

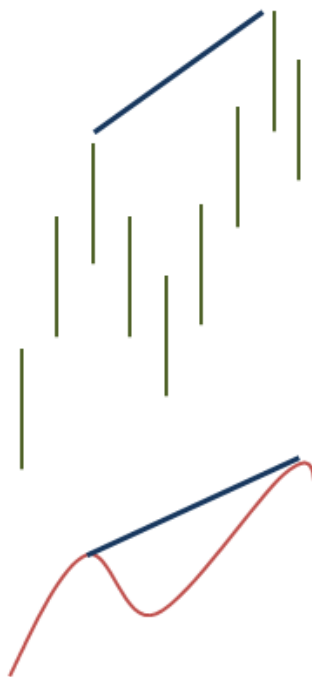
## Understanding the Importance of Divergence

Most traders have heard of divergence but do not truly understand the importance of this valuable indicator. In this week's newsletter, we will be discussing the different types of divergence and how it can help you in your trading.

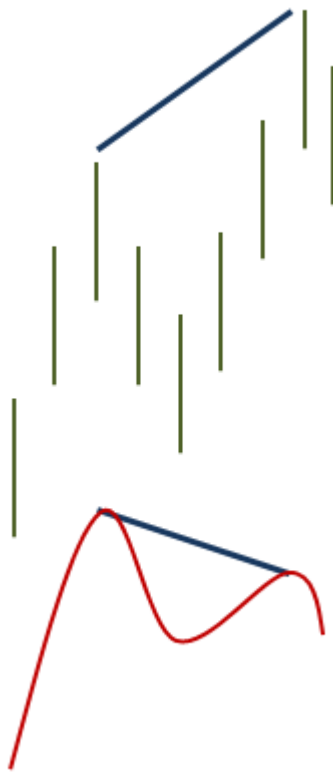
First, there are two types of divergence, regular and hidden. Regular divergence is often the first indication of an impending trend reversal, also known as trend weakness. Whereas, hidden divergence indicates trend strength. Since divergence leads price, it is considered to be a leading indicator (divergence occurs first, then price follows).

In order to identify divergence, you must have price and an oscillator -- any oscillator will do but we will be using a standard MACD for the purpose of this article.

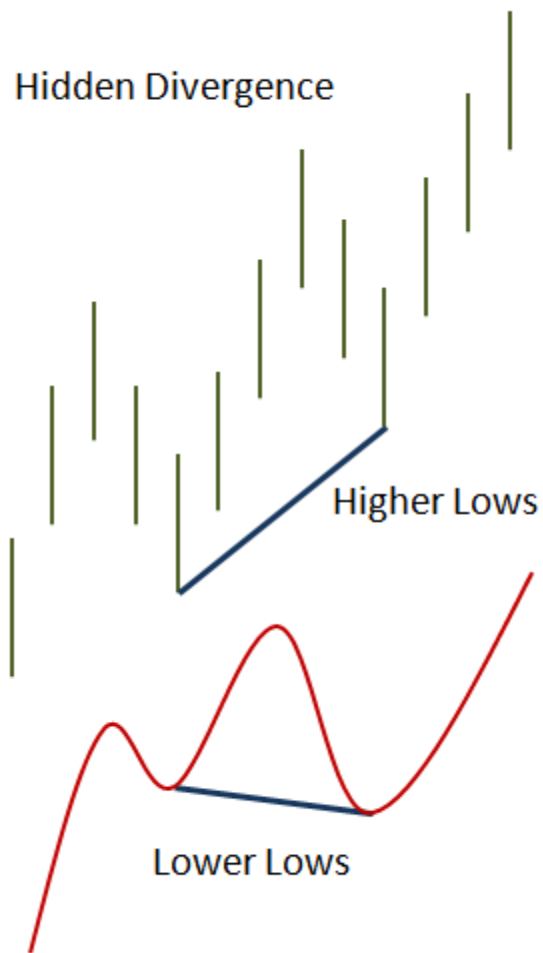
During normal price movement, the oscillator will move with price. This means if price is making higher highs, then the oscillator will also be making higher highs, as seen in the image below.



However, if price is making a new high and the oscillator is making a lower high -- meaning that the oscillator is not confirming the upward price movement -- you have regular divergence, which indicates weakness in the trend, as shown in the image below.



Most traders are able to spot regular divergence. However, hidden divergence is a little more difficult to spot. In an uptrend, price is making higher highs and HIGHER lows. To identify hidden divergence, when price makes a higher low, then look to see if there is hidden divergence on the oscillator (oscillator indicates a lower high), as shown in the image below.



An example of the importance understanding divergence occurred on the Euro Future contract, this past week. Euro went into a downtrend, making lower lows and lower highs. However, if you knew to look for the hidden divergence, then you noticed that price made a lower high but the Jurik RSX Double made a higher high, in a downtrend (marked in yellow). You would then wait for price to confirm the impending downward movement with a low risk entry point (although only one entry point is shown, there were several low risk entry points).



By Friday afternoon, price made a lower low but the Jurik RSX Double made a higher low -- indicating weakness indicating that the downtrend was possibly ending.