Trading Power Trends with ADX

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Weekly Power Trend

AAPL : WEEKLY APPLE COMPUTER INC
Moving Averages: [50: 68.36] [20: 67.46]

ADX: [13] DM+ 0.23% 0.31% 0.13%

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Power Trend Trading Principles

• Trends are created and fueled by big institutional investments companies (hedge funds, mutual funds, banks, etc.)
  • “BIGs” = big institutional guns
  • The 50-week moving average generally reflects long-term, institutional buying activity
    – Use the 50 EMA WEEKLY for Long-term Direction
    – Use the 50 EMA DAILY for entry
Power Trend Trading Principles

• The goal is to enter as early as possible at the start of the stock’s trend
  – Breakout from a bottom formation/trend reversal
  – The FIRST pullback to the daily 50 EMA
• The best trends begin out of general market bottoms or market corrections
• The best trends begin out of LOW ADX periods
• Let profits run until there are signs of trend weakness (ADX peak near 25)
Power Trend Thinking

- Follow price. If you can’t read price, indicators won’t help you.
- Ignore opinions
- Ignore upgrades and downgrades
- Ignore analyst predictions
- Ignore news hype
Moving Averages

• Pullbacks to a moving average represent reversion to the mean price

• Moving averages act as “areas” of support for countertrend retracements (pullbacks) and consolidations

• Moving averages correlate to the degree of trend
  – Daily 10 MA or 20 MA: short-term trend
  – Daily 50 MA or 100 MA: Intermediate-term trend
  – Daily 200 MA or 250 MA: Long-term trend
Power Trend Volume

• High volume is an indication of institutional buying/selling
• DMI is highly correlated with volume
• Most Important:
  – Volume greater than the previous day’s volume
  – Volume greater than the 50-day volume average
  – Volume increase of 150% above is key for breakouts and gaps
• Watch for volume strength that correlates to DMI entry signals
Four Stages of the Stock Cycle

- **ACCUMULATION**
- **MARKUP--LONG**
- **DISTRIBUTION**
- **MARKDOWN--SHORT**

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Stock Cycle Lessons

- Profits (long) are only made in the markup stage
- Even the strongest performing stocks eventually go through markdown, usually during a general market decline
- Most of the stocks that undergo markdown, never recover
- Newer stocks emerge in the next bull economic cycle
DMI
(Direction Movement Indicator)

• DMI represents price direction.
  – When +DMI is above –DMI, the price direction is up.
  – When –DMI is above +DMI, the price direction is down.

• DMI measures the strength of price “swing” highs and lows on a scale of 0-100.

• DMI is used for trade entry and exit signals.

• Note: DMI crosses alone are never used for entries or exits.
Directional Movement (DM)

• DM is the largest part of today’s range that is outside of yesterday’s range.
• When the largest part of today’s range is above yesterday’s range, we get positive DM (+DM).
• When the largest part of today’s range is below yesterday’s range, we get negative DM (-DM).
Directional Movement (DM) Concept

Note: For each bar, only one (the largest) DMI value is used; on an inside day, both values are recorded as 0.
Correlation of DMI to Price

• The +DMI moves in the direction of price.
  – When price rises, +DMI rises.
  – When price falls, +DMI falls.

• The –DMI moves “counterdirectional” to price.
  – When price rises, -DMI falls.
  – When price falls, -DMI rises.
Price Rises +DMI Rises

Price Falls -DMI Rises

ADX/DMI Stochastic (13,8,25,25)
DMI Strength (Highs)

- DMI High < 15 = Very Weak
- DMI High 15-25 = Weak
- DMI High > 25 = Strong
Bulls vs Bears

• The two DMI lines allow the trader to “independently” gauge the relative strength of the bulls and bears.
  – The +DMI is the strength of the bulls.
  – The –DMI is the strength of the bears.
• Relative DMI strength is important for seeing DMI Dominance, a key directional signal.

- Average Directional Movement Index (ADX) was developed by J. Welles Wilder
- ADX is derived from two related indicators, the Positive Directional Movement Indicator (+DMI) and the Negative Directional Movement Indicator (-DMI).
- Default periods for ADX and DMI is 14

**ADXcellence—Power Trend Strategies, 2006 (Schaap)**

- ADXcellence settings: DMI 13, ADX 8
• ADX is Nondirectional
• ADX “quantifies” trend strength
  • $\text{ADX} \geq 50$ : Very Strong (Power Trend)
  • ADX 25-50: Strong Trend
  • ADX 15-25: Weak or No Trend
  • ADX $\leq 15$: No trend (Prebreakout)
**ADXcellence Settings**

DMIs 13 Period Avg

**ADX 8 Period Avg of DMI 13**
ADX is Nondirectional

• ADX measures the strength of a trend, but doesn’t distinguish between uptrends and downtrends.
• When there is a strong uptrend, ADX rises.
• When there is a strong downtrend, ADX rises.
Strong ADX waves represent periods of institutional buying.

- ADX measures the difference between the +DMI and the −DMI.
- ADX rises when the DMI lines diverge.
- ADX falls when the DMI lines converge.
ADX Wave

Getting Stronger

Getting Less Strong

STRONG

WEAK

25
ADXcellent Benefits

• ADX distinguishes between trending and nontrending conditions.
• By quantifying trend strength, ADX allows the trader to choose only the strongest trends to trade.
Trend Momentum

Chart courtesy of TC2000.com

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ADX
Power Trend Rule

ADX power trends have one or more ADX peaks of 50 or greater and one or more ADX troughs greater than 25.
Power trends are preceded by a consolidation period (>30 bars) where ADX is below 25.
ADX usually hits peaks of 50 and retracement troughs often remain above 25.
Price remains above the 20 EMA the majority of the time.
Trends tend to “look” overextended—we think it’s too late to enter.
Power trends allow traders to “let profits run.”
Strong ADX

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<th>Flag</th>
<th>Symbol</th>
<th>Price</th>
<th>Volume</th>
<th>% Change</th>
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<th>ADX 13 &amp; Weekly</th>
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Weak ADX

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**30 bars of low ADX range consolidation**
- ADX < 25
- DMI lines are above ADX, moving sideways
- **LONG:** +DMI makes a Crossover High Signal

**Entry**
- Buy Breakout on resistance line cross
- Or Enter on 1st pullback near 20 EMA on pivot low completion
Grifols (GRFS) / 22 November 2013

Grifols (GRFS) is a Spanish biopharmaceutical company that specializes in providing infusion solutions, nutrition products, and medical devices to hospitals and clinics in Europe, the US, and Canada. This stock provides some international exposure for a portfolio in the hot sector of biotech.

This weekly chart is a 50/50 High Riser. Since August, GRFS has made an ABC retracement to the 50 EMA and held. Last week it rose on very strong volume (arrow) and reached near the highs of August. The trigger price is $33.20, and the stock is currently at $33.50 (above the trigger), easily within the buy zone ($33.20-$34.75). RSI is at 60 and strong, and RSI has made a new high in concert with price.

If the stock closes above the trigger price on Friday, it will have triggered on a weekly basis and could be a longer term hold. There is the potential for the stock to break higher on Friday, so watch the morning's action if you can, otherwise, buy you can buy at the close.

Stock: Grifols (GRFS)
Sector/Industry: Specialty Biopharmaceuticals
Timeframe: Weekly
Pattern: 50/50 High Riser I
Trigger Price: $33.20 (Zone up to $34.75)
RSI Trigger: 60 (weekly)
Stop loss: $31.75
1st Target: $36.75
2nd Target: $40.00
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Join Today!
IPO 2011, makes radios, antennas and network mgmt tools

Qtrly Sales % chg 85%, 3 Yr Sales growth 34%, Qtry EPS change 140%
IPO 2011, Chinese provider of internet security, browsers, online games
EPS%Qtrly 158%, 3 Yr Sales Growth rate 127%
IPO 2013, internet products and applications, focus android smartphones
Qtrly Sales % change 85%, 3 Yr Sales Growth rate 96%
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Thanks for Attending!