

Lines of trends, support and resistance

The trendline. A trendline is a main initial element for the price chart analysis. While the market moves in any direction not along a straight line but along a zigzag, the mutual placement of upper and bottom points of those zigzags permits to plot a line connecting the significant highs (peaks) or the significant lows (troughs) of an appropriate zigzag using technical tools of the computer program.

To draw a trendline only two points are necessary and the third one is the contact point confirmation. On a bullish trend chart it should be drawn using troughs, on a bearish •• using peaks. The trendline and a line which is about parallel to it and drawn on the opposite side (through peaks on a bullish trend and through troughs on a bearish) form the trade channel. Both lines are then channel's borders.

Lines of support and resistance. The upper and the bottom borders of trade channels are called accordingly support and resistance lines. The peaks represent the price levels at which the selling pressure exceeds the buying pressure. They are known as resistance levels. The troughs, on the other hand, represent the levels at which the selling pressure succumbs to the buying pressure. They are called support levels. In an uptrend, the consecutive support and resistance levels must exceed each other respectively. The reverse is true in a downtrend. Although minor exceptions are acceptable, these failures should be considered as warning signals for trend changing.

The significance of trends is a function of time and volume. The longer the prices bounce off the support and resistance levels, the more significant the trend becomes. Trading volume is also very important, especially at the critical support and resistance levels. When the currency bounces off these levels under heavy volume, the significance of the trend increases.

The importance of support and resistance levels goes beyond their original functions. If these levels are convincingly penetrated, they tend to turn into just the opposite. A firm support level, once it is penetrated on heavy volume, will likely turn into a strong resistance level. Conversely, a strong resistance turns into a firm support after being penetrated. In general, to evaluate the reliability (that is the possibility of a break) of the trade channel borders taking a decision to close or to save an existing position one should govern himself with following rules:

1. A channel is the more reliable the longer it exists. Hence, the solidity of very old channels (e.g. existing more than 1 year) decreased sharply.
2. A channel is the more reliable the more is his width.
3. The resistance may be broken if it is bounced on the background of a growing volume.
4. A steep channel is less reliable in compare to a gentle one.
5. The support may be broken independent on the volume.

About the Author

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