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Mini-Lesson: Support & Resistance

As mentioned in previous letters, Technical Analysis (TA) is the study of market statistics (generally through some form of *charting*) in an attempt to find predictable patterns of investing behavior. Support and resistance, like all TA constructs, may or may not be "real." But, they can be useful constructs that can help the analyst to make investment decisions.

Support and resistance are like the two sides of a coin. *Support is a price at which a stock's price tends to "bounce" upward after declining to that price*. For instance, if a stock trading at $50 declines to $40, then rises to $45, declines again to $40, then rises again, it can be said to have *support* at around 40. The stock would no longer be considered supported at $40 if the stock's price declines below $40 without again rising above it. *Resistance, then, is a price at which a stock has difficulty rising above a certain price*.

Behaviorally, *support* could be described as the point at which buyers (often value investors) consider the stock cheap enough to buy. Therefore, the price is supported by buyers entering the market on a specific stock and creating more demand than supply for the stock. *Resistance* is the point at which sellers consider the stock "expensive" given it's fundamentals, and supply of the stock for sale is greater than demand, causing the price to fall.

Support tends to be more reliable in a bull market than in a bear market. Resistance tends to be more of an obstacle in bear markets. These concepts are not totally reliable – nothing in investing is, to my knowledge. However, when used as buying or selling triggers, support and resistance can improve success rates in investing, *e.g*. by preventing an investor from holding a losing stock too long or selling out of a winning stock getting ready to make an upward "run."

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