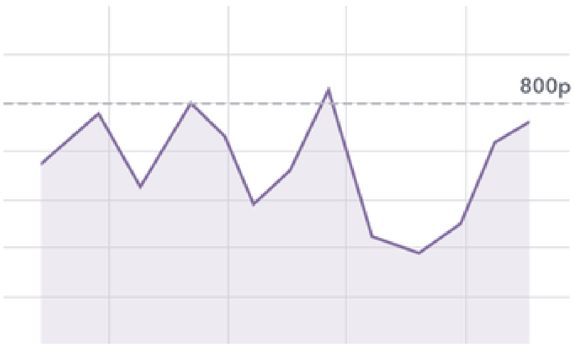
BREAKOUTS AND FAKEOUTS

In the last section we saw how certain price levels act like glass floors or ceilings. However, glass can be broken, and support and resistance lines do not hold true forever. Let's look at what you might see when the price does manage to pass through these barriers.

BREAKOUTS

If the market regularly tests a level, at some point the price is likely to break through it - called a breakout. When this happens, the price movement can be very significant - particularly if the support or resistance level was strong to begin with. But why does this happen?

Again, psychology has a role to play. Say, for example, the price of Media Company DEF has been testing resistance at around 800p.



-The more times the price reaches this level and then drops back, the more significant it's seen to be. Bullish investors might decide only to buy the stock once it's broken above this level and doesn't appear to be limited by it anymore. Bearish investors - those that have shorted the stock - could also decide to close their positions (also buying the stock) because they're worried about taking on too big a loss if the price keeps rising.

This could lead to a far greater number of buyers than sellers at this point, so pushing the price higher.

Potentially much higher. This can happen quickly, particularly if there are a lot of orders in the market placed just above the resistance level.

After a breakout through resistance, that resistance level often becomes a support area. Likewise, following a breakout through support, the support level often becomes resistant.

FAKEOUTS

However, as we've seen, support and resistance levels are areas not exact numbers. So, in our example above, even if you think the resistance has been broken at 800p, other traders might think differently and see a good opportunity to short the stock.

Sentiment also plays a part. Many traders might not feel the market is ready to push higher, so will look to go short at as high a level as possible to maximise their profits. This could potentially cause the market to rise above the resistance level briefly before dropping back down again - called a fake breakout or a fakeout.