Trend lines, resistance and supports

In this article we will discuss about a widespread, well-known key element of technical analysis. Why do you think technical analysis especially some elements work so well for financial markets? Why do you think Fibonacci levels are usually strictly followed? Because thousands and billions of traders and computer programs for trading use these elements. This way everybody acts the same at the same time…

This is why we decided to present in the category of technical analysis, the most used and well-known methods of predicting financial evolution. These methods are easy to understand and are very efficient.

We will present you the trend lines. These lines can be support or resistance of a chart. We will also learn what they are and how can be drawn. We will give some examples of charts of S&P 500 e-mini and Dow and analyze how these charts could have been interpreted and used for a profitable trading day. Finally we will draw the conclusions.

1. What are trend lines?

The trend lines are lines that join two-three or more Lows or Highs of a chart. The price rebounds when intersecting these lines.If we are talking about a support trend line, it joins two or more Lows on the chart.
Each time the price closes the line, it will rebound and go up.A resistance line is just the opposite. It joins the Highs of a chart. When getting to this line, the price rebounds and go down.A trend line can be a straight or a diagonal line.
The straight lines are strong resistance or support lines and show a calm market during a time of accumulation. Diagonal trend lines suggest that we have a positive or negative trending chart depending whether it is an upsloping or a downsloping line .

2. How can we draw trend lines?

Usually these lines join together the extreme Highs or Lows on a chart. The price must never intersect these lines! If a trend line is crossed it looses its significance and the price will go beyond it.

If the price crossed a resistance trend line, it will go up an important amount. After the price will reach a High, it will decrease until it meets the former resistance line that now became a support line. The price will rebound a couple of times at this line until, again, will break it.

It is the same with support trend lines.

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It is pretty easy to apply these information in trading. A price that rebounds on a resistance line will determine the trader to go short with a stop loss set above the resistance line. When the price rebound a support line the trader will go long and set a stop loss under the line.

If the price will break these trend lines, the trader has to adapt to the new trend and initiate a transaction accordingly, setting a stop loss on the other side of the broken trend line.

Let us study some examples:

1. The chart shows the time period between 2000 and 2001 for the American indices. In this case the trend is one of accumulation, neutral.
   After a period of positive trend, the price breaks through the support trend line, the market goes down until a new support line is formed and up to a new resistance line. From this point forward, for nearly two years, Dow's evolution was between these trend lines. When the price meets the support line there is a reason to buy, and when it meats the resistance line, to sell…Pretty clear,right?

2. This is a chart for American indices between 2002 and 2003. Following a “Head and Shoulders” pattern, the price breaks the support trend line and forms and ascending slope. The trend will now have a new support and resistance line to show the trader when to buy and when to sell. After three rebounds from the support trend line, the price goes up again and forms an upsloping trend that will last for more than a year.

3. In this example we have a series of minitrends forming a ladder. The price goes up and then down. After the support trend line is broken we should initiate selling positions. After the resistance trend line is broken, we should initiate buying positions.

<u>Conclusions</u>

1. You can observe how useful these trend lines are. The support and resistance trendlines are key elements in analyzing a trend and provide useful information regarding the best time and way of making a transaction.
2. Trading methods based only on trend lines analysis can be found and can work very well. These methods can be harmoniously correlated with other methods of financial analysis resulting in a complete and comlex trading system approaching financial reality.
3. We often use these trend lines amongst other various methods of analysis we will describe later.

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