

CHAPTER 6

Using Oscillators to Predict Trade Opportunities

TOM DEMARK

There are three distinct levels of chart analysis. Very simply, the first and most common involves the quick perusal of a chart and a “gut feeling” interpretation. Whatever may strike the viewer as important at that particular point in time colors the interpretation. There exists no sound, “scientific” basis for the conclusions drawn, which are primarily subjective and rooted in guesswork; terms such as “flags” and “head and shoulders” often are used to describe patterns.

The second level of analysis involves the use of an indicator or a series of indicators whose application is intended to provide a substantive method whereby to analyze the market. Although the indicators’ construction may be clear-cut, their implications are still subject to the viewer’s interpretation. However, by using indicators, there is greater likelihood that the interpretations will tend to be consistent, uniform, and less subjective than those formulated on the first level through primarily guesswork and intuition.

Finally, the third level of analysis is totally objective and mechanical. The indicators used are included in a defined regimen of interpretation that includes a set of prescribed rules for systematic interpretation and trading execution. The rules are clear and the steps in the analytical process are rigid and straightforward. No gray area or equivocation exists, because the interpretation is defined for the user. In analyzing the market I prefer to operate on level 2, along with using a few level 3-style indicators with which I have considerable experience and confidence.

To be successful as a trader it is critical that one conduct individual research and create and apply one’s own disciplined market timing methodology with the objective of ultimately becoming responsible for the considerations that determine one’s trading decisions. Relying on a group of indicators but not understanding their construction or proper application will impede a trader from progressing toward this goal. A thorough appreciation of both these indicators’ strengths and their weaknesses is needed to apply them effectively. Just as a jour-