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Technical indicators

Preview

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Technical indicators

- Trend indicators
- Momentum indicators
- Indicators based on volume
- Indicators measuring volatility
- Ichimoku indicator

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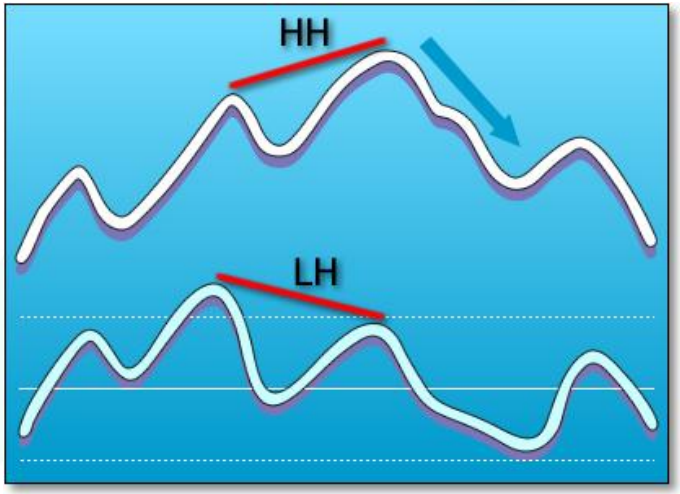
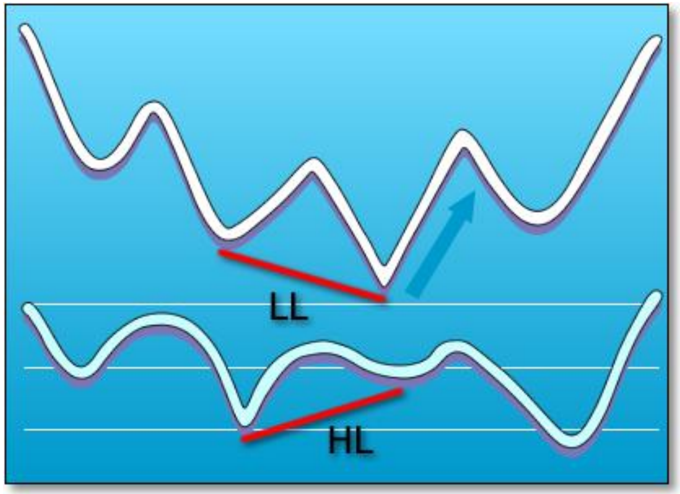
Divergences

- When the ***price movement and the indicator's movement are opposing each other***
- ***Appearance***: usually forecast qualitative progresses signalling an upcoming change in the indicators which is unobservable in the market price
- Within the divergences, processes in opposing directions can also happen
  - ***Bearish divergence***: in an ascending trend the price exceeds the previous local peak (HH), but the indicator's peak does not reach the half of the indicator's peak at the first local price peak (LH)
  - ***Bullish divergence***: in a descending trend, the indicator at the new minimum (HL) is below the previous local minimum (LL)





HH: *Higher High*
LH: *Lower High*
LL: *Lower Low*
HL: *Higher Low*

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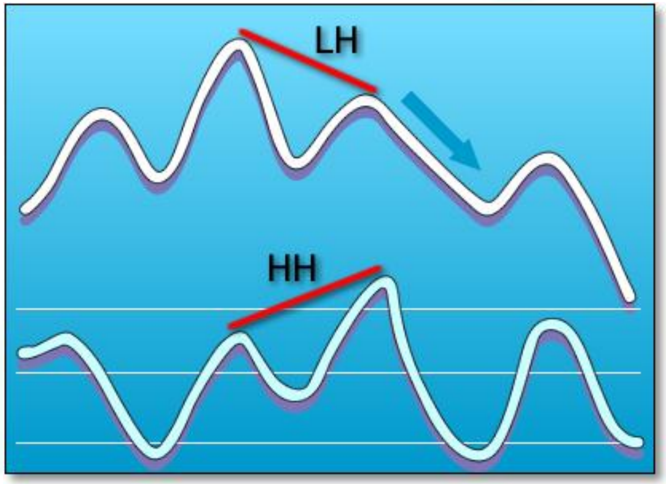
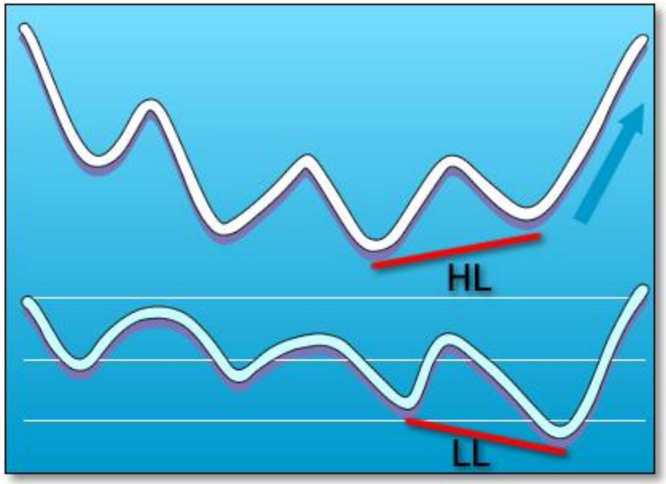
Divergences

- ***Hidden divergence***
  - ***Bearish divergence***: forms when the price forms a lower peak (LH) and the indicator exceeds the previous peak (HH)
  - ***Bullish divergence***: forms when the price forms a higher trough (HL) and the indicators is below the previous trough (LL)



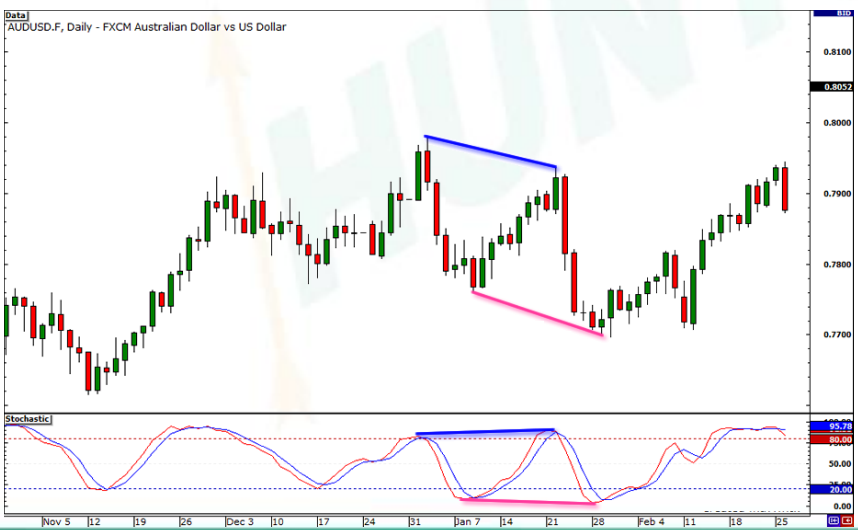


Correct use of divergences

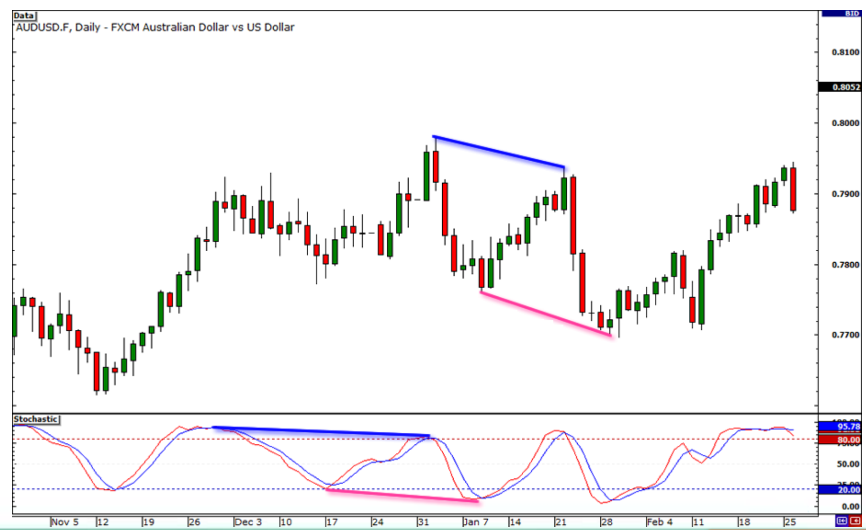
When connecting to price peaks on the graph, two peaks should be connected on the indicator's graph as well. When connecting to price troughs on the graph, two troughs should be connected on the indicator's graph as well.

Timely indicator values belong to the similar price peaks.

Correct use



Incorrect use



Correct use of divergences

Once the divergence has formed and the price has reversed and the event has happened relatively long time ago, then there should be no decision based on the signal.

The position should be opened when the trend reversal happens after the divergence. Past divergences have no effect on the present.

Moving averages

- ***Trend calculation using moving averages***
  - A trend value is assigned to the n^{th} element of a sequence the following way: the average of the values surrounding the n^{th} element is calculated
  - As the chosen period moves forward, the oldest data get discarded by new data
  - In order to get a realistic picture about the cycles, one must choose the number of elements included in the moving average calculation *correctly*. Else, the results may be misleading
    - The number of elements used in the moving average calculation must equal to the multiplication of the elements in the analysed cycle's wavelength
    - This means that *different moving average must be applied for different shares and time series* (e.g. in a quarterly cycle it is recommended to use a moving average consisting of 4 elements)

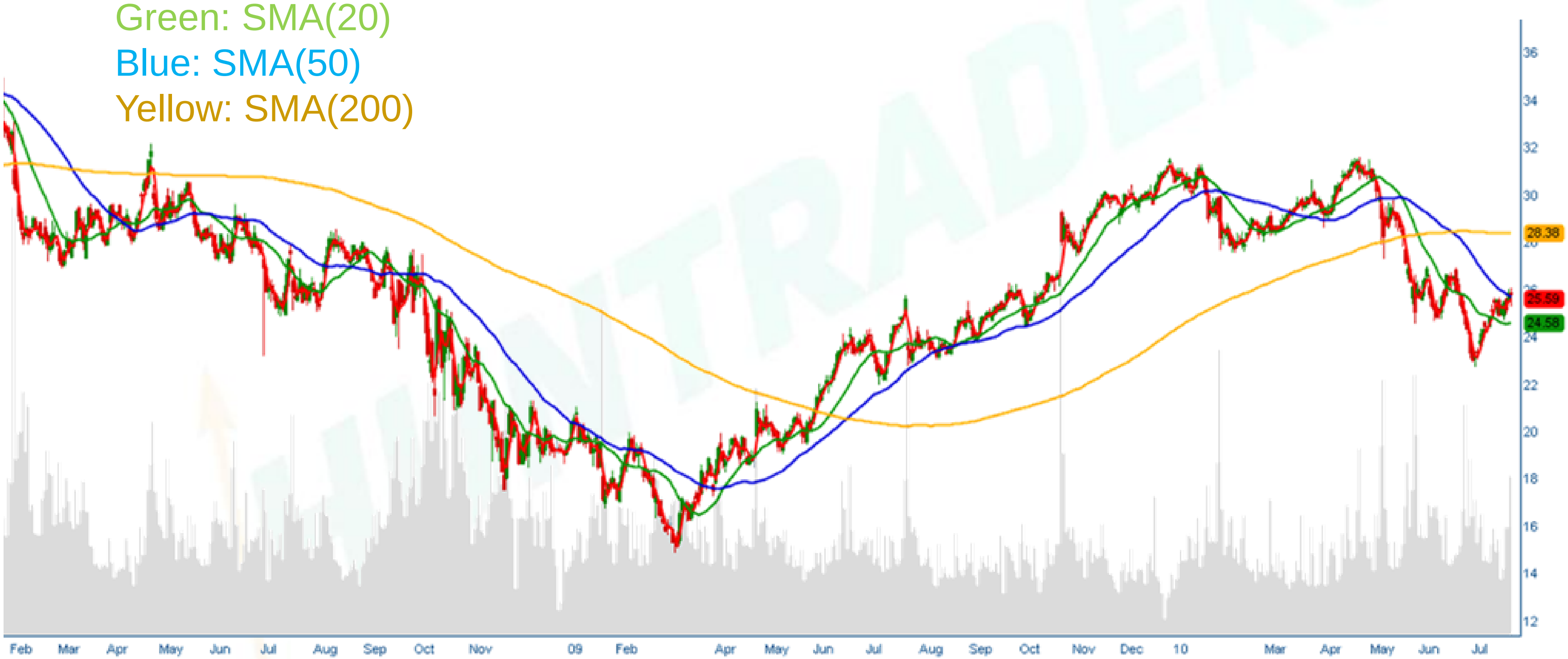
Choosing the period for moving averages

- ***The choice of the number of days is not an easy task** as it depends on the size of the trend the trader wants to "ride"*
  - A bigger number is going to be needed for the analysis of a larger trend
    - *using a too long period will not be successful because it totally smoothens out the time series,*
    - *on the other hand, a too short period would react to sensitively to every minor change on the market*
- Experts usually recommend the following intervals to choose the correct values:
  - **Short-term: 5-20 days**
  - **Middle-term: 21-84 days** (4-12 weeks)
  - **Long-term 84-200 days** (13-40 weeks)
    - In general, the *50-day and the 200-day moving averages are widely used by institutional analysts in the middle and long term. These averages are functioning as a support or a resistance*

Moving averages - example

MSFT – February 2008 – July 2010

Red: SMA(3)
Green: SMA(20)
Blue: SMA(50)
Yellow: SMA(200)



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Moving averages - example

MSFT – May 2009 – June 2010

Green: SMA(20)
Blue: SMA(50)
Yellow: SMA(200)

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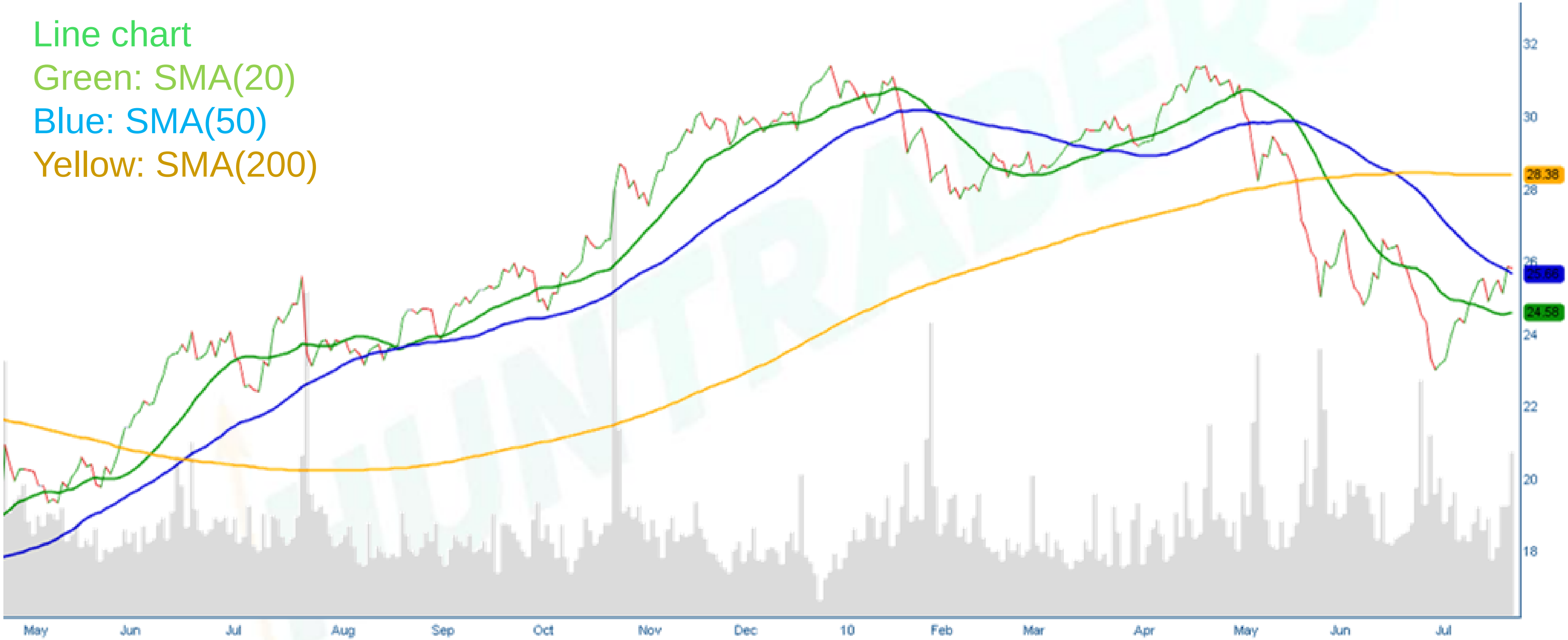
Moving averages - example

MSFT – May 2009 – June 2010

Line chart
Green: SMA(20)
Blue: SMA(50)
Yellow: SMA(200)



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