Horizontal Support/Resistance

Outline

- Does Technical Analysis Work?
- Charting Is Not Trading
- Defining Levels
- Identifying Levels
- Nuances in Levels
- Types of Setups
- Conclusion

Does Technical Analysis Work?

- Popular question, but terribly phrased
- If the answer is ‘Yes’, it exists on a spectrum
    - Extremely strong: Price charts contain all necessary information, public and private, to make accurate predictions about future prices (or even stronger form of determinism)
    - Extremely weak: The market isn’t completely random and some prices appear to be ‘stickier’ and more important than other prices in a way that can be predictive
- Why might technical analysis be useful?
    - Self-fulfilling prophecy in a retail-oriented market/where participants use similar tools
    - Order herding
    - Order splitting
    - Stop market order clustering

Charting Is Not Trading

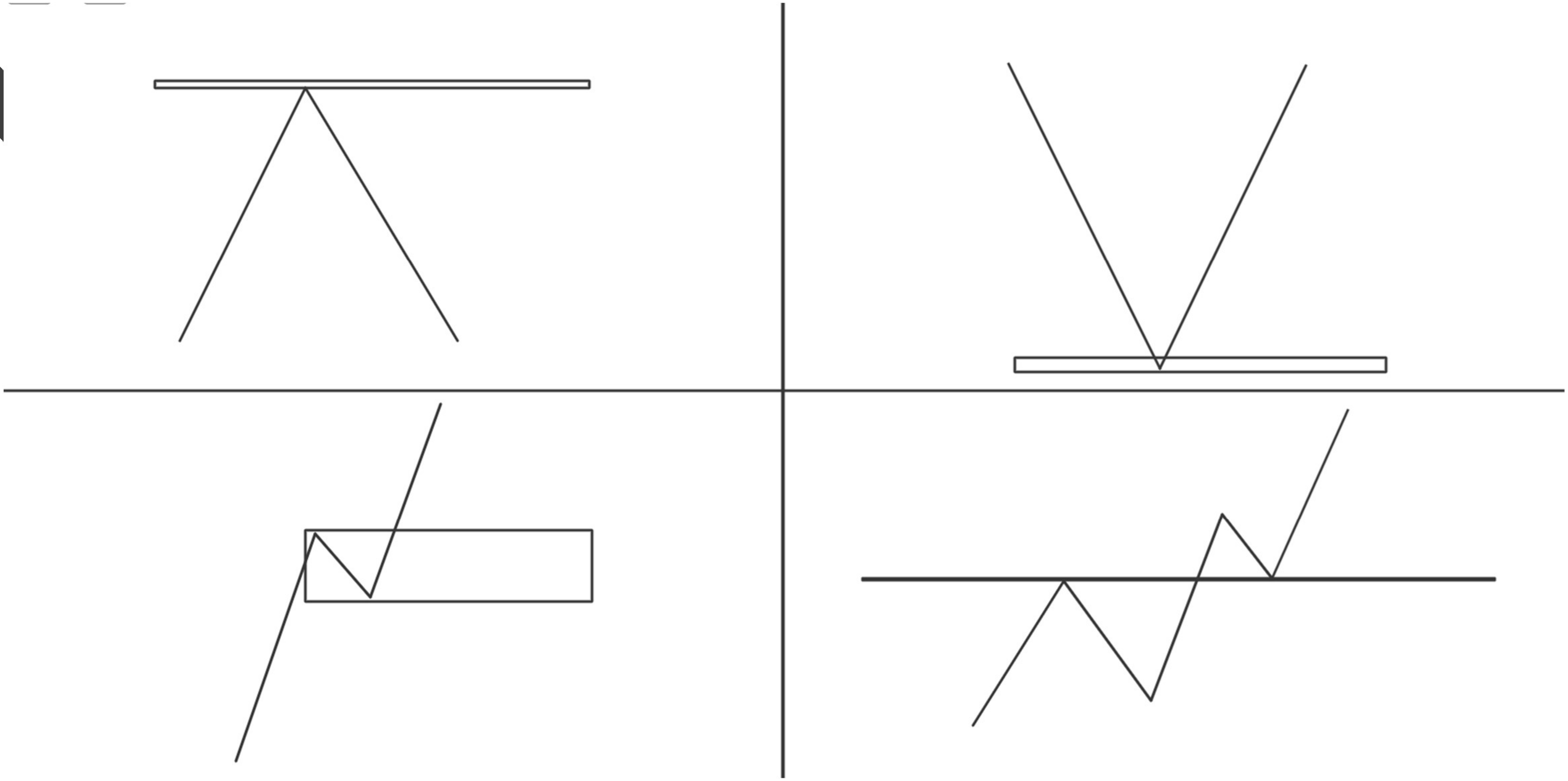
- Mapping a market is not the same as trading it
- Identifying levels, at most, gives you a broad understanding of where you might look to do business - that's all!
- Doesn't inherently build the foundations of a trading system
  - Risk management/sizing
  - Entry triggers
  - Exit triggers
  - Trade management
- Charting is the easy part, but does not confer an edge
  - Spend more time thinking about the 'boring' stuff to succeed
  - Everyone has similar levels/you can get them off Twitter, but everyone trades them differently → that's where the edge is likely to be

Defining Levels

- Definition: A level is a price, or cluster of prices, that has i) acted as a floor and/or ceiling in the past and/or ii) preceded a large move
    - Colloquially: Price action in this area doesn't immediately appear to be random/the market really seems to react to the level
- Technical analysis gurus have taken this simple premise and repackaged it 100 different ways to sell courses
    - Levels, ranges, clusters, supply/demand, blocks, pivots → all the same thing & usually end up in the same areas
- Basic identifiers:
    - Peak of a rally
    - Bottom of a dump
    - Area of recurring tests and bounces
    - Consolidations formed between impulsive moves
    - Consolidations preceding impulsive moves

Identifying Levels

- Basic heuristic technique:
  - Where did a big move start → mark it
  - Where did a big move pause before continuing → mark it
  - Where did a big move stop and reverse → mark it
  - Start from the very obvious higher time frames (monthly, weekly)
  - Work your way down to lower time frames (daily, intraday)
- Sometimes a market will only have a few clear structures - that's fine!
  - Less is more
    - The trades will be more obvious
    - More visibility + more higher time frame confluence = higher probability that the area is good
  - You don't have to have an 'explanation' for every move
  - By definition, most of the time, the market is not in an area worth trading
- Especially after a bit of practice, most levels should just 'jump out' at you



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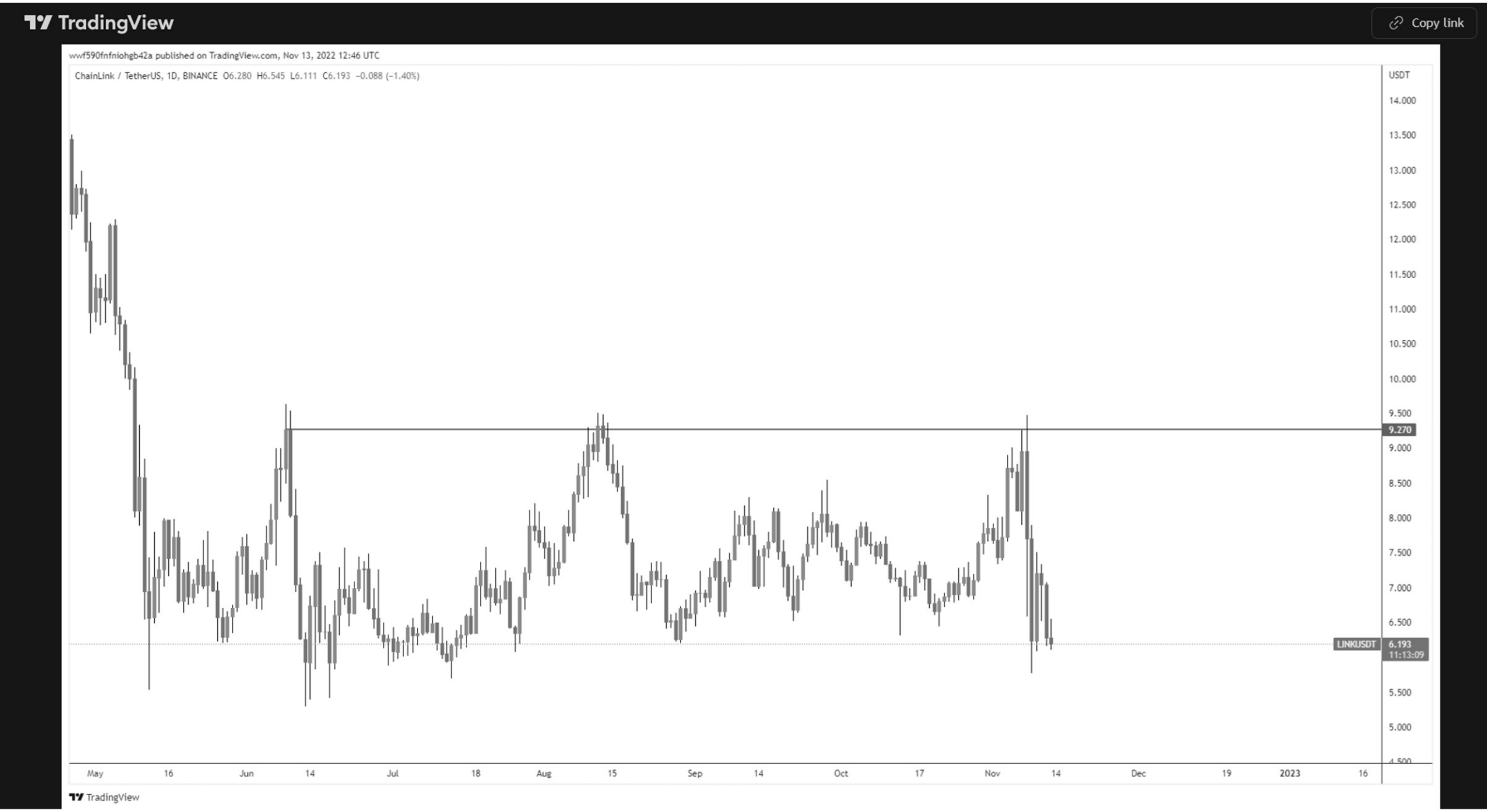

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Identifying Levels II

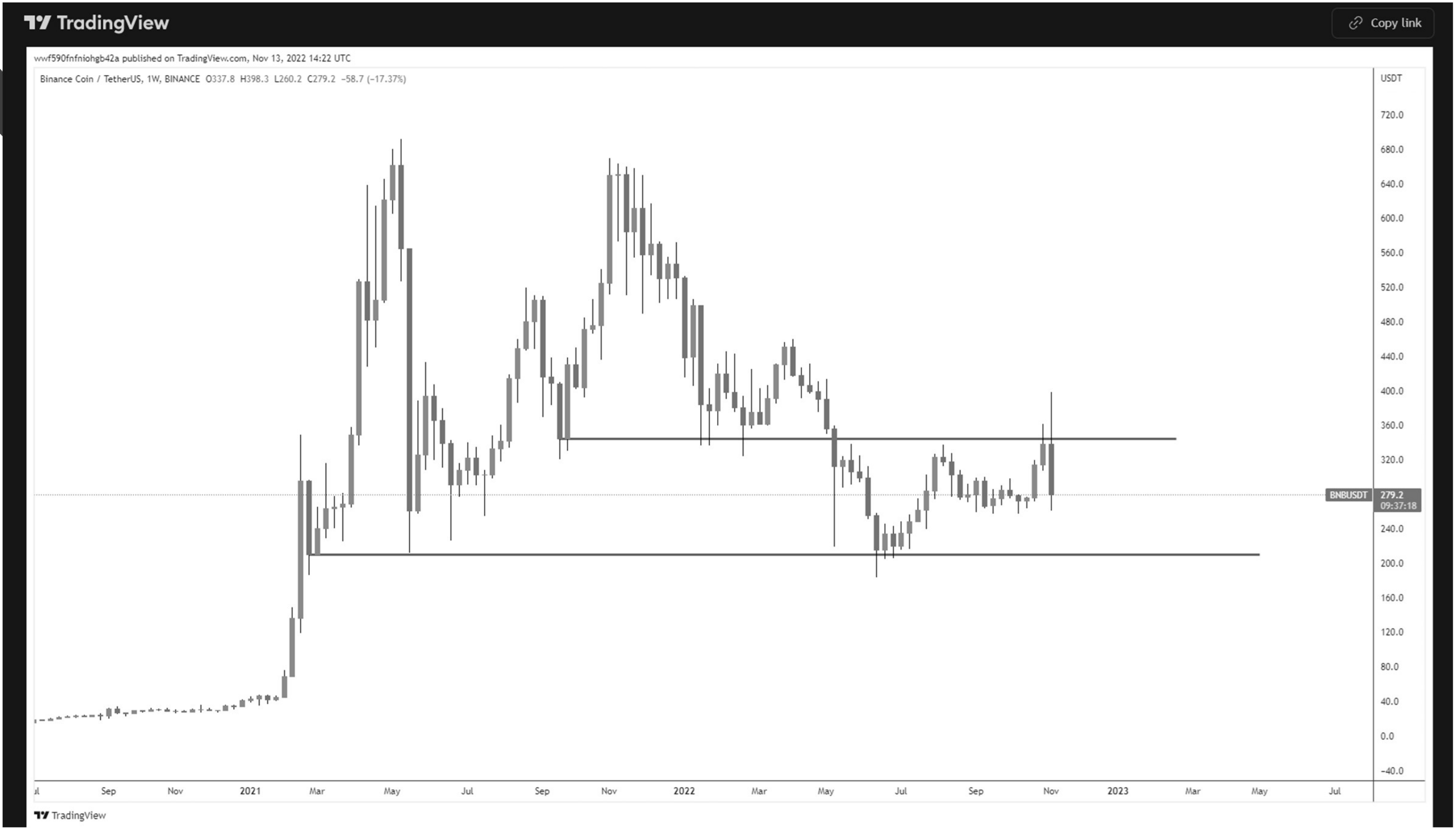
- There’s another contingent of levels worth being aware of
  - Time based levels
  - Round numbers/’psychological levels’
- Time-based levels
  - Monthly Open
  - Weekly Open
  - Daily Open
  - Can act as pivots in the context of a higher time frame view
    - E.g. Bearish daily bias, price trades above daily open early, and then back below it → can give some sense of how the higher time frame candle is ‘forming’ etc.
- Round numbers
  - Stuff that looks nice e.g. $30000, $20000, $1000, $1 etc.

Nuances in Levels

- Broken support is expected to act as resistance
- Broken resistance is expected to act as support
- Higher time frame structure = bigger moves
- Lower time frame structure = smaller moves
- Higher time frame structure = should give more time to unfold/retest
- Lower time frame structure = should give less time to unfold/retest
- Recurring tests from the same direction = weaker level (supply/demand weaker with each test)
- The best breakouts move quickly away from the level and allow little/no time to retest
  - Stalling after a big breakout is generally a red flag (higher likelihood that it's a trap)
- When buying a test of a structure, the first/fresh test is the best test
- Reclaimed levels become support/resistance once again i.e. when S/R flips fail, original structure restored
- Usual trend/flows considerations apply
  - Uptrend = support generally expected to hold, resistance generally expected to break
  - Downtrend = resistance generally expected to hold, support generally expected to break
  - Uptrend = higher likelihood that breakouts stick, lower likelihood that breakdowns stick
  - Downtrend = higher likelihood that breakdowns stick, lower likelihood that breakouts stick
- Wicks or bodies?
  - For trap/spike setups → wicks
  - For narrowing down reversal points → bodies
  - Personal preference, test & find out or just use both

Types of Setups

- Same way
  - Resistance is resistance until proven otherwise
  - Support is support until proven otherwise
  - Very common in rangebound environments
- Breakouts
  - Price broke resistance, therefore the market is likely to move higher
  - Price broke support, therefore the market is likely to move lower
  - Standard momentum trade - catching the shift from balanced → imbalanced environment
- Flips
  - Price broke resistance, if that level is retested it's likely to flip to support
  - Price broke support, if that level is retested it's likely to flip to resistance
  - Standard S/R flip - common for both breakout and trend continuation setups
- Deviations/Failed breakouts
  - Breakouts should be bullish. When bullish patterns fail, that's bearish.
    - Breakout wasn't accepted → market likely to go back down
  - Breakdowns should be bearish. When bearish patterns fail, that's bullish.
    - Breakdown wasn't accepted → market likely to go back up
- Spikes
  - Swing Failure Pattern/Failed breakout/Stop run amalgamation
  - Spike and move back below a key swing high → buyers offside → market likely to move against them (down)
  - Spike and move back above a key swing low → sellers offside → market likely to move against them (up)



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Conclusion

- This chapter isn't comprehensive → each subtopic could probably warrant its own chapter!
- Mapping levels is simple, trading them is difficult, and building a robust trading system around them is even more difficult
- Don't get lost in the price action trading - mapping levels is fairly straightforward and a lot of the content is repackaged/lightly rebranded