Divergence Cheat Sheet PDF

One of the basic tenets of technical analysis is that momentum precedes price.
However, prices never move in a smooth line, and momentum will often be out of
sync with the price.

In technical analysis, when there is a mismatch between momentum and the actual price, it's referred to as a divergence. Traders can exploit these price discrepancies for profit.

Divergences are concepts that allow investors to spot trend reversal signals in bullish and bearish markets.

This trading guide takes an in-depth look at what divergence is, the different types of divergences, and how to trade divergence in the most efficient way.
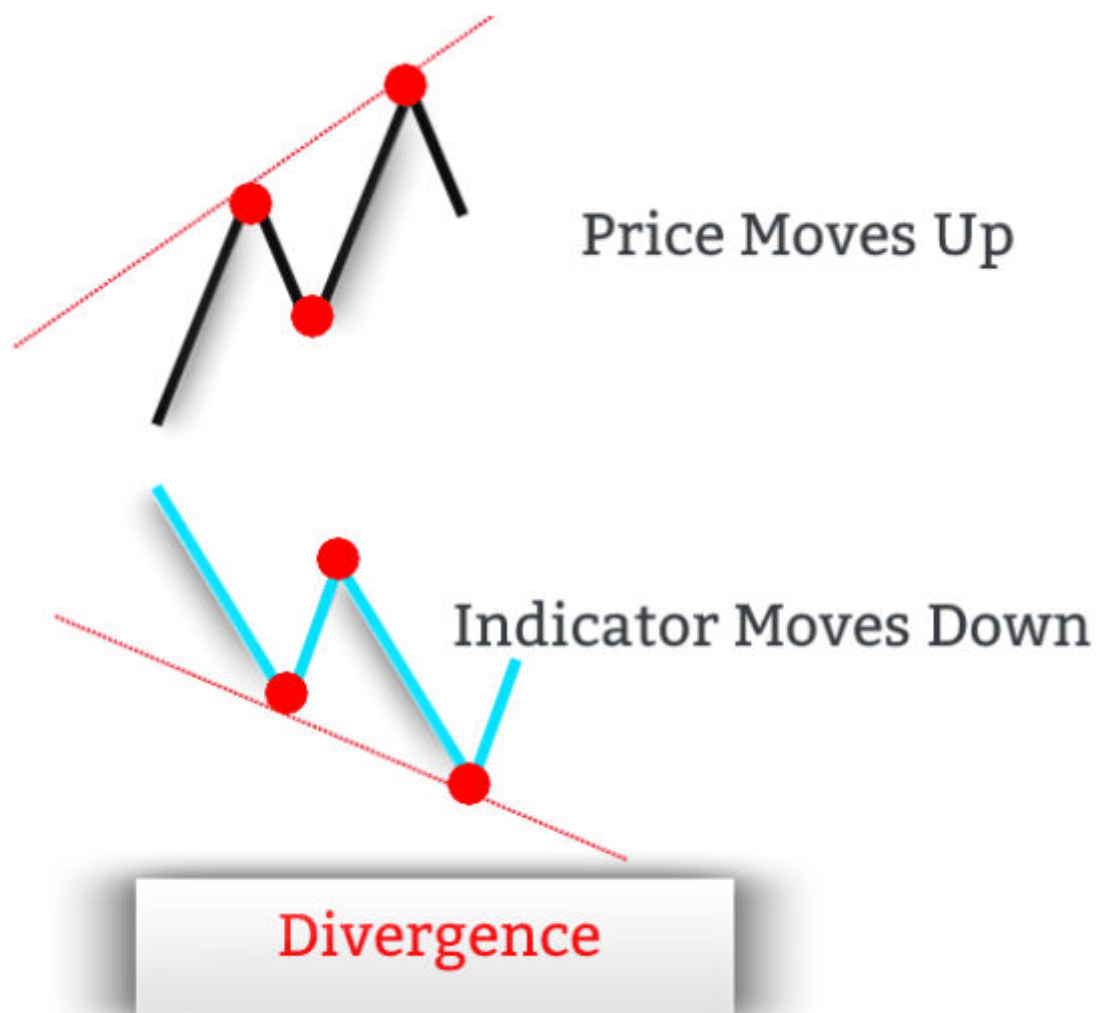
What is Divergence?

In trading, divergence happens when the price of an asset and the indicator you're looking at are moving in opposite directions. In other words, when the price of an asset is out of sync with the corresponding indicator's readings, a divergence signal occurs.

In normal market conditions, the price action of an asset and the technical indicator moves in the same direction. In other words, when the price prints a new high, the technical indicator should print a new high as well.

Similarly, when the price prints a new low, the technical indicator should print a new low. However, when this type of convergence gets out of sync, we get a divergence.

For example, we have a divergence signal if the price moves up, but the indicator moves down or vice-versa.

Price Moves Up

Indicator Moves Down

Divergence

As you have noticed, divergence is not a technical indicator per se, but it's a trading concept. There is no mathematical formula to calculate divergence, but they are visual tools on the price chart.

The main purpose of divergences is to signal momentum building up into a trend and give early reversal signals when there is a slowdown in the momentum readings.

Divergence doesn't say when the reversal will happen, but it's an early warning sign that the price might actually reverse soon.

The opposite of divergence is convergence.

Convergence happens when the price of an asset and the indicator you're looking at is moving in sync in the same direction. For example, if the price of an asset is making a new higher low, the indicator should follow the price and print a corresponding higher low.

How Does Divergence Work?

To really dig deeper into the market, traders need to understand the foundation of how price in any market moves.

At the core, asset prices move in a series of [higher highs and higher lows](#) when we're developing an uptrend. Conversely, when we're developing a downtrend, asset prices move in a series of lower lows and lower highs.

The concept of successful trading is to buy low and sell high. In other words, you have to buy when the price is making a new low and sell when the price makes a new high.

The concept of divergence can help traders distinguish when it's a good idea to buy at a new low and sell at a new high. This is done by studying the divergence signals – the mismatch between the price and the technical indicator.

The only limitation of divergence is that it doesn't provide timely trade signals. The divergence signal can persist longer without price changing direction.

Broadly speaking, there are two types of divergence signals:

- Regular divergence is also known as the classic divergence.
- Hidden divergence.

The divergence cheat sheet table below outlines the different types of divergence and the signals they generate.

Price	Oscillator	Divergence Type	Signal
High – Higher High	High – Lower High	Regular Bearish Divergence	Sell
Low – Lower Low	Low – Higher Low	Regular Bullish Divergence	Buy
High – Lower High	High – Higher High	Hidden Bearish Divergence	Sell
Low – Higher Low	Low – Lower Low	Hidden Bullish Divergence	Buy

Regular Divergence

Regular divergences can be further classified into regular bullish divergence and regular bearish divergence:

Regular bullish divergence happens when we have a disagreement between prices that are falling (making lower lows) and a technical indicator that is rising (making higher lows).

Regular bearish divergence happens when we have a disagreement between prices that are rising (making higher highs) and a technical indicator that is falling (making lower highs).

The regular bullish divergence is an early sign that the prevailing downtrend will change direction and turn to the upside. In this regard, the regular bullish divergence is a buy signal.

Conversely, the regular bearish divergence is an early sign that the prevailing uptrend is about to change direction and turn to the downside. In this regard, the regular bearish divergence is a sell signal.

The image below outlines side-by-side the difference between the regular bullish divergence and regular bearish divergence.

Price

Indicator

Regular Bearish
Divergence

Regular Bullish
Divergence
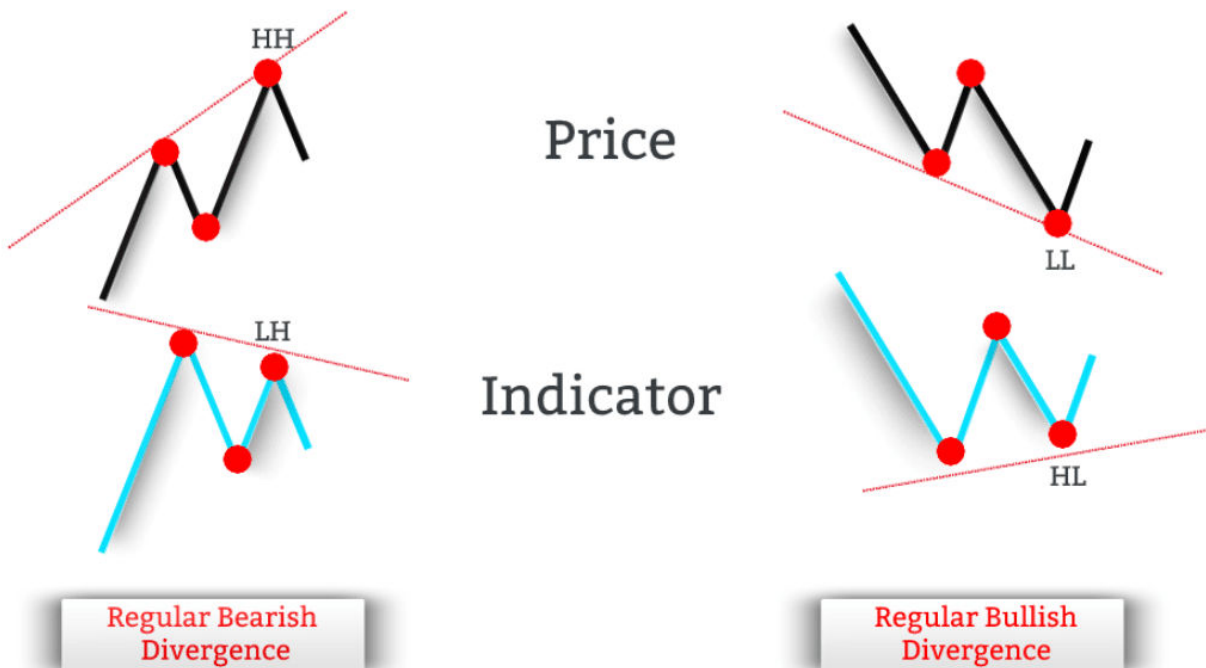
The ideal place where a regular bullish divergence can develop is at the end of a downtrend. This type of divergence then naturally leads to an uptrend.

Conversely, the ideal place where a regular bearish divergence can develop is at the end of an uptrend. This type of divergence then naturally leads to a downtrend.

Hidden Bullish Divergence

The hidden divergence doesn't differ that much from the regular divergence. For a hidden divergence to happen, we need to see a mismatch between the price and the technical indicator similar to regular divergence.

However, while regular divergence signals a possible trend reversal, the hidden divergence signals the possibility of trend continuation. Hidden divergences tend to develop within an existing trend.

Usually, hidden divergences indicate that the prevailing trend is still strong enough to resume itself.

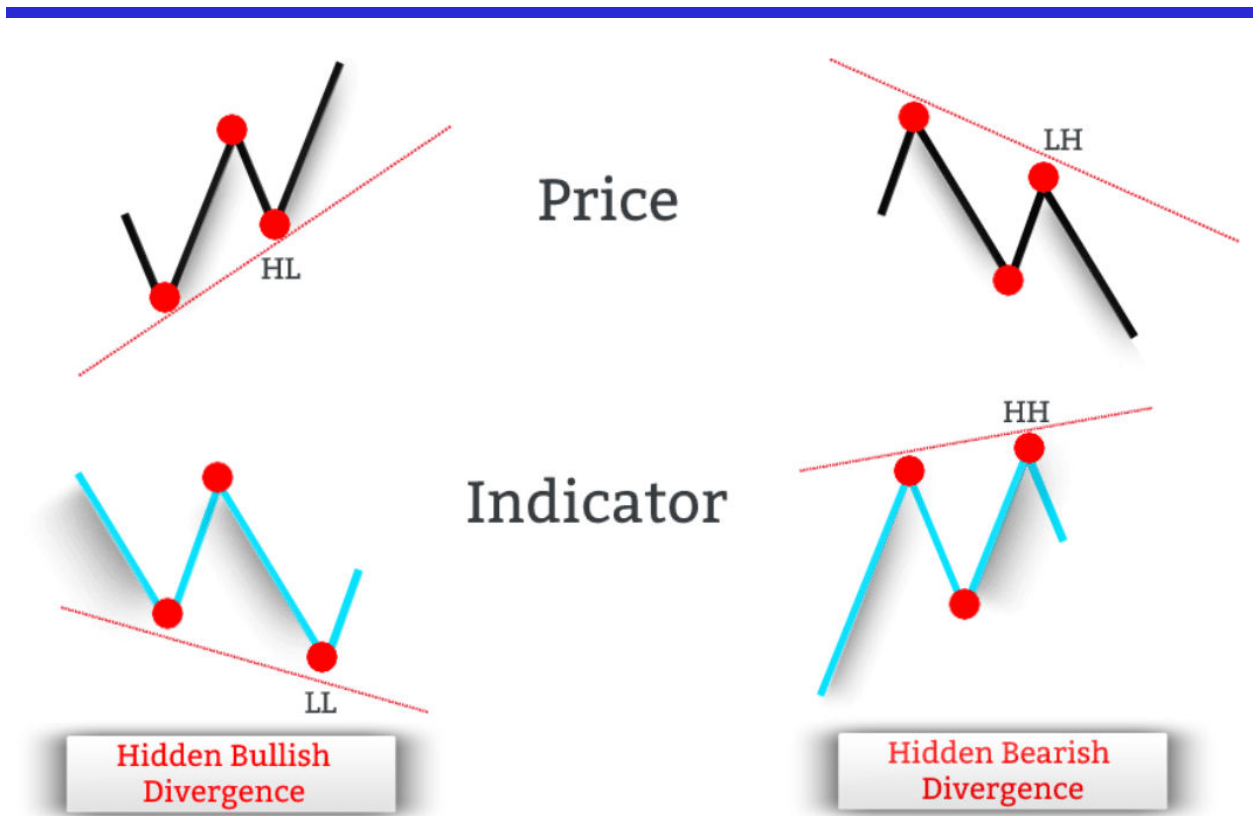Just like the regular divergence, we can distinguish two different types of hidden divergence:

1. Hidden bullish divergence.
2. Hidden bearish divergence.

Hidden bullish divergence happens when the price is making a higher low, while at the same time, the indicator is making a corresponding lower low.

The hidden bullish divergence is an early sign that the prevailing uptrend is ready to resume.

Usually, the hidden bullish divergence signal develops after prices have pulled back, and now the bulls are ready to control the market again. In this regard, the hidden bullish divergence is a buy signal.

The image below outlines side-by-side the difference between the hidden bullish divergence and hidden bearish divergence.

Usually, the hidden bullish divergence can be observed in uptrends.

Hidden Bearish Divergence

Hidden bearish divergence happens when the price is making a lower high, while at the same time, the indicator is making a corresponding higher high.

The hidden bearish divergence is an early sign that the prevailing downtrend is ready to resume. Usually, the hidden bearish divergence signal develops after

prices have pulled back, and now the bears are ready to control the market again. In this regard, the hidden bearish divergence is a sell signal.

Usually, the hidden bearish divergence can be observed in downtrends.

Finding hidden divergences is more difficult because they don't occur as often as the regular divergence. However, hidden divergences can tell traders in advance when the prevailing trend is ready to resume.

In a nutshell, the hidden divergence occurs simultaneously with short-term retracements in the price. In other words, the hidden divergence signals the potential end of a [pullback](#).

- Hidden bearish divergence – the end of a pullback in a downtrend.
- Hidden bullish divergence – the end of a pullback in an uptrend.

Divergence Indicator

Before recognizing regular divergence and hidden divergence and the possible trend reversal or trend continuation signals, traders need to pick a technical indicator.

Usually, momentum oscillators like the RSI, Stochastic, [MACD](#), etc., are often used by retail traders to spot those instances where the price of an asset and the indicator fails to converge.

The same way the price of an asset moves up and down, establishing peaks and valleys, technical indicators converge or diverge from the price making equivalent peaks and valleys.

Some technical indicators can be applied directly on the price chart or in a separate window, usually below. Traders can use any oscillator to identify divergence.

The MACD, stochastic, and RSI indicators work best to identify regular divergence.

In contrast, the money flow index (MFI) is a better alternative to identify hidden divergence. This is true because the money flow index is a trend following indicator.

One of the most popular technical indicators to spot regular divergence and hidden divergence is the Relative Strength Index (RSI) indicator.

Divergence RSI

The Relative Strength Index (RSI) is a leading technical indicator which means it can precede the price movements. This means that the RSI divergence is a leading indicator of price action.

An image of the RSI indicator is presented below.
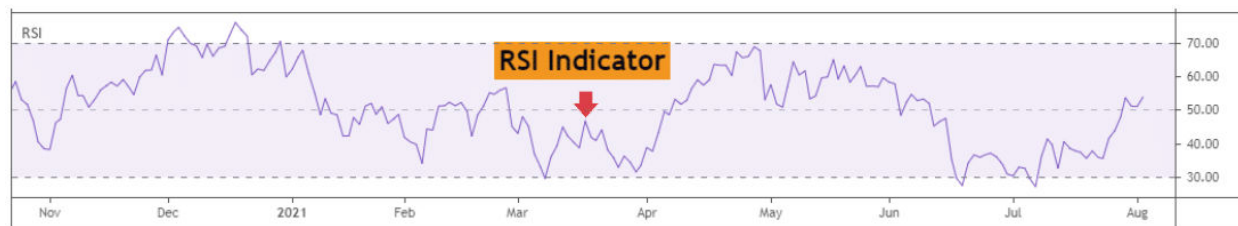
With the RSI indicator, traders can identify both regular divergences and hidden divergences.

However, the RSI divergences can't be used as a timing tool. In this case, candlestick chart patterns can act as a great confirmation signal for the resumption of the prevailing trend (in the case of RSI hidden divergence) or the trend reversal (in the case of RSI regular divergence).

Traders can look for long positions if they spot regular RSI bullish divergence or hidden RSI bullish divergence. Conversely, traders can look for sell positions if they can identify regular RSI bearish divergence or hidden RSI bearish divergence.

Bullish Divergence RSI

The chart below outlines the regular bullish RSI divergence.

Euro / U.S. Dollar, 1D, FXCM

Trend Reversal

Lower Low

Regular RSI Bullish Divergence
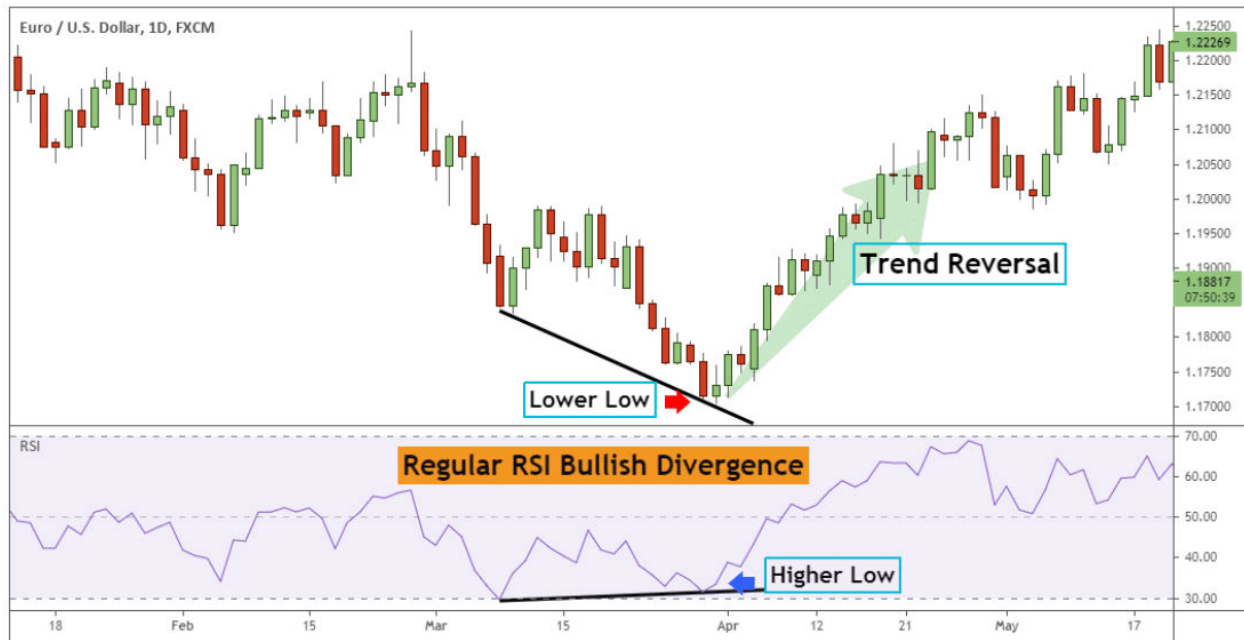
Higher Low

In this example, traders can see that the price is making a new lower low compared to the previous swing low point on the price chart. At the same time, the RSI indicator prints a higher low relative to the previous low printed on the RSI oscillator.

After forming the lower low on the price chart, the prevailing trend reversed from bearish to bullish.

The RSI indicator can also help traders spot bullish hidden divergences. The example below shows price trading in an uptrend. Comparing the swing lows in the price with the swing lows printed on the RSI oscillator, hidden bullish divergence is developing on the price chart.

Delta Air Lines, Inc., 4h, Cboe BZX

Prevailing Trend is Down

Lower High

Prevailing Trend Resumes

Hidden RSI Bearish Divergence

Higher High

RSI

After forming the higher low on the price chart, the prevailing trend resumes and moves to new highs.

It's crucial to understand that the bullish hidden divergence can develop in any place within the uptrend as long as all the technical conditions are satisfied.

Bearish Divergence RSI

The price makes higher highs in a regular bearish RSI divergence, but the RSI oscillator prints lower highs.

In the example below, traders can see that the price is making a new higher high compared to the previous swing high point on the price chart.

At the same time, the RSI indicator prints a lower high relative to the previous high printed on the RSI oscillator. Following the RSI bearish divergence, the price started reversing quickly, and a new trend emerged.

The RSI indicator can also help traders spot bearish hidden divergences.

The example below shows price trading in a downtrend. Comparing the swing highs in the price with the swing highs printed on the RSI oscillator, a hidden bearish divergence is developing on the price chart.

Following the hidden bearish divergence, the prevailing bearish trend continued to the downside.

Lastly

In summary, traders need to know that regular divergence signals a trend reversal, while at the same time, the hidden divergence signals a trend continuation.

Trend following traders are better off focusing on identifying hidden divergence as this will help them ride the overall market trend. Because the hidden divergence is a trend continuation signal, out of the two types of divergence, the hidden divergence carries a higher rate of success.

Last but not least, trading divergence works across all time frames; however, the higher the time frame is, the more reliable the divergence signal tends to be.