True Support and Resistance

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Support and resistance lines are one of the basic tenants of technical analysis. The method normally used for establishing support and resistance is by finding high and low price levels that the market has failed to exceed previously.

However, this technique has certain failings. One of the more common has to do with the occurrence of what is called "false breakouts". Quite often the market will just exceed the resistance or support lines and return, fooling a large percentage of traders along the way. Obviously, such lines are important, but they normally are not the true support and resistance lines. This statement may seem strange, considering how pervasive the thought that these lines are all important indicators of market direction. But these lines as static and the markets are anything but static.

So if these lines are not the true support and resistance lines, what is?

True support and resistance lines can more accurately be defined, "As lines that have established themselves with support and resistance within the flow of the market and are supported by price action (defined as the highs and lows touching and giving support to)."

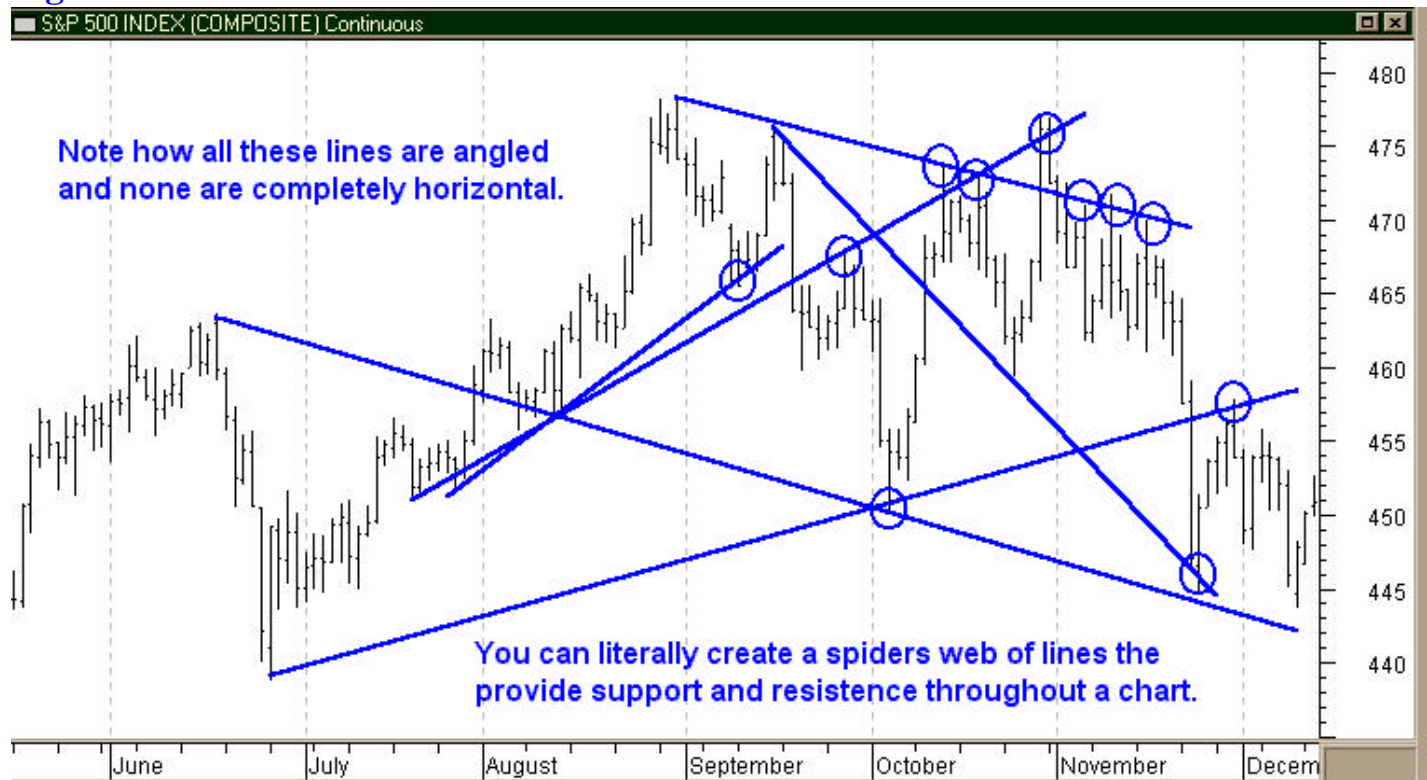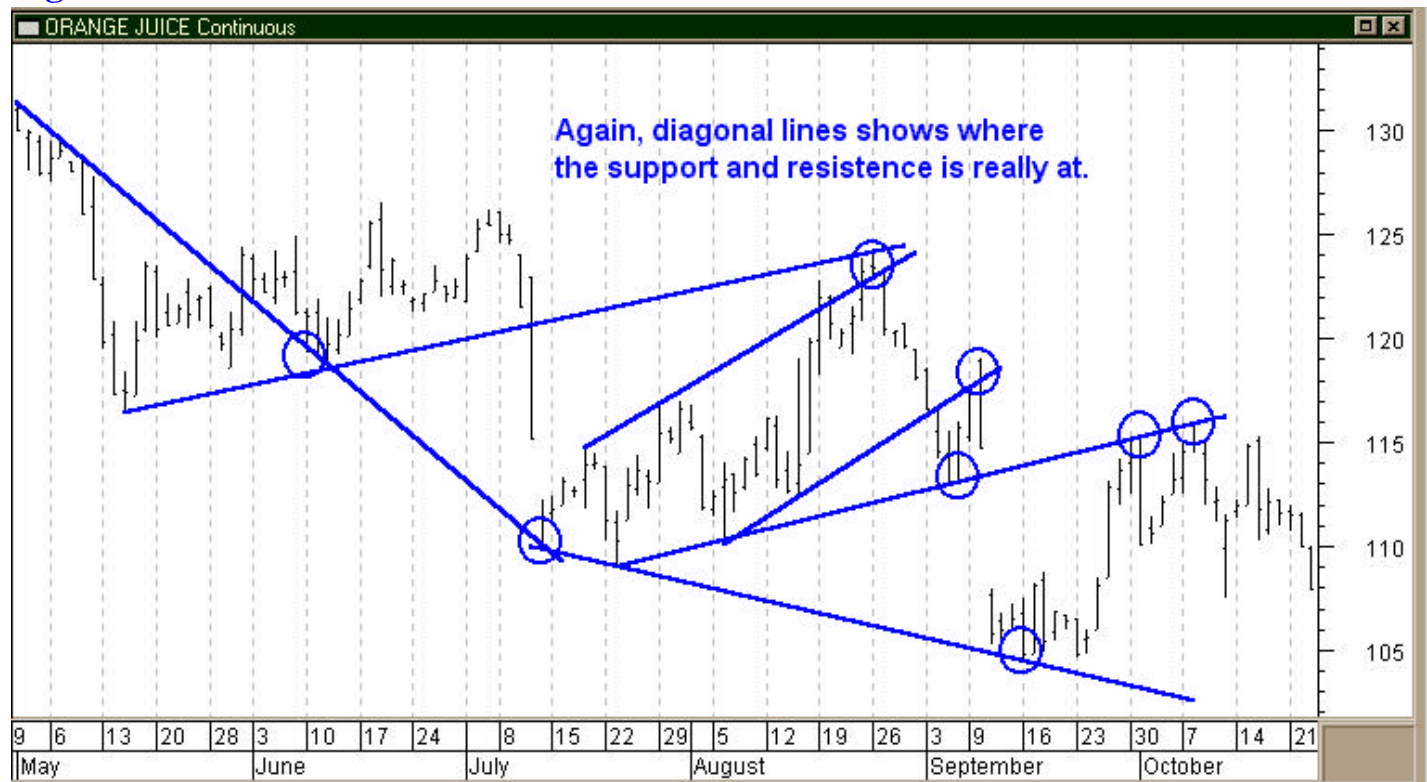To help clarify this definition, lets look at some examples.

Figure 1

S&P 500 INDEX (COMPOSITE) Continuous

Note how all these lines are angled and none are completely horizontal.

You can literally create a spiders web of lines the provide support and resistence throughout a chart.

Figure 2

ORANGE JUICE Continuous

Again, diagonal lines shows where the support and resistence is really at.

As the examples show, true resistance and support are based on the actual limits established by the price action and are rarely perfectly horizontal. The majority establish themselves in a diagonal line with its incline either up or down. They intertwine through the price action affecting each time price bars touch them. Yet, they can extend far into the future crossing voids in the price bars to reestablish themselves later when they intersect again or can even cross through price bars without affecting them and still have an effect later on.

The intertwining of TRSL (true resistance and support lines) can be quite extensive and very subtle. They can be very numerous and extend considerable distances across a chart. It takes an eye for detail and a patient careful examination of a chart to find them. There is no rushing this process. There have been many times I have attempted to do this and it resulted in missing a subtle, but key TRSL. However, whenever I have taken my time and made a careful search, the rewards have been fantastic, as you will see very shortly.

First, lets look at a few TRSL that are subtle and normally would be easy to miss.
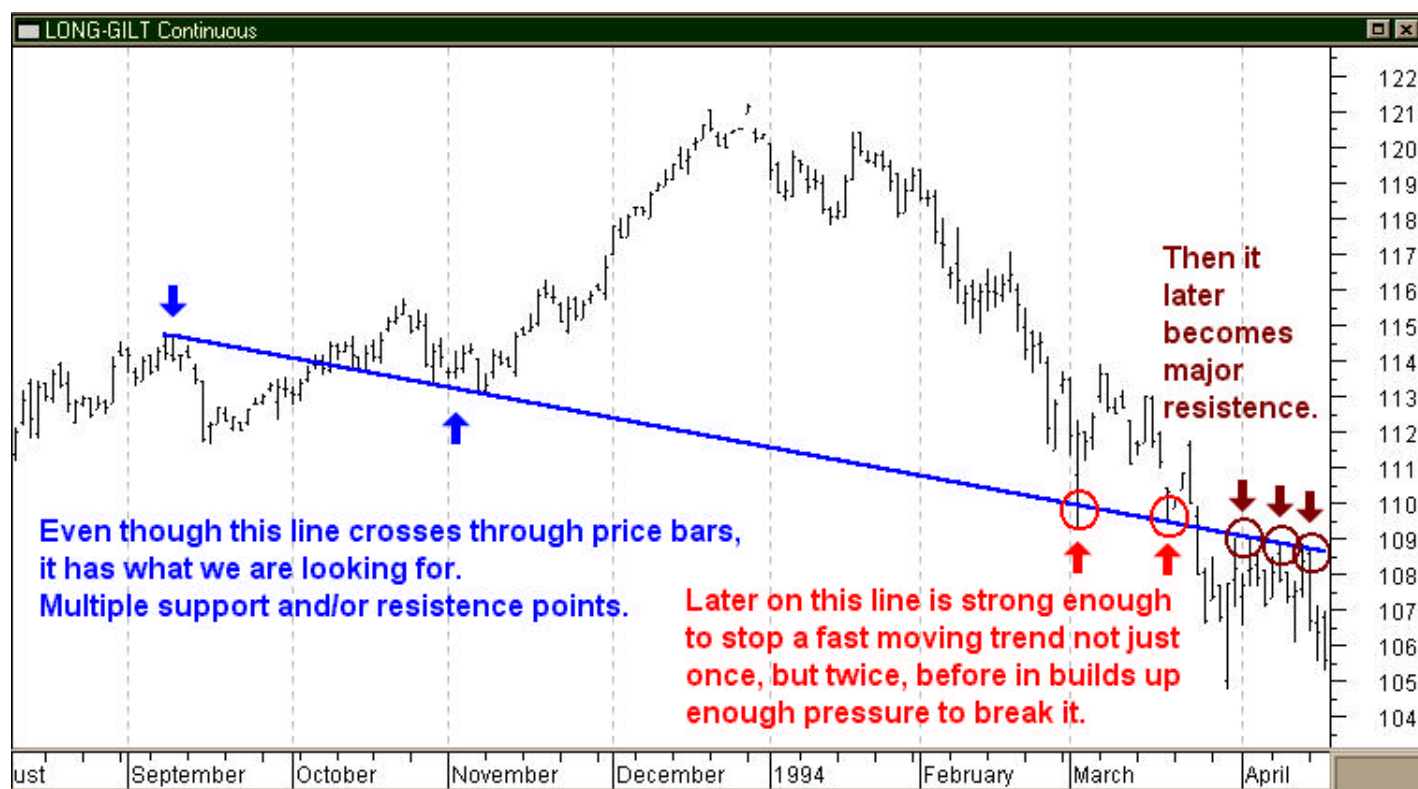
Figure 3

The chart is labeled "LONG-GILT Continuous" with price scale on the right ranging from 104 to 122, and months along the bottom from August ("ust") through April, spanning into 1994.

Annotations on the chart:

"Then it later becomes major resistence."

"Even though this line crosses through price bars, it has what we are looking for. Multiple support and/or resistence points."

"Later on this line is strong enough to stop a fast moving trend not just once, but twice, before in builds up enough pressure to break it."

Figure 4

COTTON Continuous

This line has 3 points of support and resistence covering a large distance. Whenever you see support and resistence reaffirmed over long distance, this is a strong line and one to watch.

Figure 5

COTTON Continuous

Here is the line as it progressed. Although subtle when established, this line provided major resistence.

As you can see, true support and resistance lines are not always obvious or simple to identify as your so-called standard support and resistance, but is certainly much more rewarding. It takes a trained eye to fully utilize this unique art of spotting true resistance and support, but it isn't hard to learn. Learning this technique gives you a keen eye for what is happening in the market and where it is likely to stop and reverse, or even gap or makes substantial short spurts.

Let me explain. One unique characteristic of the true support and resistance lines is that when two or more of these lines intersect, the market is attracted to these points and will try to reach them if reasonably close. Yet at the same time, these intersecting points appear to be taboo and the market will either pull away just before touching them, quickly pass through in a large move, or even gap over these points.

This is an important point to remember. If a trend is approaching one of these intersecting points, then it is a good possibility that it will pause just before reaching them, pullback until time has moved it further down the line and then resume the trend or if it actually makes it to one of these points gap over it and make a nice quick move. Knowing this gives you an edge in making the right trading decisions.
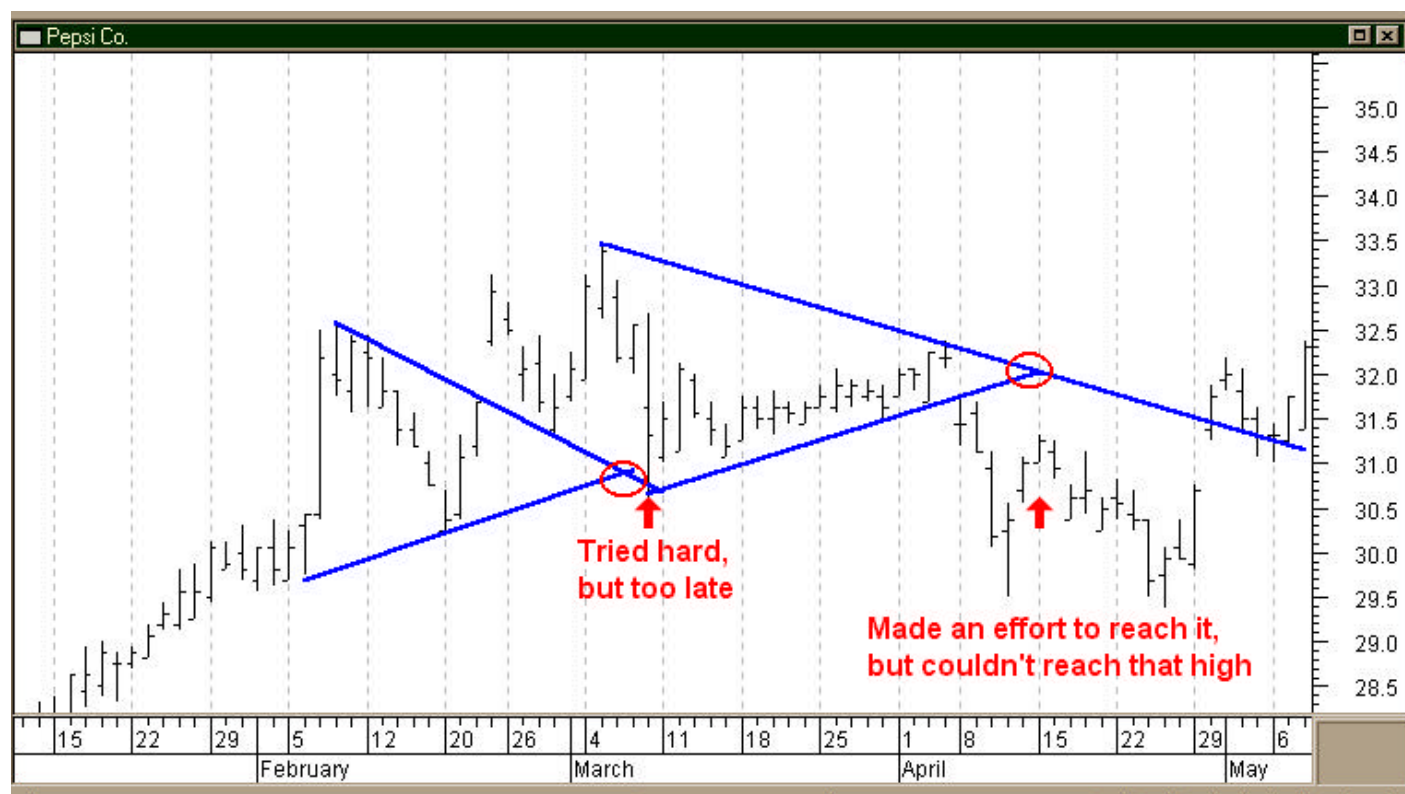
Figure 6

Figure 7

Japanese Yen Dec 96

Gaps down to avoid hitting this point

Figure 8

Gold Comx Dec 96

Drops down just before lines intersect

Drops down just before lines intersect

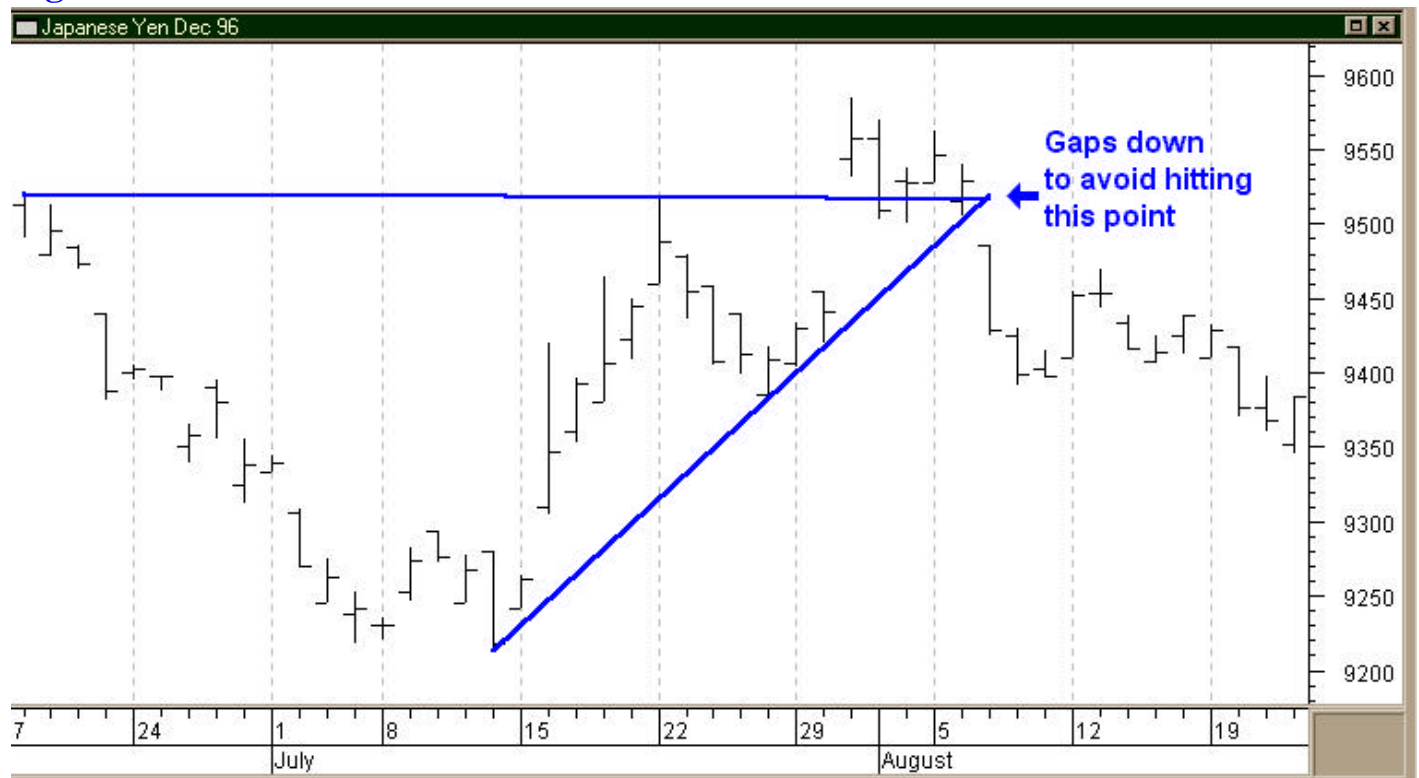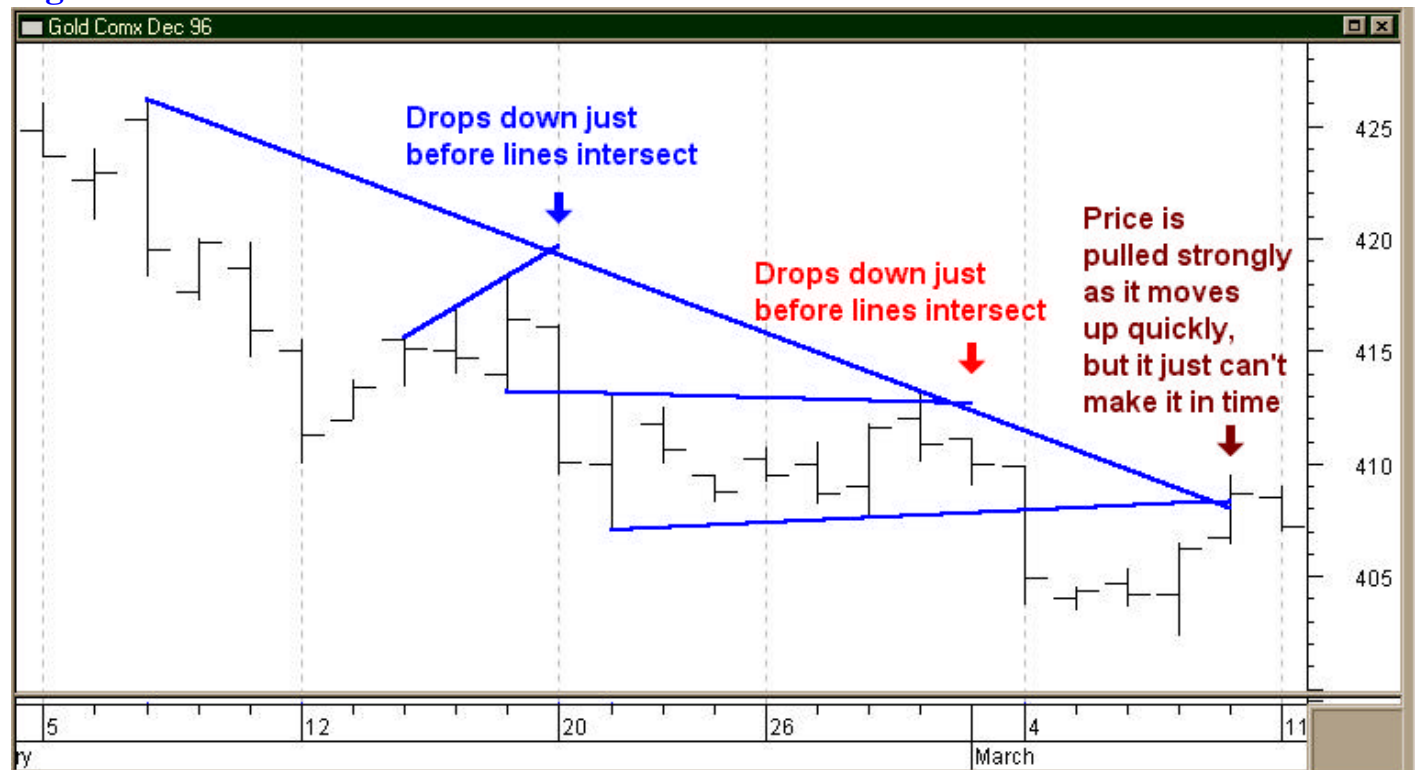Price is pulled strongly as it moves up quickly, but it just can't make it in time

One additional factor to take notice of when dealing with multiple TRSL is that they frequently are at different angles. What this means is that they will "squeeze" the price as they draw closer and closer to one another. This creates a spring effect that will often cause price to rocket off in the direction of losing trend line. It is not uncommon for this powerful move to show up on a chart as a gap.

Many of us are familiar with a common type of narrowing support and resistance lines that frequently causes price to rocket called a triangle pattern. But anywhere you have support and resistance lines putting on the "squeeze" you are likely to see a quick move when it breaks one of these lines.

But what if you are only dealing with one line? Singular support and resistance lines by themselves are a source of strength to the price movement and price will use them as a resting place, a springboard and as a home to return to. By itself, a line does not guarantee that it has the ability to stop or support a trend, but in many cases it will. The key to gauging the strength of a particular line lies in how it has demonstrated itself in the past. The more it has provided support or resistance when price reached it, the more evident it is that a stronger move is necessary to break the line. When a line that has resisted being broken several times is finally broken, then you can count on the new direction to be one of considerable strength.

Before leaving the subject of TRSL, I can't avoid one other aspect of these lines, their attractive qualities. They are like magnets to price. The stronger a line is, the more it seems to continually attract the price action. While it may wander from it for some length of time, whenever it is possible, price will return to the same line over and over again. This is one of the reasons it is important to keep track of TRSL because they may resurface as support or resistance. That is why it is always good to monitor larger time frames for TRSL. Different time frames add a whole different dimension to these lines that can be of exception value in predicting price movements.

Figure 9

US T-Bonds Dec 96

How far will this market rise?

Figure 10

US T-Bonds Dec 96

Now that you see the long term line,
how far do you think this market will rise?

If you said no more, you are correct.

Speaking of lines and their attractive qualities, note too that there are lines that run through your trends that doesn't fit the description of support or resistance lines, but more aptly as center lines. Price dances around both sides of these centerlines, jumping back and forth at will. It acts, as a magnet that price doesn't want to wander too far from until it latches onto another line that can act as its centerline. They, like TRSL, are very subtle but can be found with just a little patience.

Figure 11

Perhaps one of the most evident examples of this is when a trend reverses. The former support line in most cases becomes the line of resistance and the first important gauge of the next trends TRSL. In essence, a center line between the two trends.

Figure 12
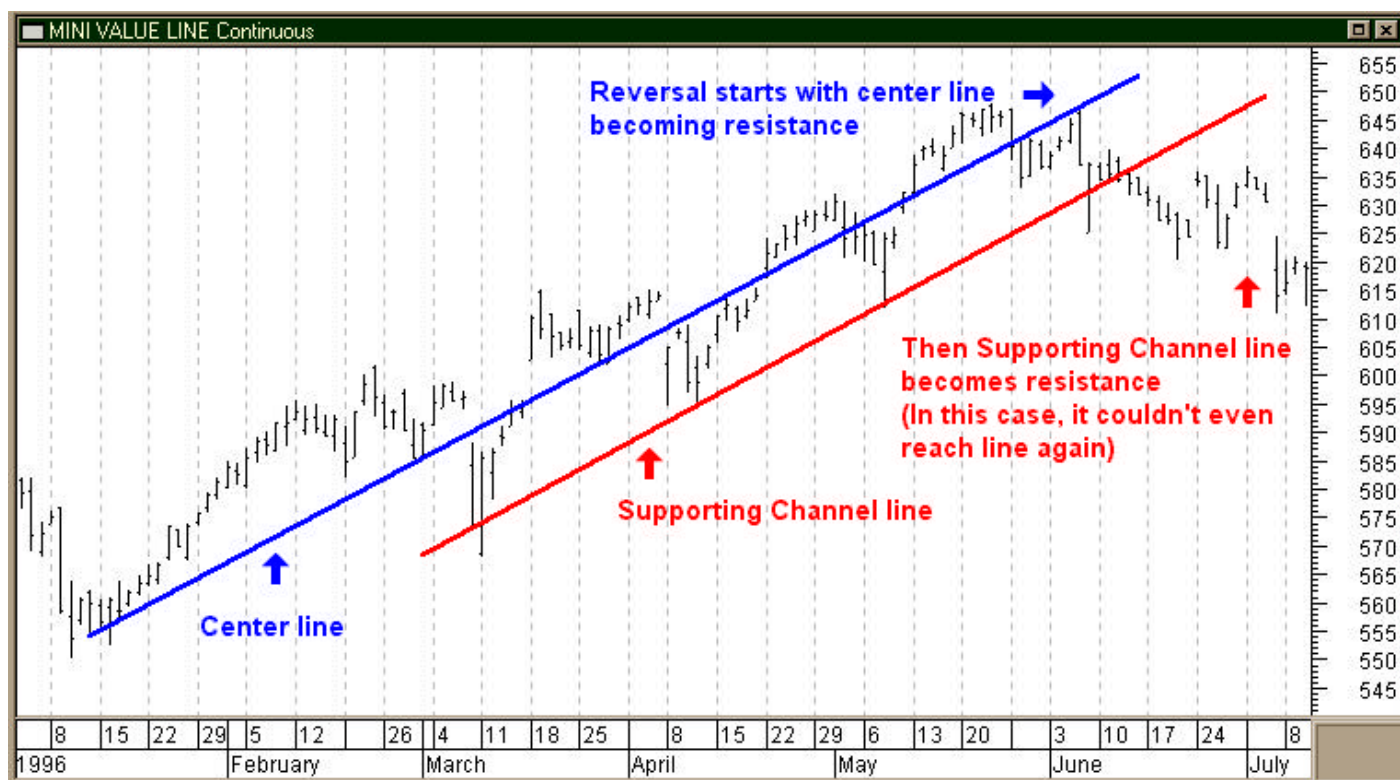
When this changing of the guard takes place and holds back the price from returning to its former side of the trend line, it is a strong signal that the trend has changed direction. I frequently use this signal as confirmation to reverse direction when it coincides with a **Reversal Magic** point.

Trend lines represent an important line of direction. When the price travels too far from a trend line and runs out of steam, it has to return to a support line for strength to be able to continue its trend. At times, these trend lines can be a considerable distance. Rather than retreating back all the way, price can refortify itself by clinging to another true support line.

Remember, that these lines are like magnets. That is also why you will see a price trend often terminate by just crossing over a resistance channel line. Although resistance lines don't add strength, they still attract price and price will do everything that it can to reach them. In a last ditch effort to reach them, price will lunge in one final effort and then die.

That is why **Channel Surfing** is such a great simple way of determining entries and exits. Price just naturally follows trend lines, support and resistance lines and centerlines. This tendency is a very predictable characteristic of price movement. When price breaks any of these lines, something has drastically changed. Each of these lines provides early warning signals that can keep you on the right side of the market.

While identifying the true support and resistance lines will take practice on your part to learn, I am sure you have already noted on the previous charts the value of developing this skill.

The more you use Channel Surfing and the better you become at it, the more you will see and understand true support and resistance. The two go hand in hand and are really extensions of the same thing. However in my opinion, true support and resistance does take more skill. It is not uncommon for these lines to start at one place and to not have a major impact until much further down the line. They can even travel for some distance through "empty space", in that they don't interact with the price bars until that market impact.

Figure 13

TSRL can travel great distances and reassert themselves
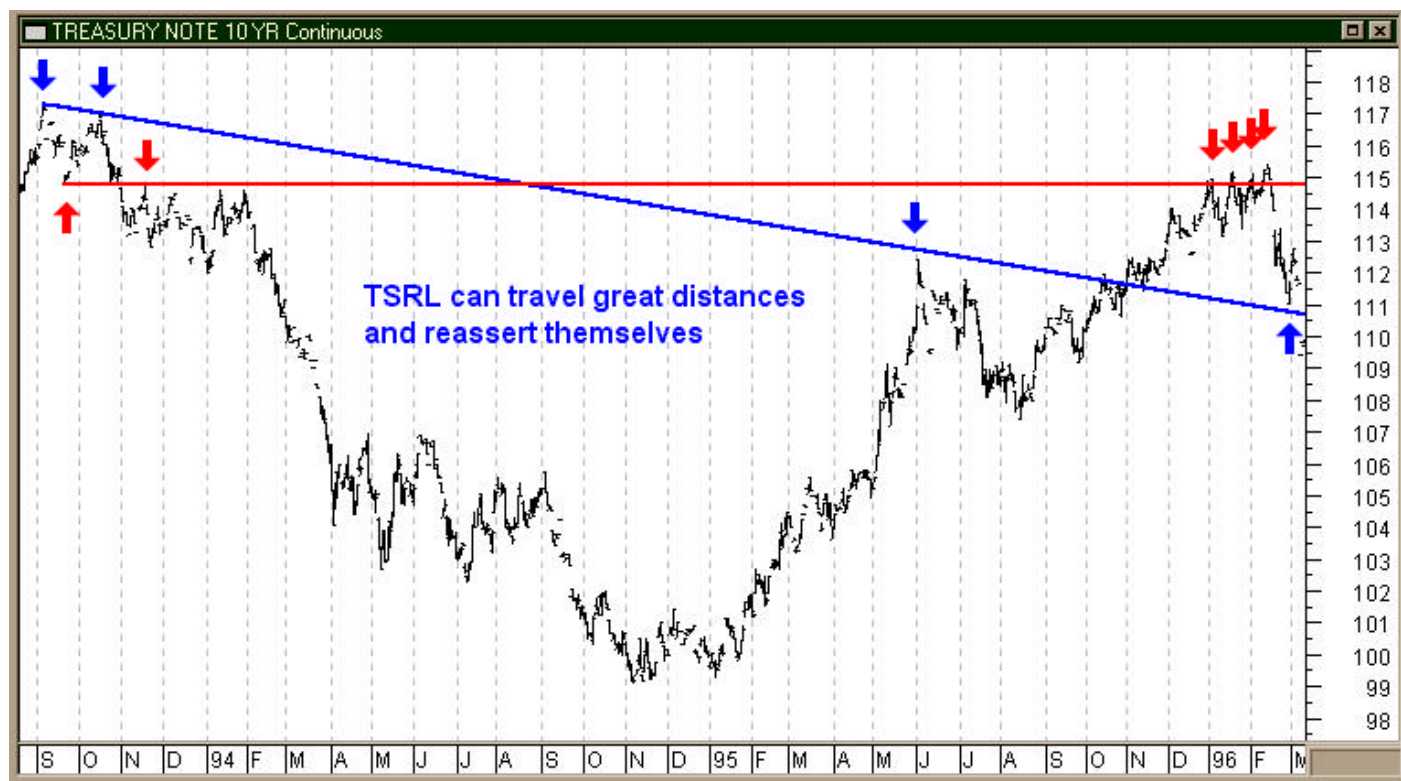
While this area takes some skill, most of that skill will develop naturally as you practice and use this method. Aside from the requirement of having a detail-oriented eye in finding and watching these lines, the method is relatively simple. It will astound you how often these lines continue to affect the market and the reliability opposed to "normal" support and resistance lines. Once you master this, you will no longer look at support and resistance the same way again.