



# PIVOT POINTS TYPES AND TRADING STRATEGIES

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## Foreword

Trading is an incredibly hard past time. Many people have become rich by trading in the forex market but, nevertheless many others have lost. Education is key to your development but with so many websites, videos, and general material it's hard to know what will help.

It's always best to stick to the basics, and then move forward to a more advanced level. The eBooks give you the basic information and look to build on that base knowledge to leave you in the best position to continue or begin your trading journey. The information provided is not just for beginners but can be used by traders with different skill sets, even as a simple reminder.

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No representation is being made that any account or trader will or is likely to achieve profits or loses similar to those discussed in this e-book.

## Forex Pivot Points

A forex pivot point is an indicator developed by floor traders in the commodities markets to determine potential turning points, also known as "pivots." Forex pivot points are calculated to determine levels in which the sentiment of the market could change from "bullish" to "bearish". Currency traders see pivot points as markers of support and resistance.

Day traders will use pivot points as a way to determine when market sentiment has gone from bullish to bearish or vice versa. If the market breaks this level to the upside, then the sentiment is said to be positive for that day and it is likely to continue its way up. On the other hand, if the price slips under this level, then the sentiment is considered negative, and it is expected to continue its depreciation.

Pivot Points are also expected to provide some kind of support or resistance, and if price can't break any of the associated R or S levels, a possible bounce from it is plausible. Since the Forex is a 24hr

market there is an eternal debate on deciding at which time the open, the close, the high and the low from each 24-hour cycle should be taken. Nevertheless, the majority of traders agree that the most accurate predictions are achieved when the pivot point is adjusted to the GMT or the Eastern (New York - EST) times. Here is an example of pivot points plotted on a 6 day EUR/USD chart:



As you can see here, horizontal support and resistance levels are placed on your chart.

## How to Calculate Pivot Points

The pivot point and associated support and resistance levels are calculated by using the last trading session's open, high, low, and close.

Since forex is a 24-hour market, most forex traders use the New York closing time of 4:00pm EST as the previous day's close.

### Pivot Point Calculation

Pivot point (PP) = (High + Low + Close) / 3

Support and resistance levels are then calculated off the pivot point like so:

- First resistance (R1) = (2 x PP) – Low
- First support (S1) = (2 x PP) – High
- Second resistance (R2) = PP + (High – Low)

- Second support (S2) = PP – (High – Low)
- Third resistance (R3) = High + 2(PP – Low)
- Third support (S3) = Low – 2(High – PP)

## How to use Pivot Points for Range Trading

The simplest way to use pivot point levels in your forex trading is to use them just like your regular support and resistance levels. The more times a currency pair touches a pivot level then reverses, the stronger the level is. If price is nearing a support level, you could BUY and put your stop just below the level. Here's a 15-minute chart of GBP/USD.



In the chart above, you see that price is testing the S1 support level. If you think it will hold, what you can do is buy at market and then put a stop loss order past the next support level.

If you're conservative, you can set a wide stop just below S2. If price reaches past S2, chances are it won't be coming back up, as both S1 and S2 could become resistance levels. If you're a little more aggressive and confident that support at S1 would hold, you can set your stop just below S1. As for your take profit points, you could target PP or R1, which could also provide some sort of resistance. Let's see what happened if you bought at market.



Most of the time, trading normally takes place between the first support and resistance levels.

Occasionally, price will test the second levels and every once in a while, the third levels will be tested.

### How to use Pivot Points to Trade Breakouts

While price may spend the majority of its time reversing between lines of support and resistance, there will also be periods of volatility when price breaks out. A price breakout simply refers to the price of a traded asset moving through a pre-designated area of either support or resistance. Savvy traders can then prepare to look for these opportunities by finding these values on their graph.

### Using Pivot Points to Trade Potential Breakouts

Before you can trade a breakout, you will first need to identify existing points of support and resistance. While there are many tools available for finding these areas, traders may again choose to use the previously discussed Camarilla pivot points. When added to the graph, these pivots will allow traders to spot a breakout using the R4 and S4 lines now available on their graph. Now traders can consider a series of options for trading. The easiest way to trade breakouts is through the use of a series of order entries. Entry orders set above resistance will be waiting to buy the market in the event price moves to higher highs. Conversely, orders to sell below the S4 line of support will be triggered upon the

market moving to lower lows. Traders that would like more confirmation may also consider waiting for a candle close, then triggering a market order. The key is to get into the market on a new surge in price, which generally transpires along with an economic announcement.



As with any trading strategy, traders should spend as much time planning their exits as they do their entry orders. Through the use of Camarilla Pivots, traders again can develop a very systematic methodology for exiting the market. Since the market is breaking out, risk can be managed by placing stop orders inside of the designated trading range. The rationale behind this is that if market conditions change, traders should close their positions and look for other opportunities.

Once a stop is found, traders can then set a profit target. Since our pivot points are calculated using a fraction of the previous day's trading range, we can again use the designated values for profit targets. Traders can look for a minimum of 1 times the denoted range, which in the example of the AUDNZD above would be 28 pips. This would equate to a 1:2 risk reward ratio when used with a standardized stop.



### **“Role Reversal”**

The Role Reversal is a common price pattern that is found on 99.9% of the charts you look at. Once you become familiar with this pattern you will be able to use it to determine your entry and exit points, on just about any trade you do. Remember that, when support levels break, they usually turn into resistance levels. This concept of “role reversal” also applies for broken resistance levels which become support levels. One of the most interesting phenomena regarding support and resistance occurs when the price of the underlying asset is finally able to break out and go beyond an identified support or resistance level. When this happens, it is not uncommon to see a previous level of support change its role and become a new area of short-term resistance. One of the difficult things about taking breakout trades is picking a spot to place your stop. Unlike range trading where you are looking for breaks of pivot point support and resistance levels, you are looking for strong fast moves.

Once a level breaks, in theory, that level will likely become “support-turned-resistance” or “resistance-turned-support.” Again, this is called a *role reversal*...since the roles have been reversed. If you were going long and price broke R1, you could place your stop just below R1. As for setting targets, you would typically aim for the next pivot point support or resistance level as your take profit point.

It's very rare that price will break past all the pivot point levels, unless a big economic event or surprise news comes out.



In this example, once you saw price break R1, you would have set your stop just below R1.

If you believed that price would continue to rise, you could keep your position and move your stop manually to see if move would continue.

### How to Use Pivot Points to Measure Market Sentiment

There is one other way to incorporate pivot points into your forex trading strategy, and that's to use it to gauge market sentiment. What this means is that you can tell whether traders are more inclined to buy or sell the pair. All you would need to do is to keep an eye on the pivot point.

If the price breaks through the pivot point to the top, it's a sign that traders are bullish on the pair and you should start buying the pair. Here's an example of what happened when the price stayed above the pivot point.



In this example, we see that EUR/USD gapped up and opened above the pivot point. The price then rose higher and higher, breaking through all the resistance levels. Now, if price breaks through the pivot point to the bottom, then you should start selling the pair. The price being below the pivot point would signal bearish sentiment and that sellers could have the upper hand for the trading session.

Let's take a look at a chart of GBP/USD.



In the chart above, we see that the price tested the pivot point, which held as a resistance level.

There are times when you think that forex traders are bearish on a pair, only to see that the pair reverses and breaks through to the top!



In this example, if you saw price breaking lower from the pivot point and sold. Later on, during the European session, EUR/USD popped higher, eventually breaking through the pivot point. What's more, the pair stayed above the pivot point.

### Know the 4 Other Types of Pivot Points

There are 4 other ways to calculate for pivot points as well:

#### Woodie Pivot Point

$$R2 = PP + High - Low$$

$$R1 = (2 \times PP) - Low$$

$$PP = (H + L + 2C) / 4$$

$$S1 = (2 \times PP) - High$$

$$S2 = PP - High + Low$$

*C – Closing Price, H – High, L – Low*

As you may have noticed the Woodies Pivot calculation is quite different than the standard pivot points formula. One of the primary differences is that the Woodie's formula puts more weight on the closing price. Notice that the Pivot Point (PP) calculation involves multiplying the closing price by 2, and then adding the High and Low. From this you would divide by 4 to get the PP level. This might sound a bit confusing at first, but essentially it works similar to an Exponential Moving Average, where the latter data is weighted more heavily than the earlier data. Also as a side note, you will often find in the FX market that the opening price is the same as the closing price. This is due to the fact that FX markets trade 24 hours a day.



Because they have different formulas, levels obtained through the Woodie calculations are very different from those gotten through the standard method. Some traders prefer to use the Woodie formulas because they give more weight to the closing price of the previous period.

### **Camarilla Pivot Point**

Camarilla Pivot Points were invented by Nick Scott in the late 1980's. They are similar in concept to Woodie's in that they use the prior day's closing price and range to compute the levels. But instead of 2

Resistance levels, and 2 Support levels, the Camarilla equation calls for 4 resistance levels and 4 support levels. Add to that the Pivot Point level, and there are a total of 9 levels plotted for Camarilla. Also, an interesting part of the Camarilla equation is that a special multiplier is included in the formula.

$$R4 = C + ((H-L) \times 1.5000)$$

$$R3 = C + ((H-L) \times 1.2500)$$

$$R2 = C + ((H-L) \times 1.1666)$$

$$R1 = C + ((H-L) \times 1.0833)$$

$$PP = (H + L + C) / 3$$

$$S1 = C - ((H-L) \times 1.0833)$$

$$S2 = C - ((H-L) \times 1.1666)$$

$$S3 = C - ((H-L) \times 1.2500)$$

$$S4 = C - ((H-L) \times 1.5000)$$

*C – Closing Price, H – High, L – Low*

As you can see, we have a total of 4 Resistance levels, and a total of 4 Support Levels. Many intraday traders utilize the Camarilla levels to fade price moves when they reach the R3 or S3 level. The idea is that the markets are cyclical in nature, and that a strong price move from the prior session, should tend to revert back within its value range the following day. Stops could be placed at the R4 or S4 levels. If, however, price action continues beyond the R4 or S4 level, then a stop and reverse can be initiated in anticipation for a strong trend day and continued price move beyond the R4 or S4 level.



Because of this, it's possible that resistance levels could be below the pivot point or support levels could be above it.

### Fibonacci Pivot Point

Fibonacci studies such as retracements, extensions, and projections are quite popular in the Forex market. The primary Fibonacci levels that traders watch most closely are the 38.2% and 61.8% retracement levels. But did you know that you could incorporate these Fibonacci levels into a Pivot Point calculation as well? In fact, it is very similar to the Standard pivot points, with the additional inclusion of the 38.2% and 61.8% and 100% ratios.

$$R3 = PP + ((High - Low) \times 1.000)$$

$$R2 = PP + ((High - Low) \times .618)$$

$$R1 = PP + ((High - Low) \times .382)$$

$$PP = (H + L + C) / 3$$

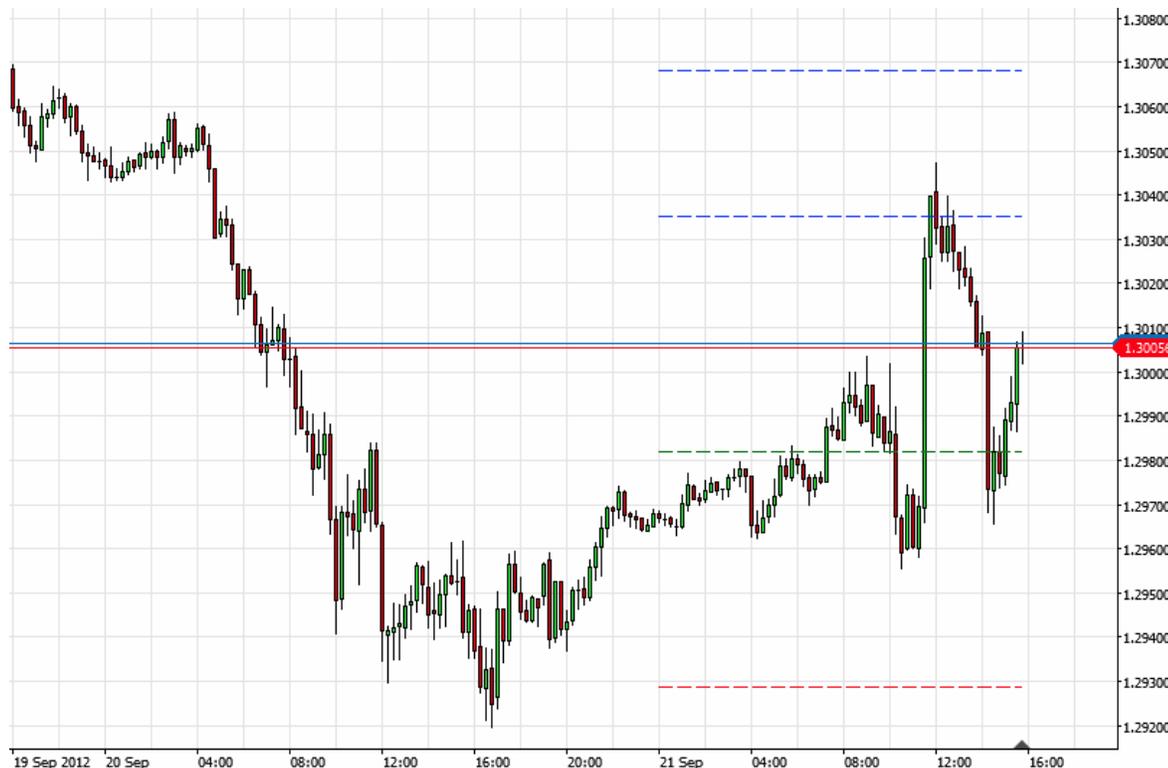
$$S1 = PP - ((High - Low) \times .382)$$

$$S2 = PP - ((High - Low) \times .618)$$

$$S3 = PP - ((High - Low) \times 1.000)$$

*C* – Closing Price, *H* – High, *L* – Low

Fibonacci pivot point levels are determined by first calculating the pivot point like you would the standard method. Next, multiply the previous day's range with its corresponding Fibonacci level. Most traders use the 38.2%, 61.8% and 100% retracements in their calculations. Finally, add or subtract the figures you get to the pivot point and you've got your Fibonacci pivot point levels!



The logic behind this is that many traders like using the Fibonacci ratios. People use it for retracement levels, moving averages, etc.

### Denmark Pivot Point

Denmark Pivot points were introduced by Tom Demark, a famous technical analyst and trader. Demark Pivots are very different from other types of Pivot Points that we have discussed thus far. These pivot points have a conditional nature based on the relationship between the opening price and the closing price. Demark uses the number *X* to compute the upper resistance level and the lower support line.

Here is how you calculate Demark Pivot Points:

If  $C > O$ , then  $X = (2 \times H) + L + C$

If  $C < O$ , then  $X = H + (2 \times L) + C$

If  $C = O$ , then  $X = H + L + (2 \times C)$

$PP = X/4$

$R1 = X/2 - \text{Low}$

$S1 = X/2 - \text{High}$

*C – Closing Price, O – Opening Price, H – High, L – Low*

Demark Pivot Points place more emphasis on the recent price action. Many Demark traders use Demark Pivot Points in conjunction with TD lines to find intraday support and resistance levels in the market. TD lines are much more objective than traditional trend lines. They are drawn from left to right based on the demand points in an uptrend and supply points in a downtrend. The objective is to find points along the TD line that are most likely prone to a breakout move.

