HACKING THE RSI:

A MASTER CLASS IN TECHNICAL ANALYSIS FOR CRYPTO TRADERS
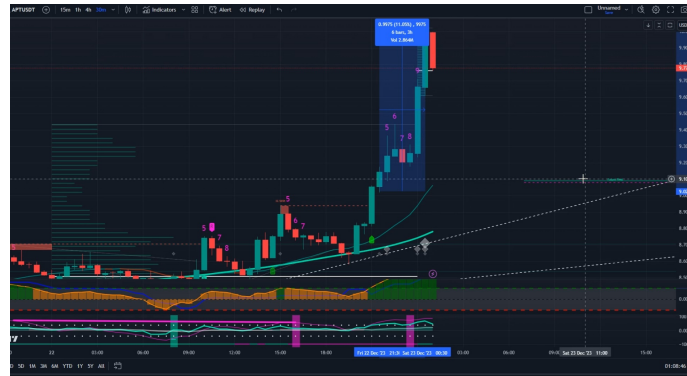
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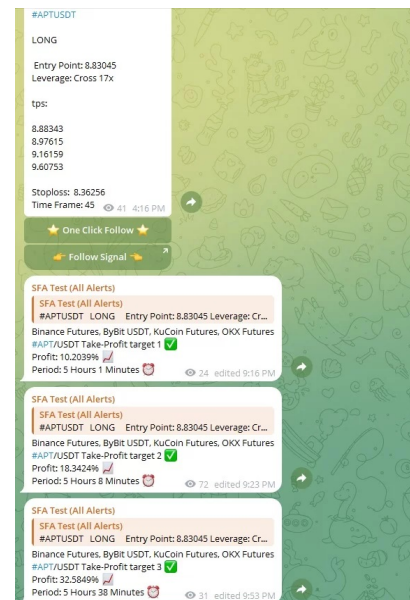
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Hacking the RSI: A Master Class in Technical Analysis for Crypto Traders

Every trader has their secrets.

For some, it's the metrics they use to spot and evaluate potential trades.

For others, it's the platforms they use to test and execute their ideas.

For me it's all of the above. My trading is based on a range of different tools and techniques that I've picked and perfected over the years, and I'm always working to expand that toolkit.

But you probably already knew that.

Still, there is one trading tool that is by far my favorite and one that I use on every single trade I make, crypto or not.

I'm talking about RSI analysis.

Never heard of it? It's one of the most powerful trade analysis techniques available to traders today, helping you determine when to enter trades, when to exit trades, how to spot trends, reversals and more.

The Relative Strength Index (RSI) was developed by J. Welles Wilder and is known as "a momentum oscillator that measures the speed and change of price movements."

The RSI oscillates between zero and 100, and its formula written out looks like: RSI = 100 – 100/(1+RS)

Relative Strength (RS) = Average Gain / Average Loss over a specific period. (the default period is 14)

Traditionally the RSI is considered overbought when above 70 and oversold when below 30.

These don't mean traders should buy or sell automatically when the RSI hits these zones. It just means that a reversal could be happening soon as these are extreme levels and there is typically a supply level or demand level that will be hit that may reverse the trend.

Still, there is a lot to the RSI and it can be a very valuable tool for traders, even crypto traders.

I've been using these concepts profitably for years, and have developed a few RSI hacks that help me in my own trading.

Hack #1: Bearish and bullish divergences help me spot potential trend reversals for long and short opportunities

An RSI divergence occurs when the price and the RSI are going in opposite directions. In practice, if the price is going up or down, the RSI will go the opposite direction.

This situation signals that the momentum behind the price movement is slowing down, and a possible change in price direction may be ahead.

A bearish divergence: Appears when the price is rising, but the RSI is falling in value.

A bullish divergence: Appears when the price is falling, but the RSI is rising in value. This generally means lower lows on price action over a long time frame, like daily, and higher lows on the RSI in the same time frame.

Let's take a look at two examples of this using Bitcoin:

First, a bullish divergence.
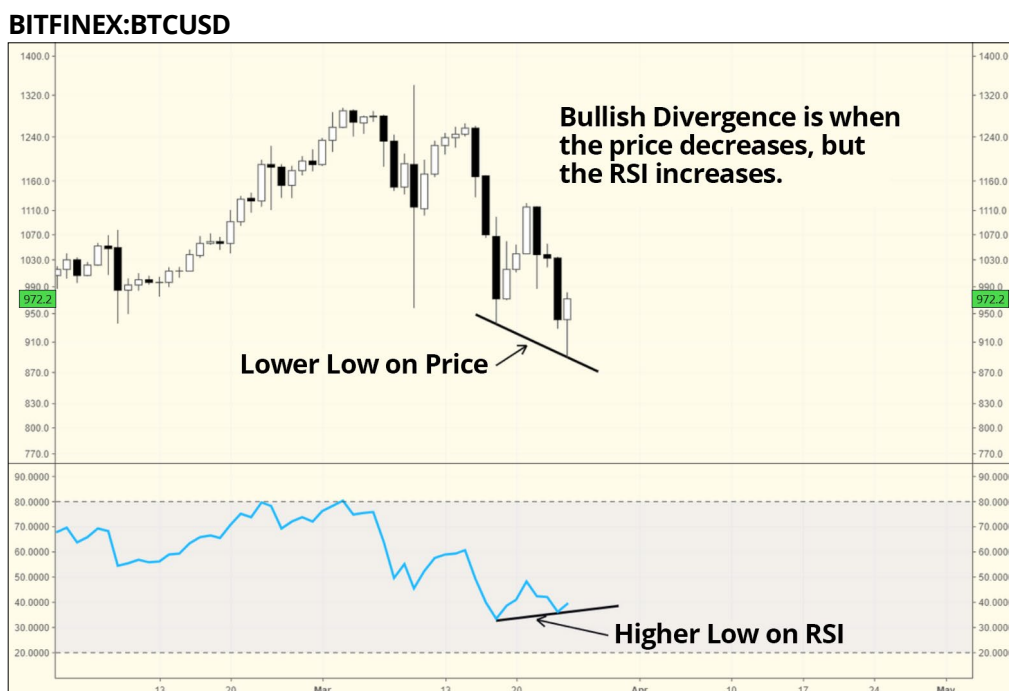
In the chart above, the RSI formed a bullish divergence on the BTCUSD daily chart in March of 2017.

Here's how to spot a bullish divergence: Look for higher lows on the RSI and lower lows on the price chart.

The RSI in the chart made a higher low, but the price failed to follow the RSI, creating a lower low. In this case, a confirmation for opening a long position should be used, and a stop-loss level should be placed just below the lower low on the price chart.

If we had taken this trade, we would have seen a 70% profit until we hit another lower low.
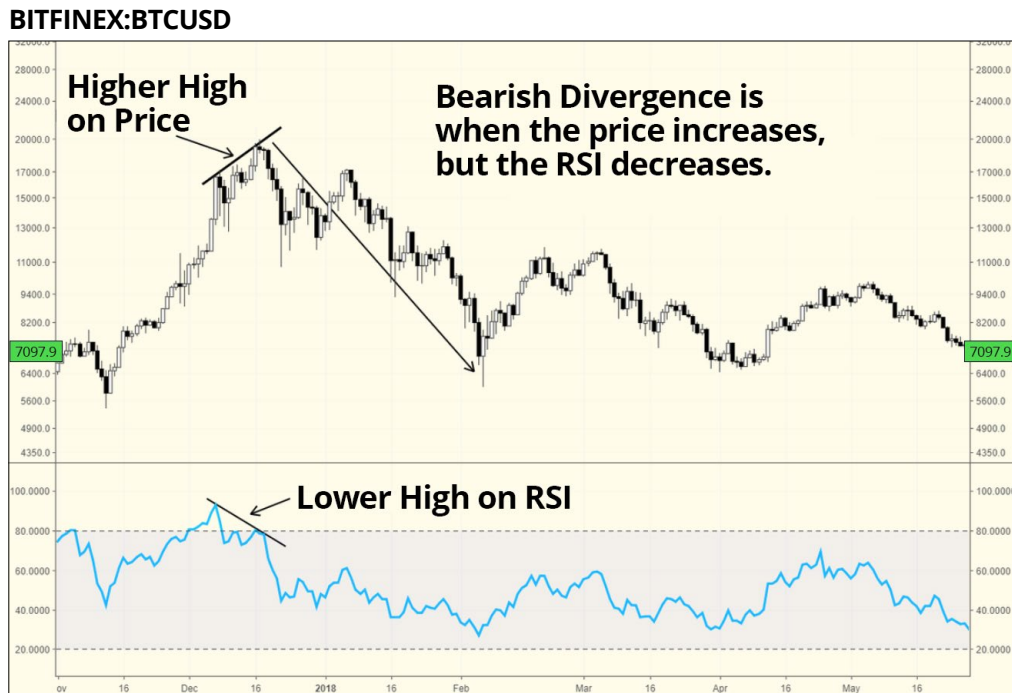
BITFINEX:BTCUSD

Next up, let's look at a bearish divergence.

The chart below is an example of an RSI bearish divergence on Bitcoin from its all-time high in December of 2017.

BITFINEX:BTCUSD
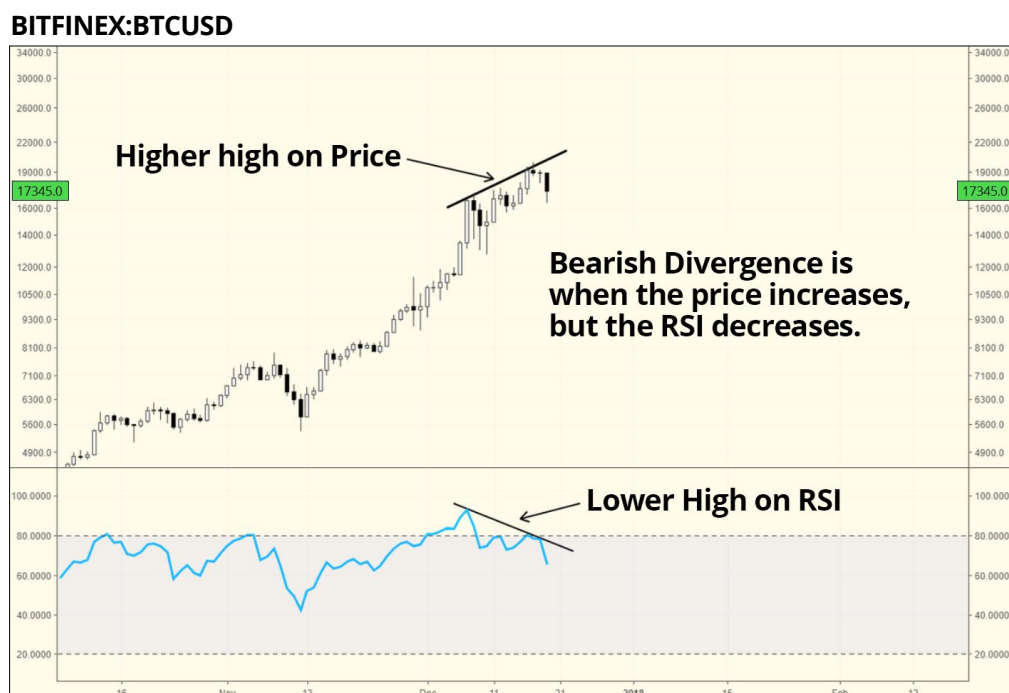
In this case, the price of Bitcoin made a higher high, compared to the RSI, which produced a lower high, thus creating a bearish divergence.

If we had taken that divergence, we would have seen the price go from $20,000 to $6,000 without ever making another higher high, for a fantastic short opportunity.

HIDDEN DIVERGENCES

So that covers both bullish and bearish divergences. Those happen when there is a trend reversal.

But there are also divergences that are known as Hidden Divergences. These are typically based on trend continuation patterns.

There are two types of hidden divergences:

1. **Hidden Bullish Divergence:** When the price makes a higher low, but the oscillator is showing a lower low.

2. **Hidden Bearish Divergence:** When the price makes a lower high, and the oscillator makes a higher high.
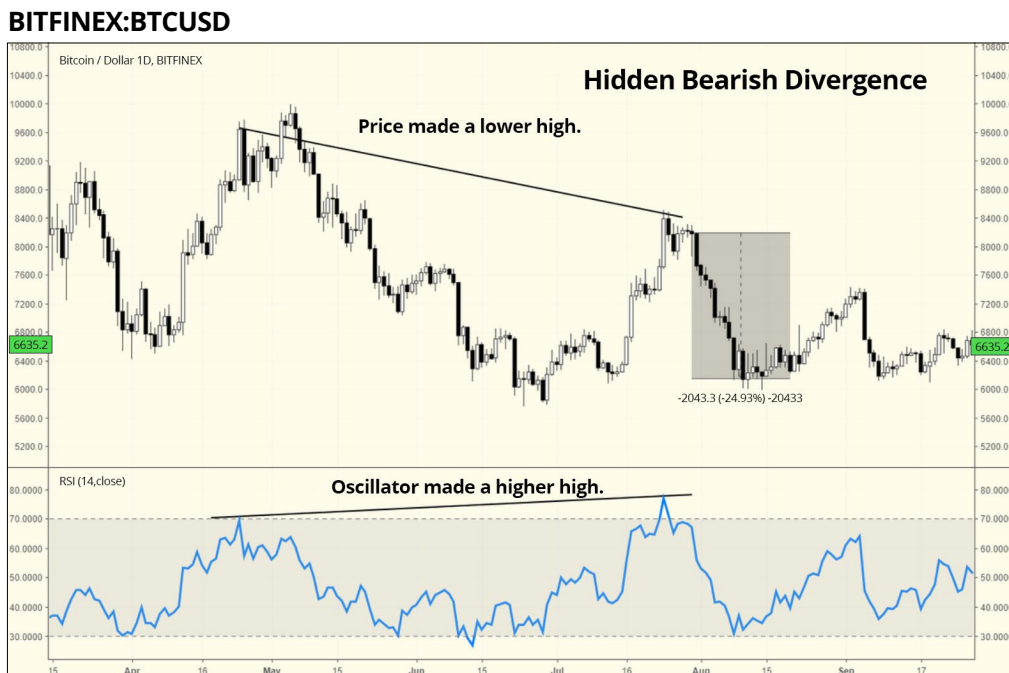
Let's look at an example.

In this example, you want to use the price that correlates with the peaks of the oscillator.

BITFINEX:BTCUSD
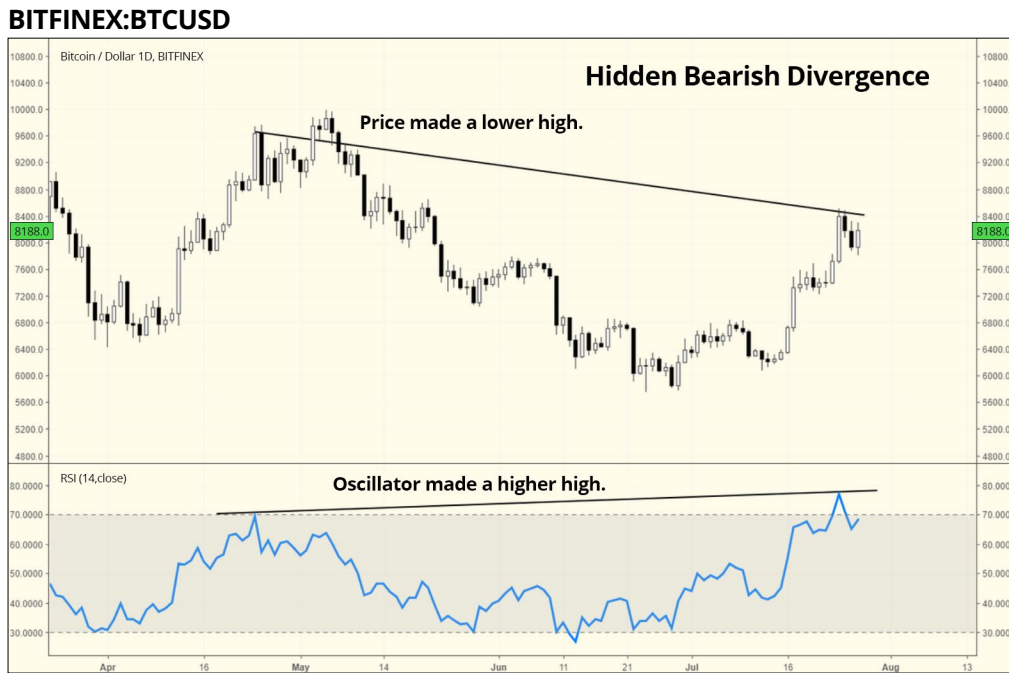
Since we were already in a downtrend, then it shows us that a bearish continuation was most likely and a short trade would have been entered for a potential profit of 25%.

BITFINEX:BTCUSD

SWING LOW AND SWING HIGH FAILURES

The last types of divergences I want to talk about in this hack are known as a "swing low" and a "swing high" failure.

A swing low failure is a bullish divergence where the RSI dips below 30. But, as the price declines, the RSI does not drop back below 30 again.

This is a highly bullish move that I see work out a lot.

Let's take a look at an example of this from Bitcoin in June.

BITFINEX:BTCUSD

This swing low failure would have resulted in a 34% increase had you bought on the confirmation candle afterward.

BITFINEX:BTCUSD

A swing high failure is the opposite. It's a bearish divergence where the RSI goes above 70 with the price, but as the price increases, the RSI does not go back above 70 again.

BINANCE:XRPBTC

As you can see below, this swing high failure gave us a perfect top on Ripple for a great short opportunity. Afterward, we saw Ripple's price decline over 33%.

The swing high and swing low patterns are typically very reliable when it comes to high volume/high liquidity coins.

When it comes to lower volume and lower liquidity trades, this is less reliable as those are typically more news-driven and bot-driven cryptocurrencies.

BINANCE:XRPBTC
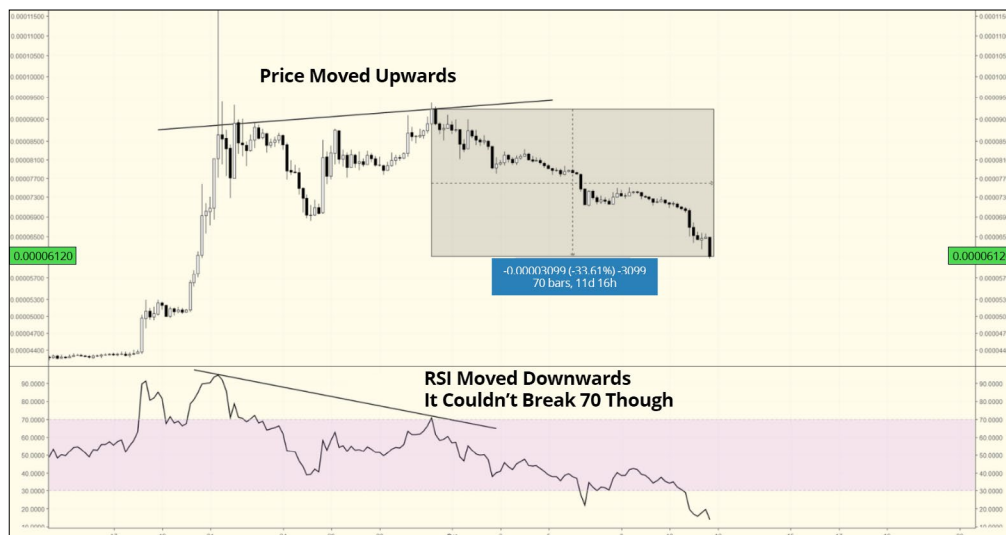
Hack #2:
Using RSI for Pattern formation analysis

Technical traders love patter formations. Double bottoms/double tops, head and shoulders, wedges, and more – all can be valuable in understanding which way the market is moving.

But here's the thing: Not all patterns show up in asset prices. Sometimes they're just too subtle.

But here's the other thing: **You can actually see patterns form on the RSI that you won't see on the price.**

I know, right?

Let's take a look at a few examples of this.

Here's a Head and Shoulders on the RSI, but no corresponding pattern visible on the price action.

BITFINEX:BTCUSD

There wasn't a clear pattern that formed on the price chart, but it formed on the RSI chart.

Head and shoulders pattern and a broken neckline for confirmation.

In this example, you can see that if we had taken the trade, we would have ended up with a 28% profitable short.

BITFINEX:BTCUSD

Below we can see that the RSI formed a double bottom while the price was experiencing a pullback during an uptrend.

BITFINEX:BTCUSD

In this example, we can long the candle with a stop below the trendline based on the strong RSI support.

After the trade, we saw a 119% increase with no stop loss ever reached.

BITFINEX:BTCUSD

4112.5 (119.10%) 41125

Stop Loss Below

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Hack #3:
Establishing trends and finding when a trend is broken

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John Hayden wrote in his book RSI: The Complete Guide that, "in an uptrending market the RSI value does not go under the 33.33 level and often stays above the 40 level while routinely exceeding the 70 level."

OK, what does this mean for us as traders?

In downtrends, the RSI doesn't go above the 66.67 level and often stays under 60 while routinely going under the 33.33 level.

In a bull market, you'll see RSI stay within a zone of 100-33 (mostly 40).

In a bear market, you'll see RSI stay within a zone of 0 – 67 (mostly 60).

When the RSI supports break to the downside, you'll see a reversal to bear markets. When the RSI support breaks to the upside, you'll see a reversal to a bullish market.

Where are the trade opportunities in this?

Look for other supports/resistances that it will move to, like the 200EMA going from above to below for a short position and the 200EMA going from below to above in a long position.

Let's take a look at an example.

From October 4th, 2017 to January 15th, 2018 the RSI stayed above 40 the entire time. This indicated a strong trending bull market, and we can use the RSI over that time period to spot when that trend shifts.

BITFINEX:BTCUSD

In a bear market, we typically see the opposite.

We can see the same thing that we said above, but with a bearish correction on Bitcoin from December 20th, 2017 to April 19th, 2018.

BITFINEX:BTCUSD

Many times, RSI will also form support and resistance for a cryptocurrency as well. For a long trade, you want to see previous resistance break to the upside.

Let's take a look at an example of this.

BITFINEX:BTCUSD

The same is true for a break to the downside. You can take a short position when the RSI support is broken.
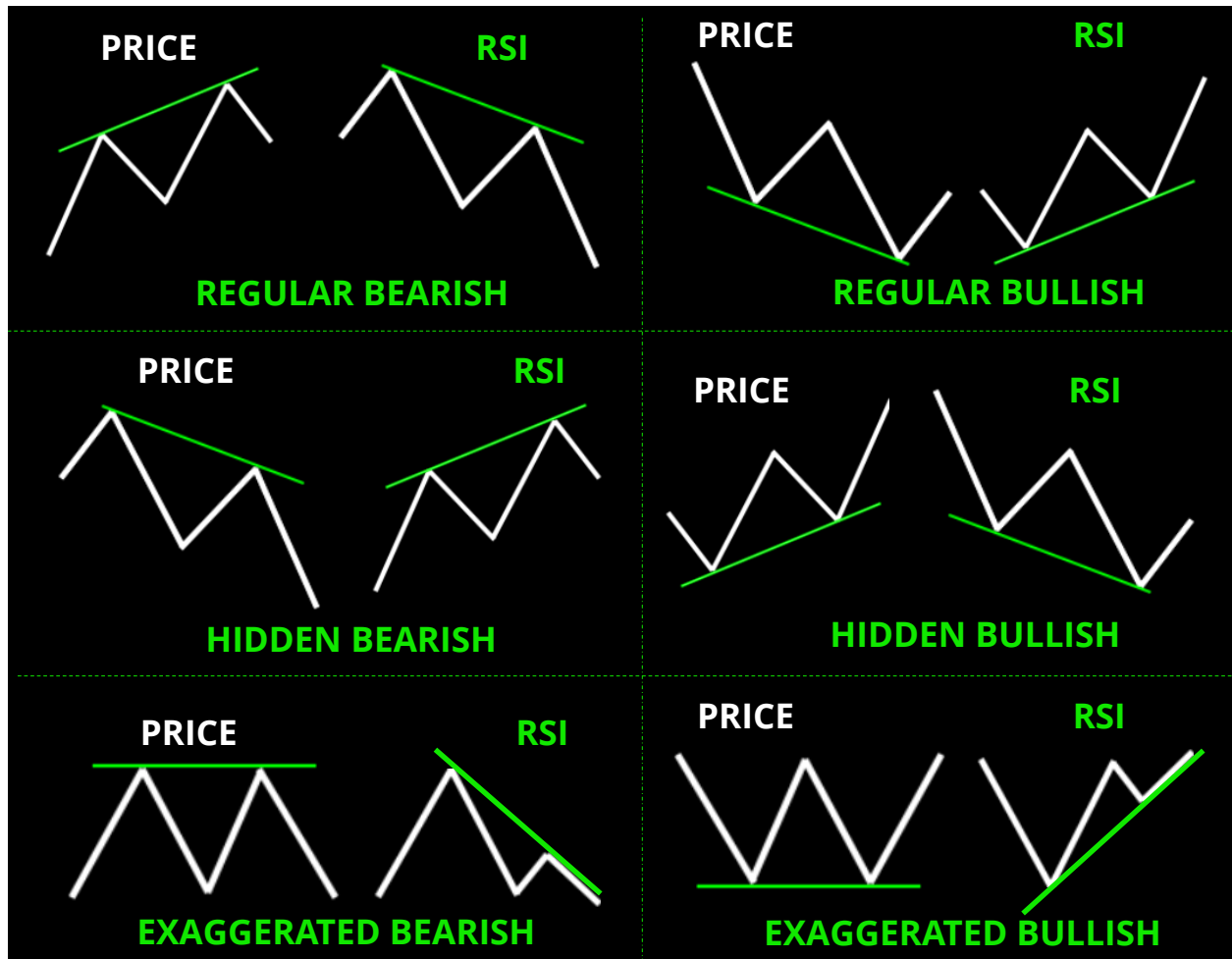
BITFINEX:BTCUSD

Like I said, using the RSI is by far my favorite trading tool, and it's worked wonderfully for me over the years. It takes some practice to use effectively, but can be invaluable in determining when to enter trades, exit trades, determine trends and spot reversals. I hope these techniques are as useful for you as they have been for me.

DIVERGENCES CHEAT SHEET

Regular Divergences = Reversals
Hidden and Exaggerated = Continuations

PRICE RSI
REGULAR BEARISH

PRICE RSI
REGULAR BULLISH

PRICE RSI
HIDDEN BEARISH

PRICE RSI
HIDDEN BULLISH

PRICE RSI
EXAGGERATED BEARISH

PRICE RSI
EXAGGERATED BULLISH

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