1. What Is a Technical Indicator?

Technical indicators are heuristic or pattern-based signals produced by the price, volume, and/or open interest of a security or contract used by traders who follow technical analysis.

By analyzing historical data, technical analysts use indicators to predict future price movements. Examples of common technical indicators include the Relative Strength Index (RSI), Money Flow Index (MFI), stochastics, moving average convergence divergence (MACD), and Bollinger Bands®.

KEY TAKEAWAYS

• Technical indicators are heuristic or mathematical calculations based on the price, volume, or open interest of a security or contract used by traders who follow technical analysis.

• Technical analysts or chartists look for technical indicators in historical asset price data to judge entry and exit points for trades.

• There are several technical indicators that fall broadly into two main categories: overlays and oscillators.

Wavestrader

2. How Technical Indicators Work

Technical analysis is a trading discipline employed to evaluate investments and identify trading opportunities by analyzing statistical trends gathered from trading activity, such as price movement and volume. Unlike fundamental analysts, who attempt to evaluate a security's intrinsic value based on financial or economic data, technical analysts focus on patterns of price movements, trading signals, and various other analytical charting tools to evaluate a security's strength or weakness.

Technical analysis can be used on any security with historical trading data. This includes stocks, futures, commodities, fixed-income, currencies, and other securities. In this tutorial, we'll usually analyze stocks in our examples, but keep in mind that these concepts can be applied to any type of security. In fact, technical analysis is far more prevalent in commodities and forex markets, where traders focus on short-term price movements.

Technical indicators, also known as "technical," are focused on historical trading data, such as price, volume, and open interest, rather than the fundamentals of a business, such as earnings, revenue, or profit margins. Technical indicators are commonly used by active traders, since they're designed to analyze short-term price movements, but long-term investors may also use technical indicators to identify entry and exit points.