

Using Support and Resistance Levels

A guide to determining approximate reversal levels

Support and resistance is a tool which is often used but quite often the source of the support and resistance levels are not often completely obvious. There are several ways to derive these levels:

1. Previous support remains supportive until broken and vice versa
2. Previous support becomes resistance and vice versa in pivot levels
3. Fibonacci derived support and resistance either by retracement or projections

The third method is the most accurate but the process of learning how to calculate these using the right levels requires a large degree of experience and skill using Elliott Wave. I shall therefore concentrate on the first two in this article.

In the image above the upper chart is of daily Dollar-Yen while the lower is the weekly chart.

Now the first thing to remember is that trends are developed when (in an uptrend) highs are moving higher and lows are moving higher. In a downtrend the lows are moving lower while the highs are also moving lower.

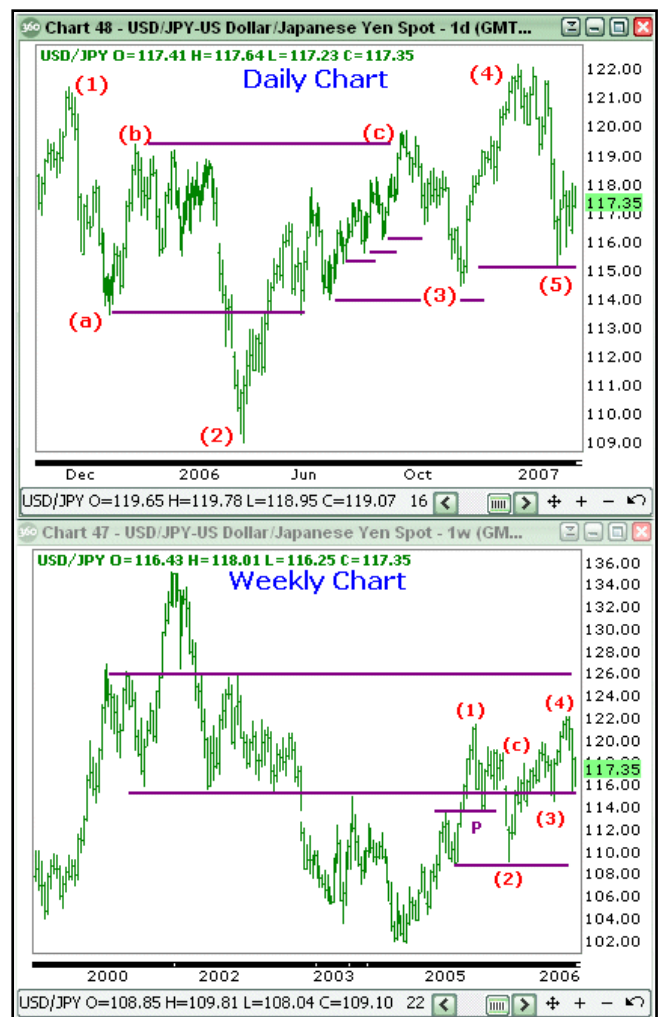
Thus when in an uptrend the most recent low is broken we need to decide where price might finally make a corrective low.

For example, we can see in the daily chart that price rallies to the 121.38 high at point (1). It then reverses, breaking below previous lows in the uptrend. So now we know the uptrend is reversed but where will the decline reach?

In the weekly chart we can see two prior lows around 115.50 which also provided resistance in an earlier correction. It is this pivot area where the first decline to point (a) completes. The correction to point (b) can often be measured by Fibonacci retracements and in the case it was 76.4%.

The next decline in the daily chart to point (2) reaches 108.96. This is just 26 points above the last major low at 108.70 before the rally to 121.38. It is very frequent that the first retracement will move to the most recent major low (after a rally) or the most recent high (in a decline). A horizontal line has been marked on the weekly chart to show this support area.

Now that we have identified the approximate area of the low and we see a recovery we can begin to look at where this may reach. We should remember the pivot area around 115.50 although while it did see a reaction for a few days price quickly broke through and we then need to look for the next resistance.



Here is a little tip that can be useful. Where you see a very distinctive 3-leg move as we did from the 121.38 high down to 108.96, the retracement will quite often move to the extreme of the middle correction – in this case at point (b). The high was at 119.38 and the rally to Point (c) ended at 119.87 – just 50 points above. From the 119.87 peak we can see how price then declined and penetrated the series of supporting lows so we then look at the 115.50 pivot area again but since this didn't hold too well on the way up we can begin to look at the series of lows that spread across from the 113.41 low at Point (a) and the last major low which was at 113.95. We should expect the correction lower to find a correction close to the 113.41-95 area. In the end the correction ended at 114.42 at Point (3).

The next rally then moves up to retest and break the 121.38 high at Point (4). We may have been tempted to call price higher then but the break below the corrective lows signaled a reversal lower which has been declining back towards the 113.41-114.41 lows and still may just get there.

Of course, using support and resistance areas in this way is an approximation and it should not be expected to find accurate or final support or resistance levels but can be useful in determining the basic direction. Certainly as price approaches these levels you should always be looking at the lower time-frame chart to spot reversal patterns or breaks of short time-frame trend lines and also of the most recent lows/highs that would indicate a reversal.

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