

Peter Brandt authored one of the most authoritative books ever written on the subject of trading with classical chart patterns (now out of print and hard to find). He was also one of Commodity Corporation's most successful trading advisors during the late 1980s. The following is Peter Brandt's presentation from the MTA's 1989 Annual Seminar in Naples, Florida (exact date unknown).

Daniel L. Chesler
October 2004

"CLASSICAL CHARTING PRINCIPLE"

"AN EDWARDS AND MAGEE' APPROACH TO TRADING FUTURES MARKETS"

I have been trading futures markets for about 15 years. For 13 of these years, my primary method of trading has been Edwards and Magee chart patterns.

Today I am going to talk about how I use Edwards and Magee to trade the futures markets, and for those of you familiar with E&M as trading practitioners, I will share some experiences I have had with a trading technique based on chart formations.

First, let me say that from the standpoint of analysis, I am probably as pure an E&M trader as is possible. For the most part, all of my analysis is limited to basic formation identification. I do not follow the Elliot Wave Theory or Gann. I do not follow fundamentals or monitor such things as oscillators, relative strength, advance/decline or stochastics. Nor do I pay a whole lot of attention to open interest or volume (with one exception which I will comment on later). The only tool that I use in trading outside chart patterns is a 13-day moving average. That I use to provide me with some sort of handle on trend.

So, with these preliminaries aside, let's get down to business, and to basics.

When many of us think of classical charting principles -- of H&S, triangles, gaps, support and resistance, trendlines and the like, we think of John Magee and Robert Edwards and their 1948 book "Technical Analysis of Stock Trends". The reality is that it was through marriage that John Magee became knowledgeable on classical charting.

In the early 1900's, the Financial Editor of Forbes was a guy by the name of Richard W. Schabacker. Schabacker was a financial journalist, but he was also an ardent student of the markets. He observed that the markets did not always act in concert with what the fundamental events seemed to dictate. He concluded that there had to be something else besides fundamentals that drove the markets and spent the remainder of his life searching for answers.

His conclusion was that:

1. Major market moves were (and are) engineered by large trading interests.
2. That these trading interests did not necessarily act as a single group, nor were they always aware of each other's identity. But they were operating with similar minds and motivation.

3. That major price mark-ups and mark-downs were almost always preceded by the "right" people doing the "right" things. In other words, major moves required preparation.
4. That by graphing prices and volume, the activities of large interests could be detected.

From a more practical trading standpoint, Schabacker came to several conclusions:

1. That any given market, at any given time, was either in a sustained trend or moving up and moving down without any real price progress (what we call today a trading range or consolidation).
2. That during the periods of consolidation, prices, when plotted on a graph, tended to form recognizable geometric configurations.
3. That depending on the exact geometric pattern formed, the direction and magnitude of the next sustained trend could be determined with above average confidence.

While Schabacker published several books on investing in the stock market, none of these books dealt with his work on classical charting techniques.

John Magee married Schabacker's daughter and became owner of all Schabacker's notes. That is the origin of the Edwards and Magee book.

Without any additional comments at this time, those geometric configurations identified by Schabacker include:

Consolidation Patterns

Head and Shoulders
Rounding (Common) Turn
Symmetrical Triangle
Right Angle Triangle
Broadening Triangle
Diamond
Wedge
Double Top/Bottom
"M" and "W" Patterns
Horn
Drooping/Accelerating Pattern

Trend Patterns

Gaps
Flags
Pennants
Channel
Double Channel
Cradle
Trendlines

Of course, this is a very simplified list. In his unpublished manuscripts, Schabacher discussed many variations, nuances, conditions and exceptions to charting techniques.

Now, before I proceed to discuss exactly what I look for in charts, I want to make some very, very important points on the use of charts.

1. Charting is more of an art than science. Successful chart interpretation takes time, study and effort.
2. Charts can be misread, much in the same way as a Wave Count can be prostituted.
3. Charting is a trading tool, not a means for price forecasting. People who use chart books to make grand economic forecasts are in dangerous territory. Charts should be used for timing trading maneuvers, not for formulating fundamental opinions.
4. Even the most well-defined and seemingly perfect chart pattern is subject to failure.

5. Not every market, all of the time, can be understood using classical chart principles. The real danger is trying to fit a chart interpretation to all markets all of the time. More often than not, a given market will defy classical charting principles.

6. It is very easy to over analyze a chart. The temptation for a novice chartist is to keep studying a chart until something is made of it. The mentality is one of ... "there has got to be something on this chart and I have to find it". My experience is that chart patterns pop off the page; that legitimate chart patterns will find us. We don't need to find them. My rule is that if I have to spend over 15 seconds on a chart, it is time to turn the page.

These six points are extremely important, and should never be understated.

I maintain daily, weekly and monthly bar charts and closing price charts on 24 markets. I do not chart livestock, OJ, Coffee, Oats,

Lumber, and some of the stock indexes. Wherever possible, my preference is to use cash market charts, for instance, the DOW, NY Composite Index and all of the currency markets.

My own personal trading is broken down into two categories.

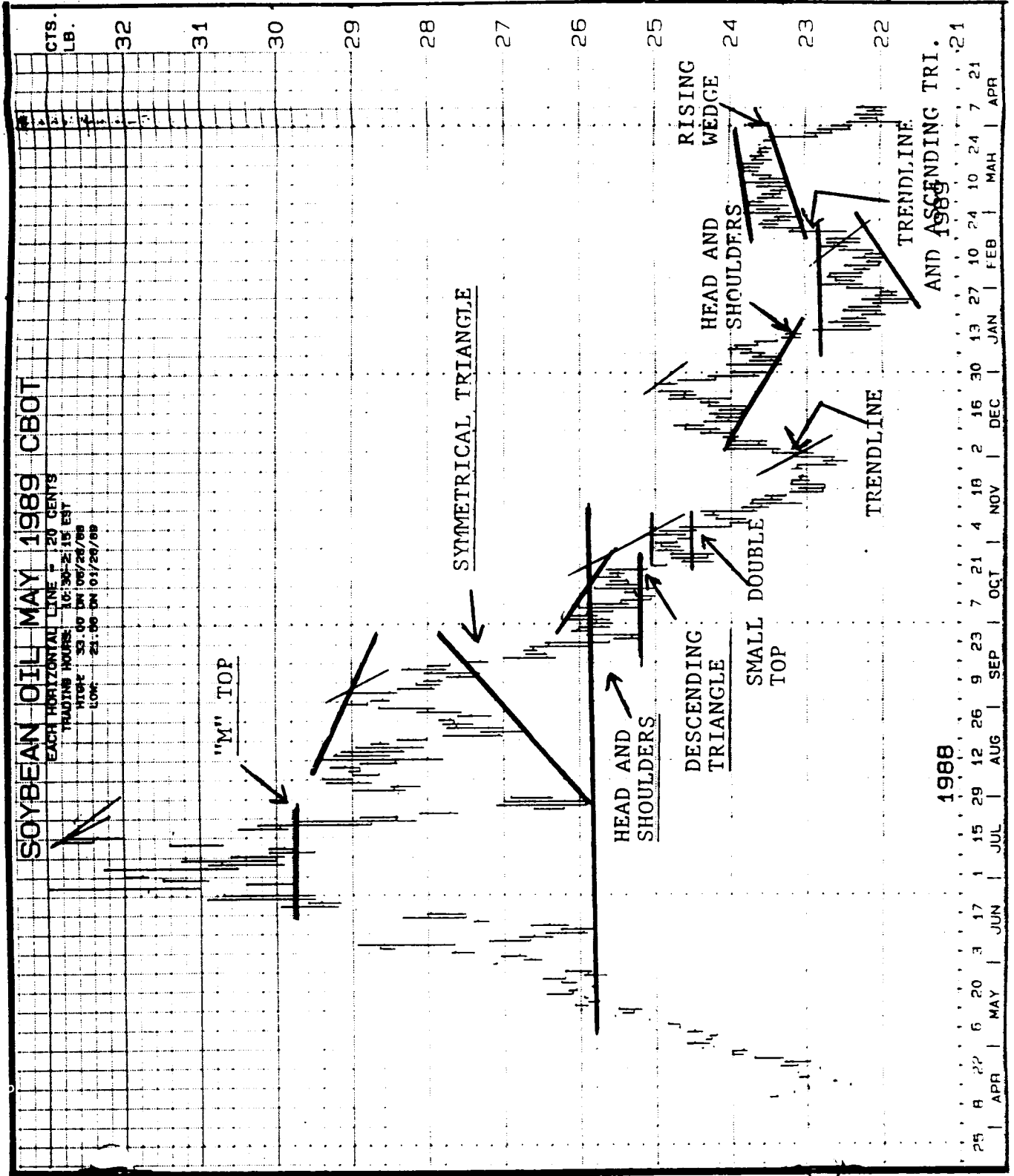
These are:

1. Every pattern trading. Recognizable patterns are appearing constantly. These may consist of such things as 2 or 3 week head and shoulders or triangle, a 5 or 6 week trendline, an 8 week double bottom or a 6 week wedge. My experience is that on average, a given market will provide about 12 to 15 recognizable classical chart patterns per year of some degree.

The following graph of Soybean Oil, which I find to be an excellent classical charting market, demonstrates my point.

Here we find a series of 10 recognizable classical chart developments over a period of 8 1/2 months (from mid-July, 1988 through late March, 1989). There were actually 3 other patterns I had drawn in Bean Oil during this time period, but I did not want to clutter the graph any more than it was.

Also in the handout book available, I include a graph on the Swiss Franc and Crude Oil.



CRUDE OIL MAY 1989 NYMEX

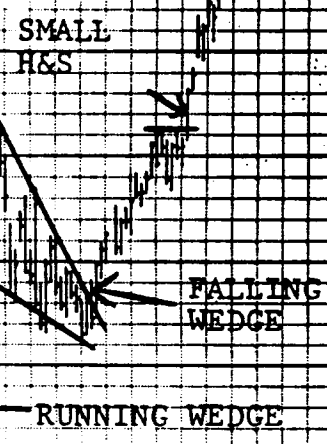
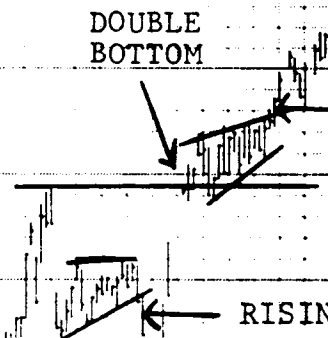
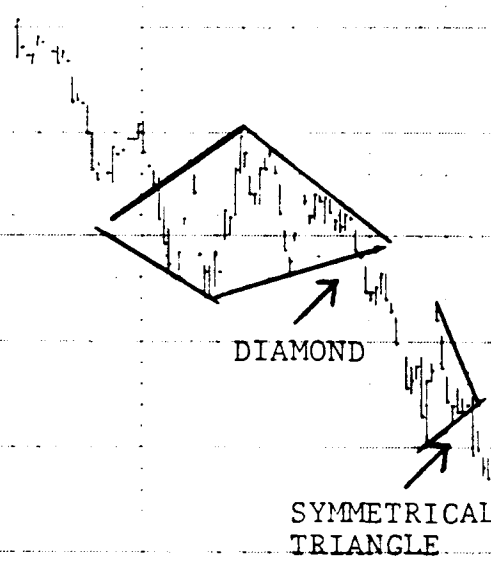
EACH HORIZONTAL LINE = .20 DOLLARS

TRADING HOURS: 9:45-3:10 EST

HIGH: 21.48 ON 03/31/89

LOW: 12.52 ON 11/18/88

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22
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1988

1989

6 20 3 17 1 15 29 12 26 9 23 7 21 4 18 2 16 30 13 27 10 24 10 24 7 21
MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | JAN | FEB | MAR | APR

DEUTSCHE MARK JUN 1989 IMM

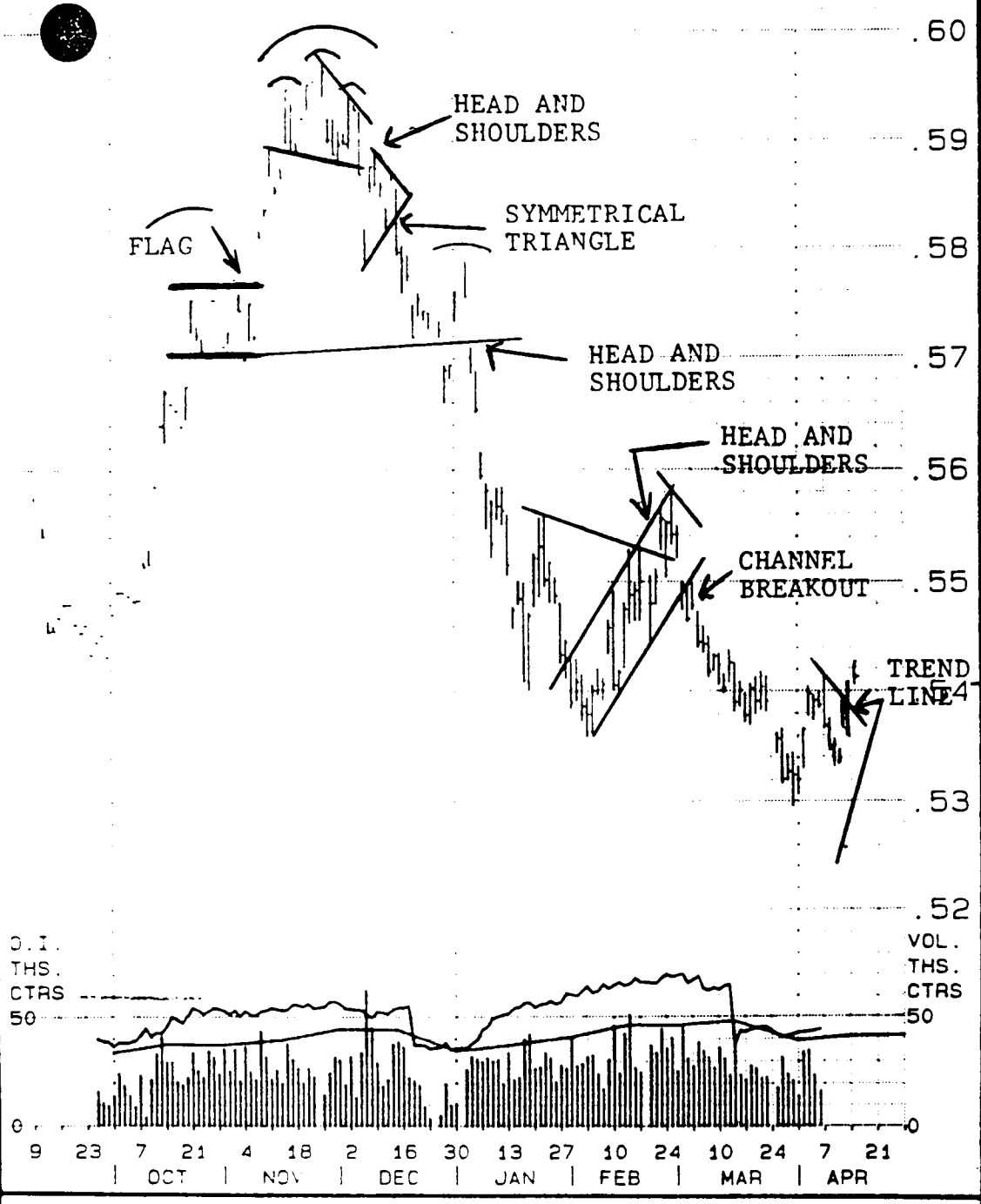
EACH HORIZONTAL LINE = .0020 DOLLARS

TRADING HOURS: 8:20-3:00 EST

HIGH: .5975 ON 11/25/88

LOW: .5296 ON 03/30/89

U.S.
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O.I.
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VOL.
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9 23 7 21 4 18 2 16 30 13 27 10 24 10 24 7 21
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So that is one part of my personal trading: taking action on every identifiable pattern development, regardless of its magnitude or implied price move.

The general rules I follow in this trading program include:

1. I assume the position at the break-out point. I do not anticipate the break-out.
2. If a market closes back within the boundaries of a completed pattern, I cover.
3. If I am out \$300 a contract, I cover.
4. I take profits at the objective.

As a general rule, I trade one contract of each signal per \$50,000 in capital. I do not pay attention to Relative Strength or Stochastics or contrary opinion or volume or open interest.

One comment on volume. Volume is more important in stocks than in commodities. In stocks, volume can always be compared to a known constant -- the float. In commodities, we create open interest regardless of a fixed supply, and therefore, volume has to be treated differently.

In this portion of my trading, I will usually trade between 25 to 35 signals per month. When I wrote this speech in April, I took a look at the previous 3 months. Out of 91 trades, there were 31 profits or 34%. That means that 66% of the trades were losers. But further, the net bottom line profit for all 91 trades was represented by only 4 trades. Less than 5% of the trades put in the bottom line.

More importantly, I am sure I would not have been able to predict which 5% it would have been before the fact.

And that is why I don't like to have market opinions. Market positions, yes. But market opinions, no.

I mentioned that this approach is only one of two I use in trading. And it is the least important of the two.

2. Major Market Moves. I believe that the real compensation in the markets does not come from trading positions, but by holding positions.

The other part of my trading is an all out concentration toward identifying the really big move.

My experience is that there are between 10 and 25 really sizable price moves in futures each year.

I define the ingredients of these moves with the following:

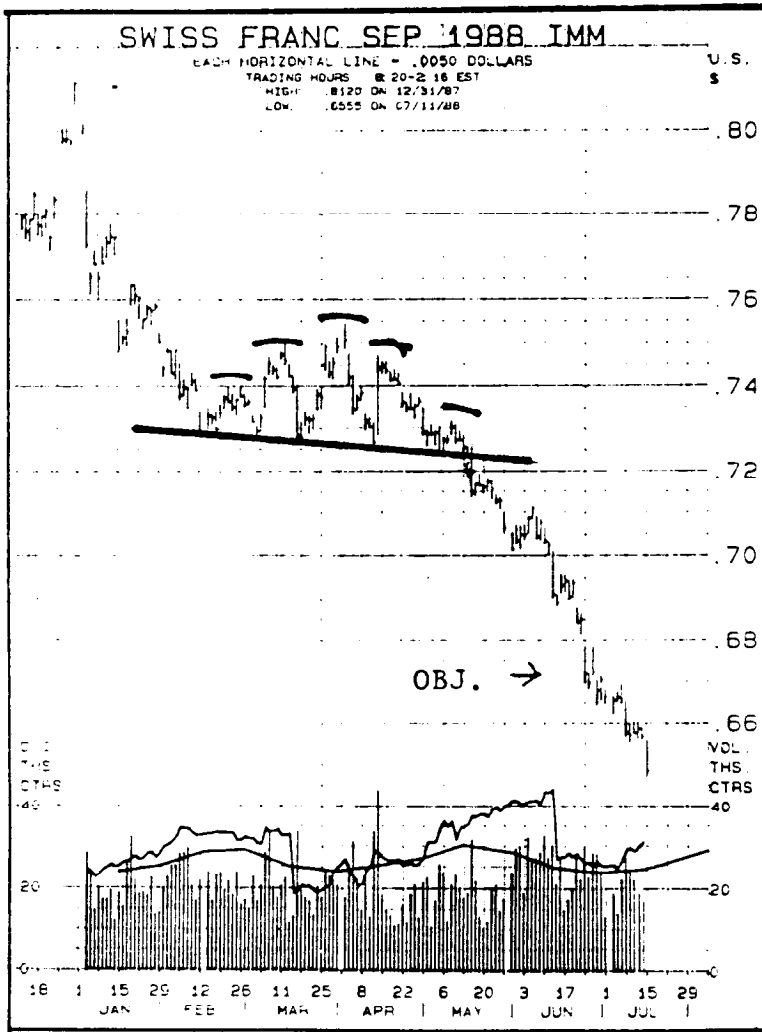
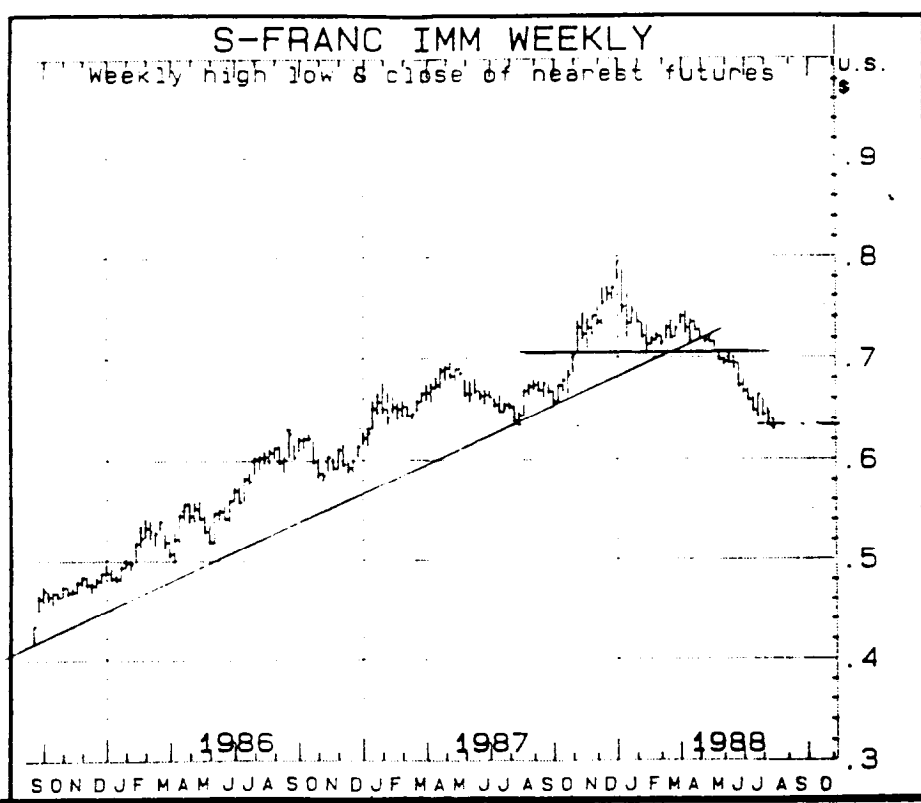
1. E&M measured move objective of \$3 to 5,000 per contract.
2. Major chart development on the daily chart.
3. Technical significance on the weekly and/or monthly price chart.

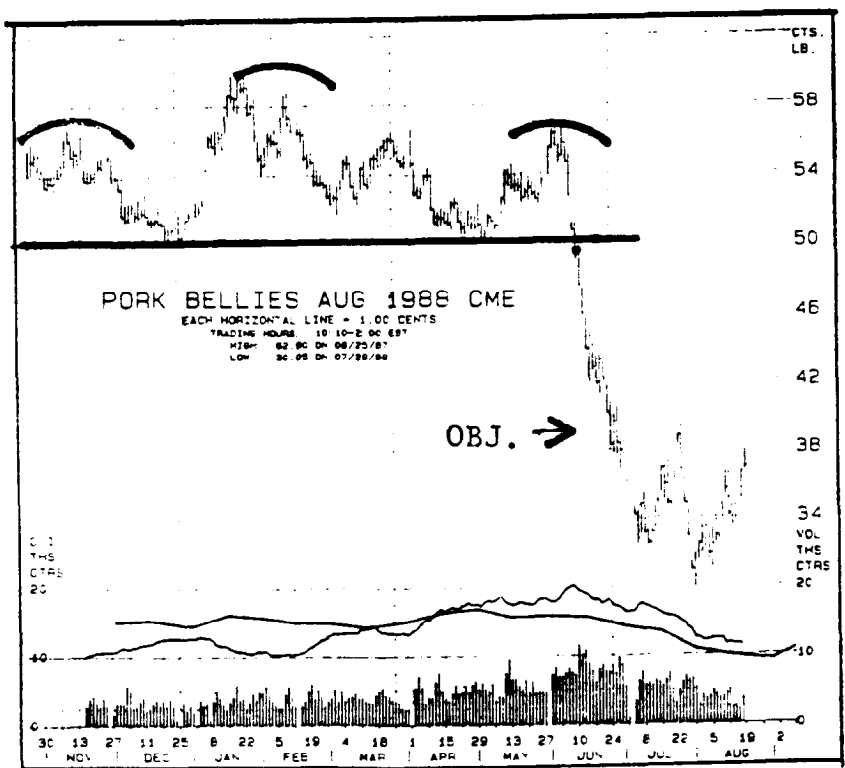
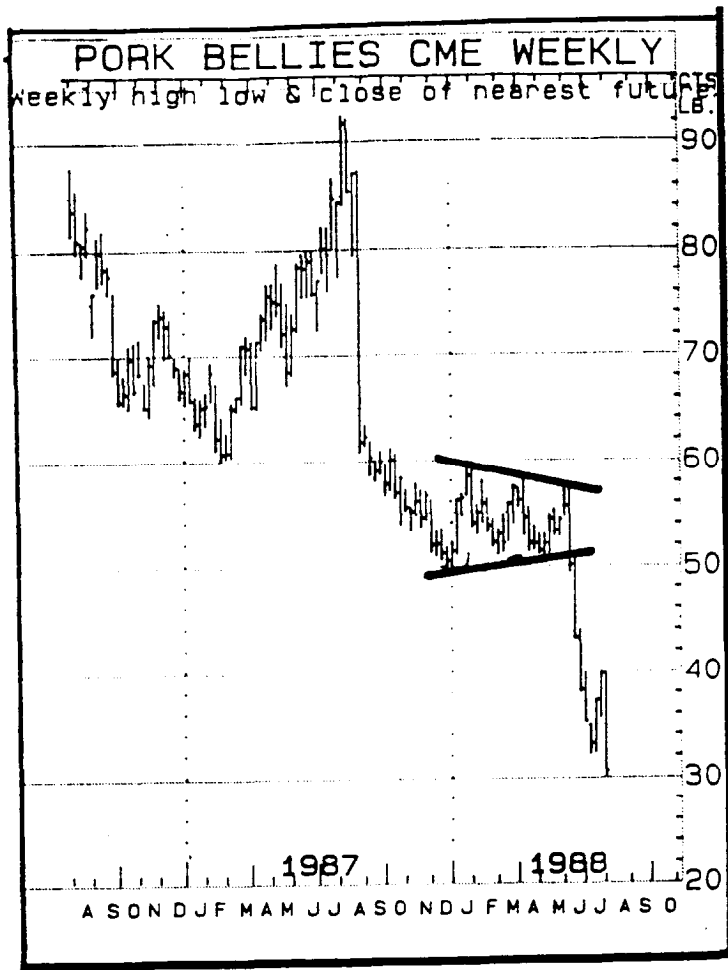
Let's take a look at the past 12 months to identify this type of situation in retrospect, and then look at the current markets to see if we have any situations currently taking form.

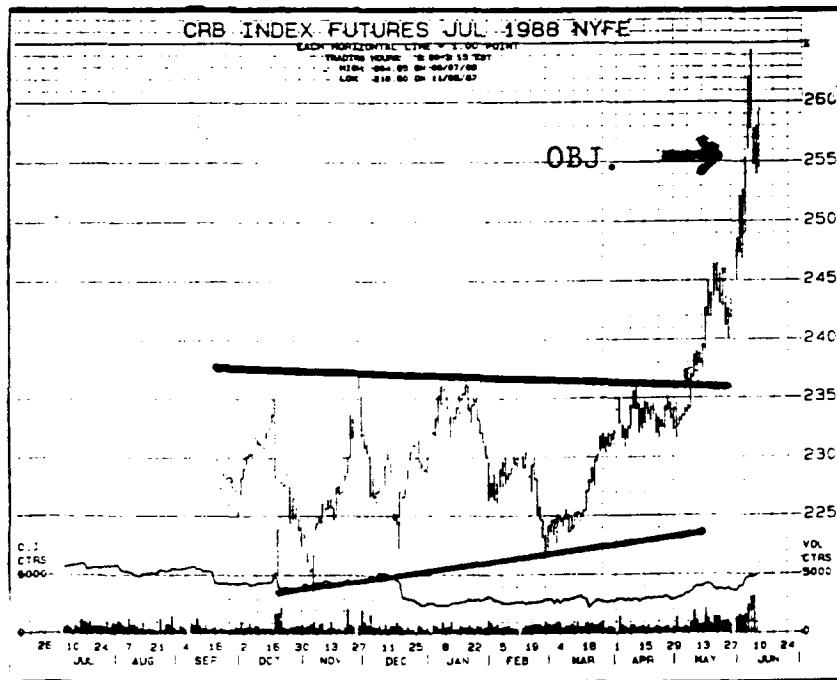
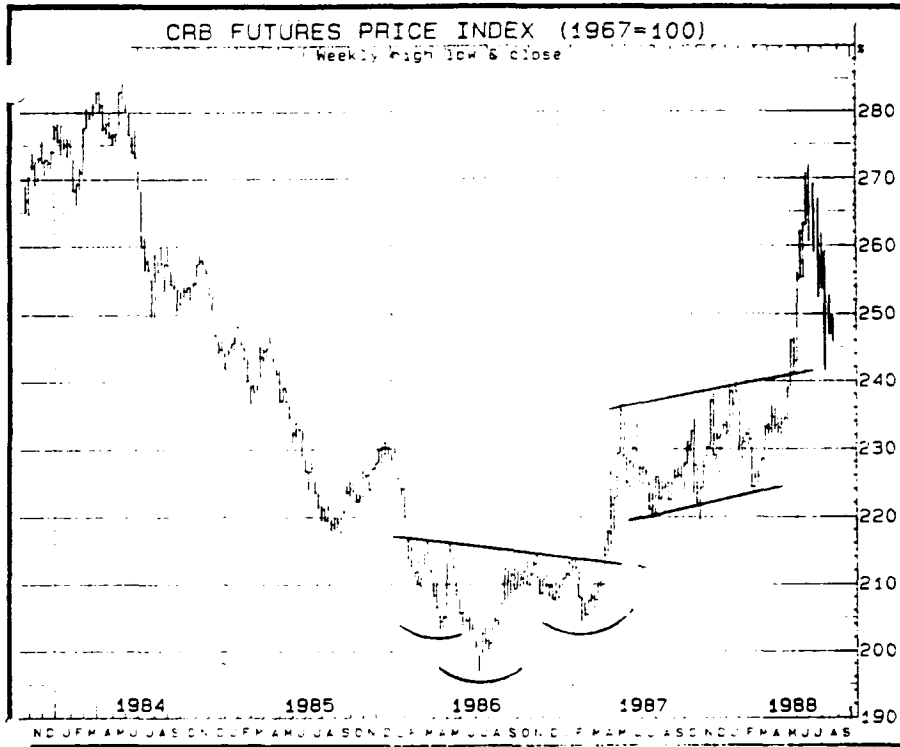
I will only cover a couple of examples. A more complete listing is in my handout materials.

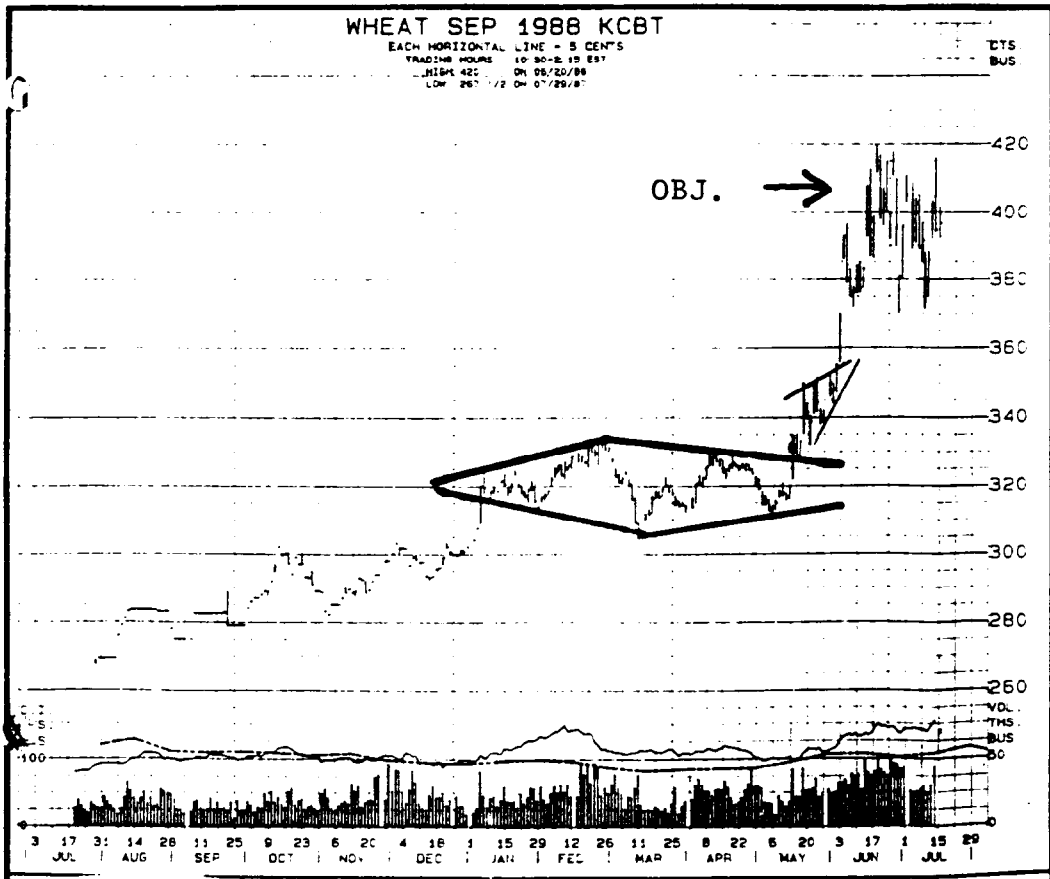
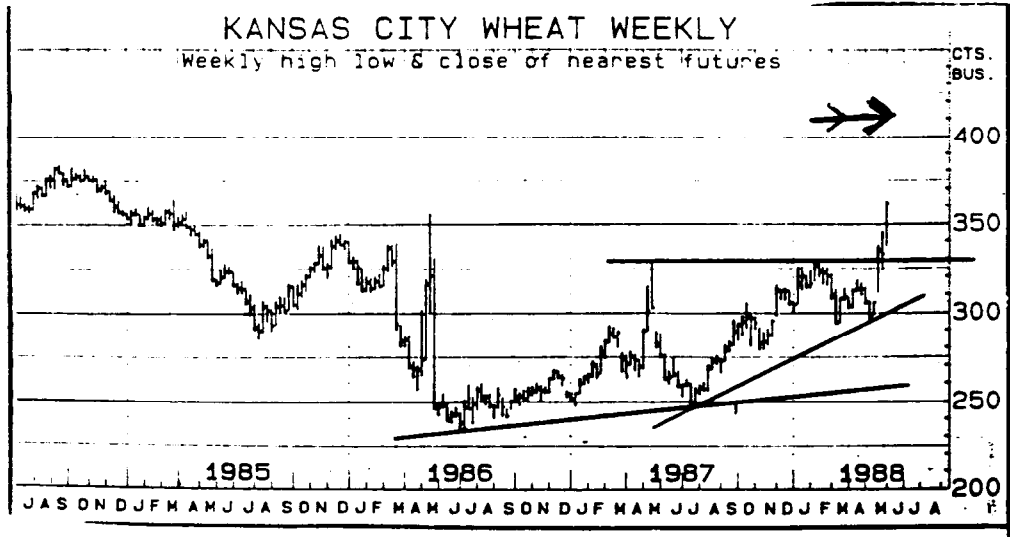
GOLD - In January, 1988 two things happend in Gold. On the weekly chart, a major trendline was penetrated. On the daily chart, a massive rectangle was completed. Notice how a symmetrical triangle launched the major breakout. Often in a major move, a pattern will develop just prior to the launch.

SWISS FRANC - In May, 1988 the Swiss completed a complex continuation head and shoulders pattern. At the same time, the major trendline from the 1985 low was being penetrated.









PORK BELLIES - I don't trade bellies, but this is a classic. Here there was a simultaneous completion of a symmetrical triangle on the weekly chart and head and shoulders on the daily chart.

COPPER - In August, 1988 Copper completed an ascending triangle on the daily chart and a symmetrical triangle on the weekly chart.

CRB INDEX - In May, 1988 the CRB Index sumultaneously completed a symmetrical triangle on the daily graph and a running flag on the weekly chart.

KC WHEAT - The breakout of a diamond on the daily chart propelled wheat prices through a major bottom on the weekly chart.

Now, let's take a look at current markets to see if we can identify any current candidates for a major move.

(Editor's Note: From this writing in mid-April until the MTA Conference in late May, there are likely to be some changes.)

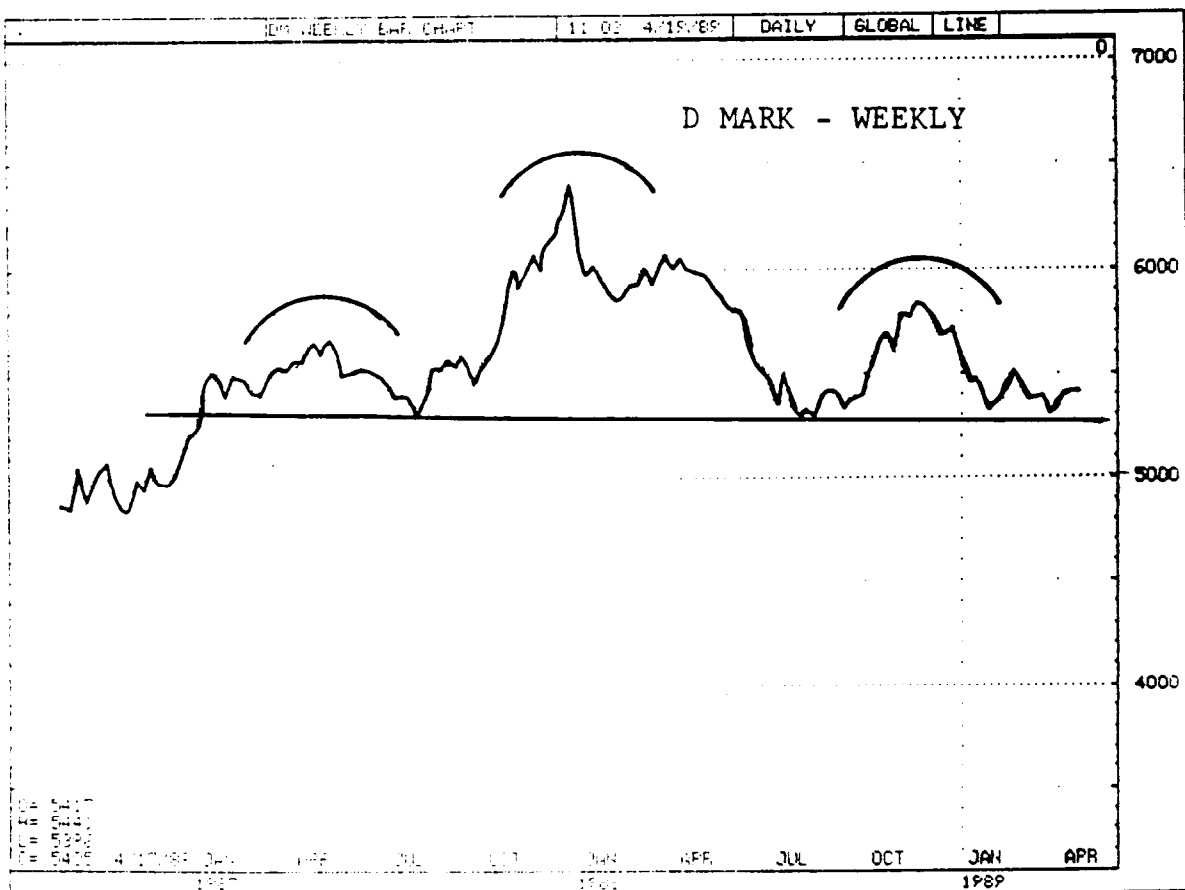
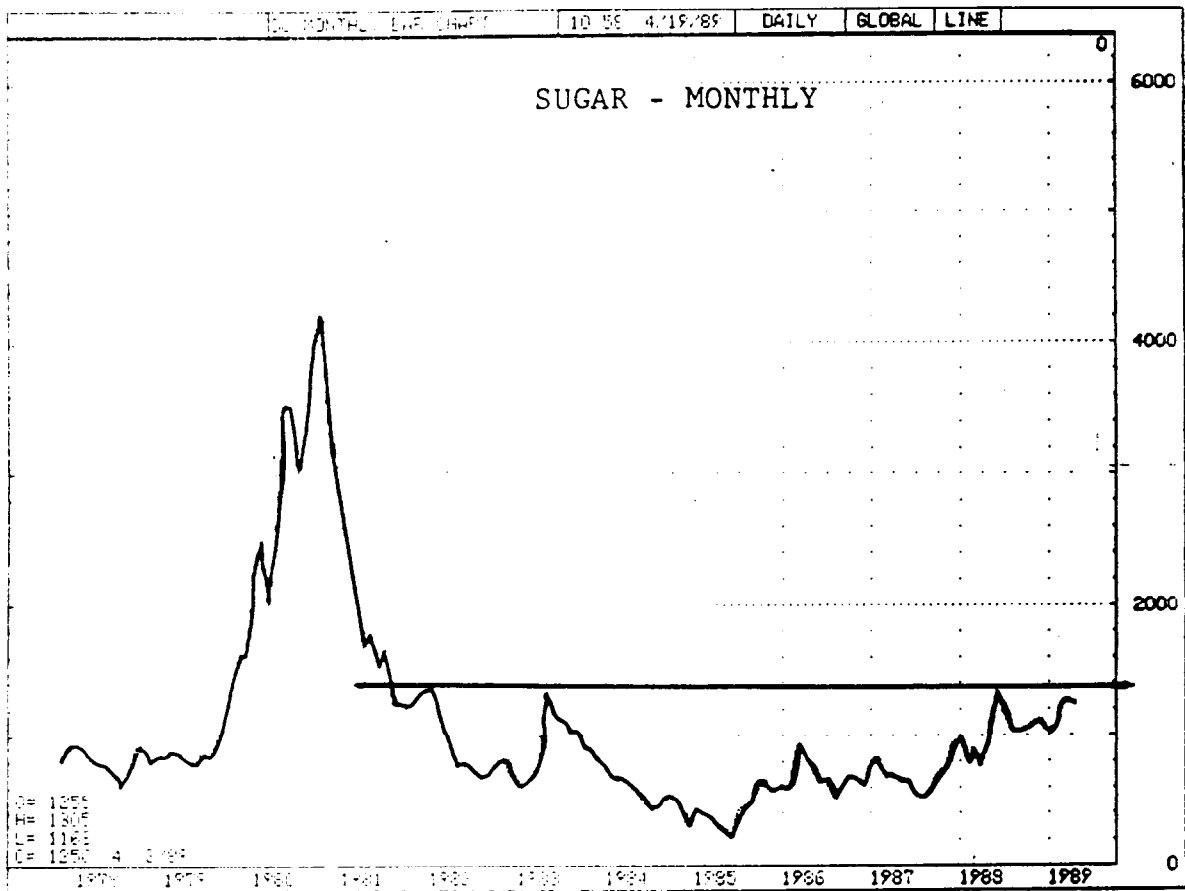
SUGAR - On the monthly chart, Sugar is forming an enormous 7-year rounding turn. A close by the near contract above 13.50 completes this bottom and establishes a minimum objective of 24.50.

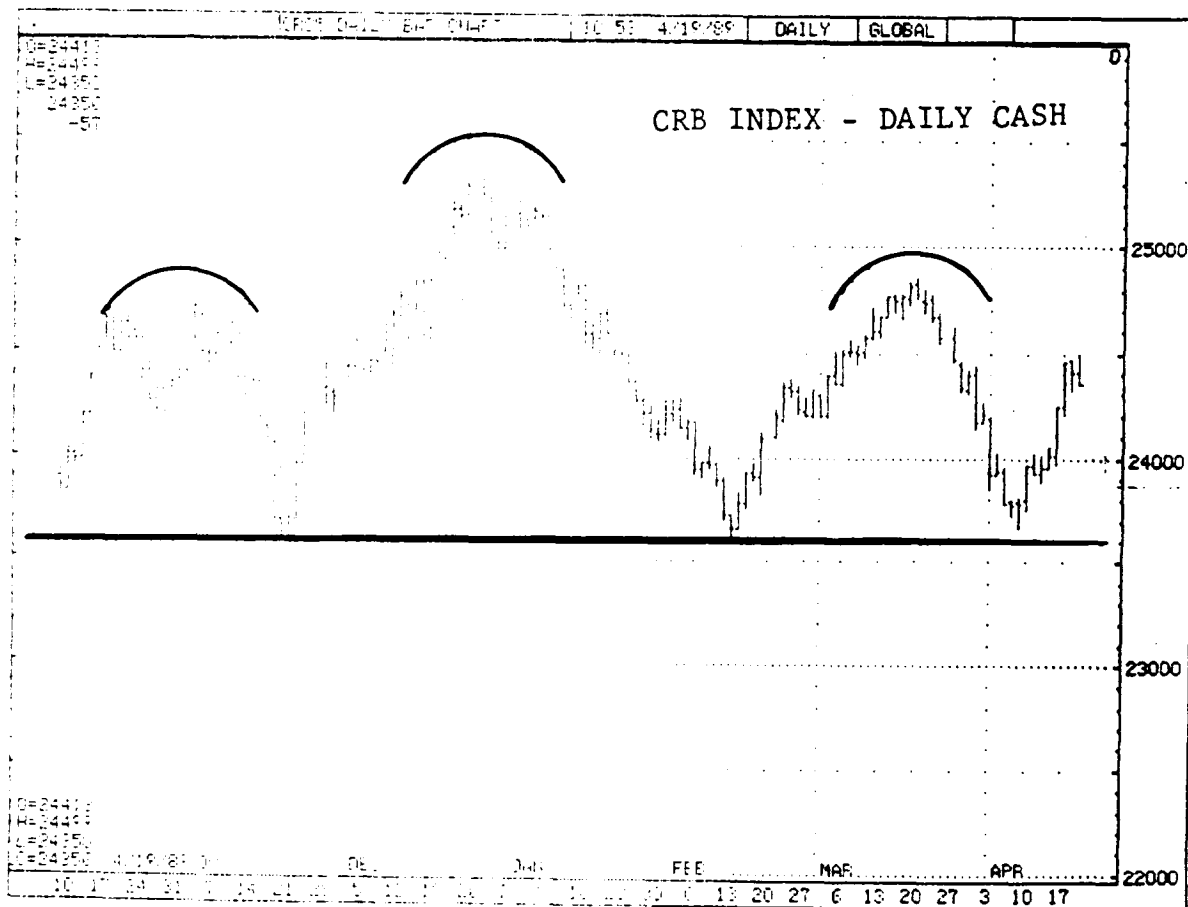
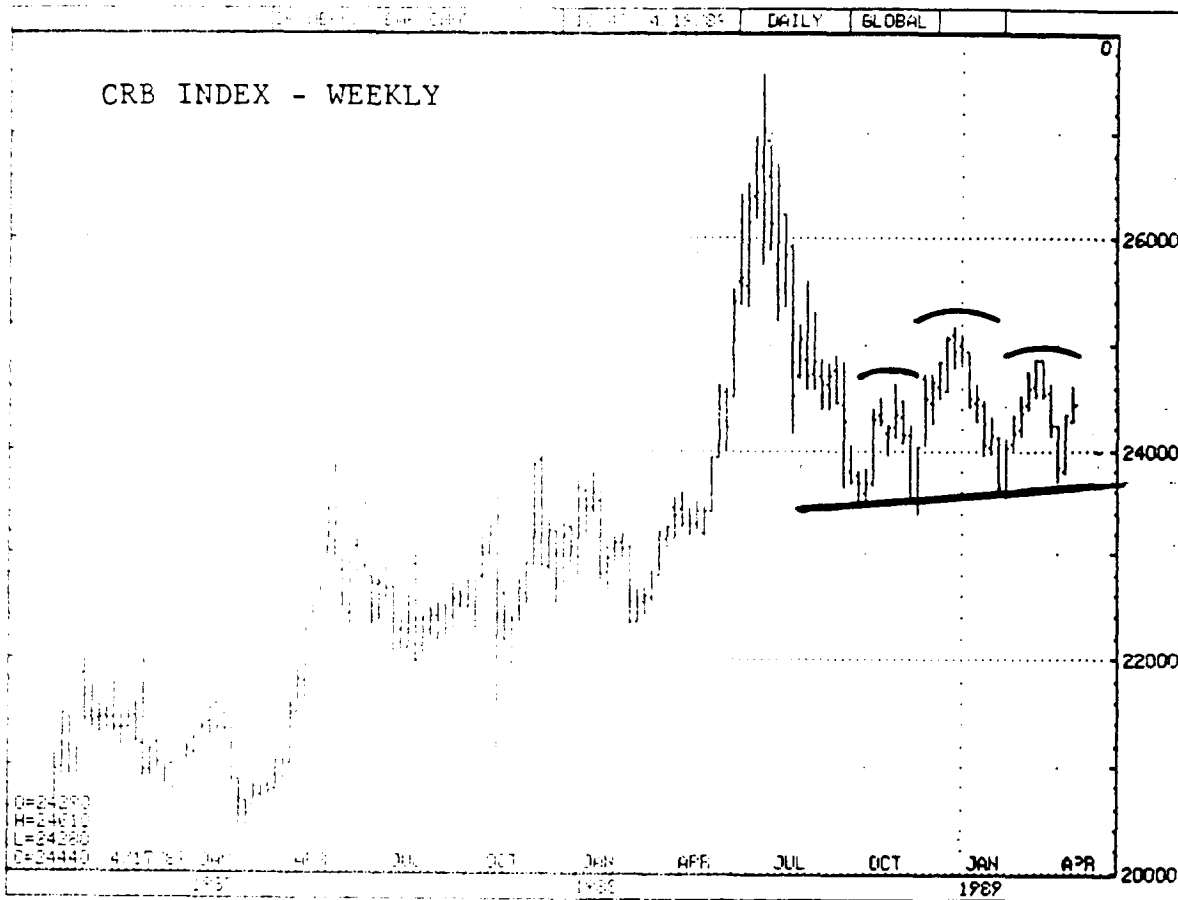
CRB INDEX - On both the daily and weekly charts, the CRB is exhibiting a possible 7-month head and shoulders top pattern with a target of 218. Note that the monthly CRB chart displays a possible multi-year top.

SOYBEAN OIL - The daily and weekly charts display a head and shoulders formation.

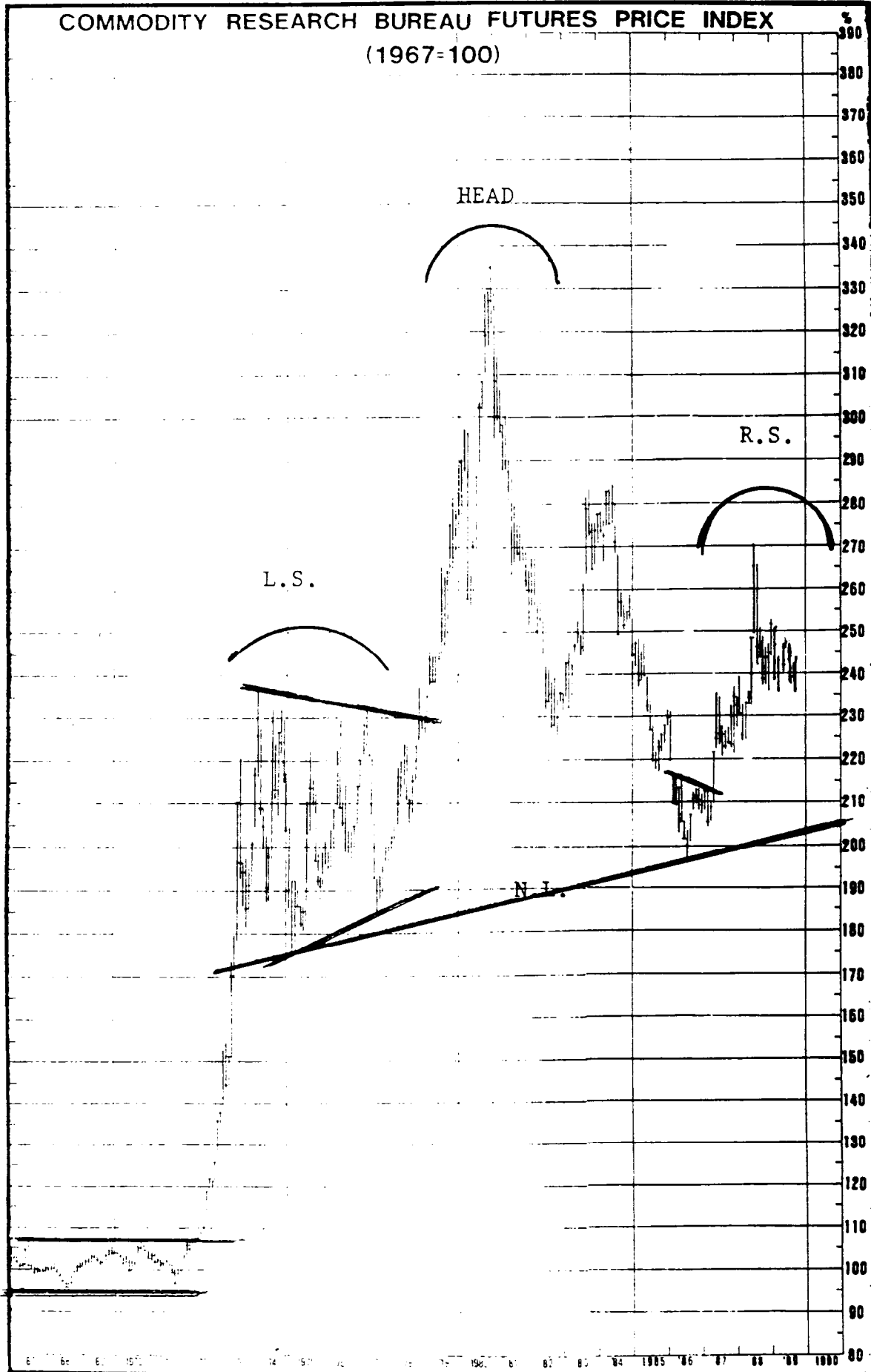
D-MARK - The weekly closing price graph shows a multi-year head and shoulders top. The objective, if completed, is 40.00.

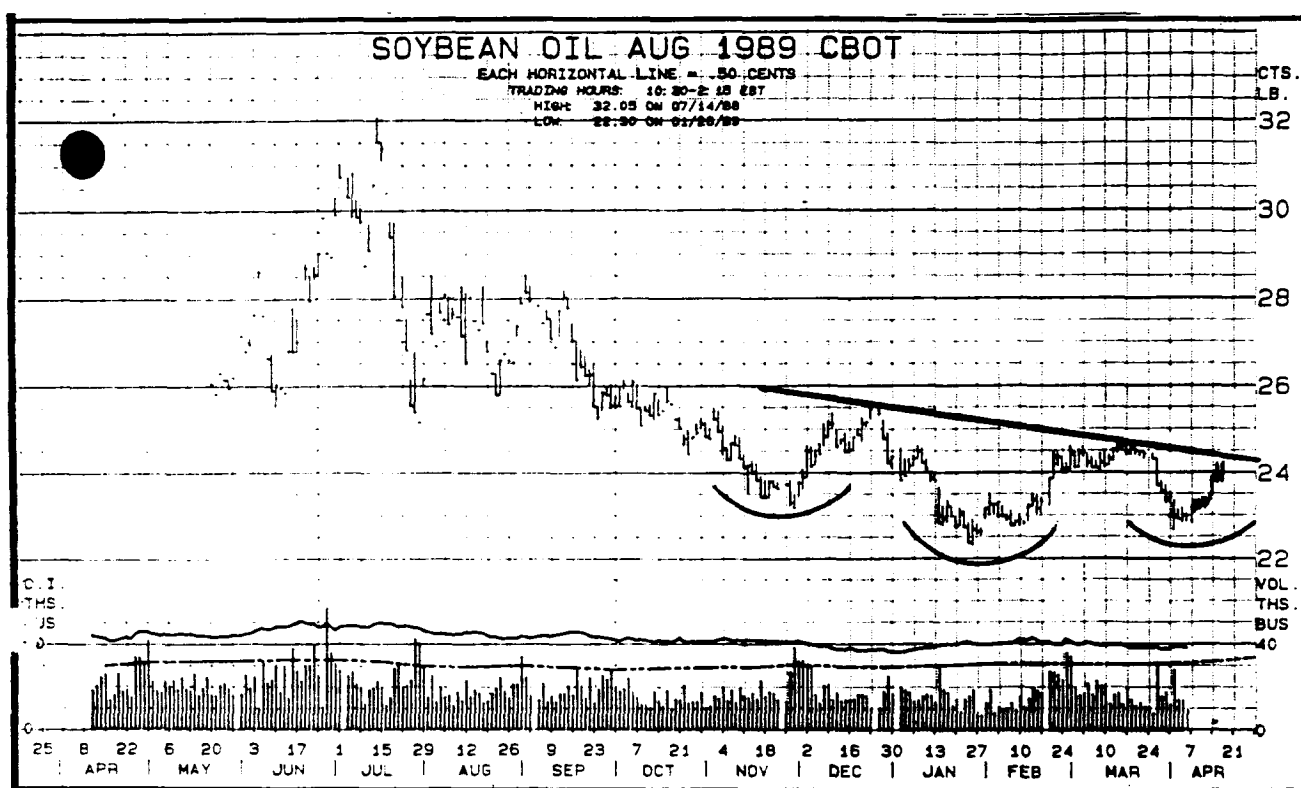
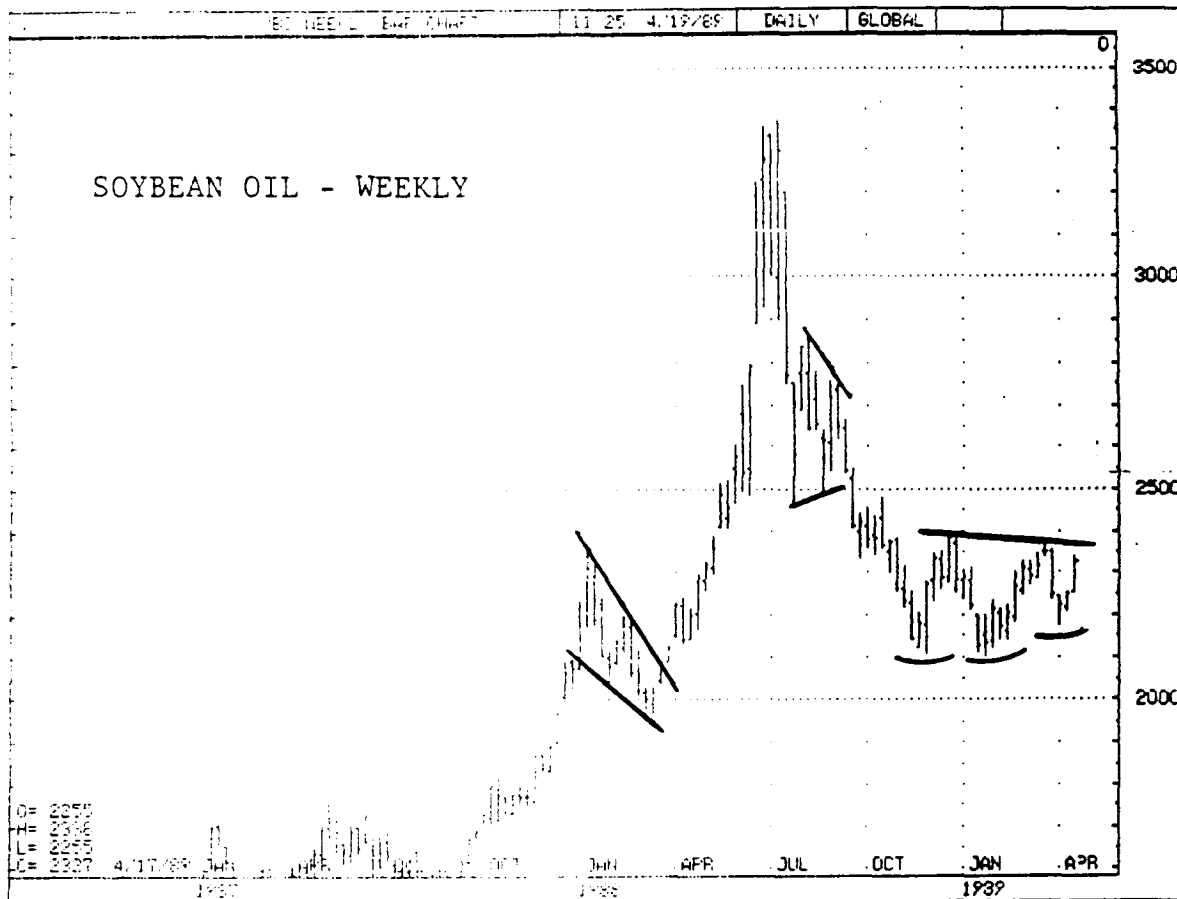
I want to thank you very much for listening. I have brought with me a handout booklet containing my presentation and other pertinent materials. But I only have a limited supply. So, if I run out of the handout, please give me your business card and I will send you a package.





COMMODITY RESEARCH BUREAU FUTURES PRICE INDEX
(1967=100)





As an advisor, the hotline service of his newsletter, THE FACTOR, has been profitable every year since its inception in 1981 and consistently rates toward the top of the CTCR rankings.

As a money manager since late 1984, Mr. Brandt's composite managed futures account program is up 154% through December, 1988.