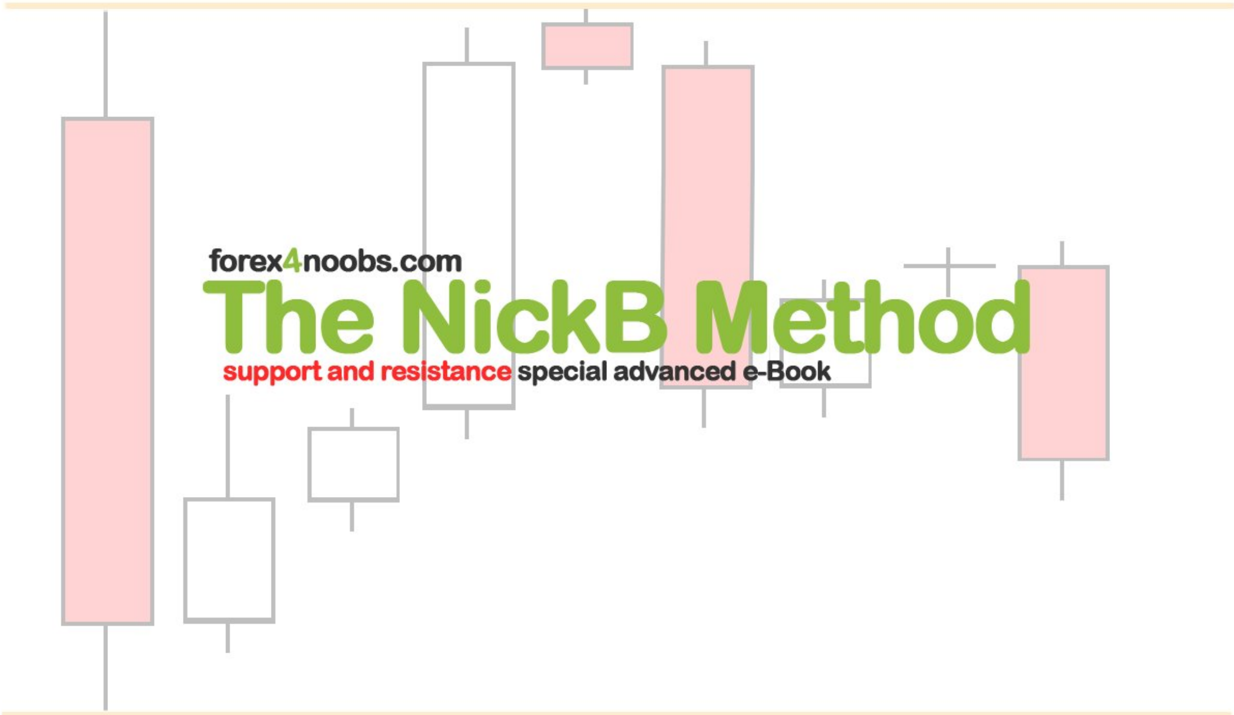

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The NickB Method

support and resistance special advanced e-Book

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Advanced S+R Lines Trading

If you have been on Forex4Noobs, and have gone through my free e-Book, you probably have a good idea what support and resistance lines (s+r lines) are and how to use them. To be honest, I have only scratched the surface when it comes to s+r lines, their many uses, and what they can do for you. In this article, I want to explain what s+r lines are, why you should use them and advanced ways to use them.

What are S+R Lines?

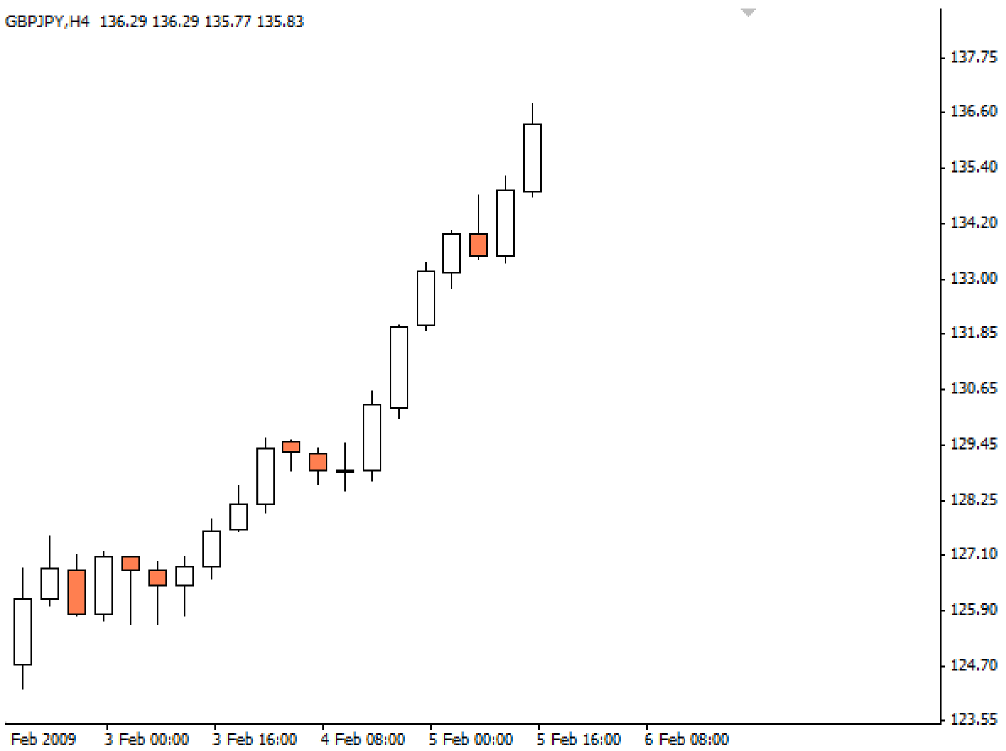
How They Form

Let's start with what they aren't.

They are not magical lines created by a wizard that magically hold the price back.

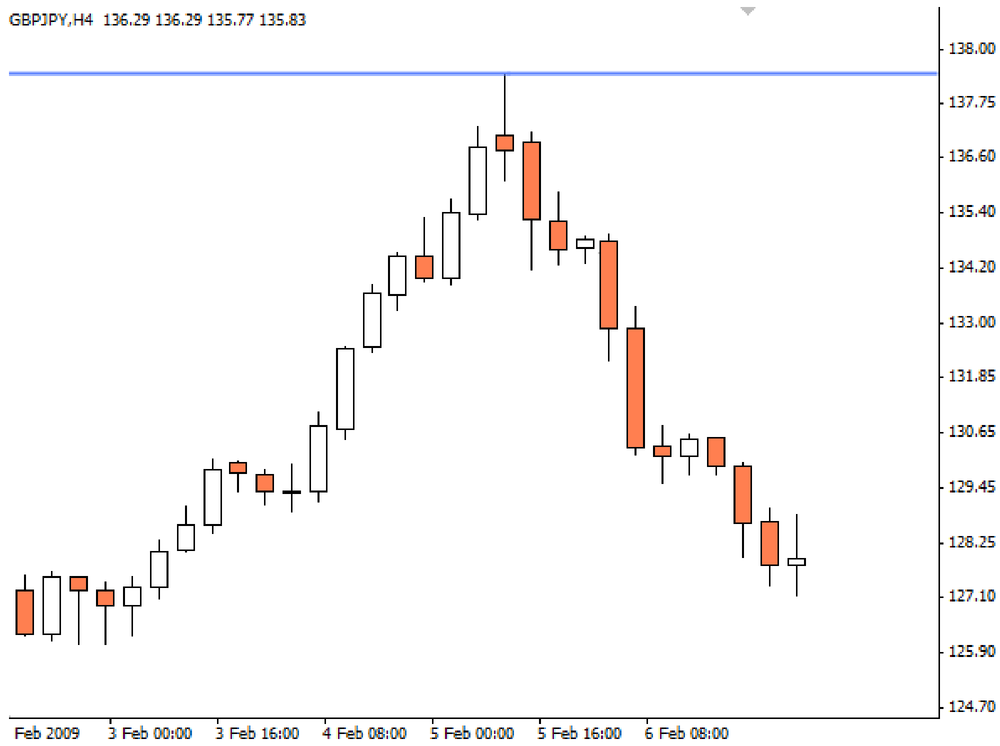
I know that sounds dumb but for some reason traders seem to think s+r lines are magical barriers. A s+r line is a temporary barrier formed by price. More accurately a s+r line is formed by traders moving the price when they buy or sell.

Imagine this scenario:
1. GBP/JPY is trending on the 4hr chart. In the past two days, it has moved in a bullish direction with barley a reversal. It has broken through several s+r lines.



2. All of a sudden, for whatever reason, the bulls become exhausted. I say for whatever reason because there could be many reasons. It could be economic data, profit taking or literally hundreds

of other events. Why the trend ends is not important. What is important is that it ends and the point at which it ends. When the trend ends it reverses and moves down quite a bit.

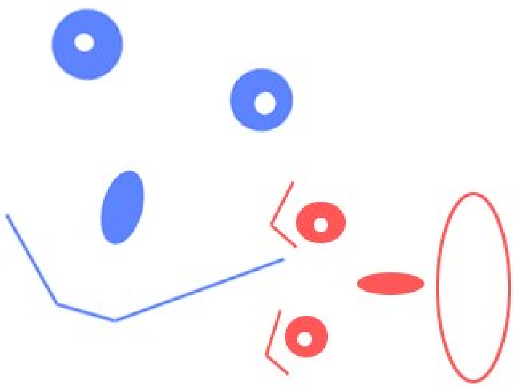


3. Now that point at which it reversed from became a s+r line...... but why?

Why it's a Line

This is my favourite part. It is a line because I think it's a line; me and the other thousands of traders out there. Humans search out patterns in everything.

Here is a perfect example:



What do you see? Faces right?

All that's there is a series of circles, lines and ovals. However, your brain is telling you there is a face there. That is because our brains subconsciously look for patterns. Before you close this and say "this guy is nuts" let's get back to trading.

The line exists because we think it does. The next time the price approaches that line traders think 'last time it was here it reversed at exactly that point, so it will probably do that again this time'.

When a trader looks at a chart they are always looking for places to enter a trade. They tend to gravitate to areas which have previously rejected the price. It is really that simple. The line exists because we think it does and, at the end of the day, the market is driven by traders. However, because the market is driven by traders it cannot be exact.

Are S+R lines exact?

This is the part most people do not understand. S+R lines are not exact, they cannot be. There are times when the price will turn away 20 pips before it reaches an S+R line. This is simply because there are so many traders out there anticipating some sort of reaction at the line. They believe it is a strong barrier, because of the reasons stated above, and they start placing trades based on that belief.

This also means that the price can sometimes break through the line slightly, but because traders still see it as a barrier the line can hold. Generally speaking though, when a line is broken traders add positions to keep pushing the price, in the direction of the break.

What is important to understand is that the market is ruled by traders. So there will not be a precise reaction to a situation every single time. It is your job to tap into the collective mind of the market and, using logic, figure out what they are thinking. I know this can seem way out there but all it involves is some logical thinking. Let's take a look at a few general examples, at how simple it is to anticipate what traders will be thinking.

Will This S+R Line Break or Hold?

Before we tackle this subject, you have to understand that this is not an exact science. You can logically analyse the strength of a line, but sometimes your analysis may be wrong. Every trade you take has inherent risk, losses are unavoidable.

There are quite a few factors to consider when anticipating what will happen to an s+r line. I have spoken about these points before in the free e-Book. However, this time I will also explain the link between market psychology and these points.

Line strength

The strength of a line is mainly judged by three factors:

- How many bounces it has had without being clearly broken.

- The power of the moves it rejected.
- What has happens on past breaks.

Think about how these three points would impact the markets mind.

Strong line: If the line has had three very strong bounces, without breaking, and the last time it broke it moved 2,000 pips beyond the line, you can assume traders will think the line is very strong. The price will likely have a lot of trouble breaking the line and when it does break it will likely move quite a bit beyond the line. The psychology here should be simple to understand. Since the line has held back such powerful moves multiple times the markets mind sees it as a powerful level. So their reaction to the break of that level will likely be to take positions, in the direction of that break, to catch some pips. They would see that last time it moved beyond the line by 2,000 pips so they try and catch pips, on what they assume will be the next big move.

Weak line: If the line has only had one minor bounce, and last time it broke it moved a few hundred pips, you can assume traders will think it's a weak line. Weak lines tend not to make for good trades. When it approaches a weak line traders will not pay it much respect, as the line has not been very impressive in the past.

So when you see a line you shouldn't think of it as a magical barrier that will hold the price back, or cause a rally when broken. You should think of it in terms of what the collective mind of the market will think.

Medium line: If the line has had 1-2 significant bounces, without breaking, I would class it as a medium strength line. These lines are my favourite. Usually once they're broken the trade works out because traders see it as a strong level and enter trades based on the break. At the same time, they don't see it as too strong of a level so they are less likely to panic and let it move back.

A strong line can make for a great trade but you should always anticipate that traders could panic. Recently, I have been experimenting with the idea of using bigger stops on strong lines. This protects the trade from a loss due to a temporary reversal. However, at the same time it can equal a greater loss.

At the moment, I am testing several strategies and will update when I find one that works consistently. I do, however, believe it is a good idea to widen stops when trading strong lines. They tend to reverse after the initial break, and then move back beyond the line. Another idea is to enter on the second break of the line. I am opening a forum thread in which we can discuss various strategies for trading strong lines and their pros and cons. Click the link below to visit the thread. If you have any input then feel free to do so.

http://www.forex4noobs.com/forums/showthread.php?p=19335#post19335

Line History

Line history is simple to gauge. All you have to do is scroll back and see if the line has had any significance in the past. I do not mean some obscure bounces from the line two years ago. I mean consistent support and resistance at the line. I would look for four or more bounces from the line within 12 months. However, there are times when a line only has one or two bounce, but they are extremely strong bounces. I mean the price bounced 1000+ pips away from the line. If I see a bounce like that I consider it historically significant too.

When traders see that a line has held well in the past they assume it will hold well in future. So when I see a historically significant line I assume that a break of the line will make for a better trade, than a line with no historical significance.

Recent Breaks

I have discussed this one before, so I will keep this short. As I explained above, each line has a grade of strength. The more a line is broken the weaker it gets. Traders see a line as strong because it has had several strong bounces. If instead a line is consistently broken it loses its strength. This is because traders stop seeing it as a significant support and resistance level.

So if a line has had more than two breaks in the past few weeks, I do not consider it a significant line. If, however, the price bounces away from the line again, I consider the line reactivated.

In the case of scalp lines, pervious passes through the scalp line area before the scalp formed do not count. Scalp lines form from the reversal points of recent price action, so past price action plays no significance.

Each Line Is Unique

As you can now see, when I look for a line break I take several things into consideration. I do not look at the line as a magical barrier that will cause a major movement when broken. I look at the line, judge its strength and I only trade it if I think it will work. Each line is unique and needs to be judged based on its own merits.

To trade support and resistance lines you have to understand how and why they work. You can't just jump into the trade blindly.