

Support and Resistance: Trading by Reading a Market

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Next chapter will be added in two weeks time (2009-01-10)

1.0 Trading method – Market Types

Forex market is a place with endless possibilities. And not just financial. By trading currencies you are learning to understand yourself, you find your strong and weak points. Some traders claiming that if you do know how to trade the market, you gain financial and personal freedom. Yes, if you are making money by trading, certainly you have a possibility to live your life as you wish, but one thing is not complete correct by saying if you know how to trade – you gain freedom. It is opposite: if you feel strong and free from the politics and economics, you can become good trader.

Before you trade – educate yourself, build up your strong personal characteristics and improve your good qualities as a human being. It is not a trading method what makes money, it is your behaviour.

In my series along the way with the technical trading method you always will find some sort of philosophical-psychological advices or remarks. What is the key for my method and I would suggest to pay at least some attention.

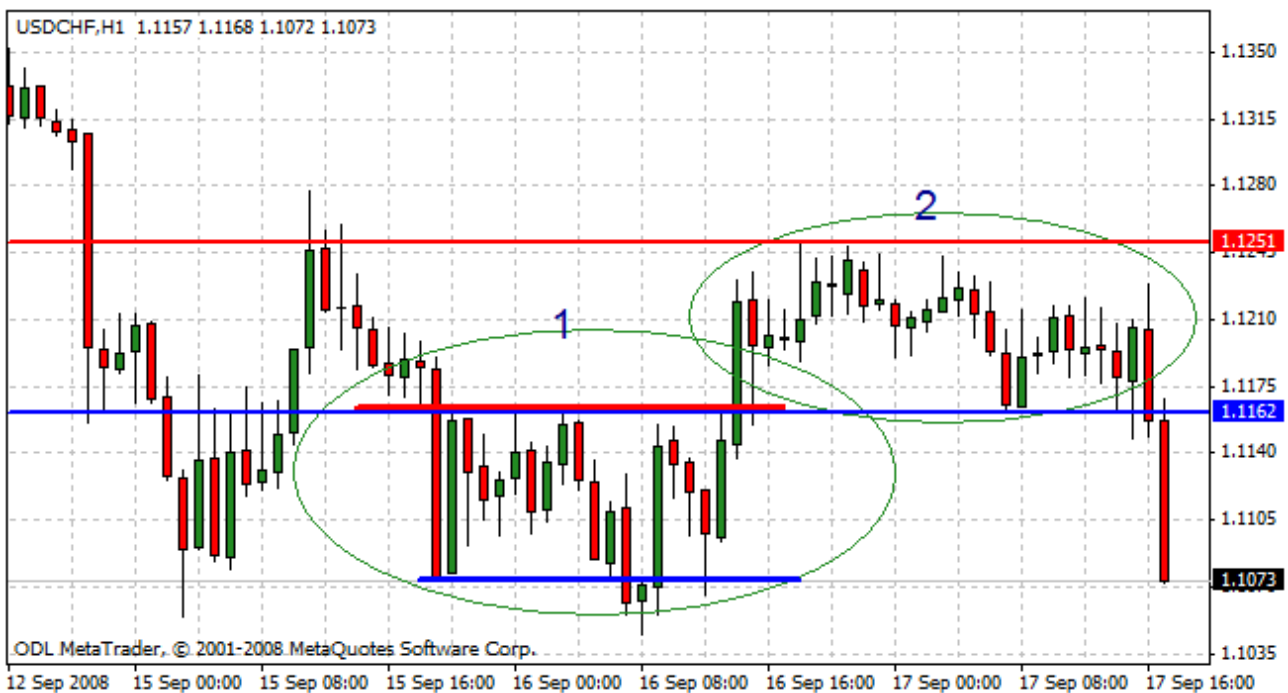
First of all, before enter any trade you need to analyse the market and this analysis will be base for all decisions. So, bad analysis leads to bad results over the period of time. Your method must contain some sort of analysis: technical or fundamental. My method contains technical analysis and I certainly have nothing to say about fundamental. This is some sort of psychological point: I do not understand fundamental analysis properly and I do not base my decisions on it. Always remember if you feel that you do not know something, ask. There is nothing wrong to ask, wrong is do not ask and take the decision, when you have no idea why are you doing this.

By analysing the market first we want to know in what state market is right now: trending or in some sort of consolidation, in other words flat. How do we do that? By drawing trend lines. How exactly to draw the trend lines we are going to discuss in details, because I had opportunity to meet some traders, who draw trend line as they wish, just with one glance at the market. I would not suggest that and if you have this habit, you better get rid of it. Why? Because you must have some

rules. Why? Because rules will make your trade easy and without emotions. Generally, rules demolish emotions and emotions demolish trading account. Less emotions, better results.

First, before we start talking about how to draw trend lines, I am going to show some sort of examples trending and flat markets. Please note, all examples and descriptions about trending or flat market is completely based on my experience and some books talks differently. Non of us are wrong. My method produces positive results, other authors as well. It is not that description of one or another chart matters, more important how you use it. I created my own understanding about the market, but I did not go far away from classical technical analysis.

Flat market. Market conditions, when price moving up and down in some range, without giving any particular direction is flat market. Usually we have support and resistance lines and price is moving between them. Occasionally breaking those lines, just to annoy us. How to draw those lines, we will discuss in the second part, but for now let's take an examples.



In this 1 hour USD/CHF chart you see market for short time stayed in the range twice. In every range you will find some very short trends up and down. If price stays in our prescribed range, we

called flat market simply because prices bouncing up and down between two lines. Is it? Price never stayed in the same position for a long time, price always moved up and down and in every flat market you will find very small trends. So why market is called flat, if prices always are moving up and down? No one exactly knows why, but here important role plays support & resistance, and we will come back to answer this question, but for now familiarise yourself how in my eyes flat market looks like. By the way, support & resistance is the essence of my trading method.

Now, let's take a look at the trending market. I personally do not separate market to fast or slow market. While trend line has not been broken, trend is still valid and how long it is going to last, just market knows.



In this 1 hour AUD/USD chart we see market is going down and we see three trend lines. Market from the price 0.8800 sharply moved down and trend line was valid until price crossed it. Is this end of the trend? No. And why I will answer in the second part, when we will talk about drawing lines. Second line was broken at the price around 0.8555 and what is the end of the trend. I

never actually draw a line No 3, to draw line likes this by my opinion could lead to losses and I show it as example – never draw lines where you like, even chart looks like going down. Next minute you could find yourself in the wrong side of the market. Is better to miss a trade, than make a bad trade.

Before going into next chapter open any chart and find for yourselves places where market is flat, where market is trending. And try different time frames. Just by simply accepting and knowing in what state market is, you already on the way to success.

Now question is: why to spend so much time on market on the things what looks so simple and unimportant? I could just write where I am entering a position, where to take profit(!?). Well, if I do that, then you will never get to understand my method and it will bring more confusion than actual profit. This is because of very simple reason: every time market behaviour is different, despite all similarities. Where is no chance to explain all possibilities of the market. But it is possible to describe some guidances. And most important guidance is this article. Without proper understanding in what conditions is the market, all other rules and methods and any sort of magic, will fall apart. In the trending market we take some actions, in the flat market – we do differently. In different situation we are acting differently. That is natural. So how can you take correct actions if you do not know what the situation is? My advice would be: if you are not sure market is trending or not – stay away from it. It should be first ground stone in your trading method. I divided market in two parts: trending and flat. And any other market conditions such as very volatile market without any direction, hardly will attract my attention, even with possibilities to make fortune in one go. Reason is – I have no idea how to trade in such conditions, so I stay away. It will come my time. It always does.

1.1 Trading method – Drawing Lines

From the previous chapter we know now that market can be flat or trending. From the examples, we have got some idea how any of those markets looks like, but all those examples been shown as trend or consolidation already happened and big possibility that market is going to do something else. Question is : how to get into the trending market from the beginning or start trading in the range? In this chapter I am going to show how to draw support and resistance lines and trend lines and those lines will help us to determinate market conditions.

First of all we discuss theory about support and resistance little bit. To discuss it in depth it is not possible in a small article, so we are going to touch just main points.

Support and resistance do not appear by some mathematical formulas, those lines appear then attitude of trader towards the market changes. The bigger shift in outlook to the market by the majority of the traders, the more important those lines become. Market always has a point, where market starts changing it's direction. If market was going down and suddenly price start to climb up, point where market turned around will be known as a support. And opposite: point where market, after going up, suddenly starts falling down, that turn around point will be known as a resistance. So we can say that at those points traders have changed their opinion about the current situation and decided to go other way. Please note, we are not going to discuss reasons for those changes. Important thing is to understand one thing – whatever fundamental reasons are, or may be is no reason at all, traders already started selling or buying. And those lines will let us know about those changes.

Another important part of theory is time frame. This we will discuss in the next article, but here I would like to mention just most important thing – the bigger time frame the more important those lines are. Price on the five minute chart could break the resistance and start running up the hill, when suddenly with the speed of light are turning around and and starts falling down. That gives the false impression about reliability of the support and resistance lines, but if you take a look at the bigger time frame, you most likely to find much stronger resistance on the 1 hour chart. My point is – resistance and support lines remains just for one time frame only and trading must be done just on

one time frame. Switching between time frames will give confusion. It does not exist trading method without loss and any attempt to find something perfect will lead to disappointment. Instead I would suggest to stick to one trading method and to one trading frame. Trading frame is important as everything else, but we discuss it in the next article.

Now we are going to talk about practical side of drawing those lines. Most of the traders won't like it, but before I am going to explain everything, including practical applications, I must write everything step by step.

I do draw lines in all the points, where white candle have been followed by the black candle and opposite – where black candle has been followed by the white candle. I do not pay too much attention to the sizes of the candle. I know that most of you will disagree with me, but I stay on my point firmly – we do not know what is going to follow next. So to ignore point where positiveness changes the negativeness and otherwise, could lead to complete ignorance of the present situation. Let's take a look at the chart.



On the chart numbers represent the lines, but those numbers I did not attached to the lines, but put near the important places. So by following my description of the chart be careful. Another important point is: I draw lines on the shorter wick of the two candles, and considering line is broken when closing price of the hour is above or below the line. Any wick of the candle above or

below the lines I usually ignoring and considering that line still valid.

At point 1 market did some movement up, but at point 2 dropped down again. But that drop did not go below line 1 and until price remains between two lines we have flat market. Lets say it is for short time, but still market is not trending and we must wait for next movement. Later on price went below line 1 and here is the beginning of the trend. We can draw a trend line (see next chart). But this trend line has been broken after short period of time and as we see price did not go below support line 4, but at the same time couldn't go above line 3 as well. So trend line broken, but price stuck between previous support line 1, which currently resistance line 3, and new support line 4. So we have another consolidation period, but at this time with the possibility to adjust trend line. Why? Because, resistance line 3 remains in the same place. If that line had been broken, definitely trend line can not be adjusted, but until resistance line is in it's place we easy can do that.

Next, after few hours, price went below support 4 , came back to the trend line, but hour closed below resistance line 5 (previous support line 4) and later fell through support line 6 and found another support at line 8. Here price turned around and for some time was climbing up, until reached resistance line 7 (previous support line 6) and again moved south. So during such short period we had two flat markets and one trend, which will remain until trend line won't be broken. Most likely we will see another few flat markets until that happens and for now we can consider this market as a trending market.



By adjusting support and resistance lines we can clearly see the conditions of the market. This example I have chosen specially, because this chart has not got very clear support and resistance line. I just wanted to show, that by accepting even small changes as a valid, we can read the market very easy, even in the conditions like this, where market still had no idea about its own direction. About practical applications we will discuss much later, for now I will suggest to practice drawing support, resistance and trend lines. Draw a lot of them, do not be shy and analyse where market is flat and where market started its trend.

I never ignore small positive candle after the big one negative. Maybe I'm not always take actions or right actions, but considering one thing – we do not know what is going to happen next hour – every small thing has a possibility to become big one. Market certainly is not going to wait for you. Carelessness in the market or ignorance about small things, could lead to the negative trade. And one by one, you won't even notice, how your trading account is screaming for help. Plus every negative trade causes sad emotions, which has a chance to turn into the panic. So, take care about every turning point, take good care about your trades and step by step you will get to the point, where everybody will talk about you as about very good trader.

2.0 The Time

Now I would like to talk about time. Timing in the market has big impact for the trading account, but so big as choosing the right direction. But even choosing the right direction after some time market will turn around and if you miss right time to get out, all the profits will go away. Based on previous sentence looks like timing is everything. I still think it is not. By my opinion it is better wrong timing than wrong direction. So why I would like to spend all article just talking about time. There are few reasons, but two important are those:

- Time is part of my trading method;
- Time frames are more psychological thing than anything else;

First I will talk about psychological side of the Time. If we would have a philosophical conversation about the time I would say this thing: time, as a separate thing, does not exist. I will not go into philosophical debate or try to prove I am right or wrong. Simply let's take more practical side.

We are all living by the time. We all do different things at different time. In the morning we set our alarm to wake up on time and go to work, we make arrangements on certain time, we celebrate our birthdays, anniversaries and other important events of our daily lives. In order to make things work smoothly we have time frames: minute, hour, day, week and so on. In modern age that became very important thing and we can not imagine living without it. That is probably why for a lot of people time becoming most important factor for their daily life.

You can ask yourself a question: “*is it really so important will you become rich man tomorrow or after one year later?*” Most of the people whom I asked this question said this: “*YES. We want now*”. Well, reality is they are still want now, but my situation significantly improved compare to theirs. Of course it is better to be wealthy now, but for me waiting is not a problem. Lack of patience, rush and everyday stress makes us to miss most precious thing: life.

Market is full of rush, greed, fear and all the possible emotions. Why market is full of it? By my opinion, market contains several time frames and all the actions becomes compressed in the small space. There is no such thing as a life. There is constant battle who will get first. Who is winning? Those, who patiently wait. Certainly not those, who try to grab bigger bite now. Once, twice, they succeed, but look, time past and in the front line stays the same people with the patience. Plus others. Who others? Those, who after few wounds, learned to wait.

Time is pushing us to make mistakes and at the same time, it can make us better, richer. Choice is ours how to use our time. Be emotional or patient. Be angry or happy. To follow our plans or change it. By putting too much emphasis on “get rich now” we try to overcome time, be smarter than others and to be right. All those things comes from one source – time for us is just pressure. If you have that pressure, success will hardly ever come. To avoid that pressure or to get rid of impatience, first you must deeply understand one thing: market existed yesterday and it will exist tomorrow. Tomorrow another day and instead of chasing the market, spend some time to create your strategy and follow it.

All above was psychological aspects on how time interferes with our decisions, let's see the trading side of it. First of all any trading strategy must contain some time frame: 1 hour, 4 hours and so on. There is no importance or any advantages among all the time frames. Importance of the time frame appears in your trading strategy.

One of my strict rules is: If you prepared plan on 1 hour chart, there is no point whatsoever to change the time frame for “better” view. That is definitely going to confuse you. Why? Take a look.





Every single picture will show some different view and your trading plans will differ from each other. So if you prepared one plan by 1 hour chart and watching daily chart, after some time you will certainly change your mind about your own trading. In the end you will get a habit to change your mind too quickly. There could be worse: if trade is going into losses, you will start changing your time frames until you find one, which supports your negative trade and most likely you will loose more. So my advice would be: once you prepared your plan on one time frame, do not take any actions by using or watching other time frame. In the long run, even with the best strategy you will loose your money.

In the end I will say one more thing. Analyse carefully, take actions responsibly and always, always follow your plan. If you take closer look to the market you will see, that every chart with the different time frame gives you different feeling and sometimes complete different picture. Do not get confused or doubtful. Follow that time frame, which suits you most, according to your personality. If you have not patience to wait or won't be sleeping peacefully at night, do not use big time frames, use smaller ones. Money is the same and having proper discipline you will be no less successful than others. Do not get that feeling, that small charts gives small results. It could be quite opposite.

3.0 Stop Loss

So far not all trades bring profit and decision where to get out from the negative trade is one of the hardest. There are few reasons why to take a loss it is so hard. First of all we all do not like to lose. It could be financial loss or sports competition. It is in our human nature. We love to win so much, that even small loss sometimes looks like end of the world. Second reason is - that have fear. This fear drives us into the madness and even insignificant loss leaves a strong print into our feelings and psychologically we are tuning ourselves to make another loss. Third reason is - we have a hope. We do expect (and asking god) market will turn around in our favor. Hope leads to complete self destruction. Here I mentioned three reasons why we do not like to take a loss, but there are much more. Basically all the negativeness, which we hold inside us, can become the reason, why we do not like to take a loss. By my opinion dealing with the loss it is most important psychological aspect of the trading and it is worth to analyse it separately. But not in this educational series. Here I will mention just few things where to get out from the negative trade.

From the psychological point of view I would suggest one thing: try to understand your own weak and strong features of your personality. This is very important. And strengthen your strong side, and try to weaken your negative side. Working to improve your own personality will certainly will help you to become good trader.

Stop loss is quite complicated thing and here can not be certain answer, but despite that I will try to give some ideas. I won't touch psychological effect, simply just few practical approaches.

Every trader has their own point of view about the market and every trader has their own strategy. So best stop loss is that stop loss which matches your trading strategy. If trading strategy has not got an exit point, that strategy is not fully complete and I would never recommend to use it in practice. You can be successful, but most likely not for long term. Always remember stable income in the market is more important than quick 1000\$ today, if you see yourselves as a traders in the future.

Most of you won't like that “best stop loss is a stop loss that matches your own trading

strategy” because it does not say where exactly to get out. And another point : you noticed I started to talk about stop loss before I say anything about entering into the market. Those two things I did deliberately not to confuse you, but opposite to make you think. Person who tries to copy others always will require somebody or something to copy. Person who is able to think for himself has better chances to succeed.

Now I will tell my points of stop loss and completely up to you to follow it or to criticize. It is your choice and any criticism I will take as a help to improve myself.

Practically, I put stop loss order just in that case if I am away from the trading platform or going sleep. If I have a possibility to watch the market, I certainly have not got any stop loss order. Why? Because if my trade goes wrong sometimes I am closing the position earlier and sometimes, when price reaches level where should be stop loss, I wait, and always I can get the price better than stop loss. Let's say it is not big difference, but even two pips are better result. Over the time you save quite few hundred pips.

This my approach is possible if you have strong discipline, no fear and no hope is confusing you. If any of this is inside you, I would not recommend to trade without stop loss order. Yes, I know, sometime price reaches stop loss order and turns around into the direction you have expected. So what? Next trade will be profit. But without having stop loss order you could be washed out just in one trade. Think, one bad trade is not the end of the world. Better to be safe than sorry.

Now where exactly I do put stop loss or in other words where I close my negative trade? Because my trading strategy is based on the support and resistance lines, if I go long - stop loss will be below support line. If I go short, stop loss will be above resistance line. There is no any complicated calculations. Yes, again, I know, sometimes so many false breaks appear in the market. So what? I am still trading and trading balance over the time is positive.

So, let's make a conclusions.

1. Stop loss should not be feared, should not give hope.
2. Stop loss must always be inside your trading plan – place order on your platform or just mentally inside your head.
3. Stop loss, if mentally placed inside your head, must be always executed, no matter what.

4. Stop loss must match your trading strategy and any strategy must contain the stop loss.

At the end I would say this: stop loss is not a horrible beast. It is opposite – your friend, who will protect you from the disaster, if you treat him well. Remember, it is not stop loss brings you financial loss, it is game itself and as long as you trade, time after time you will suffer some losses. Do not look for perfect stop loss, such thing does not exist. Better to improve your trading strategy.