



Philosophy of charting

[Note: Some of you – maybe many of you – may find the discussion to follow quite boring or think it arbitrary and irrelevant. Think again! Successful market speculation is all about critical thinking and challenging conventional wisdom. If your hard-earned money is on the line in the stock, futures or forex markets and you are not willing to think critically and deeply about issues facing traders, then your fate is already sealed.]

I am a presuppositionalist. Call me old-fashioned, but I don't buy the idea that conflicting truths can both be true. I do not accept the fact that truth is whatever I claim it to be or you claim it to be. At the same time, I attempt to be a critical thinker who attempts to look "behind the curtain" of a subject rather than accepting the worn-out dogma of others.

In light of the above, let me make a presuppositional claim and then respond to it.

"Charts (and chart patterns) provide price predictions"

Surprisingly (I say "surprisingly" because I have made a living for more than 35 years from price charts) I reject any presuppositional dogma that price charts are predictive in nature. I take this position because I have witnessed over the years that charts result in far more false signals of predictive subsequent price behavior than valid signals of predictive subsequent price behavior.

Either charts are or are not predictive of subsequent price behavior. Both statements are contrary, and, therefore cannot be simultaneously true. Further, the idea that charts are "kind of" or "sometimes" or "conditionally" predictive of subsequent price behavior is a non-starter for me in understanding the endeavor of market speculation.

My presuppositional statement about charts is this:

"Charts (and chart patterns) are not dependable for providing price predictions"

Unfortunately, I have known many traders take huge losses while stubbornly insisting that their "charts cannot be wrong."

I wish to take aim at another foolish practice of novice traders – and that is declaring the direction of many markets based on the chart developments of a seemingly correlated market. I am sure you have heard (or even thought) something along these lines:

“The stock market appears to be doing such and such – let’s see, that means that the US Dollar will do this, Gold will do that, and my wife should order a side of beef anticipating the advance of Live Cattle prices prices.”

If the a single chart pattern is not predictive of prices, then what in the world are traders doing creating complex macro scenario based on that chart pattern.

Of what value are price charts, if any value at all? Or stated differently, *“Can charts be useful for profitable market speculation even though they are not dependable for providing price predictions?”* To this question, my answer is a conditional *“YES.”*

Charts have a value to traders for two reasons:

1. Newton’s First Law of Motion states that objects in motion (trending) tend to remain in motion while objects at rest (not trending) tend to remain at rest. This is physics folks! Charts are a graphic representation of the Newton’s First Law of Motion. The most practical application of this Law occurs when one’s trading time perspective is one time frame smaller than the time frame used to determine if a trend is occurring. In other words, a market in motion on a weekly graph will dependably become manifest on a daily graph. Traditional trend-following systems are based on Newtonian physics. When a market is in motion, trend followers make money. When a market is not in motion (i.e., going up and going down but going nowhere) trend followers lose money. Sooner or later trends will occur and trend followers will make money – assuming they did not get wiped out during the chop.
2. Charts can be used to ascertain the price (of a certain time frame) at which the motion of a market is in question. In short, charts are useful for determining a price level at which a trade is probably wrong. Traders control risk and create asymmetrical profit opportunities by finding an entry closest to this price level.

This First Law of Motion is the reason I shy away from anticipating a trend by pre-positioning myself within a trading range. I have found the best bet is to wait for a trend (motion) to declare itself. Newtonian physics is also the reason I believe most periods of uncertainty and confusion within a trending market tend to be resolved in the direction of the dominant trend.

So, there you have it. I do not believe charts provide predictive results. This is why I always refer to *“possibilities,”* not *“probabilities”* and definitely not *“certainties.”*

I conclude by pointing out that the concept of *“price targets”* is foreign to the First Law of Motion. There is nothing inherent within a trend that establishes profit objectives. I use targets as a guideline only – keeping mind that my trading plan calls for putting money in the bank during a trend and not waiting for a trend reversal before cashing out of a position.

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