January 2018

# Classical Charting 101

## Introduction

This document is intended to provide novice traders with a brief introduction to classical charting principles and to explain my specific approach to market speculation. Classical charting is a specific sub-set of technical analysis as opposed to fundamental market analysis.

Fundamental analysis is the study of the "*underlying economics*" of a market in order to ascertain the proper value of that market. Underlying economics can represent enormous subsets of micro and macro factors. The exact framework for understanding the fundamentals of cryptology is a work in progress and will likely evolve substantially in the years ahead. I believe that any trader who thinks she/he has a conclusive understanding of how cryptology will play itself out in global commerce/finance is self-deceived. This is not to say that certain fundamental assumptions about the future of cryptology cannot be made.

Technical analysis (TA) is the study of buying and selling forces as reflected by price itself in an attempt to make certain conclusions about the future (defined in very different time frames by different technical traders).

There are many schools of technical analysis. Some of them include:

Numeric schemes
- Systematic trend following
- RSI
- Stochastics
- Moving averages
- ADX
- Bollinger Bands
- Other indicators

Analog analysis

Chart structure analysis
- Gann
- Cycles

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Wave counting
- Elliott Wave
- DeMark sequencing
- Others

Retracement analysis
- Fibonacci
- Cycles

Classical charting principles
- Comprehensive classical chart analysis
- Selective chart analysis

Hybrid

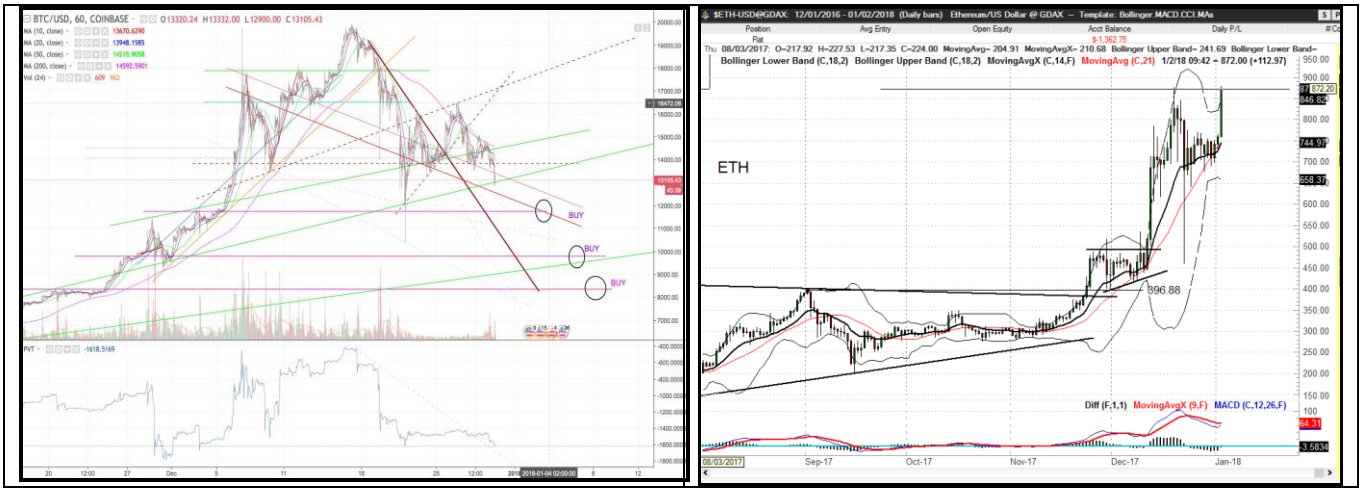
Several important points should be made about the listing of approaches to technical analysis on the previous page.

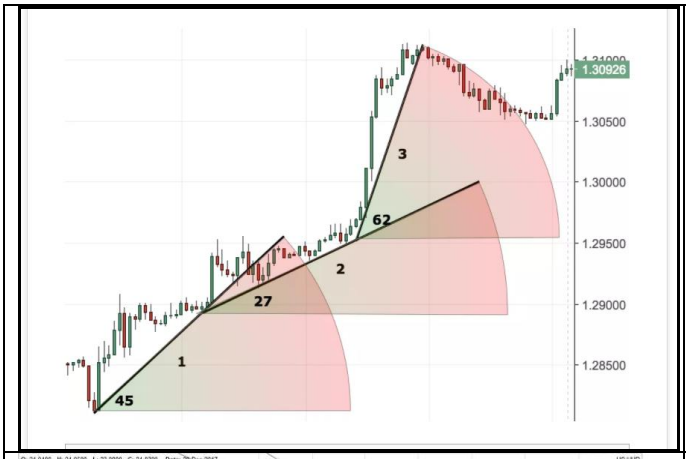
- The listing is not comprehensive and is an over-simplification
- Some specific components of TA are used in different schools
- Many technical traders have adopted a hybrid approach
- Technical traders can also be subdivided by the execution of their trading approach
    - Purely systematic
    - Dominantly rules-based
    - Dominantly discretionary
- Technical traders can further be subdivided by the time frame of their analysis and holding times
    - Day traders
    - Scalpers (several days)
    - Swing traders (several days to two or three weeks)
    - Position traders

The bottom line is this – simply to label a trader or analyst as a "technician" is completely meaningless.

There is another VERY important point that must be made on the subject of "charting." Just because a trader draws lines on a chart does not make him or her a classical chartist. Classical charting principles are well-defined and based on the foundational writings of Richard W. Schabacker (*Technical Analysis and Stock Market Profits*), expounded in 1948 by John Magee and Robert Edwards (*Technical Analysis of Stock Trends,* 1948).

Social media such as Twitter and StockTwits contain many charts similar to the following. While the specific approach to TA reflected by these charts are capable of producing profitable trading endeavors, they are not examples of classical charting principles.







[Note: It is not my intent to criticize the approaches to TA represented by the previously shown charts. There are many ways to conquer trading. I am simply making the distinction between classical charting principles and other forms of chart analysis.]

Schabacker/Edwards/Magee provide specific criteria chart construction must meet in order to be labeled in a certain way. For example, just calling a chart construction a H&S pattern does not make it a H&S pattern. Just drawing a triangle on a chart does make it a valid triangle unless certain conditions are met. An example of the required criteria is the "double top."

> *" The two highs making up a double bottom must be more than a month apart and the reaction between the first and second high must reduce price by 20% of the top value. Additionally, the highest volume must occur in the first high. If these criteria are not met – then no double bottom. Rather, the entire price action is likely to become part of a larger congestion zone."* (Schabacker)

It is critically important for newcomers to understand the strengths and weaknesses of all charting (classical charting principles included):

<u>Pros of charting</u>

- Charts show where markets have been
- Charts can show levels of previous "large-block" buying and selling
- Charts periodically can suggest the path of least resistance
- Charts are most useful for the timing needed to achieve an asymmetrical Reward to Risk (R/r) trade
- Charts are very useful for managing the initial risk of a trade
- Charts can provide valuable clues for the ongoing management of a trade

Cons of charting

- Charts do NOT predict – price targets are suggestive, not predictive
- Most chart patterns falter and morph into larger patterns – this is especially true of intraday chart construction and diagonal patterns
- The vast majority of markets defy understanding from a classical charting perspective the vast overwhelming proportion of time (this is true for ALL forms of TA)

The Factor's specific approach to classical charting

I attempt to be as true as possible to the original work of Richard W. Schabacker. Over time I have made some modifications to Schabacker's work. While I acknowledge all of Schabacker's classical charting principles to be valid, my actual trading program is quite selective as to the types of chart patterns considered before assuming market risk.

As a general rule, I tend to avoid establishing trades in response to "diagonal" chart construction, such as:

- Trendlines
- Symmetrical triangles
- Rounding patterns (especially extended varieties)
- Trend channels
- 3-fan principle
- H&S patterns with necklines slanted into the right shoulder
- Wedges
- "V"-extended bottoms/tops

All of the above can be valid patterns – my decision to avoid them is based on their tendency to provide false trading signals. Diagonal patterns are much more apt to morph into longer-duration chart construction.

In contrast, I have found "horizontal" patterns to offer greater reliability. Examples of horizontal patterns include:

- H&S tops/bottoms
- Continuation H&S patterns
- H&S failure patterns
- Rectangles
- Right-angled triangles (ascending and descending)
- Running wedges
- Rectangles
- Pennants and flags (only when formed in strong trends)
- Horns
- Double tops/bottoms (in specific cases only)

I have further modified my use of classical charting principles to be strongly biased toward chart configurations greater than 10 weeks and less than 12 months in duration. I have found that patterns less than 10 weeks in duration have a greatly likelihood of failing (with the exception of brief flags and pennants in a strong and sustained trading) and that chart patterns greater than 12 months in duration can be extremely challenging from a tactical perspective (where to enter and how to protect a trade).

Weekly graphs provide my starting point for chart analysis. Each Friday I scroll through about 120 markets – mostly futures and forex with some global equities and cryptos – in search for patterns qualifying for a risk position. From this list I identify about 25 markets to be included on my "long list." The "long list" includes three types of market situations.

1. Markets in which I currently hold a position (seldom more than 8 markets)
2. Markets whose charts are capable of generating a trading signal at any time (usually 3 to 5 markets)
3. Markets in the mid-stage of developing a tradeable chart pattern (10 to 15 markets)

I then review the daily charts of these markets, from which a "short list" is established – usually about 10 to 15 markets. The "short list" includes:

A. Markets in which I hold a position
B. Markets in which an order or alert is active for a New Initial Position (NIP)
C. Markets in the late-stages of pattern construction

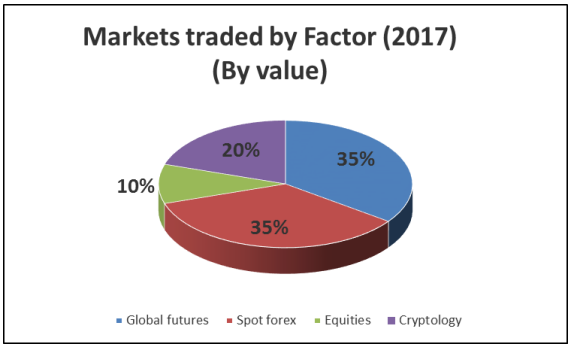
I am not a day trader. I consider myself to be more of an order-enterer than a trader. My job is to place orders that make sense based on the charts under consideration.

There are several other technical factors I pay attention to. These include:

- CFTC Commitment of Traders Report (COT) for futures
- Volume spikes – a huge slug of volume is most typically "starting" or "stopping" volume
- Moving averages – as a proxy for trend (not used systematically)
- Donchian Weekend Rule – a market that thrusts into new high or low territory prior to a 3-day weekend
- Intra-delivery spreads – in the case of futures
- Breakout confirmation by highly correlated markets
- Wide-bodied candlestick bar (WBB) breakouts
- Simultaneous completion of multiple chart features

<u>Factor's trading frequency</u>

With all the aforementioned in mind, my trading profile in 2017 was as follows:




| | |
|---|---|
| Total different markets traded in 2017 | 54 |
| Total trades (includes re-entries, pyramids and multiple tranches) | 153 |

I was more active in 2017 than normal. The reason is that trading conditions were very challenging during the first nine months of the year – so my trading frequency per trading theme was unusually high.

Another way to think about the frequency of my trading is as follows:

***<u>For each market I follow there is only one to three quality classical set-ups per year – meaning that I typically establish a New Initial Position (NIP) in an average market only one to three times through the entire year.</u>***

I find that a greater trading frequency in most markets is usually counter-productive. Of course, there are always a few markets that offer outstanding trading opportunities in a given year – Cryptos were such an example in 2017 because of the major trending behavior.

BTC in 2017 was the biggest bull market in modern times. There were no more than six chart set-ups that represented buy signals based on my approach to classical charting principles (see charts as Exhibit A).

1. Dec 21, '16 – 6-mo continuation rounding
2. Apr 27 – running wedge
3. Jul 20 – end around
4. Aug 5 – cup and handle with wide-bodied bar (WBB)
5. Oct 9 – horn/ WBB new high
6. Nov 25 – 3-mo running wedge

ETH produced a similar number of chart set-ups based on my approach to classical charting (see chart as Exhibit B).

1. Mar 11 – common bottom
2. Apr 27 -- pennant
3. May 19 -- pennant
4. Nov 23 – 5+ mo. ascending tri
5. Dec 13 -- pennant
6. Jan 2, '18 -- pennant

I want to emphasize that the large number of chart signals in BTC and ETH was exceptional – due to the fact these markets were undergoing historic trending conditions. Most markets only generate two or so major chart signals in a given year.

I want to limit my trading to the exact days (and at the exact price) generating signals. Entering trades at other times (no matter what my opinion in a market might be) leads most often to frustration and unprofitable trading.

<u>Factor's Trading Profile</u>

**My sole goal as a chart trader is to limit my trading to those signals that have a good chance of standing the test of historical scrutiny – that I can look back a year or more and understand exactly why I took trading action.**

With regards to the above statement, please know that I have sought improvement, never perfection. For a discretionary trader (as opposed to a pure systematic trader) the reality is that disharmony will always exist between real-time trading action and a retroactive analysis of price action. Yet, my journey as a trader has been to increase the continuity of the two perspectives. The most important question I ask myself each time I enter a trade is this – "*Will the chart construction I am about to trade be a clear signal when I look back at the chart a year from now?"*

With the aforementioned in mind, my trading operations can best be described as follows:

- My primary job as a trader is to protect my capital. It is impossible to be a full-time career trader until one learns to protect his or her pile of chips. What I might think about a particular market or chart is irrelevant if I am not judicious at capital preservation
- I am a swing trader
- I would define myself as 80% discretionary in terms of trade identification and 80% rules-based once a potential trade is identified
- My day is structured to avoid paying attention to markets
- I do not watch markets during "night-time" hours – although I may have limit orders working
- I attempt to place 80% to 90% of my orders between the hours of 15:30-17:00 and 05:30-06:30 (Mountain US time)
- Profitable trades are usually open for two to six weeks (occasionally several months), losing trades are generally closed within days (sometimes hours)
- My profit goal per futures contract is $2,000-plus (profit goal in spot forex is $2,000-plus per $100k of primary forex unit)
- I monitor 120-plus markets (futures, spot forex, cryptos and individual equities)
- In an average year I will trade 50 different markets – with an average of three trades in each (tranches, reentries and pyramids counted as separate trades)
- My career win-rate is less than 45%
- The loss on any given trade is limited to 1% of nominal trading capital
- My net profitability each year is usually generated by 15% (+/- 5%) of all trades. The remaining 85% of trades are throw-aways
- The 15% of trades generating the net bottom line average profits of 300 BPs to 400 BPs per trade
- My trading can best be described as throwing mud pies against the wall to see which ones will stick
- I use extremely aggressive trade management protocol. My goal is to move protective stops (or exit price alerts) to break-even within a day or two of entry
- As a rule I exit all trade that have a loss on Fridays
- My trading edge does NOT come from classical charting principles. Charts are simply my framework for identifying asymmetrical trading opportunities
- My edge comes from:
    - Aggressive risk management
    - An obsession to be diligent in order entry and order management
    - Knowing exactly what a trade is for me (my sweet spot)
    - Patience in waiting for a pitch into my sweet spot
    - Discipline in pulling the trigger when the right trade comes along
    - A refusal to let trades dig into my pocket
    - Patience in allowing a profitable trade to reach its implied profit target

New to classical charting?

- Read *Technical Analysis and Stock Market Profits*, Richard W. Schabacker, 1933
- Read *Technical Analysis and Stock Trends*, Robert Edwards and John Magee, 1948 – only the sixth edition and older are recommended. Do not buy an edition past the 6th.
- Paper trade for one year

plb
# # #

## Exhibit A


factorco published on TradingView.com, January 12, 2018 14:24 UTC
BITFINEX:BTCUSD, D 13780.0 ▲ +526.0 (+3.97%) O:13253.0 H:14100.0 L:12751.0 C:13780.0
Bitcoin / Dollar, D, BITFINEX
1
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factorco published on TradingView.com, January 12, 2018 14:29 UTC
BITFINEX:BTCUSD, D 13774.0 ▲ +520.0 (+3.92%) O:13253.0 H:14100.0 L:12751.0 C:13774.0
Bitcoin / Dollar, D, BITFINEX
2
3
Created with TradingView


factorco published on TradingView.com, January 12, 2018 14:30 UTC
BITFINEX:BTCUSD, D 13819.0 ▲ +565.0 (+4.26%) O:13253.0 H:14100.0 L:12751.0 C:13819.0
Bitcoin / Dollar, D, BITFINEX
4
5
6
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22000.0
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3300.0
2800.0
2400.0
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1270.0
Jun
Jul
Aug
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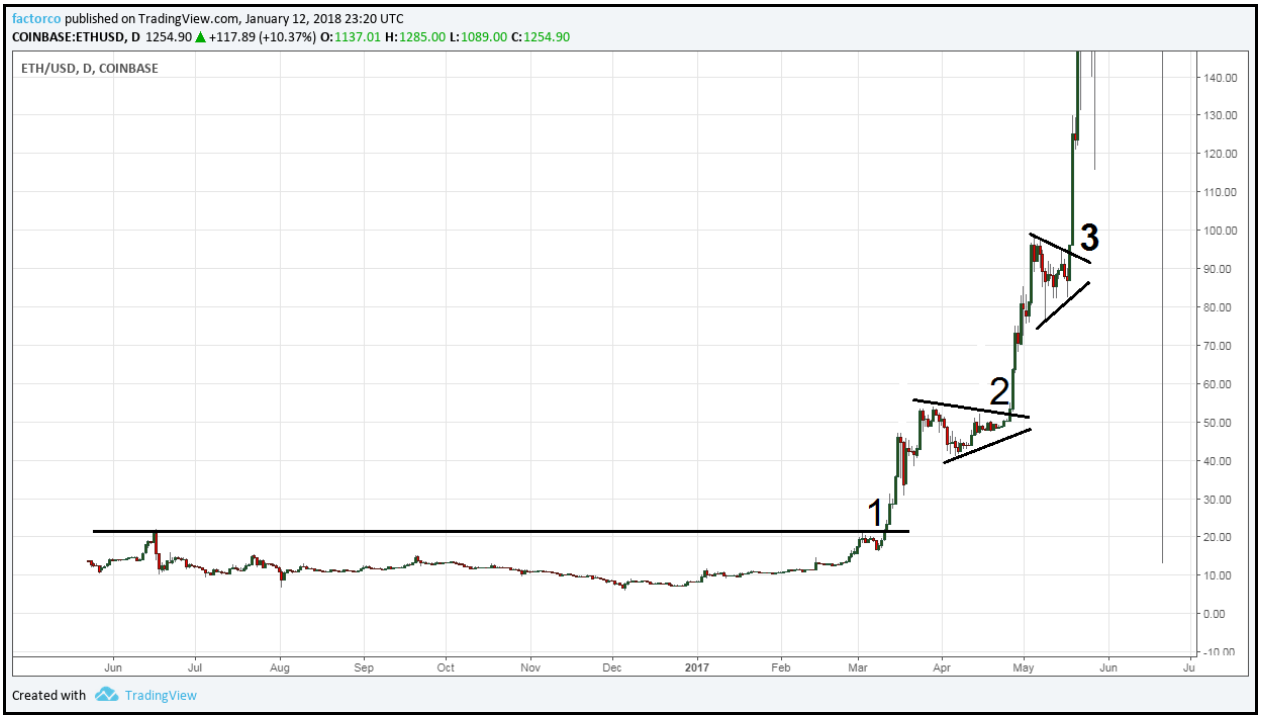
Nov
Dec
2018
Created with TradingView

Exhibit B


factorco published on TradingView.com, January 12, 2018 23:20 UTC
COINBASE:ETHUSD, D 1254.90 ▲ +117.89 (+10.37%) O:1137.01 H:1285.00 L:1089.00 C:1254.90
ETH/USD, D, COINBASE
1
2
3
Jun
Jul
Aug
Sep
Oct
Nov
Dec
2017
Feb
Mar
Apr
May
Jun
Created with TradingView


$ETH-USD@GDAX: 12/01/2016 - 01/12/2018 (Daily bars) Ethereum/US Dollar @ GDAX — Template: Default
Wed 05/24/2017: O=169.50 H=201.15 L=167.81 C=193.03 TDofM=24 TDofY=144
1/12/18 16:27 = 1255.53 (+118.52)
1086.00
ETH
4
5
6
396.88
© GenesisFT
05/24/2017
Jul-17
Aug-17
Sep-17
Oct-17
Nov-17
Dec-17
Jan-18
Feb-18