PIVOT LEVELS

Hi Traders,

Last year, after I discovered RJ, I spent few weeks to study Pivot Levels because he continued to tell me that these are very important key levels for a day trader and because I "*need*" to understand what I do or use I tried to figure out why some people made the decision to use the below formulas to calculate every day these levels.

- Central Pivot Point   (DP) = (High + Low + Close) / 3

First level support and resistance:

- First Resistance   (DR1) = (2*P) - Low
- First Support   (DS1) = (2*P) - High

Likewise, the second level of support and resistance is calculated as follows:

- Second Resistance   (DR2) = P + (R1-S1)
- Second Support   (DS2) = P - (R1- S1)

Pivot Points in a Nutshell

Pivot Points are calculated Price Levels that the floor traders, and those who read the tape, like to watch during the trading session. In general, if the day's Price Action starts above the "Pivot", it will tend to stay above the Pivot (also called the "fulcrum" of the day's activity).

On such a day, Resistance will be met at Price Level R1. Should R1 be broken, further Resistance will be expected at R2. The story is all reversed, of course, if the price action is below the Pivot. Support will be met at Price Level S1. Should S1 be broken, further Support will be expected at S2.

If, after starting the day above the Pivot, the Price crosses back through the Pivot, the Pivot will act as a Resistance area. Pivot Points and Levels are Support and Resistance levels, and behave exactly like any historical Support and Resistance level. That's Pivots in a nutshell !

(edit by : http://tradingthingys.com/PitPivotPoints.pdf)

Here you can find also a list of interesting sites where to find the usual things about these levels:

http://www.investopedia.com/articles/forex/05/fxpivots.asp

http://www.babypips.com/school/how-to-calculate-pivot-points.html

http://stockcharts.com/help/doku.php?id=chart_school:technical_indicators:pivot_points

OK, very interesting … but still I don't understand why they work and I verify any day they work; is it just "self-prophecy" (like Fibo levels)? But in this case why these formulas and not another way to determine them?
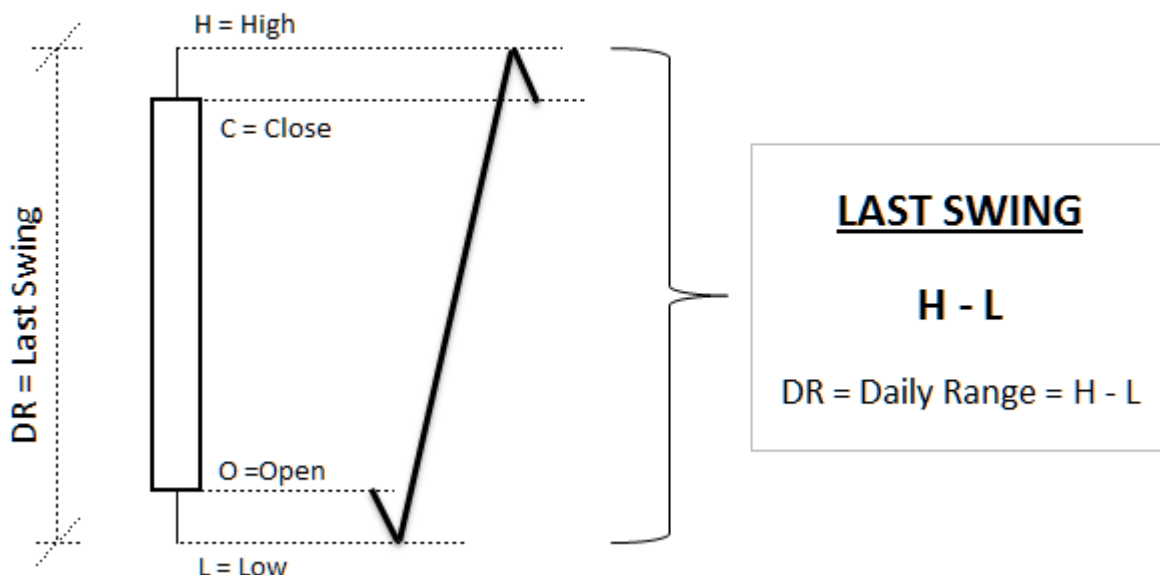
Finally light turn on in my mind thinking about the old guys in the Pit without PC or other sophisticated tools to analyze the market, They knew the Fibonacci levels but they couldn't calculate them easily and quickly without PC .... Hence what to do?

The following ideas are original … you can't find them in the web ;-)

They simply invented a roughly way to estimate the Fibo levels by using just few data:

- Yesterday Low
- Yesterday High
- Yesterday Close

Without getting you bored with math have a look at the below pic …. What is a daily bar? In general we can say that it is simply the last swing (in the pic I drew a long day bullish).

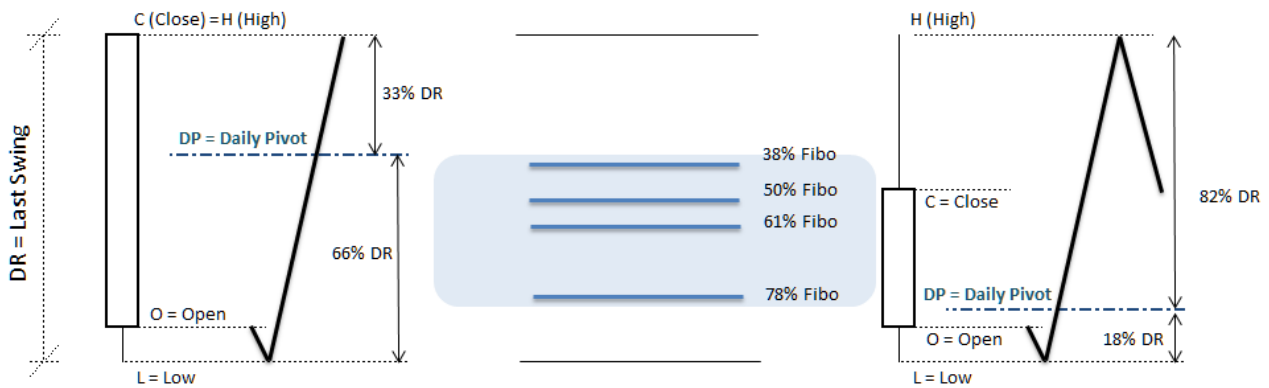Well if we suppose that Close = High and change this in the pivot formulas you get that

DP = Low + 66% DR

While if Close = ½ High = 50% last swing we get

DP = Low + 18%DR

Therefore we can say that DP is a level moving in a range which depends on the close of the previous day whose boundaries are 34% to 80% from High if Close doesn't go below the middle of the swing (Bullish bar)

Do these numbers remember you something ? …. You are right : Fibonacci levels!

C (Close) = H (High)

33% DR

DP = Daily Pivot

66% DR

O = Open

L = Low

DR = Last Swing

38% Fibo
50% Fibo
61% Fibo

78% Fibo

H (High)

82% DR

C = Close

DP = Daily Pivot

O = Open

18% DR

L = Low

Is it helpful to know that? I think yes. Indeed now we can understand better the pivot behavior.

Let me say that if YDAY bar was a long bullish bar we should expect to have DP close to 38% fibo and if today will be another bullish bar this could be a good support. But if the YDAY bar was spin (range daily) the power of fibo & pivot is lower and we could expect some DP breakout …. Does it make sense now?

All the considerations done are the same if we have a bearish bar of course.

AH … I forgot! And pivot S/R? I don't want to get you bored with these topics but if you do the math you will discover that there are also Fibo expansions …. eh eh eh.

Have a great week end

Ciao

Wiz

P.S. only for math fanatics:

If C=H and H=L+DR $\rightarrow$ DP = (2H+L)/3 = (2L+2DR+L)/3 = 3L+2DR=L+2/3DR = Low+66%DR

If C=1/2 DR and H=L+DR $\rightarrow$ DP = [H+2L-1/2(H-L)]/3 = (1/2L+1/2DR+5/2L)/3 = (3L+1/2DR)/3 = L + 1/6DR = Low + 18% DR

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