Identifying the Major Trend

This chapter explores the tools used to determine the major trend in the market and what large-scale outside factors may change it and how. By the end of this chapter you should be able to identify the major trend on a chart and begin to understand how other markets can change that trend.

Why do we need to identify the trend in the first place? If you consider that the four large indexes listed previously hold 2,630 stocks and the vast majority of the market capitalization of the entire market, they are a good approximation for the direction of all stocks. Identifying the trend, then, is like knowing which way the wind is blowing when you are raking leaves or which way the current flows in the river. No matter which individual leaf you are trying to pick up, it will be blown by the same breeze to some extent. It helps to do some of the work with the wind behind you, and it is easier to move your boat downstream than against the current. Trading or investing with the direction of the trend is the same. The trend helps give every stock a tailwind to some extent. That makes sense, right? If the Standard & Poor’s (S&P) 500 is going up, then on average all 500 stocks included in the index are also going up. If all of the other indexes are rising as well, then there are, on average, 2,630 stocks that are rising. However, we know in practice that not all stocks move in the direction of the major trend all the time. In fact, the indexes themselves may move against the trend for periods of time without changing the trend. But the definition of the trend is such that if it is determined to be moving higher, then the vast majority of stocks will also be moving higher. At the end of any analysis you want to
be choosing stocks or sectors or indexes that are moving with the trend to trade or invest in. Think about it this way. Which has an easier way of life: a dolphin riding the wave or the salmon trying to swim upstream? Do you want to be the salmon swimming upstream or the dolphin riding the wave? Trading and investing are hard, so try to make it as easy as it can be. And for simplicity I will use the S&P 500 to illustrate all indexes.

When I refer to the trend, I mean the major direction of prices. That is, are prices going up, down, or sideways? It really is that simple. Well, it is easy to write that at least. In practice it is not always so simple. Take a look at the chart in Figure 1.1 of the prices of the S&P 500 from the past 20 years.

Which way is the trend? There are many answers to that question from this picture. From 2009 through 2013 the S&P trend was higher. But in 2008 and 2009 it was down. And from 1997 through to 2013 it was sideways, albeit in a very broad channel. Looking at a tighter picture of weekly prices in Figure 1.2, the upward trend from 2009 to 2013 is noticeable, but you can also see that from April to July 2010 and from July to October 2011 the trend was down, with sideways periods from May until September 2010 and January through July 2011. And if you zoom in further to the daily time frame shown in Figure 1.3, there is a clear upward trend higher from mid-November 2012 until mid-May 2013 but a downtrend from mid-October
FIGURE 1.2  2009–2013 Weekly S&P 500

to mid-November 2012. We could continue to drill down further to the 30-minute, 15-minute, and even 5-minute price charts where each plot represents only 5 minutes of price action. Which gives the right answer?

What is clear is that the time frame of your trading or investing matters. Also, the trend can change many times. As an investor holding stocks

FIGURE 1.3  November 2012 to June 2013 Daily S&P 500
for weeks or months at a time, it is not necessary to look any closer than the weekly charts. They will give you enough information and filter out the daily noise. A trader holding much shorter-term positions may want to focus on the daily and even shorter charts. How you determine where you focus your analysis should be based on how much time during the day you have to devote to managing your trades, your risk tolerance and return expectations, and the direction of the trend. If you can spend only 30 minutes a day and are investing for long periods of time, then the weekly time frame is for you. If you are sitting all day staring at your brokerage account with your expendable cash, then maybe you can focus on a shorter time frame. As a swing trader holding positions for a few days up to a couple of weeks on average, I spend my time looking at daily charts and occasionally weekly charts. I will be using daily charts for the rest of this book. Day traders will look at daily charts to identify the trend, but then use shorter 30-minute or even 5-minute charts of price action to determine their entry and exit points.

When you determine your time frame, it is also useful to look at the next larger time frame to see how the trend in your context fits with the next broader view. Price charts are continuous, so the price action at a 30-minute level may give a signal that a change might be about to happen in the daily charts. The opposite might be true as well; a daily chart may be showing a potential for a trend change that does not show up in the weekly chart, for example. Having the perspectives from the different time frames is important.

With the indexes and time frames determined, the next task is to identify the direction of the trend. Let's start by assuming it is obvious and, as in the November 2012 to May 2013 time period, upward. If that is the case, then we can quickly shift to the rest of the world to determine what might change it.

Reading the Chart

All of the charts in this book use Japanese candlesticks. There are other charting methods as well. The price bars shown in Figure 1.4, used in bar charts, are what most people are familiar with if they have been looking at charts. Price bars are read from left to right. The nub sticking out to the left is the opening price of the period, and the nub sticking out to the right is the closing price. Most bar charts are all the same color, solid black, so there is no distinction between an upward price period and a downward price period without a close examination of the nubs. The two ends of the bar designate the range for the day—the high and the low prices.
Japanese candlesticks are very similar but also come with color coding to make them easy to read at a quick glance. The same two periods in a Japanese candlestick chart are shown in Figure 1.5. Notice that the change for the period (the difference between the open and close) is readily identified by the colored (shaded) segment. This is called the real body. It is easy to see at a glance whether the stock moved more or less than the prior day from open to close—that is, whether it had a big range or a little range. However, the full range for the day includes the upper and lower shadows as well. These are the needlelike lines that extend out of the real body. The shadows can also convey information at a glance. The existence of small or no shadows implies that the stock had a strong movement during the day from open to close. The existence of long shadows implies that it had a reversal intraday, retracing from the extreme.

The color of the real body also conveys information quickly on the computer screen. A green candle (or more traditionally a black outline with a hollow interior, making a white candle) designates a period when the price moved higher, and a red (or lighter) candle designates a period when it moved lower. There are also two special candle colors. If the price closes above the previous candle but the intraday price movement was lower (i.e., it started high and fell but not below the previous
Identifying and Understanding the Trend

Armed with the knowledge that the S&P 500, Russell 2000, and NASDAQ-100 are the most important indexes, it is easy to follow these and collect price data using the ETFs S&P 500 SPDR (ticker: SPY), Russell 2000 iShares (ticker: IWM), and PowerShares QQQ Trust (ticker: QQQ). As mentioned before, it can sometimes be very easy to determine the trend. If the index is rising and has been rising for some time, the trend is higher.

So with Japanese candlesticks it is easy to see three things at a glance: the open and close range against the full range for the period, whether the price movement was positive or negative, and the relative strength of the period’s move.
If it has been moving sideways for six months, then it is neutral or said to be consolidating; and if it has been falling, then the trend is lower. It does not take a degree in anything to recognize a long trend in one direction. But just because this part is easy does not mean that your work is done. When the trend is easy to determine, it becomes more important to understand those outside forces and markets that affect the trend. These may not always lead or influence the U.S. equity indexes, but they are the ones that can change things quickly if they experience a shock. There are countless examples of markets that have an impact on the U.S. markets, but I like to focus on seven: gold, crude oil, the U.S. Dollar Index, U.S. Treasury bonds, the Shanghai Composite Index, emerging markets, and the Chicago Board Options Exchange Market Volatility Index. I check these on a weekly basis to help discern their potential to move markets. Small movements generally do not have a big impact, so I am looking for the potential for outsized moves that either have happened or may happen. This is done through a direct review of the price action (charts) of each influencer.

Gold is known both as a store of real value and measure of inflation and as a vehicle in which to place wealth during times of uncertainty, like war or other crisis. It is one of the most heavily traded commodities and certainly one of the most controversial. In theory it has no actual intrinsic value, yet it has cast a spell over people for thousands of years. At one point it backed the major currencies of the world, but now it just sits in the form of bars in the vaults of banks deep underground. Some parts of the world find gold more important than others, and some give it almost a religious connotation. It tends to gain in importance during times of political uncertainty or social unrest as a safe haven. It also gains importance in times when paper currency is being debased quickly through inflation. A shock higher in gold has at times led to or confirmed higher equity prices, as it did with the onset of quantitative easing during the recent financial crisis. Conversely, during times of deflation it may be a signal to the markets and raise the risk of a potential downturn. Examining the chart for gold prices can give clues to changes in its trend that may lead to changes in the broad indexes.

Crude oil is another measure of inflation, as a hard asset. You can use either West Texas Intermediate Crude (WTIC) or Brent to look for an impact. A signal that the price of crude oil is going higher can mean many things. It can be bullish for equity prices if it is not associated with a potential shortage, like from a war, as it shows increased demand for power and thus an expected robust economy. It can also mean rising inflation, so the relationship with gold is important. A falling crude oil price can also be good for...
the economy and thus stock prices, as it will reduce the cost of gasoline and inputs to consumer products. Following the crude oil chart can often give a heads-up as to what may happen to equities.

The U.S. Dollar Index has long been thought to be inversely correlated with equity markets. As the dollar strengthens, equities usually fall and vice versa. But this is not always the case. The two can trend together for long periods of time, when the dollar is appreciating mainly due to weakening world economies outside of the United States or those economies depreciating their currencies, as is happening in the 2012 to 2013 time frame. The U.S. Dollar Index is heavily weighted toward the euro (over 50 percent) but also has a large allocation to the Japanese yen, British pound, and Canadian dollar. So extreme currency moves in those countries can impact the U.S. Dollar Index and thus U.S. equities.

U.S. Treasuries are also normally inversely correlated with U.S. equities. So a strong move higher in Treasury prices (falling Treasury yields) often leads to falling equity prices. But like the U.S. dollar, Treasury prices can move in the same direction as equity prices for long periods of time. This tends to be true when a shock happens to Treasury prices. From the chart in Figure 1.6 you can see that in general Treasuries and equities moved higher together during the period between 2003 and 2008. But spikes in Treasuries in 2009, 2010, 2012, and 2013 have changed that relationship for periods of time. Also, a major shift in interest rates over a long period of time can

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**FIGURE 1.6** SPY versus TLT Weekly since 2003
vastly impact equity indexes, as it can lead to a reallocation of funds, away from Treasuries and into stocks, or the other way around.

The health of the Chinese market has long been tied to the U.S. market, rightly or wrongly. So it can be useful to look for shocks halfway around the world that could impact markets here at home. With the intertwined trade between the countries, this is easy to understand. A strong Chinese market can signal growth in the country and demand for U.S. commodity consumer products. Weak growth and a weak stock market can drag down the world economy and, if substantial enough, impact equity index prices. Since the bottom in the U.S. market in 2009, the Chinese market has been negatively correlated, with a fall in the Shanghai Composite being positive for U.S. equities.

Perhaps a little less obvious is the relationship between emerging market equities and the U.S. equity market. Strength in emerging markets is seen as a measure of risk taking. This is a positive for U.S. equities, as they are also deemed to be risky assets. U.S. equities can surely go higher without strength in emerging markets. Factors like slow Third World growth or war can impact this relationship. But in general strong emerging markets are positive for U.S. equities. Crises in emerging markets can lead to a drag on the U.S. equity indexes.

The Volatility Index, also known as the Fear Index, can foretell moves in U.S. equities. A big trend higher is generally a negative for equities whereas a low value is like the tailwind we discussed earlier. This index is derived from S&P 500 options pricing, and can range only between 0 and 100. Extremely high values rarely last, whereas extremely low values can persist for years. What is most telling with the Volatility Index is if it starts to change character, moving from a flat to a rising trend or rising to falling. Short-term spikes that remain in a tight range do not usually impact equities for more than a day or two, despite the fact that they may be big moves in the actual value of the index. Sharp persistent spikes in volatility do have a negative impact on stock prices.

Each of these influencers can be measured either directly or by using exchange-traded funds (ETFs). I prefer the direct measure when looking to see how they may influence the equity trend. The ETFs are good for trading these influencers if you do not trade futures contracts. Rather than a derived value from the direct markets for trading, using the direct measure might give a nuance that an ETF does not see. In the end if they are used to help identify the influence to the equity trend, and not for trading, it does not really matter which you use. Each factor may not have any significant role
Identifying and Understanding the trend from week to week. Some may dominate for weeks at a time. Some may seem unimportant for months. It is important to carry this analysis through time to gather a good understanding of which influencers are important and how they change thorough time. It is the mosaic of all of these influencers that is most important. In a time with European economies in recession and the United States and other world powers fighting global deflation, a strong reversal in gold to go higher, for example, would cut across many relationships and might foretell a major change in equities.

These are obviously not the only influencers, and you can pick more. On a monthly basis I also use the German DAX Index, the strongest and most powerful market in Europe; the price of copper, a commodity that is said to have a PhD in economics as it is used worldwide in housing and other areas so can forecast economic growth globally; and natural gas, a fuel of growing importance in the U.S. economy as it replaces coal and takes market share away from crude oil. Bringing in the Japanese market makes sense as it and its currency can play a major role in our markets through how large investors and hedge funds finance their trading activity. The key to any of these influencers is that along with a feel for the direction of the primary trend of the equity indexes, you are watching for externalities that could change that trend quickly. Outside of looking at the price action of each of these influencers directly, many are worth reviewing in ratio charts as well.

**Ratio Charts**

A ratio chart shows the price of one security valued in terms of the other security. Said another way, take the price of one security and divide it by the price of the second security to get the ratio. The actual value is not usually as important as the technical trend of the ratio. This type of chart is quite useful in uncovering trends between two assets and when they may change. It can also be useful in debunking myths about perceived relationships between assets. One of these myths is that the Chinese market is highly correlated to U.S. equity markets. There are many so-called expert opinions as to why this is so. Some say it has to do with the use of Chinese labor to manufacture goods for U.S. companies. Others point to the Chinese housing market and its use of raw materials from the United States. Still others reference the size of the population of China and the growth of its middle class as a potential market for U.S. goods. These are all good theories and may hold some merit. But the ratio chart of the China A Shares Index (a broad-based index of Chinese company stocks available only to Chinese investors) to the S&P 500 shown in Figure 1.7 suggests otherwise.
This chart shows a clear downtrending channel continuing from late 2009 through to late 2013. As of this writing, the ratio has retraced 88.6 percent of the entire run-up it saw from 2006 to 2008, the time that built these expert opinions. Nothing continues forever and trends can change on a dime, so making sweeping statements about correlations can be dangerous. But this chart looks to be heading lower toward a full retracement. So what has happened during this time? The U.S. market has recovered from the financial crisis lows to new all-time highs. Yet the ratio chart shows that all during that time the Chinese market has been ceding ground to the U.S. market. Clearly, for a four-year period these markets were not positively correlated but inversely correlated. Armed with that knowledge, it will likely be important when this trend changes. I wonder if at that point the expert opinions will be that these markets are always inversely correlated.

**Significant Market Ratios**

Every trader has additional measures that are used to monitor the health of a trend. For me, aside from seeing a visual of the aforementioned influencers, it is also useful to look at many ratios involving those influencers.
The ratio chart can be interpreted as a visualization of the flow of capital from one market to another. It is not a measurable flow like the flow of money into or out of mutual funds, for example, but a flow in terms of relative strength. In that way relative risk measures can be quickly established. Here is a quick rundown of several that I use. Most are a proxy for global market risk appetite in one way or another. The trend is the most important aspect of these charts. The actual level is often not important at all. And even more important than the trend itself is a trend that is starting to change. This is where that portion of the ratio, the potential influencer, needs to be watched most closely for a possible impact to the indexes.

**The S&P 500 versus Emerging Markets**

The ratio that looks at the flow of funds between the S&P 500 and emerging markets is a very good indicator of the global risk appetite. When the ratio is rising there is relative strength in the S&P 500 compared to emerging markets. A trend like this can occur when emerging markets experience a recession or other shock to their economies. It can also happen when the U.S. economy is perceived to be growing more strongly than those of emerging countries. In this trend, the S&P 500 looks to continue strong. But oddly, even if the flow is favoring emerging markets, this can be good for the U.S. market. Especially deep into a trend, it can show that the appetite for risk is growing, which can signal that the strength in the U.S. market can continue. Trends in both directions can be good for U.S. stocks. This ratio really emphasizes the importance of the change in trend over the trend itself.

**U.S. Treasuries versus Junk Bonds**

U.S. Treasuries versus high-yield (“junk”) bonds is another measure of risk appetite, but mainly within the U.S. economy. As investors and traders take on more risk, there is a flow into high-yield bonds from U.S. Treasuries. A trend lower in U.S. Treasury prices compared to high-yield bond prices is an indication of acceptance of more risk in the bond market. It is not a direct one-for-one correlation between high-yield bond prices and U.S. equity prices, but high-yield bonds can be a good proxy for equities in terms of the amount of risk taking in the broad marketplace. This is a very good measure of the direction of risk appetite in fixed income securities.
S&P 500 versus U.S. Treasuries

The S&P 500 versus U.S. Treasury securities is another measure of risk appetite within the U.S. marketplace. As discussed earlier, these two markets are usually perceived to be negatively correlated. So a flow from one to the other can indicate either the addition of risk or a flight to safety that may not be as obvious in the individual charts. That is a good short-term view. In the longer term, though, as discussed in the previous section, bond prices and stocks have tended to move in the same direction. This ratio’s current trend persisting is a nonevent, but a change is often triggered by some sort of shock and becomes important. If the trend changes, keep watching.

Silver to Gold Ratio

The silver to gold ratio stands as a good proxy for the direction of the S&P 500. From the chart in Figure 1.8 it is easy to see that the correlation between this ratio and the S&P 500 was very strong until the end of 2011. Prior to that, for

FIGURE 1.8 Silver to Gold Ratio versus S&P 500
more than 10 years, the direction of this ratio could be used to identify the
direction of the S&P 500. The magnitudes of the moves were not precise, but
knowing the direction is 70 percent of the game. Many traders follow it to look
for clues, based on this correlation, as to when the S&P 500 might turn before
the change shows up in stock prices. Sadly, it looks as if this relationship has
run its course, with the correlation flipping 180 degrees in 2012 to an inverse
correlation. Again, it was the change that mattered. As the correlation flipped,
the S&P 500 started its long uptrend, with gold reversing its 15-year uptrend.

Shanghai Composite to S&P 500 Ratio

The ratio of the Shanghai Composite to the S&P 500 is a recent addition.
It has shown over the past four years that there is a negative correlation
between the two markets (see the “Ratio Charts” sidebar and Figure 1.7).
What is bad for Chinese stocks is good for the S&P 500.

This list is not exhaustive, nor is it always useful. But having these additional
tools in the shed can help the trader occasionally to clarify a scenario that
cannot be seen in the individual charts. Focus on the changes to trends more
than the trends themselves in terms of what can impact the equity indexes.

■ Other Indicators

There are many other time-tested indicators that professionals have used for
years as well.

Sentiment

The put/call ratio is one to measure bullish or bearish sentiment. The higher
the ratio, the higher the bullish sentiment is thought to be. There are also
many investor surveys that measure sentiment, like the American Associa-
tion of Individual Investors (AAII) Sentiment Survey. I also use some breadth
measures, like the percentage of stocks that are over their 200-day simple
moving average (SMA). You do not need to use any or all of these. The point
is to get comfortable with a set of indicators that do not all derive from the
same market that you are trying to learn about.

Sentiment can play a large role in the markets, and many traders base
their decisions entirely on sentiment. The area of behavioral economics is
attempting to add perspective in this area.
Trend Tools

There are a couple of trend tools that I find particularly useful: Andrews’ Pitchfork and Renko charts. These two types of charts do not give targets but can be very helpful in determining the trend.

Andrews’ Pitchfork is named for Dr. Alan Andrews, who developed it. It is very simple in its interpretation. The chart of the S&P 500 in Figure 1.9 displays a pitchfork active in the S&P 500 SPDR as I am writing this book. From the uptrend that began in June 2012, there is a pullback that defines three parallel lines, like the tines of a pitchfork. These are called the upper median, median, and lower median lines—not very creative, but descriptive. There are also two midlines in this chart that show the midpoints between the three main lines. The thesis is that the three major lines attract the stock price and there may be a struggle at the midline between them. This chart is a great advocate for their use, as the price has been tightly tied to the median line and has snapped back after wandering away every time for the six months shown. This can be an easy way to see the trend. There are more complicated measures and indicators that can be applied to Andrews’ Pitchforks that can give a buy or sell signal, which we will touch on later. For now, just notice the simplicity of the tool in showing which way the trend is heading.

![Andrews' Pitchfork Chart](image)

**FIGURE 1.9** SPY—Andrews’ Pitchfork
Renko charts can be just as simple. Shown in Figure 1.10 in green (or white) and red (or black) bricks, there is no room for interpretation here. Up means buy and down means sell. If it is green it is a buy signal. If it is red it is a sell signal. There are mostly green bricks in this trend, so it is bullish. How easy is that? These charts are derived from Japanese candlestick charts, which we will discuss in more depth later with the individual charts.

**Momentum and Other Indicators**

As stated earlier, sometimes it is easy to see the trend. Other times it is not so clear. When it is less clear, there are many tools that have been developed that can help. Some of these are momentum based, others volatility based, and still others can be based on historical price data directly. Let’s take a look at a few of these. There will be more detail later in the book.

*Simple moving averages* (SMAs) are one of the most frequently used indicators. A 50-day SMA is nothing more than the average of the price of the index over the prior 50 trading days. Traders use all sorts of SMAs, including the 9-, 13-, 20-, 50-, 100-, 150-, and 200-day SMAs. For simple trend analysis, there are only two things to look for in the SMA: whether the
index is above or below the SMA, and the direction in which they are both heading. In the simplest terms, if the index is above the 50-day SMA, that is bullish, and the bias is for it to continue higher. If it is below the SMA, that is the opposite. If the SMA is rising, that also supports a rising trend, and a falling SMA emphasizes a falling trend. The chart in Figure 1.11 shows the S&P 500 with its 50-day SMA (dark line) since January 2012. There are three distinct periods when the index was above the 50-day SMA, and in each period the trend was rising. Also notice that the two periods when the index crossed below the 50-day SMA the trend changed for a period of time until it crossed back above.

Using the same chart, the Bollinger bands (the channel above and below the index price) can be used to find a trend. They use the standard 20-day SMA as the midline and two standard deviations to each side for the envelope. When the channel is rising, the trend is up; and when it is falling, the trend is down. Traders use these for other nuances, which we will discuss later in the book as well. At the top of the chart, the Relative Strength Index (RSI) is a measure of the strength of the trend, a momentum oscillator. On a scale of 0 to 100 it is deemed to indicate a bullish (higher) trend over 50 and
Identifying and Understanding the Trend

A bearish (lower) trend under 50. Many traders expand this for stronger confirmation to look for measures over 60 or under 40. When the RSI is over 70, the index is considered overbought, and under 30 it is considered oversold.

Finally, at the bottom of the chart, the moving average convergence/divergence (MACD) indicator is a measure of momentum strength. In simple terms, when the choppier (blue) signal line is rising, the trend is higher; and when it is falling, it is lower. A trend change occurs when the signal line crosses up or down. The (red or black) histogram can be viewed the same way. When it is growing and positive, the trend is higher; and when it is falling and negative, the trend is lower.

Each of these indicators can be customized by traders to try to gain an edge. Like the 9-, 13-, 20-, 50-, 100-, 150-, and 200-day SMAs, I have also seen 144 and 250 days used. Traders will convert them to exponential moving averages (EMAs), giving more weight to the recent activity than the distant past, whereas the SMAs are equally weighted. The Bollinger bands (a measure of volatility) can be replaced with moving average envelopes, Average True Range (ATR), or other volatility measures. They can also be adjusted to use other than the standard 20-day SMA as the midline and two standard deviations to each side for the envelope. The RSI, which uses a 14-day moving average on a closing basis on the chart, can use any other moving average; I see many day traders use two days. And the MACD, which uses two different exponential moving averages, can also be customized to suit the trader, or any number of other momentum oscillators can substitute for the MACD.

I am not advocating any particular combination here for help in determining the trend, but will make three points. First, keep it pretty simple. One SMA, one oscillator, and one other indicator are enough. I have seen traders’ charts with 15 indicators on them and cannot understand how they can ever make a decision with that much information. The indicators will all turn at slightly different times. Play around with them if you like to find the ones that suit you best, but do keep it simple. Second, many charting packages come preprogrammed for RSI, MACD, and other indicators. For use in determining the trend, it is not necessary to change these factory-installed settings at all. You will likely have the same settings as 95 percent of users and may think that will not give you an edge. But it is much more efficient just to leave them alone if you are using them only for trend identification. Unless you have some kind of quantitative system that has been tested and proven to work, you are likely just spitting into the wind trying to customize these tools for this exercise. Finally, remember that these indicators are...
derived from price action. The primary source of trend identification should be from examining price. Try looking at the chart with nothing but the price action first to determine the trend. Then add the indicators. These indicators may confirm that action or show divergences that may lead to a change in trend, but the emphasis is on may. Price should always be the first determinant of the trend.

**Conclusion**

You should now be pretty well initiated into the process of trend identification. You should be able to identify the trend as either rising, consolidating, or falling over the proper time frame. You should also be able to identify which, if any, other markets may influence that trend and change its direction. Finally, you should be able to use other indicators such as sentiment, trend tools like Andrews’ Pitchfork and Renko charts, momentum, and other tools like SMAs, RSI, Bollinger bands, and MACD to help identify the trend when it may be choppy or hard to determine.

You have seen that there can be many variations on the multitude of indicators used, which can create an infinite number of potential tools to use to follow and determine the trend. Do not get sucked into the complexity. If you can see that the price is moving from the lower left of the chart to the upper right, then that may be all that you need. It can be that obvious.

To determine what could impact that trend, again look at the price action. It is better to look at the price action of a few key markets week in and week out to create a montage of the global marketplace than to try to create precision in any particular indicator. There will be few outside influences that give an edge in determining a trend change. Most will continue along the same path that they have been on without impacting the equity indexes.

Look specifically for changes in trends of those markets that can influence the equity indexes to heighten your awareness of a potential impact on the equity market. Even then they still may not make an impact. It is the shocks to the system that sometimes show up early in other markets that matter in terms of a change of trend, not a continuing trend.

When adding other indicators, again keep it simple. Putting two or more momentum indicators and four oscillators will not do much to improve your ability to identify the trend and may even inhibit that ability.

In Chapter 2, we delve into the next layer of the onion, sector analysis, to see how to refine the process.