How To Identify

DIVERGENCE

www.forexrebellion.com

By Russ Horn

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Divergence

Dear Trader,

Divergence is a very common tool used by traders to identify stronger possibilities of a potential trade. Divergence is the disagreement between the price movement and the indicator movement. There is Bullish Divergence and Bearish Divergence. The indicators used to spot divergence are oscillating indicators such as the MACD, Stochastic Oscillator, RSI and other such oscillators. Divergence is to be used along side your trading system's rules and can offer a higher probability trade.

There are 2 kinds of divergence,

> Regular Divergence
> Hidden Divergence

Regular Divergence is the most common kind of divergence, most traders are familiar with this type. Once you have spotted this set up, you can use a moving average crossover or a trendline break to identify your entry level, or whatever rules your trading system has in place.

Bearish Regular Divergence:
Regular divergence in an uptrend will suggest a possible short entry. You will see price making higher highs, but the indicator will make a lower high.

Bullish Regular Divergence:
Regular divergence in a downtrend will suggest a possible long entry. You will see price making lower lows, but the indicator will make a higher low.

Hidden Divergence is not as common as regular divergence. Most traders are not even aware that it exists. It has also been referred to as Slingshot Divergence. Once you have spotted this set up, you can use a moving average crossover or a trendline break to identify your entry level, or whatever rules your trading system has in place.

Bullish Hidden Divergence:
Hidden divergence in an uptrend will signal a possible continuation of the uptrend. To identify hidden divergence, you will see the price making higher lows, but the indicator will make a lower low.

Bearish Hidden Divergence:
Hidden divergence in a downtrend will signal a possible continuation of the downtrend. To identify hidden divergence, you will see the price making lower highs, but the indicator will make a higher high.

These different kinds of divergence will take some getting used to, they are not often easy to spot as they are being formed. The way I approach it is to generally look for the divergent set up after I get my entry signal from my system. If I get a signal to go long, I will look to see if my indicators are disagreeing with my price chart, possibly showing me a better signal.

Divergence isn't a system on it's own, it simply an additional tool you can use to better your chances of success.
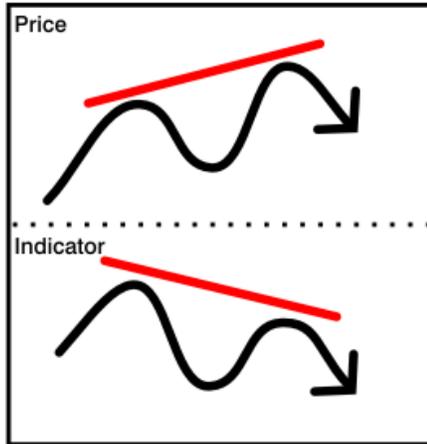
It's important to note, the peaks and valleys of the indicator must associate to the peaks and valleys of the price.
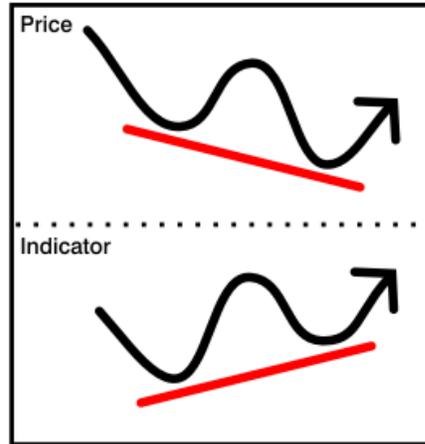
Here are some diagrams to help you see what the setups look like.
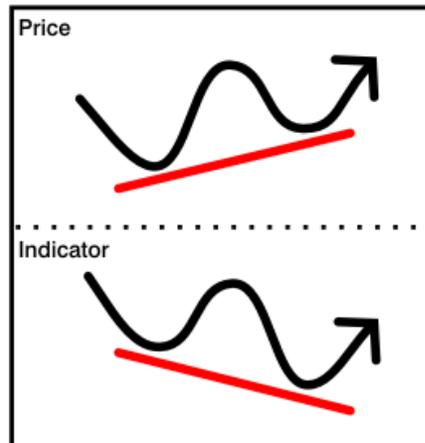
Regular Bearish Divergence

Regular Bullish Divergence

Hidden Bearish Divergence
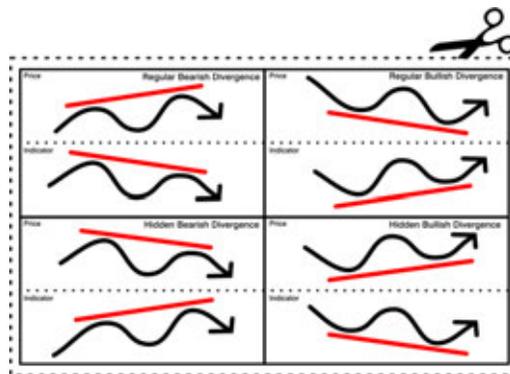
Hidden Bullish Divergence

NOTE:
Bearish Divergence is analyzed from the peaks of the price and indicator.
Bullish Divergence is analyzed from the valleys of the chart and indicator.

Here is a smaller version of the chart. If you choose, you can cut this out and stick it into your computer so you can reference it until you become familiar with it.

Next, I will show you an example of each of these divergent setups on actual charts.

Below is an example of Regular Bearish Divergence.
You can see the price is making a higher high, yet the indicator has made a lower high.

Below is an example of Regular Bullish Divergence.
You can see the price is making a lower low, yet the indicator has made a higher low.

Below is an example of Hidden Bearish Divergence.
You can see the price is making a lower high, yet the indicator has made a higher high.

Below is an example of Hidden Bullish Divergence.
You can see the price is making a higher low, yet the indicator has made a lower low.

I hope you are able to get something out of this short ebook. Divergence is a very powerful tool to add to your Trader's Toolbox and should not be overlooked. It will take a little bit of effort if you are not used to looking for it, but once you become familiar with divergence, these setups start to jump out at you.

The best of luck to you!

To your trading success

Russ Horn

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