock. The interest paid on the loan is fully tax deductible.

This section will be devoted to the problem of choosing a convertible bond for trading and investment purposes by Point and Figure charts. Also, does the chart of a convertible anticipate or follow the chart of the related common and how can they be used in conjunction with each other?



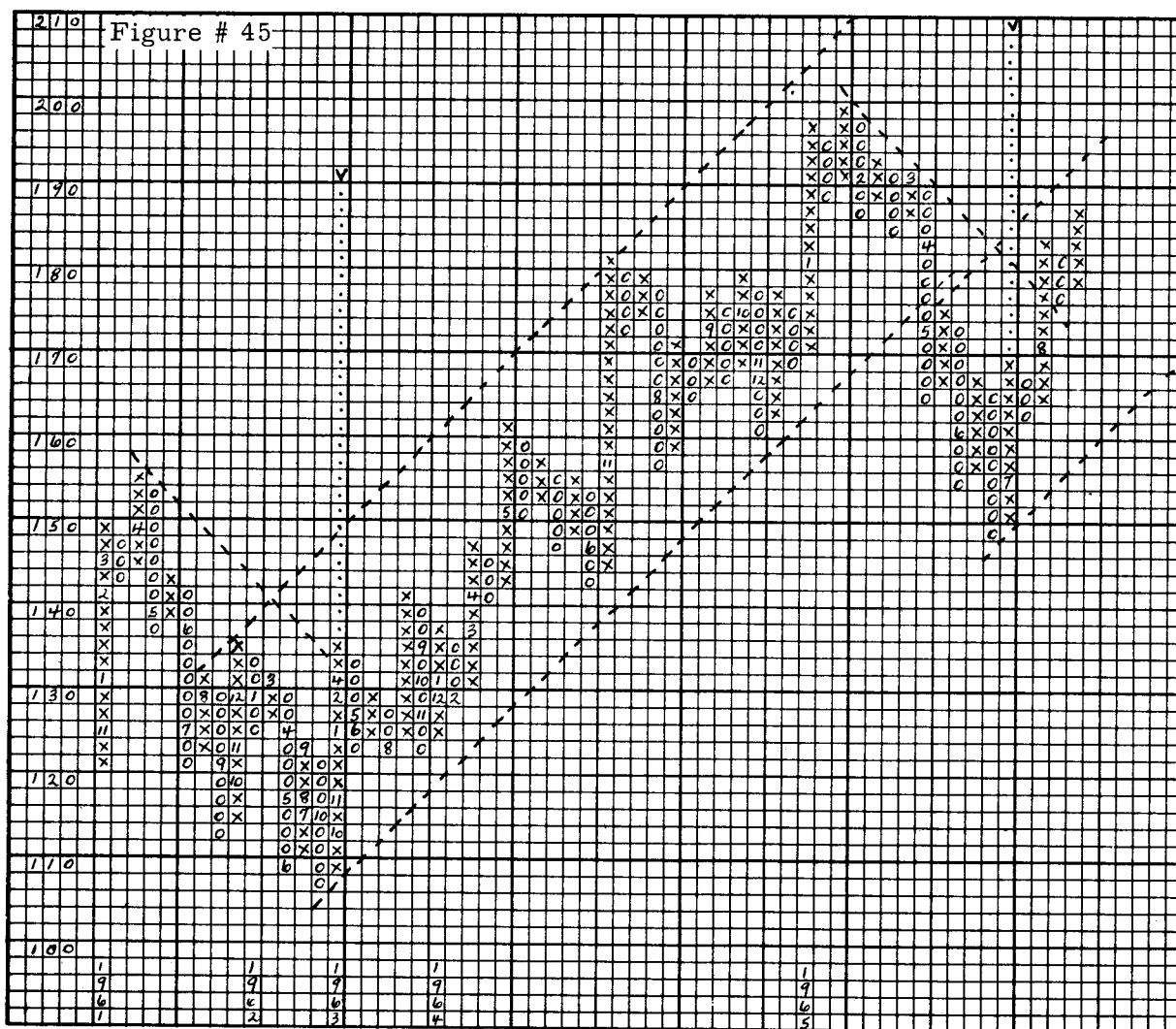


Figure # 45 is a chart of the convertible bond of Richfield Oil (5 3/8s '83). It is constructed exactly as the chart of a stock. Since its price range is above 100, each square represents two points with three squares or six points necessary for a change in direction. The chart is based on the daily highs and lows of the convertible appearing in the Wall Street Journal.

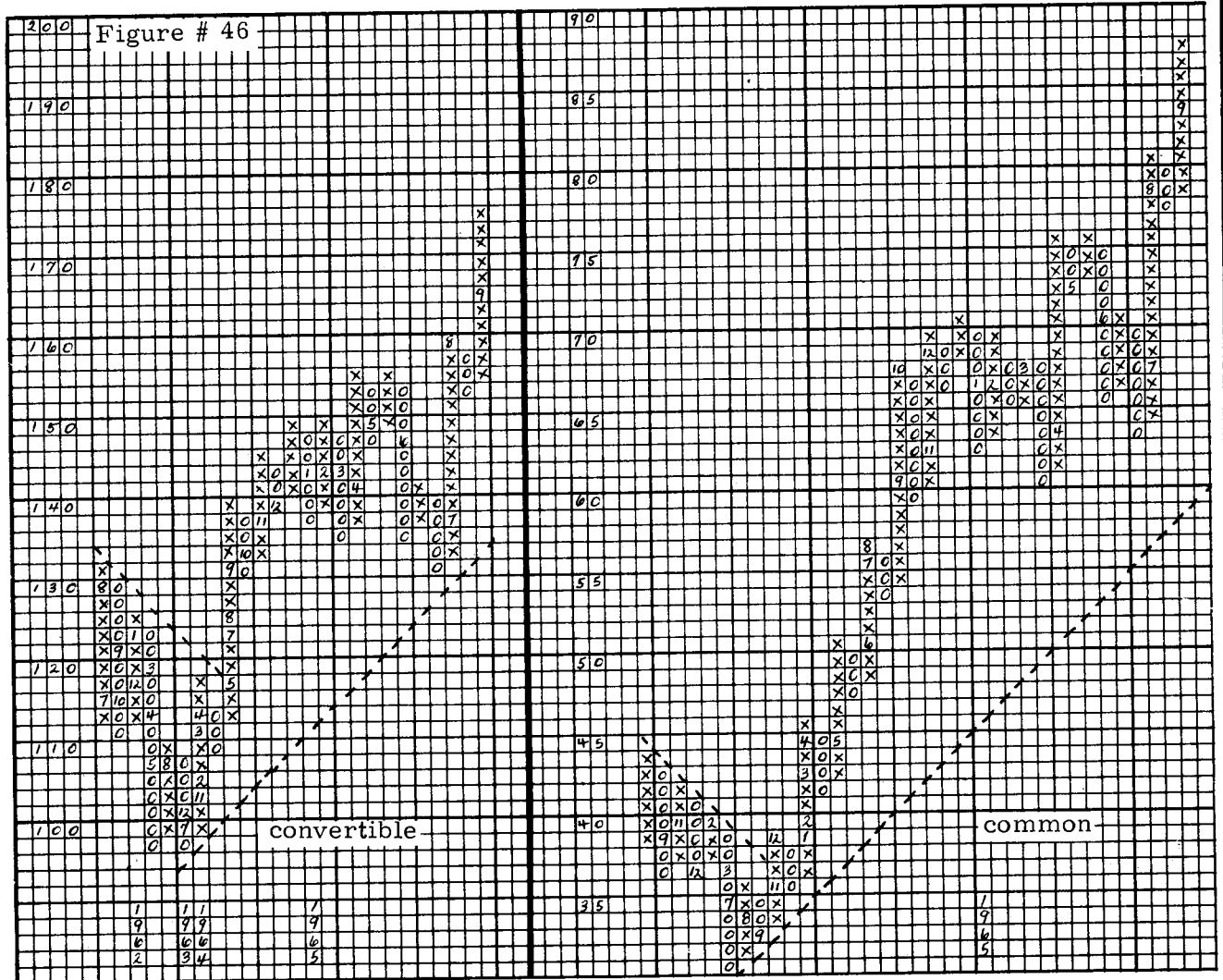
The Bearish Resistance Line was penetrated in April 1963 at 136. The first buy signal, after this penetration, took place in August at 132 on a Double Top formation and one immediately thereafter at 138 on a Spread Triple Top formation. These signals were both valid since they took place after the penetration of the Bearish Resistance Line and above the Bullish Support Line. The Bullish Support Line was drawn from the October 1962 low of 108.

A vertical count on the first up-column after the October 1962 low yields a Price Objective of 192. There are 14 Xs in that column each representing 2 points; since the reversal consists of 6 points we multiply the 14 by 6 and get a product of 84. If we add this 84 to the low of 108 we get a total of 192. This is the Price Objective.

After the buy signals indicated were given, we could have waited for a pullback. During September, October and November the price actually pulled back to 124, a much better point to buy than at the original breakouts.

None of the sell signals had to be acted upon since they all took place above the Bullish Support Line. The Price Objective of 192 was reached in January 1965. The Bullish Support Line was finally penetrated in April 1965.

BOEING COMPANY



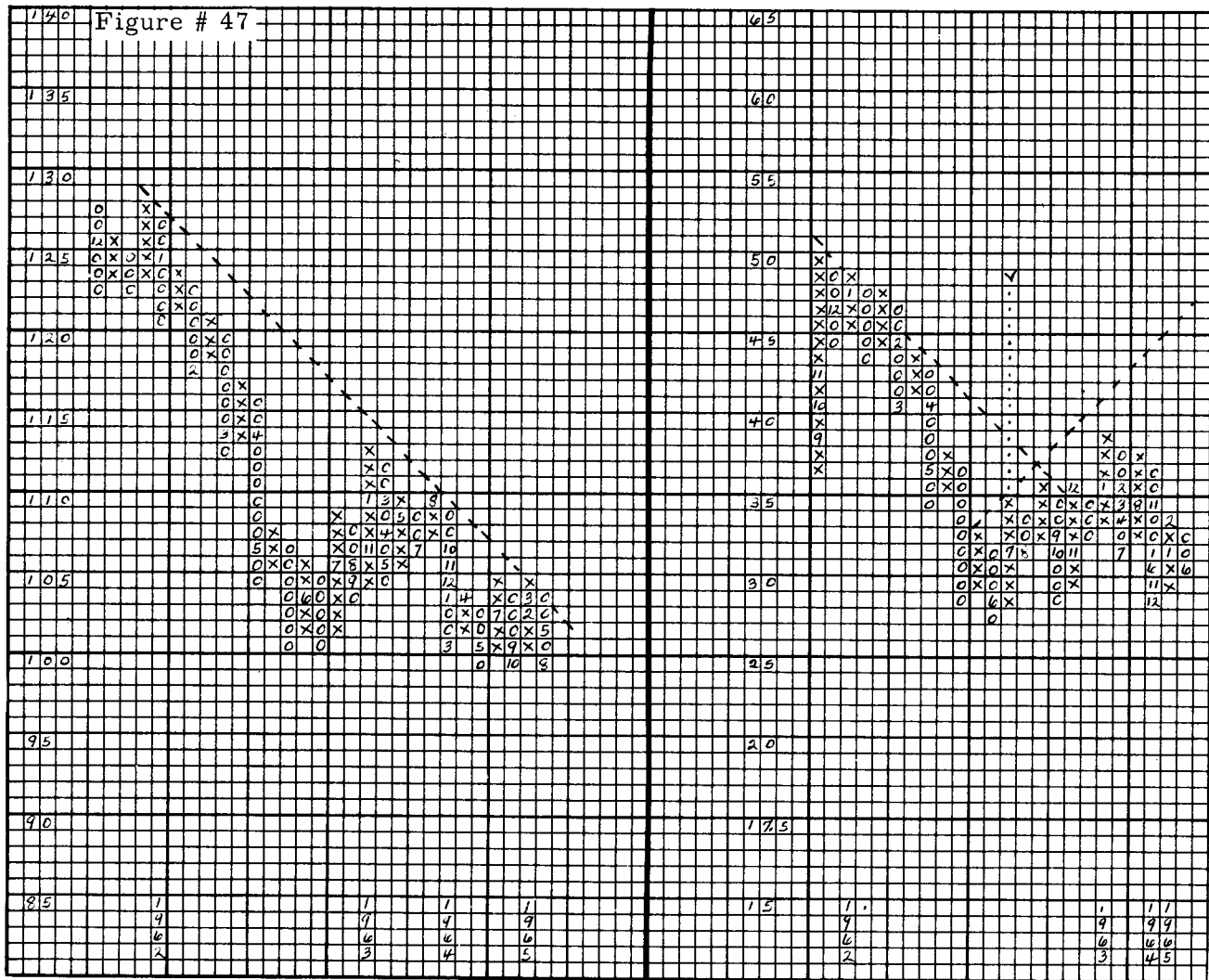
The chart of the convertible bond is constructed as we would the chart of a common stock. The Bearish Resistance Line and the Bullish Support Line are the conventional trend lines described previously.

In most cases there is very little difference between the chart of the common stock and the chart of the convertible. The overall similarity can be seen in the charts of Boeing. Both have thus far held above the Bullish Support Line.

In the case of Boeing, one could have bought the convertible bond just on the action of the common stock. As a matter of fact, acting only on the chart of the common would have resulted even in greater profits because the trade would have been established much earlier. The common stock penetrated its Bearish Resistance Line in December 1963, while the convertible bond did not penetrate its Bearish Resistance Line until May 1964. Actually, however, the dynamic upmove both in the common and in the convertible did not start until May 1964, and acting on the chart of the convertible would have been much better from a timing point of view. Capital could have been employed elsewhere between December 1963 and May 1964.

The difference in these two charts is of minor importance although some difference in timing is evident. The same holds true for most charts and a person could buy the convertible bond when getting the proper signal on the common stock. However, there are occasions when there is a significant difference between the two charts. Such a difference is illustrated in the following charts of American Distilling.

AMERICAN DISTILLING



The chart of the convertible bond of American Distilling is constructed in the same manner as that of a stock. It is a 3-point reversal chart. One exception was made, however, above 100, one-point units are used. This is because of the relative inactivity of the bond.

Trend lines are used in the same manner as on a chart of a stock. The convertible has a Bearish Resistance Line. A trader or investor, with this chart in his possession, would never have purchased this convertible bond. Its price pattern never penetrated this Bearish Resistance Line.

The person who only had a chart of the common stock might have acted differently. The Bearish Resistance Line was penetrated and the stock gave a buy signal in January 1963 at 37 on a Triple Top formation. A vertical count from the June 1962 low yielded a Price Objective of 49. On the basis of this chart alone, he might have decided to buy the convertible in order to obtain more leverage because of the lower margin.

The person who had both of these charts would have bought neither the convertible nor the common. He could have used the convertible chart to confirm the action of the chart of the common. Since an investor in convertibles is usually more sophisticated and knowledgeable than the average trader, he would have seen the lack of confirmation by the convertible chart and, therefore, refused to take a position even in the common.

## SECTION TEN

### *OVER-THE-COUNTER STOCKS*

For every one issue of stock traded through recognized Stock Exchanges there are about nine issues traded in the Over-the-Counter Market. Besides trading in industrial and utility stocks, it is also the main market for insurance and bank stocks.

Can Over-the-Counter stocks be charted in Point and Figure? The answer is yes. And they are even simpler to chart than stocks listed on recognized exchanges.

Bid and asked prices for Over-the-Counter stocks may be found daily in *The Wall Street Journal* and *The New York Times*. To chart these stocks, we use only the bid price. The following 3 pages illustrate such charts. Since these charts were produced by computer, the months October, November and December are indicated by the letters A, B and C, instead of the numerals 10, 11 and 12. These charts are reproduced from our quarterly O-T-C Chart Book.

The charts reproduced on the following 3 pages are from "*The Chartcraft O-T-C Point and Figure Chart Book*," published quarterly.

A B A INDS I ABAT 3701CC

Table with 11 rows and columns for A B A INDS I ABAT 3701CC. Includes BEAR PD 10.00 and various alphanumeric codes.

ABKCO INDS I ABKC 774100

Table with 9 rows and columns for ABKCO INDS I ABKC 774100. Includes BEAR PD .25 and various alphanumeric codes.

AEL INDS INC AELN 1030100

Table with 12 rows and columns for AEL INDS INC AELN 1030100. Includes BEAR PD 19.50 and various alphanumeric codes.

AES TECHNOLO AEST 1032100

Table with 11 rows and columns for AES TECHNOLO AEST 1032100. Includes BEAR PD 6.50 and various alphanumeric codes.

AIC PHOTO IA APHD 1348100

Table with 12 rows and columns for AIC PHOTO IA APHD 1348100. Includes BEAR PD .25 and various alphanumeric codes.

A P F ELECTR APFE 1855100

Table with 19 rows and columns for A P F ELECTR APFE 1855100. Includes BEAR PD and various alphanumeric codes.

API IR APIT 1864100

Table with 17 rows and columns for API IR APIT 1864100. Includes BEAR PD .50 and various alphanumeric codes.

APL CORP APLC 2024110

Table with 11 rows and columns for APL CORP APLC 2024110. Includes BEAR PD .25 and various alphanumeric codes.

ASG INDS INC ASGN 2051100

Table with 11 rows and columns for ASG INDS INC ASGN 2051100. Includes BEAR PD 6.50 and various alphanumeric codes.



ALYN E BACO ALYN 2005110C

19	BEAR PD 7.50
18	
17	X+
16	X0+
15	X X2 +
14	XOXO +
13	XOXO +
12	XOXO +
11	XOXO +
10	XOXO +
9	XOXO +
8	XOXO +
7	XOXO +
6	XOXO +
5	XOXO +
4	XOXO +
3	XOXO +
2	XOXO +
1	XOXO +
0	XOXO +
34	5 6 7 8

AMAREX INC AMRX 2300610C

20	XOXO XOXO XOXO
19	XOXO XOXO XOXO
18	XOXO XOXO XOXO
17	XOXO XOXO XOXO
16	XOXO XOXO XOXO
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14	XOXO XOXO XOXO
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12	XOXO XOXO XOXO
11	XOXO XOXO XOXO
10	XOXO XOXO XOXO
9	XOXO XOXO XOXO
8	XOXO XOXO XOXO
7	XOXO XOXO XOXO
6	XOXO XOXO XOXO
5	XOXO XOXO XOXO
4	XOXO XOXO XOXO
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AM BK TR PA APEN 2421310C

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20	XOXO XOXO XOXO
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18	XOXO XOXO XOXO
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16	XOXO XOXO XOXO
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14	XOXO XOXO XOXO
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12	XOXO XOXO XOXO
11	XOXO XOXO XOXO
10	XOXO XOXO XOXO
9	XOXO XOXO XOXO
8	XOXO XOXO XOXO
7	XOXO XOXO XOXO
6	XOXO XOXO XOXO
5	XOXO XOXO XOXO
4	XOXO XOXO XOXO
3	XOXO XOXO XOXO
2	XOXO XOXO XOXO
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34	5 6 7 8

ALPHATYPE CC ALIP 20815100

14	BULL PD 12.00
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7	XOXO XOXO XOXO
6	XOXO XOXO XOXO
5	XOXO XOXO XOXO
4	XOXO XOXO XOXO
3	XOXO XOXO XOXO
2	XOXO XOXO XOXO
1	XOXO XOXO XOXO
0	XOXO XOXO XOXO
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AM APPRAISAL AMCA 23852100

14	BULL PD 9.00
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AM BKRS INSR ABIC 24447200

14	BULL PD
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ALTON BOX BR ALTN 21573100

25	BEAR PD 6.00
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AM BANCSHARE ABSH 24085100

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AM BKRS LIFE ABLA 24465100

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## SECTION ELEVEN

### *TECHNICAL INDICATORS*

Besides analyzing stock chart patterns, technical analysis has also developed "technical" indicators—tools designed to aid in the determination of general market trends. A complete count of such indicators would probably reach to 200 or more.

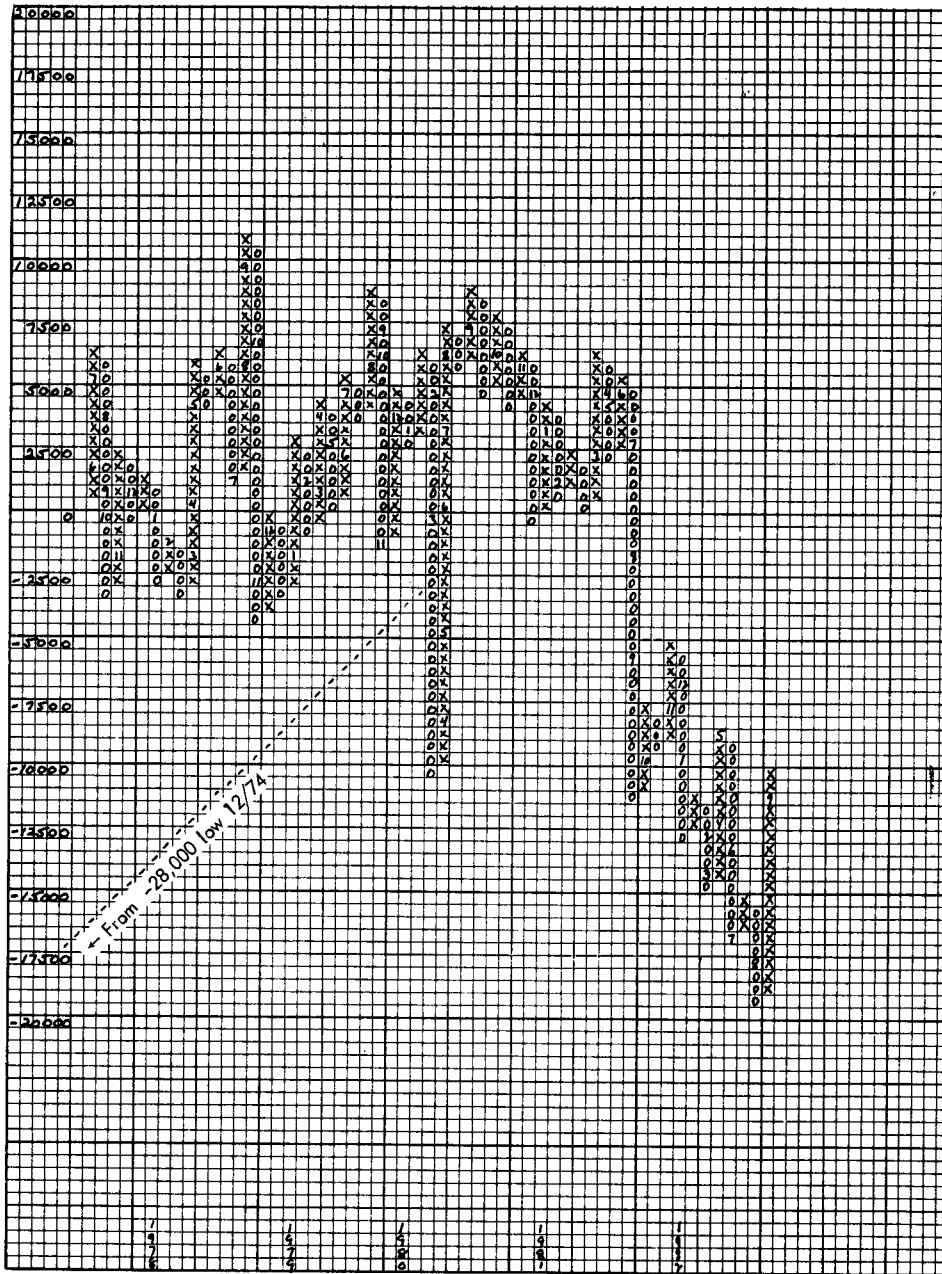
We are presenting here those that we believe to be the most valuable and the most popular. They are:

- The Cumulative Daily Advance-Dcline Line
- The High-Low Index
- The On-Balance Volume Index
- The Odd-Lot Balance Index
- The Odd-Lot Short Sales Index
- The 10-Day Advance-Dcline Ratio
- The 10-Day Upside-Downside Volume Ratio
- The 200-Day DJIA Momentum Index
- The DJIA One-Year % Chart
- The Index of Speculative Confidence
- The Gold Mining Disparity Index
- The Short Interest Ratio
- The % of NYSE Stocks Above Their 10-Week Moving Average
- The 10-Week Most Active Stocks Ratio
- The NYSE Bullish Percentage
- The DJIA Bullish Percentage
- General Motors as a Bellwether Stock

All these indicators, and more, are covered every two weeks in  
*"The Chartcraft Technical Indicator Review."*



### CUMULATIVE ADVANCE/DECLINE LINE

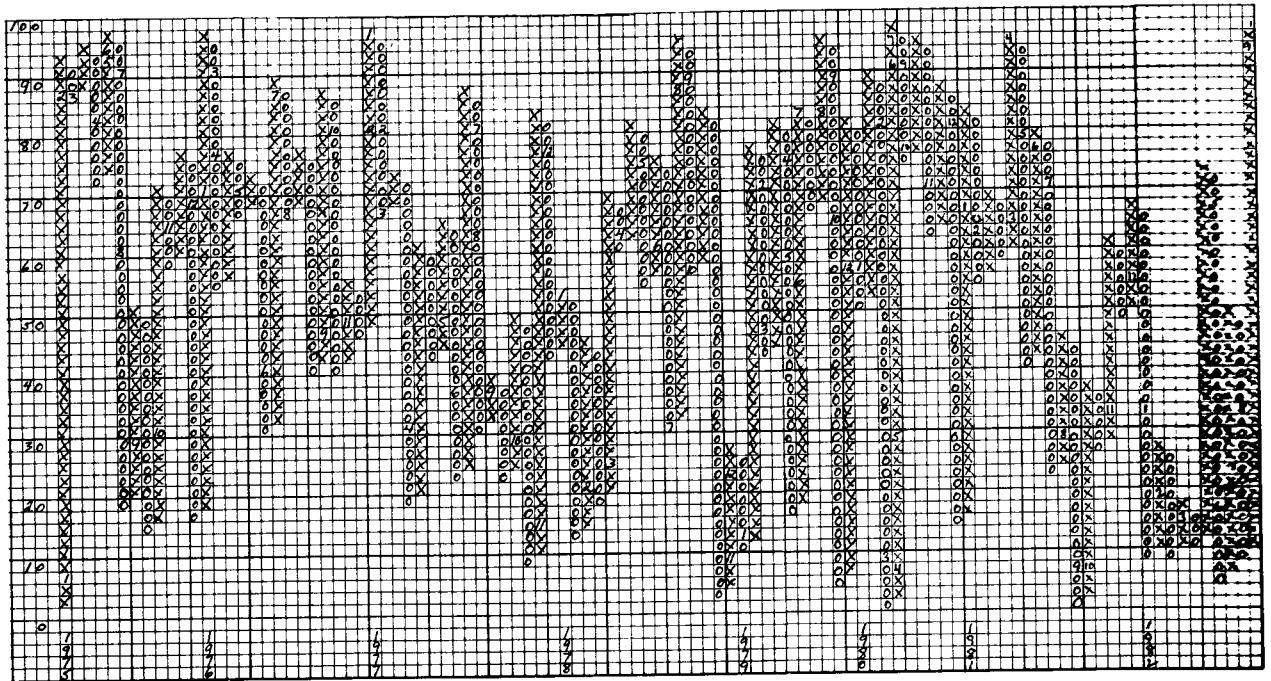


This index is a non-price measure of the trend of the market. It is based upon the number of NYSE issues advancing and declining and not upon the price of these issues. Every day the difference between the issues advancing and issues declining is calculated. If more issues advanced than declined, the difference is added to the preceding day's total; if more issues declined than advanced, the difference is subtracted from the previous day's total. The advance-decline line may be started with any arbitrary number. Each square on our chart represents 500 and 3 squares, or 1500, are necessary for a change in direction.

The direction taken by the advance-decline line is always compared to that of the Dow-Jones Industrial Average. When both are advancing, the market is bullish. When both are declining, the market is bearish. A divergence in direction between the two usually indicates a coming change in trend.

It should also be borne in mind that the daily advance-decline line has a bearish bias. It made its high in March 1956 and this high has never been exceeded. Since then, at least up to December 1974, every bull market high and bear market low has been lower than the previous one.

## HIGH-LOW INDEX



CONSTRUCTION OF INDEX: DIVIDE THE DAILY NEW HIGHS BY THE SUM OF THE DAILY NEW HIGHS AND DAILY NEW LOWS. PLACE THE RESULTING PERCENTAGE FIGURE ON A 10-DAY MOVING AVERAGE AND POST TO CHART. EACH SQUARE ON THE CHART REPRESENTS 2%, AND 3 SQUARES OR 6% ARE NECESSARY FOR A CHANGE IN DIRECTION.

THE EXTREME PERCENTAGES ON THIS CHART ARE ABOVE 90% (OCCASIONALLY ABOVE 80%) AND BELOW 10 (OCCASIONALLY BELOW 20%).

INTERMEDIATE DOWNMOVES AND BEAR MARKETS USUALLY END WHEN THIS PERCENTAGE IS BELOW THE 10% LEVEL. INTERMEDIATE UPMOVES AND BULL MARKETS USUALLY END WHEN THIS PERCENTAGE IS ABOVE THE 90% LEVEL.

THE BEST TIME TO GO LONG IS WHEN THE PERCENTAGE IS BELOW THE 10% LEVEL AND TURNS UP. THIS IS A BULL ALERT SIGNAL. SHORT POSITIONS SHOULD BE COVERED AND LONG POSITIONS TAKEN. A RISE IN THE PERCENTAGE ABOVE A PREVIOUS TOP OR ABOVE THE 50% LEVEL IS A BULL CONFIRMED SIGNAL.

THE BEST TIME TO SELL SHORT IS WHEN THIS PERCENTAGE IS ABOVE THE 90% LEVEL AND TURNS DOWN. THIS IS A BEAR ALERT SIGNAL. LONG POSITIONS SHOULD BE CLOSED OUT AND SHORT POSITIONS ESTABLISHED. A DROP IN THE PERCENTAGE BELOW A PREVIOUS BOTTOM OR BELOW THE 50% LEVEL SIGNALS A BEAR CONFIRMED MARKET.

THE HIGH-LOW INDEX IS ONE OF THE BETTER MARKET TREND INDICATORS.

## ON-BALANCE VOLUME INDEX

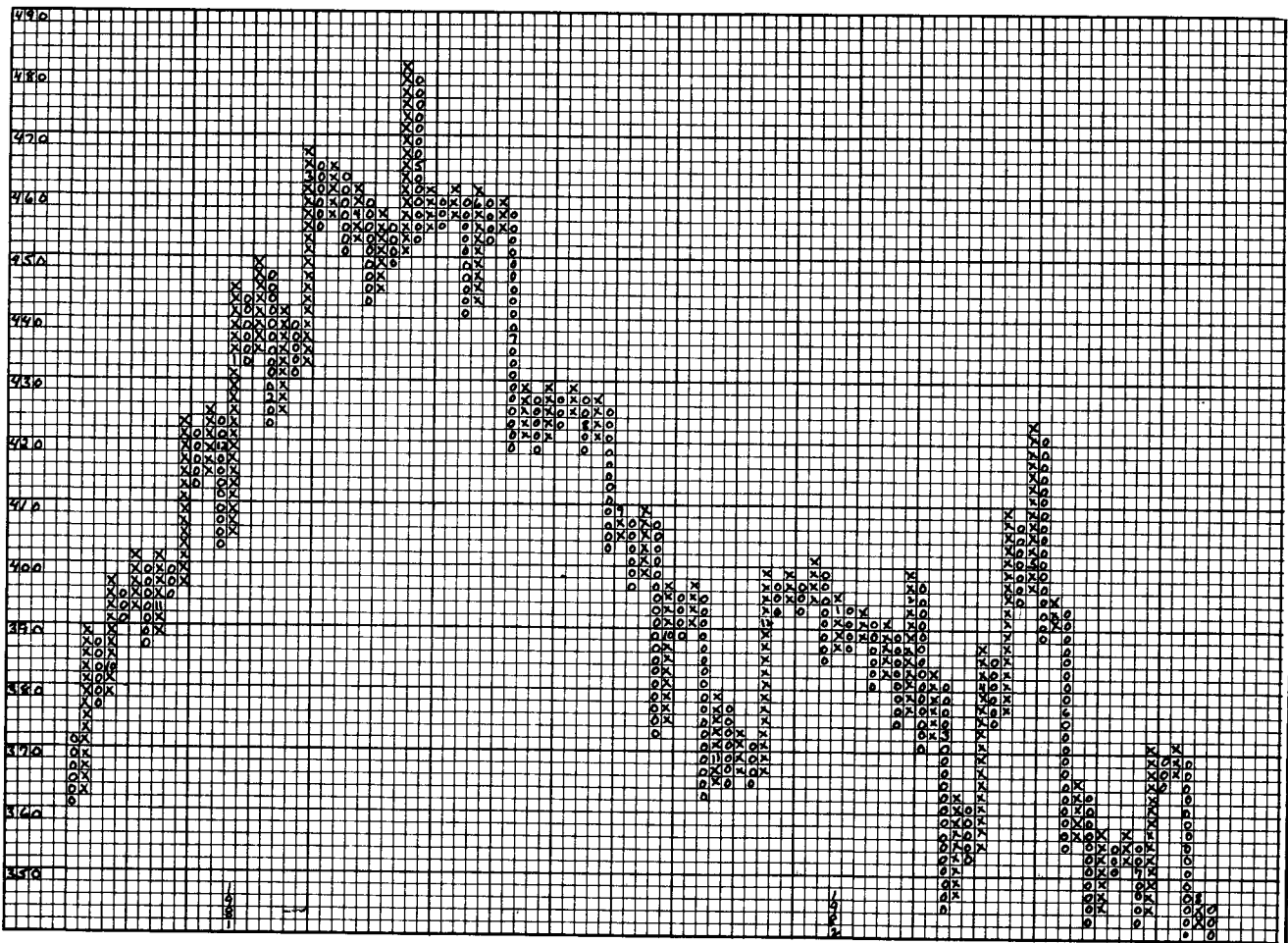
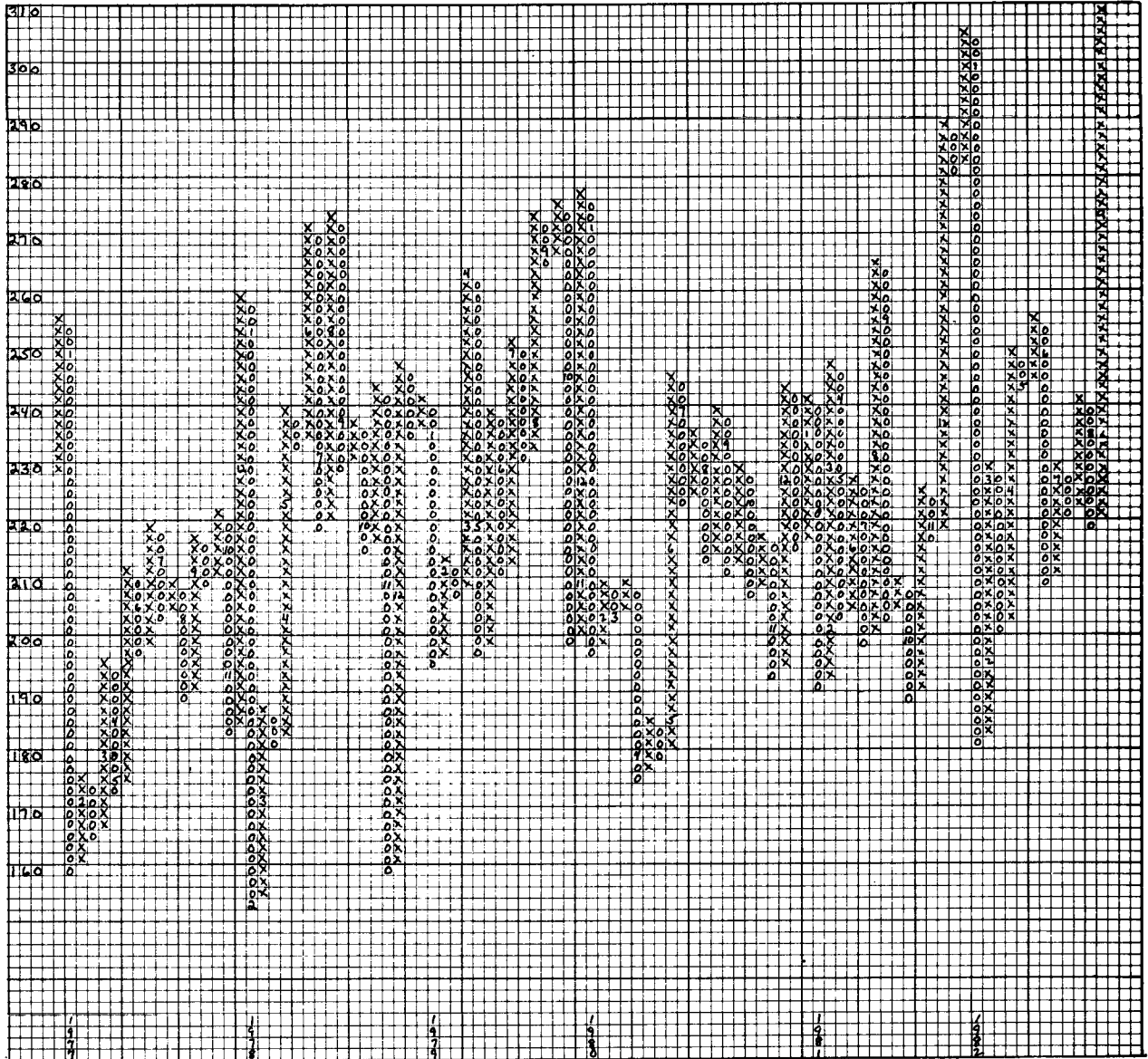


CHART CONSTRUCTION: WHEN THE DOW-JONES INDUSTRIAL AVERAGE CLOSES HIGHER, ADD THE TOTAL NYSE VOLUME FOR THAT DAY TO THE PREVIOUS DAY'S CUMULATIVE TOTAL; WHEN THE AVERAGE CLOSES LOWER, SUBTRACT THE TOTAL NYSE VOLUME FOR THAT DAY FROM THE PREVIOUS DAY'S CUMULATIVE TOTAL. EACH SQUARE ON THE CHART REPRESENTS 20,000,000 SHARES, AND 3 SQUARES OR 60,000,000 SHARES ARE NECESSARY FOR A CHANGE IN DIRECTION.

THE ON-BALANCE CHART SHOULD BE USED MAINLY AS CONFIRMATION OR NON-CONFIRMATION OF THE ACTION OF THE DOW-JONES INDUSTRIAL AVERAGE. IF THE DJIA PENETRATES A PREVIOUS TOP WITHOUT THE ON-BALANCE VOLUME DOING THE SAME, THEN THE UPMOVE IS SUSPECT. AND VICE VERSA, IF THE DJIA PENETRATES A PREVIOUS BOTTOM WITHOUT THE ON-BALANCE VOLUME DOING THE SAME, THE DOWNMOVE IS SUSPECT. FOR A BULL MARKET, BOTH THE DJIA AND THE ON-BALANCE VOLUME SHOULD GIVE BULLISH SIGNALS; FOR A BEAR MARKET, BOTH THE AVERAGE AND THE ON-BALANCE VOLUME SHOULD GIVE BEARISH SIGNALS. A SIGNAL BY ONLY ONE OR THE OTHER IS NOT ENOUGH TO CHANGE THE EXISTING TREND. THIS IS ACTUALLY A MODIFICATION OF THE DOW THEORY BY SUBSTITUTING ON-BALANCE VOLUME FOR OR ADDING IT TO THE TRANSPORTATION AVERAGE.

VOLUME ACTION SOMETIMES PRECEDES PRICE ACTION; AT THESE TIMES THE ON-BALANCE VOLUME CHART WILL ANTICIPATE THE DIRECTION OF THE DOW-JONES INDUSTRIAL AVERAGE.

ODD-LÔT BALANCE INDEX



CONSTRUCTION: DIVIDE TOTAL DAILY-ODD LOT SALES (INCLUDING SHORT SALES) BY ODD-LOT PURCHASES AND PLACE RESULTING PERCENTAGE ON A 70-DAY MOVING AVERAGE. PLOTTED ON A CHART EACH SPACE REPRESENTS 2% AND 3 SQUARES OR 6% ARE NECESSARY FOR A CHANGE IN TREND.

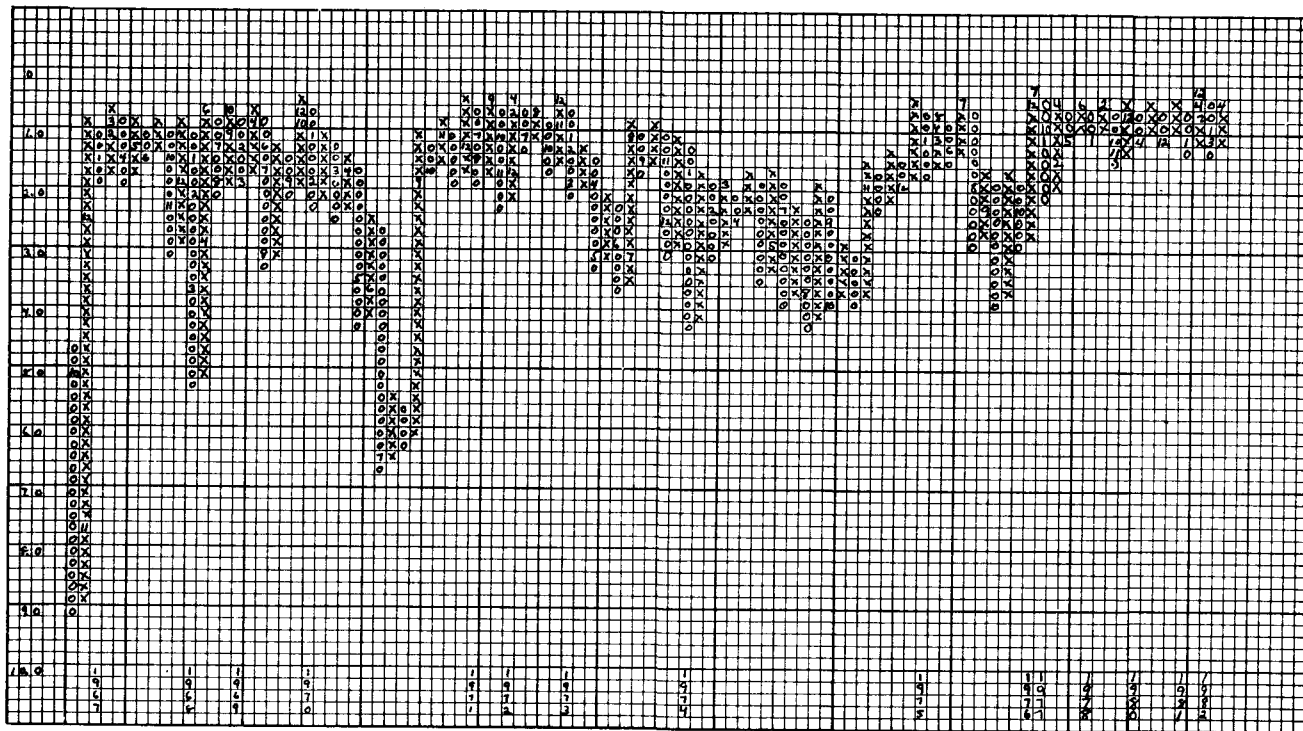
WHEN THE ODD-LOT BALANCE IS ABOVE 100%, IT INDICATES SELLING BY ODD-LOTTERS;WHEN IT IS BELOW 100% IT INDICATES ODD-LOTTERS ARE BUYING ON BALANCE.

IT HAS BEEN MANY YEARS SINCE ODD-LOTTERS HAVE BOUGHT ON BALANCE.

THE INTERPERTATION THAT ODD-LOT TRADERS ARE ALWAYS WRONG SHOULD BE AVOIDED. THEY HAVE TENDED TO INCREASE THEIR SELLING IN RECENT YEARS NEAR TOPS WHILE SELLING LESS WHEN THE MARKET WAS DOWN. THE PARAMETERS ON THESE OCCASIONS HAVE SHIFTED OVER THE YEARS AND THERE ARE NO SET POINTS TO WATCH FOR AT PRESENT. THEY DO SELL HEAVILY EVERY DECEMBER.

THIS INDICATOR HAS LOST MUCH OF ITS USEFULNESS IN RECENT YEARS.

### ODD-LOT SHORT SALES INDEX



THIS INDEX IS CONSTRUCTED BY DIVIDING THE DAILY ODD-LOT SHORT SALES BY THE DAILY ODD-LOT TOTAL SALES. THE RESULTING RATIO OR PERCENTAGE IS THEN PLACED ON A 5-DAY MOVING AVERAGE. THIS MOVING AVERAGE FIGURE IS PLOTTED ON THE CHART. THE SCALE OF THE CHART IS .2% AND 3 BOXES OR .6% ARE NECESSARY FOR A CHANGE IN DIRECTION. THE SCALE OF THE CHART HAS ALSO BEEN REVERSED SO THAT UNUSUALLY HEAVY ODD-LOT SHORT SELLING APPEARS AS A BOTTOM AND VERY LIGHT ODD-LOT SHORT SELLING APPEARS AS A TOP.

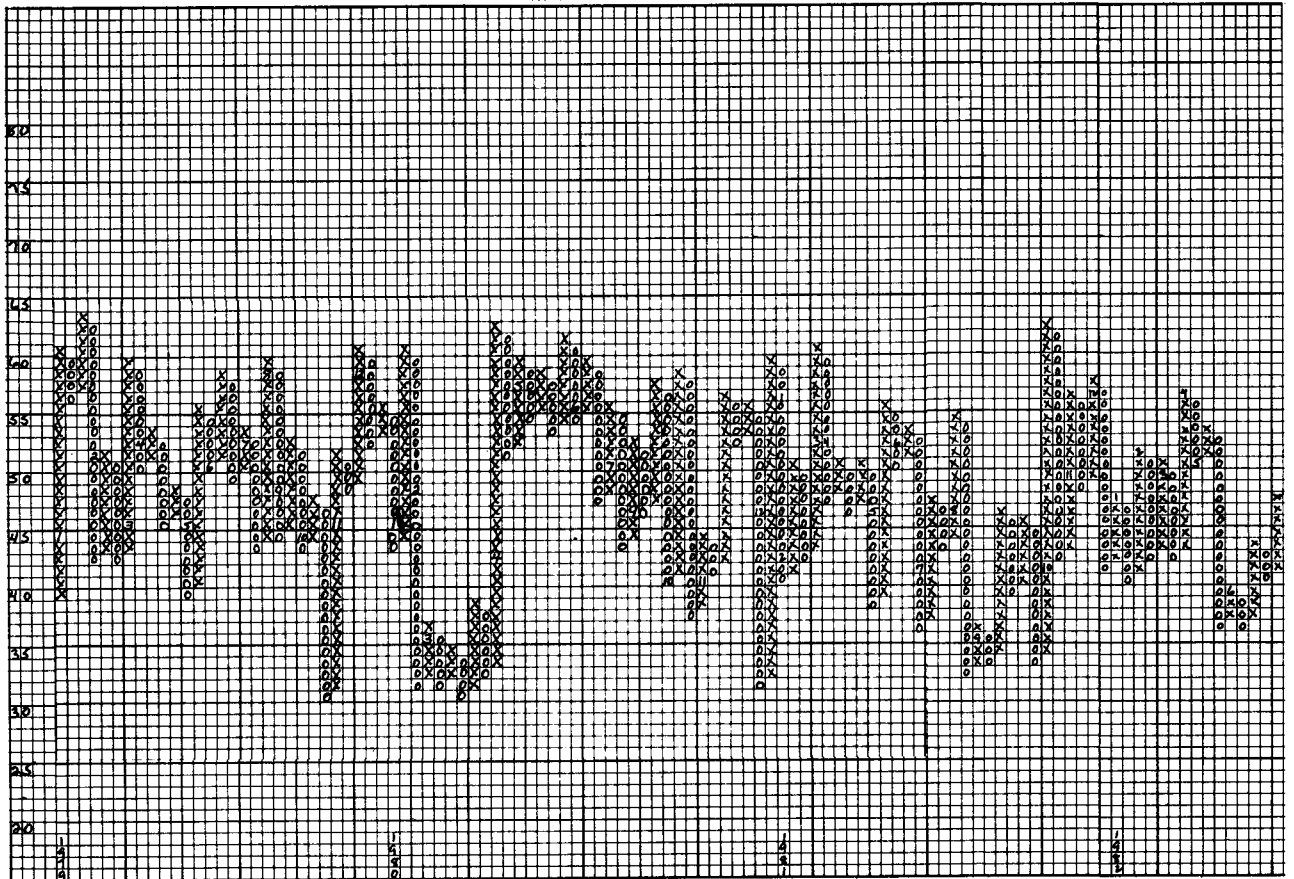
THIS INDICATOR HAS UNDERGONE A MAJOR CHANGE IN RECENT YEARS DUE TO THE EXISTENCE OF LISTED PUTS AND THE GRADUAL EXPANSION OF THE NUMBER OF PUTS OFFERED FOR TRADING.

IT MAY BE SEEN THAT THE PARAMETERS HAVE RAPIDLY CHANGED SINCE THE 1960'S. THE 1966 BEAR MARKET ENDED WITH ODD-LOT SHORT SALES REACHING 990 OF TOTAL ODD-LOT SALES. IN THE NEXT DECADE PEAK LEVELS DROPPED GRADUALLY TO 3.8% IN 1975.

VERY LIGHT ODD-LOT SHORT SELLING WAS USUALLY INDICATED WHEN THE PERCENTAGE WAS AT .4. THIS OCCURRED IN DECEMBER 1962, MARCH 1965, JANUARY 1966 AND DECEMBER 1969. THE LAST THREE WERE GOOD INDICATIONS OF MARKET TOPS. SINCE THAT TIME, HOWEVER, WE HAVE HAD A WHOLE SERIES OF SUCH INDICATIONS. ONLY DECEMBER 1972 INAUGURATED A MAJOR DOWNMOVE. IN JULY 1976, PERCENTAGE REACHED .2%. A DOWNMOVE IN THE DJIA FROM 1020 TO 750 FOLLOWED.

AS A GENERAL RULE, IT CAN BE STATED THAT ODD-LOTTERS SELL SHORT VERY LITTLE AT MARKET TOPS AND SELL SHORT QUITE HEAVILY AT MARKET BOTTOMS - AT BOTH INTERMEDIATE AND MAJOR TURNING POINTS. OVER THE LAST FEW YEARS, THIS INDICATOR HAS LOST SOME OF ITS RELIABILITY.

### 10-DAY ADVANCE/DECLINE RATIO



The above point and figure chart is constructed as follows: Each day divide the daily Advances by the total of daily Advances and Declines. Place the resulting ratio on a 10-day moving average and plot the resulting figure on the chart. Each square equals 1% and 3 squares or 3% are necessary for a change in direction.

Chart interpretation consists of the following elements: (1) direction of the movement, (2) penetration of a previous top or bottom, (3) whether above or below the 50% level, (4) upside and downside parameters, and (5) comparison of direction of movement with that of the Dow-Jones Industrial Average.

This index changes direction earlier than the DJIA. When the percentage is 60% or higher, market is entering an overbought area and a change in the immediate trend is not too far away. This change is confirmed by the index turning down, penetrating a previous bottom and/or declining below the 50% level. This signifies a change in the immediate trend from bullish to bearish. When the percentage is 35% or lower, market is entering an oversold area, and a change in the immediate trend is not too far away. This change is confirmed by the index turning up, penetrating a previous top, and/or rising above the 50% level. This signifies a change in the immediate trend of the market from bearish to bullish.

This indicator should be used to anticipate or confirm only the immediate trend of the market without any consideration of whether this trend is minor, intermediate or major.

## 10-DAY UPSIDE-DOWNSIDE VOLUME RATIO

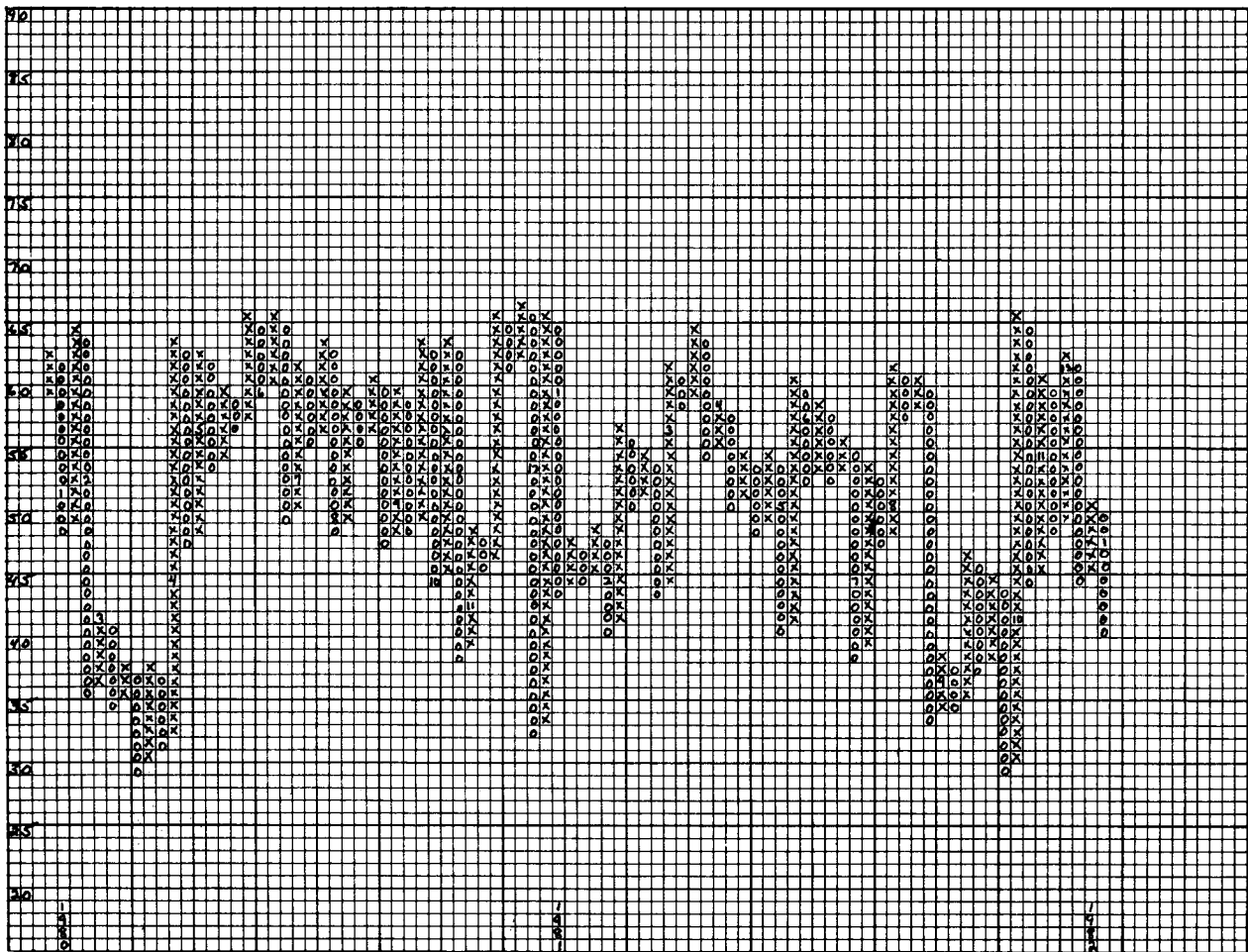


Chart Construction: Each day divide Upside Volume by the sum of Upside and Downside Volume. Place the resulting ratio on a 10-day moving average. Each square equals 1% and 3 squares or 3% are necessary for a change in direction.

The interpretation of this indicator is similar to that of the 10-day Advance-Decline Ratio. It often leads the latter both up and down. Both of these indicators should be in gear, one confirming the action of the other.

When the percentage is 60% or higher, the market is entering an overbought area and a change in trend is not too distant. This change is confirmed by this ratio turning down, penetrating a previous bottom and/or dropping below the 50% level.

When this percentage is 35% or lower, the market is entering an oversold area and a change in trend should be expected. This is confirmed by the ratio turning up, penetrating a previous top and/or rising above the 50% level.

This indicator is used only to judge the immediate market trend, without any consideration of whether it is minor, intermediate or major.

## 200-DAY DJIA MOMENTUM INDEX



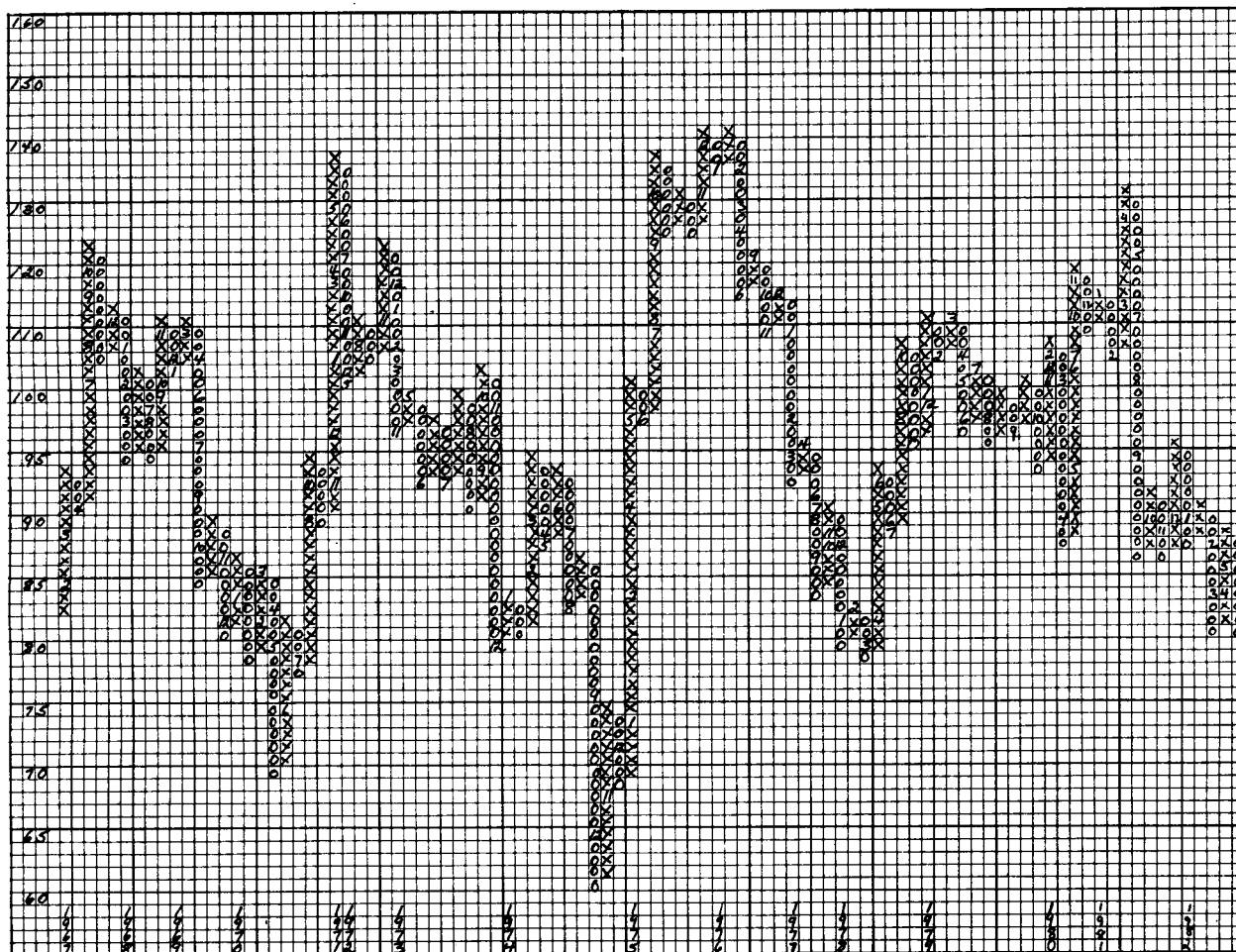
THIS INDEX IS CONSTRUCTED BY DIVIDING THE CURRENT DOW-JONES INDUSTRIAL AVERAGE BY ITS 200-DAY MOVING AVERAGE. THE RESULTING PERCENTAGE IS THEN PLOTTED ON THE CHART. EACH SQUARE REPRESENTS 1% AND 3 SQUARES OR 3% ARE NECESSARY FOR A CHANGE IN DIRECTION.

THE 200-DAY MOVING AVERAGE LINE IS ALWAYS AT 100. AS A GENERAL RULE, A PERCENTAGE ABOVE 100 INDICATES THAT A BULL MARKET IS IN PROGRESS, AND A PERCENTAGE BELOW 100 INDICATES THAT A BEAR MARKET IS IN PROGRESS. AT VARIOUS TIMES, A CHANGE IN TREND MAY BE ANTICIPATED BEFORE THE 100 LEVEL IS PENETRATED EITHER UPWARDS OR DOWNWARDS. A BULLISH SIGNAL MAY BE GIVEN BELOW 100 BY THE PENETRATION OF A PREVIOUS TOP; A BEARISH SIGNAL MAY BE GIVEN ABOVE 100 BY THE PENETRATION OF A PREVIOUS BOTTOM.

BEAR MARKET BOTTOMS USUALLY TAKE PLACE BELOW 85. IN JUNE 1962, THE BOTTOM WAS MADE AT 78, IN AUGUST AND OCTOBER 1966, A DOUBLE BOTTOM WAS MADE AT 83; IN MAY 1970, THE BOTTOM WAS MADE AT 80; AND IN OCTOBER 1974, THE BOTTOM WAS MADE AT 73. HOWEVER, IN FEBRUARY 1978, THE BOTTOM WAS MADE AT 87 AND IN MARCH 1980 AT 89.



## DOW-JONES INDUSTRIAL AVERAGE : ONE-YEAR PERCENT



THIS INDEX IS CONSTRUCTED BY TAKING THE CLOSING WEEKLY PRICE OF THE DOW-JONES INDUSTRIAL AVERAGE AND DIVIDING IT BY THE CORRESPONDING WEEKLY PRICE ONE YEAR AGO. (THESE FIGURES MAY BE OBTAINED FROM BARRON'S.) THE RESULTING % IS THEN PLOTTED ON THE CHART. EACH SQUARE REPRESENTS 1% UP TO 100 AND 2% ABOVE 100. 3 SQUARES ARE REQUIRED FOR A CHANGE IN DIRECTION.

TOPS USUALLY OCCUR ABOVE 120% AND BOTTOMS AT 80% OR LOWER. ONCE THE PERCENTAGE HAS GONE ABOVE 120%, WATCH FOR A BEARISH SIGNAL - THE PENETRATION OF A PREVIOUS BOTTOM. THIS BEARISH IMPLICATION IS CONFIRMED WHEN THE PERCENTAGE DROPS BELOW 100%. A BEAR MARKET IS THEN IN EFFECT. ONCE THE PERCENTAGE HAS GONE TO 80% OR LOWER, WATCH FOR A BULLISH INDICATION - THE PENETRATION OF A PREVIOUS TOP. THIS BULLISH IMPLICATION IS CONFIRMED WHEN THE PRICE RISES ABOVE 100%. A BULL MARKET IS THEN IN EFFECT.

BULLISH INDICATIONS WERE GIVEN IN NOVEMBER 1962, FEBRUARY 1967, JULY 1970, JANUARY 1974 (FALSE - NEVER WENT ABOVE 100%), JANUARY 1975 AND MARCH 1978.

THIS INDICATOR SHOWS THAT A BEAR MARKET USUALLY ENDS WHEN THE PERCENTAGE IS 80% OR LOWER OF WHERE IT WAS A YEAR AGO - THE AVERAGE FIGURE IS 74%. WHEN THIS LOW PERCENTAGE LEVEL IS REACHED, BEGIN LOOKING FOR A CHANGE IN TREND.

BUY SIGNALS BELOW 100 LEVEL ARE FEW AND FAR BETWEEN. ALL SUCH SIGNALS SINCE 1958 ARE LISTED BELOW:

2/58 Buy @ 96 - Sell 6/59 @ 134	7/70 Buy @ 83 - Sell 6/71 @ 128
1/61 Buy @ 95 - Sell 12/61 @ 118	1/74 Buy @ 85 - Sell 7/74 @ 87
11/62 Buy @ 85 - Sell 11/63 @ 117	1/75 Buy @ 76 - Sell 2/76 @ 135
2/67 Buy @ 86 - Sell 1/68 @ 105	4/78 Buy @ 85 - Sell 4/79 @ 104
	12/81 Buy @ 93 - Sell 2/82 @ 87

## INDEX OF SPECULATIVE CONFIDENCE



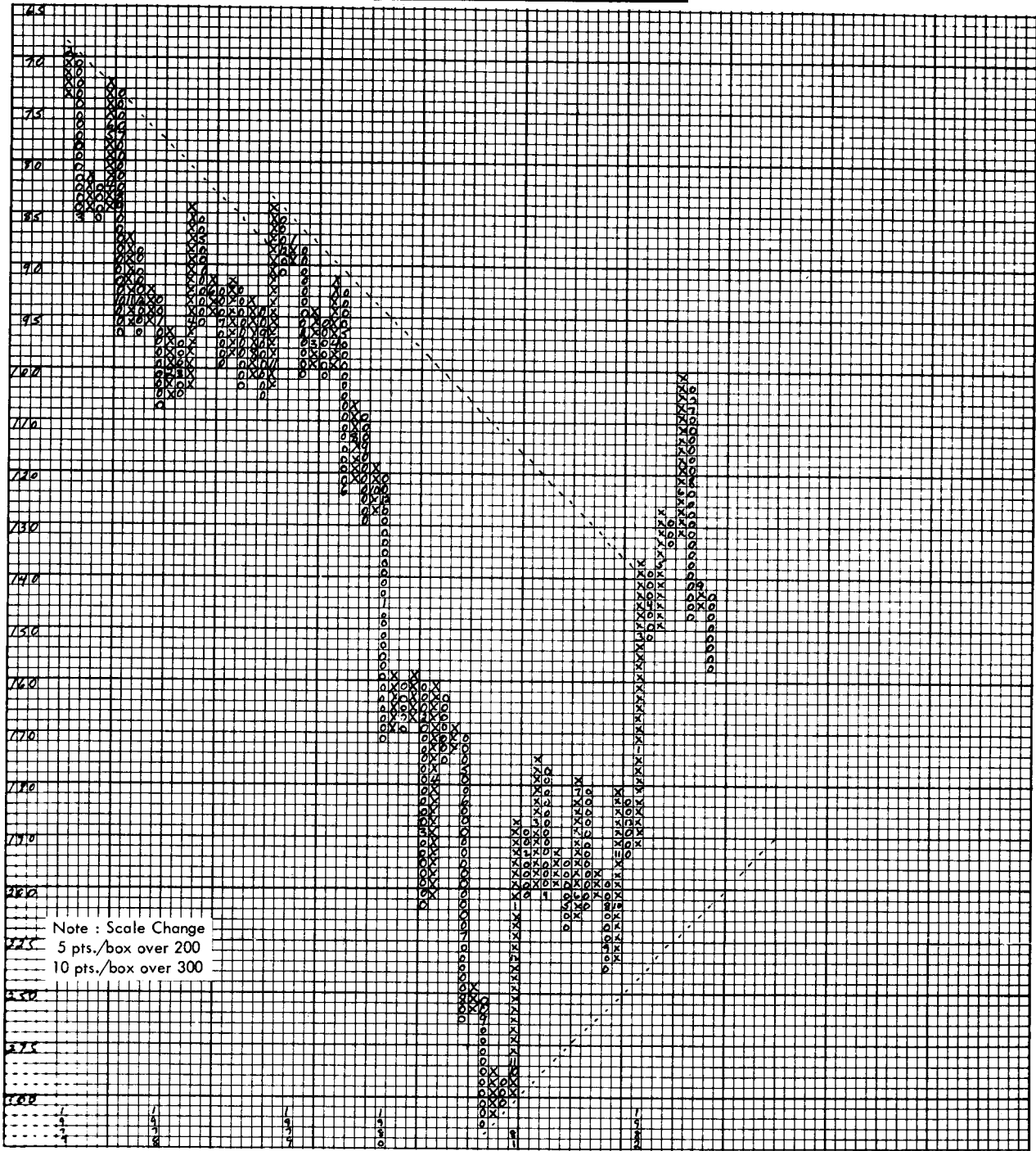
This Index is constructed by dividing Standard & Poor's Low Priced Stock Index by S & P's High Grade Common Stock Index. The resulting percentage, or ratio, is plotted on the chart. Each square represents 1% below 100 and 2% above 100, and 3 boxes (3% or 6%) are necessary for a change in direction.

When this Index rises, low priced stocks are outperforming high grade stocks; when this Index is declining, the reverse is true.

When low priced stocks are outperforming high grade stocks, there necessarily is greater public participation and speculation. Speculative confidence in the future upward trend of the market is increasing. When high grade stocks are outperforming low priced stocks and the Index is declining, speculative confidence in the future uptrend of the market is waning.

An important top was made in January 1969. An important bottom was made in December 1974.

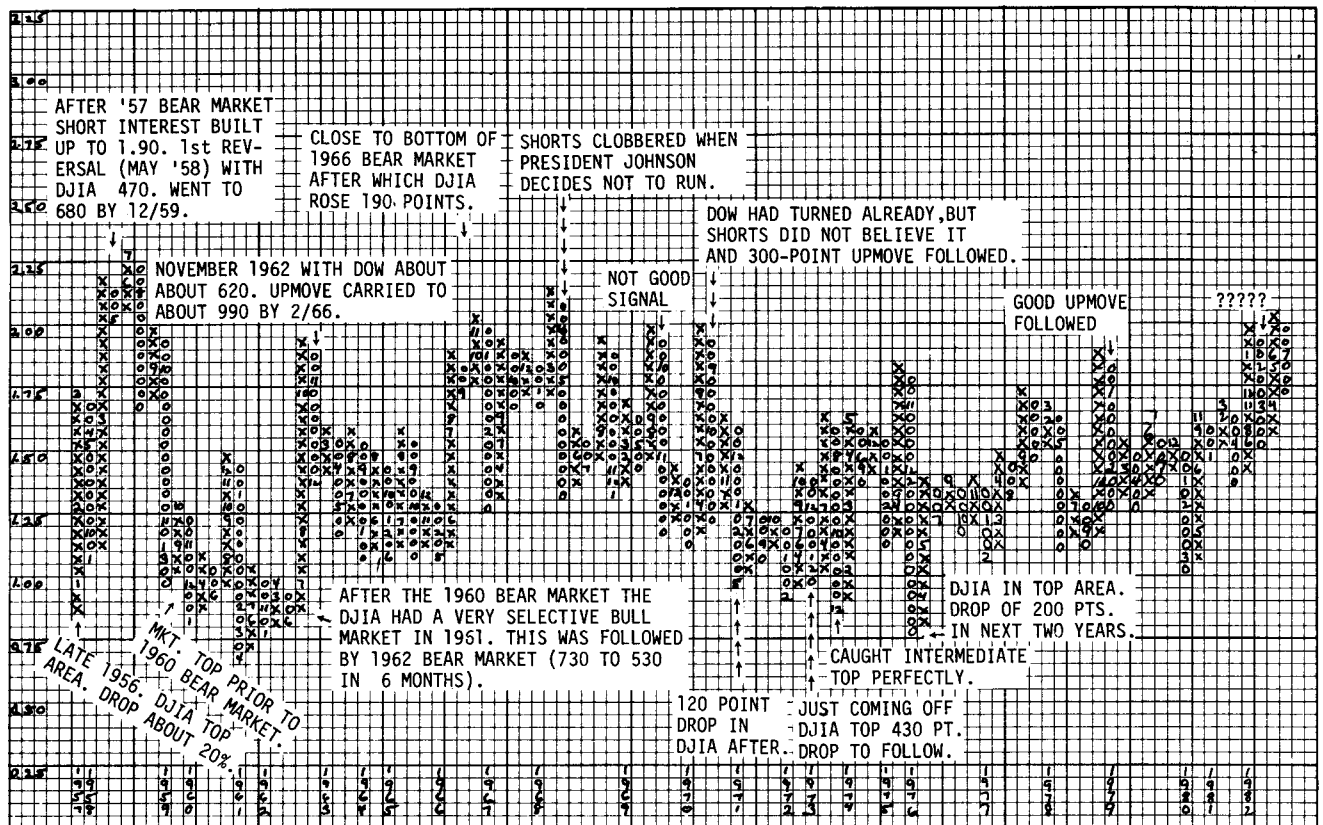
### GOLD MINING DISPARITY INDEX



THIS INDEX IS CONSTRUCTED BY DIVIDING STANDARD AND POOR'S GOLD MINING INDEX BY THE INDEX OF 425 INDUSTRIALS. THE RESULTING RATIO, WHICH IS ACTUALLY A RELATIVE STRENGTH FIGURE OF THE GOLD MINING GROUP, IS POSTED ON THE CHART. THE SCALE REVERSED. EACH SQUARE ON THE CHART REPRESENTS 1 POINT AND 3 SQUARES OR 3 POINTS ARE NECESSARY FOR A CHANGE IN DIRECTION.

THE SCALE IS REVERSED SO THAT AN UPMOVE IN THE RELATIVE STRENGTH OF THE GOLD MINING GROUP WILL APPEAR ON THIS CHART AS A DOWNMOVE FOR THE MARKET AS A WHOLE; AND A DOWNMOVE IN THE RELATIVE STRENGTH OF THE GOLD MINING GROUP WILL APPEAR AS AN UPMOVE FOR THE MARKET AS A WHOLE. GOLD MINING STOCKS ARE SUPPOSEDLY DEFENSIVE IN CHARACTER - STRONG WHEN THE MARKET IS WEAK AND WEAK WHEN THE MARKET IS STRONG.

## SHORT INTEREST RATIO



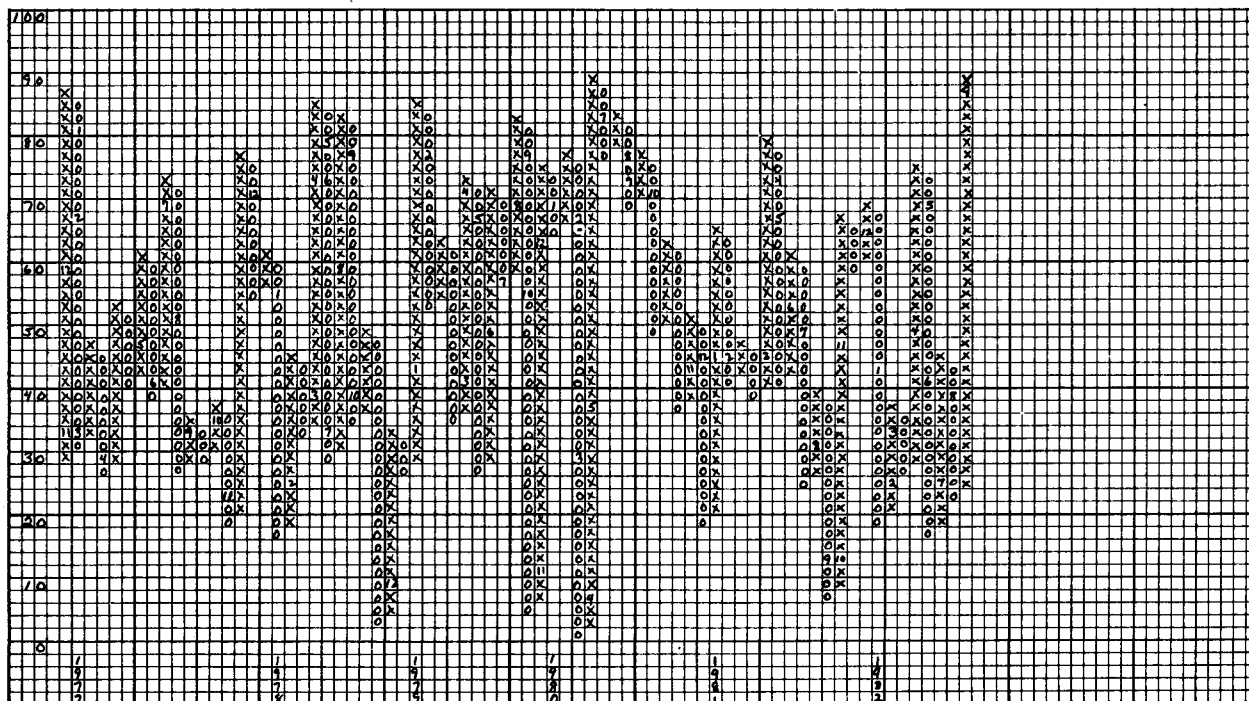
THIS INDICATOR IS CONSTRUCTED BY DIVIDING THE TOTAL SHORT INTEREST BY THE AVERAGE DAILY VOLUME OF TRADING FOR THE PERIOD FOR WHICH THE SHORT INTEREST IS REPORTED, USUALLY THE PREVIOUS 30 DAYS. EACH SQUARE ON THE CHART REPRESENTS .05% AND 3 SQUARES OR .15% ARE NECESSARY FOR A CHANGE IN DIRECTION. IT MAY BE FOUND IN BARRON'S'S ONCE A MONTH. THE SHORT INTEREST RATIO REPRESENTS THE NUMBER OF DAYS TRADING THAT THE ACTUAL SHORT INTEREST CAN ACCOUNT FOR IF ALL SHORT POSITIONS WERE COVERED AT THE SAME TIME.

A COLUMN OF O'S AFTER THE 1.90 LEVEL HAS BEEN REACHED IS A BULLISH INDICATION IF THE MARKET HAS HAD A BIG DROP. SIGNALS THAT TOOK PLACE IN MAY 1957, NOVEMBER 1962, SEPTEMBER 1966, SEPTEMBER 1970, JANUARY 1979 WERE ALL TIMELY SIGNALS. THE APRIL 1966 AND OCTOBER 1969 SIGNALS WERE NO GOOD. THIS INDICATOR HAS A SUCCESS RATIO OF 71.4% (5 OUT OF 7).

A MOVEMENT TO 1.00 OR LESS IS A BEARISH INDICATION. SUCH SIGNALS IN LATE 1956, DECEMBER 1959, NOVEMBER 1961, MAY 1971, FEBRUARY 1973, OCTOBER 1973 AND FEBRUARY 1976 WERE ALL GOOD SIGNALS. THE JANUARY 1961 SIGNAL WAS USEFUL, BUT PREMATURE, WHILE THE JANUARY 1972 SIGNAL WAS NO GOOD. THIS USE OF THE INDICATOR WAS SUCCESSFUL 7 OF 9 TIMES OR 77.7%.

NOTE: YOU DO NOT NEED A HIGH SHORT INTEREST FOR A BEAR MARKET TO END. SEE 1973-1974. WHEN STOCKS WERE 7-9 TIMES EARNINGS THERE WAS VERY LITTLE SHORT SELLING, BUT THAT DID NOT PREVENT THEM FROM GOING TO 4-5 TIMES EARNINGS WHEN THE BEAR MARKET ENDED.

**% of NYSE STOCKS above their 10-WEEK MOVING AVERAGE**



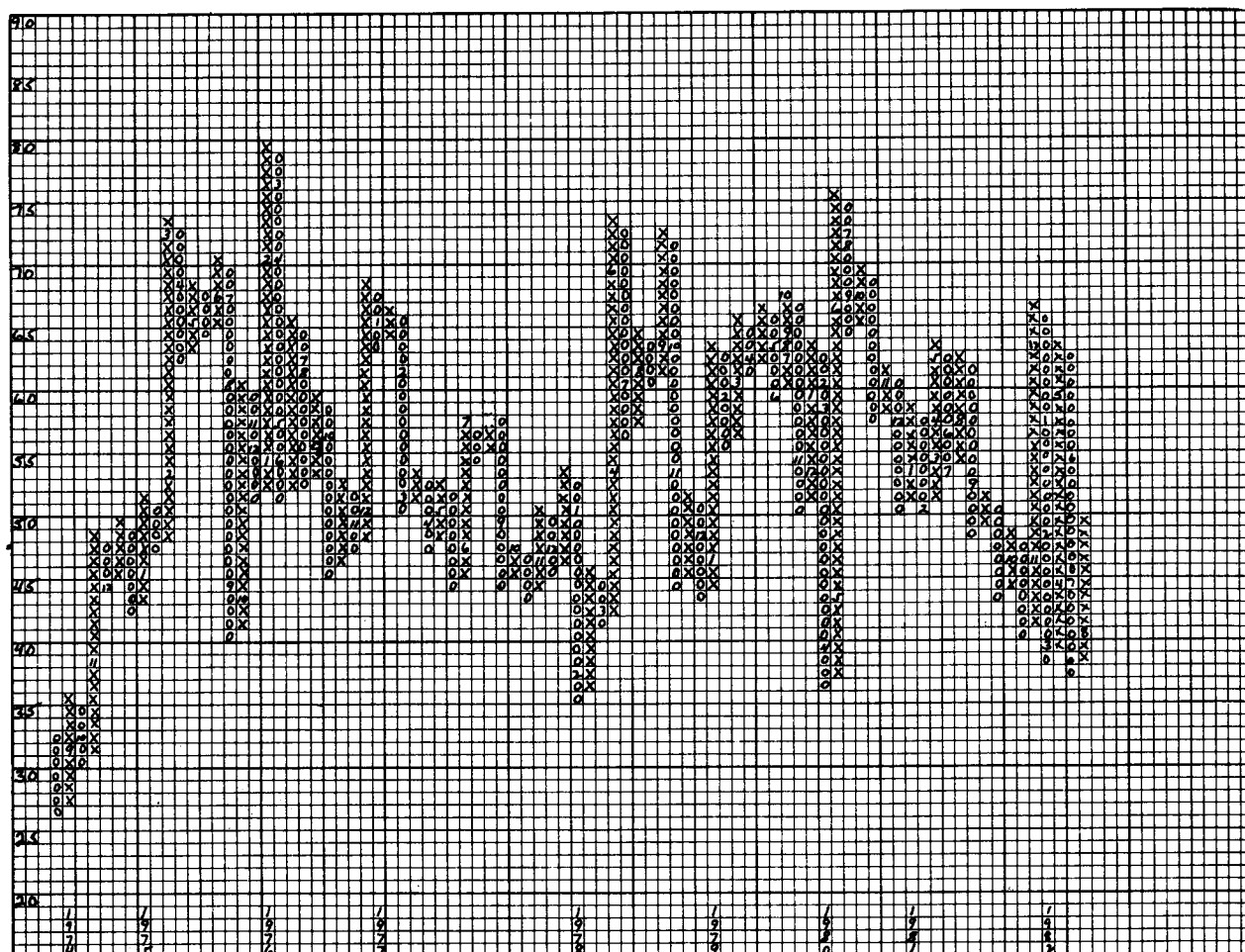
EVERY TUESDAY, AT THE CLOSE OF THE MARKET, CHARTCRAFT MAKES A COMPUTER TALLY OF THE PERCENTAGE OF STOCKS ABOVE THEIR 10-WEEK MOVING AVERAGE. THIS PERCENTAGE IS PLOTTED ON THE CHART. EACH SQUARE REPRESENTS 2% AND 3 SQUARES OR 6% ARE NEEDED FOR A CHANGE IN DIRECTION.

THIS INDEX IS WHAT IS KNOWN AS A DIFFUSION INDEX. IT TENDS TO CHANGE DIRECTION AHEAD OF ITS AGGREGATE. WHEN IT STARTS TO DECLINE FROM A HIGH LEVEL, THE AGGREGATE WILL STILL CONTINUE TO RISE AND CONVERSELY, WHEN IT BEGINS TO RISE FROM A LOW LEVEL, THE AGGREGATE WILL STILL CONTINUE TO DECLINE. ONLY AFTER THE INDEX CROSSES THE 50% LEVEL DOES THE AGGREGATE FOLLOW THE DIRECTION OF THE DIFFUSION INDEX.

UPMOVES END WHEN THE PERCENTAGE RISES ABOVE THE 70%, 80% OR 90% LEVEL DEPENDING UPON THE STRENGTH OF THE BULL MARKET. DOWNMOVES TERMINATE WHEN THE PERCENTAGE DROPS BELOW 30%, 20% OR 10% DEPENDING UPON THE STRENGTH OF THE BEAR MARKET.

A COLUMN OF Xs BELOW THE 50% LEVEL MAY BE REGARDED AS AN UP-ALERT SIGNAL; WHEN THIS COLUMN OF Xs RISES ABOVE 50% OR PENETRATES A PREVIOUS TOP, IT MAY BE REGARDED AS AN UP-CONFIRMED SIGNAL. A COLUMN OF Os ABOVE 50% SHOULD BE TAKEN AS A DOWN-ALERT SIGNAL; WHEN THE COLUMN OF Os DECLINES BELOW 50%, OR PENETRATES A PREVIOUS BOTTOM, IT MAY BE REGARDED AS A DOWN-CONFIRMED SIGNAL. BUYING LONG SHOULD BEGIN WHEN AN UP-ALERT SIGNAL HAS BEEN GIVEN AFTER THE PERCENTAGE HAS DROPPED TO 30% OR LOWER. LONG POSITIONS SHOULD BE CLOSED OUT ON A DOWN-ALERT SIGNAL AFTER THE PERCENTAGE HAS REACHED AT LEAST 70%. SHORT POSITIONS SHOULD BE ESTABLISHED WHEN IT LATER DROPS BELOW THE 50% LEVEL.

## 10-WEEK MOST ACTIVE STOCKS RATIO



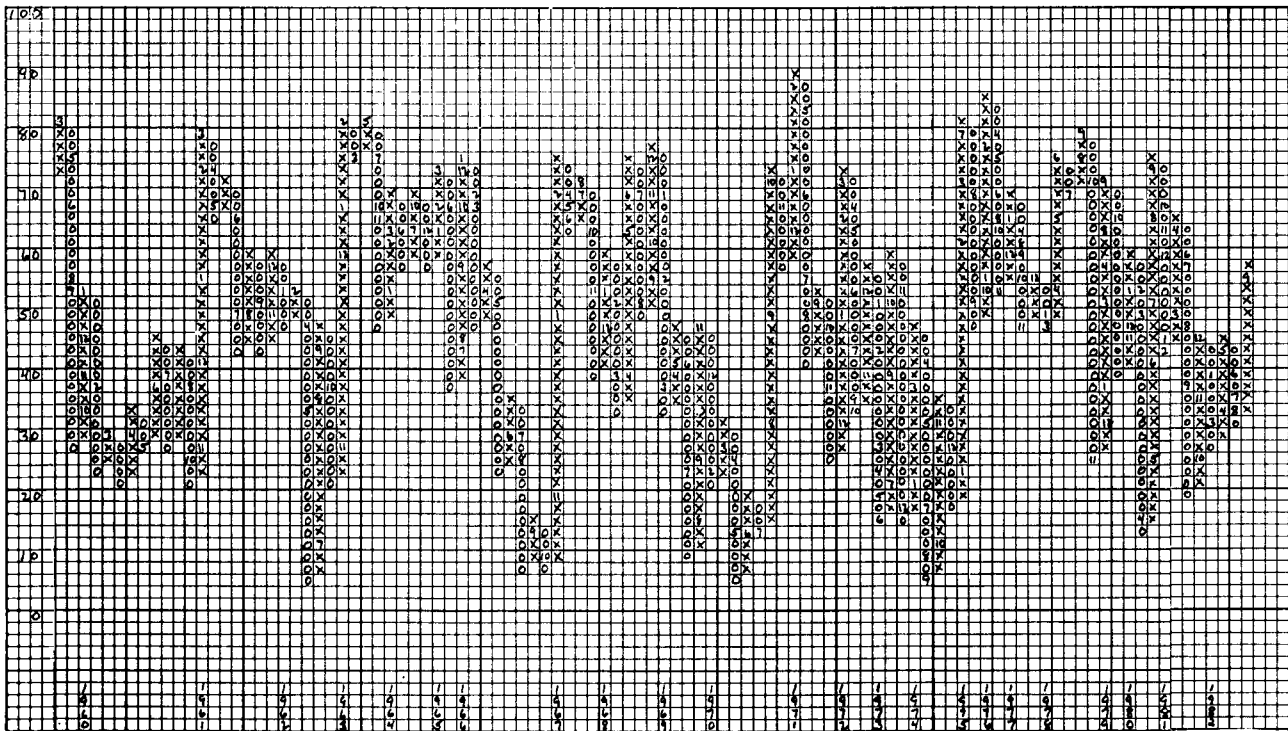
EACH WEEK EXAMINE THE 20 MOST ACTIVE STOCKS FOR ADVANCES AND DECLINES. THESE FIGURES MAY BE FOUND IN BARRON'S. DIVIDE THE NUMBER OF ADVANCING STOCKS BY THE TOTAL NUMBER OF ADVANCING AND DECLINING STOCKS. PLACE THE RESULTING RATIO ON A 10-WEEK MOVING AVERAGE.

THIS INDICATOR MAY BE USED BOTH AS AN OVERBOUGHT-OVERSOLD INDICATOR AND AS AN INDICATOR THAT GIVES BOTH BUY AND SELL SIGNALS.

IN LONG-TERM BEAR MARKETS SUCH AS 1969-1974, OVERBOUGHT MARKET CONDITIONS CAN BE RECOGNIZED WHEN THIS RATIO GOES ABOVE 60% AND AN OVERSOLD CONDITION WHEN IT DECLINES BELOW 35%. IN LONG-TERM BULL MARKETS SUCH AS 1975 - PRESENT OVERBOUGHT MARKET CONDITIONS CAN BE RECOGNIZED WHEN THE RATIO GOES ABOVE 70% AND AN OVERSOLD CONDITION WHEN IT DROPS BELOW 45%.

A BUY SIGNAL TAKES PLACE WHEN CHART PATTERN PENETRATES A PREVIOUS TOP. A SELL SIGNAL TAKES PLACE WHEN CHART PATTERN PENETRATES A PREVIOUS BOTTOM.

## NYSE BULLISH PERCENTAGE



AS ITS NAME IMPLIES, THE ABOVE INDICATOR IS BASED ON THE DAILY PERCENTAGE OF BULLISH STOCKS ON THE NEW YORK STOCK EXCHANGE. A STOCK IS CONSIDERED BULLISH IF ITS MOST RECENT CHART PATTERN SHOWS THE PENETRATION OF A PREVIOUS TOP; A STOCK IS CONSIDERED BEARISH IF ITS MOST RECENT CHART PATTERN SHOWS THE PENETRATION OF A PREVIOUS BOTTOM. THE NUMBER OF BULLISH STOCKS IS TALLIED EVERY DAY AND DIVIDED BY THE TOTAL OF ALL STOCKS BOTH BULLISH AND BEARISH. THIS PERCENTAGE IS THEN PLOTTED ON A 2% BY 6% POINT AND FIGURE CHART. EACH BOX EQUALS 2%, AND 3 BOXES OR 6% ARE NEEDED FOR A CHANGE IN DIRECTION. THIS INDICATOR WAS ORIGINATED BY CHARTCRAFT, INC., IN 1955.

UPMOVES USUALLY END WHEN THE PERCENTAGE RISES ABOVE THE 70%, OR 80%, OR 90% LEVEL - DEPENDING UPON THE STRENGTH AND MOMENTUM OF THE BULL MARKET. DOWNMOVES TERMINATE WHEN THE PERCENTAGE DROPS BELOW 30%, OR 20%, OR 10% - DEPENDING UPON THE MOMENTUM OF THE BEAR MARKET.

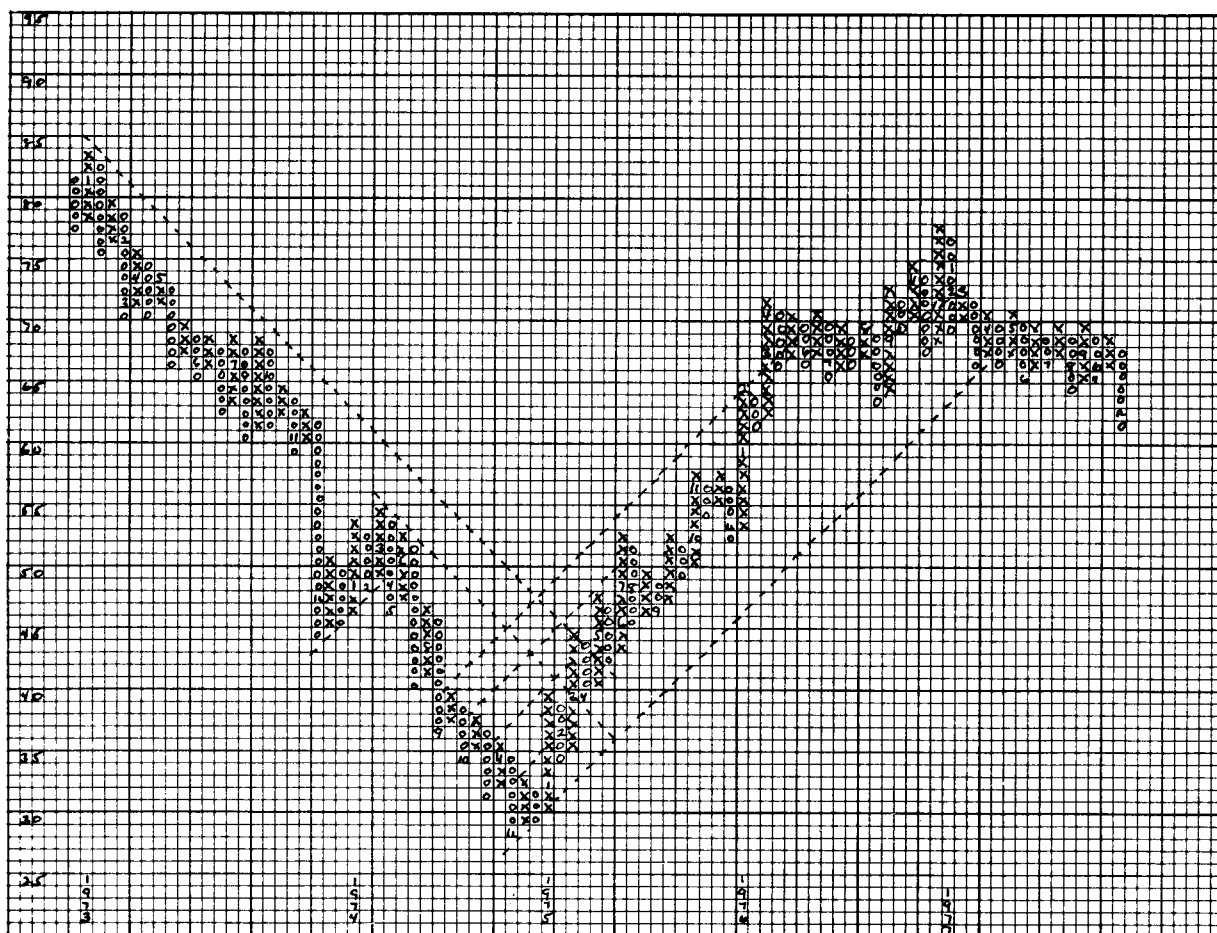
AFTER A LOW LEVEL HAS BEEN MADE, A COLUMN OF Xs BELOW THE 50% LEVEL MAY BE REGARDED AS A BULL ALERT SIGNAL; WHEN THE COLUMN OF Xs RISES ABOVE THE 50% LEVEL, THIS MAY BE REGARDED AS A BULL CONFIRMED SIGNAL. AFTER A HIGH LEVEL, A COLUMN OF Os ABOVE THE 50% LEVEL MAY BE REGARDED AS A BEAR ALERT SIGNAL; WHEN THE COLUMN OF Os DROPS BELOW 50%, THIS MAY BE REGARDED AS A BEAR CONFIRMED SIGNAL. A BULL CONFIRMED SIGNAL MAY OCCUR BELOW THE 50% LEVEL WHEN A COLUMN OF Xs PENETRATES A PREVIOUS TOP; A BEAR CONFIRMED SIGNAL MAY OCCUR ABOVE THE 50% LEVEL WHEN A COLUMN OF Os PENETRATES A PREVIOUS

ANY UPTURN FROM BELOW THE 10% LEVEL IS USUALLY THE SIGNAL FOR A NEW BULL MARKET.





## GENERAL MOTORS AS A BELLWETHER STOCK



General Motors is regarded as a bellwether of the stock market as a whole. The bellwether theory holds that in a downtrend, whenever 4 months pass without General Motors declining to a new intermediate low, the odds favor a conclusion that the market's trend has turned upward. Conversely, when the trend has been upward, but 4 months pass without General Motors rallying to a new intermediate high, the odds favor a conclusion that the market itself will turn downward. The theory's originator was Stephen J. Stanford and its present guardian and interpreter is Robert H. Stovall, of Dean Witter Reynolds, Inc.

It should be borne in mind that no theory or technical indicator works all the time. Witness the fact that GM made a low in December 1973 and 4 months elapsed without GM declining to a new low. This would have led to the erroneous conclusion that the bear market was over. GM then made a new low in December 1974. Again GM made a high in April 1976, and then 4 months elapsed without this high being exceeded. Was the bull market over? No, because GM then went on to make a new high in September. The next intermediate high in GM was made in December. Four months went by without a new high and a bear market signal was given in April 1977. This signal is still in effect.

SECTION TWELVE

PUTS AND CALLS

Buying a stock	$\frac{+}{-}$	Buying a Call	$\frac{+}{0}$	Writing a Call	$\frac{-}{0}$
Selling a stock short	$\frac{-}{+}$	Buying a Put	$\frac{0}{+}$	Writing a Put	$\frac{0}{-}$

The stock buyer gains when the stock rises and loses when the stock declines.

The Call buyer gains when the stock rises and neither loses nor gains when the stock declines.

The Call writer loses when the stock rises and neither gains nor losses when the stock declines.

The short seller gains when the stock declines and loses when the stock rises.

The Put buyer gains when the stock declines and neither gains nor loses when the stock rises.

The Put writer loses when the stock declines and neither gains nor loses when the stock rises.

(Commission and option premiums are excluded for clarity of presentation.)

## OPTION CONTRACTS

### 1. Types of Option Contracts

A Call is an option to buy 100 shares of a specified stock at a fixed price on or before its expiration date.

A Put is an option to sell 100 shares of a specified stock at a fixed price on or before its expiration date.

The exercise price is the price at which the stock under option may be called or put.

The premium or option money is the amount the buyer pays for the option contract.

A straddle is an equivalent number of Puts and Calls covering the same underlying security and having the same exercise price and expiration date.

### 2. Length of Option Contracts

Under present practices, each class of options is assigned to one of three expiration month cycles: the January-April-July-October cycle; the February-May-August-November cycle; or the March-June-September-December cycle. Trading options of a particular expiration month normally commences nine months earlier. No option purchaser can take advantage of the long-term capital gains period for tax purposes.

### 3. The Exercise Price and Premium

Exercise prices are generally fixed at 5-point intervals for stocks trading below 50, and 10 point intervals for stocks trading between 50 and 200.

The premium on the price of an option is agreed upon between the buyer and writer of an option or their agents. Options may be purchased or sold through securities brokers. The premium is determined in the auction market. Both purchasers and writers pay transaction costs.

The exercise price is not affected by a dividend distribution; dividends are collected by the writer of the option.

### 4. Buying a Call vs. Buying the Stock

Advantages — 1) The trader or investor can take a larger position in the stock than he might otherwise be able to. 100 shares of a \$50.00 stock would cost \$5,000; the same amount of money can theoretically buy 10 calls on the same stock; \$5,000 can do the work of \$50,000 during the contract period. 2) Buying a stock means making money if the stock goes up and losing money if the stock goes down. Buying a call means making money if the stock goes up and not losing money if the stock goes down (excluding the premium, of course, which has already been paid).

Disadvantages — The call must go up in price during the contract period; it may go up after the contract period has expired. The holder of the stock has no time limit as to when the stock must move up for him to take a profit.

## 5. Buying a Put vs. Selling the Stock Short

The advantages and disadvantages in buying a Call vs. buying the stock apply as well to buying a Put vs. selling the stock short.

## 6. Trading Formations and Call Options

In using trading formations as a guide to buying Calls, the time factor is of the utmost importance. Because of the length of the option contract, the time factor is even more important than percentage of time a trading formation is profitable and the average percent gain. With this in mind, two trading formations seem to be particularly applicable to buying calls: 1) the Bullish Triangle formation, and 2) the Bearish Signal reversed formation.

### The Bullish Triangle Formation (see page 24)

The Bullish Triangle formation is profitable 71.4% of the time, for an average percent gain of 30.9%. The average time required for such profit is 5.4 months. This formation, therefore, lends itself to a 6-month Call. If the Call can be purchased on the buy signal given by this formation, the profit potential is very attractive. One should still be able to realize a profit of between 2 and 3 times the premium.

### The Bearish Signal Reversed Formation (see page 40)

The Bearish Signal Reversed formation is profitable 92% of the time, for an average gain of 23.2%. The average time required for such profit is 2.5 months. This formation, therefore, lends itself to a 3-month Call. Here too, there is a potential profit of two or three times the cost of the premium.

## 7. Trading Formations and Put Options

Any bearish trading formation may be used for the purchase of Puts. The time element in these formations ranges from 2.5 months to 4.7 months. A 6-month Put should, therefore, work out satisfactorily. However, you must be sure that a bear market has really begun. Don't buy all your Puts at one time; space them weeks apart so that you spread your timing as advantageously as possible.

If you prefer to buy a 3-month Put, then restrict your action to the Bearish Triangle formation. This formation is profitable 87.5% of the time, for an average percentage gain of 33.3%. The average time for such gain is 2.5 months.

## 8. Options vs. Stoploss Orders

Up to this point, we have discussed the purchase of options as vehicles of speculations. There is, however, another use to which options can be put—a substitute for stoploss orders. In this case, an option is not used for speculation but for insurance.

Suppose a person buys 100 shares of a stock at \$50.00 and decides that all he wants to risk on this purchase is 10% of his capital (exclusive of commissions, etc.). He has two alternatives: 1) He can place a stoploss order at 45, or 2) Buy a Put on the same stock. We will assume he can obtain a six-month Put at \$50.00 for a 10% premium or \$500.00. In both cases, he is attempting to limit his risk to 10% or \$500.

Advantages of a Stoploss Order — 1) A stoploss order is permanent, it may be kept in effect as long as the stock is held. 2) A stoploss order may be changed, it may be raised as the price of the stock rises and thus not only limit losses but insure profits.

Disadvantages of a Stoploss Order — 1) A stoploss order may be touched by a temporary downmove in

the stock and thereafter the price of the stock may start a dynamic upmove; the trader or investor thus loses his position in the stock and has to repurchase it. 2) A stoploss order at 45 does not necessarily mean that the trader or investor will necessarily receive \$45 when the stock goes down; a stoploss order becomes a market order when the stoploss order point is reached and the execution of the order may take place at a much lower price, especially if there is a sudden and severe drop in the market as a whole.

Advantages of a Put — 1) During the contract life of the Put, the trader or investor is not worried about being whipsawed out of his basic position in the stock. 2) During the contract life of the Put, the trader or investor is guaranteed of getting \$50.00 a share for his stock, no matter how suddenly or violently the market may drop.

Disadvantages of a Put — The protection offered by a Put is limited in time; after the Put expires, the trader or investor will have to buy a new Put or use a stoploss order.

When a person buys a stock and protects his position by a 6-month Put, he has in effect converted his position into a 6-month Call.

#### 9. The Option Writer—Selling Puts and Calls

The Option Writer is a person who sells Puts and Calls either as an auxiliary to his investment program or as a means of speculation. A person who writes or sells a Put expresses his willingness to buy a certain stock at a certain price—to have the stock “put” to him at the contract price. A person who writes or sells a Call expresses his willingness to sell a certain stock at a certain price—to have the stock “called” from him at the contract price.

An option writer who writes Calls and Puts as an auxiliary to his investment program is usually a “covered option” writer. A covered Put writer is one who, so long as he remains obliged as a writer, holds on a share-for-share basis a Put of the same class as the Put writer where the exercise price of the Put is held equal or greater than the exercise of the Put written. A covered Call writer is one who, so long as he remains obligated as a writer, owns the shares of the underlying security covered by the Call, or holds on a share-for-share basis a Call of the same class as the Call written where the exercise price of the Call held is equal to or less than the exercise price of the Call written.

Suppose an investor wishes to accumulate shares of a certain company. Instead of buying the stock immediately, he writes Puts on the stocks. As the writer of the option, he has obligated himself to buy the stock at a stipulated price during the life of the contract. For undertaking such an obligation he receives a premium. If the stock is “put” to him, then he buys the stock at the stipulated price; his actual cost, however, is the price of the stock less the premium he previously received. If the stock rises in price during the term of the contract, and as a result is not “put” to him, he pockets the premium. The writer of a Put has to deposit and maintain a margin of 30% of the price of the stock.

Suppose an investor wishes to distribute stock which he had previously accumulated. Instead of selling the stock outright, he writes Calls on the stock. As the writer of the option, he has obligated himself to sell the stock at a stipulated price during the life of the contract. For undertaking his obligation he receives a premium. If the price of the stock goes up and is “called” from him, he receives the price of the stock as per the option contract and also pockets the premium previously paid him. If the stock drops in price and the option is not exercised by the buyer, he pockets the premium.

The trader or speculator will sell a Call on a stock which he believes will not rise in price during the contract period or sell a Put on a stock which he believes will not decline in price during the contract period. In the case of a Call, he deposits and maintains a 30% margin and in the case of a Put, the same margin applies. If he successfully judges the price action of the stock during the period of the contract, he will not have the stocks either “called” from or “put” to him and he will pocket the premiums he received from writing the options.

Wherever possible, Calls should only be written on stocks in Bearish formations and Puts should only be written on stocks in Bullish formations. The option writer may not always have this choice, since option trading is usually confined to the most popular and active stocks.

The option writer as a speculator may, however, protect his position and cut his losses short after writing a Put or Call. If he has written a Put, and the stock has declined 10% from the contract price, he may protect himself by closing out his position by buying a Put. If he has written a Call and the stock has risen 10%, he may protect himself by closing out his position by buying back a Call.

#### 10. Where are Option Contracts Traded?

Options are traded on the Chicago Board Options Exchange ("CBOE"), the American Stock Exchange ("AMEX"), the Philadelphia Stock Exchange ("PHLX"), the Pacific Stock Exchange ("PSE"), and the Midwest Stock Exchange ("MSE").

Detailed quotations on options are provided by the above exchanges and printed daily in the Wall Street Journal and the New York Times.

As of this writing, there are about 220 Call options and 20 Put options. This number is to be increased in the near future.

#### 11. Certain Risk Factors

A Call or a Put is a diminishing asset. It is an asset for a limited time only and can be diminished in value as its expiration date approaches.

The purchaser of a Call or a Put, therefore, runs the risk of losing his entire investment (the premium he paid) in a relatively short period of time.

The uncovered writer of a Call is subject to a risk of loss should the price of the underlying security increase. The uncovered writer of a Put who does not have an equivalent short position in the underlying security is subject to a risk of loss should the price of the underlying security decrease.

The writer of a Call who owns the underlying security has, in exchange for the premium, given up the opportunity for gain resulting from an increase in the price of the underlying security above the exercise price. The writer of a Put who has a short position in the underlying security has, in exchange for the premium, given up the opportunity for gain resulting from a decrease in the price of the security below the exercise price.

Potential buyers of Puts and Calls and potential writers of Puts and Calls should always bear the above risks in mind and realize that trading in Puts and Calls is a highly speculative venture. The only possible conservative use of Puts and Calls is as a substitute for stoploss orders to prevent whipsaws.

With these precautions in mind, the Put and Call trader should always be aware of the trend of the market as a whole and the specific chart patterns of the underlying stock.

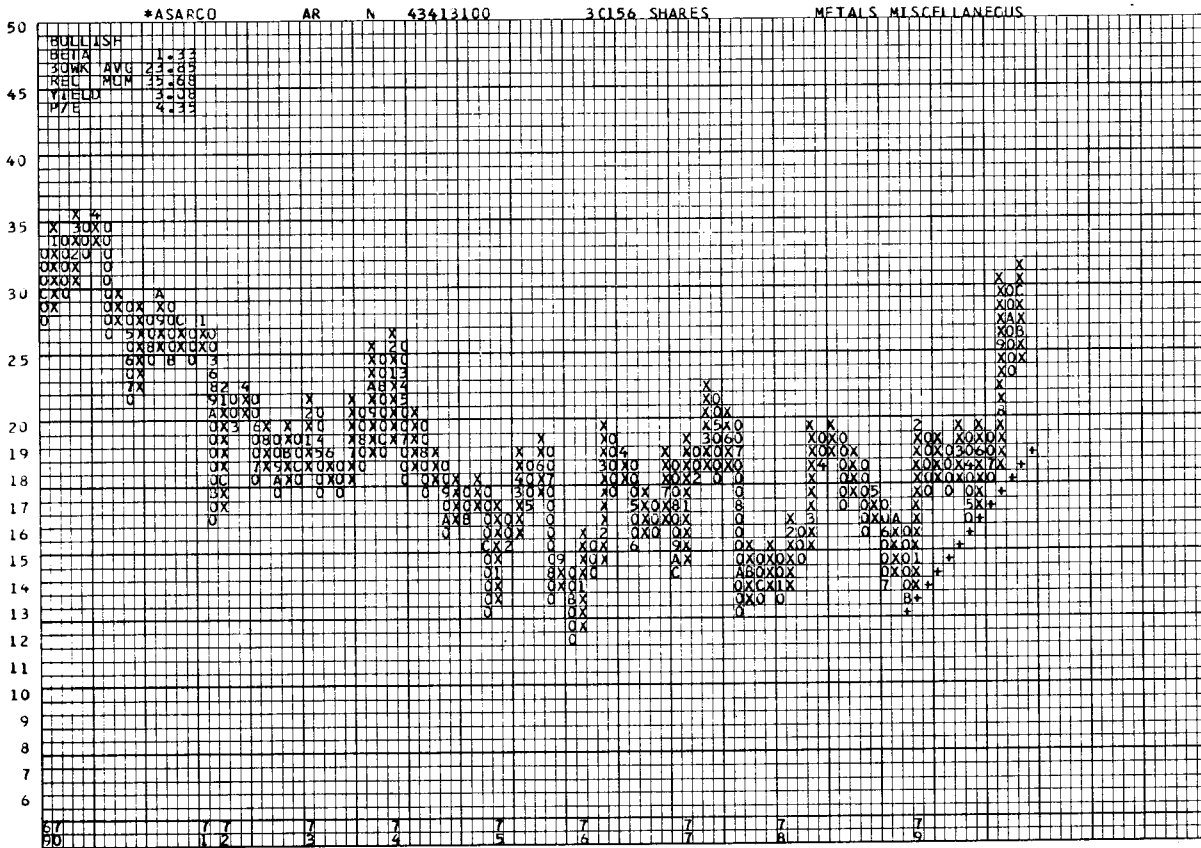
#### 12. IMPORTANT INDICATORS

A potential trader in Puts and Calls should be thoroughly acquainted with the underlying stock he is taking a position in.

He should know whether the underlying stock is bullish or bearish; what its upside or downside price

objective is. He should also be familiar with its relative momentum (strength)—the % it is above or below its 30-week moving average. He should also be familiar with its Beta or volatility factor. The higher the Beta the more volatile the stock. This is important because an option is limited in time.

The Chartcraft Options Chart Book, published quarterly, can help you with the above factors. A sample chart is reproduced below.



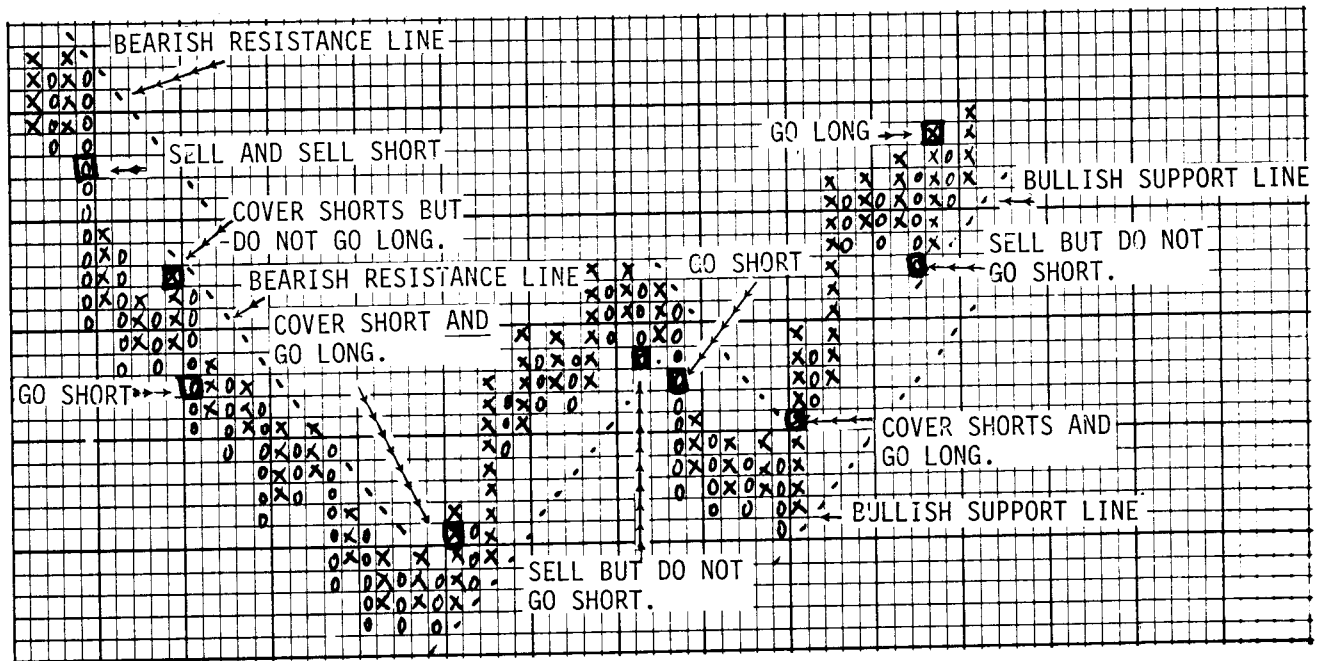
SECTION THIRTEEN

COMMODITY TRADING

Point and figure charts on grains and other commodities are constructed in the same manner as the charts on stocks except the units of charting are different for each commodity. The units of charting have to be worked out in such a manner that not only are buy and sell signals given, but that whipsaws are as few as possible. In trading in commodities one must expect a greater percentage of unprofitable trades than in stocks, so it is extremely important to keep losses small while letting profits run.

Over the last decade volatility has increased in the commodities market and we have seen many more long-term trends, both up and down, than in the past. As a result, we have made some changes in our approach to trading

Trendlines have taken on much greater importance. It is also important to move trendlines following a sequence of buy-sell-buy or sell-buy-sell signals as illustrated in the following chart.



We also found that price objectives are not terribly important here. It is much more profitable to let your profits run, which is not possible if you take small gains when price objectives are reached. This will sometimes result in reduced profits or even losses if the commodity reacts after the P.O. is reached, but in the long run you will do much better if you play for the big move.

Diversification is important. It is good to spread your money over a few situations, both long and short, rather than to concentrate everything in one commodity.

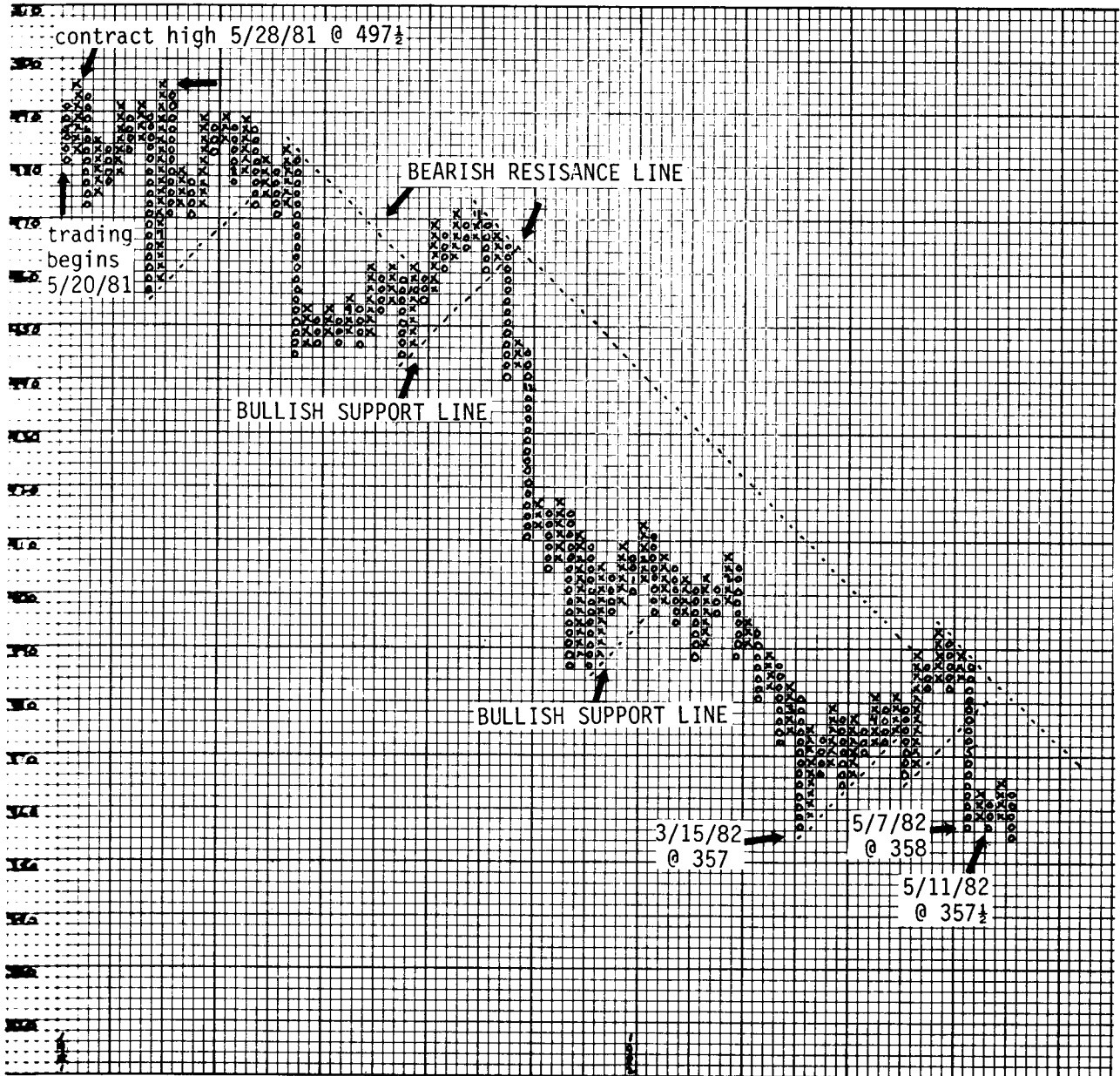
All charts are kept on a three box reversal basis.

In the following pages, we give the correct trading unit for each commodity.



WHEAT

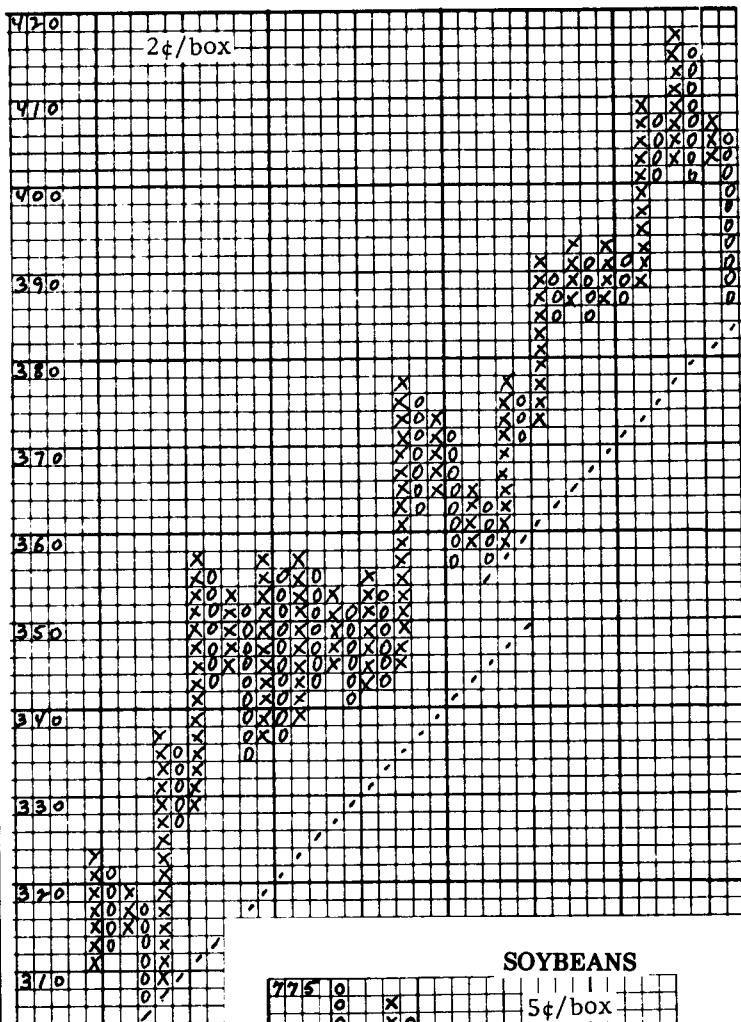
WHEAT JULY 1982 (CBT) LIFE OF CONTRACT



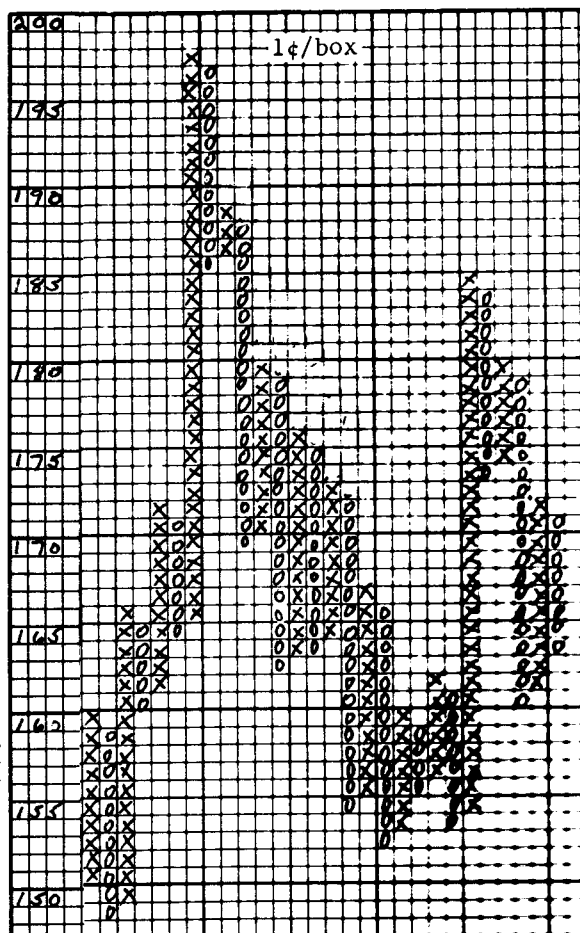
Wheat and the grains markets have been characterized by large bull and bear markets in recent years. Signals in line with these main trends have been very profitable.

# GRAINS

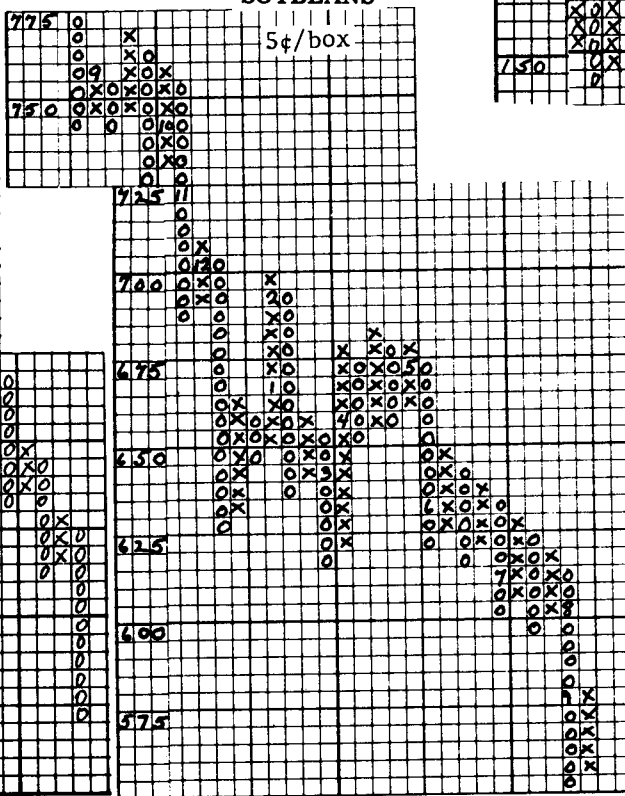
## CORN



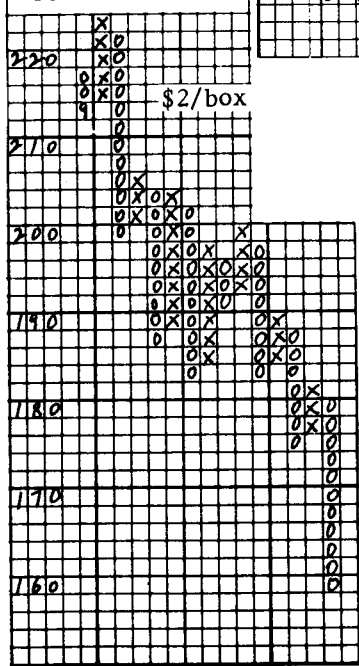
## OATS



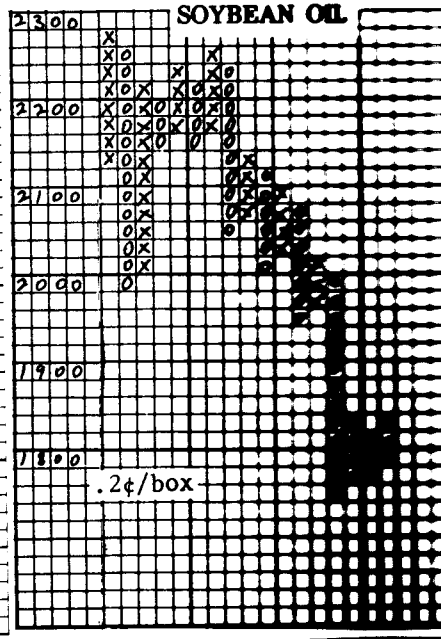
## SOYBEANS



## SOYBEAN MEAL

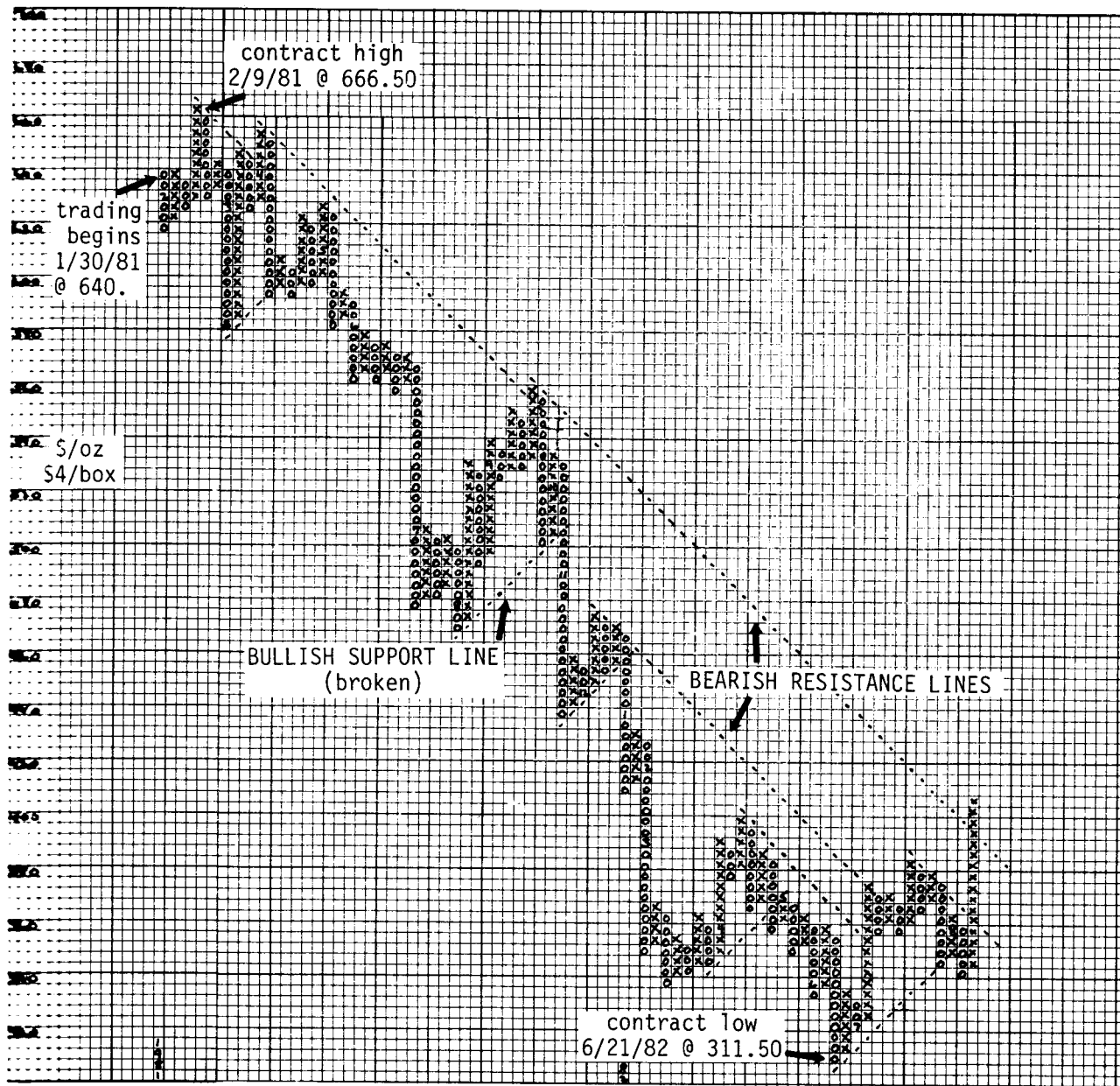


## SOYBEAN OIL



GOLD

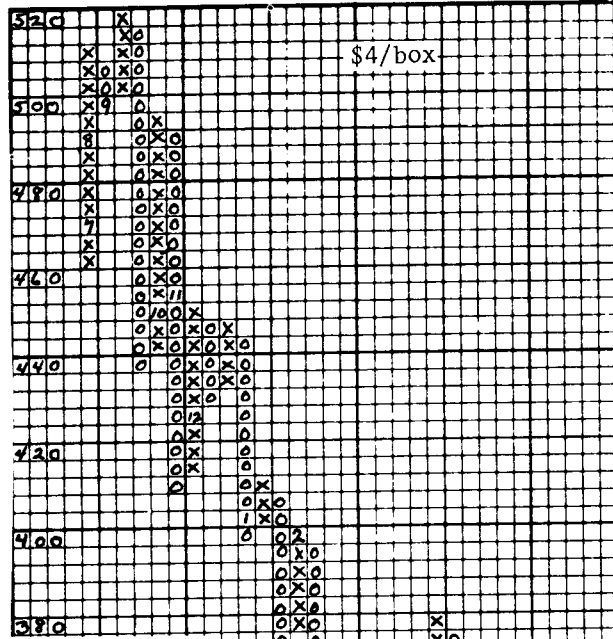
GOLD (CMX) DECEMBER 1982 LIFE OF CONTRACT



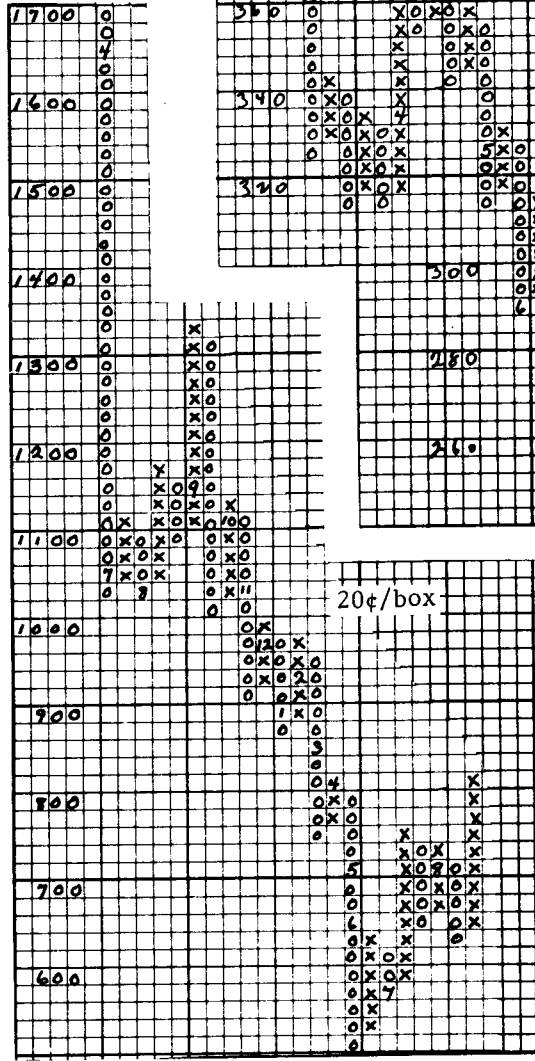
Gold and other precious metals make substantial moves, both up and down, and, as a result, have attracted a big following among speculators.

# METALS

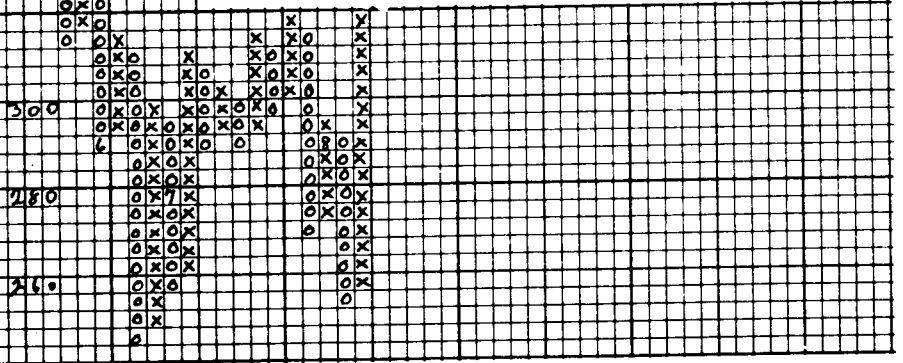
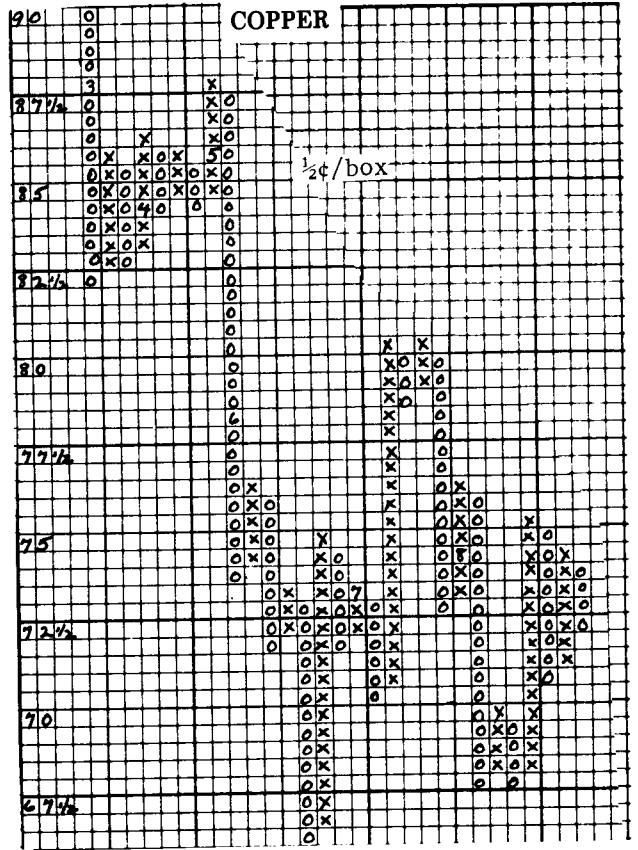
## PLATINUM



## SILVER

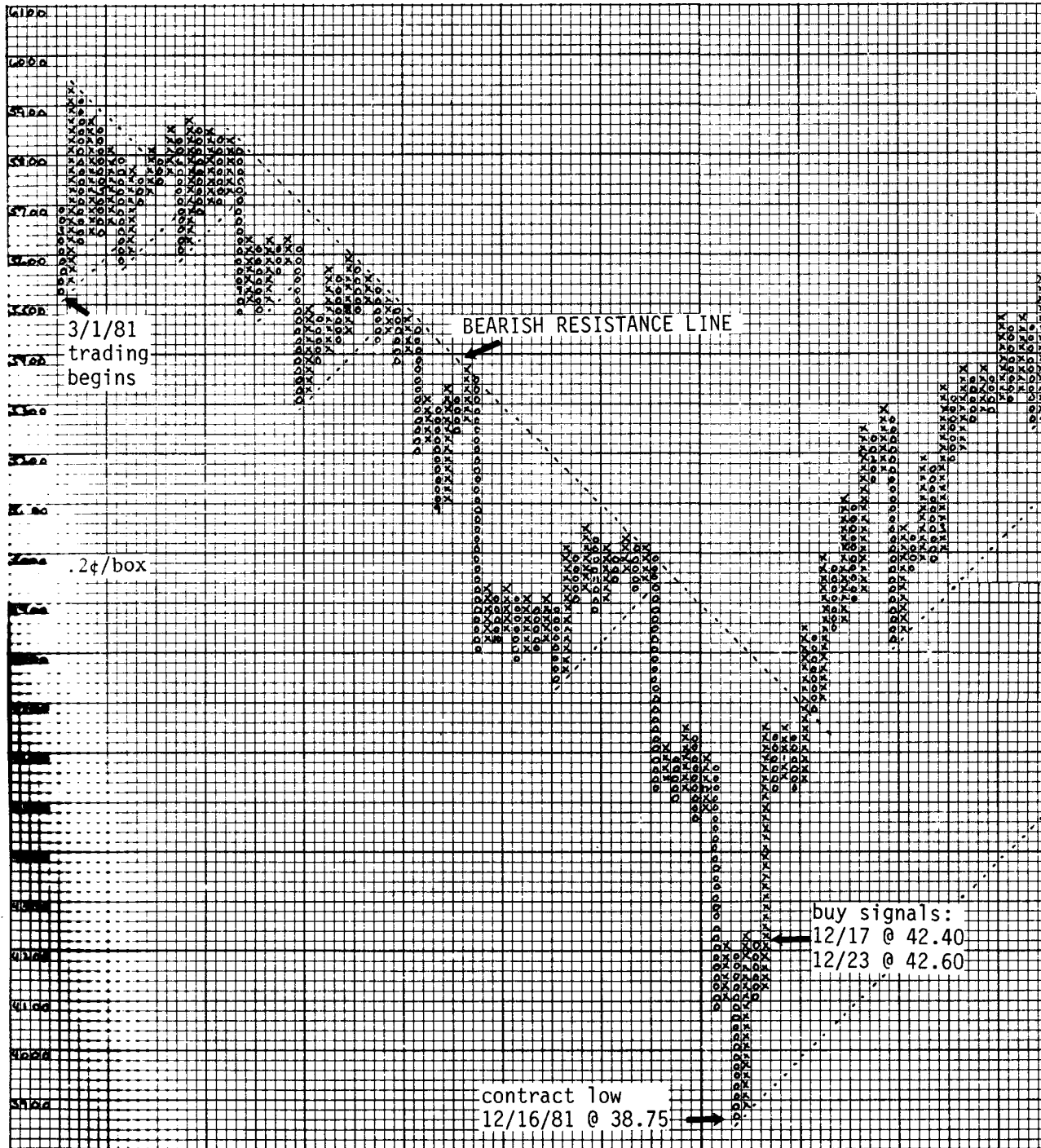


## COPPER



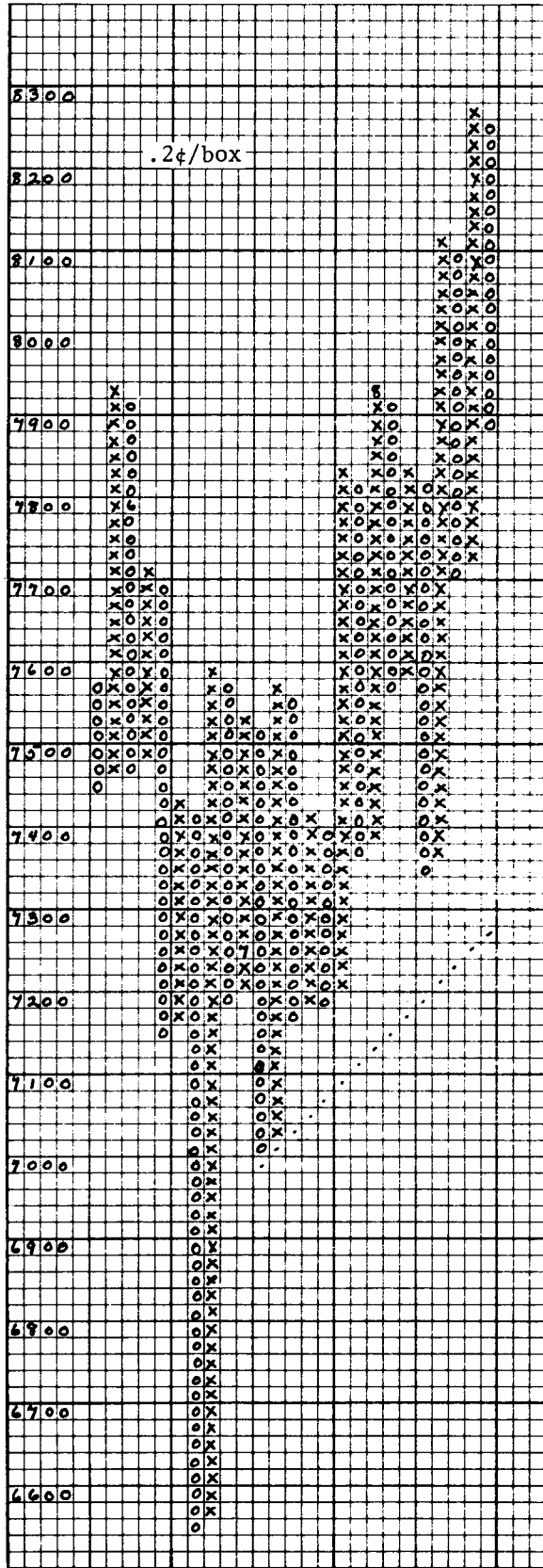
# HOGS

HOGS    JUNE 1982    (CBT)    LIFE OF CONTRACT

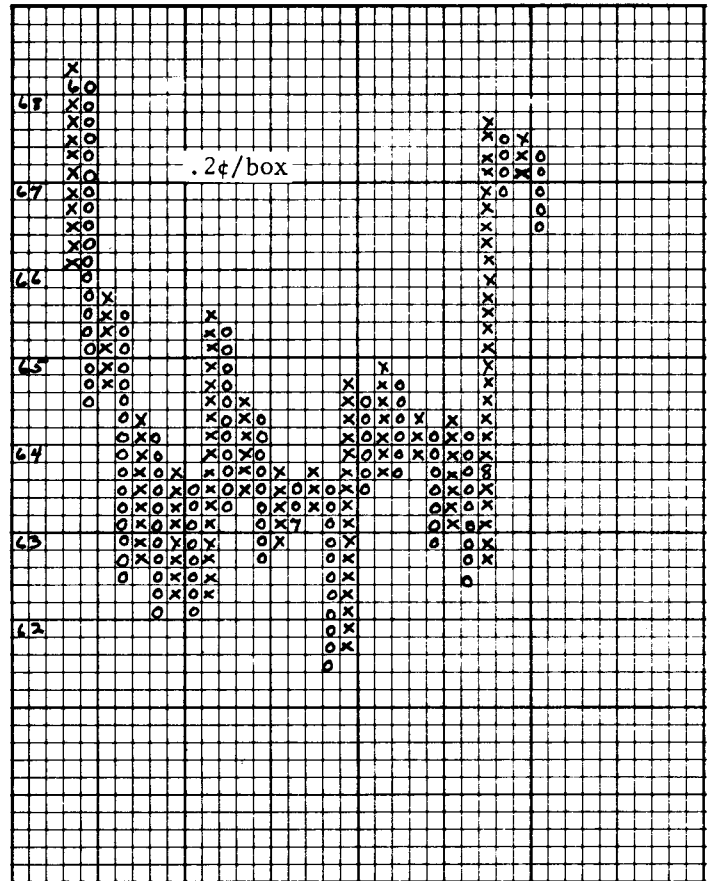


Hogs and other meats have had spectacular bull and bear markets which have turned quickly. Note the small length of time it took to complete the bottom formation.

FROZEN PORK BELLIES

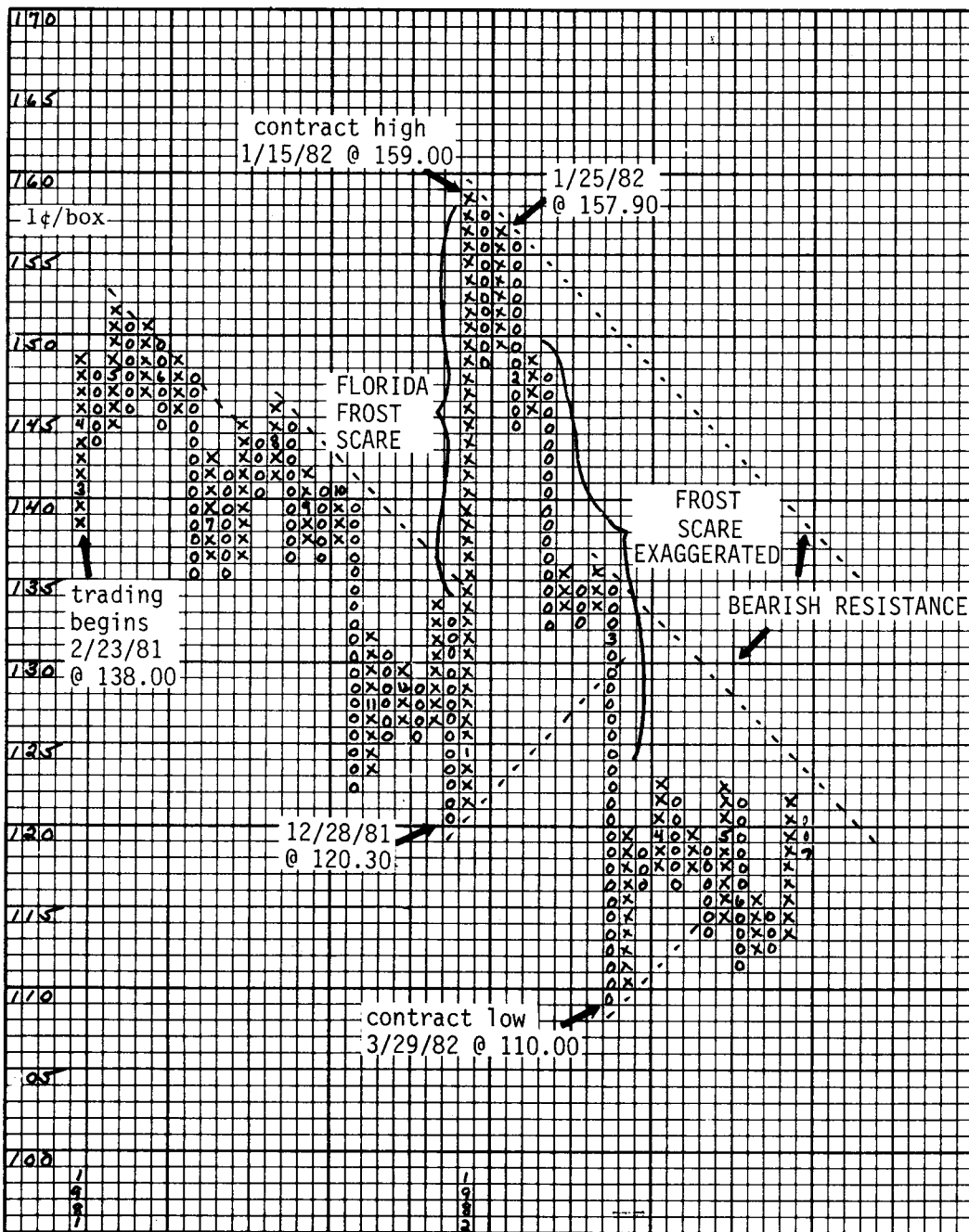


CATTLE



FROZEN ORANGE JUICE

FROZEN ORANGE JUICE JULY 1982



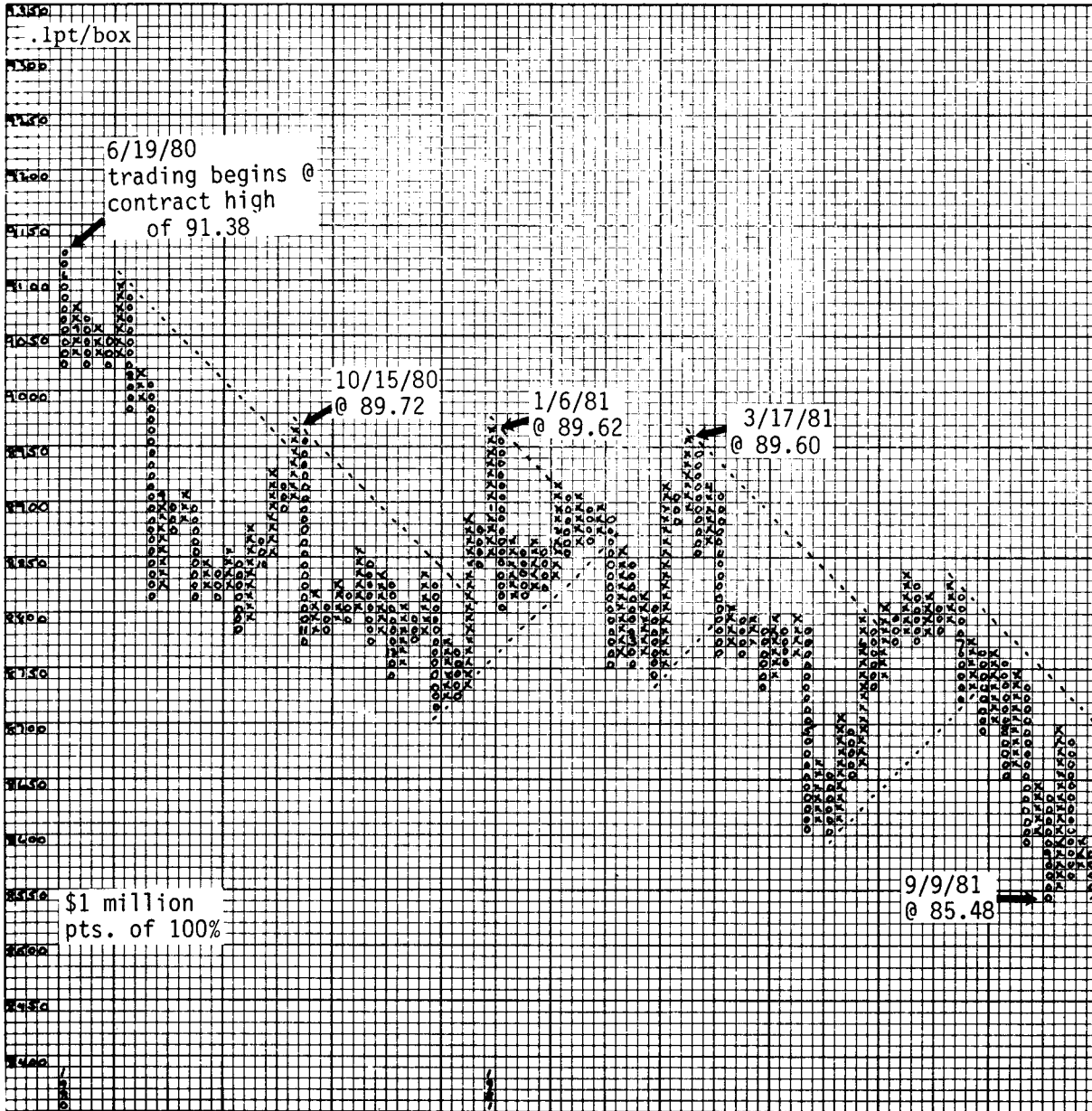
These contracts have had more "weather-related" moves than any other commodity.





U.S. TREASURY BILLS

U. S. TREASURY BILLS (IMM) JUNE 1982 LIFE OF CONTRACT



Financial futures are a recent addition to commodities markets, but their popularity was immediate.



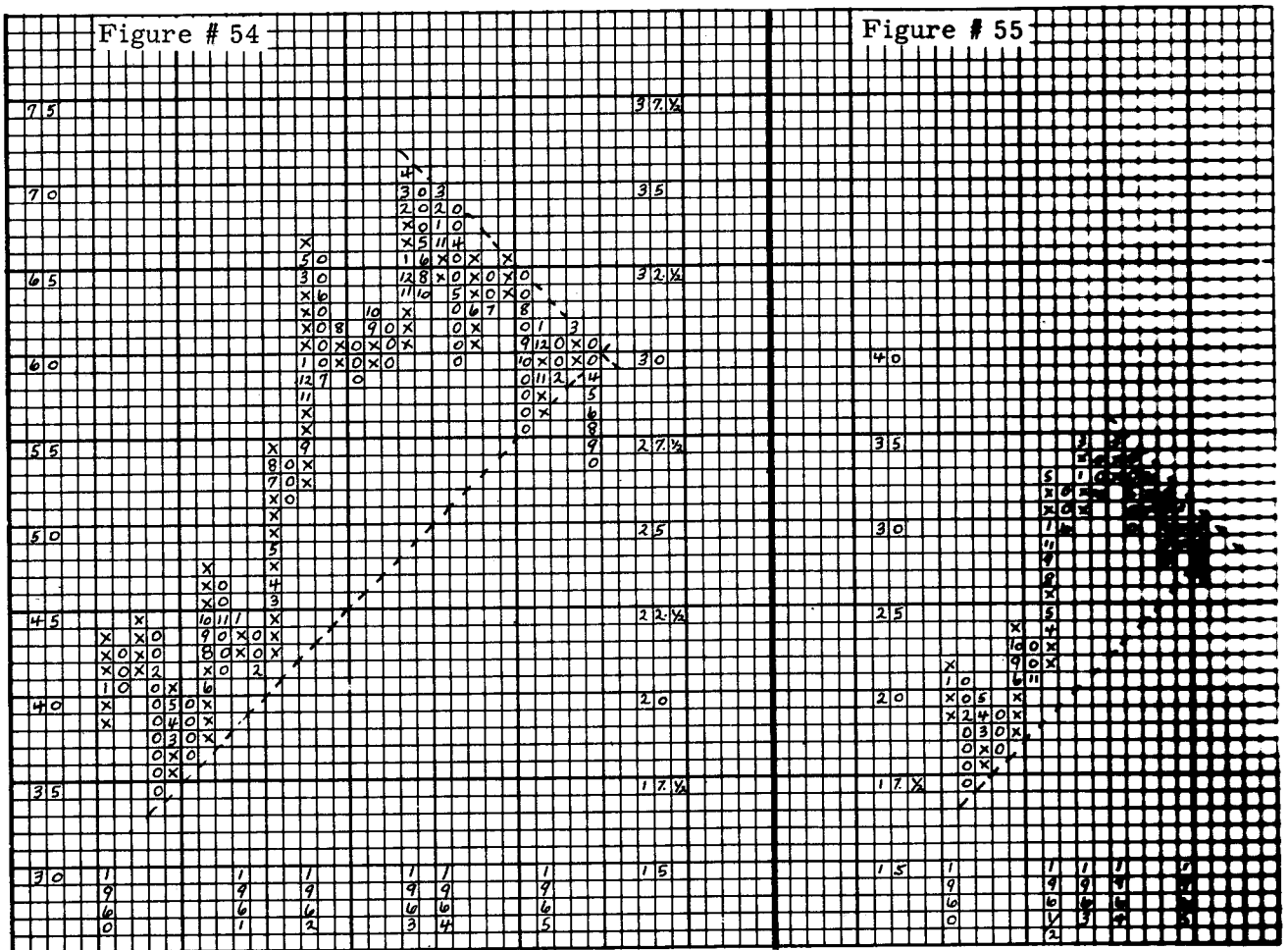
CHARTCRAFT COMMODITIES SERVICE

Explanation of Chart Scales

Commodity	Value/Box	Trading Increments	\$/Box
Corn	2¢	¢/bu.	\$ 100
Oats	1¢	¢/bu.	50
Soybeans	5¢	¢/bu.	250
Soybean Meal	\$2	\$/ton	200
Soybean Oil	.2¢	¢/lb.	120
Wheat	2¢	¢/bu.	100
Sugar	.2¢	¢/lb.	224
Frozen Pork Bellies	.2¢	¢/lb.	76
Cattle	.2¢	¢/lb.	80
Hogs	.2¢	¢/lb.	60
Copper	½¢	¢/lb.	125
Platinum	\$4	\$/oz.	200
Silver	20¢	\$/oz.	200
Lumber	\$1	\$/1000 bd. ft.	130
Plywood	\$1	\$/1000 sq. ft.	76
Gold	\$4	\$/oz.	400
Cocoa	\$20	\$/ton	200
Coffee	2¢	¢/lb.	750
Cotton	½¢	¢/lb.	250
Frozen Orange Juice	1¢	¢/lb.	150
Potatoes	.2¢	¢/lb.	100
British Pound	1¢	\$/Pound	250
Canadian Dollar	.2¢	\$/Can. \$	200
Japanese Yen	.00002¢	\$/Yen (.00)	250
Swiss Franc	.2¢	\$/Franc	250
W. German Mark	.2¢	\$/Mark	250
Heating Oil	.2¢	\$/gal.	84
U.S. T-Bonds	½ pt.	% of 100%	500
G.N.M.A.	½ pt.	% of 100%	500
U.S. T-Bills	.1 pt.	% of 100%	1000
Bank C.D.s	.1 pt.	% of 100%	1000
Value Line Composite Index	½ pt.	—	250
S. & P. 500 Index	½ pt.	—	250
N. Y. S. E. Composite Index	½ pt.	—	250
South African Gold Stocks	\$1 over \$20		
	50¢ btwn. \$5 & \$20		

SECTION FOURTEEN

ADJUSTING A CHART FOR A STOCK SPLIT



In Figure # 54 we have the chart of a stock that has announced a two for one split. The original price scale appears on the left hand side of the chart. The first thing to do when you want to adjust a chart for the split is to draw the new scale on the right hand side of the chart. In the case of a 2 for 1 split, you simply cut the price of each square in half. Using the right hand price scale, you now have a chart in  $\frac{1}{2}$ -point units with a  $1\frac{1}{2}$  point reversal both below and above the 20 price level.

The next step is to draw a new and correct price scale in  $\frac{1}{2}$ -point units below 20 and in 1-point units above 20. This is illustrated in Figure # 55. Working with the  $\frac{1}{2}$ -point units in the old chart you draw your new chart according to the correct units. This has been done in Figure # 55. If you will trace each movement on the new chart and compare it with the old chart you will soon learn how this is done.

Do not adjust a chart for less than a 10% stock dividend. If a stock has been split 3 for 2, each square is multiplied by  $\frac{2}{3}$ rd, if it has been split 3 for 1, then each square is multiplied by  $\frac{1}{3}$ rd, etc.

In adjusting a chart, it should always be borne in mind that many of the chart patterns in the old chart will disappear in the new chart. Sometimes, an adjustment will even change a chart from bullish to bearish and vice versa.

## SECTION FIFTEEN

### THE 5-POINT REVERSAL CHART

On the facing page we have two charts of Natomas covering the same time period. The upper one is a 3-point reversal chart and the lower one is a 5-point reversal chart.

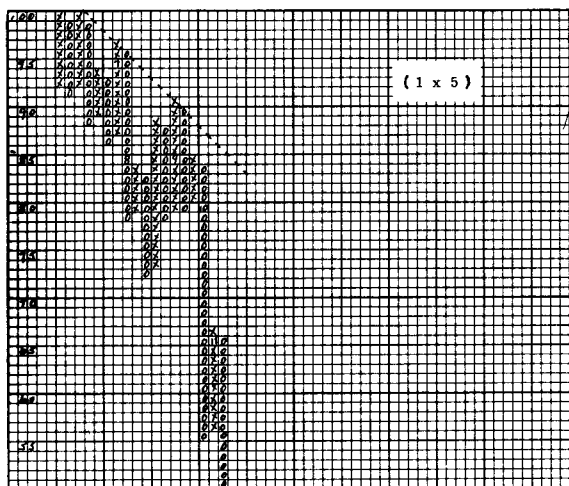
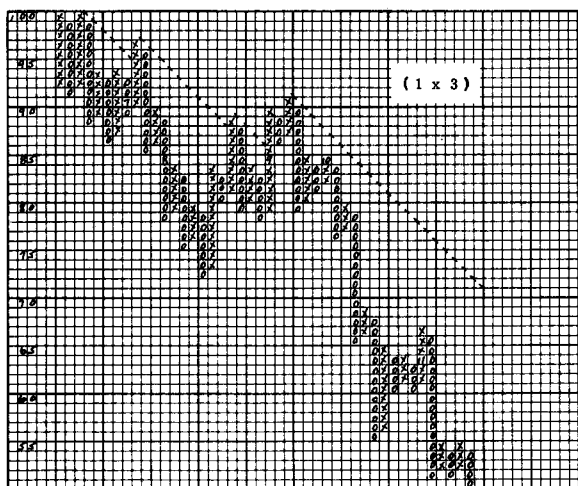
The 3-point reversal chart is spread over forty-four columns while the 5-point reversal chart is condensed into eighteen columns. The 3-point reversal chart gave ten buy and sell signals; the 5-point reversal chart gave only five such signals. The 3-point reversal chart has four Bearish Resistance Lines; the 5-point reversal chart has only one Bearish Resistance Line which is still in effect.

It is obvious, even at a glance, that the 5-point Natomas chart is superior to the 3-point reversal chart in that it is subject to much fewer whipsaws. Also, if one follows the Bearish Resistance Line on the 5-point chart, one would never have gone long of Natomas during this period.

Although the 3-point reversal chart works very well about 90% of the time, there are some stocks which should be charted on a 5-point reversal. These are usually the higher priced stocks, the very active stocks, and the so-called "glamour" stocks. In such stocks the 3-point reversal method still shows minor moves; it takes a 5-point reversal chart to eliminate them.

The long-term investor might also use the 5-point reversal chart on almost all stocks, while the short-term trader must use the 3-point reversal chart.

The 5-point reversal chart is constructed from the 3-point reversal chart by eliminating all moves under 5 points.



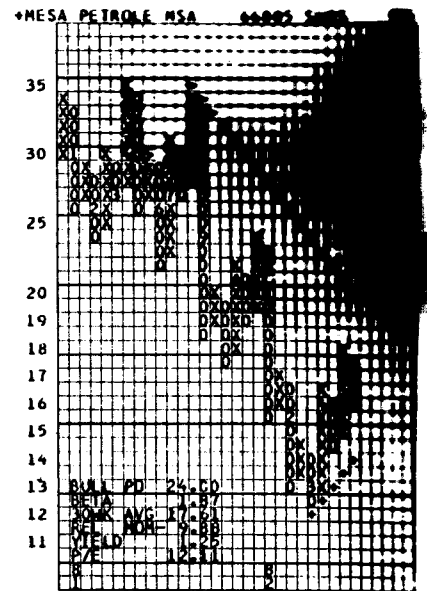
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