Module 1 – Chapter 7 – Support & Resistance

Support and resistance are two fundamental concepts in technical analysis that are used to identify key levels in the price of a security or asset. Understanding these concepts can help traders make more informed decisions about when to buy and sell, as well as identify potential entry and exit points for trades. In this lesson, we'll explore what support and resistance are, how they work, and how they can be used in trading.

Support

Support is a price level where buying pressure is strong enough to prevent the price from falling further. In other words, it is a level where the demand for the asset is greater than the supply. When the price of an asset approaches a support level, traders often expect it to bounce back up, as buyers enter the market to take advantage of the lower price. For example, imagine that a stock has been trading in a range between Rs.500 and Rs. 600 for several weeks. If the price of the stock falls to Rs.550 and then bounces back up, Rs.550 can be considered a support level. Traders may use this level as a buying opportunity, assuming that the price will continue to rise from this point.

Resistance

Resistance is the opposite of support. It is a price level where selling pressure is strong enough to prevent the price from rising further. In other words, it is a level where the supply of the asset is greater than the demand. When the price of an asset approaches a resistance level, traders often expect it to fall back down, as sellers enter the market to take advantage of the higher price.

For example, imagine that the same stock mentioned above is now trading in a range between Rs. 600 and Rs. 700. If the price of the stock rises to Rs. 650 and then falls back down, Rs. 650 can be considered a resistance level. Traders may use this level as a selling opportunity, assuming that the price will continue to fall from this point.

How to identify support and resistance:

Support and resistance levels can be identified using a variety of technical analysis tools, such as trend lines, moving averages, and Fibonacci retracements. Some traders also use chart patterns, such as double bottoms and head and shoulders, to identify support and resistance levels.

When identifying support and resistance levels, it is important to look for areas where the price has reversed direction multiple times in the past. The more times the price has bounced off a particular level, the stronger that level is likely to be.

Using support and resistance in trading:

Support and resistance levels can be used in a variety of trading strategies. One common strategy is to buy an asset when it reaches a support level and sell it when it reaches a resistance level. This is known as range trading, and it can be an effective strategy in markets that are trading in a range.

Another strategy is to look for breakouts of support or resistance levels. A breakout occurs when the price of an asset moves above a resistance level or below a support level, indicating a potential trend reversal. Traders may use breakouts as a signal to enter a trade in the direction of the breakout.

It is important to note that support and resistance levels are not always precise. The price of an asset may break through a support or resistance level, or it may temporarily pierce a level before reversing course. Therefore, it is important to use other technical indicators and risk management strategies in conjunction with support and resistance analysis.