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# MODULE I - INTRODUCTION

## 1. WHY PRICE ACTION?

Price Action means reading price movements on the Price chart over a period of time.

Unlike other trading strategies that rely on indicators or news events, the price itself tells the whole story and provides all the information needed to take trading decisions.

*Price never Lies.* The basic idea is that price reflects all available information and market sentiment, so by studying how prices move, we can measure the strength of buyers and sellers in the market and try to anticipate future price movements.

*Price Action is based on Logic.* Price Action trading is straightforward and logical because it doesn't involve complex formulas or relying on external factors. Instead, it focuses on observing patterns, trends, and price levels on the chart to identify potential trading opportunities.

Price movements reveal everything we need to know about the market's dynamics, making it a simple yet powerful approach to trading.

In this book, we're going to learn all about Price Action. Whether you're a beginner or experienced trader, we'll explore how to use this special map to understand the market better and make better choices.

Before we dive into Price Action, let's first explore two important types of Analysis: Technical Analysis and Fundamental Analysis.

# 2. TECHNICAL VS FUNDAMENTAL ANALYSIS

## Differences Between **Fundamental** and **Technical** Analysis

| Fundamental Analysis | Technical Analysis |
|---|---|
| Fundamental Analysis evaluates securities by attempting to measure their **Intrinsic Value**.<br>If the market price is below intrinsic value, then the price will go up and vice versa. | Technical Analysis looks into **Statistical Trends** of the stock's price and volume. |
| Focus on **Economic Forces** that cause prices to move higher, lower or stay the same. | Focus on **Price Movements** because price discounts everything. |
| Fundamental Analysis **doesn't cover** Technical Analysis. | Technical Analysis **Cover** the Fundamental Analysis, because fundamentals reflect in the market price. |
| **Inflexible** i.e. separate analysis needs to be done for each and every Stock, Currency or Commodity. | **Flexible** i.e. Technical Analysis is applicable in any Stock, Currency or Commodity. |

Though Fundamentals of the company play a greater role, it is always advisable to go for Technical Analysis while opting for Trading or Short-Term Investments.

However, if one opts to go for Long Term Investments i.e. for more than a period of 10 years, one can go for either one or both of Fundamental and Technical Analysis.

# FUNDAMENTAL ANALYSIS

## What is Fundamental Analysis?

Fundamental Analysis involves evaluating a company's stock by examining its financial health and the factors that affect its Business.

In Fundamental Analysis, we look at things like how much money a company makes, how much debt it has, how well its products are selling, and if it has a good management team.

We also look at things like the overall health of the Economy, growth possible of that particular Industry and any big events happening in the world that could affect Businesses.

By looking at all these things, we can get an idea of whether a Company or the Economy as a whole is doing well and if it's likely to grow in the future.

## Here are some of the factors for Fundamental Analysis:

### 1. EPS (Earnings Per Share):

Earnings Per Share is the amount a company earns per share. This figure tells you how much profit a company makes for each share. Higher EPS generally indicates better profitability of a company.

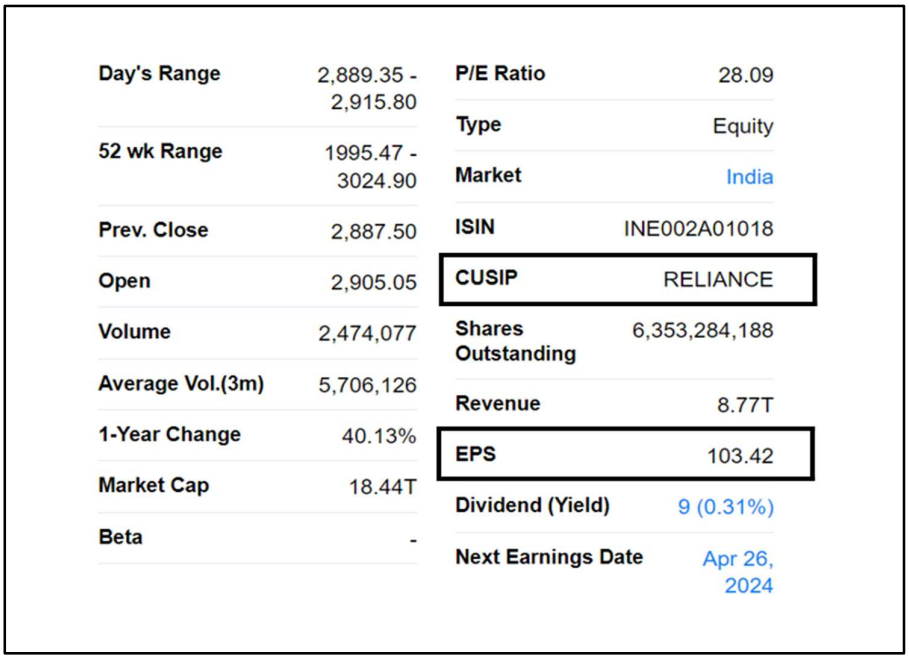
The higher the EPS value, the better the company.

**The formula for calculating EPS is:**

$$\text{EPS} = \frac{\text{Net Profit}}{\text{Number of Equity Shares}}$$

**Here is the EPS of Reliance Ltd. as of 21st March 2024.**

Source: Investing.com



| | | | |
|---|---|---|---|
| Day's Range | 2,889.35 - 2,915.80 | P/E Ratio | 28.09 |
| 52 wk Range | 1995.47 - 3024.90 | Type | Equity |
| Prev. Close | 2,887.50 | Market | India |
| Open | 2,905.05 | ISIN | INE002A01018 |
| Volume | 2,474,077 | CUSIP | RELIANCE |
| Average Vol.(3m) | 5,706,126 | Shares Outstanding | 6,353,284,188 |
| 1-Year Change | 40.13% | Revenue | 8.77T |
| Market Cap | 18.44T | EPS | 103.42 |
| Beta | - | Dividend (Yield) | 9 (0.31%) |
| | | Next Earnings Date | Apr 26, 2024 |

## 2. PE Ratio (Price-to-Earnings Ratio):

PE ratio means we are looking at a company's current stock price compared to its Earnings Per Share (EPS) - how much money it makes for each share of stock.

If a company's stock price is ₹500 per share and its EPS is ₹50 per share, then its P/E ratio is 10 (₹500 divided by ₹50 equals 10).

A low P/E ratio means the stock is undervalued. But a high P/E ratio means the stock is overvalued, like paying too much for a stock compared to how much earnings it brings in.

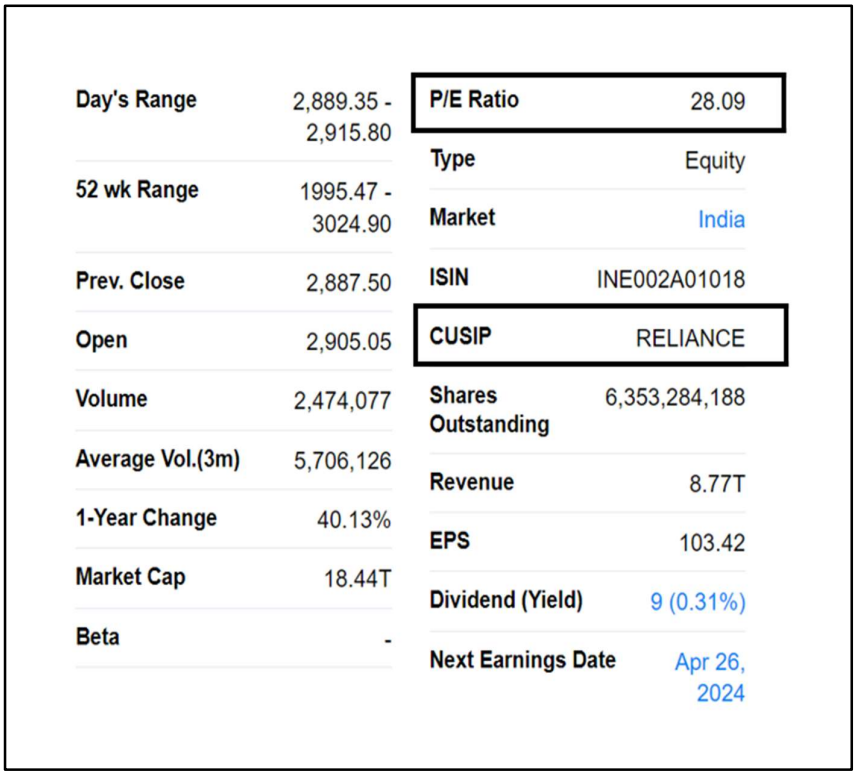
Thus, the P/E ratio helps us understand if a stock is priced reasonably compared to its earnings, just like comparing a house's price to its rental income helps you decide if it's a good deal.

**The formula for calculating the Price-to-Earnings (P/E) ratio is:**

$$\text{P/E Ratio} = \frac{\text{Share Price}}{\text{Earning Per Share}}$$

**Here is the P/E Ratio of Reliance Ltd. as of 21st March 2024.**

Source: Investing.com



| | | | |
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| Market Cap | 18.44T | EPS | 103.42 |
| Beta | - | Dividend (Yield) | 9 (0.31%) |
| | | Next Earnings Date | Apr 26, 2024 |

### 3. Growth in Profit:

Growth in profit analysis is a way of looking at how a company's earnings are changing over time.

It involves examining the company's financial statements, such as the Income Statement, to see if its profits are increasing, decreasing, or staying the same from one period to another.

**4. Growth in Sales:**

Growth in Sales analysis is a process of examining a company's sales data to understand its performance, trends, and factors affecting sales.

To analyze growth in sales, we can analyze revenue growth, sales trend, segment analysis, customer base, sales efficiency etc.

Also, we can check if the profitability of the company is increasing with an increase in revenue or the profit is stagnant.

**5. Director's Performance:**

Examining the track record and decisions of a company's management team can give insights into the company's potential future performance. A competent and successful management team often leads to better company performance.

We can consider several key factors to assess a director's qualifications, experience, and alignment with shareholders' interests. Here are some things to check:

Biographical Information, track record, reputation and integrity, industry knowledge, share ownership, corporate governance practices, etc.

**6. Book Value:**

The Book Value of a share is like the amount of money we would get if we sold all of a company's stuff (like buildings, equipment, and cash) and paid off all its debts. This is the net value of a company's assets after subtracting its liabilities.

Then, the remaining amount is divided by the number of shares the company has. It gives us an idea of how much each share would be worth if we split up the company's assets among the shareholders.

**Here is the Book Value of Reliance Ltd. as of 21st March 2024.**

Source: Investing.com

| | | |
|---|---|---|
| Profitability | - | - |
| Per Share Data | | |
| Book Value/Share | 1,182.42 | 868.68 |
| Tangible Book Value/Share | 594.49 | 465.87 |
| Cash/Share | 108.33 | 82.44 |

# TECHNICAL ANALYSIS

## What is Technical Analysis?

Technical Analysis is a method used to evaluate and predict the future price movements of Stocks based on historical market data, primarily price and volume.

Unlike Fundamental Analysis, which focuses on a company's Financial Health and Economic Factors, Technical Analysis is concerned with Patterns, Trends, and Statistical Indicators derived from past trading activity.

**Technical Analysis can be based on two major concepts:**

- Indicator Based Analysis
- Price Action Based Analysis

Indicator based analysis includes different indicators to identify the trades, these indicators are based on some formulas.

## Below are a few Indicators which are commonly used.

### 1. Relative Strength Index (RSI)

Relative Strength Index (RSI) measures the speed and magnitude of a stock's recent price changes to evaluate overvalued or undervalued conditions in the price of that share.

When the RSI is above 70, it is considered overbought or expensive, suggesting that the stock may be due for a price correction or may fall. Price Correction is explained in Chapter “Extended Moves”.

Similarly, when the RSI is below 30, it is considered oversold or available at discounted price, indicating that the stock may be undervalued and due for a potential price increase.

This usually works in Sideways market conditions.

If we’re using RSI to know if the stock is overbought or oversold, then we may get results in the Sideways market, but might not get results in the Trending market.

And to understand if the market is Sideways or Trending, we should know the Price Action.


The above image is an example of Relative Strength Index (RSI) Indicator, showing price fell because Stock was overbought


The above image is an example of Relative Strength Index (RSI) Indicator, showing price rallied because Stock was oversold

## 2. Super Trend

The Super Trend signal line is used to give trading signals. When the price crosses above the Super Trendline, it gives a buy signal, indicating a potential uptrend. Similarly, when the price crosses below the Super Trendline, it gives a sell signal, indicating a potential downtrend.

This indicator usually works in Trending market conditions. However, we can judge whether the market can be trending, only using price action.

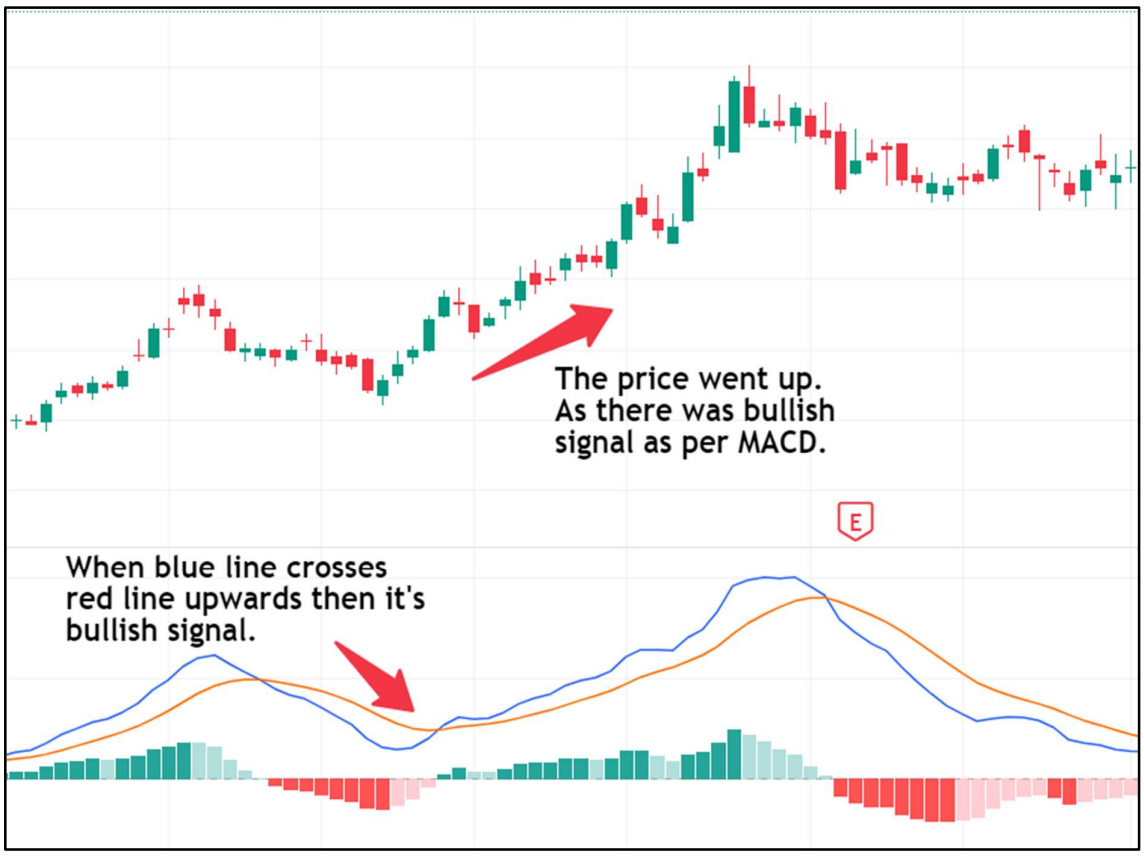

The above image is an example of Super Trend Indicator

## 3. Moving Average Convergence Divergence (MACD)

MACD helps us identify if two different speeds of moving averages are getting closer together or moving farther apart. It gives us clues about potential changes in a trend.

When the MACD line crosses above the Signal line, it generates a Bullish signal, suggesting that the momentum is shifting upward and indicating a potential buying opportunity.

Conversely, when the MACD line crosses below the Signal line, it generates a Bearish signal, indicating a potential downtrend and a potential selling opportunity.




The above image is an example of
Moving Average Convergence Divergence (MACD) Indicator

## 4. Bollinger Bands

Bollinger Bands consist of three lines plotted on a price chart: a middle line, typically a Simple Moving Average (SMA), and an upper and lower band that are a specified number of standard deviations away from the middle line.

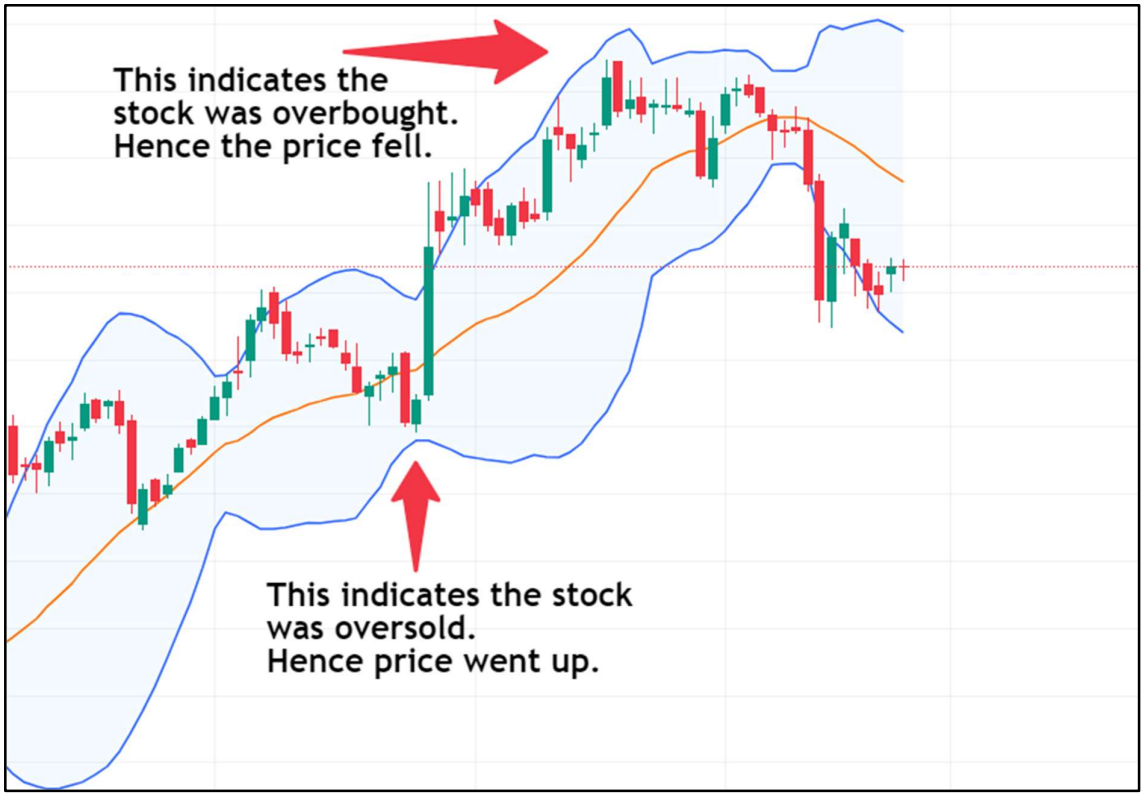
The middle line represents the short-term trend.

The upper and lower bands are calculated by adding and subtracting a specified multiple of the standard deviation of price movements from the middle line.

Bollinger Bands are used to analyze volatility and identify potential overbought or oversold conditions in the market. When the price is trading near the upper band, it may indicate that the asset is overbought, suggesting a potential reversal or pullback. Conversely, when the price is near the lower

band, it may indicate that the asset is oversold, suggesting a potential buying opportunity.

Bollinger Bands usually work in the Sideways market and can give wrong signals in the Trending market.




The above image is an example of Bollinger Bands Indicator

## 5. Volume

'Volume' indicator helps us identify the strength or weakness of price movements by analyzing the trading volume associated with those movements.

Trading volume represents the total number of shares or contracts traded (bought and sold) during a specific period, such as a day, week, or an hour (depending upon which chart we are analyzing).

So, the Volume indicator helps us see how much trading activity has happened. The colour of the volume candle doesn't matter.


The above image is an example of Volume Indicator

## 6. Simple Moving Average (SMA)

SMA takes the closing prices of a specific time frame for a specific number of candles and calculates their simple average.

For example, if we want to see SMA 20 on 1 Hour Chart:

SMA will be calculated by adding closing prices of recent 20 candles of 1 hour and divide it by 20.

We call it a moving average because as soon as the 21st candle is closed, the moving average will be calculated considering the 2nd to 21st candle, so on and so forth it will keep moving ahead considering the latest 20 candles.

However, we will not use the Simple Moving average Concept because it gives equal weightage to recent as well as old prices. Rather we should focus on Weighted Moving Average Concept i.e. called Exponential Moving Average.

## 7. Exponential Moving Average (EMA)

Exponential Moving Average (EMA) is a type of average that gives more weight to recent candle or price while calculating the moving average.

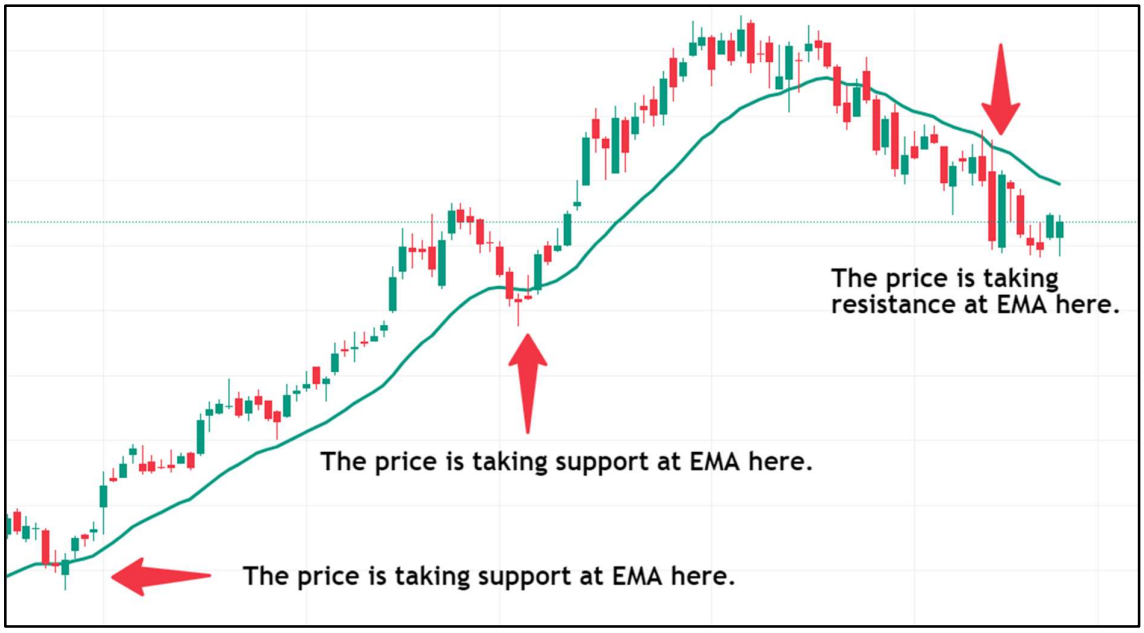
It's like looking at the most recent prices more closely while still considering older prices.

This makes EMA more sensitive to change in price compared to SMA.

So, if the price is going up or down rapidly, EMA will reflect those changes faster than the SMA.

EMA can act as a Support or Resistance. If the price is above EMA, then it can act as a Support and if the price is below EMA, then it can act as a Resistance. However, in Chapter "Extended Moves", we have discussed which time frame's EMA to rely more on.

There are many strategies for EMA crossover, but we don't directly plan trades at crossover of two EMAs, as EMA crossover strategies may give results in trending market conditions, but it might not work in sideways market conditions.




The above image is an example of
Exponential Moving Average (EMA) Indicator

These are the few common indicators which are used for trading purposes. But we will not trade on the basis of the indicators. We will always use Price Action concepts for trading.

The reason behind that is the Entry we get using indicators is delayed meaning we get late entries and because of that we do not get the desired Reward for the Risk we will be taking.

We will always aim for a minimum of 2:1 Reward to Risk Ratio which is possible though Price Action as we can get early Entries using Price Action.

# NOTES:

# 3. HOW PRICE MOVES?

When a transaction between a Buyer and Seller happens at a particular price, the price moves in that direction. For example, if a price is at 100 and the next order of a buyer and seller is at 100.50 then the price will move Up as the transaction of buying and selling happened at 100.50 and if the next order of a buyer and seller is at 99.50 then the price will move Down accordingly.

So, the price moves in real time as soon as the buying and selling transactions happen. Many transactions happen within a second, therefore we can spot very fast price movement during the live market.


The above image shows that the current price is at 2800.10


The above image shows that the price moved Up as the next order gets triggered (transaction of buying and selling happened) at 2803

Please note that at every price movement there is a transaction happening of buying and selling both, while reading charts logically we have to keep this in mind.

However, the question then arises that if both the transactions of buying and selling happen, then why does the price rally or fall?

**The answer to this question is, there are 2 reasons for the price coming up.**

1. When buyers are aggressive to buy the shares (means they anyhow want to buy immediately at whatever available price), they start buying it at a costly price and sellers are happy to sell at a costly price, due to which transactions occur at higher prices and price moves higher (rally) accordingly.
2. Another reason can be buyers want to buy particular shares, however sellers are not ready to sell it at that price, but they want to sell at a higher price only. Now if the buyer genuinely wants to buy, he/she has to buy at a costly price, due to which the transaction happens at a higher price and the price moves higher (rally).

Due to the same two reasons, prices fall as well.

# NOTES:

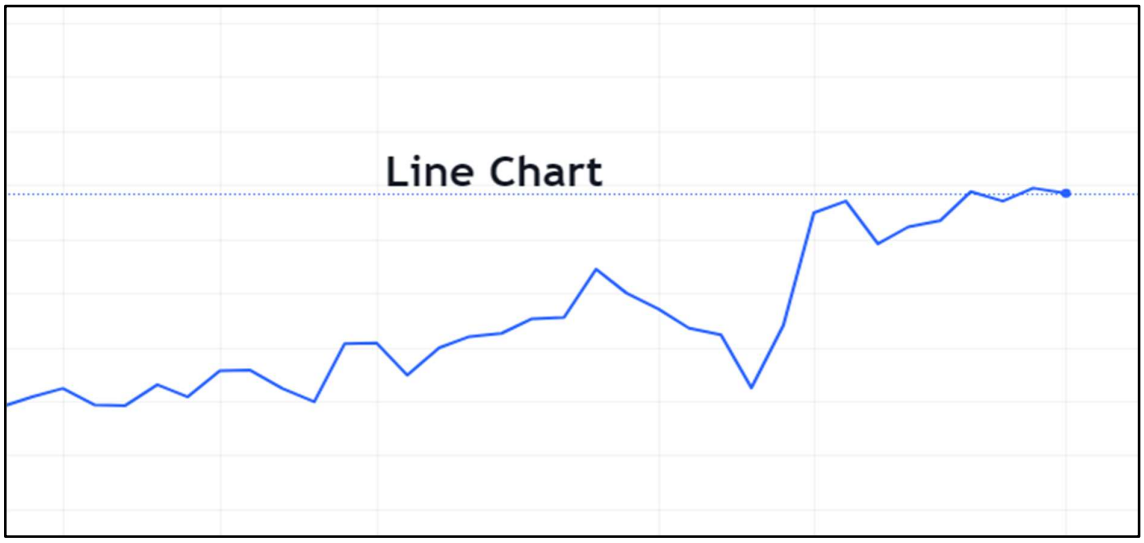
# 4. DIFFERENT TYPES OF CHARTS

We read the price movement on a chart, we should first understand different Types of Charts that represent the price movement.

There are many different types of charts, let's see few of them:

## 1. Line Chart:

Line chart oversimplifies the market data by showing only closing prices, lacking details on high price, low price, and opening price, thus, limiting comprehensive analysis.




The above image is an example of Line Chart

## 2. Bar Chart:

The Bar chart shows the span between the highest and lowest prices using a horizontal line. This line also marks the opening and closing prices. Although it shows opening, closing, high, and low values, it is difficult to use this chart as it can seem crowded and a bit tricky to understand at times.


The above image is an example of Bar Chart

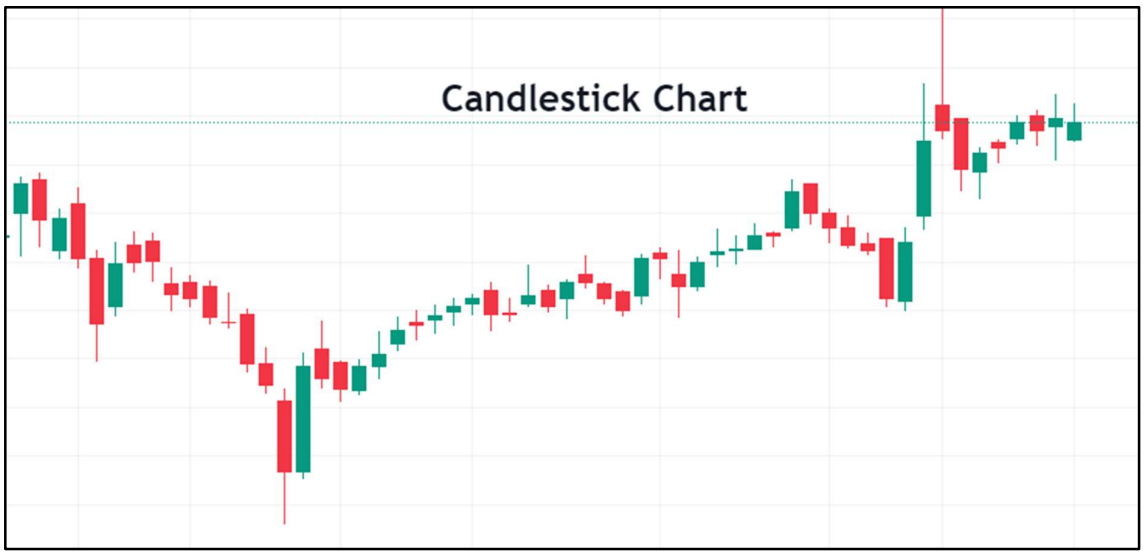
## 3. Heikin Ashi Chart:

In the Heikin Ashi Chart, we get all four parameters (Open, Close, Low, High Prices) , but it is based on a Formula, which is why we should not use Heikin Ashi Chart. Because we need original opening, closing, high and low prices to read the charts


The above image is an example of Heikin Ashi Chart

## 4. Candlestick Chart:

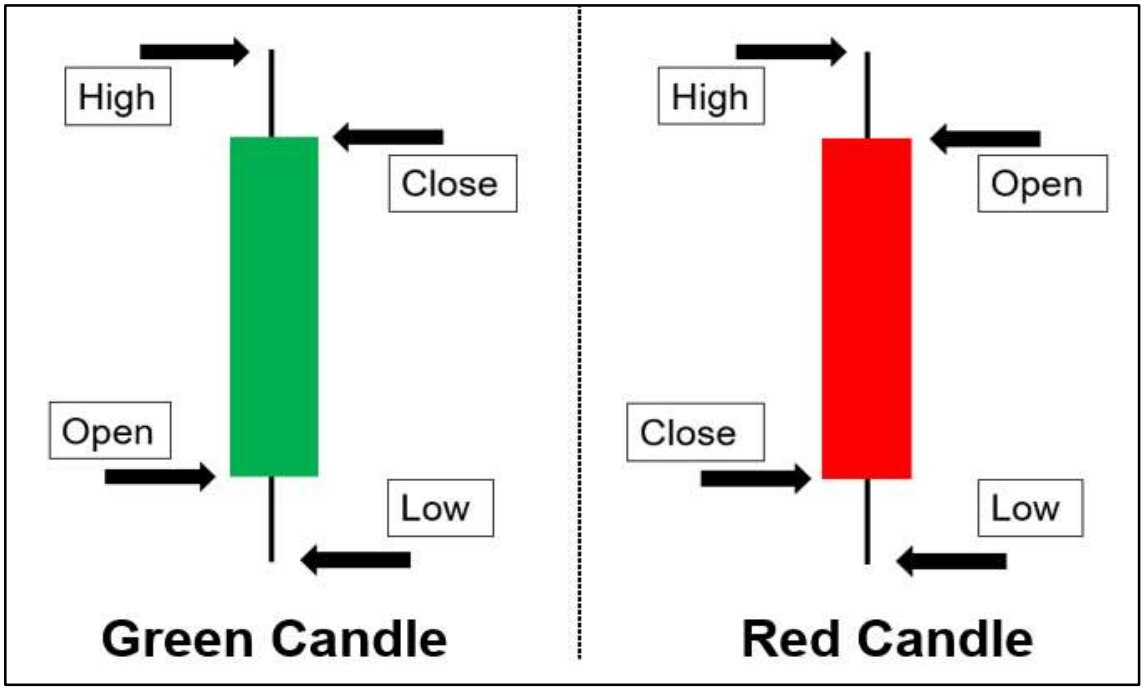
Candlestick chart displays four data points—opening, closing, high, and low prices—helping to understand the market fluctuations and price movement in a specific period in an easy manner.




The above image is an example of Candlestick Chart

To understand Price Action, we prefer to use the Candlestick chart only because in the Candlestick Chart, we get all the original (not formula based) parameters like Opening price, Closing price, High price, Low price.

In Green candle, the Closing price is above the opening price and in Red candle the closing price is below the opening price. High and Low in both the candles are same.




The above image shows opening price, high price, low price and closing price of green and red candle

Assuming we are analysing the "15 minutes chart" so every candle is of 15 minutes.

So, for the Indian stock market suppose the second candle is a Green candle starting at 09:30 AM.

**Opening Price:** First Order triggered at sharp 09:30:01.

**High Price:** Order triggered at Highest price between 09:30:01 and 09:45:00 am.

**Low Price:** Order triggered at Lowest price between 09:30:01 and 09:45:00 am.

**Closing Price:** Last Order triggered at sharp 09:45:00.

# 5. HOW TO READ CANDLES

## Introduction:

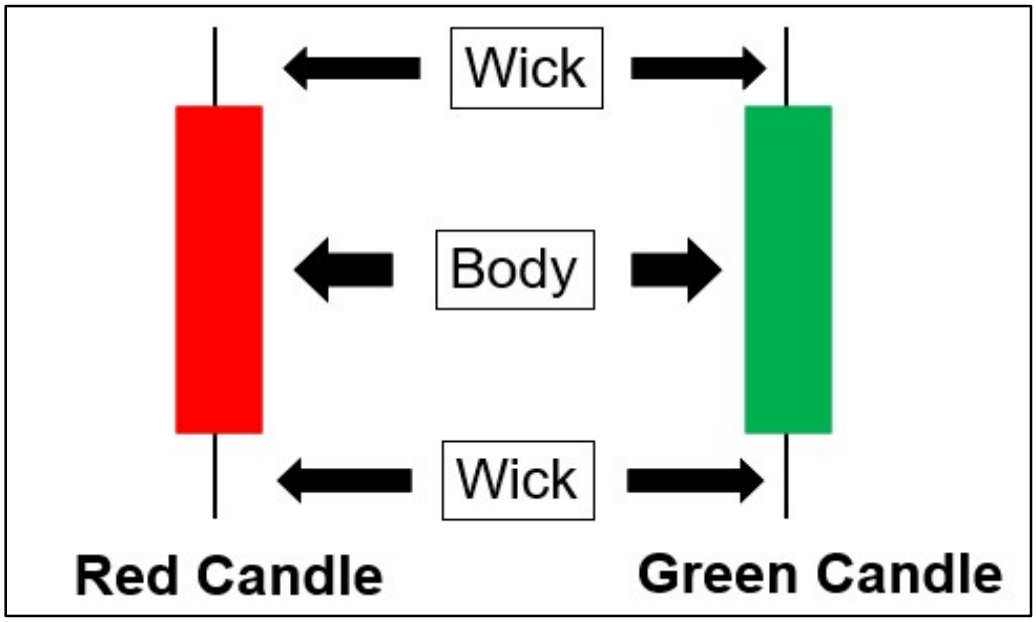
Candlesticks are formed based on the price movement within a specific time frame (e.g. 15 minutes in above example).

A candle can be of any time frame from 1 minute to 12 months as well (e.g. 5 mins/10 mins/1 hour/125 minutes/1 day/1 week)

If the closing price is higher than the opening price, a Green candle (also called a bullish Candle) is formed indicating a bullish movement.

If the closing price is lower than the opening price, a Red candle (also called as bearish Candle) is formed indicating a bearish movement.

The highest point of the upper wick and the lowest point of the lower wick represent the highest and lowest prices reached within that time frame. For both Green and Red candles, these high and low points remain the same.




The above image shows wicks and body of green and red candle

## HOW TO READ CANDLES

Bullish candles indicate aggressive Buying pressure in the market. These can be identified by:

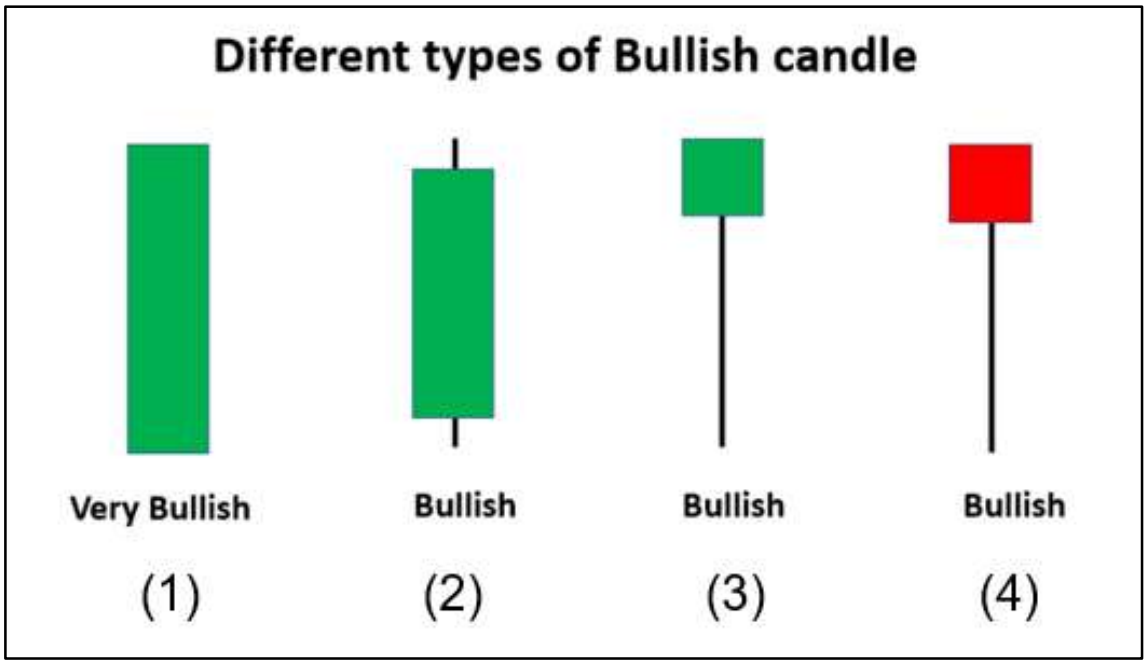
**1st case:** A complete green candle with no wicks at all.

**2nd case:** A complete green candle with very small lower and/or upper wicks.

**3rd case:** A small green candle with a significant lower wick - indicating buying pressure as the price reached its lowest point, but buyers pushed it for a higher close.

**4th case:** A small red candle with a significant lower wick - even though the candle opened above and closed down making it a red colour candle, sellers attempted to bring the price to its lowest, but buyers became aggressive, pushing the price higher. Although the closing might not be above the opening price, the strong buying pressure makes it a bullish candle for that time frame.

**Point to remember:** A candle with a long lower wick signifies substantial buying pressure, hence it can be called a bullish candle.




The above image shows different types of bullish candle

Similarly, Bearish candles indicate aggressive Selling pressure in the market. These can be identified by:

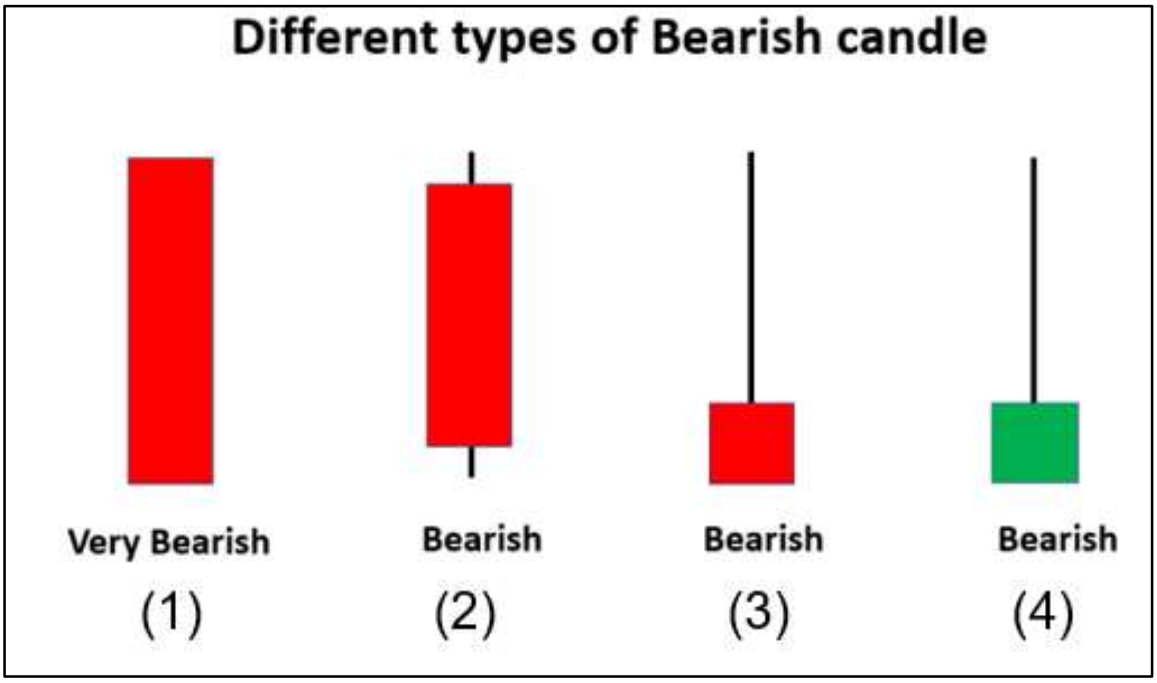
**1st case:** A complete red candle with no wicks at all.

**2nd case:** A complete red candle with very small lower and upper wicks.

**3rd case:** A small red candle with a significant upper wick - indicating selling pressure as the price reached its highest point, but sellers pushed it for a lower close.

**4th case:** A small green candle with a significant upper wick - even though the candle opened below and closed up, buyers attempted to push the price to its highest, but sellers became aggressive, pushing the price lower. Although the closing might not be below the opening price, the strong selling pressure makes it a bearish candle for that time frame.

**Point to remember:** A candle with a very long upper wick signifies substantial selling pressure, hence it can be called a bearish candle.




The above image shows different types of bearish candles

# 6.DIFFERENT TIME FRAMES OF CHARTS

The Time frame of a chart refers to the duration of each individual candle on the chart. For example, in a 15-minute chart, each candle shows a price movement of 15 minutes, while in a Daily chart, each candle shows an entire day's price movement.

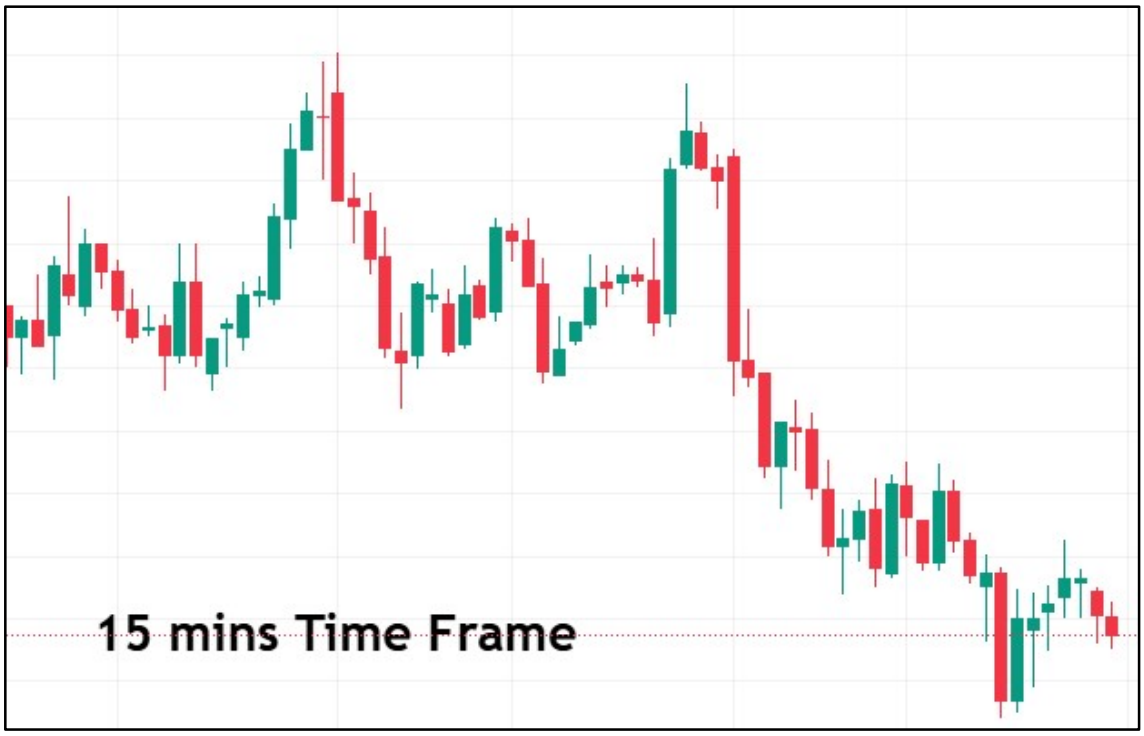
We will use different time frames depending on our Trade type i.e. Intraday, Swing or Investment.

Smaller time frames, like 10-minute, 15-minute, 75-minute, etc, charts are ideal for Intraday traders who focus on shorter trends. Longer time frames, like Daily, Weekly, etc, charts are better suited for Swing traders and Investors who focus on broader trends.

Combining multiple time frames gives a clearer picture of the market, with Higher Time Frames providing the overall trend and Lower Time Frames offering precise Entry and Exit points.

This will be discussed in detail in the Intraday Specific Program, Swing Specific Program, Options Trading Program and Investment Specific Program.

## Let's see few examples of Different Time Frames of Charts:




The above image is of the 15 mins time frame chart in which each candle represents opening, closing, high and low prices of every 15 minutes time period.


The above image is of the 75 mins time frame chart in which each candle represents opening, closing, high and low prices of every 75 minutes time period.


The above image is of the Daily time frame chart in which each candle represents opening, closing, high and low prices of the Daily time period.


The above image is of the Weekly time frame chart in which each candle represents opening, closing, high and low prices of the Weekly time period.

# 7. WHY LOGICS & PROBABILITY ENHANCERS OF EVERY PRICE ACTION CONCEPT?

## About Price Action

- Price Action means reading price movements on the Price chart over a period of time.
- In Price Action, we look at Patterns, Trends, Support and Resistance levels, and other aspects visible in the price movement to create a viewpoint or to determine Entry and Exit points for taking appropriate Trading Decisions.
- Price Action is used to determine the Buying & Selling areas in which we can trade.
- Price Action is used to determine logical Entry & Exit points rather than just formula or fundamental based.
- Price Action is based on Logics and not on Formulas or Fundamentals.

## Price Action is a Subjective Concept

Subjective means it's based on personal opinions or experiences rather than universal facts. Since price action concepts are purely based on logic and not on formulas, we have to understand that there can be differences of opinion while applying the price action practically on charts, so we have to focus on a more logical perspective and need not to debate upon.

Even though Price Action is Subjective, Subjectivity in price action analysis does not imply that it lacks value or reliability. We can develop our own trading strategies based on the observations and experience, aiming to minimize subjectivity and increase the consistency of the analysis. We have to establish specific rules and guidelines to make our approach more objective and reduce the impact of personal biases.

## Logic of Price Action Concepts

We will be covering the logic of most of the Price Action concepts in this Book.

In Trading, having a logical understanding of each and every concept is essential for long-term success. It's not enough to simply follow strategies or memorize market patterns.

By understanding the logic behind every concept, we can understand not just the "what" but also the "why" and "how." Understanding the logic behind these concepts allows us to see how various factors interact in the markets.

The logical foundation of each and every concept will help us in making informed decisions, adapting to different market conditions, and avoiding costly mistakes.

This ensures that knowledge is not just surface level but can be applied effectively in practical situations.

## Probability Enhancers of Price Action Concepts

### What are Probability Enhancers?

Probability means the chance or likelihood of something happening.

Enhancers are things that improve or increase quality or effectiveness.

Probability Enhancers are things that improve the chances of something happening successfully.

It refers to techniques or concepts that increase the likelihood of success of a particular price action concept.

For example, to draw a Trendline we need any 3 pivots (far or nearby) but if those 3 pivots are recent (nearby pivots) then we can rely more on that Trendline. We will cover this topic in detail in Chapter “Which Trendline to Rely On?”.

Trendline is a concept which is a pattern we identify and draw on charts but identifying and drawing Trendline with recent pivots is a Probability Enhancer.

Probability Enhancers increase the trader's edge by providing additional confirmation.

We will be discussing Probability Enhancers of most of the Price action concepts. You have to focus on understanding these probability enhancers logically, rather than just memorizing the same.

# NOTES:

# MODULE II-
# BASIC PRICE ACTION

## 8. DOW'S THEORY

### About Dow's Theory

The Dow in Dow's Theory refers to Charles H. Dow, an American journalist, economist, and co-founder of the Dow Jones & Company. He is best known for creating the Dow Jones Industrial Average (DJIA) and for his foundational work in technical analysis, which later became known as Dow's Theory.

Mr. Dow studied numerous charts and observed that whenever Prices move Upward, they don't go straight up, and the same applies when prices move downward—they don't go straight down either. Instead, there's a pattern: a movement in a particular direction either Up or Down followed by a Retracement or Correction.

Based on his observations, he formulated a theory that revolved around studying pivotal points, also known as Swings. Pivots or Pivotal Points are the turning points in the price movement.

These pivots are of two categories: High pivots and Low pivots.

**High Pivot-** A High Pivot is a reversal point of a stock reaching a peak and starts to go down.

**Low Pivot-** On the other hand, a Low Pivot is a reversal point of a stock reaching low and starts coming up.


The above image shows High Pivot and Low Pivot on a chart

By studying these pivots, we can identify the trend movement. For this, we need to consider the latest four pivots (2 high pivots and 2 low pivots) regardless of the previous ones.

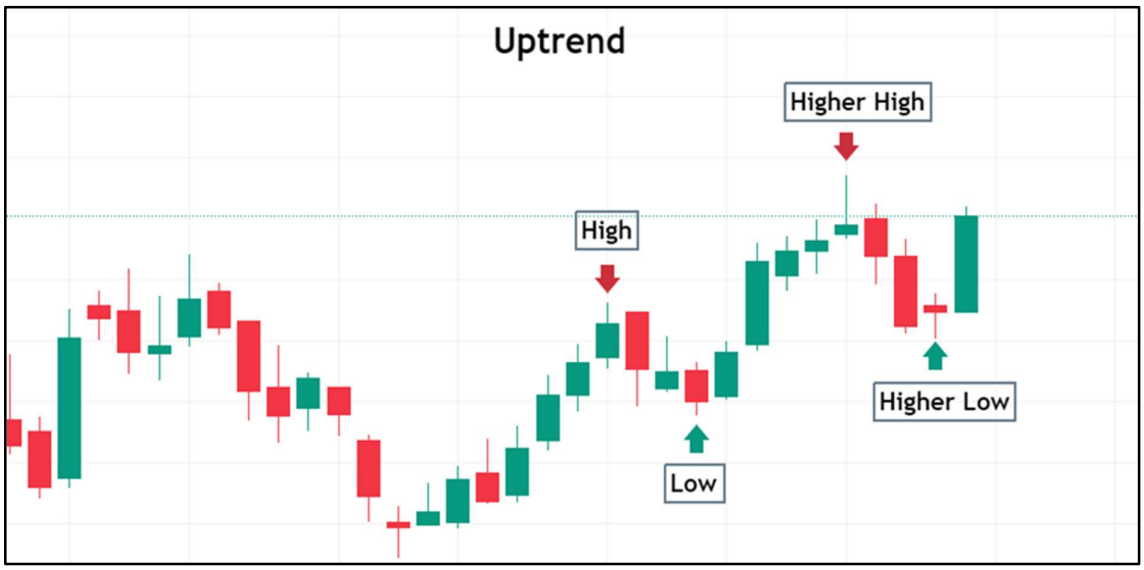
When the price forms Higher Highs and Higher Lows, it indicates an Uptrend—a direction where the stock's trend is Upwards.

Conversely, a Downtrend occurs when the price forms Lower Highs and Lower Lows.

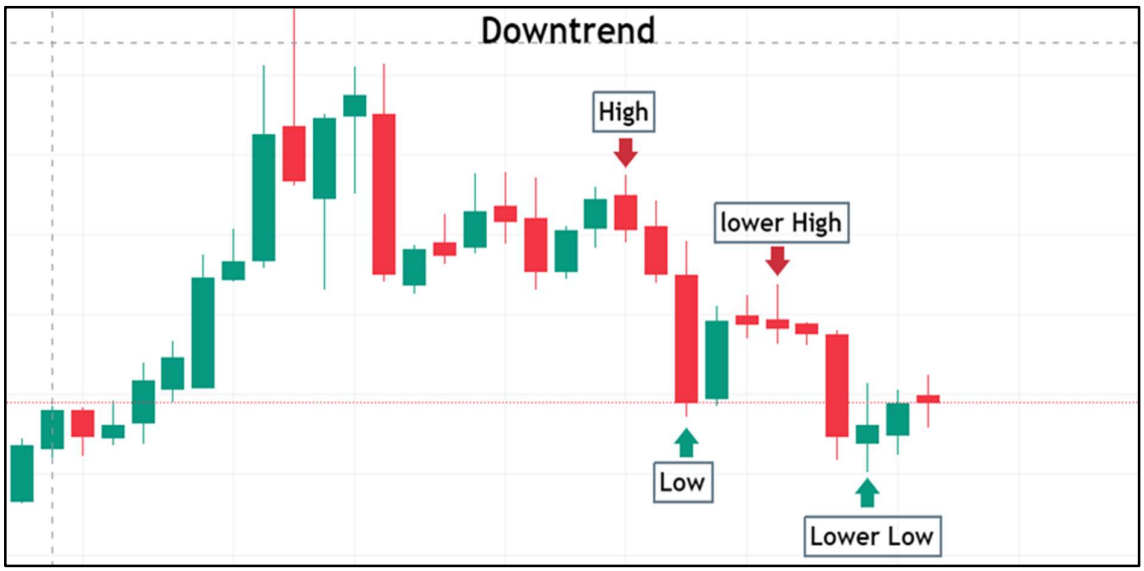
Any other pattern indicates a Sideways trend i.e. Lower High- Higher Low, Higher High- Lower Low, Lower High- Equal Low, Higher High- Equal Low, Equal High- Lower Low, Equal High- Higher Low, Equal High- Equal Low.

| SWING's Condition | Trend |
|---|---|
| Higher Highs & Higher Lows (HH-HL) | UP |
| Lower Highs & Lower Lows (LH-LL) | DOWN |
| Neither HH-HL nor LH-LL | SIDEWAYS |

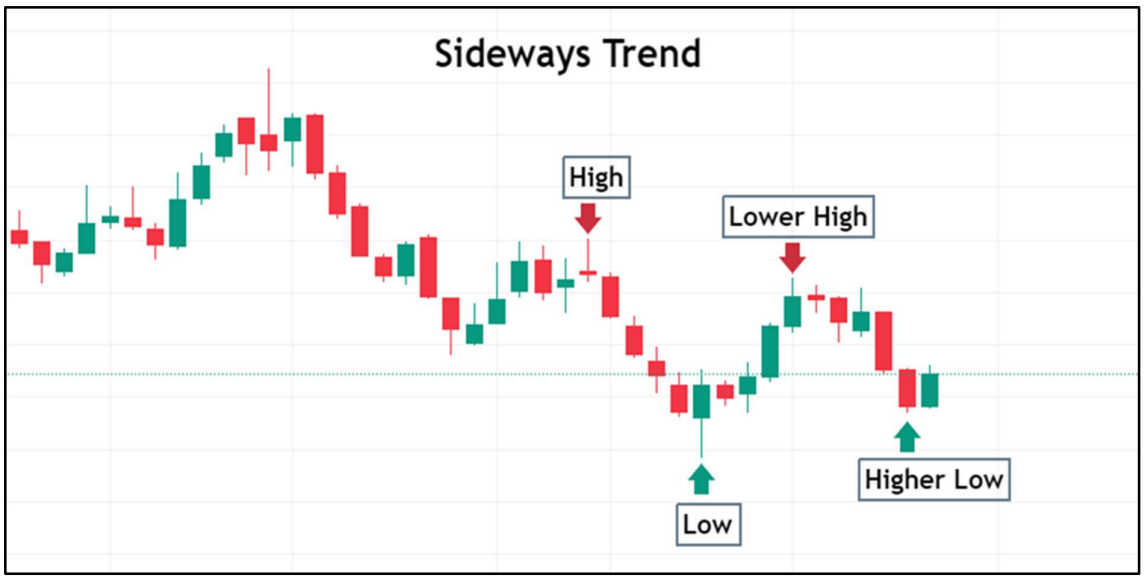
Trend conditions change with each movement, and this change occurs across different time frames. For instance, when examining a 15-minute chart, one would refer to a 15-minute trend, and the same principle applies to other time frames.



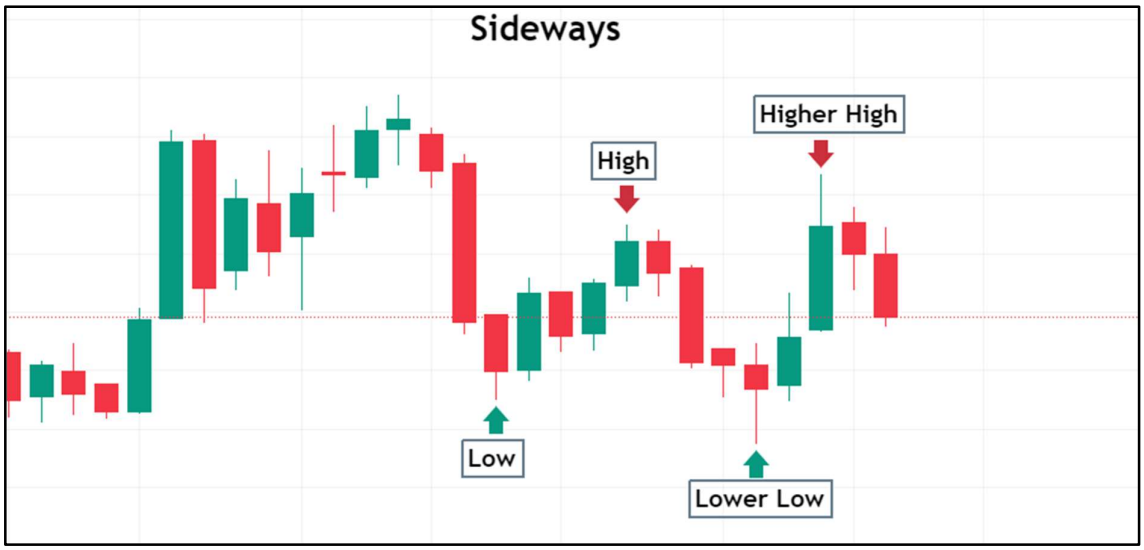

The above image is an example of Uptrend as latest 4 pivots are Higher High-Higher Low (HH-HL)




The above image is an example of Downtrend as latest 4 pivots are Lower High-Lower Low (LL-LL)

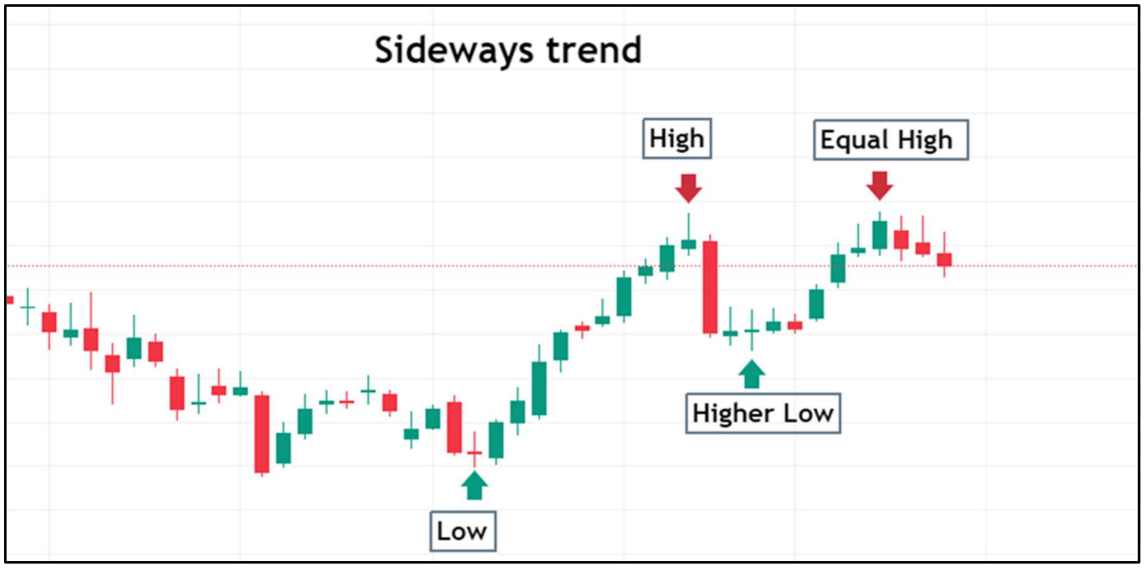



The above image is an example of Sideways Trend as latest 4 pivots are Lower High-Higher Low (LH-HL)




The above image is an example of Sideways Trend as latest 4 pivots are Higher High-Lower Low (HH-LL)


The above image is an example of Sideways Trend as latest 4 pivots are Lower High and Equal Lows




The above image is an example of Sideways Trend as latest 4 pivots are Equal Highs and Higher Low

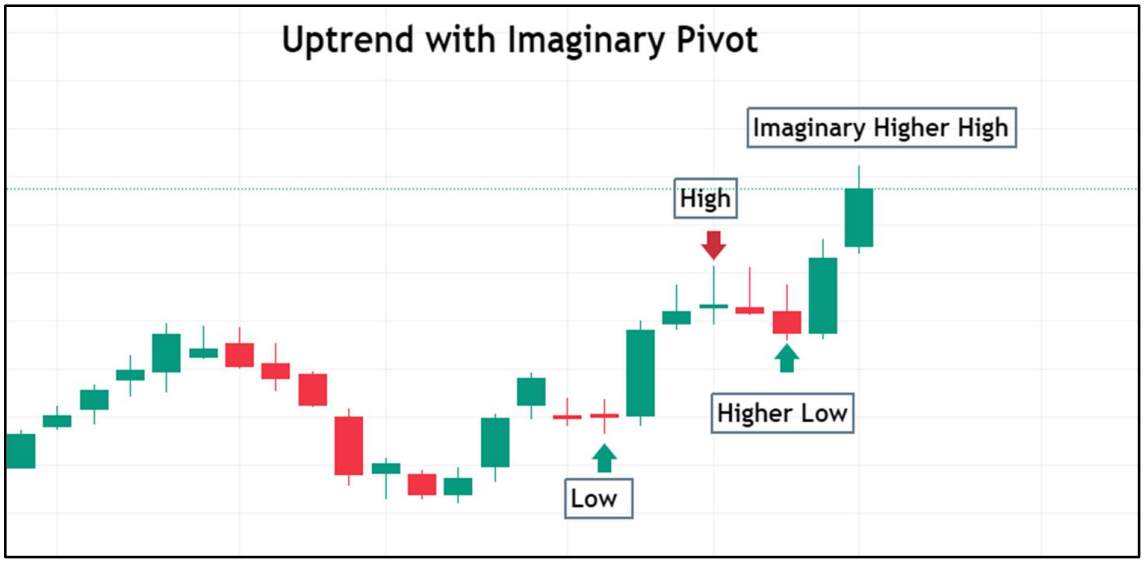
**Summary:** Dow's Theory is used to identify the trend condition of a chart using the recent 4 pivots. According to Dow's Theory, when the recent 4 pivots are in a formation of Higher High and Higher Low it is said to be in Uptrend and when the same are in a formation of Lower High and Lower Low it is said to be in Downtrend. If the formation of recent 4 pivots are anything other than Higher High-Higher Low and Lower High-Lower Low, then it is said to be in Sideways Trend.

## IMAGINARY PIVOTS

An imaginary pivot refers to the recent pivot, which is not yet formed, but its point/place is logically estimated before it is formed. They're like markers that help predict where the price has changed direction or could change the direction.

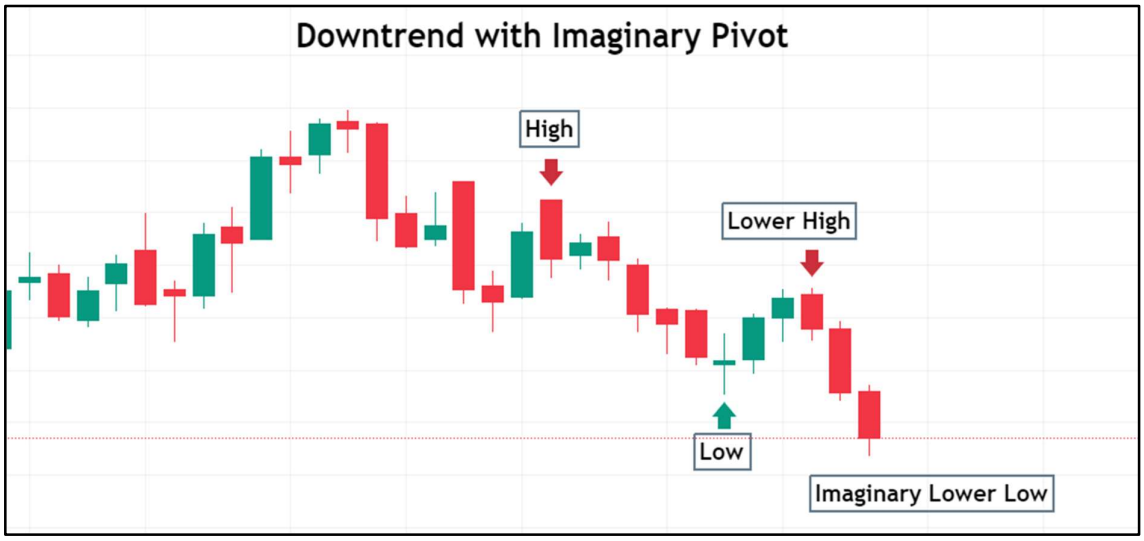
To determine an imaginary pivot, we consider the three most recent pivots, and the fourth one will be an imaginary pivot, i.e. an estimated pivot before it actually forms.

- When the price crosses a recent High pivot, logically the next High pivot is going to form above the previous High, making it an Imaginary Higher High formation.
- In such situations, we have to Imagine the next High pivot and identify the Trend condition accordingly.




The above image is an example of Uptrend with an Imaginary Higher High as price has crossed the previous High.

- When the price crosses a Low pivot, logically the next Low pivot is going to form below the previous Low, making it an Imaginary Lower Low formation.
- In such situations, we have to Imagine the next Low pivot and identify the Trend condition accordingly.




The above image is an example of Downtrend with an Imaginary Lower Low as price has crossed the previous Low

## LOGIC OF DOW'S THEORY

Now, as we know, that price doesn't travel in a straight line, it gives pullback or retraces. So, the question comes, "Why does pullback or retracement happen?"

There are 2 main reasons due to which price gives pullback/ retracement:

1. Profit Booking
2. Costly Price

Profit Booking: When the buyers keep buying a particular stock, the price moves up. At some point, a few buyers will think that they have made enough profit from that particular stock. After that, they will start booking their profit, meaning they will start selling now. As a result, price will fall which we call as pullback or retracement.

Now, at the time of pullback or retracement, another group of Buyers might think that now the price is cheaper as compared to the earlier rally and they will start buying which makes the price go up again.

This is how the price generally moves up after a pull back.

Costly Price: When the buyers are continuously buying, due to which price is constantly coming up, at some point a group of buyers might think that now the price of that particular stock is very costly. Due to this they stop buying which reduces the buying pressure and then the seller might take control to bring the price down for a pullback.

## PROBABILITY ENHANCERS OF DOW's THEORY

### MAJOR PIVOTS vs MINOR PIVOTS

Minor pivots mean Small U-turns.

Major pivots mean Big U-turns.

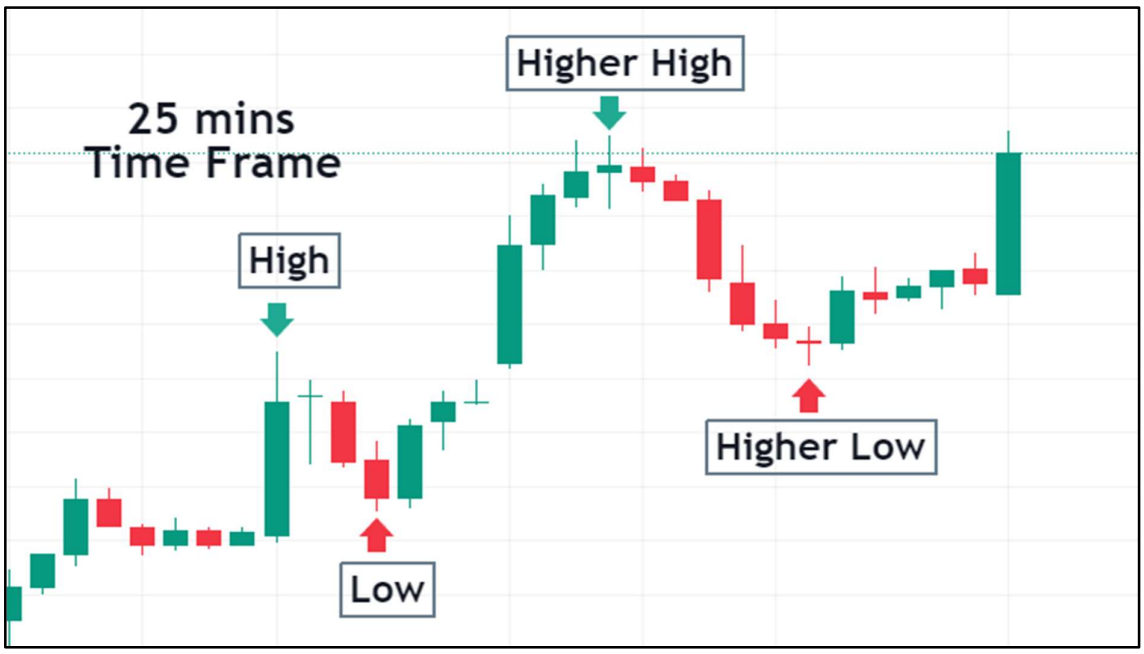

The above chart shows Major pivots and Minor pivots formation

Identifying trends can be confusing due to the presence of both Major and Minor pivot points on charts. To clarify this confusion, we should focus on following:

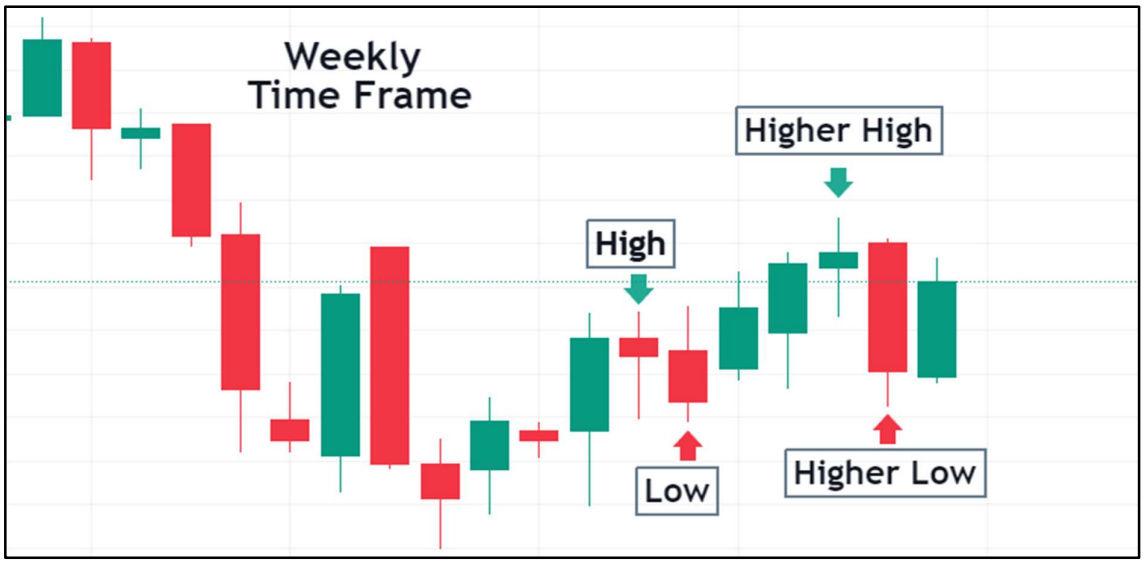
**1st Priority:** Try to identify the pattern of price movement, looking at recent few pivots, if stock mostly forming major pivots, then focus more on major pivots and vice versa.

**2nd Priority:** If you are not able to understand using the first priority, then it is recommended that when looking at shorter time frames like 15 mins/75 mins/ 125 mins we focus on Major Pivots to determine the trend. And, for longer time frames such as Weekly or Monthly, we pay attention to Minor Pivots as well as major pivots, whichever looks more appropriate. In the Daily Time Frame, we might consider both Major and Minor pivots, and the choice between them depends on the overall chart pattern.

| Time Frame | Pivots we should consider |
|---|---|
| Less than Daily Time frame | Major Pivots are preferable |
| Daily | Major or Minor Pivots depending on the overall chart pattern |
| More than Daily Time frame | Major or Minor Pivots depending on the overall chart pattern |




In the above chart we have considered Major pivots to identify the trend




In the above chart we have considered Minor pivots to identify the trend, as price has recently formed 4 minor pivots, and the time frame is also Weekly (Above Daily Time frame)

Point To Remember: While identifying a trend, we have to study the Highs and Lows by focusing on the wicks, not the Opening and Closing prices.

## What to do when in doubt?

When we are confused whether the trend is Up or Sideways or sometimes confused between Down and Sideways or in a very rare situation, we are confused whether the trend is Up or Down then we will take conservative approach and reject the trade.

For examples,

1. Suppose we are confused whether the trend is Sideways or Down and there is an opportunity in which if the trend is Sideways then we will reject the trade and if the trend is Down then we will take the Short trade. In such a situation, we will take the conservative approach by considering that the trend is sideways and will reject the trade.
2. Similarly, if we are confused whether the trend is Sideways or Up and there is an opportunity in which if the trend is Sideways or Up then we can take the Long trade. In such a situation, we will take the trading decision as it doesn't matter in that particular trade. If the trend is down, then we will reject the trade but other than that if it doesn't make a difference then we will proceed without wasting time and simply plan the Long trade.

When we are in doubt, we will take the conservative approach and simply reject the trade and will move on to look for another better opportunity. We will always prefer to take a **Best Quality Trade**.

## Focus only on your Time Frames Trend

Suppose we are planning an Intraday trade, and we have to look for trend condition in a 15 or 25 or 75-mins time frame then we will focus on those time frames only. We will not check trend conditions in Weekly or Monthly or any other time frames.

Similarly, if we are planning a Swing trade, and we have to look for trend condition in the Daily time frame, then we will not look for trend condition in any other time frame.

To summarize this, we simply have to focus on our time frame in which we have to check the trend condition to take trading decision and ignore other time frame's trend conditions as they are not useful for that particular trade or trade type.

# NOTES:

# 9. SUPPORT AND RESISTANCE

## SUPPORT:

Support refers to a specific level on a chart where buying pressure is strong enough to overtake the selling pressure and move the falling price to a rally or does not allow the price to fall from a particular level.

Imagine this scenario: When the price of a stock is dropping due to selling pressure but, at a certain point, buyers step in and start purchasing the stock, causing the price to reverse and move upward. This turning point, where buying pressure overtakes selling pressure, marks the Support level.

The Support level will always be below the current market price.


The above image shows price is taking Support at a particular point

## RESISTANCE:

Resistance refers to a specific level on a chart where selling pressure is strong enough to overtake the buying pressure and move the rising price to fall or does not allow the price to rise from a particular level.

Imagine this scenario: when the price of a stock is rising due to buying pressure, but at a certain point, sellers step in with a stronger force, causing the price to turn around and head Downward. This turning point, where selling strength overtakes the buying pressure, marks the Resistance level. Here the selling interest becomes dominant, preventing the price from rising further.

The Resistance level will always be above the current market price.

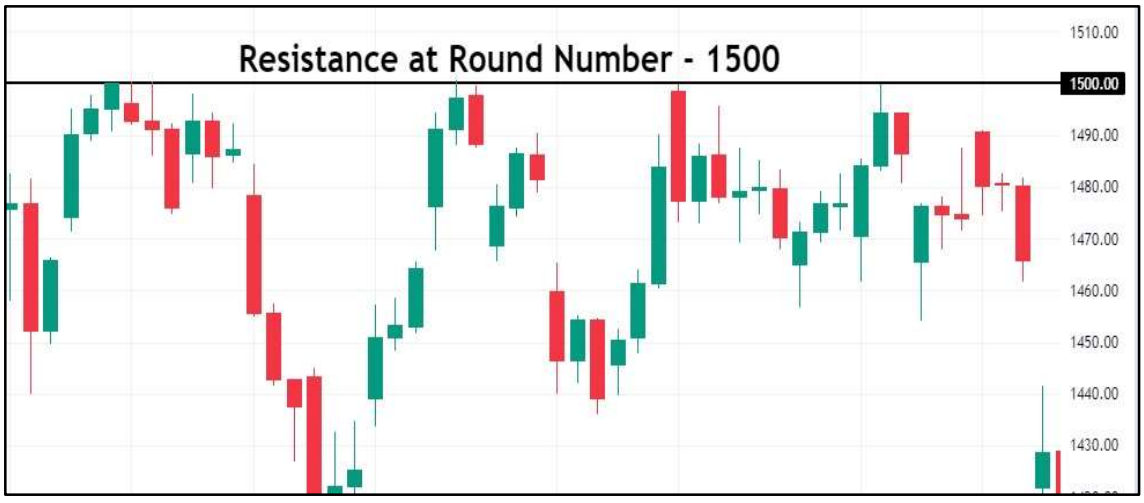

The above image shows price is taking Resistance at a particular point

## WHAT ALL CAN ACT AS A SUPPORT & RESISTANCE?

**1.** Round Numbers: Round numbers such as 100, 500, 1000, 2000, 1500, or 1800 can often act as a Support or Resistance due to psychological impact.

If the price is below a round number, then it can act as a Resistance and if the price is above a round number, then it can act as a Support.


The above image shows that 1000 round number acting as a Support




The above image shows that 1500 round number acting as a Resistance

**2.** <u>Straight Lines:</u> Horizontal lines drawn on a chart at consistent price levels where the price has previously reversed can indicate Support or Resistance. Ideally, we draw a straight line by connecting 2 or more support/resistance pivots.

Support line will always be below the current market price and Resistance line will always be above the current market price.


The above image shows that Straight Line acting as a Support

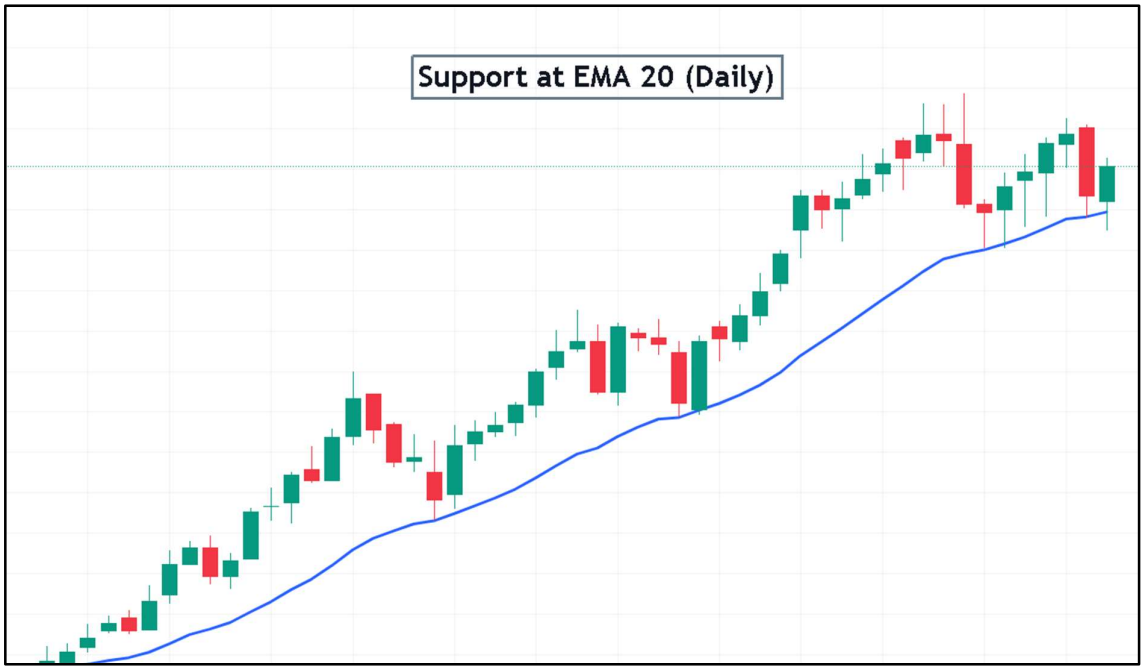

The above image shows that Straight Line acting as a Resistance

**3.** <u>Moving Averages (EMA):</u> We consider EMA 20 of Daily/ Weekly/Monthly time frames to act as a support or resistance. The logic and reason behind this are explained in Chapter "Importance of EMA 20 or Why EMA 20?"

If the trend is up, the price may take support at EMA 20.

Conversely, if the trend is down, the price may take resistance at EMA 20.

In sideways markets, there is no significance of EMA 20 at all.




The above image shows that price taking support at EMA 20 of Daily Time Frame


The above image shows that price taking resistance at EMA 20 of Daily Time Frame

**4.** <u>Trendlines:</u> Sloping lines drawn to connect recent pivots (price lows or highs) in an Uptrend or Downtrend can act as support or resistance depending on how the price interacts with them. Trendline means price tends to take Support or Resistance at a specific angle.

The above image shows that price taking resistance at Trendline

The above image shows that price taking support at Trendline

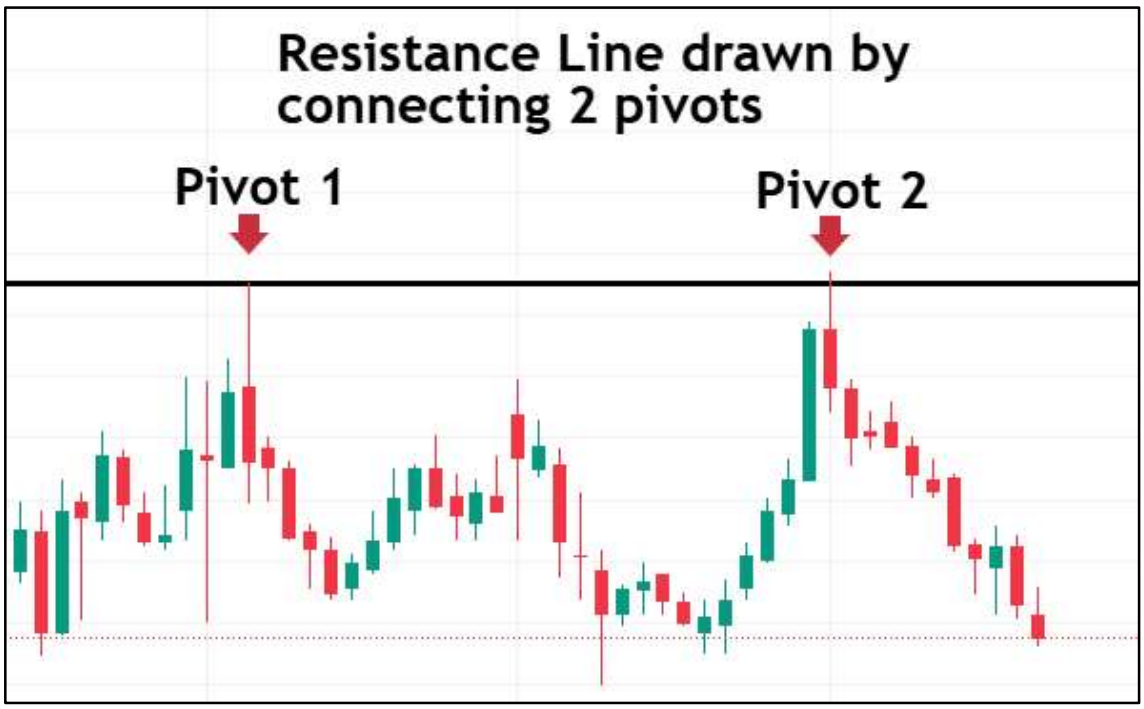
## How to Draw Support & Resistance

### Round Numbers:

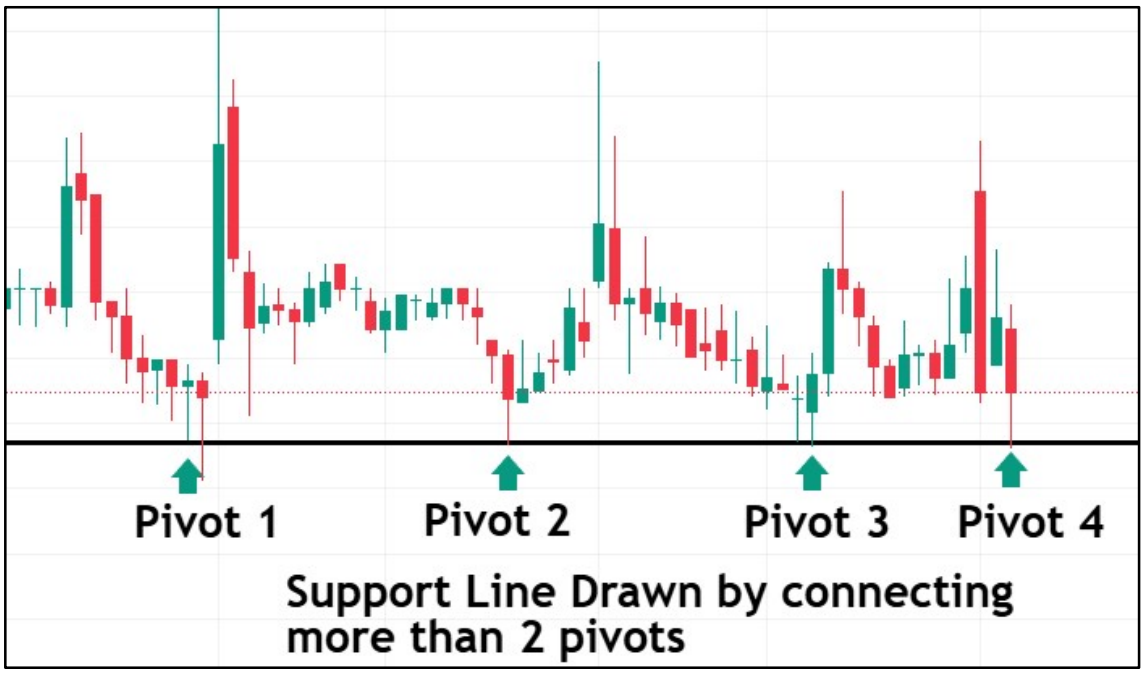
We will simply draw a horizontal line at strong round numbers such as 100, 500, 1000, 2000, 1500, or 1800; as these round numbers can often act as a Support or Resistance due to psychological impact.

### Straight Line:

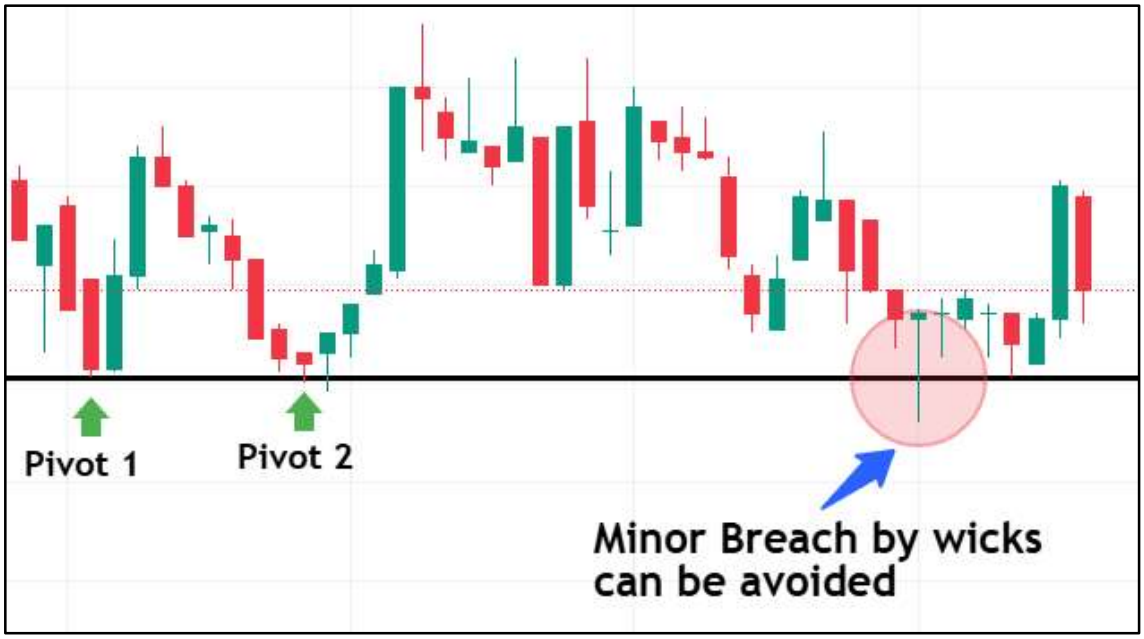
- We draw a straight line by connecting 1 or more Support/Resistance pivots.
- In support, we try to connect lower wicks and in resistance, we try to connect higher wicks. Price should not close beyond the support or resistance line. Minor breach by wicks can be ignored.
- We will always try to connect maximum points in a straight line, but care needs to be taken that not a single candle should close beyond this straight line.




The above image shows a valid Resistance Straight line is drawn by connecting 2 pivots




The above image shows a valid Support Straight line is drawn by connecting more than 2 pivots




The above image shows a minor breach in the Support Straight line. But as the breach was by wicks (candles not closing below the support line), it can be avoided.


The above image shows a minor breach in the Support Straight line. But the breach was by candle closing below the Support line. We should not draw a line like this.


The above image shows the proper way to draw the line by taking the line a little bit lower and instead of trying to connect 4 pivots, we will connect 3 proper pivots.

## Exponential Moving Average (EMA):

EMA is an indicator which is an inbuilt tool in Trading View. We just have to enable it. We don't have to calculate or plot it.

## Trendline:

We will discuss 'How to draw a Trendline' in detail in Chapter "How to Draw a Trendline" ahead.

## MORE TESTING OF A LEVEL MAKES A LEVEL WEAKER

Testing of a level (Support/Resistance) repeatedly, will make the level (Support/Resistance) weaker.

For example, imagine a Straight line acting as Resistance at 500. Every time the price approaches this level, the resistance level becomes weaker and weaker i.e. this level can be violated at any point.

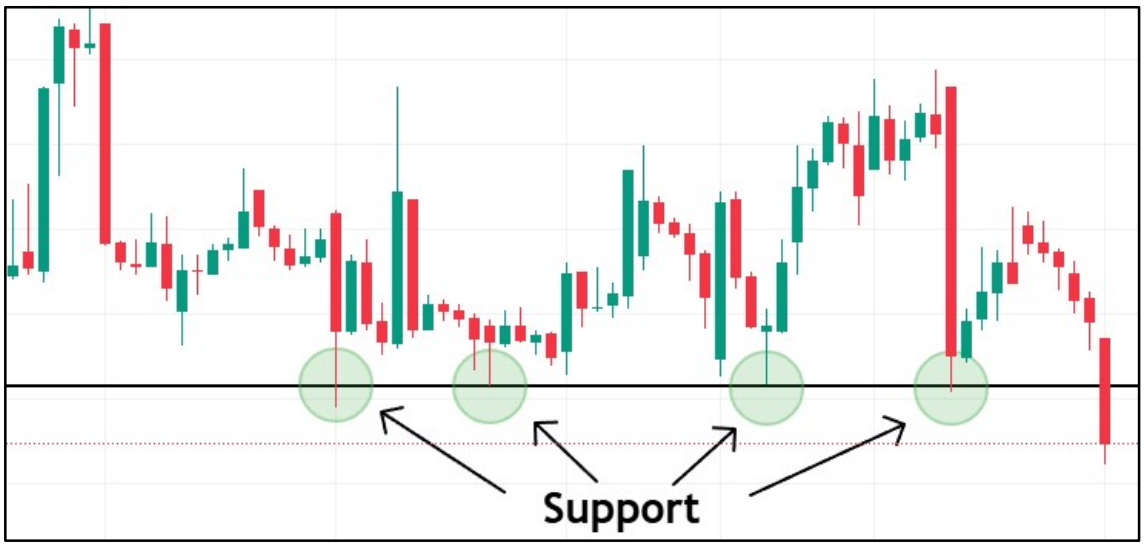
Logic 1: Sellers actively push the price down from the resistance level, however after several attempts, sellers might struggle to defend their position (Resistance level), allowing the price to break through the Resistance level eventually. This repeated testing weakens the Resistance level as sellers exhaust their capacity to keep the price below that mark.

Logic 2: If Price approaches the Resistance level, again and again that means sellers are not that strong to bring the price down enough that the price doesn't come at resistance level again. Since, the price approaches the level again and again that means sellers are not at all strong.

Considering both the logics we can say that since this resistance level is multiple times tested, it can be violated (Breakout) at any given point.

This logic applies to both Resistance as well as Support levels, including Round Numbers, Straight lines, or Trendlines.


The above image shows more times tested Resistance Level got violated (Breakout)




The above image shows more times tested Support Level got violated (Breakdown)

# REVERSAL IN ROLES (LAW OF POLARITY)

## What is Law of Polarity?

The Law of Polarity means when a significant support/resistance level is breached decisively, it can reverse its role from Support to Resistance, or vice versa.

A Support line usually becomes a Resistance line once it is decisively broken.

A Resistance line usually becomes a Support line once it is decisively broken.

**Example:** When the price hits a resistance level at 500 and forms a straight line, it indicates a strong barrier. However, when sellers give up and the price breaks above this resistance level, that straight line can transform into a support level. Essentially, the previous resistance can now act as a potential support for the price, suggesting a higher chance of the price continuing to rise after giving pullback to that level i.e., 500. Hence, we say "Resistance becomes Support."

The same concept is applied for support as well, where we can say “Support becomes Resistance”.


The above image shows Straight Support Line acting as a Resistance after it is decisively broken


The above image shows Straight Resistance Line acting as a Support after it is decisively broken

## Logic of Law of Polarity:

If the price has taken resistance at level 500 that means sellers have sold aggressively at 500 level. However, if the price fluctuates within a small range i.e. doesn't fall too much beyond 500 level that means sellers are still into position, they have not booked the profit yet. Now, if the 500 level is multiple times tested that means sellers are not strong enough to bring price down enough from 500 level, to book their profit. Now, suppose price violates (breakout) the 500 level convincingly, those who held selling positions (sellers) now find themselves in a trap and are at a good loss. Because of this trap, their mindset might shift from aiming for significant profits to breaking even by closing their positions at 500 level. This change in mindset prompts these sellers to buy back what they previously sold at 500 level. Essentially, if the price comes at 500 level, the sellers become buyers in an attempt to square off their positions at break-even, creating a hike in buying pressure at 500 level. This collective action of sellers turning into buyers results in a price taking support at 500 level.

This means two things:

The price is taking support at resistance level i.e. 500 level because sellers are buying aggressively at 500 level after getting trapped at breakout.

Sellers got trapped at breakout point, therefore they bought aggressively at 500 level, to close their position at breakeven level.

This again means Law of polarity works because sellers/buyers are getting trapped at breakout/breakdown level, so if we are able to identify the intensity of trap at breakout/breakdown level, we will be able to identify the more probabilistic levels where law of polarity can actually work better. Let's see the probability enhancers to understand the same.

# NOTES:

# Probability Enhancers of Support & Resistance:

## Let's understand 3 scenarios:

SCENARIO 1: In the given image, we can see that the price is taking support at a particular level again and again, this means buyers have bought aggressively at this level, also they have defended (means bought more quantity) at this level again and again. This overall means that buyers are in a good buying position expecting price to come up from this level (support), however suddenly a single big red candle violates (breakdown) the support level. Due to this big red candle buyers didn't even get time to decide about their buying position, and they find themselves trapped (i.e. their position is in loss now). Because of this trap, buyers might decide to exit at breakeven, provided price comes back at this level.

Now, assuming price comes back at this level (as shown in the image price has come at the previous support level, which now acted as a resistance), buyers will become sellers due to which price actually took resistance at this level. That means support becomes resistance (Law of Polarity) worked better.

Conclusion: If a level is violated (breakout/breakdown) with a single big green/red candle, we can say the chances of Law of Polarity working is around 80% (Nothing can be 100%).


The above image shows Straight Support Line acting as a Resistance after it is decisively broken

SCENARIO 2: In the given image, again we can see that the price is taking support at a particular level again and again indicating that buyers are buying aggressively and also defending their position.

Buyers are in good positions and expecting the price to come up from this Support level. However, a small red candle violates this support level indecisively means that the red candle is not big or strong enough. Here the buyers are not in a big loss and have time to think to exit their position before the price falls further to avoid getting trapped as the support level is now violated.

Now, the next candle formed is a green candle giving more time and a better breakeven price to buyers to exit their position at breakeven.

This indecisive violation of a support level and more time near breakeven point, didn't trap many buyers.

Now, after a few candles, the support level is violated decisively with the big red candle. Here not many buyers are trapped as they have already exited their positions when the support level was violated with the small red candle.

Now, assuming price comes back at this level (as shown in the image price has come at the previous support level, which didn't act as a resistance), not many buyers were trapped due to which price didn't take resistance at this level. That means support did not act as resistance.

Conclusion: If a level is violated (breakout/breakdown) with a small green/red candle indecisively and also price halt after breakout/breakdown for even one candle, not more buyers/sellers get trapped due to which even if later big green/red candle violates it decisively, we can say the chances of Law of Polarity working is just 40%.


The above image shows the price didn't take Resistance as the price didn't break the Support line convincingly

SCENARIO 3: In the given image, we can see the same situation where the price is taking support at a particular level again and again, which means buyers have bought aggressively at this level and also, they have defended at this level again and again. So, the buyers are in a good buying position expecting price to come up from this support level.

Now, the price halts at the support level means price is neither going up nor breaking the level. At this time, buyers are still trying to bring the price up from this support level due to which they have more quantity of shares now, but they failed to defend their position. At one point, buyers got exhausted, and a single big red candle violated (breakdown) the support level. Due to this big red candle buyers didn't even get time to decide about their buying position, and they find themselves trapped with more quantity (i.e. their position is in loss now). Because of this trap with more quantity, buyers might decide to exit at breakeven provided price comes back at this level.

Now, assuming price comes back at this level (as shown in the image price has come at the previous support level, which now acted as a resistance), buyers will become sellers with more quantity due to which price actually took resistance at this level. That means support becomes resistance (Law of Polarity) worked better.

Conclusion: If a level is violated (breakout/breakdown), after a halt, with a single big green/red candle, we can say the chances of Law of Polarity working is around 90% (Nothing can be 100%).


The above image shows the Support Line acting as a Strong Resistance after the price halts before breaking the Support line

The difference between the 2nd and 3rd scenario is that in the 2nd scenario, price was traveling below and above the Support level before breakdown, while in the 3rd scenario price took halt just above the Support level before breakdown.

Since now you know the better probabilistic scenario of the 'Law of Polarity', you will have that additional edge to use the same.

## Law of Polarity at Lifetime High

When a Lifetime High is breached/violated, then it can act as a strong support level. This concept is primarily used in Swing Trading and Investments. The logic behind this is that lifetime high is considered as one of the strongest resistances and hence it can act as a strong support once violated (breakout decisively).


The above image shows the Previous Lifetime High acting as a Strong Support

POINTS TO REMEMBER:

## Try to Connect Maximum Points/Pivots

While marking support or resistance levels, try to connect maximum pivots. Here, there is no debate whether to connect bodies or wicks, however, connecting wicks is recommended.

The above image shows a Resistance straight line drawn by connecting maximum pivots.

## More Times-Tested vs Less Times-Tested Support and Resistance

The more times tested support/resistance level is considered superior as more buyers/sellers will have buying/selling positions, due to which the 'Law of Polarity' can work better.

In the below image, we can see that more times tested Support level acted as a good Resistance level after it was violated decisively.

The above image shows that More times tested Support Line acting as a Resistance after the price breaks it decisively

## Support and Resistance Breakout with Gap

Convincing breakout with a Gap is considered more effective as compared to breakout with a candle, because many buyers get trapped, as they didn't get the chance to exit the position at breakeven/small loss.

The above image shows that the Support acted as a Resistance after the price breaks it convincingly with a Gap

The above image shows that the Resistance acted as a Support after the price breaks it convincingly with a Gap

## Support & Resistance Area

We cannot expect price to reverse exactly from the drawn support/resistance horizontal line, hence we can also consider the area nearby as a support/resistance area. We will expect price to take support/resistance from that area.

## How to Draw Support Area:

To identify and draw a support area, we will draw 2 horizontal lines.

The 1st horizontal line will be drawn at the lowest wick of the support pivots.

The 2nd horizontal line can be at the lowest body of the support pivots, considering this, if you find the area of support is very narrow, then you can also draw as per your best judgement.


The above image shows how to draw the support area using 2 horizontal lines

## How to Draw Resistance Area:

To identify and draw a resistance area, we will draw 2 horizontal lines.

The 1st horizontal line will be drawn at the highest wick of the resistance pivots.

The 2nd horizontal line can be at the highest body of the resistance pivots, considering this, if you find the area of resistance is very narrow, then you can also draw as per your best judgement.


The above image shows how to draw the resistance area using 2 horizontal lines