INDICATOR 2 *Momentum*

RSI Explained: How to Use the Relative Strength Index

The Relative Strength Index is the most popular momentum oscillator in the world. It tells you how strong recent buying or selling has been, on a simple scale from 0 to 100.



What it is

RSI was created by J. Welles Wilder and published in 1978. It compares the size of recent gains with the size of recent losses. When gains dominate, RSI rises; when losses dominate, it falls. It's a momentum indicator: it measures the speed and strength of price moves.

How it's calculated

1. Over the last 14 periods, work out the average gain on up bars and the average loss on down bars (using Wilder's smoothing).
2. Divide the average gain by the average loss. This is the relative strength (RS).
3. RSI = 100 minus 100 divided by (1 + RS).

You don't need to calculate it by hand; every platform does it for you. What matters is what the number means.

Default settings

- **Period:** 14.
- **Levels:** 70 (overbought) and 30 (oversold). Some traders use 80 and 20 for stronger signals.
- **The 50 line:** the midpoint between bullish and bearish momentum.

How to read it

- **Above 70:** buying has been very strong. The market may be stretched.
- **Below 30:** selling has been very strong. A bounce becomes more likely.
- **Above 50:** momentum is on the buyers' side. **Below 50:** the sellers' side.

Three practical ways to use it

1. **Overbought and oversold in ranges.** In a sideways market, RSI below 30 that turns back up near support can signal a buying opportunity, and RSI above 70 near resistance a selling one.
2. **Divergence.** If price makes a new high but RSI makes a lower high, momentum is fading. This bearish divergence often comes before a pullback. The bullish version is a lower low in price with a higher low in RSI.
3. **Trend confirmation.** In strong uptrends, RSI tends to stay between 40 and 80 and bounce off 40 to 50. In downtrends, it tends to stay between 20 and 60. A shift in this range can hint at a change of trend.

Common mistakes

- **Selling just because RSI is above 70.** In strong trends, RSI can stay overbought for weeks while prices keep rising.
- **Ignoring the trend.** Oversold signals work far better in uptrends than in downtrends.
- **Trading every divergence.** Divergence can last a long time. Wait for price to confirm, for example with a break of a trendline.

Works well with

- **Moving averages** to know the trend.
- **Support and resistance levels** and **candlestick patterns** for timing.

Quick summary

- RSI measures momentum on a 0 to 100 scale.
- 70 and 30 mark overbought and oversold zones, but they're not automatic signals.
- Divergence and the 50 line are often more useful than the extremes.

For education only, not investment advice. Charts use illustrative data. Indicators describe past price and volume and do not predict the future. Free guide by BullpenXP, prepared with AI assistance. More at bullpenxp.com/technical-indicators-guide