

How to Calculate Point and Figure Price Targets when Swing Trading

I can honestly attribute the use of point and figure charts as one of the turning points in my trading career. Earlier on as I studied the works of Richard Wyckoff, point and figure (P&F) charts were a staple of his trading methodology.

As I began to define and refine my own trading systems, I slowly drifted away from P&F for more sexy analysis techniques such as Elliott Wave and candlestick patterns.

I soon realized that while these other analysis methods made me feel sophisticated, it wasn't adding much in terms of money to my account. As I continued to refine my trading methodology, oddly enough I landed back where I started – P&F charts.

Across the web you will find a number of articles and books on how to create P&F targets. However, what I aim to do in this article is to not just give you the mechanics for how to perform a count, but to show you my exact settings for determining a profit target. I will also provide real-life examples so you can see things in action.

Why perform P&F counts

I am a firm believer that the market will do whatever it wants to. So, it begs the question, why would I get in the business of attempting to predict or guesstimate where the market is headed?

The simple answer to this question is that I seek to understand how far a stock can run for the basis of

calculating my risk versus reward for every trade I take on. This provides me the means to see before I enter a trade whether the stock fits the criteria of my risk profile.

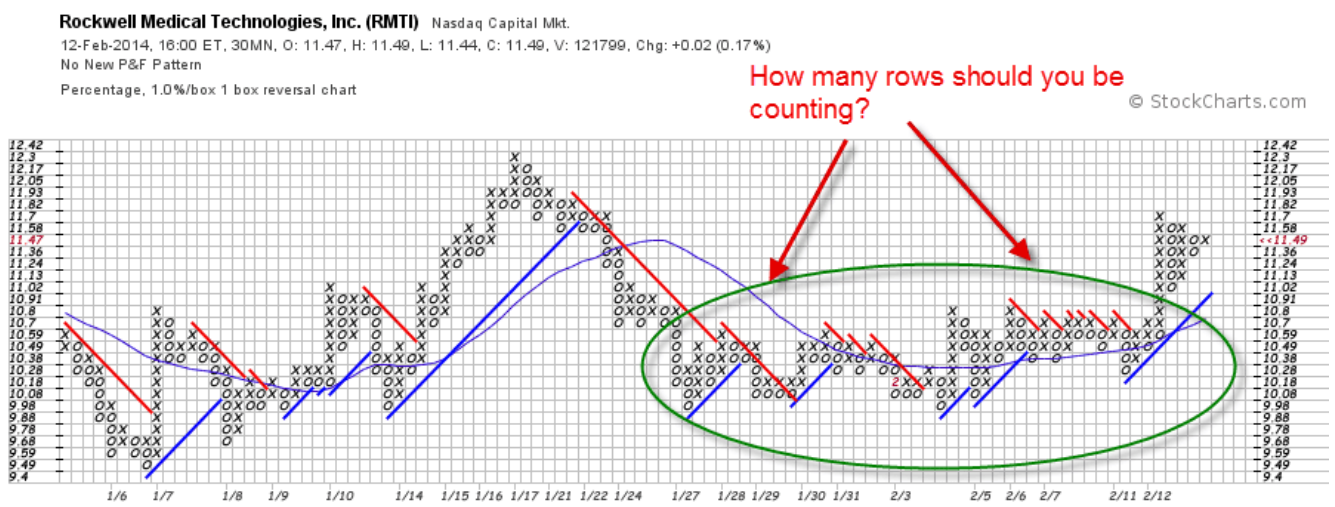
Where people get in trouble with targets (P&F, Elliott Wave, Gann, etc.) is when the trader begins to believe that the market must conform to his or her analysis. I have personally seen this lack of flexibility ruin otherwise would be great traders.

Methods for calculating P&F Targets

There are two primary methods for calculating P&F targets: (1) vertical and (2) horizontal. I will not be covering horizontal counts in this article because over time I have found this method unreliable.

Reason being when you have a significant consolidation range, determining which level and how many boxes to count can be challenging. While there are methods out there for properly determining which row to count, for me these methods lend themselves to too much subjectivity.

For an example of a horizontal count, below is 1-box P&F chart of the stock Rockwell Medical Technologies, Inc. (RMTI).



Where would you have made your horizontal count?

Now, let's look at the same chart, but on a 3-point reversal.

Rockwell Medical Technologies, Inc. (RMTI) Nasdaq Capital Mkt.
 12-Feb-2014, 16:00 ET, 30MN, O: 11.47, H: 11.49, L: 11.44, C: 11.49, V: 121799, Chg: +0.02 (0.17%)
 No New P&F Pattern
 Percentage, 1.0%/box 3 box reversal chart
 Bullish Price Obj. (Rev.): 14.64

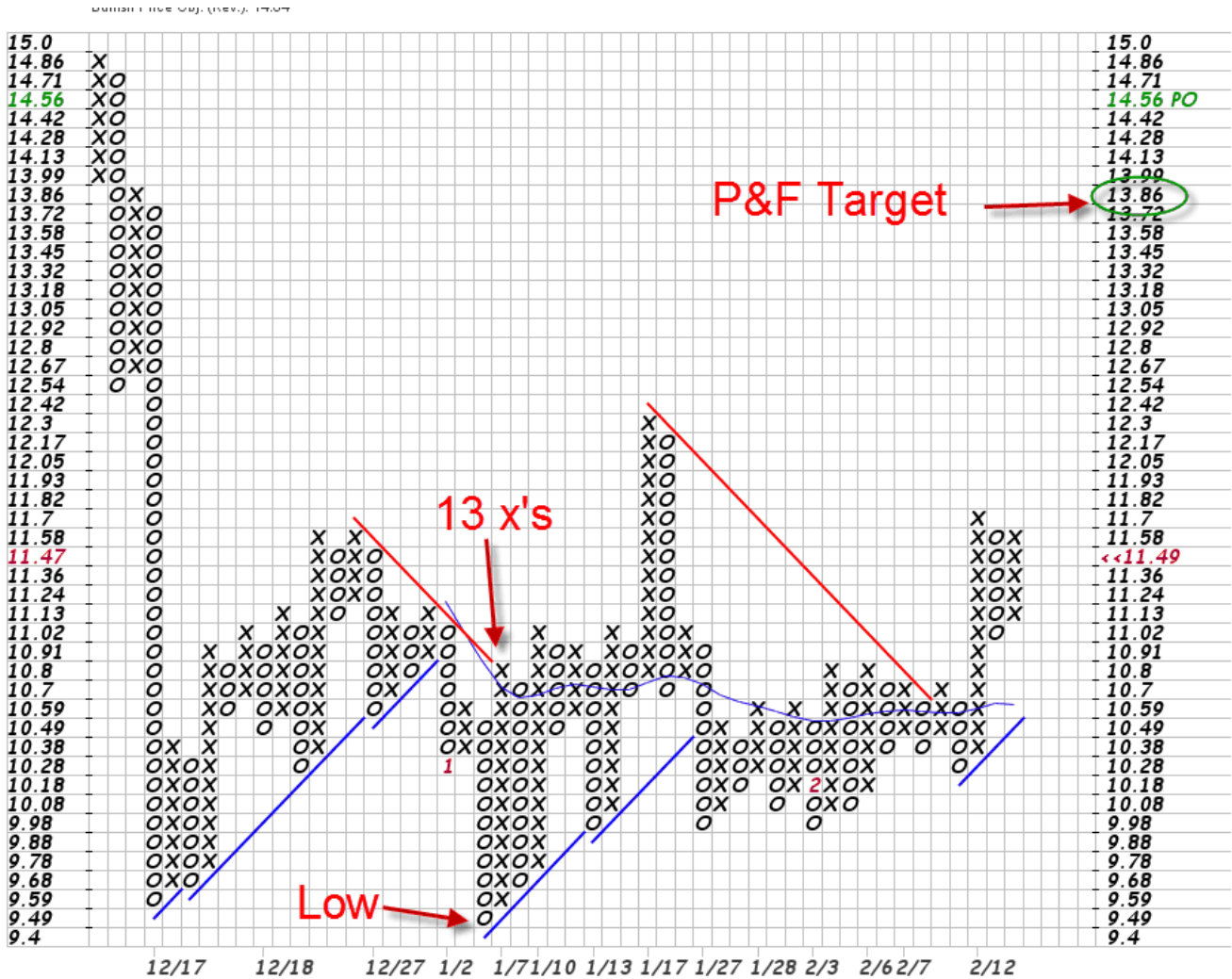
© StockCharts.com



I don't know about you, but that doesn't give me the warm and fuzzies either. Now, let's apply a vertical count to the same 3-point chart instead of horizontal.

We first identify the low of the chart which is \$9.49 and we count the next column of x's. The next column has a total of 13x's. To find the P&F target, we take 13 x 3 (remember we are on a three point chart) which gives us a total of 39. We then count up 39 boxes from \$9.49 to arrive at a price target of \$13.86.

With this additional level of clarity, let's go back and look at the previous chart example to illustrate the count.



Simple as pie right? I am being facetious, but on some level it really is just that simple. You find the low or high of a major swing. You then look to the next column of x's or o's and take that count times 3 to get your target from the swing point.

This to me is much simpler than trying to take horizontal P&F counts or worst trying to determine what sub-wave we are in of an Elliott Wave pattern.

My Specific P&F Configuration Settings

Those of you familiar with P&F counts are probably saying to yourself, well great job numbnuts, you managed to explain vertical P&F counts.

You would be right in this statement, so let me take it a step further and give you my exact configuration.

(1) Number of P&F boxes

1. As stated earlier in the article, I use a box count of 3 to reduce the level of clutter on the chart.

(2) Vertical Count

1. The vertical count reduces the level of subjectivity and provides a clear column of boxes to determine a count.
2. Vertical counts also reduce the potential for counting too many boxes horizontally, which will produce unrealistic P&F targets.

(3) Scale

1. I use the percentage scale and more specifically 1% boxes. This is a critical factor for nailing the precision of a target. I previously used the traditional scale, which prescribes a set number of boxes for price levels. This means that the P&F vertical will increase in fixed increments (.25, .5, 1) until a new high or low is breached (\$10, \$100) and then the count moves to the next increment level up.

The reason I like percentages, is because it takes into account the price movement at each box levels versus key price levels where the increments increase. Timeframe

1. I look at the 30-minute timeframe for my P&F charts. Intraday P&F charts are not the same really as candlesticks or bar charts. The charts themselves remove time from the equation, so really all we are doing is capturing more price moves throughout the day, versus using a daily timeframe where only a few price inputs are used to calculate the P&F. The old school

method of using P&F was based on using tick charts, but for the purposes of my analysis, 30-minute gives me the perfect mix of staying close to the price action, without overloading myself with fresh data.

For the most part numbers 1 through 3 should be pretty common; however, number 4 is where I separate myself from the pack. The key inputs of using a scaling method of percentages and the timeframe of 30 minutes will provide you a level of clarity on the market similar to the first time you put on a pair of glasses (assuming you own a pair).

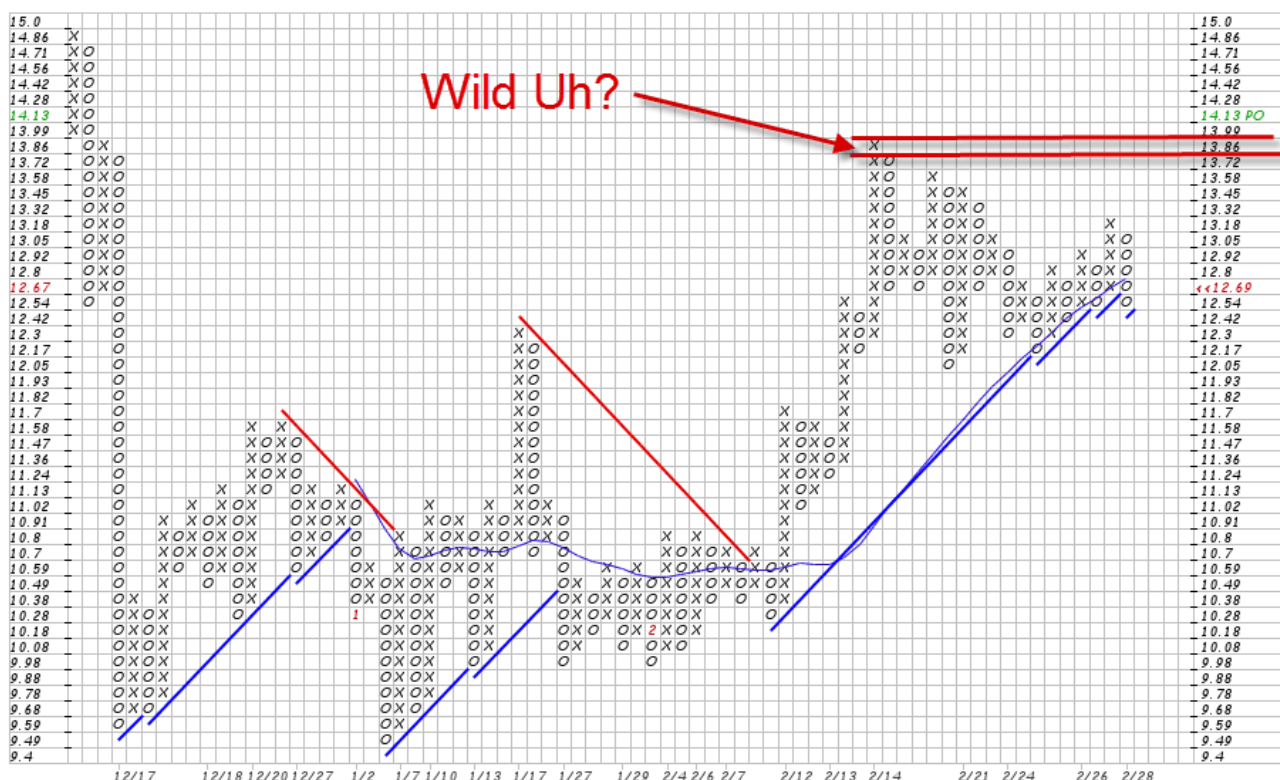
Real-life examples

Now that we have covered how to develop P&F counts in theory, let's look at some real-life examples.

RMTI Long Position

Going back to the RMTI position, I entered the trade at \$10.17 on 2/5/2014. From there, RMTI went flat for a period of time working through its consolidation phase. Once the stock began to take off, I knew that all roads would point to ~\$13.86 based on the P&F count.

Below is a chart of how the price action ultimately played out.



I was able to close the stock out slightly below the P&F target for a 30+% gain on 2/14/2014.

I use to worry about why things happened and needed to know every single detail. I have reached a maturity level now where frankly I no longer care. Call it luck; call it divine intervention, P&F targets simply work.

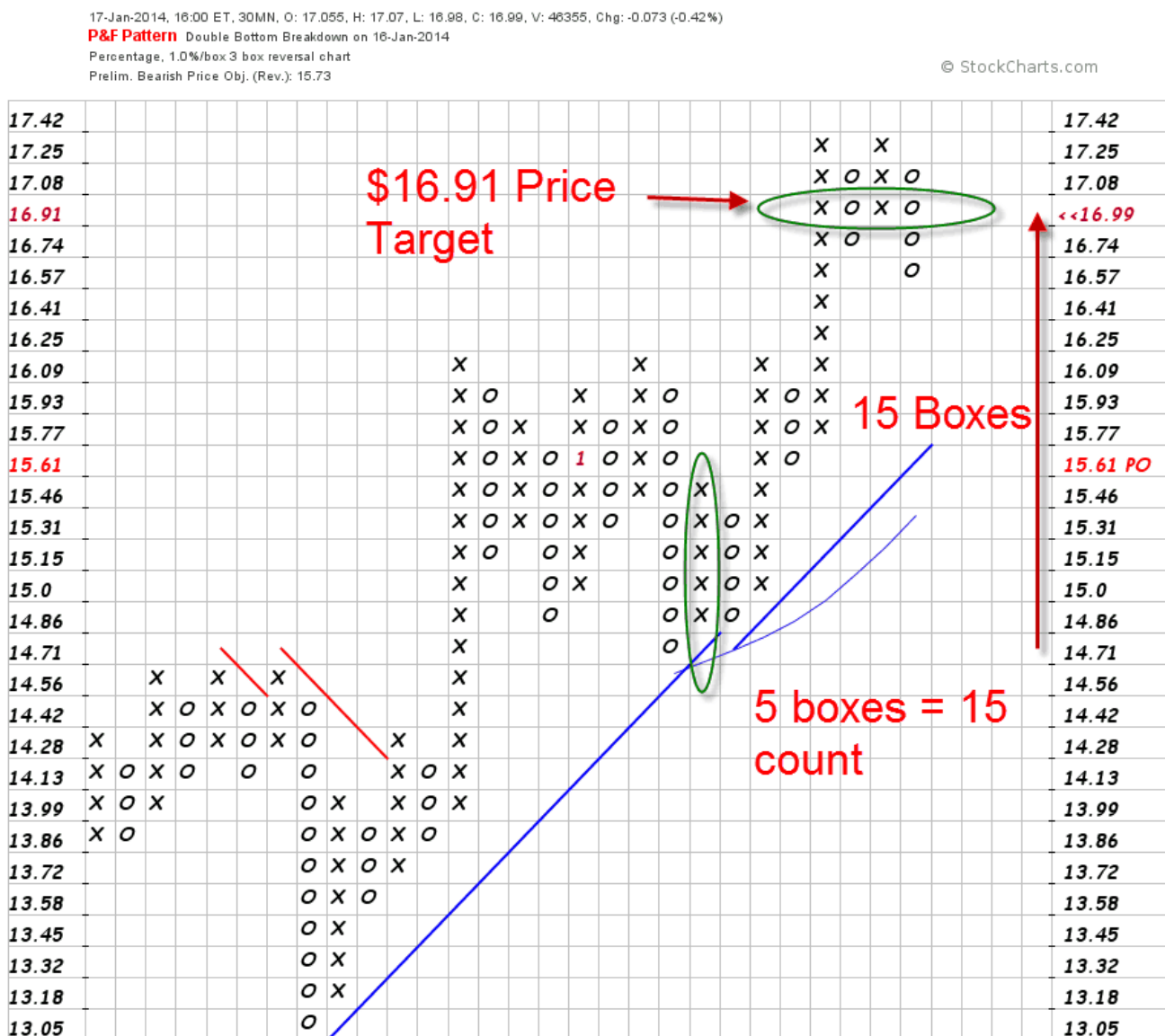
I shouldn't be so flipid; P&F targets are the result of the battle between supply and demand at key congestion zones. Once the price is able to leave these consolidation formations, the box count provides the resulting target for the move.

HWAY Short Position

HWAY took me for a bit of a ride. I placed the short trade on 12/26/2013. Looking back I was hungry for action while I was on vacation and I had no business placing the trade as the market was in full holiday mode.

Needless to say, HWAY went well above my entry point of \$15.43 and drifted north of \$17. This process of letting HWAY tire out the longs would have been unbearable if it weren't for my trusty P&F count.

One little ace up my sleeve was the P&F target for HWAY was \$16.91. Please see the count in the below chart:



So, you may be asking how did I know \$16.91 was the target? I knew this for a couple of reasons:

- (1) The P&F target from the \$13.05 low was met (\$15.93), so the next target would be the count coming out of the trading range.
- (2) \$14.71 was the low of the consolidation range. From

this low there was a 5-box vertical count on a three point chart up to \$16.91.

I knew with a high degree of confidence that HWAY would face significant resistance at \$16.91. As you can see from the chart, HWAY actually exceeded the P&F count slightly, only to later rollover.

Healthways, Inc. (HWAY) Nasdaq Global Select Mkt.

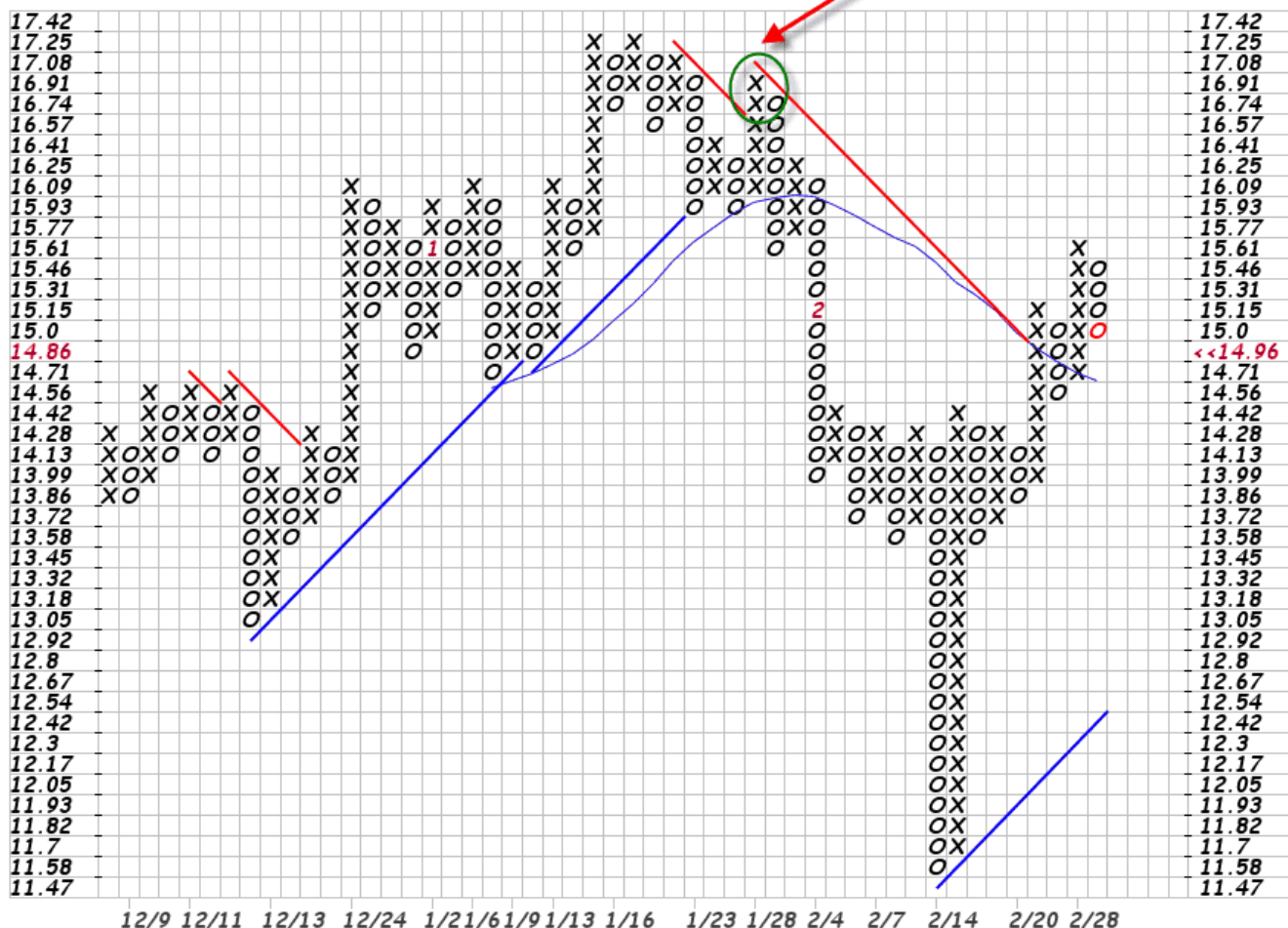
28-Feb-2014, 16:00 ET, 30MN, O: 15.10, H: 15.11, L: 14.905, C: 14.96, V: 87076, Chg: -0.15 (-0.99%)

P&F Pattern High Pole Warning on 28-Feb-2014

Percentage, 1.0%/box 3 box reversal chart

Bullish Price Obj. (Rev.): 20.2

As you can see HWAY
backtested \$16.91 before
rolling over © StockCharts.com



Without knowing the potential reversal zone at \$16.91, I would have had a tough time sitting through the position as the stock initially moved against me.

Pros of P&F Counts

- Provides you a roadmap for where a market or stock is likely headed.

- Serves as an alert to pay closer attention to your positions as key levels are hit.
- Helps determine risk reward parameters.

Cons of P&F Counts

- The counts are “targets”, remember the market can always go higher or lower.
- When determining counts, look back to see how closely a stock has met these target levels. If the stock has overshot targets in the past, it will likely do so in the future.
- You have to control the urge to find counts on multiple timeframes. This will cause analysis paralysis to set in. Just use one timeframe to ensure you do not cloud the technical picture.

In Conclusion

The P&F settings discussed in this article are specific to my swing trading system. By using these settings I am able to achieve anywhere from 10% – 40% gains when taking into account my trade management strategy which calls for me to let my winners run.

As you explore the possibility of using P&F charts to determine price targets you will want to take the following into account:

(1) Are you swing trading, day trading or long-term investing?

(2) What is the volatility of the stocks you are trading? This will directly impact the validity of the P&F targets.

Continue to tweak your P& parameters until you find a system that gives you the most profit on every trade.