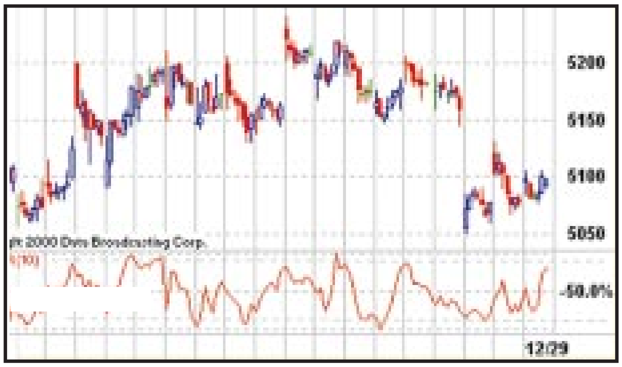
eSignal

TRADER'S GUIDE TO TECHNICAL INDICATORS

Riding the high end of the range

(This is the 23rd article in a series of articles on basic technical analysis.)



The 30-minute chart of March soybeans shows how the 10-period %R indicator fluctuates between overbought and oversold conditions and suggests market turns.

(Chart produced by eSignal)

Traders always like to know where they are relative to previous price action. That is the premise of a number of indicators including %R, also known as Williams %R because of Larry Williams' research and writing about the concept in the 1970s. %R essentially is another variation of stochastics, the subject of the December article in this series.

Like other indicators, %R views the close as the most significant price of a trading period because it best reflects professional traders' composite opinion of value and reveals whether the bulls or the bears won that particular round. However, instead of comparing the closing price with the lowest price for a specified number of periods as stochastics does, %R compares the close with the highest price for a designated number of periods. The total range for the period selected (typically half of a cycle) is 100 percent. %R is a means of putting a value on where the close falls as a percent of that range from high to low for that period.

The basic formula for %R is 100 times ((high of the range for the selected period minus the close) divided by (high minus low or the range for the selected period)). Instead of a scale of 0 at the bottom and 100 at the top, as with stochastics, %R flips the scale so that 0 is at the top and -100 is at the bottom. %R is the same as 100 minus %K from stochastics. However, %R does not use the smoothing techniques of %D from stochastics.

If the bulls are in charge, prices are likely to close at or near the top of the range, recording a %R reading of less than -10. If the bears control the period, the close is likely to be at or near the low end of the range, recording a %R reading greater than -90. You may want to experiment with the number of periods or the -10/-90 levels to see what works best for signals in your trading time frame. A reading close to 0 that indicates market strength also typically indicates an overbought condition and a potential downturn. Conversely, a reading near -100 that suggests market weakness also may be a signal that the market is oversold and ready to move up.

Like stochastics and other similar indicators, %R can provide several types of trading signals. Perhaps the most important is divergence. If prices move to a new high or low but %R does not, it may be tipping off underlying market weakness or strength that is not evident in the price action.

Another type of signal involves applying technical analysis techniques to the %R line. If it moves above -10 to near 0, drops below the -10 line and then fails to reach the -10 line on the next rally, that failure indicates a weakening bull effort and a market top, suggesting a short position. A bullish signal may be given on divergence at the bottom if %R falls below -90 to near -100, moves above the -90 line and then does not drop back below the -90 line on the next price decline.

The direction and position of the %R line itself can also provide clues about what trading action to take. However, %R shares another characteristic with stochastics and other indicators in that its readings can suggest overbought or oversold conditions before the market is ready to make a turn. Although neither bulls nor bears can usually maintain momentum for an extended period, strong trends can sometimes develop and produce premature - and potentially costly - %R signals. The market may actually be signaling that it is powerful enough to carry the trend far beyond the current level, even when logic and %R signals suggest otherwise.

Although %R can work well in trading range situations, its signals can be erratic in trending conditions. Therefore, you need to discern the long-term trend first before relying on %R signals, and you should always use this indicator in conjunction with other analysis techniques.

Next . . . market trendiness

DATA BROADCASTING CORPORATION

www.esignal.com
800-799-6638