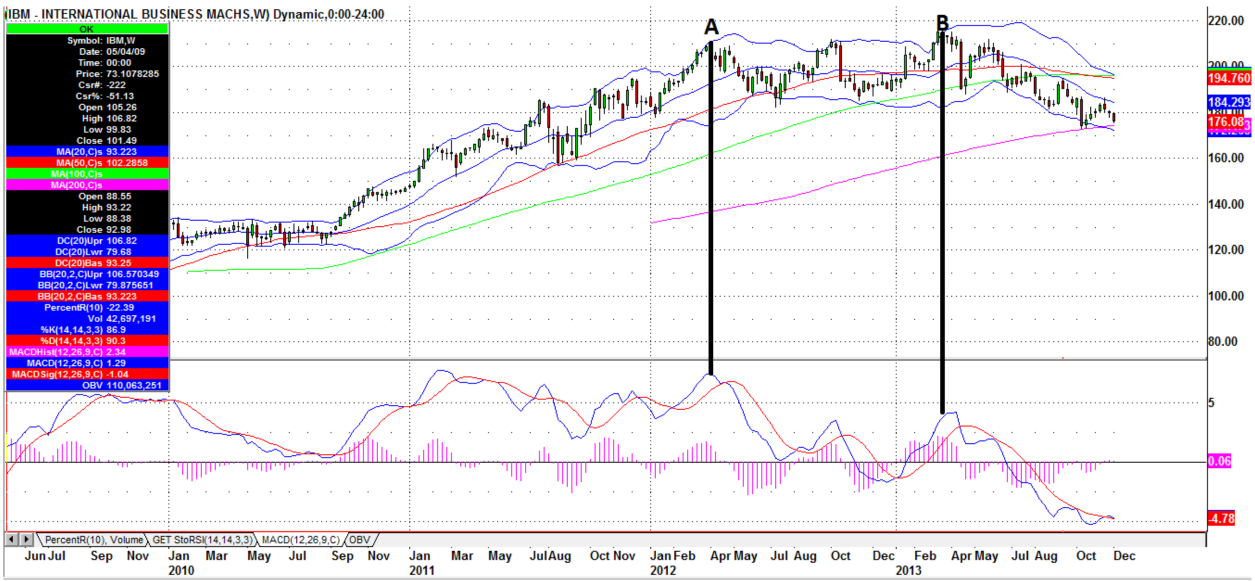
KPP FINANCIAL

Chart Lesson

MACD Divergence

December 2013



While price and pattern are the most important factors in technical analysis, there are other factors you must consider as well. Certain chart indicators can give investors a heads up to future weakness or strength that may lay ahead counter to the current price move on the chart.

One of the most widely followed indicators is the Moving Average Convergence Divergence line, most commonly referred to as MACD. The image above shows a weekly chart of IBM. In early 2012 (A) the price of IBM made an all-time high but soon rolled over and began to trade in a range for about a year before price finally exceeded those highs in the early part of 2013 (B). Now usually price breaking out to all-time highs should be celebrated by anyone that owns the stock, but we sold the stock for our clients instead because the fundamentals were not backing up the move and one other important factor. If the move was indeed bullish the MACD would have followed by also making new highs compared to its 2012 level. In this instance that was not the case and thus another bearish layer was added onto our analysis. When earnings came out the following quarter the stock broke down creating a MACD crossover and has not looked back since, falling nearly 20%.

This method can be used to find false bottoms in a stock that may be near a low, but should really be bought. Look at whether or not MACD confirms a stocks new high or low price and look for divergence as an indicator of a potential opportunity to buy or sell the stock.