

TRANSCRIPT

Trading with momentum

Presenters: Matt Davison and Robert Kwon

Matt Davison: Yeah, thanks so much, Trey, and as you said my name is Matt Davison. He's Robert Kwon. We're going to be talking about momentum, how it fits within the framework of a trading strategy, because I think it's certainly one of those things when we talk about technical analysis that's just a little bit misunderstood. I think the tendency for people to go out and look for that magical signal that's always going to work 100 percent of the time, and that's what people are looking for, and I can certainly understand and appreciate that. However, we're certainly not going to completely solely rely on momentum and momentum-based indicators when it comes to a trading strategy. We need to keep in context how it fits into some other concepts such as price. Are we at an extreme whether that be a high, a low? Are we at a point of resistance, support? How does this fit into a chart pattern, candlestick patterns? And incorporate all of the other components of technical analysis as well before we just jump straight to the indicator and say, "I'm making this decision," whether that be a buy or a sell solely based on something that we're seeing. Throughout the presentation we are planning to focus on momentum-based indicators. Two specifically, I'm going to introduce a third throughout the presentation. But we'll see it's actually very

similar to one of the first two that we're going to demonstrate. The first half of this, we're going to spend some time just going through defining what momentum is, what the indicators are, how they're constructed, what the basic uses are. And then on the back half we're going to take some time to go through some demonstration, look at some live examples from some symbols that are in the Dow Jones 30. So with that being said, let's go ahead and take a look at the two main types of indicators that we're going to be working with. These are considered oscillators and the reason that they're called oscillators, these are going to be bounded. So what do I mean by bounded? This means that on the understudy that we put beneath our chart in Active Trader Pro we're going to see certain levels where it can reach. On the bottom hand it can't go lower than that. And then also on the upper hand it can't go higher than that. Now not every momentum indicator falls within this category of an oscillator but the main two that we're going to focus on today are in fact that way. They're bounded. There's going to be a 0 point, a 100 point, and then anything in between, but it can't go beyond those bounds. Now the reason that this is important is because we're also going to identify certain zones within the actual indicator which may indicate that the security is overbought or oversold. So in the case of an oscillator we're usually going to identify some sort of line, and there's different methods to selecting where exactly to put it. Most of these indicators have creators that went and did backtesting studies.

And there's a standard default which Active Trader Pro is going to give you. But if you wanted to make it more or less sensitive depending on what the security is that you're trading or more importantly your specific trading style, you can certainly modify that. However, once we reach one of those zones, so in an oscillator on the top-hand side we're going to have a specific zone, once it reaches that area, it's going to be potentially considered overbought. On the flip side once we have a zone on the bottom at a certain level, once it goes down past that it's going to be considered oversold. Now this is where it's very important to keep in context the other ideas of technical analysis. So thinking about what is trend doing, where is price, is it at one of those relative extremes. And the reason this is important is because if we'll notice over here on the right side of the screen if we have a strong trend present, it's not as easy as just saying, "Okay, it went above this line, this is an automatic decision to sell, it went below this line and is piercing back above it, it's an automatic decision to buy." Because we do need to take into context what the trend is doing, and more importantly if we're in a trend is there a specific pattern to the trend that we can identify, is there a specific point of support or resistance where we may be running up and to that's going to make our decision maybe a little bit different, or at the very least gives us some extra consideration before we actually make a decision. So to further the idea, however, if we're working with a nontrending market, let's say, we're working with a market

that's going sideways, this is typically where the overbought, oversold idea is going to give us the best sort of signals. And what it's trying to interpret there for us is once we hit that level what's potentially going to happen to the security. Well, it's potentially going to be vulnerable to a reversal. And that's what we see over here on the left-hand side. So what are we looking for? Well, we're looking for on the overbought side the indicator to go above our overbought line, and then back beneath it. Once we go above and then back beneath, it exits one of the zones. That's going to give us our actual signal. And then in some cases we have to keep in mind that just because we go above that line, and this is what I mean by the trend again, it doesn't necessarily mean that it's an automatic buy or sell. And the reason why is because potentially this could indicate a new trend. If we think about what momentum is, really it's either buying or selling pressure, it's the velocity at which price of the security is moving. Well, in order to establish a new uptrend, usually momentum is going to have to gain some steam. And oftentimes when we're breaking out of a former level of resistance or support, well, the buying or the selling pressure is going to be increased at that moment in time, and that's what's giving us the boost to actually break out of whatever pattern we might have been in or whatever level we might have seen that's held in the past. So it's very important to keep that in mind and I'm going to make sure to demonstrate that as we go through some of our

examples later on in the presentation. Takeaway from this slide, we can certainly use overbought, oversold in the oscillators, especially in the nontrending market, but if we do have a strong trend present, certainly important to keep in mind that the trend is there and how that's affecting our decision whether or not the stock is overbought or oversold. So the first indicator that we're going to talk about here today is going to be the stochastic oscillator. So the stochastic oscillator, this is one that was created back in the 1950s. What the main goal of the indicator does, it's going to show you the location of the close relative to the high-low range. So in most cases in Active Trader Pro it's going to give us a range of 14 days. Again we can adjust that depending on if we're wanting to look at a weekly chart, daily chart, less than that timeframe. Or we can make it basically anything that we want in order to make it more or less sensitive. So what it tries to do is it tries to tell you within whatever range you select where the current close of the stock is. And then it's giving you a relative percentage from 0 to 100 and that's literally what it's graphing on the screen. So that's what you see here, 0 to 100 for the range, and then it's telling you basically is it in the top half, the bottom half, and then specifically the number on the right is going to tell you what percentage we are within that range. So how it works. So generally the area above 80. We talked about that overbought region. That is going to be the overbought region. While the area below 20 is considered an oversold region. So what

we're looking for here is if the indicator gets above the 80 line, and then crosses back below, this is generally what's given as the sell signal. Conversely on the other side a buy signal is generated by the security in the stochastic indicator falling beneath that 20 line and then crossing back above the 20. That's the classic signal for how this indicator works. And then there's also a crossover signal. So in both the full, or not the full, but the fast stochastic and the slow stochastic, there's two different versions of this, they're both based on one another, the fast is the original and then slow stochastic is just a derivation, basically a smoothing of the data from the fast, there's going to be two lines. So there's going to be that number that we're getting from this high-low range and where the relative close is, but then we also have a smooth, usually it's a three-day moving average, but again we can adjust that as we see fit, and that is going to generate our two lines. A crossover signal can also occur when we have the percent K and percent D. Percent K is this over here. The relative close to the high-low range. And then the percent D is the smooth moving average. When we have a crossover of the two lines in either the overbought or the oversold region, this is going to also generate a signal. Third thing that we can look at here, divergence. And this is more on the leading end of what this indicator does. We're looking for places where price action is not being confirmed by a new high or new low in the actual indicator. So what do I mean by this specifically? What we're talking about is

if price is making in a bullish trend a new high and continued higher highs, what we would want to see is the stochastic oscillator doing the same thing. But once we make a new high in price but we're not seeing the same thing in stochastic oscillator, this is going to be a situation where we have divergence. Potentially signaling that the momentum might be slowing down. And then it might be subject to reversal. So all certainly things that we can do with this oscillator. And we will show some examples here in just a moment. But before we do, Rob, I will turn it over to you. I know we have one more indicator that we want to go through here on the slides before we get to some examples.

Robert Kwon: Yeah. And I apologize, Matt. On my screen it's still stuck on the stochastics. Are you on RSI for me?

Matt Davison: Yeah, there we go, sorry about that.

Robert Kwon: Okay, no problem. So listen. Essentially what momentum type indicators, not to be confused with the actual momentum indicator which does fall in this category, it's trying to compartmentalize price and give it to you in a different perspective to try to quantify some version of rate of change, kind of the speed of the move. However, Matt talked about one of the very simple

indicators, the stochastics. It's basically just a range. Whatever you set as the lookback period, by default 14, what was the highest point in the last 14 days if you're on a daily chart, and what was the lowest point, and then where are you in relation to those relevant points. Relative strength index is quite a bit more complex, and kind of responds quite a bit slower due to more complex math. So the way this is calculated is you're taking average gains and comparing them to average losses. By default it's set at 14. So if you're on daily it's going to be 14 days. You're going to find that that's a very popular setting on a lot of indicators because a lot of them were either created by the exact same person or people who derived their work or used similar concepts. So in terms of RSI, what you're basically doing in the beginning is looking back 14 days and averaging the gains and then comparing them to the losses in that period. If you had all gains the initial calculation would be 100. So all gains versus no losses. If there was all losses and no gains your RSI value would be zero. So just like stochastics, this is a bounded oscillator. There is a maximum and a minimum value. However, once the initial calculation is run, Wilder applies his smoothing formula in which he takes the previous value and multiplies it by one less than whatever lookback period you are utilizing. So in the default case, which we'll look when we switch to the demo, you would take the previous value and multiply it 13 times. So average gain, previous value 13 times, and then add in the newest, if it was a gain. You would take the average

losses, multiply it by 13 times, and then update the value. So once the initial RSI is run it is then very slowed down by using the prior value basically one less than the lookback period. This causes it to while thematically trying to show something similar to stochastics, it moves quite a bit slower. And the default overbought and oversold settings for stochastics was basically the upper fifth which is 80 or above or the lower fifth which is below 20, Wilder set the default to 70 for the overbought and 30 for the oversold. However, we're going to find in practice that depending on the condition of price, essentially whether or not it's trending or not, trending up, trending down, or no trend or sideways trend, you're going to find that RSI on a daily perspective with 14 doesn't typically get to its oversold or overbought levels if the trend is still intact. And if there's no trend you can often find it ping-ponging between levels of say 60 and 40. So let's take a look at this slide. If we are in an uptrend, and you have to define that, we typically would expect RSI if price weakens and RSI declines to not actually go all the way down to the oversold level of 30. We would actually expect it to hold around the 40-to-50 area. And conversely if we're in identifiable downtrend, if price then bounces and RSI bounces, so it bounces out of the 30 zone and goes higher, we wouldn't typically expect it to actually get to the overbought area. We'd expect it to fail in the 50-to-60 range. And again if we are starting to go sideways you're going to notice a lot of ping-ponging between 60 and 40. Now here's the thing, right, Matt? You touched

upon this at the beginning. The desire to get the early signal. And the way I like to think about indicators, it's just visual mathematics. It's just showing you what's already happened from a different perspective and therefore can any one of these indicators ever predict the future for sure? Of course not. So the context matters. Think about a traffic light in the United States. Through context green means to a lot of people go. But that's not literally what it means. It means you have the right-of-way. Absent other factors. Like a police officer overriding the signal. And then you're waiting to see if other people are obeying their signals. So if you automatically think green means you just go without context what can happen in real life? An accident. Green just means yellow is coming next, followed by red. That's the literal aspect of it. And once you understand that that's all indicators are doing, it's literally showing you something, and any actions you take are based off your interpretation of what's going on, you can avoid the mistake of looking to these things to accurately predict the future. Hopefully that type of analogy kind of makes sense. I know this is something I looked for often when I was a younger trader, Matt, what's the best indicator, what's the best settings. Then you're going to find it's like why are there thousands of indicators. Because everybody's trying to build a better mousetrap. But as long as you understand you pick a momentum indicator for a specific reason, a perspective of price other than trend. And then there's other categories like volatility, which Matt

touched upon at the beginning, and volume. And you try to bring everything together to make the most effective decision possible. So hopefully that gets you in the right framework of mind of what we're trying to accomplish here by having this webinar today. But I'll kick it back to you, Matt. Why don't we start looking at some specific examples? I think the practical application. It's easy to talk about things in a textbook version. So I think we do have a slide demonstrating. The next one over.

Matt Davison: Yeah, absolutely. And let me just go back a slide here because this is for stochastic. So as far as the stochastics go, we kind of glossed over this. I just wanted to demonstrate and kind of define what both indicators were that we were planning to use. And then we'll start looking at this. So effectively what this is trying to show us is a couple of different things. So when we're more in the sideways trend over here on the left-hand side, we can see that we're getting signals when we have the cross beneath the 20 line back above potential entry. As we go and continue to have the stochastic stay above that 20 line, we see it go up and hit right at that 80 line, and this is our potential exit. And we can pretty clearly see this was a solid trade. If we actually made it strictly based on looking for the overbought and the oversold regions, we could have done it again right here and right here. Looking for places where price action is going down, touching that 20 line, and then going back up,

touching the 80. In a sideways market, which is arguably what this is, maybe a little bit of a bearish downtrend to it, but more or less sideways, you can see it's very effective in going in there and giving us potential places to buy and sell. And it's relatively easy. Where it gets a little less clear is where we have the strong trend. And where do we see that in this particular case? Well, we see this resistance line right here and we see a gap up above the resistance, which I'm basing off this high point right here. Well, when you see that occur, you see it get above the overbought area, and though it falls beneath it, it goes right back above it. And it does it again, and it stays above this line consistently. And the reason why is because we have strong strong buying pressure, and that's what this is trying to tell us at this moment in time. As we exit out of this kind of sideways trajectory and then we have this bullish buying pressure, we get into this strong trend, and it keeps going even though we're technically in the overbought region. So this is why it's very important to keep in context what support and resistance are, what trends you're viewing, because just because we got to this level, well, yes, we could have sold out here, we still would have more than likely been able to make a gain. However, we missed out on the significant portion of the move. And while it didn't have to go that way, most people want to take part in the majority of this move. That's the whole reason we're trading. So have to keep that in mind. And one other concept here that this slide introduces, and then, Rob, I'll let you take a

look at the example that we have on the RSI, is this idea of the divergence. So divergence. Basically what we have, we have a high here. And then we see continued price action moving higher. And once we get a little bit of a pullback we go on and make a third peak right up here. Well, what is happening on the stochastic side of things? On the momentum side of things this is not what's occurring. We're seeing a high here, a lower high here, and an even lower one here. So this is a pretty good warning sign. When we're looking at price action do one thing and then the momentum side is diverging, what this is trying to warn us of is well, this thing may be subject to a reversal. And sure enough we see it. The next couple of bars we see this is actually a high and it sells off pretty significantly. We actually give up 40 points here in just a couple of trading sessions. So very important uses for all three of these. This is a great slide because it highlights the three main concepts that we'll look at when using stochastics. And Rob, I'll pull up the one here for RSI, let you take that, and then I'll get Active Trader Pro ready to go for our live demonstration.

Robert Kwon: Yeah, perfect. So just really quick. What creates the divergence on the stochastics? Remember, it's a locked window looking backwards. So even though price was higher than it was in the past, compared to its lookback window, it was trying to let us know that the speed in this fixed box with the

changing height depending on the high and the low was fading a little bit. But what's the most important signal? It's the price. It's when the price broke down. Remember, price doesn't care how it's interpreted. That's what creates the divergence in the first place. So what you're looking for with momentum is kind of like warning signs. It's like hey, price is continuing but momentum is waning. So you don't necessarily act on the momentum signal itself. It's if price then starts correcting. Whether up or down. Then your momentum indicator kind of potentially gave you a heads-up. So on this RSI example, what are we seeing on price action? There was a low. An attempt to bounce. And then a lower low. Think about what just happened recently in the market. But based off how it's converted into a signal in terms of RSI, you can see that the initial down move created a low point of RSI, so even though price itself went lower afterwards, RSI responded with a higher low. So this is the bullish divergence. Of course that's ignoring the fact that price was lower. So what was the signal? The signal was price starting to go back up. And then you can say, "Hey, momentum was also showing some hidden strength and perhaps this is an entry." Now notice that it powered all the way to the classic overbought level using the default. And in the short term when it fell out of the overbought zone what did it do? It gave you a good exit signal to take profits or manage risk. But you can also just see that from the price going down. Now notice what it did. Unlike stochastics, which is very easy to ping-

pong between its overbought and oversold levels depending on what that range was, it takes quite a bit more to get RSI to move, because of how it's calculated. And where did it hold? It held in kind of the middle of the range. And that's typically where you would expect momentum to hold if the move is more sideways or potentially still up. What happened? It responded by both price and the indicator bouncing and holding where you'd expect it to hold. Once again got to the overbought level, and once again gave us a nice exit when it fell out of that area. Notice throughout this whole time on the screenshot when we look back with the benefit of hindsight did price substantially move higher? No. It started trading sideways really. Look at what RSI looks like when price goes sideways. It never really a lot of times even gets to some of those boundaries. So this is where you can kind of customize to say, "Are the settings that this gentleman invented decades ago really going to fit every single circumstance? No." And that's the benefit of understanding what the indicator represents. And then you can go and fine-tune it to say, "Hey, do I think this creates more effective signals versus the default?" Because if anybody just used the overbought and oversold on this thing from a daily perspective, what happened after that third green circle? You didn't get a signal for weeks. Eventually we want to be able to make a decision to try to make some type of profit when we're trading or investing. But I think that's enough of looking at textbook examples, Matt. Why don't we

kick it over to the demo and start looking at maybe some circumstances that have actually occurred more recently? And again just for a reminder, any security we bring up is not intended as a recommendation. So we're just going to take samples from like the Dow just to use for demonstration purposes today.

Matt Davison: Exactly. Yeah. Couldn't have said that better myself. So let me before we jump actually into Active Trader Pro, always want to demonstrate for any of you in the audience that may not actually have the software downloaded yet and are using it, you can get this for free if you're a Fidelity client by going on Fidelity.com, accounts and trade, and then right down here to Active Trader Pro. Once we click that it'll take us to this page right here, get Active Trader Pro. Depending on whether you have a PC or Mac you can download the appropriate version. So always like to show that at the beginning. Now let's switch over to Active Trader Pro and look at some of these concepts. So my plan here is to basically go through three different components of the Dow. I have them highlighted on the right-hand side here. And each of these is going to show us a slightly different version of trend. And the goal of this is to show you how it can differ, or how basically to use stochastics, that's what I'm going to focus on, differently depending on whether we're in that sideways trend, maybe the bullish trend, or the bearish

trend. So I'm going to start with Johnson & Johnson. And even though we can certainly argue that going back to 2020 we've been in somewhat of a bullish trend, I think you can look at two main areas here and identify pretty clear moments where we're in rectangular patterns or sideways trend. So right there to start off with, if we move it up here I think we can certainly argue as well that if we look at this area relatively the same, there's some areas that it attempts to break out from some of these levels. And even right now it's kind of trying to do that as we speak. But for the most part we're sitting right at that level where it would want to hold if we're not going to fall right back into that rectangular pattern. So first of all what can we do to get these added to our actual chart? So we're going to go right over here to indicators. Once we do this I'm going to add two things. So I'm going to go to SF, which is stochastics fast. And just in case you don't remember that you can always just scroll over to the right-hand side here. And what we'll see, stochastics fast, getting finicky, my apologies. Little bit slower here. Stochastics fast right here. Going to add that. And then we're going to add the slow stochastics. So a couple of things on this. So fast stochastics, slow stochastics, what are the main differences? So again the percent K in the fast one, it's looking at a 14-day range in this case because I'm on a daily chart and it says 14 right here. It's looking at the high and the low for that range. And then it's looking at relative to that where is the last close and what percentile effectively are we in. Once

we get that, it's going to go over here and create this percent D line. And all that is is just a simple moving average smoothed of the percent K. The slow stochastic. How are we getting this percent K number? Well, what we're actually doing, all it does is it takes this right here, the percent D from the fast stochastic, and that becomes our percent K. And then again we're going to take a three-day simple moving average of this percent K line for the slow stochastic. And that gives us our percent D for slow. And just so this is clear for everybody here. If we were to actually go in there and we were to start to look at what this would look like and we modify this, if we take this off, make this white, and then let's take this gray one off here, we'll make this white, we'll notice that these are the exact same. So the percent D for the fast stochastic and the percent K, they are in fact the same thing. So what does this mean? Which one is better? That's the most common question that we certainly get. And the answer of course is there's not one that's inherently better than the other. They're different in what they're trying to give you. So for the fast stochastic I think it's pretty clear to see just from looking at this there's a lot more noise on this. And the reason why is because this one has been smoothed. The slow has been smoothed. The fast one not as much. So if you're looking to generate more signals, the fast one is certainly going to do that for you. What's the downside? Well, some of the might not be good signals. Whereas the slow stochastic is going to give you less signals but

because it's giving you less signals basically more data, more buying pressure, more selling pressure, whatever it's actually doing has to be present in order for it to get to certain levels. So that's kind of the difference between the two. I would say that between the fast and the slow the slow is generally speaking one that we work with people more on. So I'm going to focus on that one for the presentation. But before I do I just want to show one other thing here because we get questions on this idea of Williams percent R. And this is that third one that I was going to introduce. And what's interesting about this one, people want to know what's the difference between fast stochastic and Williams percent R. And the thing is they're really going to show you the same thing. They're just calculating it slightly differently. So rather than going from 0 to 100 on the scale on the right-hand side here, this one goes from 0 to negative 100. And that's a product of determining where the close is relative to the low versus the close relative to the high. It's telling us the same information because they're still dividing it by the range. It's just slightly inverted. And I'll prove this. If we go over here and take away this percent D line for the fast stochastic what we'll notice is we have the identical line. This and this is going to be the same thing. So you can use either one. Some people like this. Some people like using that percent K on the fast stochastic. Completely fine. Just know it's a little bit noisier. You can even make it more noisier by reducing the 14 down to something else. Or more so by making it a

larger number if we want to slow it down just a bit. So with all that being said, let's focus on the slow stochastic here for just a minute. Get this back up. And I'm going to focus right here on this area, because I thought it was pretty interesting. Because it's starting to change. I think everybody can see pretty clearly this is a neutral pattern that we have in Johnson & Johnson going back to 2019. There's attempts to break out. This is where we're setting some of our resistance points. So one right there. And more importantly if we go and start to look in this area, this is where it's attempting to break out. So what I'm going to show everybody here is how we can use this in the nontrending market and it's working quite well, and then as things start to change how we need to start considering what we're seeing on the stochastics just a little bit differently. So as you can see, after we have this run-up here, we have the sell-off, and we're getting a clear signal as we start to go back into this area. We're falling beneath that 20 line right here. And then we start to come up and get above the line. So we're getting clear signal at this point for the buy entry. Notice that as we're doing this we're buying it on a peak. A little bit concerning certainly. But this would be the signal if we were to use it in the most pure fashion possible. Now even though we get a retracement over the next few trading sessions, notice what momentum is starting to do. It's not getting back down to that oversold level. Indicating that potentially there's still a little bit of buying pressure there. And sure enough, it does come to fruition.

We get continued movement and we get all the way up into the overbought region at this point. And if we're using it in a really pure fashion potentially a sell right at this point. Now as you'll notice as Robert was just pointing out to us, we go on to make lower lows. But as we're doing so we're getting close to the area. And maybe if you were trying to front-run a trade as he mentioned you might consider these buys. And if you did, pretty good trading signal here as well. You could continue to see it run up. Doesn't go back beneath that 20 line. All the way up until this point right here. We get a crossover into the overbought. And then we get the cross back down. Sell signal right here. But where does it start to change? And I think this is something that's extremely crucial to be aware of. So we see this run-up here. And this was also foreshadowed, a little bit of the reversal here. We see higher high. Just so everybody sees this. In terms of the price action. Well, we're not quite seeing that when we're going over and looking at momentum. So we see a high here. Going to there. But it's diverging on the momentum side of things. The stochastics is saying this is starting to slow down a little bit. And you can see sharp reversal after we get this peak. You see the gap down. Huge intraday bar. So that's just an example of divergence. Wanted to show that since I noticed it real quick here. But what we start to see is a breakout from the sideways condition. So once we get up here, we go, and maybe this is a sell for us at this point in time. If we were staying really pure to a trading mechanic

of every time it gets above this line that's going to be my decision to sell, we would have sold out here. But notice that after mildly retreating we get momentum back above where the 80 line is in conjunction with a breakout from this high right here. So we're breaking out of the rectangle. It continues to move above and as we're doing this we're going out and we actually within the next few trading sessions, we take out this high. All while staying above the 80 line on the stochastics. And if we zoom back out just a little bit here we can see that the trend continues to go significantly. So we get a mild pullback here but even in this situation we're not breaching that 50 line. And just like with RSI we have that midpoint. Oftentimes I'll go in there and I'll just add a horizontal line right here to the slow stochastics. Once we get that maybe make it dashed, a little bit bigger just so we can see it. Do a 50 line. And I'll put it right in the middle. Even here on this pullback we don't break being in the top half of the range. Indicating that buying pressure is still holding at a relatively good level even though we're having a small pullback here in the breakout. And had we filtered it that way, we can see it continues to go on and make a high. So that's what we're noticing here. This is where condition of price, support and resistance, and then changing of the trend might have led us to make a slightly different decision here, as we exited the rectangular pattern and into a strong bullish uptrend. And then once we got here, well, let's talk about the exit strategy. Well, what do we see again? Well, I think

we're seeing a high here in this area. And again we see this idea of divergence start to come back into play. So we see the divergence in the stochastics again. So high, higher high, high, lower high. And then what does it end up preceding? Significant downfall. Now can you sell and know that this is the peak? Absolutely not. You're never going to know if this is the peak because we don't know what the next bar is going to be. If the next bar were significantly higher this might have made this a higher high. So this is where we again might incorporate the idea of trend. This concept. Drawing trend. Are we waiting for crossover back beneath the 80? Are we actually looking for confirmation that maybe this run is over by the stochastics going back beneath the 50 line? If we were doing that we'd be looking at this bar right here. And coincidentally it's aligning with this trend line. So once we see this break all warning signs, getting confirmation on the slow stochastics, maybe this is the time where we want to consider mitigating some risk. So that is the example for J&J. I'll show one more here. Because I wanted to show Boeing and how it's a little different. So with Boeing everybody can see if we go to the last two years here in the intermediate term it's certainly been in a downtrend. I think this is pretty obvious to see for everybody. So this is the first thing I always do. What is trend actually doing? Everybody can see trend is clearly going down. Now as we're going down we can still use this indicator. It's giving us pretty good signals here. We're seeing the cross beneath the 20, back above the 20.

And in this area we're getting a pretty good signal to buy. We're potentially going to wait though. If we want a stronger confirmation, well, maybe we're waiting for it to do this and then clear this 50 line. Or maybe we're seeing this level, if we want to get a little bit more aggressive with our trade, we're seeing it go up, and when it rallies it's going up to here on a momentum standard. Well, once it actually breaks this level, maybe that's what I'm waiting for to enter my trade. And that would be right around here. Then you can see we get a clear overbought sign right here. Sold out right here. Or when it crosses back down the 80. Either one of those, pretty good trades. We would see if we were to go right here somewhere between 10 and 8 percent. If we were to stay true to that mechanic right at that moment in time. Now the one thing that you have to be careful of when you're using this for buy and sell signals is be aware of the overarching trend. So this is a downtrend. So if you're trying to be a buyer in a downtrend or if you're trying to be a shorter in an uptrend, understand that the trend can sometimes be the most powerful part of the price of the security. So just because we're getting a little bit of bullish momentum or bullish buying pressure here, understand that in the longer run we've seen price continue to deteriorate. And we don't know when it's going to continue to make lower lows. I would argue right now for example we're seeing an attempt to break out, another one, from this pattern. As we go down to the bottom here right now we temporarily have a short-term peak

right in this area. Notice how we're almost there in terms of the overbought region. But we never quite got there. So now we have quite a decision on our hands. It looks like if we were to zoom in on this, it looks like it's still in a pretty good bullish trend. But if it continues to stall here and we're starting to see momentum fade, do we want to take action even though we didn't quite get to our overbought line? So that's a decision that we'll have to make. Right now trend is still very much intact in this case. On the very short-term level. But are we able to clear over this level of resistance right here? And if not, if this starts to fade and come back down, where is our potential exit going to be? Are we waiting to cross over that 50 line? Are we just wanting to front-run it and do it as soon as this looks like it's starting to peak? These are some of the ways to begin to manage and think about an exit strategy for some of these trades. With that being said, Rob, I know we have about 15 minutes left here. I'll turn it over to you, let you hit RSI, because I know you have a lot to cover in that regard.

Robert Kwon: Yeah. So before I switch my screen, notice that what's the final determinant of taking action, it's the price itself. The momentum is a type of indicator. It's just giving you a slightly different perspective. So in this Boeing example, if this is a more substantial turning point in the bigger picture and the short-term up move continues, you would expect the obvious, which is price

continuing to bounce. Take out that previous horizontal resistance. And more than likely what would the slow stochastics look like? It would get to the overbought area and stay there. If it starts faltering in terms of price and perhaps this is what we call a technical shortfall, in the wider down move, if it bounces and then fails here without getting back to the upper declining line, what would we expect the stochastics indicator to also do? Start turning back down here in response to price failing. Again I think the tricky part here is, and I know I found this when I learned about momentum, is this some type of leading indicator. Traders try to use it that way. But it's more like an early warning sign. It's kind of like the fire alarm. It's like sometimes when your fire alarm goes off it's because you need to change the batteries or it starts beeping. Sometimes you burnt some toast. Other times there's an actual fire. So if you use this the way I think it's more beneficial, as an early warning system, to prepare yourself depending on what price does next, that means it serves its purpose. Just like the fire alarm. No matter how many false alarms it gives. As long as it goes off when there's an actual fire, it's done its job. I try to use analogies to make sense of what are we trying to use these supplemental tools for. It's to give us a heads-up to get ready. But the most important thing in any of the examples Matt talked about is what is the price doing. If you own it you want it to go up. Going sideways, okay, doesn't hurt you. What's the scenario that hurts you? Going back down. Hopefully that

helps. So let me steal the screen here. Now I'm just going to cover the S&P itself and then one of the components in the S&P. And let me share my screen. And hopefully that's coming through for everybody here. So just like Matt showed you how to customize things on the indicator, when I use RSI I like to color-code it with those parameters that were described in the slide. So I'll show you how to do that really quick by starting with this blank daily S&P with candlesticks. So I'm just going to go up to indicators. And again you can either scroll over using the arrows. You can type it in the search. Or since I've used it recently I'll just click recently used. And you'll notice that RSI by default is kind of plain-looking. It's just got that 70 level, the 30 level, and this default 14 periods. So what I do is I modify this and the first thing I do is I just make the opacity 100 percent. And what that does is it dark-shades above 70 or below 30. Then what I like to do is I like to add a second RSI. So I can add those additional levels that we talked about, the 60 and 40. So once I have the second one I'm going to modify it. Change the overbought from the default of 70 to 60. The oversold from 30 to 40. I make the colors match. I personally just turn the shading about halfway. And voila. So for me I'm not really interested in the actual number. I'm just looking for general symmetry. So the time period I have for you actually extends back to the last presidential election roughly. The moments leading up to it, to where we are present-day with the recent volatility at the beginning of the year and the even more recent

attempt to bounce back. So let me click on my RSI tab. And I did a little bit of prework here. And you'll notice before the weakness in the fourth quarter of last year you can see that the trend was strong but we did have some divergence. Look at the peaks in price. Made a higher peak. But then look down below at RSI. When trend broke, how did it end? Well, we made an initial bottom and then bounced. The short-term downtrend held. We ended up making a lower low. Look down at RSI. What happened to it? Well, we did not make a lower low on RSI on the subsequent lower price. And when the sharp downtrend ended it emerged into a powerful up move that did eventually make a new all-time high. Now look at the more recent price action from the end of the year. Notice the green mountaintop. We retract it to test the breakout area that we broke through earlier. On the subsequent bounces what was RSI doing? It was putting in lower peaks. So instead of dark green mountaintops we were just getting green. Then what happened? We actually bounced quite strongly at the same level again and did temporarily make a new peak. Look at the peak in RSI at this level. So multiple perspectives by divergence. But what was the real damage? The real damage was when we went back down and failed to hold the level we just bounced off of twice. And in similar fashion look at RSI on this initial sell-off. Deep red sea. Then we tried to bounce. And although we peaked above this little shelf I drew, after testing it twice it failed to sustain, and we ended up selling off and making a

lower low. Not too dissimilar, just in a more exaggerated fashion than, what happened at the end of last year. But notice what RSI did. It started putting in higher or similar lows but not as low as the inflection low. And when we broke short-term trend, we had this massive bounce higher. And we are now trying to bounce and rechallenge the area we just fell from. Look at where RSI is. Not too dissimilar from the previous example. What happens next is going to determine what the indicator is going to look like. If we look back at this and we break through this level, more than likely RSI will respond by getting back above 60 if it happens in short fashion. If we look back at this and this is a short-term top, it'll either end up going sideways or down further, RSI is holding where we'd expect it to hold in a sideways or more sustained down move. And just to show you some relevance to the past, I click on this five-year perspective. I'm going to take us back to a similar technical narrative and a similar interest rate narrative. And this is the volatile fourth quarter of 2018. Notice the trend was rising before the fourth quarter. Notice RSI peaks were declining. Then we had the break of trend which led to a powerful down move in a short period of time, does that sound familiar? That's exactly what happened this year so far. There was an attempt to bounce that failed to break the short-term downtrend. We made lower values on the S&P. But RSI responded with higher lows and once the short-term down move broke it led to a substantial bounce. Sound familiar? That's exactly where we are right

now conceptually in the S&P. Where did this one fail in 2018? Kind of similar to the area it would if we fail right here on the S&P versus breaking through. And if you look down at RSI, where did it happen? Underneath 60. So hopefully this is helping you. You're trying to create the mechanism to make the next decision. Generally what does RSI look like in comparison to price and the different conditions of price? I'm moving this back forward. Are you starting to see the same type picture? Now whether you try to act earlier or not, that's up to you. But hopefully this example on the broader market which I assume a lot of people follow because it's mentioned on financial news all the time, you can apply this to individual stocks. You can apply this to indices. You can apply this to exchange-traded products. So I'm going to take a look over at Microsoft. Obviously Microsoft is a big part of pretty much all the major indices. And if we go back to the bigger picture, you can see that this one was able to get to certain overbought oversold levels. Even at the 70 and 30 level. So let's just focus on this more recent price action. Well, let me get my vertical line. It's easier for everybody to follow. So you can see the powerful trend pushing higher. Then it was able to really jump higher here. But it continued. So in the end if you owned Microsoft stock, as long as this is going higher the shares keep increasing in value. And in the end that's the only thing that matters. But you'll notice if you look down from this vertical line to the dark green mountaintops on RSI, when it popped higher the next time it

didn't create a new peak. And when trend broke the short-term trajectory that got it there, notice that this one didn't reverse into a violent down move but it did kind of change into a sideways move. So from this blue line now that we know in hindsight that Microsoft effectively went sideways in this wide range for a while, look at what RSI looks like when price is in that condition. It kind of ping-pongs between 40 and 60. When price buckled testing the bottom end of the range around here, notice that that condition also changed and we got below 40. So again above 40 typically is the support level for more sustained up moves. If you're actually getting below that level and challenging 30, it's not typically something you see historically on the default of 14 unless the trend is potentially changing. And we can see with the benefit of hindsight that it did. So let me click on the five-year, and you can see that same bullish divergence that we had on the broader S&P. The reaction low that happened here was the low point in RSI. Microsoft ended up touching lower points in price but RSI was holding up better. So again it was clearly in a down move here. So some traders will use the divergence to try to get an early entry. But the most important thing in this sequence right here was that it didn't put in a new low in price. Was able to bounce and is trying to challenge this concept of down. But notice that it is stalling at the recent horizontal peak. And if we look back and Microsoft is either lower or sideways from here, this is also logically where we'd expect RSI to start turning back lower as well. So listen.

Hopefully these examples helped you.

END OF AUDIO FILE

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