Twitter Thread by Yash Mehta



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#RSI is a common indicator which most of us use in the stock market.

This learning thread would be on
"■■■■ ■■ ■■■"

Like■ & Retweet■ for wider reach and for more such learning thread in the future.

Also, an investment strategy is shared using RSI in the end.

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Setup 1:

RSI- commonly used to show whether price is overbought or oversold.

General rule:
■■■ > ■■ -- ■■■■■■■■■■
■■■ < ■■ -- ■■■■■■■■

One becomes cautious once price becomes overbought and optimistic when price becomes oversold.

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Let's understand this with an example of Laurus Labs:

1. It was in overbought zone and after a few days when a small dip was seen from 693 to 588 (15% downside)

2. It was in oversold zone and after a few days when a small rally was seen from 59 to 107 (82% upside)

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Well, this looks very easy, but it is not.

When a price is in overbought zone and is in momentum, then it can move up without taking a dip and exiting or shorting stock would prove wrong.

When IRCTC was in overbought zone, price went up from 2718 to 6396 (135% rally).

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Similarly, for oversold stock.

When a price is in oversold zone and is crashing, then it can move down without taking an upmove and buying stock would prove wrong.

When DHFL was in oversold zone, price went down from 126 to 11 (91% crash).

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What's the way of trading this then?

If a price is oversold, then wait for the price to turn towards neutral zone and also check on other setup whether support is available or not.
Other setup can be Price Action, Support Lines, Demand Zones, Fibonacci or any indicators.

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If a price is overbought, then wait for the price to turn towards neutral zone and also check on other setup whether resistance is available or not.

Combine multiple setup for high probability trades.

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Setup 2: Divergence

Another popular use of RSI by the traders.

Two types of Divergence:
1. Bullish Divergence
2. Bearish Divergence

Divergence is used by the traders who like to take contra trade (i.e. trade against the actual trend)

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Bullish Divergence:

Condition-
1. Price should form lower lows
2. RSI should form higher lows and in oversold region

Laurus Labs weekly chart- Bullish Divergence.
It went up from 450 to 740 (60% rally)

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Bearish Divergence:

Condition-
1. Price should form higher highs
2. RSI should form lower highs and in overbought region

Neuland Labs weekly chart- Bearish Divergence.
It went up from 2725 to 1500 (45% correction)

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Based on divergence, then can be multiple divergence formed one after the other.

Like two bullish divergence in continuation or two bearish divergence in continuation.
This can be high probable trade setup.

One double bearish divergence is shown in the chart below.

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Final Setup: Using RSI for investment.

Simple setup for long-term investment.

Setup:

1. Select Fundamentally good companies
2. Use monthly time frame
3. Buy if RSI is above 50 on monthly closing basis
4. Sell if RSI goes below 50 on monthly closing basis.

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Let's check charts now.

Asian Paints Monthly Chart.

Condition got satisfied in 2008 when it was trading at 108 and still after 13 years exit condition is not fulfilled in Asian Paints.

CMP is 2982.

Returns of 2660% times in 13 years or 29% CAGR.

Easy right!

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Another example of Deepak Nitrite.

RSI crossed above 50 in 2012 when it was trading at 18.
And RSI crossed below 50 in 2016 and the exit was at 56.

Returns of 210% in four years which means CAGR of 33%.

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Strategy is easy only if one follows all the rule.
Key point is to sit with the patience for the returns.

As quoted by Livermore: "Sit tight when you are Right"

50 is just a random number in investment strategy and one can select their own number for entry and exit.

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I hope everyone got a feel of how RSI can be used.

These are not a universal rules one must follow. One can create their rule or follow someone else rules.

Only important thing is one must follow a fix rule instead of tweaking or changing setup frequently.

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