How to Sell a Stock at Resistance

Why Selling at Resistance is a good idea

The purpose of trading is to make money. It’s not to pick up an expensive hobby, or a place to gamble away your retirement fund. So, while this article may sound like a common sense topic, far too many traders forget that selling or closing a position is the key to turning a profit.

Selling at a predefined resistance level is a basic way to define parameters of when you should exit a trade. If you read my previous article on how to buy a stock at support, then this article will provide you the insight on how to close out a position.

After reading this article you will know how to:

1. Place an order to sell a stock
2. Able to identify optimum selling opportunities
3. Know when it is a bad time to sell
4. Know when to go short

How to enter a Sell Order

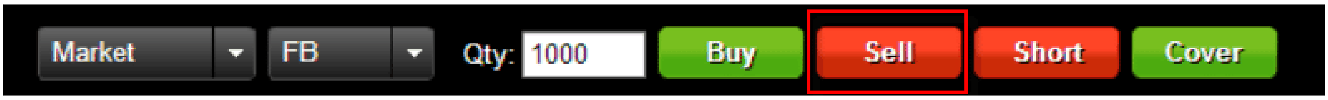
For you expert traders out there, you can skip this section of the article.

For everyone else, you first want to determine the type of order you want to enter. Market orders if you are just looking to get out on momentum or a limit order if you want to have more control around your actual exit price.

You will also need to know the number of shares you are currently holding of the stock and lastly you will need to know the symbol.

So to quickly recap you need 3 things: (1) order type, (2) number of shares and (3) stock symbol.

Below is a screenshot of a sell order to sell 1,000 shares of Facebook.



Selling at Resistance Levels within a Channel

Figuring out where to sell in the confines of a channel is a traders dream. Reason being, there are upper and lower boundaries which provide clear support and resistance levels.

Even though trading is a honed skill, at the end of the day it's not that complicated. Remember, we all have access to the same charts and technical analysis, so odds are we will all draw the same conclusions.

Below is a chart from the stock XOMA. Notice how the stock has been trading in or around a clear channel since late 2012. The key thing to note here is that while the stock is pretty volatile, when approaching the resistance XOMA consistently backed off to support.

Selling in uptrend channels should be used as an opportunity to close out long positions. The trend is clearly to the upside, so while shorting could be profitable, remember the market always has surprises and these surprises are generally in the direction of the primary trend.

Shorting in Downtrend Channels

To this point in the article we have only discussed closing out a long trade by selling the position. However, when trading a downtrend channel, you will want to use the test of the top of the channel as an opportunity to get short.

The above chart is of the stock Proof Point (PFPT) which experienced a sharp downtrend from March through the end of April. Once the downtrend channel was defined, there was an excellent opportunity to short the top of the channel test for the push down to the support line.

The key thing to remember is that for stocks in an uptrend, you want to sell long positions at the top of the trendline and in downtrends you want to use the test of the upper trendline to sell short.

Resistance in the form of recent swing highs

Outside of trend channels, resistance can rear its ugly head at key swing points (clearly you can see I like going long). Unlike channels which provide clear repetitive trading points, a swing high may be the only decision point you can find on the chart. You will have to make the call of whether that swing point will likely trigger a reversal or a bump on the road to higher prices.

To gauge the significance of a swing high, the biggest indicator is the volume when the stock sets the high. If the volume on the second test is much higher and the stock is able to close above the last swing high, odds are in your favor for higher prices and you will likely not want to close your long position.

However, if the stock approaches the last swing high and either has a 20% increase or decrease in volume and closes below the last swing high, odds are the stock will reverse and go lower and you will likely want to open a short position.

You could be asking yourself why it would be a bad thing if the stock has higher volume even though it closes below the swing high. While the volume is higher, the bulls were unable to maintain control on the close which is an early indication the stock could be experiencing a blow off top.

An example of this can be seen with XOMA below. Notice how the stock ticked over the last swing high with increased volume, only to retreat and begin a vicious 2 month sell off that saw the stock lose over 50% of its value.

When it’s a good idea to go short

Up to this point in the article I have really focused on going long or buying a stock, but the flip side to this equation is the idea of shorting the market to make money as a stock loses value.

Shorting at Resistance

What better place to enter a short position then at resistance. Think about it, the upside risk is limited as the stock has reached its upward boundaries. If you are wrong you will immediately know as the stock should retreat at key resistance levels.

Some general rules of thumb for going are:

1. A stock is below its 200-day moving average
2. A stock is below its 30-week moving average

3. The stock has set 3 consecutive lower lows and lower highs
4. 50-day moving average crosses below the stock’s 200-day moving average.

Flipping from Long to Short

One option is to wait for the stock to approach these resistance levels and open a short position. Another option (which I have yet to master), is to take a winning long position, close it out and then open a short position for the ride down.

For some reason it’s hard for me to flip between short and long positions on the same stock on the same day for swing trades. This however does not mean it couldn’t work out for you.

Don’t get caught in the crosshairs of the bulls

In the above example with XOMA let’s assume you decided to take a short position in December, which on the surface would have made perfect sense. Now, notice how the stock hit this key level and then abruptly pulled back. At this point you would have felt like you were in complete control of the trade. However, notice how XOMA quickly picked up steam again and then took a run another run at the resistance level.

This should be a clear red flag to you that the resistance level would likely fail under the pressure from the bulls. Sure enough, XOMA sliced through this level with ease and almost made a 100% run.

In this situation, there is no point in fighting the bulls or trying to prove that you are right. Unlike long positions where you can only lose what you put in, short trades in theory can go against you with no ceiling on the pain you can feel. This is why it's very important to monitor your short trades and when faced with a trade like XOMA, exit before long lasting damage is done to your trading account.

Limit the use of Margin when Shorting

The market Gods will allow you to use more money than cash you have on hand, which when used by the right trading professional can be an explosive combination. However, most traders are not ready for the discipline required to effectively manage a margin account and this fact is most important when shorting.

While the brokerage firm will have stricter rules for shorting, you can still quickly get in over your head if you leverage up too heavily and what looked like the sure beginning of a bear market, becomes a bull’s dream. Since you have unlimited risk to the upside, your best bet is to use less margin than if you were going long in the market.

Bear markets are generally short-lived as the market has a natural tendency to the upside. So, while you should look to make money anyway you can, remember that the real money is in going long on margin, not the other way around.

Stop Fighting the Need to Call a Top in the Market

One of the signs of a trader still going through their maturation process is the need to call market tops and bottoms. While bottoms are hard to call, they generally are a little easier, because markets often fall on fear and then rally as the selling reaches a tipping point. Rallies can go on and on for what seems like years. Check out the QQQ from 2013 – 2o14 if you think I’m making this up.

For most traders, there is often a need to be right and calling a market top is the ultimate manifestation of this trading flaw.

Let me tell you a little secret, the market has no limits. It can go as high or as low as it likes. The key thing for you is not to worry about every tick as a stock approaches resistance, but rather use resistance levels as a guidepost of when to go on the defensive.

So, if you have a decent profit in a trade, look to closely monitor the trading performance of the stock at key resistance levels to see if it is in fact time to get off the bus.

Mental Aspect of Selling

Selling requires a completely different part of the brain then buying. Traders are really good at opening positions, but quite frankly are horrible when it comes to closing out the position. This is because we will believe that our stock is going to go to the moon when in reality we need to be prepared to get off the train much sooner. The hard thing is that when you sell, for some it means they are giving up hope or they risk losing out on the big move. The reality is that none of us know what is going to happen, so if you decide to sell you have to be prepared with the idea that the stock could go higher. This ok and should not be stressed. The big point I'm trying to make here is that you define your exit criteria and you execute that to the letter. No one ever went broke taking money out of the market.

Good Luck Trading

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