

# **THE SECRETS OF SUPPORT AND RESISTANCE**

**Support/resistance is relevant to tops and bottoms.**

**The basic terminology is overhead resistance and bottom support. Wherever price is positioned, the closest price top above it is the 1st level of resistance. The closest price bottom below is the first level of support.**

**But, before one can see S/R one must know what constitutes a market top and a market bottom and it is not necessarily the highest price that creates a top nor the lowest price that creates a bottom. That is the most fundamental reality of support/resistance.**

**Then you have separations into major support/resistance and minor support/resistance. The definition above illustrates major support/resistance.**

**Then you have minor support resistance. For example; the closest market top could be 200 pips overhead. That is major resistance. But 100 pips overhead, before that market top, is a prior market bottom. This prior bottom is also overhead resistance but it is classified as minor resistance. This functions oppositely on the way down.**

**A move that is with the trend can be expected to break through minor resistance and test major resistance. A move against the trend can be expected to be stopped by minor resistance.**

**When a market hits support/resistance there will occur a reaction. The reaction can be read by the pattern that forms at support/resistance and knowing how to read the reaction will tell you if price will proceed to the next S/R level, bounce off and then recover to continue through the level, or reverse off the level to test S/R in the opposite direction.**

**If we continue with our example of overhead resistance, when price hits resistance the real battle between buyers and short sellers begins.**

**You have two types of traders here. The longs that bought here and are waiting for price to come back to them so they can sell and break even.**

**Then you have the short sellers who sold here and did not take profits and see their paper profits eaten away and don't want to go negative.**

**So, at resistance it is counter intuitive because you've got sellers who will**

have to buy to close their short positions and you have buyers who have to sell to break even.

If price closes above resistance on higher volume this signals a valid break through of resistance because that tells you that all the short sellers have gotten out and the breakout was sustained by new buying. If the breakout is on lower volume it cannot be sustained because it is not supported by new buying, and indicates the move was a short covering rally.

In most cases due to buyers selling to break even there will be a bounce off the level even if it does eventually signal a valid breakout later. A valid breakout without a bounce indicates a strong move and a continuation to major resistance is a high probability.

However, a reversal is different from a bounce. A reversal is a three bar pattern which consists of the bar that tests resistance, the bar after the bar that tests resistance, and the bar following that bar. If the 3rd bar closes down below the low of the 2nd bar you have a reversal and probability is high that price will go back down to test the prior high which it had broken through to get up to the level of current resistance.

That prior high is now minor support on the way back down where the same process repeats itself.

This is the nature of support/resistance reactions. That is why Support and resistance tops and bottoms are often called reaction highs and reaction lows by professionals.

The reaction is the psychology and the chart pattern indicates the resolution of the psychology at that particular level.

The chart below illustrates major support levels for the Euro/Usd. The market had been in an up-trend that terminated at point A. When the market turned down we need to determine the support levels that are likely to catch the price fall and bounce the market back up. In order to do that we need to locate the closest point that the market made a bottom.

The bottom can be identified by the low of the swing of the closest bull pivot. That is point 1. We can see that on the way down the first bar that touched point 1 on 5-4 07 bounced 96 pips up off this level before reversing back down.

Now how could we have taken advantage of this bounce? When price reached the support level, since we are expecting at least a bounce up, this

is where we want to drop down to our 4hr or 1hr chart and look for a bull pivot.

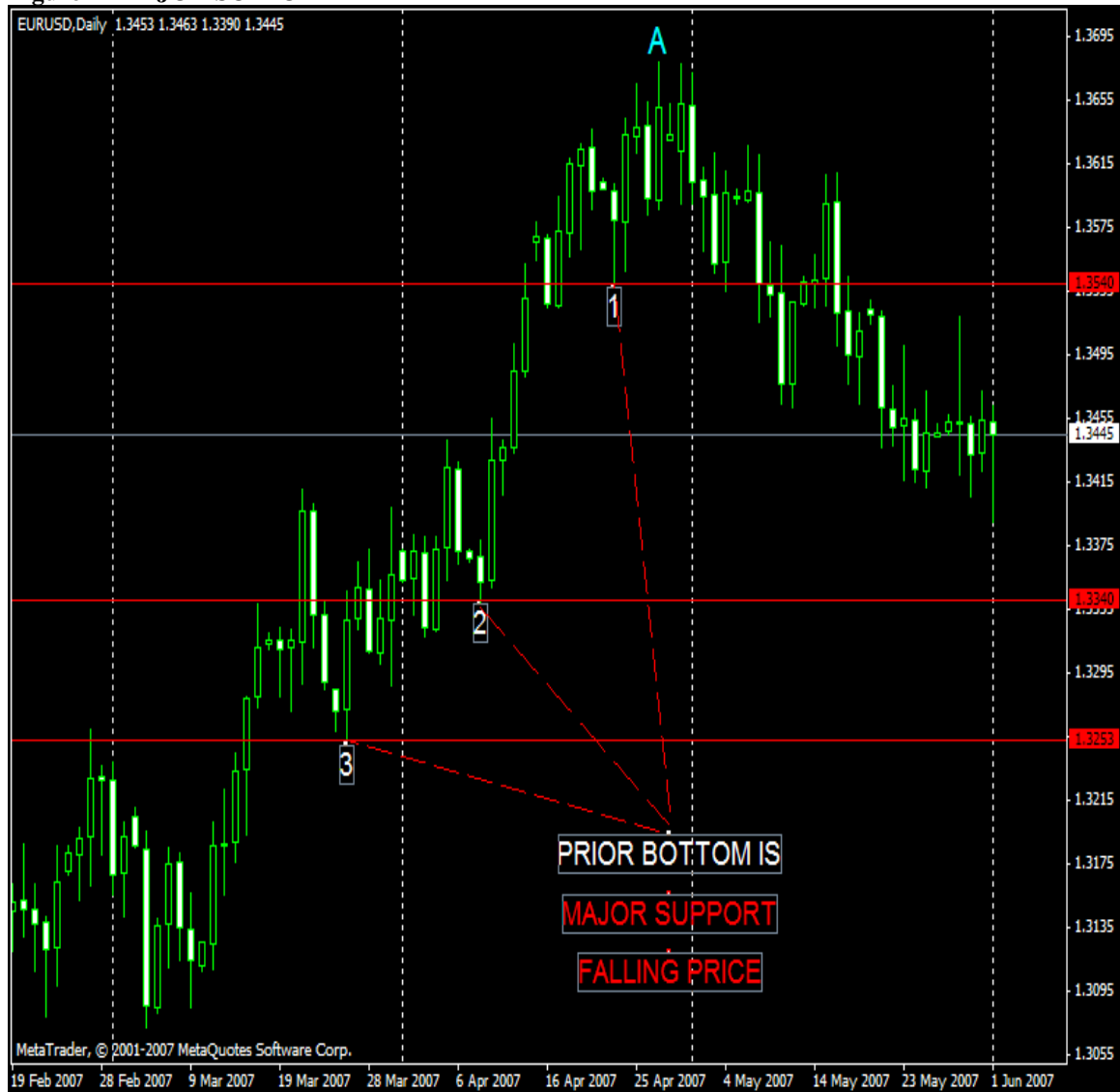
In fact, the 4hr chart on 4-4-07 signaled textbook bull pivot off this level. Using our LCM pivot entry technique we would have extracted 60 pip from this bounce safely.

This 4hr chart move took price up to major resistance 3 ( see figures 4 & 6 below).

Then we had a 4hr pivot below major resistance which gave us an opportunity to capture and gave us an opportunity to capture another 70 pips on the way back down to support 1 using our LCM PIVOT ENTRY.

After you read this lesson you should take out your charts, draw you lines and look back on your charts 4hr, 5-4-07.

**Figure 1 MAJOR SUPPORT**



Now we can see that price closed below support 1 on 5-9-07. **This means that major support 1 has now turned into minor resistance.** So, we want to drop down to our 4hr or 1hr and look for a bear pivot down off resistance to go short.

And on 5-9-07 we did get the 4hr bear pivot which gave an opportunity to capture 55 pips using our LCM entry and exit technique. Exiting on a volume reversal before price touched minor resistance 1. (see figures 2 & 3 for minor support)

Figure 2 MINOR SUPPORT

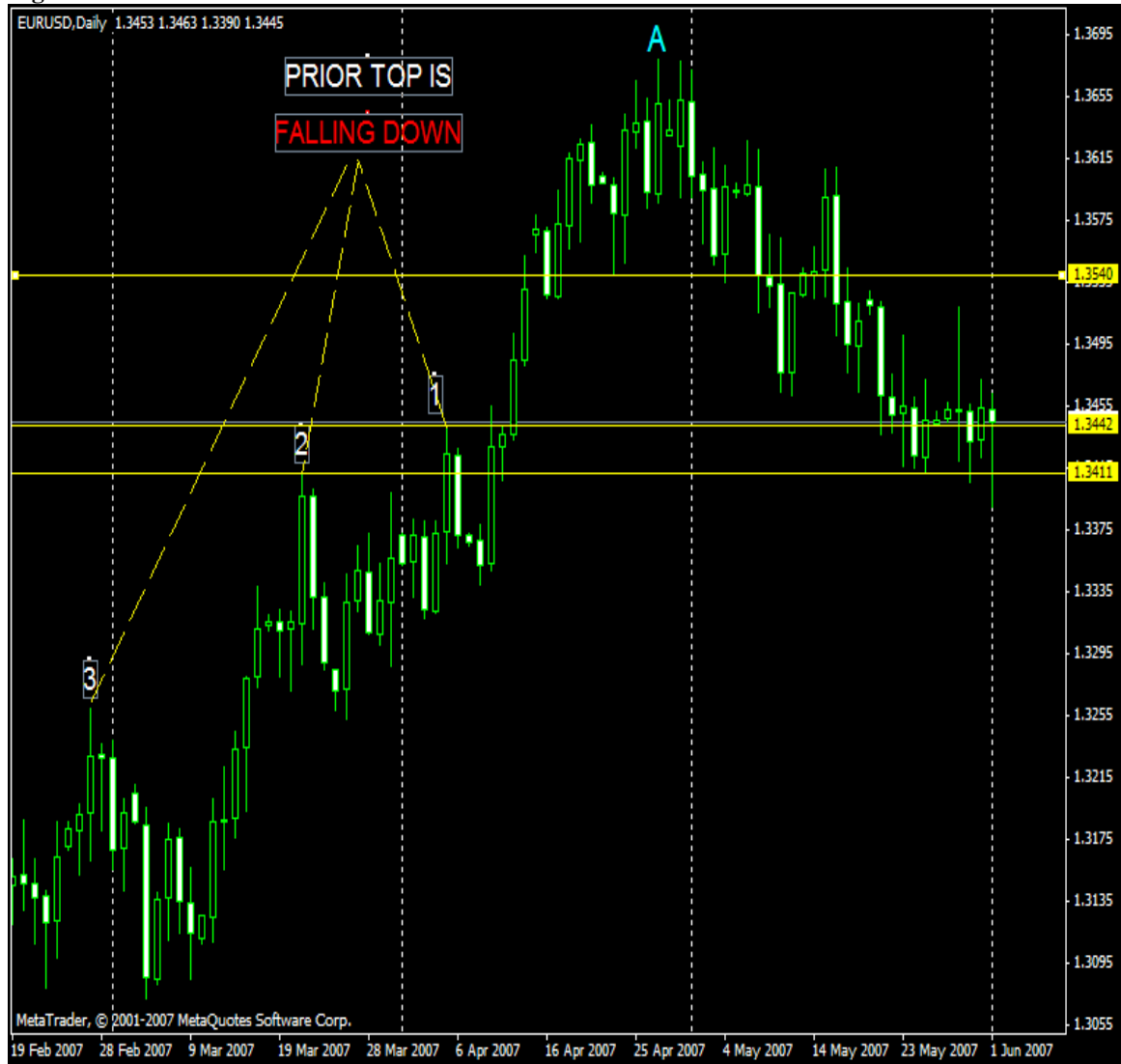
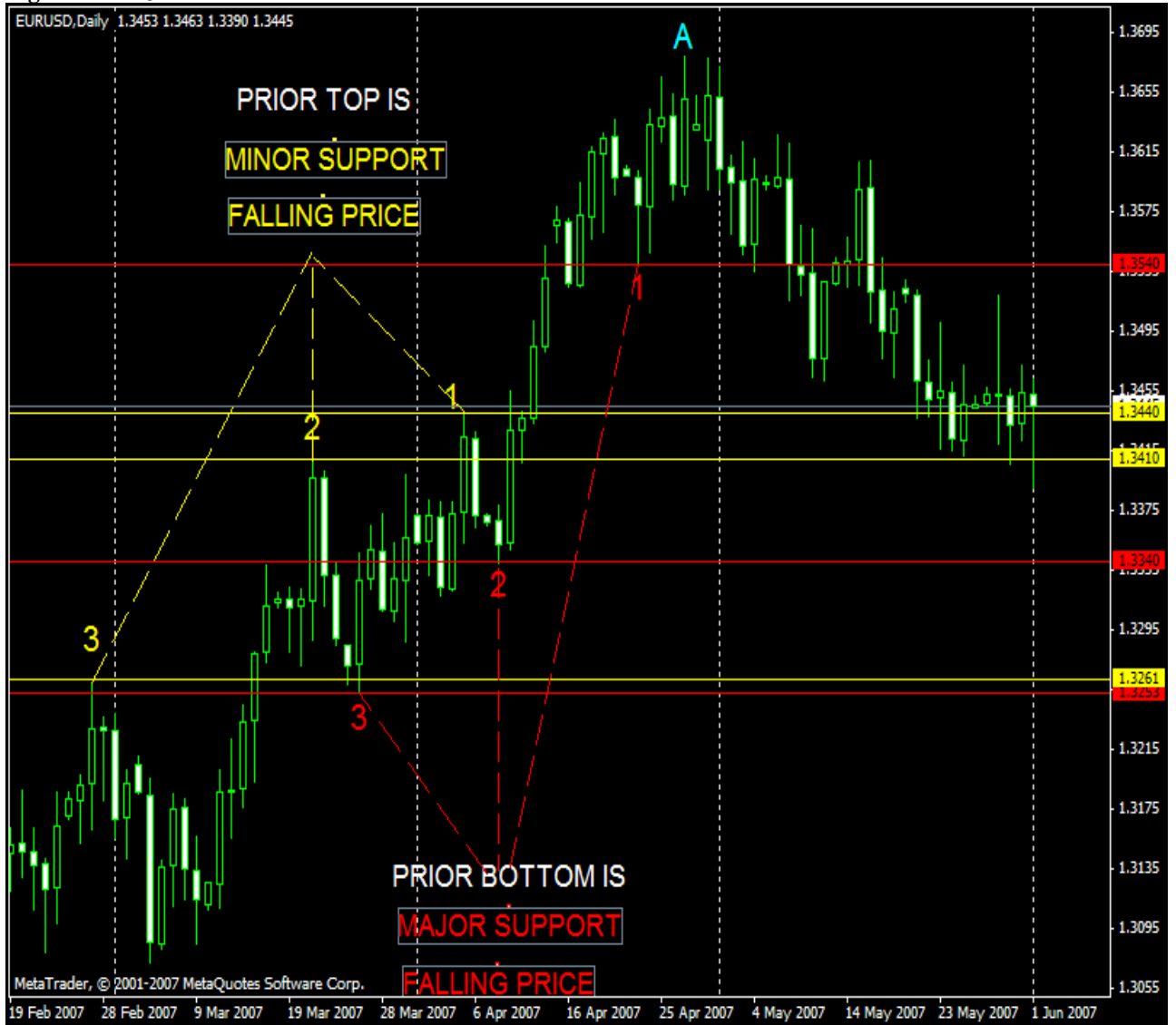
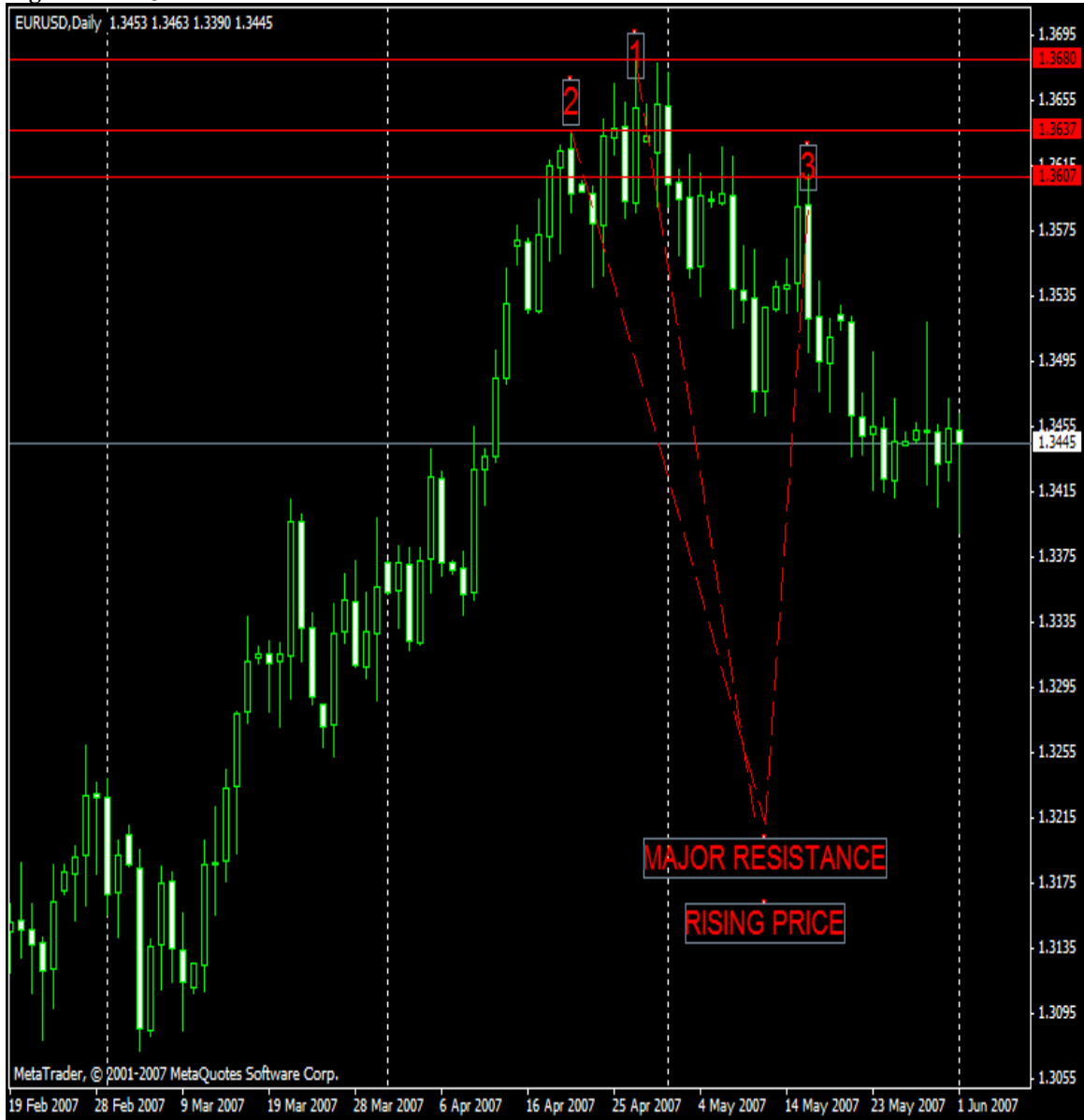


Figure 3 MAJOR & MINOR SUPPORT COMBINED



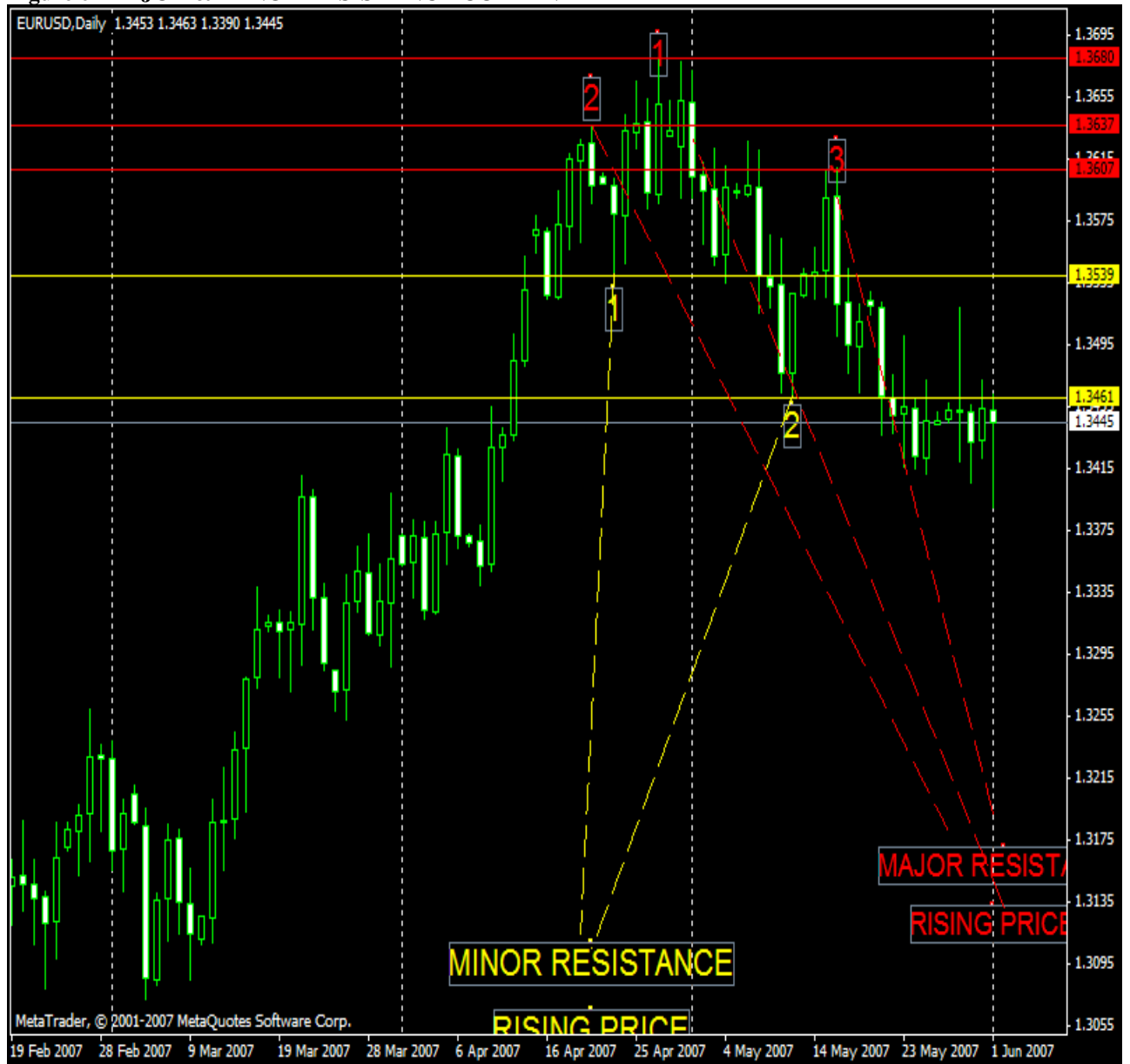
**Figure 4 MAJOR RESISTANCE**



**Figure 5 MINOR RESISTANCE**



Figure 6 MAJOR & MINOR RESISTANCE COMBINED



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