

Moving Average Convergence Divergence (MACD)

This indicator combines the use of two Exponential Moving Averages (EMA) with different time periods (usually the 12 and 26 EMA), on the price chart and measures their convergence or divergence which is essentially the distance between them. Since the EMA with the shorter time-period will follow the prices more closely while the longer period EMA lags behind, there will be a resulting difference. This difference is plotted on a separate chart with a line that oscillates above and below the zero line whenever the two moving averages intersect. This is the MACD line.

In order to better estimate entry or exit points from the market a Simple Moving Average (SMA) of the MACD line is plotted on the chart and thus crossings of the MACD line with the EMA of the MACD line give buy/sell signals. The time frame usually applied is the 9 SMA. For visual purposes it is common to plot the zero line as crossings of this line give buy/sell signals.

In the Graph below The MACD is represented by the RED line while the MACD Signal Line is GREEN.

Daily EURUSD chart from June 2007 to Nov 2008



Indications:

1. Buy/Sell signal when MACD line crosses above/below the MACD Signal Line.
2. Buy/Sell signal when MACD Line crosses above/below the Zero Line.
3. Signal of weakness in trend when Price Trend and MACD Trend diverge.

The above indicators will prove very helpful but as expected some tweaking may help contain losses and increase profits.

Since such modifications are subjective, the graph below will reveal a recommended use of the above signals.

Daily EURUSD chart from June 2007 to Nov 2008



This graph reveals multiple features that the MACD indicator provides.

It is simple to see how a support line is formed at -0.005 (just below the 0 line) on the indicator and is effectively changed to a resistance later on in 2008.

In addition the channel lines and trend lines show the indicators convergence or divergence from the trend in the price chart, thus effectively warning of the imminent reversal in mid July 2008, two months ahead of the price chart.

Another helpful tip would be to follow the buy/sell signals but buy or sell only in the direction of the underlying instrument (in our example EUR/USD) trend. Important supports or resistances can help find entry or exit points.

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