

Support and Resistance Theory and practice

I am in the forex market just for few years and my experience is not huge, but after some gains and losses I started feel very confident about my trades. In this article I simply would like to share my points of view to the market and I strongly feel that support and resistance lines do not get it's deserved appreciation in the publications. We all know that support and resistance are very important, but still most of the trading methods do not include those lines at all. Drawing tools in the technical analysis are very powerful and all drawing tools contains support and resistance.

Some years ago I started trade in the forex market and due to lack of my knowledge about economy (I am IT specialist in programming) my approach to the market was purely technical. I studied all available indicators, theirs construction, how and when to use them. Due to my enthusiasm I very quickly developed few trading methods and started to trade. Well, my account started to jump up and down as a crazy horse. One minute you feel as a king of the world, but with the next glance at the market you simply can not believe – you already counting losses! I started ask myself questions: does technical analysis really work? Sure it does. With one condition – if you are using it correctly. I studied more about technical analysis and more I studied more clearly I could see everything. And at this point I would like to advice all the new traders – do not go into the market until you fully understood why are you selling or buying. To buy or sell just because MACD indicator declining or advancing simply is not good enough. Have theory part of your trading method ready, in case if somebody will ask you why are you taking such and such action.

Theory

After my trading account started dance with the wolves without any sense at all, I started investigate what is driving the market. Answer would be – fundamental news. Personally I have a doubt about that. In my point of view – market is based on traders emotional response to the current economical events, but news itself remains just news. Important word in the previous sentence is – emotional. Traders do not respond to any news rationally or logically. Emotions is driving the market and probably, if we take human nature itself, that is why trading on the market is so attractive. We all striving for positive emotions, we all have a hope. Let's be true to ourselves: even if we follow any fundamental news, we still respond emotionally, and just traders with strong economical background, can interpret those news in correct way. Not all traders have finished some school of economics, but it does not mean their are not making money. And this is probably the reason why some fundamental news sometimes produce movement of the market in the opposite direction. At least for some time. Basically I believe that fundamental news are very important, just requires longer time to convince the traders to go that direction.

To find emotional state of every trader in the world practically is impossible. Plus professional traders have their emotions at minimum. That is why their are professionals. But at the same time every trader has his point of view to the market and traders are acting upon that view. If market is going up – traders are buying, if down – traders are selling. Market is just constant battle between buyers and sellers. In order to make money all you need is just to join right side. That is all. Looks simple, but how to do it in practice?

We all know about support and resistance lines. How those lines appear on the chart? And why sometimes those lines are broken, sometimes not? If we agree that the market is just constant game between bulls and bears, those lines will represent the price where one side taking over another side. If price is not going down below the support line it shows that buyers are in strong position or most of the traders has INTENTION to buy. And if price are not going above the resistance lines, it means just one – there is not enough buyers to go further up, in others words, traders at this moment

have no INTENTION to buy above that particular level. I intentionally marked word “intention”. I simply would like to make traders aware – if most of the traders have no intention to buy or sell, market will not move in that direction. Market is driven by the traders actions and if there is no intention to buy or sell, market, in the best scenario, will stay flat. In the worst scenario - it will start to go opposite direction. If there are not enough buyers, sellers could start theirs attack. Congestion around the support and resistance lines are probably most important factors in the market. Even if bears start pushing strongly bulls down, victory can be decided just after support line is broken. If support line remains in tact, all the bears actions still in vain. And the same remains for the bulls – no matter how strongly you feel about the market and sitting with the long position, you can not say that market is going to move north if the resistance line is still holding its current position.

After I wrote for myself this theory and started to take actions according to it, my trading account started stable movement up. On my charting screens I left just two lines – support and resistance. I do agree that technical indicators are very good, but we all need to find our own way to trade the market. I am into the market just for one reason – to make money, and my trading approach is very simple, but yet affective. As long as traders will remain human beings, those support and resistance lines will exist. It is our human nature. We all taking actions according to the current situation. We all need base for our decisions. That is why some traders look at some technical indicators to take theirs decision. Again, I am not against technical indicators, but buy or sell just purely relying on them is not for me. But I believe are very good traders who simply can make money just with indicators. At the same time I do believe if their start paying more attention to the support and resistance lines, their will be more successful.

Another positive side of the support and resistance is this: support and resistance are the core of all drawing tools. Trend lines, Fibonacci numbers , channel lines and etc.

So let's take a look at my practical side. You know now why I am doing that way, let's see how I am doing.

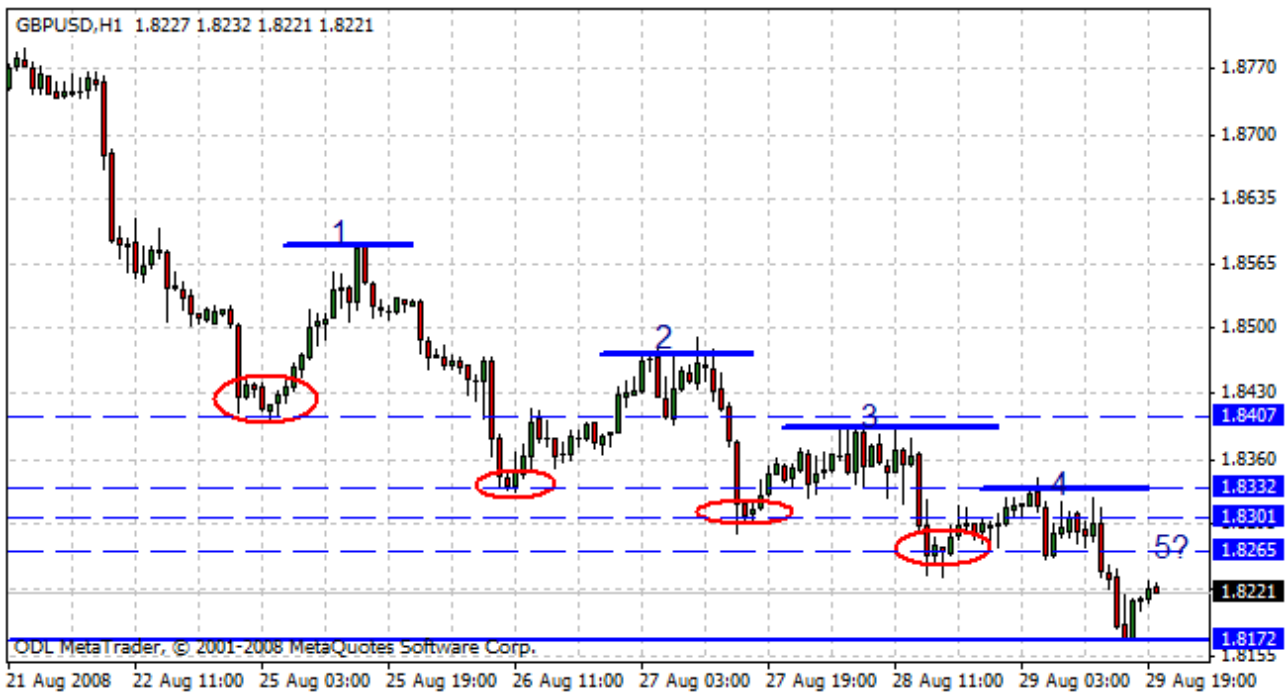
Practice

First of all I would like to say that I am going to give examples of the charts at the time I write this article. There is no point to look at the past and find best examples. I would feel cheating. And probably that would mislead most of the traders. If my approach is working, it should work in any situation, not just in the past. And if this article will be printed, you will be able to see what happened next.

Second of all I will give those examples in order of the three market conditions: strongly trending market, slowly trending market and flat market. Reason is to make traders aware, that whatever your trading method is – it is not perfect and do not ever get excited about Holy Grain. There is no such thing. Your discipline and patience and actions without emotions makes money, not your method.

Third of all, for the general conditions I am using 4 hour charts, but for trades I am using 1 hour charts. Basically is possible to skip 4 hour chart for this article, because this article about support and resistance, not about my curiosity on the big picture.

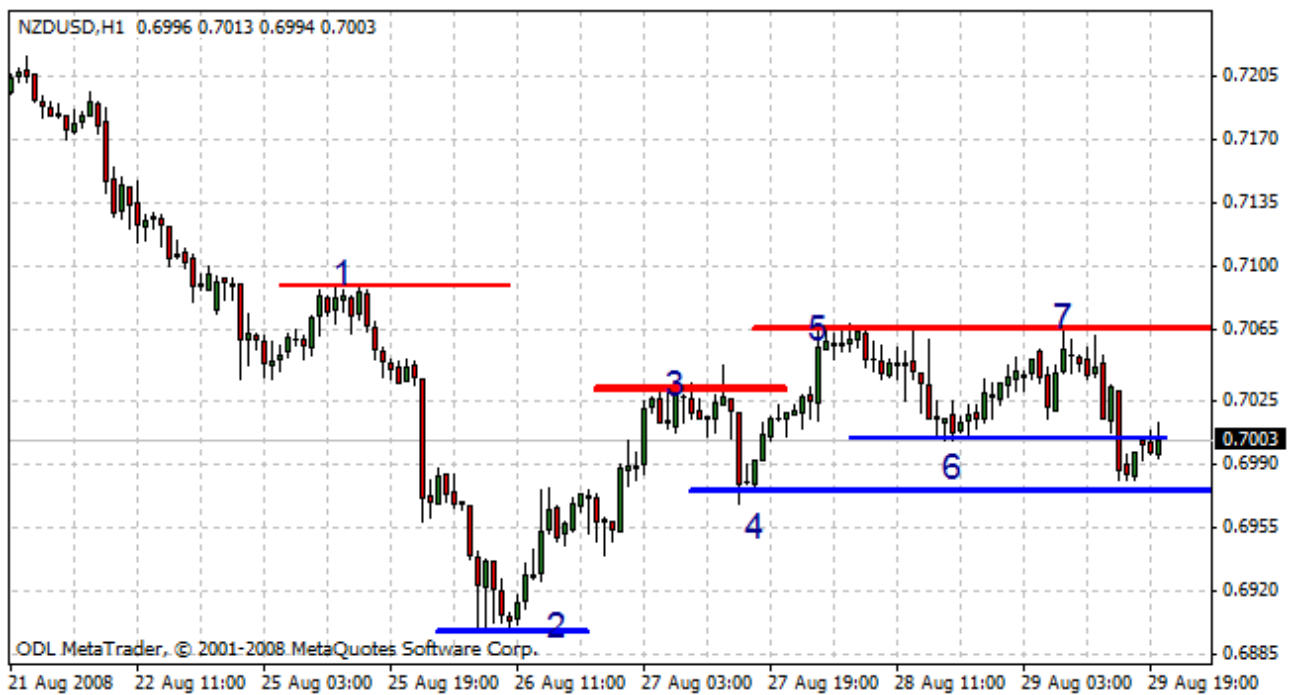
Let's start with the strong trending market. Everything what I am going to show remains in power and for the bull trend, but in opposite direction. I think there is no reason to repeat myself twice, just to opposite direction. Here you will see bear market on the GBP/USD (1 hour chart).



Let's analyse. Here on the chart red ellipsis represents the moment when I drew support lines blue colour. After line has been broken I made that line broken. Last support line is still in tact. Thick blue lines represent resistances.

Why I am considering this movement as strong trending? First of all support lines were broken with on strong candlestick. Next - movement down is enough sharp without looking back, but movement up (retracement) is slow and unconvincing. Third point is – market did not retraced more than 60% of the previous movement down. Those three points is my major analytical points. On the chart you can see number 5 with the question mark. This is the point where I am ready to sell again with the stop loss above number 4. But before I really going to sell I will wait for bearish candlestick formation around area of number 5, with the expectation that price are going to test existing support. And if the support will be broken easy as a previous ones, I will make (again?) another nice profit. If not, I will take at least something. But do not get excited. I have not got illusions and I fully aware that after prices reached point number 5 , did bearish candlestick formation, and after I gone short, market will follow direction I want. Not always. But until resistance point number 4 for is still in place I can hold my position, and just after it has been broken I will take loss.

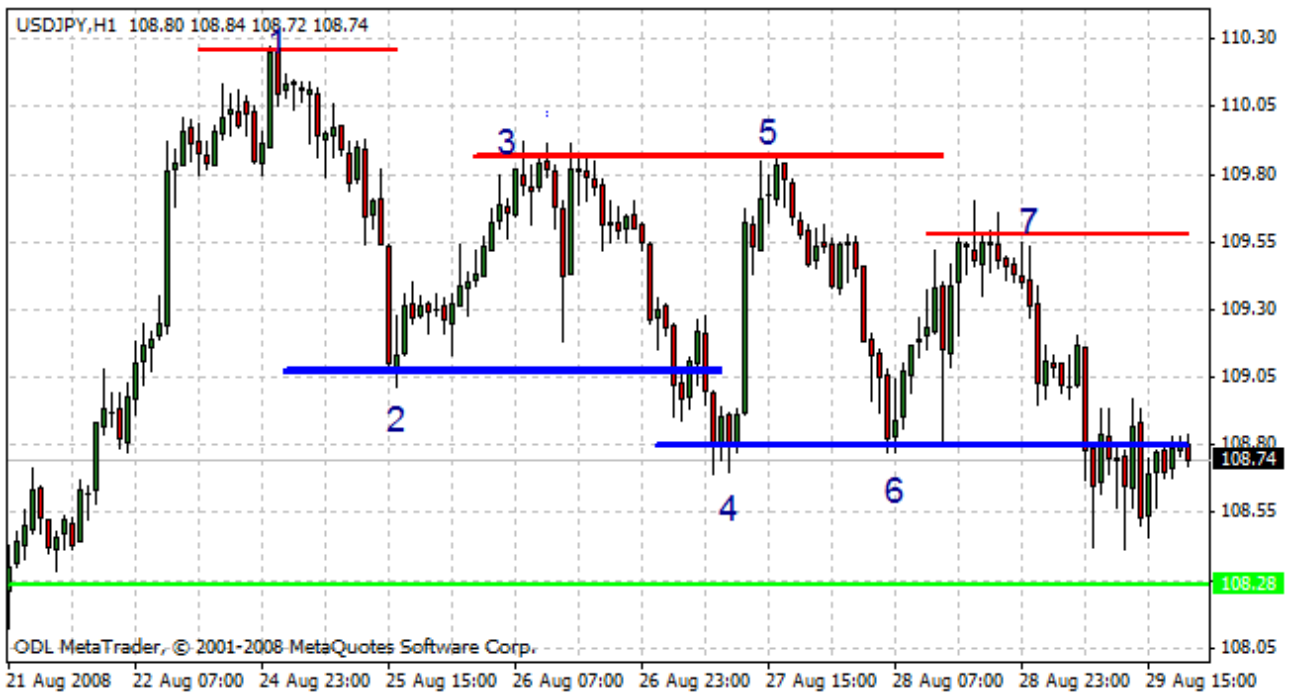
Hopefully you have basic idea how do I trade. Support line is broken – I look for retracement to go short. And opposite – resistance line broken, I am looking for dip to go long. In the previous chart we saw nice trending market, but unfortunately such market conditions is not so often as we wish. Let's take another example of NZD/USD (1 hour chart), where I consider slow trending market.



Here we have strong bearish market from resistance (point No 1) to support (point No 2). And we see that at point number 3 market stuck and would be my selling point with the protective stop loss above point No 1. Market dropped down and we can easily draw resistance line at No 3 and move stop loss from point No 1 to just above point No 3. As we see market did not go down to far and breaking the resistance point No 3 moved up. Despite previous strong bears market, I for some moment considering that bulls taking over. But not very convincingly. So after resistance (point No.3) is broken I will be bullish market supporter. Here many can argue and say that I am wrong. Well, is not a problem to be wrong. Problem is to assume where market is going to go. Just market can tell you that. But for me for now market is moving up and as long as it is going up I will follow. So, after market reached point No. 5 I will look for some dip down. Let's say I bought at 0.7016 (in fact I really did). After market moved up I put stop loss below point No.6. But look at that movement up. Slow, lazy and boring as a fly on the hot summer's day. This movement from point No. 2 to point No. 7 I consider as a slow trending market. I do not have any doubts and my task is to get out from the market near the point No. 7. I took some profit. And market dropped below support No.6. My intentions changed as well, for now I will wait for opportunity to sell around 0.7025 with stop loss 0.7065 and profit 0.6900. That is the plan, but just market will show where its direction.

Here I would like to remind dear readers about my three major points: First – resistance and support lines should be broken with the sharp movement of the price. Second - retracement should be slower than direction of the current trend. And third – retracement should not be more than 60% of the last strong move. I have got theoretical and practical background for those three rules.

Now let's see flat market. Here is 1 hour chart of USD/JPY.



From the resistance (point No. 1) market moved down to point No.2 and started to climb back. At No. 3 good opportunity to sell, I went short with the expectation to reach 108.30. But look how market broke support line (point No. 2). If you take a look back at my three trading rules, so there is the first signal that traders still has some intentions to go up, instead of down. I placed stop loss at 108.35 just in case. Well, after some time market bounced back from the point No. 4 with very impressive strong movement, but... couldn't go above resistance No 3. What's it. Market did not broke the support line No. 2 and the same time couldn't go above the resistance. For now I will stay and wait. Later market moved down, but still support in place, later up again, but again resistance was not broken, and even recently, when prices looks like broke down below support line, I still have some doubts. I did one trade, have got little profit and will let the market to decide, where it wants to go. And after market take its course I will join.

As you see, by analysing just support and resistance lines, is possible to get good results. This article just simple reminder of the support and resistance. How and when to draw those lines, how to draw trend lines and to use other drawing tools, time frames, psychological factors – this are that things requires another discussion. Those simple tools requires precisions. Trust me, wrong trend line with certainty will produce negative results.

What did support and resistance lines gave me? Confidence, clear vision of the market and most important – emotional approach to the market. Always remember – everything is constantly changing, nothing is permanent.

I wish best to all traders, I wish success and prosperity.