

SUPPORT AND RESISTANCE

You *should* buy “low” and sell “high”

- Add imperfect information and emotions and often the *opposite* occurs

Stocks often trade within ranges:

- Lower end: **SUPPORT** – a price where the stock is viewed as being a “bargain.” When price hits this level, buyers jump in (buying pressure (demand) exceeds selling pressure (supply)), and price *rises*
- Higher end: **RESISTANCE** – a high price where the stock is viewed as being overpriced and its price likely to fall. Here, sellers jump in (selling pressure (supply) exceeds buying pressure (demand)), and price *falls*
- Ideally, you should buy at or close to support. When you add emotions, and people often buy close to resistance (they falsely assume the price will keep going up)
- Ideally, you should sell at or close to resistance. Often people do the opposite

Actual graph of Wal-Mart’s stock (WMT)



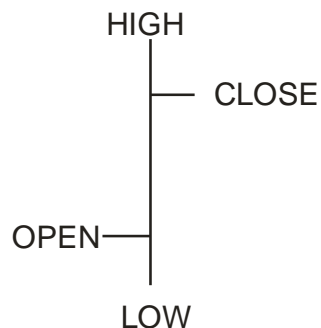
Resistance – at \$57.70
Support – around \$52

RULES:

1. **NEVER** buy a stock when it is close to resistance (unless you have some relevant information on it)
2. **NEVER** sell a stock at close to the support price (unless you have some information to justify this)
3. **Your reward-risk ratio should be about 3 to 1 or better.** Above, in November (at \$56.50) the potential reward was \$1/share, the risk was \$4/share. **YOU SHOULD WAIT** until the stock breaks through prior resistance before buying it.

A Preferred Way to Determine Support/Resistance

Don't restrict yourself only to closing price each time period (ex: day), but to open, high, low, and close – use OHLC bars



SUPPORT: Use **LOWS** – a support line should lie below (at the bottom) of the price bars, connecting *at least two* **LOWS**

- **UPTREND** – **higher lows and higher highs** – connect *lows*

Uptrend in GOLD



RESISTANCE: Use **HIGHS** – a resistance line should be above (at the high points) of the price bars, connecting *at least two* **HIGHS**

- **DOWNTREND** – **lower highs and lower lows** – connect *highs*

Downtrend in Commodities (represented by the CRB Index)



COMBINING SUPPORT AND RESISTANCE WILL OFTEN PRODUCE TRIANGLES

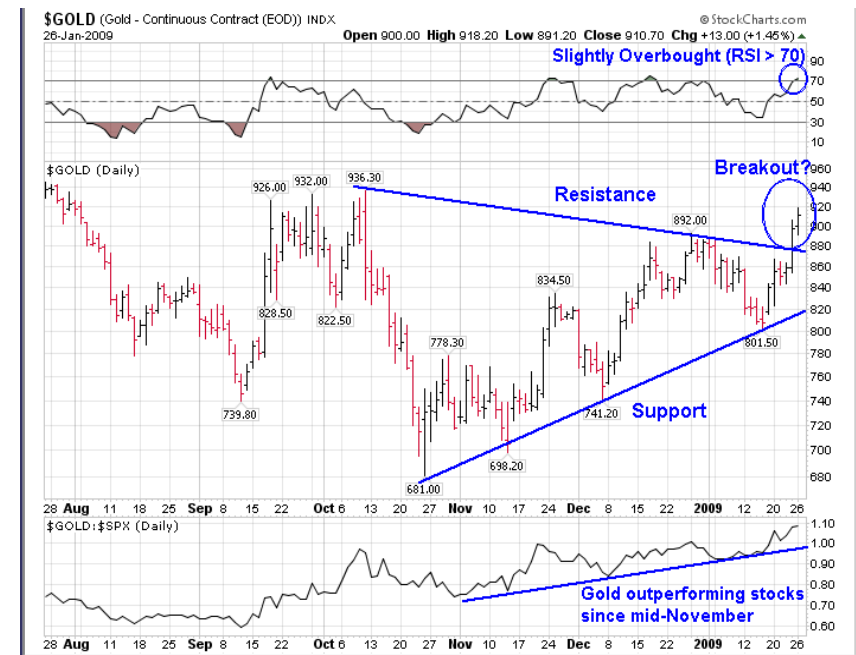


Triangles suggest an eventual breakout (higher) or breakdown (lower). Above, GOLD had a breakout (higher).

-Breakouts (such as this) and breakdowns provide critical *real-time* economic information.

-In this case, look for markets with breakdowns and *ascertain the intermarket implications*

Extending the above: Include the RSI(9) and Relative Strength Indicators



Relative Strength (below) has been rising since mid-November, showing that over that period GOLD outperformed stocks (here the S&P 500)

As Gold has broken out, the **RSI** has moved into slightly overbought territory (above 70), suggesting the possibility of a short-term pull back soon.

So, find the next level of resistance.

- Either use moving averages or a recent high. Using a recent high, resistance is just below \$940.
- Given that GOLD is now overbought, it is very likely that resistance near \$940 will hold for the short-term



How can we determine more systematically whether resistance will hold?

-Use economic theory and intermarket analysis.

Identify the factors that are behind the price of gold and predict what those factors will do in the short term.