RESISTANCE AND SUPPORT

If you ever hope to make money in the markets, you better get a grip on resistance and support concepts.

Resistance is a level, or ceiling price, that a tradable repeatedly tries to go above, but fails.

Support is an area that a tradable repeatedly tries to go below, but fails.

After repeated attempts, the price will often finally break through the level it has been testing.

The most common resistance and support levels are generated by traders trying to make a profit or minimize a loss.

To illustrate, at a level of resistance, the tradable's price hits a ceiling, preventing it from going any higher. Selling then takes place as traders take their profits. Price then retreats to a level of support, where buying resumes. Traders see price as too low, and anticipate that profits lie ahead.

The area between levels of resistance and support is often called the *resistance/support area.* Price breaks out of this area when either of two conditions materialize: the number of repeated attempts to overcome resistance is greater than the number of attempts to break support (or vice versa), or buyers outnumber sellers – called an *upside breakout* – or sellers outnumber buyers – called a *downside breakout.*

Where you see price trying to overcome resistance more so than trying to penetrate support – i.e., more hits at the level of resistance than at the level of support – this means that buying is occurring at the top level, and price action could very well break through resistance.

As far as volume is concerned, where you see a sudden increase in volume coincident with a significant drop in price, you can anticipate that price will probably fall right through support. If you had been merrily buying up to this point, your profits are now in jeopardy. After the fall, profit-taking and loss-minimization activities keep prices from crossing the level of resistance from whence it came.

Where you see that OBV is reflecting that the underlying tradable is being sold, but A/D is flat, you can't discount OBV's falling momentum. If you are long, logic would dictate that you would start selling at the best possible profit or smallest loss you can achieve.

To better understand the potential for breakout, you need to determine the level of trading (volume), and the accompanying price change. There are two indicators that can shed some light on these two areas: *A/D* and *OBV*.

Accumulation/Distribution (A/D) sums up volume based on the close of the day relative to the high and low of the trading session.

On-balance volume (OBV) sums up volume based on where the close of the trading session compared with the close of the previous session.
In each case, a positive amount is added to the summation of the previous session's volume if price goes up, and a negative amount if price goes down. Both indicators increase in value when more and more buyers are buying.

By using these two indicators, you can get a handle on resistance and support areas, and where price is likely to go.

If a tradable is trading in a range bound by resistance and support – in a relatively narrow price range - and price action has failed to violate either area, keep your eye on these two indicators. It could just be that traders are buying more than they are selling – i.e., accumulating. They obviously don't think the tradable is going down. They believe that it is headed up.

Conversely, if the tradable is range-bound, and these two indicators are trending down, this is indicative of traders dumping the tradable.

Although these two indicators are related, its good practice to use them together as a check and balance against each other.

A/D and OBV are momentum indicators. The most reliable use of such an indicator is as *momentum trend.* This addresses whether momentum is increasing or decreasing, and can be seen in the respective values rising or falling. Where you see both A/D and OBV falling, this means that sellers are dominating the buyers.

As you can tell, OBV and A/D are good indicators to anticipate a price drop or rise.

To guard against a situation where OBV is trending up, while price is range-bound , and price goes below support, you are advised to use both A/D and OBV to confirm what's going on. You want to see both indicators trending in the same direction.

Let's suppose one of the indicators is trending, and the other is not (i.e., it's flat). You can still take a position – but not with as much certainty as you would if both were trending in the same direction. Should the two disagree – OBV trending in one direction, and A/D in the opposite direction – avoid the trade. One could be right, but it's just a guess.

Other important concepts: Previous resistance levels become support levels and vice versa. Areas of resistance and support act to support or resist further price changes at different times. Also, volume is crucial in determining what direction price will take when it breaks out of resistance and support levels.

To conclude, a resistance level and a support level are levels at which the price of a tradable hesitates to go further, or fall below respectively. After repeated attempts, the price will make its move either way – or not at all.

Price breaks out of the resistance/support area when the number of repeated attempts to overcome resistance is greater than the number of attempts to break support (or vice versa), or buyers simply outnumber sellers or sellers outnumber buyers. But, this rule isn't hard and fast. To get a better understanding of what's going on, using OBV and A/D will give you the edge you need to anticipate the possibility of price making its move through resistance or support, and the subsequent role reversal of the respective level.

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