

TACTICAL Oscillator Divergence

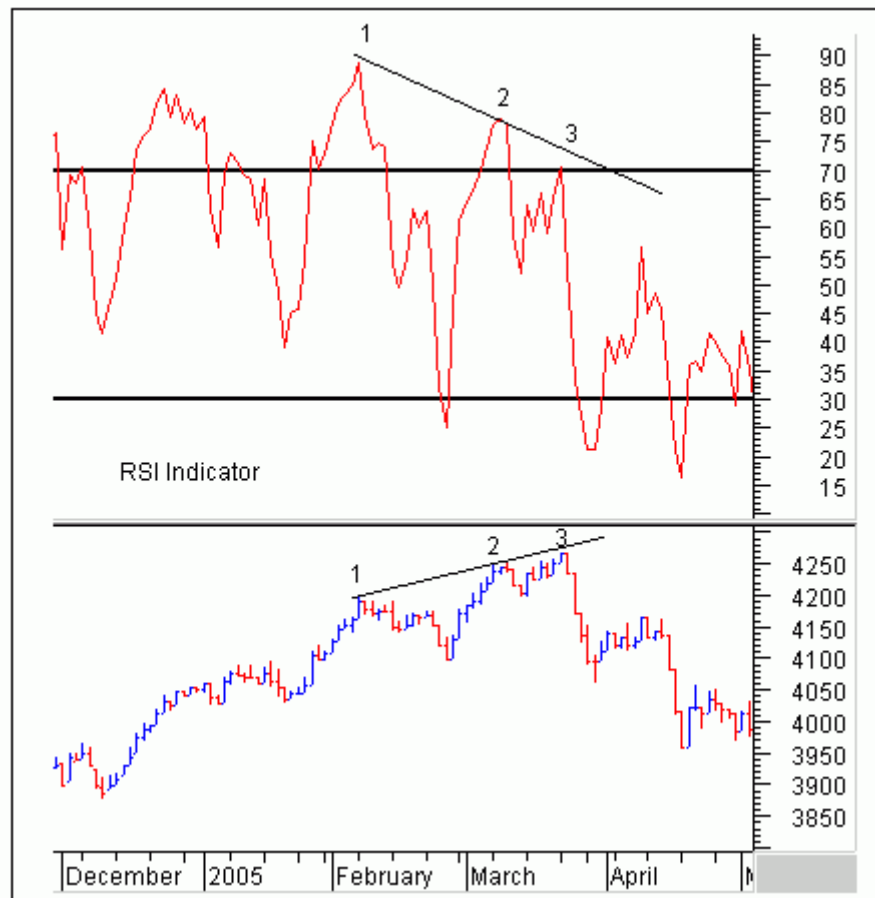
By Daryl Guppy

INDICATOR – OSCILLATOR DIVERGENCE

This can be applied to all oscillator based indicators, but it is most useful when applied to the RSI indicator. We use RSI in this example, but the rules apply to all oscillators.

APPLICATION

This is an early warning sign of a trend change. Most useful when applied to a daily chart. Can be used to confirm that a sudden drop or a slow trend change is the start of a new trend rather than just temporary trend weakness.



TACTICS

- Provides early warning of trend weakness. This may change the tactics applied to a particular trade, or the stop loss methods used.
- Dominant indicator that overrides trend strength signals from other indicators
- Primary usefulness is to alert the trader to trend weakness. It is not useful for timing.

RULES

- Trend lines are based on joining the peaks or valleys of price activity. Trend lines are not applied to the detail of the intervening trends
- Trend lines join the peaks or valleys of the RSI but only those peaks or valleys that appear above or below the trigger lines. I.e. above 70 or below 30 on the RSI.
- Peaks and valleys within the body of the indicator i.e. between 70 and 30 on the RSI, are unimportant
- Divergence occurs when the peak or valley trend line on the price chart move in the opposite direction to the peak or valley trend line on the RSI display.

ADVANTAGES

- This is a leading signal
- Reliable signal, particularly with RSI.
- It prepares traders for a trend change and tells them it is time to listen more carefully to other trend change signals
- Early warning to tighten stops
- Early warning that time has become an important risk factor

DISADVANTAGES

- Timing is not good. The signal may appear weeks or months ahead of the actual trend change. Traders need to use other indicators to confirm the time of trend change.
- Does not indicate the degree or level of trend reversal. This may be significant, or just a temporary interruption to the existing trend.