

Supply and Demand Trading

What is Supply and Demand?

What are the laws of Supply and Demand?

What is Supply and Demand trading?

How do we use Supply and Demand trading in forex and other financial markets?

Supply and Demand is the heart of a market economy [Capitalism]. Since market economy is based on exchange of goods and services for a value, for it to function there has to be some goods and services on offer [supply] and people who are willing and able buy them [demand]. Supply and Demand in textbooks look as two separate things for study purposes but in reality they are strongly interconnected. One cannot exist without the other.

In an ideal open market, prices are defined by supply and demand, creating a base framework for allocating resources in the most efficient way possible. However, in reality this is not always the case. Monopolies and regulators in certain sectors or systems can define prices as they like regardless of buyers. Prices may also be manipulated by speculators unnaturally thus overriding basics laws of supply and demand.

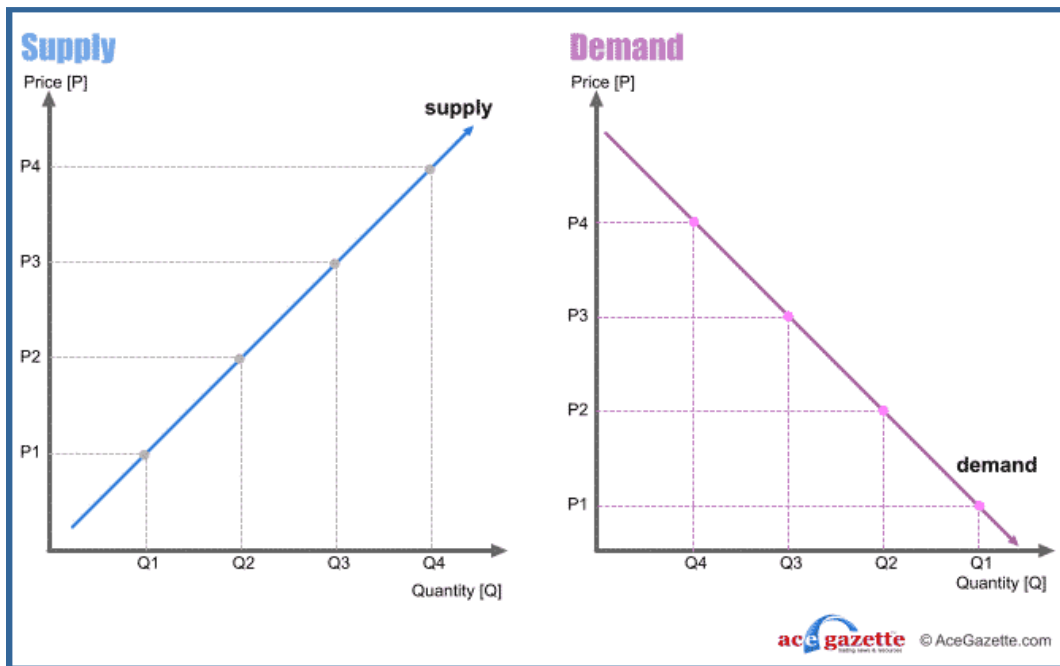


Figure 1

As it can be seen on the above illustrations, suppliers will produce more when prices going up while buyers will increase their demand when prices are going down. A clear conflict of interest supposes to create a healthy and efficient market.

That's in theory, but in reality we know that there are situations when prices are going up but suppliers will not increase their output unless there are healthy competition. Or buyers will not increase their buying even if prices are going down when they don't have a buying power.

The Textbook Law of Supply

1. In order to maximize their profits, suppliers [producers] will be offering more products and services for sale at higher prices.
2. The supply increases as prices increase and decreases as prices decrease.
3. At certain price levels, when there is a good enough profit margin, suppliers will increase their productions without demanding higher prices in order to increase profits.

The Textbook Law of Demand

1. In order to save some money, people will buy more products at lower prices.
2. At a lower price, more people can afford to buy more goods and services more frequently, than they can at a higher price.
3. At lower prices, people tend to buy some goods and services as a substitute for more expensive ones.

Putting Supply and Demand together

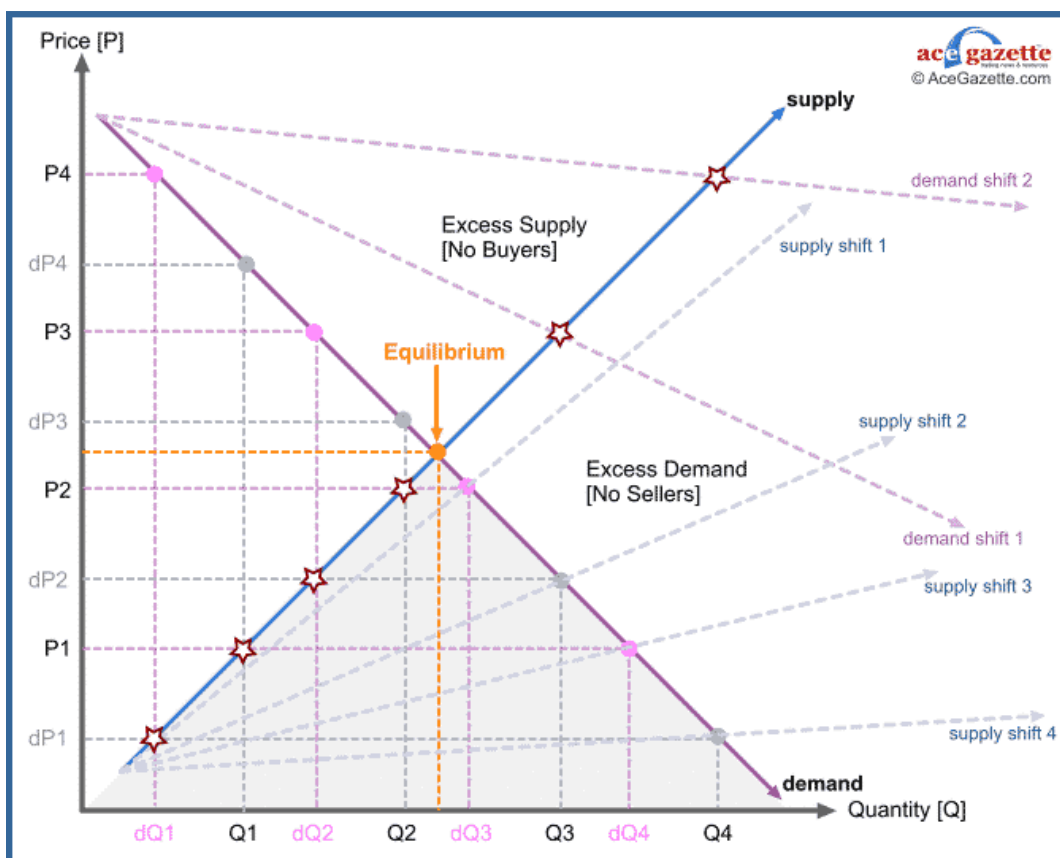


Figure 2

For the purposes of simplicity, Supply and Demand lines are drawn as straight lines. In reality they are curved.

Equilibrium represent the ideal quantity and price match. It's the intersection point where market reached optimum efficiency. For example we have 20 products for sale and 20 people willing to buy. No wastage whatsoever. However, in reality equilibrium cannot be sustained. It's just a temporary point that may be reached from time to time for a brief period. For the life and everything else in this universe to continue we need minus and plus. When all things are equal nothing will happen.

Sellers and buyers need to keep fighting for the price to sell and buy. Sellers will want maximum possible high price while buyers will be looking maximum possible lowest price for the goods and services. Welcome to the markets.

Depending on the economic climate supply and demand curves can move or shift either way, thus altering price and quantity structure.

The above is absolute basics of Supply and Demand in open markets. My intention is to utilize them on ways to apply Supply and Demand in trading rather than detailed study of Supply and Demand itself.

What is Supply and Demand trading?

Trading in financial instruments, whether it's Forex, Futures or Equities takes place in markets. We already know that for markets to function it needs sellers and buyers. Supply and Demand is all about spotting where buyers and sellers are sitting on our trading charts. However, we as retail traders do not have access to current order flow. We cannot spot them within their current position. All we can do is looking back [left of our charts] to history and define previous Supply and Demand zones with the expectation that in those zones will still exist some serious buyers and sellers. Using lagging Supply and Demand information, we are making our trading decision based on historical data, not the current definitive data. We also know that what has happened in the past will not necessarily repeat at present time. We have probabilities to deal with. We use price action chart and candle patterns to improve probabilities in our favor.

There is one important difference between classic Supply and Demand theory and Supply and Demand that applies to traders. While on classic approach suppliers generally stays as suppliers in the process of exchange, however in trading we can not identify certain participants as sellers or buyers. All participants in trading can be buyers or sellers at any one time, even at the same time. Remember, trading means buying and selling. Buyers doesn't turn into sellers and vice versa. They already are both. When applying Supply and Demand in trading keep this in mind.

Foreign-exchange market has many participants in various class and size.



Figure 3

As we can see from the above graph Banksters are firmly in control of Forex. In spite of healthy growth of retailers market share, banksters will remain in control. Even if market share of retailers hit similar levels of banksters, they will still be in control.

- a. Banksters generally acts in sync like one big cartel
- b. Many funds and insurance companies are extensions of banksters
- c. Retailers are extremely fractured and can not act in sync.

According to the graph above, retailers represent 18% of \$4 trillion a day forex market as of 2011. That represents hundreds of billions of dollars up for grab on daily basis. Unfortunately, it's mainly grabbed by banksters.

Our task here clearly is to spot banksters and follow them. Forget about novice trader talk. We don't care who is on the other side of our trade as long as we are at the winning side. I have seen many non-novice so called pro traders and institutions loosing large sums to markets. We don't care about losers, our task is to identify winners and follow them. Remember, we do not anticipate but with guidance of the price we try to participate. That's all. Nothing more, nothing less.

How to identify and draw Supply and Demand zones on a trading chart?

Well, you don't have to. There is an freely available indicator does it for you automatically. Instead of spending time on drawing and updating your zones manually, it may be more beneficial for your trading to watch PA and check out historical price levels.

For those, who like to understand how zones are defined on a trading chart lets try to demystify it.

There are three types of price moves in markets.

1. Going up
2. Going down
3. Going sideways or nowhere [ranging]

There are some fancy terms circulating around to keep you busy for the purpose of expanding learning process for paid mentoring services or some who likes to keep their website busy with useless stuff. My advice is to keep clear of such complications as they are not aimed to improve your trading. Unfortunately many new traders would be get caught in these useless jargons and end up wasting their time.

What the heck are all these DBD-RBR-DBR-RBD?

Apparently they stand for:

DBD means Drop Base Drop

RBR means Rally Base Rally

DBR means Drop Base Rally

RBD means Rally Base Drop

Price drops and rise with flags, pennants and various chart - candlestick patterns or without out them. That's it. Why make things complicated? Keep in mind complicated things bound fail sooner or later.



Chart 1

Here we have a chart without any markings other than ask and bid price lines. Where are supply and demand zones?

Supply and Demand zones indicate price turning areas, where price reaches a point that balance will change in favor of other participants. It's the tipping point where imbalance between buyers and sellers is at peak. When imbalance is at its peak, change in direction is bound to follow.

For instance, when balance is on buyers' side we see price is going up. Simply, there are more buyers than sellers at those prices. However, once the price reaches to certain levels, participants start thinking price become too expensive, they start selling at new highs to maximize their profit. Additionally, certain participants would have exhausted their resources during their buying activity and there will be certain participants waiting on certain levels to sell too, which helps to cement a decent supply zone. Now, we have new sellers entering to the market plus some of those buyers closing their buys and joining in as sellers. Price will be travelling down until it finds the demand [where buying interests supersede selling ones].

So, supply and demand zones don't represent magical decision points as some may be stating, but rather zones representing imbalance at its peak. You can pour so much of water into a glass.

Just like in classical supply and demand theory. Suppliers can increase their prices so much, perhaps until there is not enough people willing to buy their products or services at those prices. Unless the supplier is a bone headed with a gigantic ego then he has to reduce his prices to get buyers interested once again.

However, we also know that heavy manipulation is going on in markets. We simply couldn't say natural laws of supply and demand. Remember fake-outs!

Lets use good old zigzag indicator as a visual helper to see peaks and drops clearly rather than polluting our heads with DBD-RBR-DBR-RBD stuff.



Chart 2

With the help of zigzag indicator we can identify major and minor price turning zones including older ones with ease. Now lets add supply and demand zones to the chart ignoring minor/weak zones.

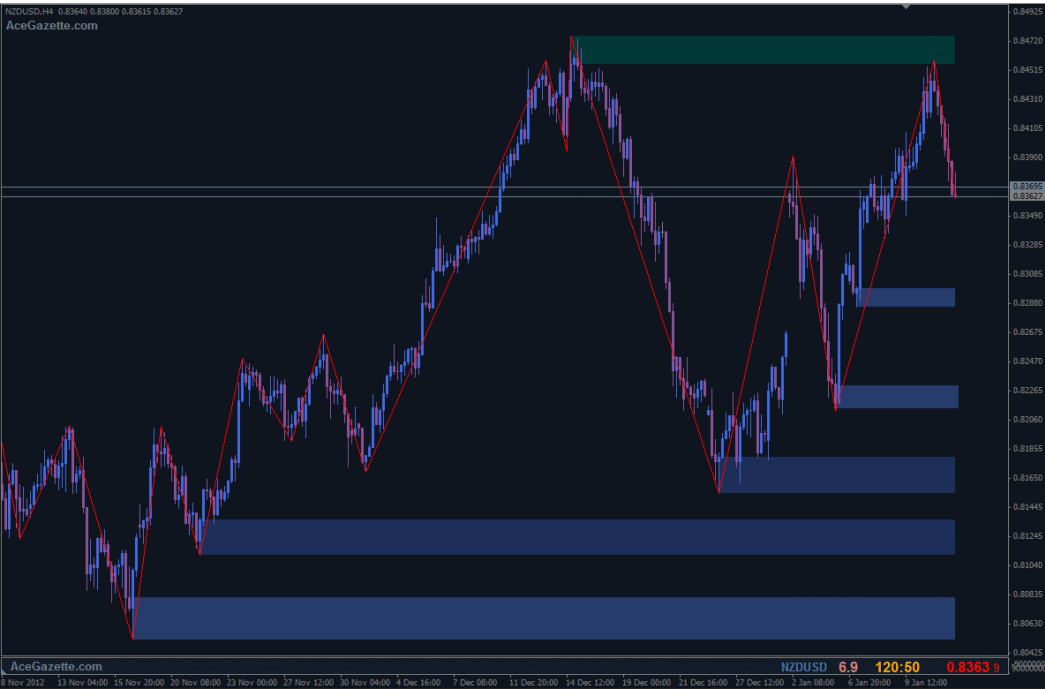


Chart 3

Notice where zones are drawn in relation to zigzag highs and lows. It's not a big deal to recognize possible supply and demand zones, is it? I used default settings of the zigzag indicator.

It's fine looking at history and talking on hindsight but how do we know current higher high [hh] is the actual hh?

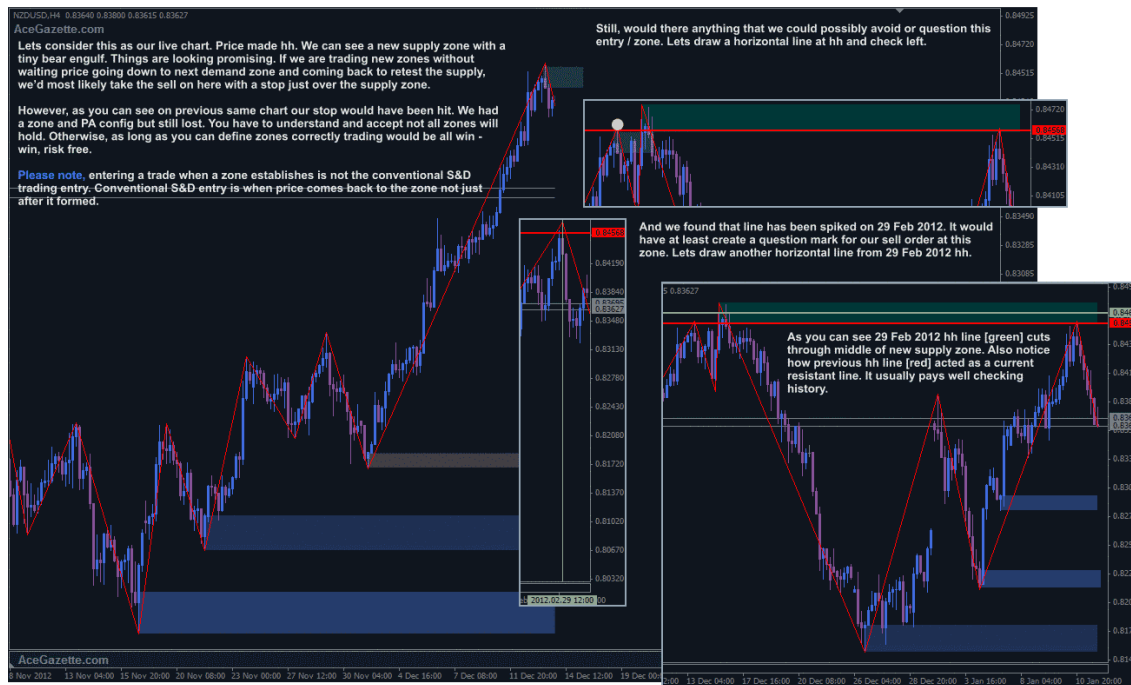


Chart 4

How to draw zones?

There may be different approaches on this but I like how supply and demand indicator draws them.

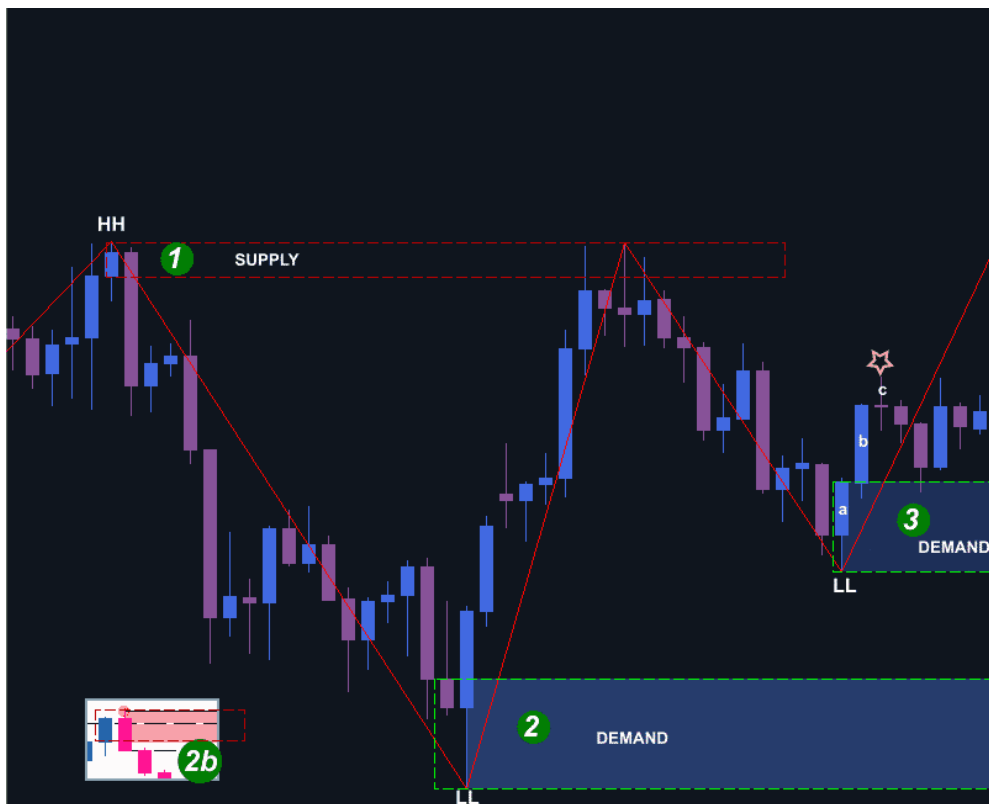


Chart 5

The key point to watch when drawing a supply or demand zone are HH [higher high] or LL [lower low] as they are starting points of a zone.

1. Bull candle at opening starts printing a bear candle [wick] then retraces making new HH. We take HH and the opening point of the bull candle draw the supply zone as shown on the chart 5. Before drawing the zone at least we have to wait for the close of following candle. Without it we wouldn't know our HH is HH as next candle easily can make new HH.

2. In situation like this, where LL is made by an engulfing candle we start drawing our demand zone from LL [which is bull engulf candle] to close of previous bear candle instead of close of bull engulf candle. Unlike most other zones with cases like this we use two candles to draw a zone instead of one. Similar situation applies when drawing a supply zone with HH engulfing bear candle. We take HH of the bear engulf candle and opening of the previous candle [please see 2b]

3. We see a usual one candle demand zone drawn. However, if you are using supply and demand indicator you will not see the demand zone printed until after candle c closed. Zone is not valid until a candle closed and not touching to zone. So it's always better to wait for confirmation before drawing a zone.

How to trade supply and demand zones?

Conventional recommendation is that we wait for price to come back to the zone [preferably untested fresh zone] to take a trade.

1. Enter when price deep in the zone with a small stop-loss.
2. Wait for PA confirmation then enter with bigger stop-loss.



Chart 6

Obviously on hindsight entry 1 would have been the best one but on live charts at this point we don't know if price is going to be contained in the zone or not. We could simply take the trade and hope for the best or look for something to indicate possibilities of price turning, zone holding. In my case first thing I see is signs of RSI divergence, and that would most likely be enough for me to take the trade [entry 1] as the risk is minimal, rather than delving into deep chart analysis.

On the other hand when we check left we don't have clean clear arrival, zone has been tested before twice which means it's not a fresh zone. Are there still decent buyers? Some negative vibes against taking trade. If we add a horizontal in the zone and check farther left we see some positive history.

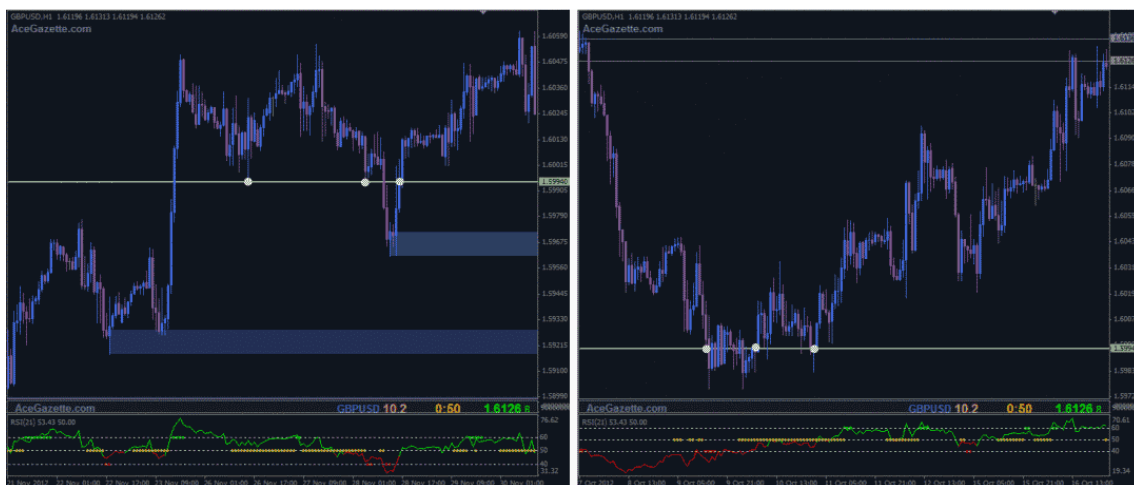


Chart 7

If we opted for entry type 2, which says wait for PA confirmation once the price hits the zone, then we get two opportunities of entries on this occasion as highlighted on the chart 6 above. Notice, stop-loss size of entry 2a and 2b is bigger than entry 1.

In my trading, I use additional S&D zone entry in addition to above entries. I tend to take trades as or when a new zone established too. Sometimes before zone in sight. I will not go in details for this type of entries as it involves a few things to be taken into account such as reading left PA, spotting viable historical price lines and the way a new zone is created. This type of entries [some calls it "ahead of time trading"] requires a lot of experience and ability to keep in sync with overall market sentiment. Needless to say it's more riskier than conventional entries.

How do we workout PA Config [Price action confirmation] in supply and demand zones?

This is where chart and candlestick patterns come in. Remember, we use PA reading in and around the zones to try to determine if the zone will hold or not. I already have written few articles about PA patterns and their use in "Introduction to Price Action" AG forum category and under Education menu "Candle n Chart Patterns". I need to add few more PA patterns yet but what is available so far is more than enough to make a good start. You don't need to learn all PA patterns to be profitable trader. Important ones are more than enough in my opinion. I have started with important ones and most are done. I would recommend you to check them out so that you can fill the PA confirmation puzzle piece in place within the concept of S&D trading.

What time frames are best for supply and demand zones?

Supply and demand zones are applicable to any timeframes, in other words supply and demand zones can be drawn and traded on any timeframes. Only thing to keep in mind, supply and demand zones in lower timeframes can be taken out more often and easily than higher time frames. Seasoned S&D traders tend to trade in the direction of higher time frame zones.

What does this mean?

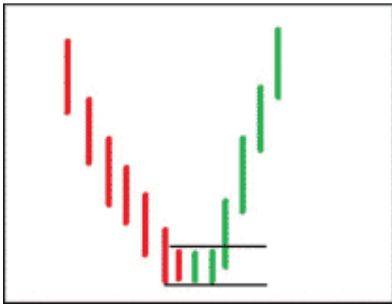
For instance, we have price just tested H4 supply zone, zone is holding and price started to move away [down] the zone. In this situation if we are trading on say M5 we'd be looking to sell on decent supply zones of M5 rather than buying at demand zones. Is this means we shouldn't enter any buy orders in such circumstances? Of course not. You can always benefit from decent M5 demand zones too as price rarely moves in one straight line but using supply gives us additional probability in our favor. There are no need to be greedy. We cannot get all the pips. That's until price comes close to possible reaction levels or closing on H4 demand zone. Regardless your trading chart time frame, it's always wise to keep an eye on higher timeframes.

Why some zones doesn't hold?

If I knew the answer to this question, I'd say I have the ultimate crystal ball. I could trade with zero losses. Unfortunately, I don't possess such crystal ball. All we can do is check the history, especially historical price lines to see possibilities for the zone may to be taken out or not. The only place to look for possible hints is left of your trading chart. Also keep in mind, during major events such as NFP, ECB press conference, FOMC minutes etc... most zones may be taken out easily.

I may comeback and expand this article further as and when needed.

Supply and Demand



Back To Basics. I wanted to make a simple document about "How to identify a Supply / Demand zone / level".

This will be my contribution to the PIE / AceGazette community as I will be forever grateful for all the knowledge and skills that has been shared with me...

I wanted to document this file in a very simple fashion so that new traders could be able to identify a Supply/Demand level pretty easily. Traders Helping Traders... Mel

What is a Supply/Demand trading?

K.I.S.S.

Every possible market, whether it is a financial market or not, is being moved by the ongoing supply and demand that is present in this particular market. Supply (sellers) represents the quantity of products that is available in the market and Demand (buyers) represents the quantity of products that is wanted in the market. When there is more demand than supply, the price of any product is going to rise (demand exceeds supply) and when there is more supply than demand (supply exceeds demand), the price of the product is going to drop.

Selling at Supply or Buying at Demand offers you the best price possible. So why would you want to pay more for a product, service or currency if you can get it at a better and cheaper price?

The Edge

In trading, knowing where a Supply/Demand level is, is knowing and understanding what type of trader or trading account is on the other side of your trade.

Knowing that there are two different types of market participant: The novice trader that belongs to the 95% and the Banks, institutions and Big Money that belongs to the 5% ...

A small retail trader isn't able to move price in the market, only institutions and banks are able to do so. The good news is that it is possible to trade in the right direction and to follow the Big Money by simply buying at Demand and Selling at Supply. In other words it is up to you to choose which market participants you want to join!

How to recognize a novice trader?

Most of the retail traders aren't trading profitably, it is a fact. They are losing because they buy after a period of buying and they sell after a period of selling while institutions/banks are doing just the opposite!

Identifying a Supply and Demand Level/Zone

Finding a good Supply or Demand level on a price chart isn't that difficult. The first thing we want to do is:

1) Look for an area on your charts where you see that price shot up (for demand) from a certain point in a strong fashion or dropped (for supply) from a certain point in a strong fashion.

We look for a specific point where price has to left, where it simply couldn't stay there. We can tell this because of the strong move up or down.

See chart below for an example:



2) Once we found an area on the charts where price shot up or dropped down in a strong fashion, we then want to see if we can find the base of the move.

The base is basically a cluster of trading, where the candle's bodies are trading sideways, next to each other, creating a zone.

If you can find that kind of zone and then see price dropping or rising in a strong way from that zone, then you have a Supply or Demand area.

Let's look at the charts from point 1 to see if we can find a zone.

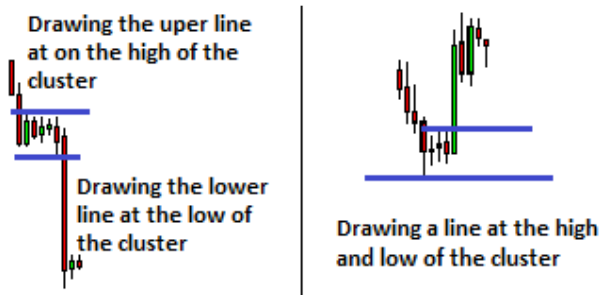


On both of the examples we clearly see the zones we were looking for, preceding the strong moves. This is a Demand level on the left and a Supply level on the right!

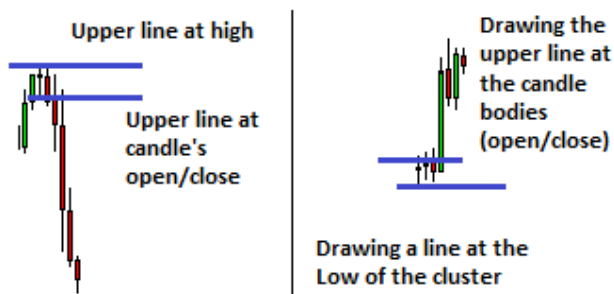
Concretely defining a Supply/Demand zone

Once we found a zone/area like explained above we want to define the base as well as possible by drawing a line on the upper and lower part of the trading cluster. There are two possible ways to define the base (depending on the traders' preference).

1) Draw the upper line at the high of the cluster, draw the lower line at the low of the cluster.



2) For Supply: Draw a line at the high of the cluster for the upper part and draw a line at the candles' bodies (open/close) for the lower part.



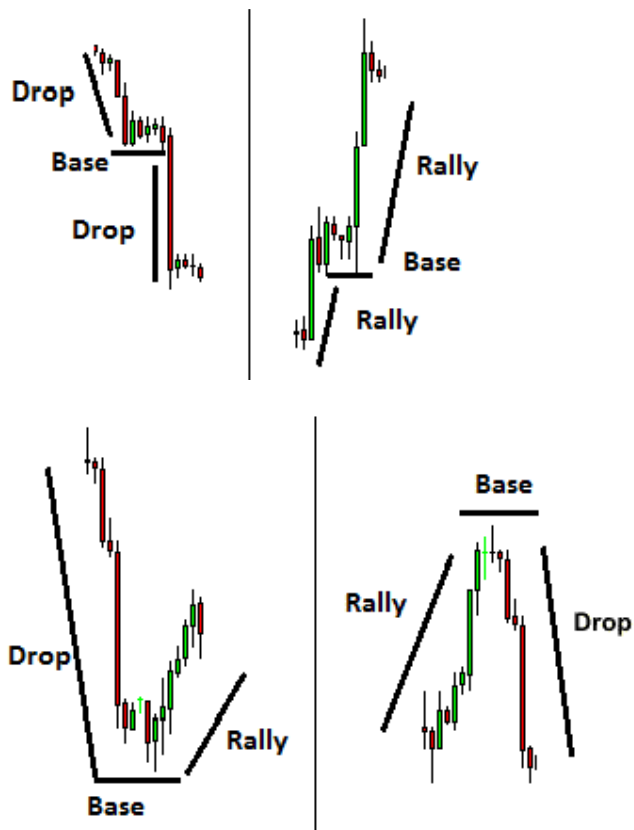
For Demand: Draw a line at the low of the cluster for the lower part and draw a line at the candles' bodies (open/close) for the upper part.

DBD-RBR-DBR-RBD

Another way to identify a zone is also to look at DBD-RBR-DBR-RBD

DBD means Drop Base Drop
RBR means Rally Base Rally
DBR means Drop Base Rally
RBD means Rally Base Drop

Let's look at some chart and find an example of each.



Balance VS Imbalance

Now that we know how to identify a Supply/Demand level, we should ask ourselves what the level represents...

When the level/zone is being formed, we consider price to be Balanced. There are as many sellers as buyers present in the market. However a decision to push price lower or higher has to be made.

So sooner or later, the balanced cluster that we saw will become imbalanced as there would be more seller than buyers.

This will cause a rise or drop in price and therefore price will break the cluster.

The best possible scenario is price breaking the cluster in a strong, violent way because if that happens then we would know for sure that there were more buyers/sellers at this precise point.

Therefore we can expect price to bounce from there when the Level/Zone will be revisited.

How to trade a Supply/Demand Level/Zone?

They are different ways to trade a Supply/Demand level/zone but the highest probability trade is to trade the first visit of the zone because since it's the first visit, the level/zone will still be fresh/untested. Furthermore, it is up to the trader to decide whether they want to take a "Touch Trade", trading the touch of the level/zone or wait for confirmation PA when price arrives at the level/zone.

When a level/zone is getting tested for the first time, we know that this "freshness" gives us the highest probability trade, however this doesn't mean that you have a 100% guarantee that it will bounce there as nothing is 100% in trading.

Also, it is possible that price will bounce at the 2nd or 3rd visit... We don't know how many times it will be tested until the level/zone breaks. Every time a level is tested, it gets weaker and weaker, this is why the first visit gives the highest probability trade...

Broken Supply/Demand

When a Supply/Demand gets tested different times we know that soon or later the level/zone will eventually break.

When we see a strong break from a supply zone, we know that bulls did buy there, therefore, we don't consider this zone as Supply anymore but instead we consider it to be a Demand zone now and vice versa for a broken Demand zone.

Supply became Demand or Demand became Supply, this is also called a swap level. If the level was broken in a strong fashion, then we would look to buy/sell from a swap level when price will come to visit the level.

Important Note:

We also look at swap levels for targets, those are important decision points too.





The Profit Margin

Having a good Supply/Demand level/zone isn't just enough to take a trade blindly ... You have to make sure that the potential profit on the trade will be high enough. Make sure that the R:R is good enough by identifying where a previous decision point, Supply/Demand point was.



As a final word, I would like to mention that supply and demand opportunities can be found in every timeframe and in any trading market.

Now that you know what to look for, I suggest that you go and find some examples for yourself on your charts. Try to master this as I believe this is what will take your trading to some new levels... At least it was the case for me...

Trading Supply & Demand (1/5)

Let's first agree that at one point, when you start trading, you feel like a blind one-legged man on a highway. Our goal as traders is then to make our task easy, enjoyable and why not even relaxing. As a wise man recently said on the Ace Gazette forum, **"trading is not complex, traders make it complex"**. Let's not be one of them then.

In order to do so, we need to understand what the bleep is going on day in, day out on your charts. You see bars or candles, up and down, with or without wicks, bodies, gaps: PRICE ACTION. Then you learn some patterns -some of them with crazy names- and start to see clearer: PRICE STRUCTURE. But they are only the expression of a larger force, a key to read what really happens. **One thing I will tell you, nothing is random in the market, absolutely nothing. There is no chaos.** It is only a question of understanding. And to understand it, you need to decipher it.

So why is price moving up and down like this?

In the Ace Gazette community, we mainly focus on the oldest and still more valid as ever law in economy: **THE LAW OF SUPPLY AND DEMAND.**

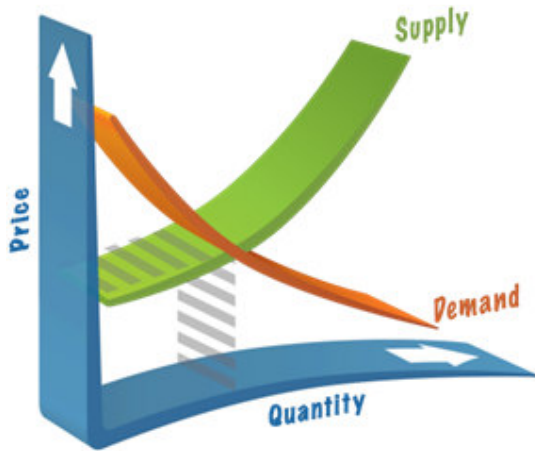


What is it?

"Supply and demand is perhaps one of the most fundamental concepts of economics and it is the backbone of a market economy. Demand refers to how much (quantity) of a product or service is desired by buyers. The quantity demanded is the amount of a product people are willing to buy at a certain price; the relationship between price and quantity demanded is known as the demand relationship. Supply represents how much the market can offer. The quantity supplied refers to the amount of a certain good producers are willing to supply when receiving a certain price. The correlation between price and how much of a good or service is supplied to the market is known as the supply relationship. Price, therefore, is a reflection of supply and demand."

The relationship between demand and supply underlie the forces behind the allocation of resources. In market economy theories, demand and supply theory will allocate resources in the most efficient way possible. How? Let us take a closer look at the law of demand and the law of supply." (Investopedia.com)

For the mathematics and economics geeks who want to read more about the technical side of it, it is possible to do so [here](#).



But to put it simple:

DEMAND SENDS PRICE UP

At the Olympic Games, tickets for the 100 meters dash are sold out in a few minutes. The numbers of tickets, the offer (supply) is limited. There are more people who want to buy a ticket (demand) than tickets available (supply). So what are people willing to do to purchase one? Pay way more expensive than the original value of the ticket! The price of the ticket is being pulled up by the force of demand and the lack of supply. OK?

SUPPLY PUSHES PRICE DOWN

Now, imagine that a strawberries producer benefits from outstanding weather conditions and produces a lot more strawberries this year than last year. But he is selling to the exact same amount of people in the same customer catchment area. Let's say he is selling at the same price as last year. When all customers are served (demand satisfied), there is none left. But still a lot of strawberries in the stocks (high supply). So what will the producer do in order to sell his strawberries? He will set the price lower to attract new buyers. So the price of his fruits will decline until it finds some people willing to buy them. OK? Rings a bell?

It should, because this is exactly what happens to the prices on your charts. Although it is easy to understand if you are trading commodities, it can be trickier for currencies pairs. But just forget they are pairs for a moment, and call them instruments.



Sam Seiden, who is considered as a supply and demand guru in the tradosphere, wrote: *"The foreign currency (Forex) market is where global exchange rates are derived for everyone including market speculators and end users of currency. People and companies buy and sell currency much like you would buy and sell anything else. Strong economies have strong currencies. When we trade the Forex markets, we are trading economies. Therefore, supply and demand for currency depends on the current and expected perceived health of a country's economy. [...]"*

You can basically trade any instrument as long as its value can be represented by a chart. Because you will always find some levels of supply and some levels of demand clearly identified. It means: opportunities of buying or selling.

"Understand that there are always two competing forces at work in the market, buyers and sellers. Our goal is to quantify those forces and identify price levels where the imbalance is greatest as this creates change, or movement in price." (Sam Seiden, Lesson from the pros, August 2008)



So, why do we like the principle of **SUPPLY AND DEMAND** so much? Because on a chart, levels of **SUPPLY AND DEMAND** (where strong decisions are taken by the big money) are represented by horizontal lines. And horizontal lines are simple enough for the dummies we are (remember, we want our job to be relaxing).

So, horizontal lines. Have you ever heard of **SUPPORT AND RESISTANCE**? They are wonderful tools for trading that requires only **patience, logic, observation and common sense**. We will cover this subject with charts in the next post.

Until then, take care and be safe out there.

Trading Supply & Demand (2/5)

In the first article of the serie "Trading Supply and Demand", we studied the definition of Supply and Demand as a principle. In this second article, we will see how we can illustrate it on a chart and what lies behind the notions of support and resistance.

What is a support?

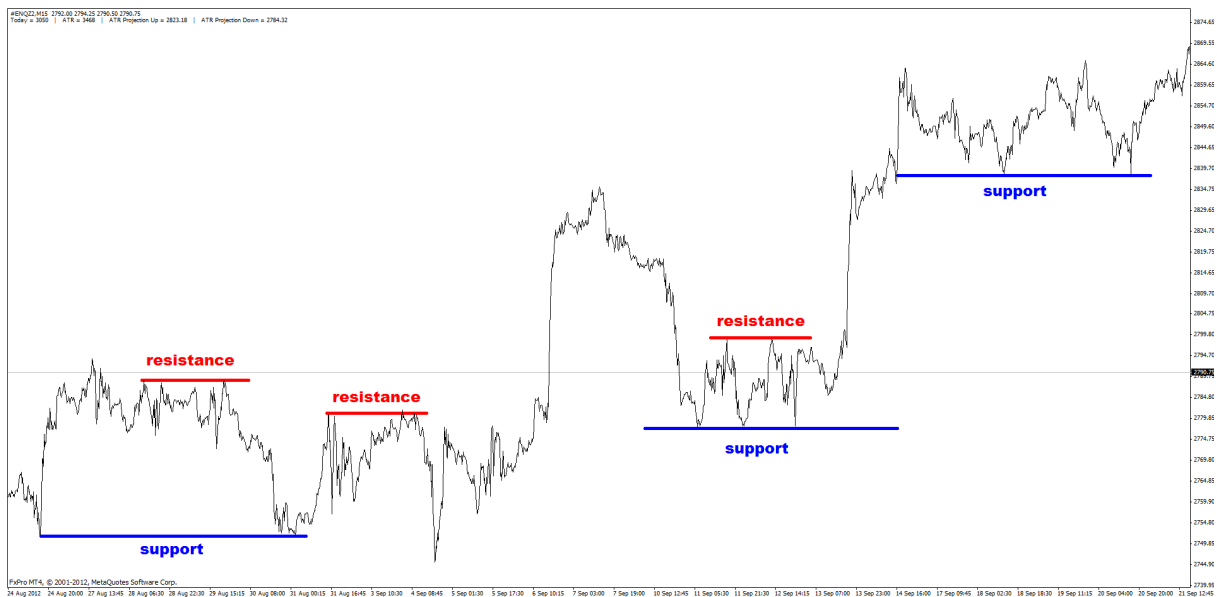
A support level is a price level located below the current value of price, where there were previously more buyers than sellers (demand was previously more important than supply), and which sent the price upwards after preventing it from falling any lower. It is a level that the big players consider a good price to buy. A support level, as stated earlier, is represented by a horizontal line, which makes it simple enough for us to trade as there is nothing simpler than a horizontal line.

Investopedia explains "Support" : *If the price of a stock falls towards a support level it is a test for the stock: the support will either be reconfirmed or wiped out. It will be reconfirmed if a lot of buyers move into the stock, causing it to rise and move away from the support level. It will be wiped out if buyers will not enter the stock and the stock falls below the support.*

What is a resistance?

A resistance level is a price level located above the current value of price, where there were previously more sellers than buyers (supply was more important than demand), and which sent the price downwards after preventing it from raising higher. It is a level that institutions consider a good price to sell. A resistance level is also represented by a horizontal line.

What do support and resistance levels look like on a chart?



To sum-up, you can remember that support represents demand and resistance represents supply. Bulls (buyers) put buying pressure at support levels and bears (sellers) put selling pressure at resistance levels. To find your support and resistance levels, observe where price respectively stalled and started to raise or stalled and started to drop.

Is a line enough or should you rather consider a zone?

As supply and demand traders, we like to approach the support and resistance principle as zones/areas more than one unique line. But in the end, a zone is made of two lines, so let us say that we like to use two lines instead of one. This is because you will see that although price can respect a single line very nicely, it can also turn a bit above or a bit below the initial price line.

Investopedia explains "Zone of support": A price zone in which a stock finds support and begins to trade upward once again. In technical analysis, support occurs not at a finite point, but in a zone. The "density" of the zone of support (how far the price can move down through it) depends on the volume of trading as the price approaches and enters the zone. The higher the volume of trading in the zone of support, the higher the point at which actual support will most likely occur.

Investopedia explains "Zone of resistance": A price zone in which a stock finds resistance and begins to trade downward. In technical analysis, that support occurs not at a finite point, but in a zone. The "density" of the zone of resistance (how far up the price can move through it), depends on the volume of trading as the price approaches and enters the zone. The higher the volume of trading in the zone of resistance, the lower the point at which the actual resistance will most likely occur.



Why does it work?

Support and resistance levels are the simplest yet the most effective tools to trade profitably. But why? Well, there are two answers to that. The first one is mechanical and results from the human psyche. Greed, to be more precise. Let us put it this way: if you go to the store at 8h00 in the morning to buy a diamond, and you see the price is 1000 usd. You tell yourself, well, I do not know if I am ready to pay this price for a diamond. I will think about it and come back later. You come back at noon, and the diamond now costs 1300 usd! Damn, you think, I should have bought it when it was at 1000usd! Now it is too expensive anyway. I will come back later. You come back at 4.00pm, and the diamond now cost 1000usd again! Fantastic, I am so lucky, I am a buyer! Except you are not the only one willing to buy at

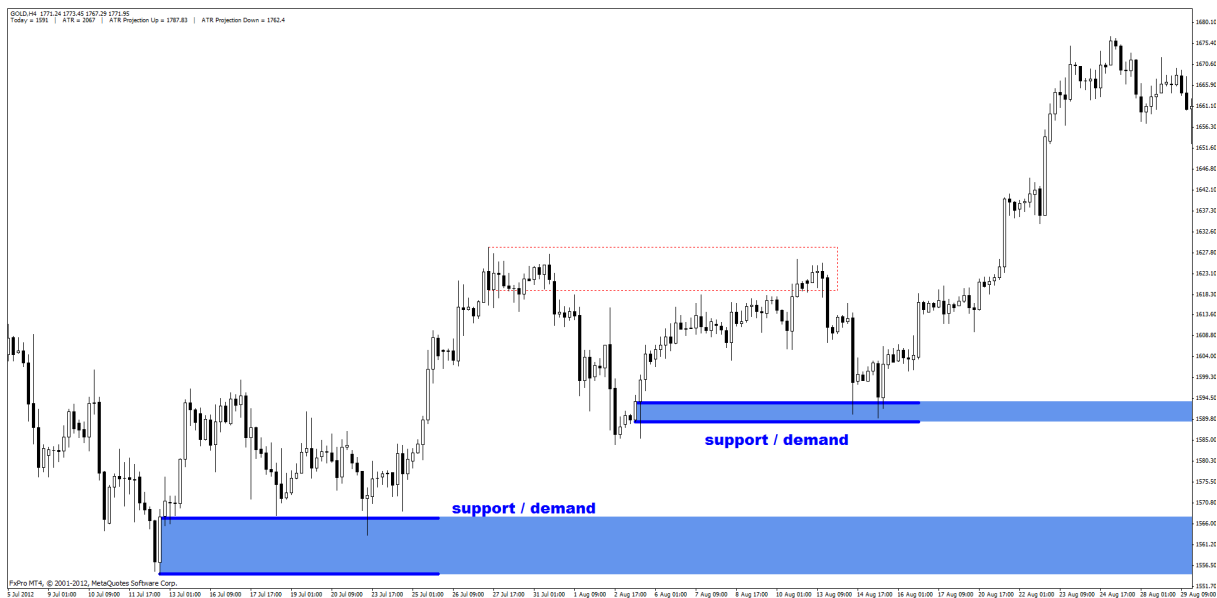
1000usd now, there plenty of other buyers who unfortunately missed the first train in the morning. Consequently, a massive demand for the diamond at 1000usd will result in a lot of buyers purchasing the diamond, reducing the supply and sending the price up again. On a chart, you could draw a horizontal line at 1000usd at 8.00am and wait for the price to come back to it. In this example, the support level for the diamond was at 1000usd.

The second reason is not as rational as the first one. Because the market considered the above story to be true, it acted consequently again and again, for years and years. So now, it is just working by itself. Some call it a self-fulfilling prophecy. These levels are so widely accepted in the trading community that they are closely monitored and are likely to be significant and to have a serious effect on the price.

Now try to think about it when looking at the two charts below.

Support / Demand

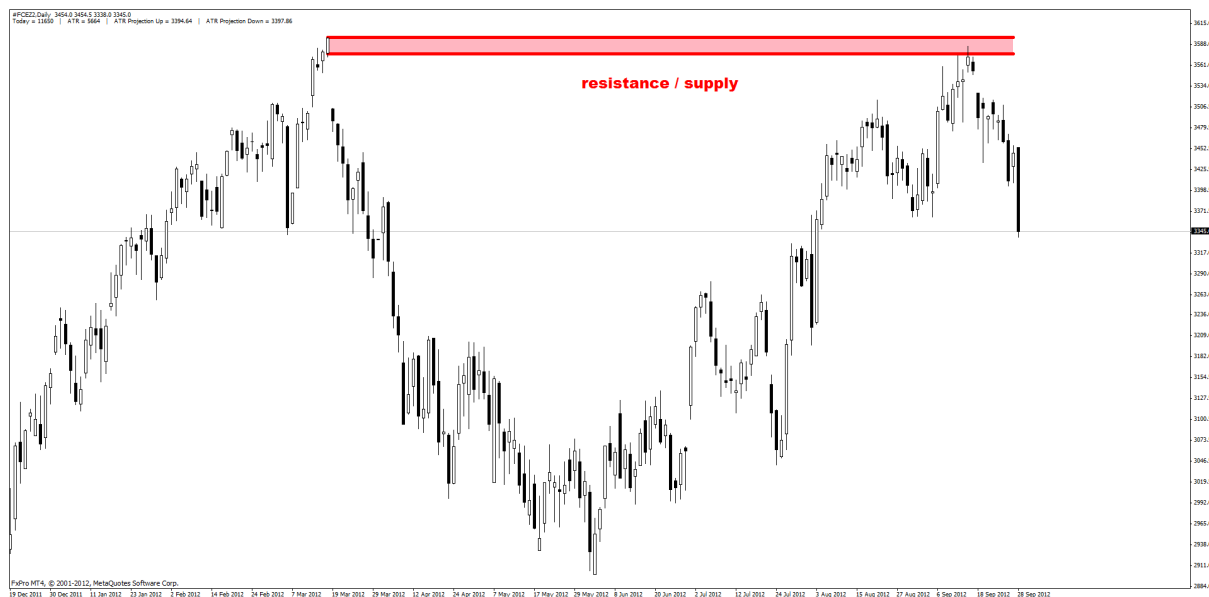
In the Gold H4 chart below, you can see that price went up a first time because the market decided it was a cheap price to buy. This is the most crucial information. This is almost everything you need to know. Did you miss the first move up? Yes, but you were not the only one. See how price reacts when coming back to the support level? It rises. In the first zone, price comes back several times, never really deep (meaning bulls are impatient to buy and do so even a tad higher than the lower level where the price comes from), and goes up again. Buyers show up every time, before it goes up for good. The second zone is even better as price leaves it faster and higher. This is an indication that is good support, meaning a very good price to buy it at. What happens next is obvious.



Resistance / Supply

In the CAC40 futures (French stocks) chart below, you can see that price climbs to a very clear level of resistance, where supply was obviously stronger than demand in the past. This imbalance between supply and demand sent the price down violently. When resistance is reached, sellers who have been waiting to sell again at this nice opportunity do so and price drops. But you also need to realize that because it is a self fulfilling prophecy, buyers know that sellers are waiting at this level. And because they do not want to see their profits vanish

if price goes down, they close their position, going from buyers to sellers (to liquidate a position means to invert the action you initially did to enter the market. They are mechanically sellers when they close their positions because if they were buyers, they need to sell it to someone. Most of the time, to retailers.) So new sellers + buyers closing their orders = massive drop. In this case it is not a resistance, it is an iron wall.



To finish with these general principles, it is also good to know that when price moves sideways, buyers and sellers are quite happy with the level the price is at. Supply and Demand are fairly equal. Bulls and Bears just send each other the ball until bulls violently throw the ball at the bears' face or vice-versa.

Summary

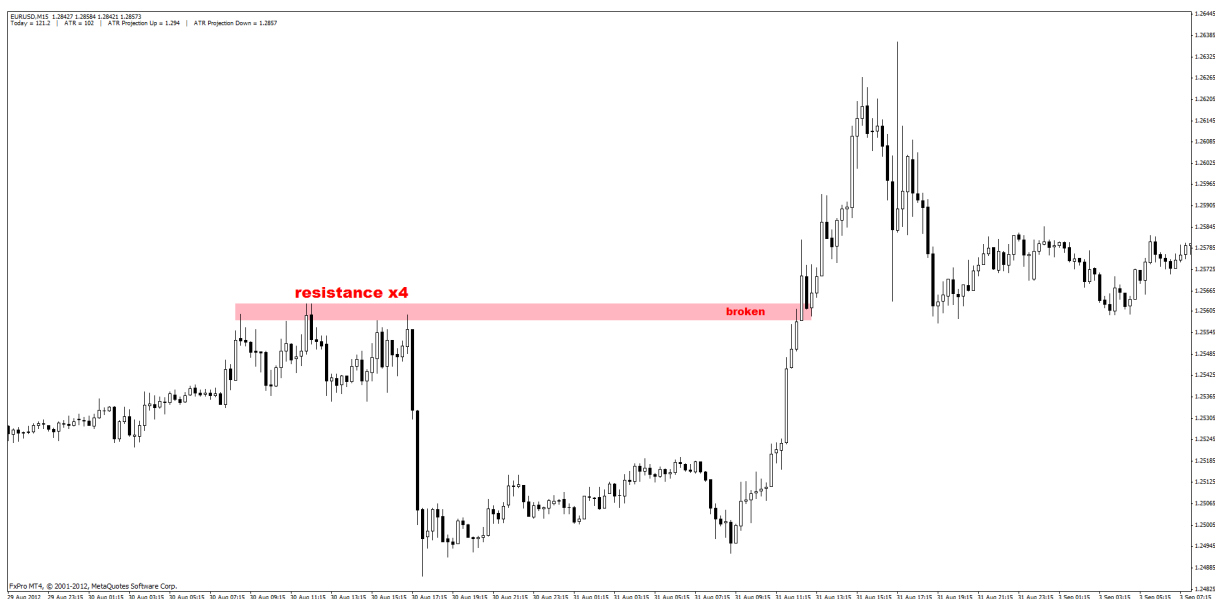
Buyers and sellers create two opposing forces that move prices. Buyers want to buy cheap and then sell more expensive. They use support lines / areas to know where price is cheap. Sellers, in the contrary, are always looking to sell expensive to buy cheaper afterwards. They use resistance lines / areas to know where price is expensive. When everybody is happy, prices move sideways. The fact that some precise price levels have been significant in the past is telling us that they may have sufficient impact on price movements in the future. Sometimes, levels of support and resistance are very clear on the charts and remain valid for a long time. Price has a good memory, write it down and never forget it. If you keep this in mind, you have a great advantage on other traders.

Is it that simple?

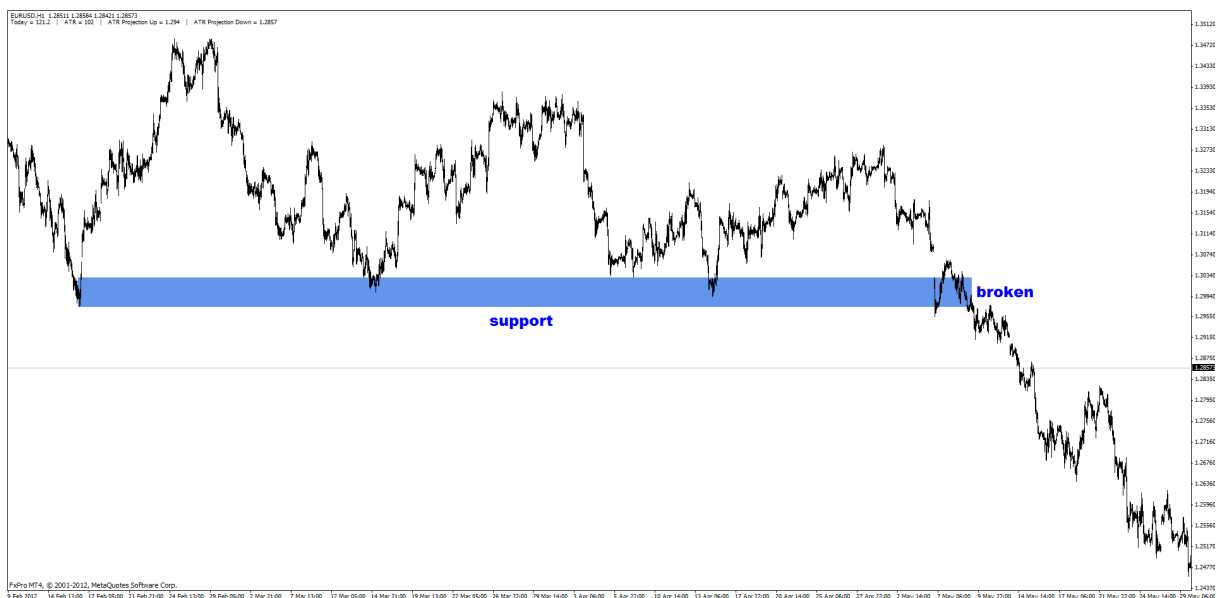
Yes and no (but more yes than no). You see, if price was only travelling from one line of support to one line of resistance and vice-versa, every trader would be rich and retired! So although support and resistance lines (demand and supply areas) can work for a long time, they eventually become invalid. How do we know they become invalid? They just get broken! This is the moment when you go long at support and price gets below it and you scream "Gadzooks!" or anything else appropriate in this case.

In reality, what was a good price to buy (a support) may weaken until the price finally breaks down and what was a good price to sell (a resistance) may weaken until the price finally breaks up.

In the EUR/USD chart below, resistance held for a time and rejected price 4 times before eventually getting broken. It simply means that supply was exhausted and demand was stronger. It does not mean to be a terrific amount of demand, it can just be that there a very small amount of sellers willing to sell again at this price. Always think about the imbalance between buyers and sellers.



In this one, no buyers were left at the level. Support got broken. Here, price action showed in advance that there was some selling pressure on the level because of the gap down preceding the breakout. In this case we can imagine that supply was stronger than demand.



So now what?

Now you must have understood that price raises until sellers judge it is a good enough price to sell, and price drops until buyers judge it is a good enough price to buy. When price breaks a resistance level and reaches new peaks, this means that buyers have increased their expectations and are now willing to buy at higher prices. Sellers, in the contrary, will wait for a better price to sell and will let the buyers control the market. When price breaks a support level and makes new lows, this means that sellers are now willing to sell at lower prices. Buyers will step out and wait better level to buy, hence leaving the markets at the bears' mercy.

Your mission is very simple. Observe price action in the areas of interest, around support and resistance, and train your eyes to see if there are any signs of reaction that could end up in a reversal or in a breakout. In order to do that, I advise you to read the other articles available in Ace Gazette and whose focus is PRICE ACTION.

The next article will again focus on support and resistance lines, how to find the levels, how to draw the lines, and how to trade them. We will also see dynamic support and resistance lines (diagonals).

If you want to find support look for resistance and if you want to find resistance look for support.

Why? Answer in the next article. Until then, keep safe and enjoy your trading.

Compression - Part 1

This great article by a great teacher **Ifmyante** is better suited under PA (Price Action) category but for it's in-depth approach to the subject of compression and length deserved it's own category.

Ifmyante is fun of abbreviations. There are some abbreviations used in this document. You can find the [full list of Ifmyante's abbreviations here](#).

Lets get started...

To understand exactly a scenario, or indeed to read any situation at all on the charts, past present or future, you should look for a certain set of clues.

General: HTF [Higher Time Frames]. Know where price is coming from and going to, and the PA [Price Action] past and present in all the TFs [Time Frames], from the Monthly down.

Specific: At the zones you want to trade, look to.

Past: study the zone in all TFs, down to M1 ask yourself.

- Where were the decisions made? Clean S/D? Mark these lines. No clean S/D? - compressed zone.
- Did price really shoot away from the zone, or did it CP away?
- Did the zone itself react at the right place? Look beyond the zone further into the past. See what it reacted to. Was there a better S/D nearby that price wants to visit? This explains many fakeouts.
-

Present: Approach. How is price returning to the zone?

Where's the nearest flag in the TF you want to trade? This is your tg1 in this TF. Flags in the LTFs? What does PA tell you?

Has price tested the last flag on approach? (good sign)

Has price compressed into the zone in this TF or LTFs? (good sign)

Is there big news on the way? Has there just been big news?

Reaction: In LTF, does price react violently to the first decision point? Does it quickly engulf the nearest S/D? (good sign)

Does price simply CP away? Maybe it wants to go to the next decision point. If the first decision point breaks, watch the signs on approach to the next, and, of course, reaction.

Compression Definition by Ifmyante

We talk about compression when price taking out last decision point and the orders that were left there.



Chart 1

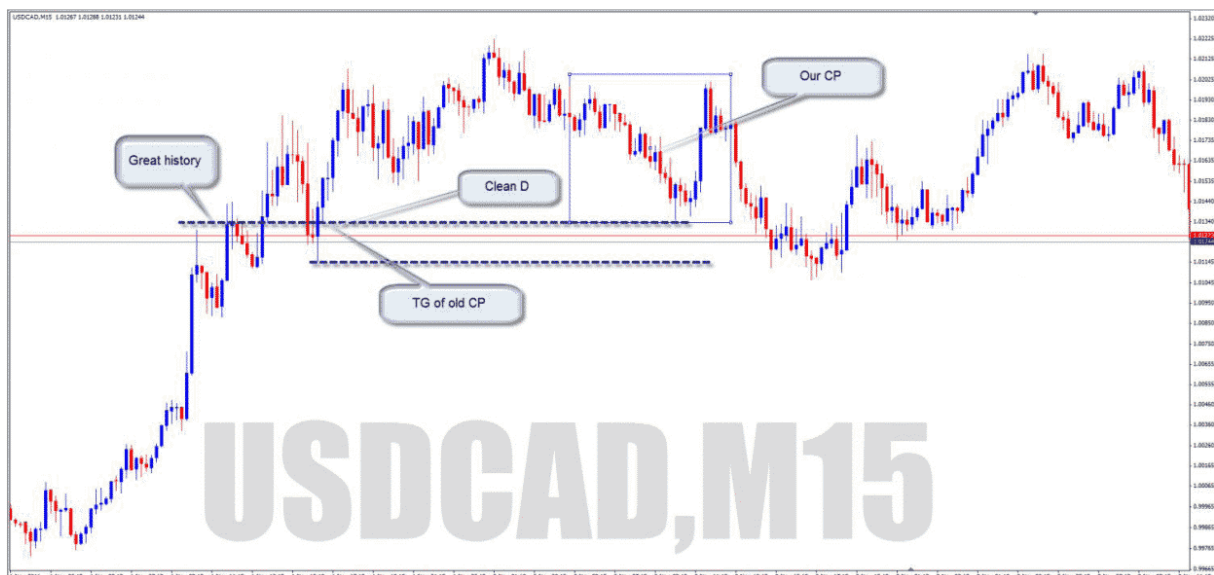


Chart 2

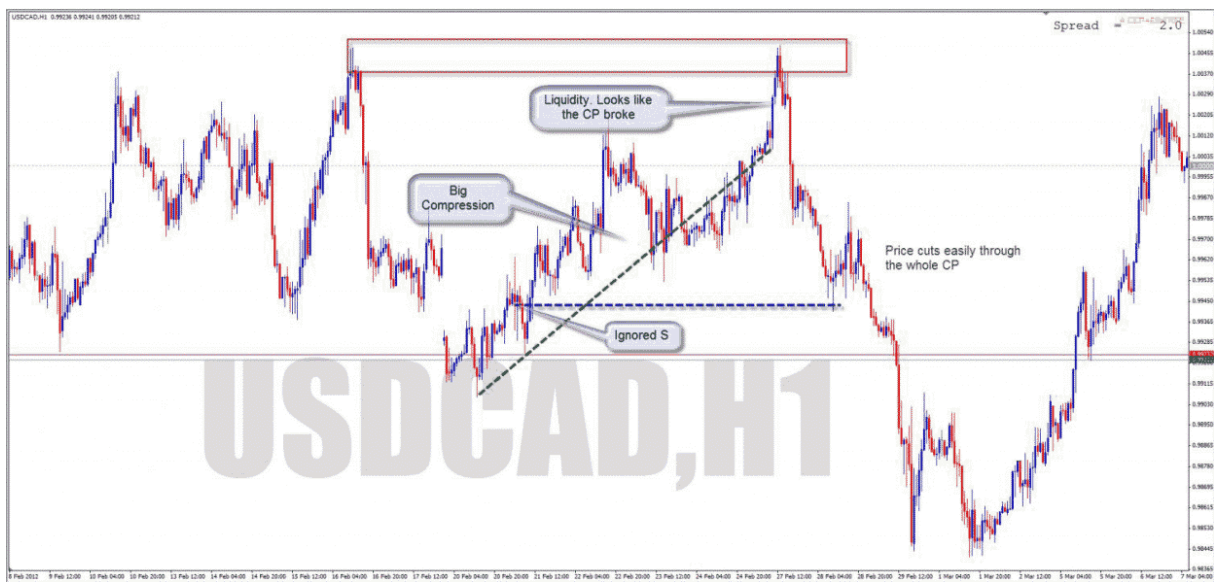


Chart 3



Chart 4

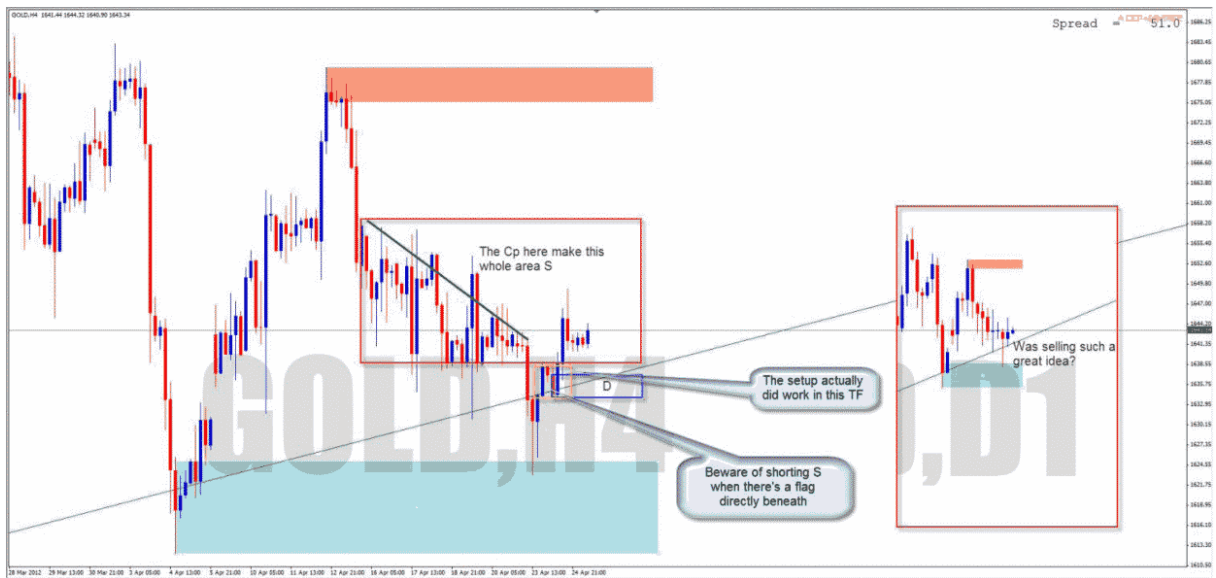


Chart 5



Chart 6

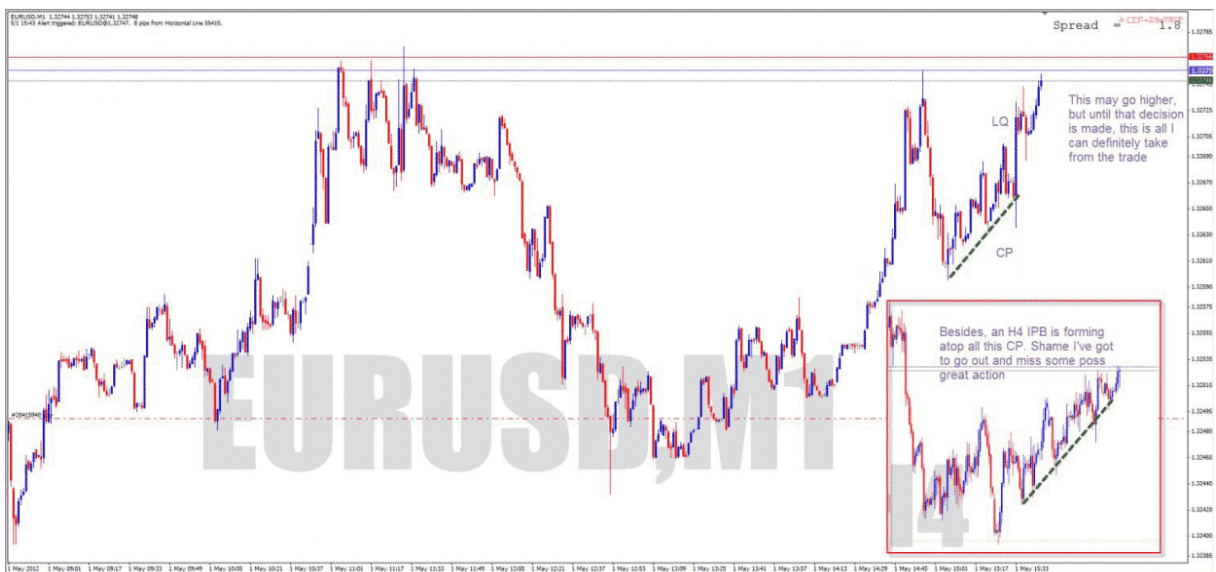


Chart 7



Chart 8

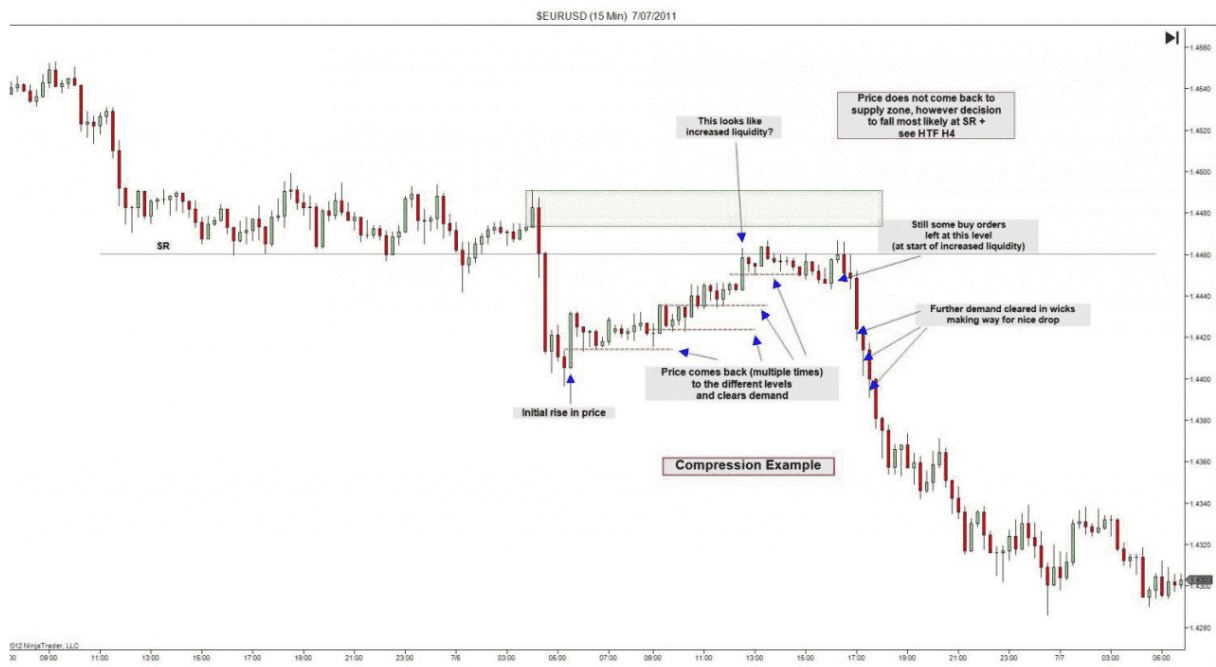


Chart 9



Chart 10

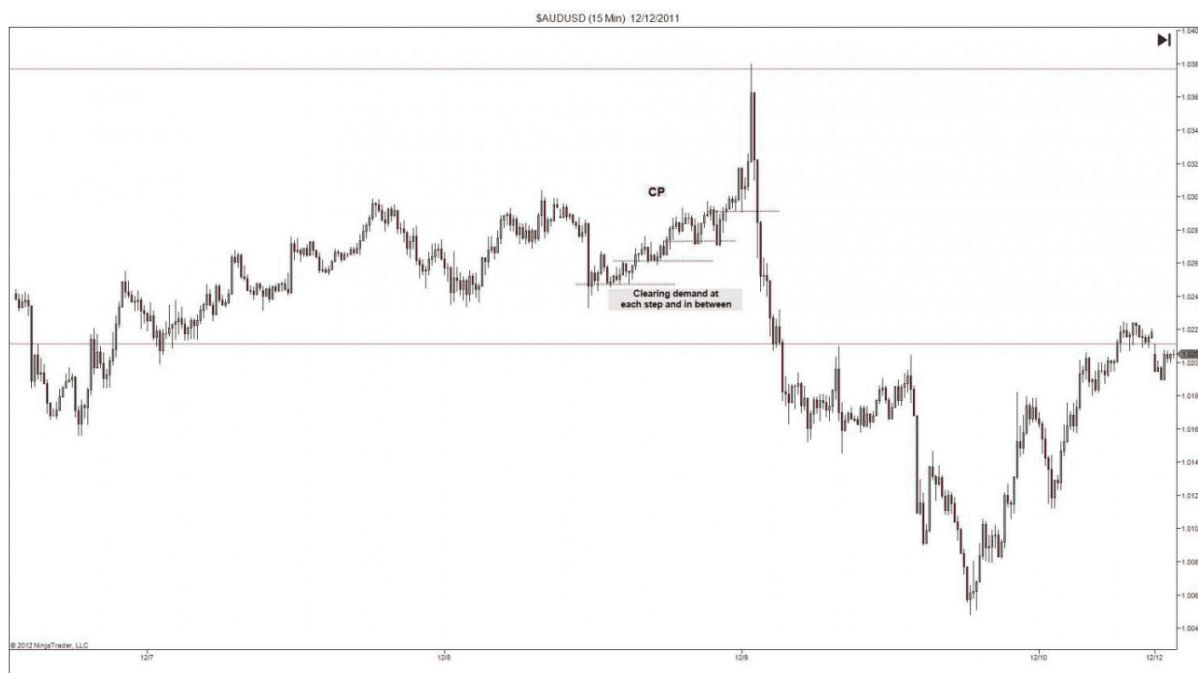


Chart 11

Compression - Part 2

Lets put an end to what's compression (otherwise known as a finishing triangle) and what not compression. Noticed some confusing comments and charts lately with regards to compression. So, below is an entry from the past to clearly identify the PA.

Firstly, we look left and notice a supply zone - supply zone identified simply by noticing prices fell hard from there before, therefore sellers exceed buyers.

Now we wait for PRICE ARRIVAL

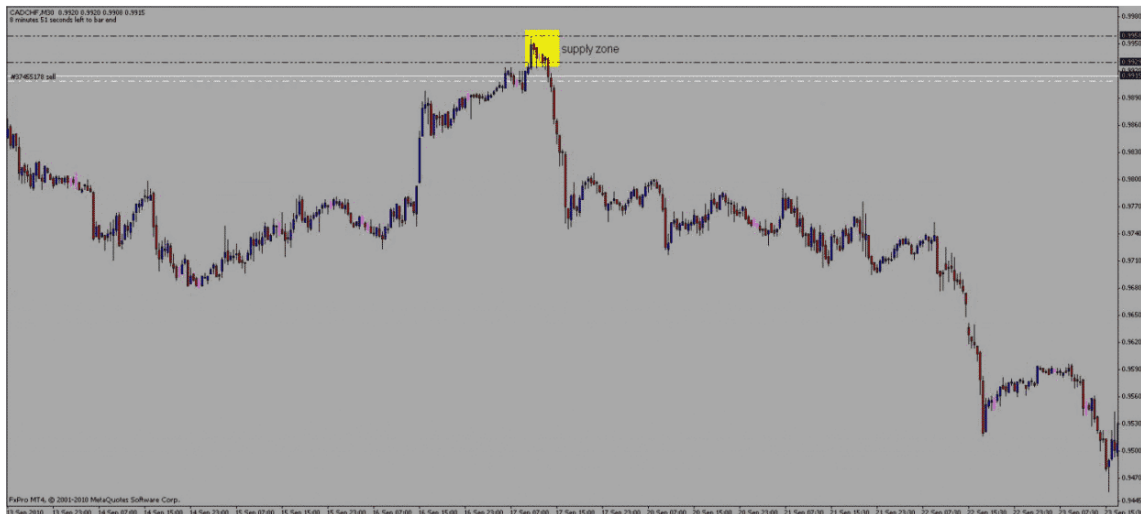


Chart 12

As i know, Red was the first who have talked about CP, so all the credits goes to him. Then, why don't put his charts firstly ? Because his audience on PIE was generally skilled, he was talking to expert traders, that don't need so much explanations. On the other hands, the charts of Ifmyante and the charts presented here are more "noob" proof, so study on them before all.

In detail, seems that the "spiking" is the most complicated part of the story for inexperienced trader. "Where the hell are the spikes ? I don't see any spikes on your chart" was my first question to Ifmyante; well, remember that you have to understand the dynamics of price in LTF that produces the spikes on the HTF, and never ever forget that candles are just a representation of what happened to price over a given time - your broker time, not the PA itself, so always looks at the dynamics of the PA, and remember what CP represent: "price taking out last decision point and the orders that where left there".

..... ok, now price arrival to zone. But notice the manner in which it approaches - its spiking south WHILST RISING what does this mean? Rising to find supply, spiking south is doing several things @ the same time. Prices are finding small pockets of demand and testing them to rise to supply. So, as its spiking south its also consuming those small pockets of demand therefore the path south is begin cleared of demand @ the same time!



Chart 13

PA watch and entry, ok now look @ the result. Notice how the bears that dropped through the compressed zone are large and clean suggesting no demand or resistance, reason? - the demand was already consumed by the SPIKING SOUTH ON APPROACH TO SUPPLY ZONE this is why I have stated often - PRICES THINK AHEAD OF TIME, prices already decided to turn because prices cleared the zone of demand by spiking south before they reached supply clearing the path south for the bears..... so there it is

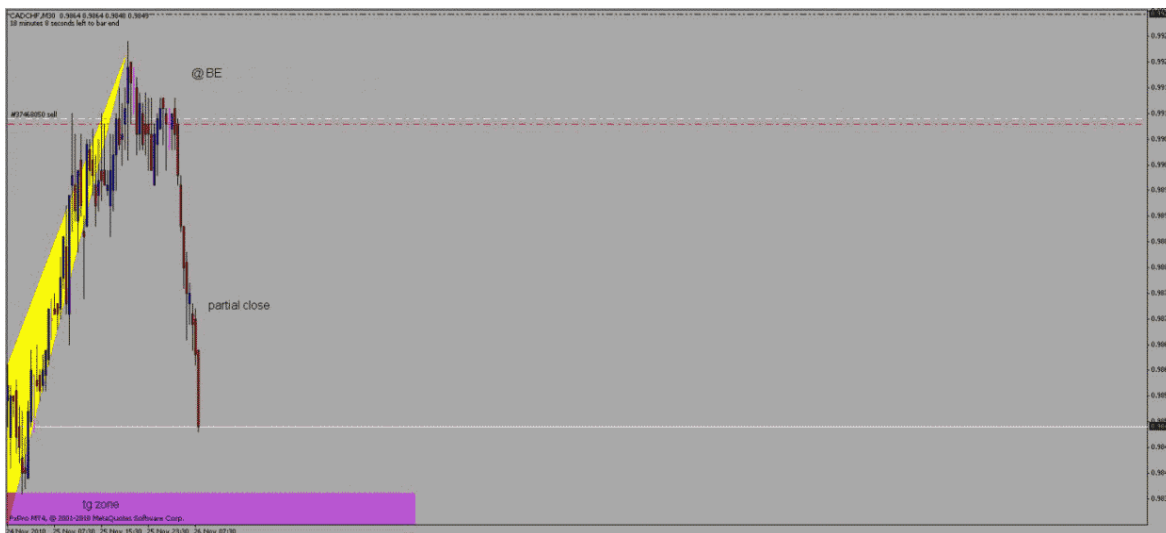


Chart 14

another example - some of you have been confusing flags for compression. Why does a BULLFLAG DIP? Its dipping to consume sellers @ a given level, once the sellers have been consumed, the flag is complete and prices can advance - no mystery. Then prices leave the flag to advance, then once prices reached supply, the approach to the zone there was compression, so I sold it.

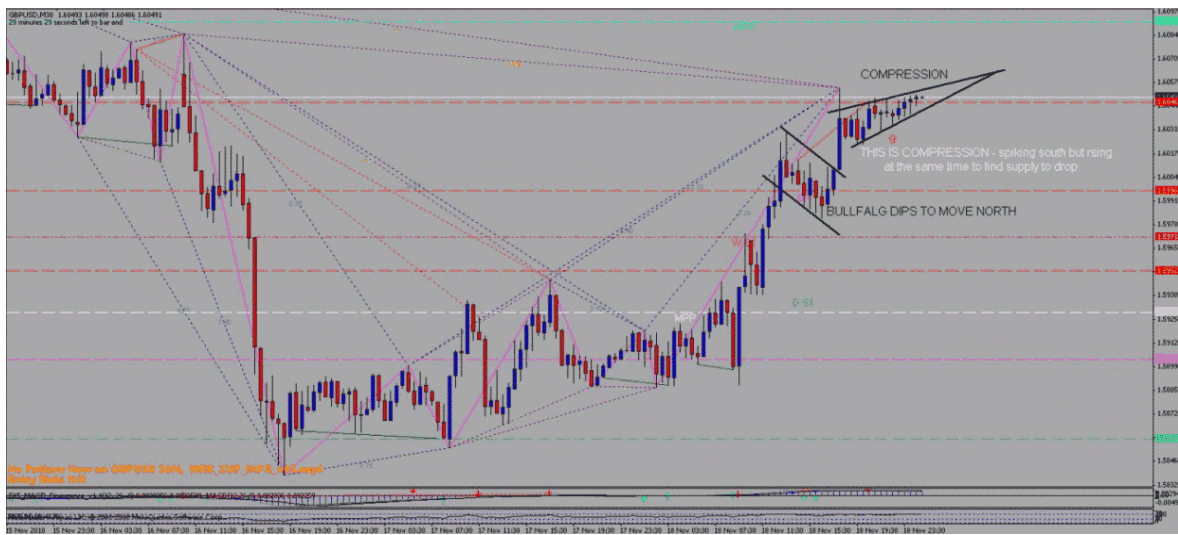


Chart 15



Chart 16

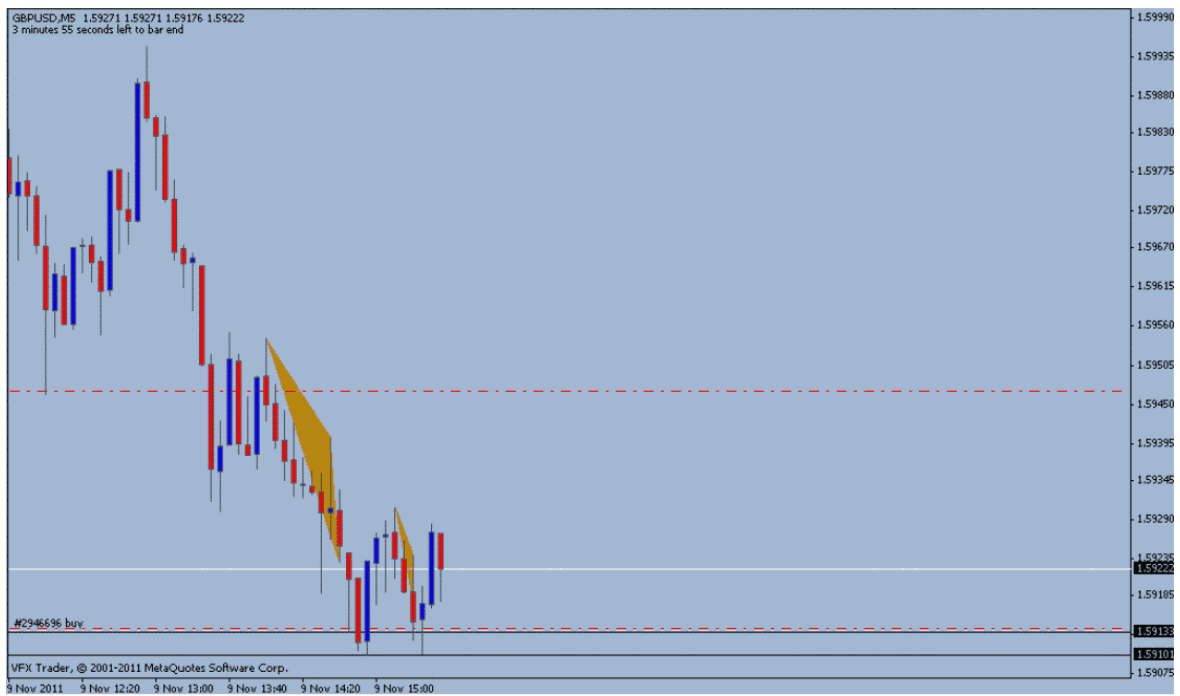


Chart 17

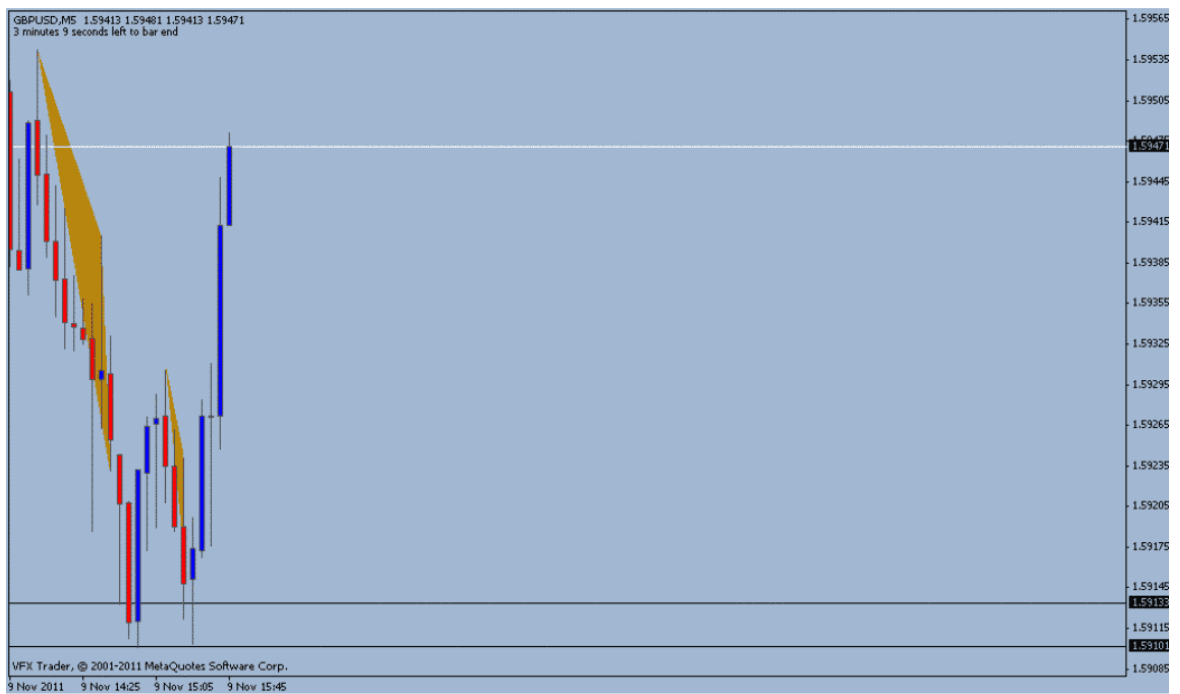


Chart 18

Compression - Part 3

A quick video on CP and the importance of finding the Drop Base Rally that creates an SR flip.

Price compresses up/down then pulls back from hitting a resistance/suppose|sup/dem and balances out before an advance in the compressed direction.

The res/sup|sup/dem usually comes from a higher TF... this would normally make me biased for a reversal.. but when you watch the PA unfold you see that actually price wants to carry on.. also keeping in mind of where price came from. For example, if price has only just left a 4H demand zone and it hits 30M resistance.. the likely scenario here is that the 4H demand is more powerful and will break the 30M resistance.

These are some structures that I have found to have happened in example of this scenario.

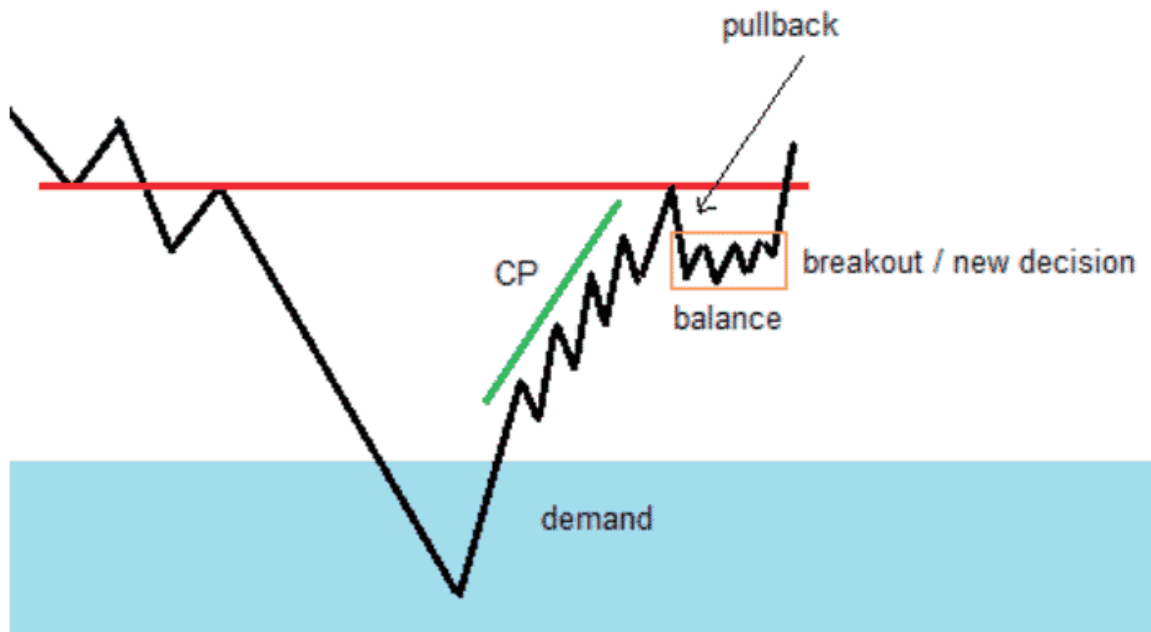


Chart 19

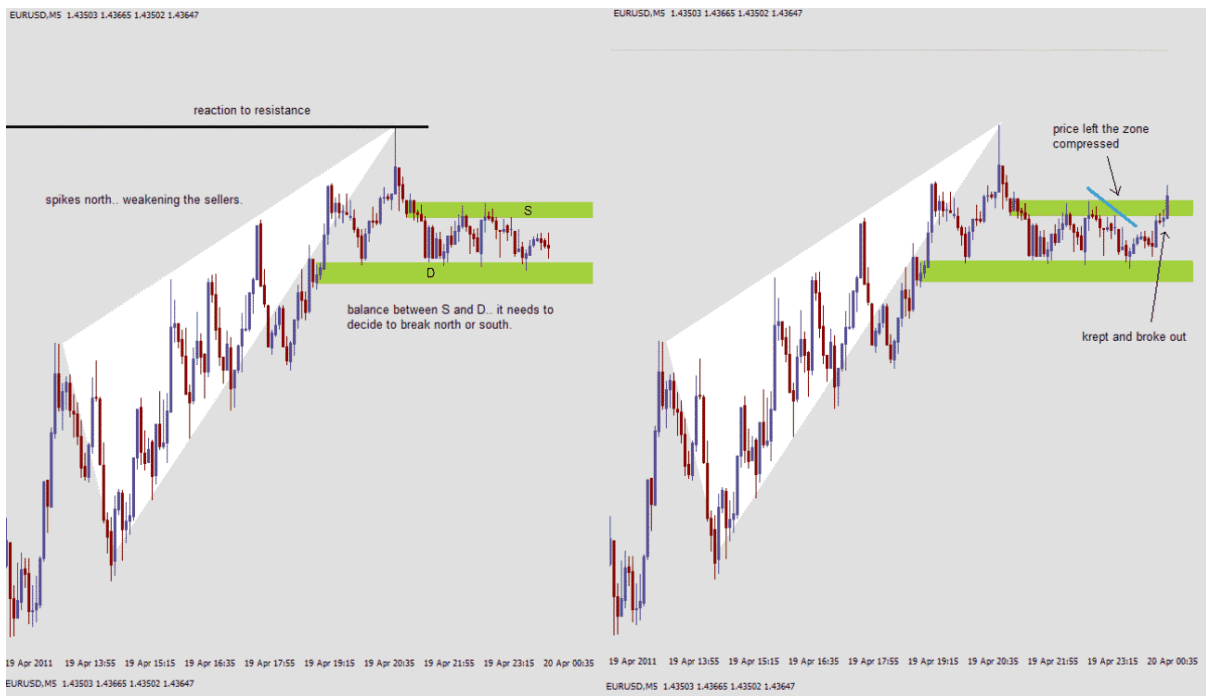


Chart 20



Chart 21



Chart 22

A note of Ifmyante: If price flags atop a cp zone, nothing is valid 'til the flag breaks, one way or the other.

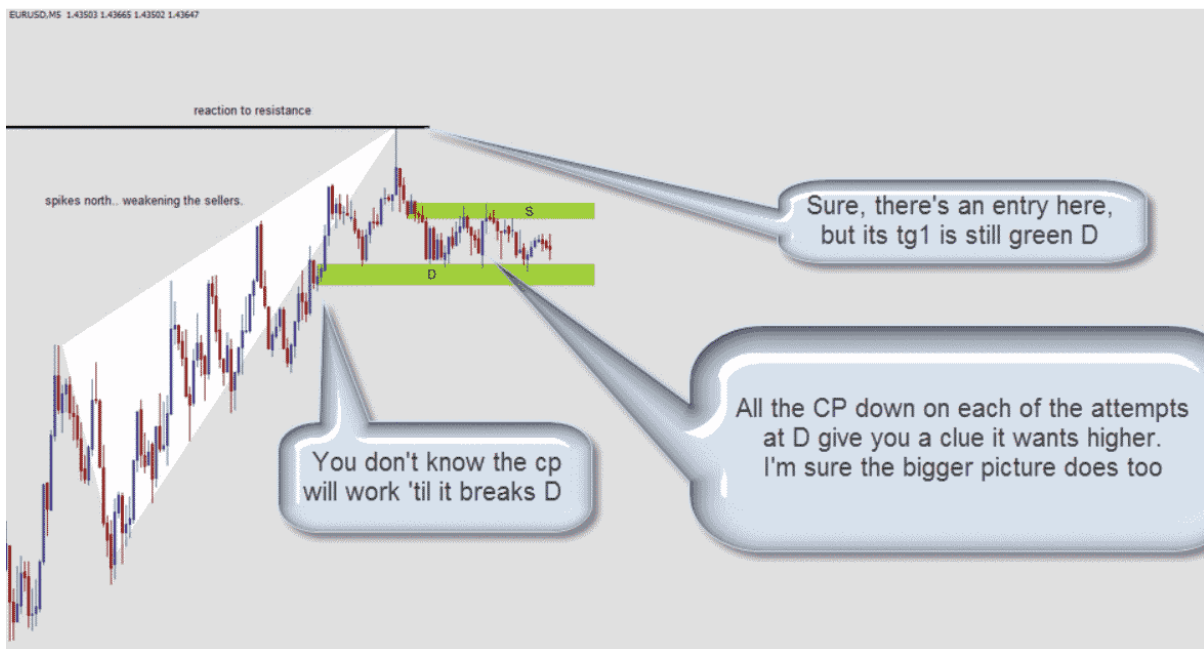


Chart 23