Top 7 Technical Analysis Tools

Introduction

Indicators are used as a measure to gain further insight into to the supply and demand of securities within technical analysis. Those indicators (such as volume) confirm price movement, and the probability that the move will continue. The Indicators can also be used as a basis for trading, as they can form buy-and-sell signals. In this slideshow, we'll take you through the second building block of technical analysis, and explore oscillators and indicators.

1. On-Balance Volume

The on-balance volume indicator (OBV) is used to measure the positive and negative flow of volume in a security, relative to its price over time. It is a simple measure that keeps a cumulative total of volume by adding or subtracting each period's volume, depending on the price movement. This measure expands on the basic volume measure by combining volume and price movement. The idea behind this indicator is that volume precedes price movement, so if a security is seeing an increasing OBV, it is a signal that volume is increasing on upward price moves. Decreases mean that the security is seeing increasing volume on down days. (For more, see *Introduction to On-Balance Volume*.)

2. Accumulation/Distribution Line

Notice how the A/D line was sloping upward while the price of the stock was moving sideways. The positive slop suggests that this stock was being accumulated.

Acumulation/Distribution (7,437,444.0)

Chart by MetaStock

One of the most commonly used indicators to determine the money flow of a security is the accumulation/distribution line (A/D line). It is similar to on-balance volume indicator but, instead of only considering the closing price of the security for the period, it also takes into account the trading range for the period. This is thought to give a more accurate picture of money flow than of balance volume. The line trending up is a signal of increasing buying pressure, as the stock is closing above the halfway point of the range. The line is trending downward is a signal of increasing selling pressure in the security. (For additional reading, see _Trend-Spotting With The Accumulation/Distribution Line_.)

3. Average Directional Index

Increasing values above 20 suggest that the trend's strength is increasing. An ADX value crossing below 40 suggests that the trend is getting exhausted and is likely to reverse.

The ADX is usually plotted alongside two other indicators (shown below) because alone it does not give the trader any information about the trend's direction.

ADX (black line)

Chart by MetaStock
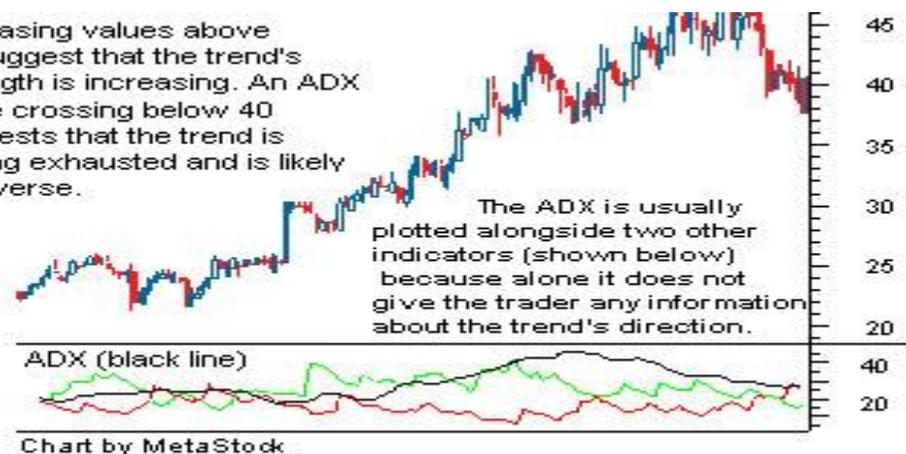
The average directional index (ADX) is a trend indicator used to measure the strength and momentum of an existing trend. This indicator's main focus is not on the direction of the trend, but with the momentum. When the ADX is above 40, the trend is considered to have a lot of directional strength - either up or down, depending on the current direction of the trend. Extreme readings to the upside are considered to be quite rare compared to low readings. When the ADX indicator is below 20, the trend is considered to be weak or non-trending. (For more, see *ADX: The Trend Strength Indicator*.)

4. Aroon Indicator

Notice how the trend is up when the Aroon up (green line) is above the Aroon Down (red line). Conversely, a downtrend occurs when the Aroon down is above the Aroon up.

New Downtrend

Chart by MetaStock

The Aroon osciallatro is a technical indicator used to measure if a security is in a trend, and the magnitude of that trend. The indicator can also be used to identify when a new trend is set to begin. The indicator is comprised of two lines: an Aroon-up line and an Aroon-down line. A security is considered to be in an uptrend when the Aroon-up line is above 70, along with being above the Aroon-down line. The security is in a downtrend when the Aroon-down line is above 70 and also above the Aroon-up line. (For more on this indicator, see *Finding The Trend With Aroon*.)

5. MACD

Chart by MetaStock

The [moving average convergence divergence](#) (MACD) is one of the most well-known and used indicators in technical analysis. It is used to signal both the trend and momentum behind a security. The indicator is comprised of two [exponential moving averages](#) (EMA), covering two different time periods, which help to measure momentum in the security. The idea behind this momentum indicator is to measure short-term momentum compared to long-term momentum to help determine the future direction of the asset. The MACD is simply the difference between these two moving averages, which (in practice) are generally a 12-period and 26-period EMA. (For more information, see *Exploring Oscillators and Indicators: MACD*.)

6. Relative Strength Index

RSI values above 70 suggest that the asset is overbought. Conversely, readings below 30 suggest the asset is oversold.

Overbought

Oversold

Chart by MetaStock
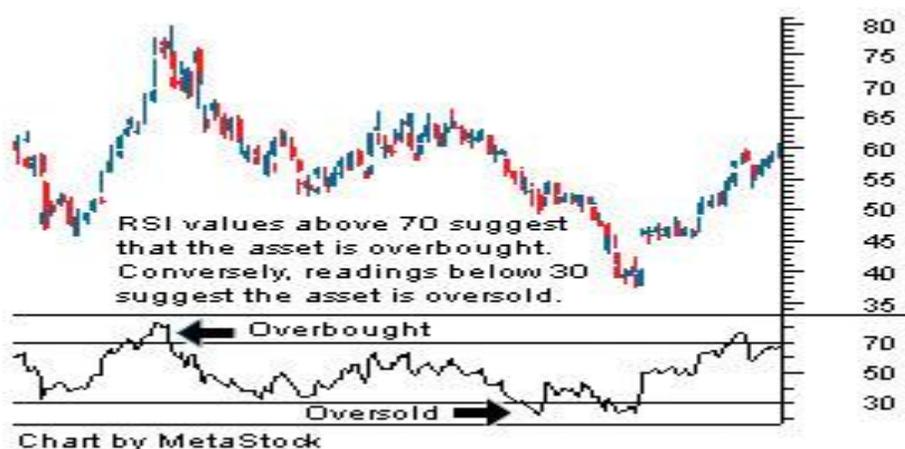
The relative strength index (RSI) is used to signal overbought and oversold conditions in a security. The indicator is plotted between a range of zero-100, where 100 is the highest overbought condition and zero is the highest oversold condition. The RSI helps to measure the strength of a security's recent up moves, compared to the strength of its recent down moves. This helps to indicate whether a security has seen more buying or selling pressure over the trading period. (For more on this indicator, see *Ride The RSI Rollercoaster*.)

7. Stochastic Oscillator

The stochastic oscillator is another well-known momentum indicator used in technical analysis. In an upward trend, the price should be closing near the highs of the trading range. In a downward trend, the price should be closing near the lows of the trading range. When this occurs, it signals continued momentum and strength in the direction of the prevailing trend. The stochastic oscillator is plotted within a range of zero-100, and signals overbought conditions above 80 and oversold conditions below 20. (For more, see *Trading Psychology And Technical Indicators*.)

Tools Of The Trade: Conclusion

The goal of every short-term trader is to determine the direction of a given asset's momentum and to attempt to profit from it. There have been hundreds of technical indicators and oscillators developed for this specific purpose, and this slideshow has just revealed the tip of the iceberg. Now that you have been

acquainted with a few of the basic indicators used in technical analysis, you can go forward and learn more - you are one step closer to being able to incorporate powerful technical indicators into your own strategies. (For further reading, see *Basics Of Technical Analysis*.)