

Supply & Demand, and Support & Resistance

Dow Theory Tenet 2: The Market Has Three Trends

The market moves in three distinct types of trend, each operating on a different timeframe. Understanding which trend you're looking at is critical — your timeframe must match your investment/trading goals.

Primary Trend (The Tide)

- The most significant and long-term trend — lasts **months to years**
- Most reliable for investment decisions because it's **less prone to manipulation**
- Two types: bull market (upward) and bear market (downward)
- Like the tides of the ocean — shows the long-term direction
- The primary trend **cannot be stopped** by any macro event. Wars, depressions, pandemics, financial crises — on the S&P 500's 100-year chart, they're all just blips on a trend that keeps going up
- If you're investing long-term (years), you should be looking at the **3-monthly (quarterly) timeframe or above**

Secondary Trend (The Waves)

- Temporary movement in the **opposite direction** to the primary trend
- Lasts **several weeks to several months** (the example shown was ~7-8 months)
- Retraces approximately **1/3 to 2/3 (or half to two-thirds)** of the primary trend's movement
- The "zag" in the zig-zag — if the primary trend is the zig (direction), the secondary trend is the zag (correction)
- **Two types of corrections:** sharp (fast V-shaped drops) or sideways (extended horizontal movements). Both are secondary corrections

- **Key rule:** The primary trend resumes when price surpasses the highest/lowest point of the secondary action. If it can't get back above that point and breaks the secondary low on increasing volume, it may signal a new primary bear trend rather than just a correction
- The 50% retracement level is emphasised by Dow Theory as particularly significant

Minor Trend (The Ripples)

- The shortest trend — lasts **days to weeks**
- Daily market fluctuations — compared to ripples on waves (can't predict which way they'll go)
- **Erratic, can be manipulated, and is largely noise**
- The only thing worth paying attention to within minor trends are **horizontal lines on daily charts** (support and resistance) — which is what this week covers
- Dow considered everything below the daily to be manipulated noise

How They Interact

The zig is the primary trend direction. The zag is the secondary correction. Within both, the minor trend creates the day-to-day ripples. When investing, you care about the primary. When trading, you're navigating the secondary and minor within the context of the primary.

Support & Resistance — Psychology

Support and resistance are fundamental concepts tied to the principles of supply and demand. They represent the battlegrounds where supply and demand forces collide.

Psychological Impact

Support	Resistance
Price points where buyers typically step in, perceiving the asset as undervalued	Psychological barriers where sellers see the asset as overvalued
Traders associate these levels with safety nets, triggering buying pressure	Leads to increased selling pressure — hesitation, shorting, or profit-taking

Breakouts and Failures

When support or resistance levels are breached, they signal shifts in sentiment — either stronger conviction (breakout) or panic selling (breakdown), leading to rapid price changes. Recognising these psychological shifts helps anticipate market moves.

Supply & Demand

Financial markets work exactly the same as any marketplace — it's all supply and demand. Think of it like a flea market, or bartering in Bali. Prices move based on the balance between willing buyers and willing sellers.

Key principle: For every buyer, there is a seller. For every seller, there is a buyer. It doesn't just magically go somewhere — when you're selling, someone else is buying because they think it's a good deal.

Demand Zones

- Areas where a large volume of buy orders accumulate
- Signal strong belief in potential price increases
- When price reaches a demand zone, it tends to stop falling because there are many buyers looking to purchase
- Think: only 2 Ferraris for sale at \$100K but 100 people wanting to buy — bidding war pushes price up

Supply Zones

- Areas with concentrated sell orders
- Traders expect prices to decline due to perceived overvaluation
- When price reaches a supply zone, it may stop going up because there are too many sellers trying to get rid of their stuff
- Think: thousands of people trying to sell Ferraris at \$100K — too many options, price can't go higher

Everything Has a Price

Even the worst-performing assets eventually reach a price where someone thinks it's cheap and demand steps in. Examples:

- **AGL:** From \$28 down to \$5 — "it's a dog, it's the worst" — but demand stepped in at \$5 and it recovered to ~\$12
 - **ZIP:** From \$14 down to ~\$0.20 — at some point buyers perceived value, it bounced to ~\$3
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Support (Demand)

Support is a price level where an asset usually stops falling and starts to see more buying. It marks a point where the balance between supply and demand shifts in favour of demand.

Key Concept: Support is a ZONE, Not a Line

Never draw support as a single line — it doesn't work. Support is always a zone (a range) where historical buying interest has caused price reversals. Buyers don't step in at one exact price — they step in *around* an area.

Example: Buyers might step in at \$208, \$209, \$212, \$214, \$211 — that's all a zone around \$208-\$214, not a precise price point.

Visualising Support

Think of it literally as people standing at different price levels willing to buy:

- \$38: one person → weak support
- \$33-\$34: two people → bit of a demand zone
- \$30: one more person → some support
- If \$30 breaks, nobody until \$24-\$25 → price will fall quickly to the next cluster of buyers
- Below that, nobody until \$9-\$10 → another rapid drop

The gaps between clusters of buyers are where price moves fast — when support breaks, it falls to the next level where people are willing to buy.

How to Draw Support Zones

1. Find your pivot points where buyers have stepped in (swing lows)
2. Look for multiple pivot lows clustered around a similar horizontal area (like "dot to dot")
3. Use the **rectangle tool** in TradingView (5th icon down → click arrow → Rectangle)

4. Draw the rectangle encompassing as many of those candlestick wicks as possible
5. Change the colour to **green** (Settings → Border → green, Background → green, lower transparency so candles are still visible)
6. Add text label "Support" for quick identification

Support Key Points

- Analyse support on **multiple timeframes** — daily, weekly, monthly. Higher timeframe support is more reliable (monthly > weekly > daily > 4H > 1H)
 - Identify **major support** — strong levels that have held over a long period and are respected by many traders
 - Use support levels for determining entry points and setting stop losses
 - If price breaks through support, it can trigger sell-offs as traders' stop losses get hit — price then falls to the next support zone
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Resistance (Supply)

Resistance is a price level where an asset tends to stop rising due to selling pressure. It represents areas of supply where sellers are willing to exit.

Key Concept: Resistance is Also a ZONE

Same as support — resistance is always a zone, not a single line. Sellers step in *around* an area, not at one exact price.

Example: Sellers might step in at \$228, \$230, \$232, \$234 — that's all a zone around \$230, not a precise price.

How to Draw Resistance Zones

1. Find your pivot points where sellers have stepped in (swing highs)
2. Look for multiple pivot highs clustered around a similar horizontal area
3. Use the rectangle tool, encompassing as many candlestick highs/wicks as possible
4. Change colour to **red** (Border → red, Background → red, lower transparency)
5. Add text label "Resistance"

The Battle Between Bulls and Bears

Once you have support (green) and resistance (red) drawn, you can see the battle. Eventually one side wins:

- **Sellers get exhausted → bulls win → breakout upward**
 - **Buyers get exhausted → bears win → breakdown downward**
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Resistance/Support Flip (Role Reversal)

"If you can master this strategy, you can honestly make money on the market." — ASX Trader

A resistance/support flip occurs when a former resistance level becomes a new support level (or vice versa). This is one of the most powerful concepts in technical analysis.

How It Works

1. Price approaches resistance repeatedly — sellers step in each time
2. Eventually, sellers get exhausted — no more sellers left at that price
3. Price breaks through resistance (breakout)
4. Price comes back to test that old resistance level
5. **Those sellers have now become buyers** — old resistance is now support
6. The flip is confirmed

What It Signals (Two Buy Signals)

1. **Sellers are exhausted** — they're no longer stepping in at that price
2. **Sellers have become buyers** — the level that was previously seen as overvalued is now seen as undervalued

The Fake-Out Warning

If price breaks out of resistance but **immediately pops back within the zone**, that's a sign of weakness (fake-out), not a genuine breakout. The opposite also applies — breaking below support and popping straight back in is a sign of strength (this links to the "spring" concept from Week 1).

CBA Example — The Staircase

Commonwealth Bank's entire existence is essentially a series of resistance/support flips — climbing steps:

- \$7 resistance → became support → \$9.90 resistance → became support → and so on
 - Tech bubble bottom support at \$23-\$25 zone → held during GFC (buyers stepped in at the same zone again across 10+ years)
 - GFC top resistance at \$60 → exhausted → broke through → during COVID drop, \$60 became support (people saw it as cheap at \$60 when they previously thought it was overvalued)
 - As long as it keeps climbing steps (flipping resistance to support), it's in an uptrend. If it starts breaking below support floors, each floor becomes the next ceiling on the way down
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Trading Strategies Using Support & Resistance

1. Breakout Strategy

Objective: Profit from significant price movements following a breakout of support or resistance.

- **Buy** when price breaks above resistance (sellers exhausted)
- **Sell/short** when price breaks below support (buyers exhausted)
- **Stop loss:** Just below the pivot low (for longs) or just above the pivot high (for shorts)

2. Pullback/Retest Strategy (Resistance/Support Flip)

Objective: Enter trades when price retraces to a support/resistance level after a breakout.

- Wait for breakout through resistance
- Wait for price to **pull back and test old resistance as new support** (the flip)
- Enter when it bounces off the new support
- **This is probably the best strategy** — it gives the ultimate risk:reward because you get two confirmations: (1) sellers exhausted, (2) sellers become buyers
- Stop loss below the new support zone

3. Range Trading Strategy

Objective: Profit from price fluctuations within a defined sideways range.

- Buy at support, sell at resistance — repeat until the range breaks
- When it breaks out → switch to breakout or pullback strategy
- **ASX Trader's view: "I personally don't touch sideways markets."** He only trades trending markets (bull or bear). Range trading can get messy — price doesn't always bounce cleanly off the boundaries
- **Key insight: People don't lose money in bull or bear markets — they lose money in sideways markets.** They keep trying to go long or short, keep getting stopped out, and lose trade after trade

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