

## RULES for Divergence Tops and Bottoms

Note: Using *divergent bottom as example* in phrasing, but the reverse applies to divergent tops, of course.

1. Set %d full stochastic oscillator to 5, 5, 5
2. Set % k full stochastic oscillator 5, 3
3. Make sure you are not in dead zone, or that regardless you have decent volume so that the trends indicate real market sentiment.
4. Make sure you have a strong trend downward in pricing, but cannot be Grind/wiggle; in other words, there should be decent size waves in the trend downward
5. Wait for stochs to trend downward in same direction as lower lows (lower market structure lows, MSLs) on pricing.
6. Know where the next support level is at. It is far best to look for the reversal signal near that level and that is of course where they tend to be the best for a strong move in reverse.
7. As the price approaches the support level or hits it, there is normally a very low low on stochs, say about 1-10% on %D (the Red stochs line here), then a fake reversal occurs there. Like in the chart below for OIH at 12:20 PM, there was a very low stochs and a slightly, but fast upward bounce, then about 5-7 minutes



later, a fast reversal downward again. Think of this as your “tornado watch” alert; no tornado is sighted yet, but the conditions are coming together for one to potentially form (but; it also may not form).

8. Wait for the next stochs low. If it is higher than previous, but the new MSL on price is lower; that is the divergence “in slopes” you are waiting for; the Yellow lines were added to show this. **WARNING: If the new stochs low is NOT noticeably higher than the previous stochastics low OR if the MSL is not a lower low, then DO NOT Enter Long Yet!** The slopes need to be fairly pronounced, as shown, in opposite directions, and the triggering MSL needs to be near a predicted support level. The higher low on stochastic begins about 12:30 PM on the chart above. (See page 338 of Jea’s second book for good description and example charts of all of this, with some modifications here. See other examples below as well.)
9. It is “may” also be best if the higher low on stochs is at about 20% band, but in the example above for OIH, the lowest low on stochs is about 7% and the higher low is about 17%.
10. The firm confirmation of this trigger point will be a good green candle upward (normally, larger than previous few candles). In addition, it is great if the lowest low on price has a Bullish candle, like a Hammer, etc. The good green candle may be the first to fifth minute after the lowest candle. So, there must be a MSL and it must eventually have a significant green candle after that within a few minutes (or perhaps that big green candle will be the first candle that is higher than the lowest low candle, so it may be part of the MSL formation). *Note that many times, the big candle up immediately crosses the 5ma and within one or a few candles, it will also cross 15ma; this is very good for increasing the follow-thru.*
11. Usually, the higher low on the stochs will form before the lower MSL forms. This case is easy to play because now you just have to wait for the MSL to form completely and then you are likely safe (will make a gain). But BE SURE the higher low on the stochs is significantly higher (say 10-20% higher) than the one before and it is best if the higher low on stochs is at or above 20%. With that said, I have had lots of good plays where the low and the higher low were both below 20%.
12. In some cases, the lower MSL forms first. In that case, I normally enter as soon as the stochs starts to turn up on the higher low on stochs, so I do not always wait for the first big candle to complete (I may not wait a full minute), but then I set the stop at the MSL. Then, once the candle confirms, I add to position on a higher MSL (on price, of course), if one forms, on way to completion of 1 full oscillation of %d through 80% band or up to next major resistance level.
13. I set my STOP at the MSL (the lower one that triggered the divergence).

14. If the 5ma crosses the 15ma, then you can start making decisions on exits based on pups and mini pup formations.
15. I normally move my STOP up with each successive higher MSL, if there are any new MSLs. This way I capture something even at a STOP.
16. If this is a SCALP play, that is counter trend in all time frames, then you normally want to exit ALL of position at 80% stochs to 90% stochs. **WARNING: DO NOT presume more than one full oscillation up to 80% band on stochs for any SCALP play; be sure to exit there!!**
17. If 5min or 15min or 60min aligns or confirms the reversal, or if those longer time frames are already in the same direction as the reversal (Long, in this case), then I will clip out 75% at 80% (or sometimes 90% stochs) on %d and then let the rest ride through a one or more mini pups or pups (or through one full oscillation upward in the longer time frame); or up to some reversal signal the other direction.
18. **Try to let it play one oscillation (to 80% band), exiting too early too many times will limit your gains.** Set your STOPS and your Gains targets per these instructions and you should average 80% winning plays and only small negatives or perhaps break-evens on the STOPS which may occur 20% of the time. Normally, the 20% STOPS is Not because the divergence trigger failed, it is because I do not always follow the rules perfectly (including sometimes I do not exit on the SCALP at the 80% band and then the stock gets slapped down hard).

#### Notes:

- Many bottoms (and tops) do not have divergence. For instance, a double bottom is not the same as a divergence bottom, but a double bottom can also be a good reversal signal, however I think divergence is more reliable. Other tops and bottoms seem to have No signals are all. Oh well, this method is only for the tops and bottoms that give a “tornado watch alert” first.
- If you are using other methods as your primary way to enter and leave a trade, then watch for divergent signals to make sure you don’t get surprised with a sharp turn against you. So, if your other method says to SHORT, but if a divergent bottom also forms against you in the 1 min chart, then the SHORT may still be the best play for the next 1-2 hours, but the entry for the SHORT will likely not be as good as it could be. In such cases, you likely want to wait one full oscillation (let the divergent bottom play out) and then enter the SHORT if it still makes sense from your other method. Similar, if you are SHORT already and a divergent bottom triggers, you should exit the SHORT (at least for now).

# Other examples:



