INDICATOR:

RELATIVE STRENGTH INDEX (RSI)

Relative Strength index (RSI)

Introduction :

The Relative Strength Index (RSI) is developed by J. Welles Wilder, is a momentum oscillator that measures the change of price movements with respect to its strength. The RSI range is from 0 to 100 and it moves between 0 and 100. Traditionally the RSI is considered overbought when above 70 and oversold when below 30 but sometimes traders consider overbought above 80 and oversold below 20 zone also. The RSI oscillator's readings, which are normally calculated over a 14-day period

Relative Strength Index Signals can also be generated by looking for divergences and its one of the biggest advantages of this indicator and its very useful too most of the times. RSI can also be used to identify the general trend. Sometimes during strong trends, the RSI may remain in overbought or oversold territory for extended periods or for longer duration.

How RSI Works :

Now Let's discuss Relative Strength Index boundaries and how it works. Whenever the RSI goes above 70 it is said to be in overbought territory and when RSI goes below 30, it is said to be in oversold territory. As discussed earlier sometimes If required, these levels can also be changed depending on the assets price or traders style. For Example if, trader wish to increase this threshold from 70 to 80 if a security is consistently approaching the overbought level of 70 and similarly for downside.

Please note that RSI may spend a lot of time in overbought or in oversold territory during the strong up trends or downtrends. In addition, the RSI frequently creates chart patterns similar to price like double tops and double bottoms and trend lines that might not be seen on the underlying price chart. Observe the RSI for signs of support or resistance as well.

Relative Strength Index generally moves in the range of 40 to 90 during an up move or in bull market, with the 40-50 zone serving as support while 70-80 acts as a resistance. The RSI at the same time moves between 20 and 60 during a down move or in bear market, with the 50–60 zone acting as a resistance while 15-20 serves as a support. These ranges keep changing depends on the RSI parameters and the strength of the underlying trend for the securities

RSI Divergence

This is a very important tool and the best feature of Relative Strength Index. RSI shows both positive and negative divergence based on the price moves. An RSI divergence occurs when price moves in the opposite direction of the RSI, Chart may display a change in momentum before a corresponding change in price.

A bullish divergence occurs when the RSI displays an oversold reading followed by a higher low that appears with lower lows in the price. This may indicate rising bullish momentum, and a break above oversold territory could be used to trigger a new long position.

A bearish divergence occurs when the RSI creates an overbought reading followed by a lower high that appears with higher highs on the price.

Bullish divergence was spotted when the RSI formed higher lows as the price formed lower lows. This is a valid signal, but divergences can be rare when a stock is in a stable long-term trend. Using flexible oversold or overbought readings will help identify more potential signals.

Conclusion :

In all technical trading approaches, price action analysis is a mixture of multiple confirmations. There are multiple indicators in this universe and all indicators are not for everyone. But if it suits the way traders prefer to analyze and trade markets, then perhaps this discipline is worth a try. Traders might also modify a hybrid approach that focuses on price action with a combination of relative strength index and also includes technical and fundamental analysis with it.