Principles of trading based on Moving Averages

Reliance on price charts without moving averages is hard. These simple lines above or below the current price can tell a lot and their use in interpreting the market really is unprecedented. In short, they are the most valuable indicators in technical analysis.

You can trade without moving averages, but doing so greatly increases your risk taking. These lines represent median levels where traders in the market take important decisions about whether to open a position and whether it should be short or long.

Below are presented 15 principles that you can use in trading with the use of moving averages:

1. The 20-day moving average usually shows the short-term trade, the 50-day moving average shows the mid-term trend and the 200-day moving average shows the long-term market trend.

2. These 3 moving averages are natural limits on price adjustments. In favor of this are two arguments. First, they determine levels where profit making or acceptance of loss should weaken after strong price movement. Second, their general recognition incites traders to self-realize the strategy every time the price approaches these levels.

3. Moving averages emit false signals during non-trend trading because they are indicators that are trend-following and that measure upward or downward momentum. They lose their effectiveness in markets, showing weak or missing price movement.

4. The characteristic of moving averages changes as they flatten and invert. Reversing the moving average horizontal implies a loss in momentum for that time format. This leads to increases in the chance that the price will cross the moving average relatively easy. When moving averages with different period are arranged in a horizontal line near one another, price often oscillates across these lines, creating a lot of “market noise”.

5. Moving averages emit continuous signals because they are formed directly from the high price. Their relative correlation with price changes with each bar. They also demonstrate an active relationship in the form of addition-subtraction with all other types of support and resistance.

6. Use exponential moving averages, or EMA for longer time formats and jump to simple moving average, or SMA, for shorter time formats. EMA gives greater weight to recent amendments price, while SMA considers each price action equally.

7. Short-term SMA allow the trader to understand how others will act. Market audiences use simple moving averages because they do not understand EMA. Good intraday signals are more based on what other market participants think, rather than on technical side of the evolving situation.

8. Displace 5-,8- and 13-period SMA on intraday charts to measure the strength of the short-term trend. In strong movements Moving averages line up and point in the same direction. But they are divided into maxima and minima until the price does not go in the other direction.

9. Positioning price according to the 200-day MA sets the long-term psychology of the investor. Bulls live above the 200-day Moving average, while the bears live below it. Sellers swallow recovery rallies below this "line in the sand" while at the same time buyers come to the rescue above it.

10. When the 50-day moving average crosses the 200-day moving average in any direction, it predicts significant change in behavior of buyers and sellers. When the 50-day moving average rises above 200-day moving average - this is called "Golden Cross" while crossing bearishly (Top-Bottom) is called “Death Cross”.

11. For the price it is more difficult to sneak over falling MA and conversely, it is harder for the price to fall below rising moving average, rather than e declining.

12. Moving averages established in various time periods show the speed of trend through their relationships with each other. This can be measured by classic MACD indicator or by using multiple moving averages with the graph and how they converge or diverge in a specified time.

13. Position the 60-day moving average for volume below the price chart in order to determine given sessions show unexpected interest. The slope of the MA also identifies hidden pressure from buyers and sellers.

14. Do not use long-term moving averages to make short-term forecasts, because their information will lag behind current events. The trend may already be mature and nearing to an end at this time, when the MA will send a signal to buy or sell.

15. The levels of support and resistance are established by the MA when they converge or diverge from one another. Keep track of when a moving average bounces from the other, rather than immediately to cross, thus confirming support or resistance. After finally crossing took place this level becomes support or resistance for future price movement.