

>: The New Market, New Support Levels, New Resistance Levels

Tuesday, March 24, 2009 / Chris Rowe

Today I'm going to bless you with analysis I save for members of my options trading service, "The Trend Rider", regularly.

Every Tuesday in my *Tycoon Report* articles, I had been beating the bearish drum [\(since early January\)](#) until last week when I told you that odds favor a continued intermediate advance. I'm sure you saw yesterday's 7% rally, which was the 4th largest single day rally in history, as the Obama administration unveiled its toxic asset plan.

So what's next?

The question everyone is asking is whether or not we've seen a bottom yet.

The answer that everyone is giving (myself included) is that "typically" in a bear market bottom, we see capitulation. We see a huge sell off, and nobody is asking about a bottom. Instead everyone is talking like it will just go much lower. To top it off, chartists know it's extremely likely that the market will test the low it recently made - a low that is below that of the bear market of 2002-2003. That fact, alone, makes it likely that we will retest the recent bottom and even go lower.

That's the question and the common answers to it. The answers are true, but the fact to remember is that, just because something is typical, or happens most of the time, doesn't mean it has to happen that way this time. Just keep that in mind but always continue to play the odds. Odds are, everything the chartists say (above) is absolutely true, so we have to play the market as if the bottom will look that way.

Luckily for us, we aren't concerned about whether we have seen the bear market bottom or not, because we change our stance based on the intermediate trend (weeks to months). One of the most important parts of a chart to focus on is the resistance and support levels. Let's talk about them, because when you identify them you have a better understanding of where the market is more likely to pause, and why certain market achievements are very significant, and raise the odds of higher or lower prices.

First let's study yesterday's action.

For the last 4 or 5 months, savvy investors have been focusing on two major levels on the S&P 500: 752 and 800. And when most savvy investors are looking at the same price levels for resistance, they all get excited and more confident when those levels are penetrated. Another thing they look at is the degree of strength the market had when those levels were penetrated.

Hold that thought.

How do we know 752 and 800 were potential resistance levels? Because of an important rule that you MUST add to your arsenal if you haven't already: Old support becomes new resistance.

The two red lines below show the 752 and 800 level on the S&P 500. The November low is where we find the 752 level because that's where the market closed at the low. We draw a horizontal line from that point on. You can see, in late February, when the market was in a steady decline, it hesitated for 4 or 5 days at that 752 level before moving lower. That was largely because savvy investors knew that was the possible support level the market might bounce off of. The fact that it broke that level was very significant, because it was the market's last hope in the eyes of many before another "leg" down.



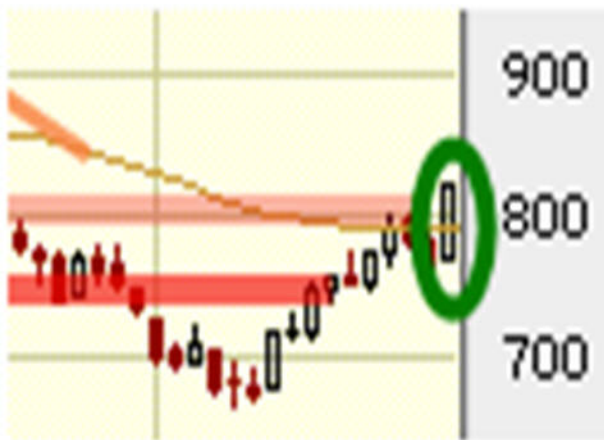
(November) becomes new resistance. But as you can see, the market found no resistance at 752. That gave traders lots of confidence. It showed that although people suspected they would see selling pressure at 752, it wasn't there. Instead, traders kept buying.

Once a potential resistance level is penetrated, traders look to the next potential resistance level, which would be where resistance had been found in the past, at another old support level or at a major moving average that has proven to act as resistance. When we look for these, we find two out of three.

We connect the matching support level found on the first trading day in December and in mid January. (Notice, since traders realized that was a key level, after the level was violated in mid February, the market seemed to give up hope and move lower.) Since 800 was obviously an important level, that's where we look for more resistance as the market started to advance again. (See upper red horizontal line above). Let's look at the moving averages...

The two most commonly used moving averages are the 50-day exponential moving average and the 200-day moving average. As you can see above, the 50-day exponential moving average acted as resistance in early January, late January, and early February. If you look at a longer term chart, you'll see resistance numerous times at the 50-day exponential moving average.

Yesterday, not only was that horizontal resistance penetrated, but the 50-day EMA was penetrated. But the true story is told by the manner in which they were both penetrated. It happened with *astrong* up day. The next chart shows a strong white candlestick (up day). It's considered strong for two reasons: Because it's a very large gain and because the market opened at its low and closed at its high. It didn't first decline and then move up. It just charged higher all day. That's HUGE for the bulls. So potential resistance wasn't just p



The next thing savvy investors want to know is how any other points of resistance, if any, converged. And this is important, because if there was more than one reason that the market would have likely found resistance at the same level, that's all the more odds the market had against it, and since it was penetrated, that's all the



t's zoom in to a 3-month chart.

We have been talking about horizontal resistance levels. But there was also a down trend line that we found by connecting two recent highs in early January and early February. Since this down trend line converged with the horizontal resistance, chartists knew that JUST BASED ON THE CHART OF THE MARKET (and no other indicator), the odds favored a decline once the 800 level was reached. All the more reason to take this

feat seriously.

STOP HERE FOR A SEC. Notice I said "just based on the chart of the market" odds favored a reversal lower after hitting 800. That was assuming we only had this chart to work with. But I told you last week that odds favored an advance, and I knew this by focusing on the important internal indicators. I said: "We're looking at a market that, on one hand, is running into resistance in many ways (which is why bears will say "stay bearish"), and on the other hand, has major implications of demand taking control". If you read the article, you'll see I was telling you to exit bearish trades and get bullish if you're aggressive (by [clicking here](#)).

The point is that we have to understand the importance of support and resistance while understanding the importance of looking at many different important market indicators. It's the difference between what most technicians were saying recently (look for a reversal lower) and what I have been saying. Let's move on...

Okay, now we know the reasons why yesterday was so important. There are others (such as advancers on the NYSE beating decliners by 35-1) but let's talk about what to look for next. Where is the next potential resistance level? Where is the new support level?

What's the rule we are supposed to remember?

Old support becomes new resistance.

Well, it works both ways. Old resistance becomes new potential support. So the 800 level that savvy traders were focused on as resistance will be viewed as likely support. So expect the market to rebound off of that level. This coincides with the fact that 800 had acted as support 2 or 3 times in the past. But if that level is violated, look to 752 as potential support (which has proven to be weak as we broke right through it previously) and if 752 is violated, look at the latest low of 666.79 for support. But guess what: if, as and when that happens, you'll hear people talk about that number 666.79 as a bad luck number - mark my words. And it will likely break (not for that reason). We'll cross that bridge when we get to it and I'll update you.

What about the next potential resistance?

I thought you'd never ask.

The chart below is a "logarithmic" chart (a chart for which the price scale - usually on the vertical axis - is skewed so that a given distance always represents the same percentage change in price, rather than the same absolute change in price). And I don't know how much you'll hear about this down trend line on the financial stations or publications, but this is something savvy traders will focus on. Following the down trend line we get by connecting the early November top to the early January top will show you where there is a resistance level. That might even coincide with a horizontal resistance level at the time but since the down trend line slants diagonally, the price level changes over time to it's hard to tell today if that will happen.



The importance of understanding support and resistance levels can't be overstated. This goes for individual stocks, sector ETFs and even commodities and currencies. Sometimes (as you'll probably see in the comments section on this article) support and resistance levels can be subjective. That's okay. Just know that there are the levels that can be debated (which tend to be a bit less relevant) and those that everyone agrees

on like proven support and resistance levels and moving averages (which tend to be more relevant, especially when several converge).

If you are having trouble with it, don't sweat it. Keep reading *The Tycoon Report* and I'll keep showing you these tricks and offering clarity. For recommendations of exactly how to take advantage, check me out at [The Trend Rider](#)

Until next Tuesday.

?Profit from the Trend?

A handwritten signature in black ink that reads "Chris Rowe". The signature is written in a cursive, slightly slanted style.

Chris Rowe

Chief Investment Officer

[>](#)