Anticipating Intraday Reversals with TICK Divergences

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Would you like to know the magic secret for forecasting intraday reversals in advance?

Unfortunately, there's no magic secret, but using the TICK in a non-conventional way can help you spot a better chance of a short-term or full intraday price reversal as soon as it occurs, allowing you to take advantage of a potential price turn earlier with less risk.

What is the TICK?

The TICK is a market internal indicator which refers to the number of stocks on the NYSE Exchange making an "up-tick" at a particular moment in time versus those making a "down-tick." If the TICK registers above zero, then it is an indication that more stocks are "ticking up" or rising at that particular moment in time than those "ticking down" or declining at that same moment. A positive TICK is associated with a rising price swing of the general market and is generally bullish, while a declining TICK is associated with a decline in price and is generally bearish. Traders often use the TICK to assess short-term sentiment in the market and also as an "overbought" and "oversold" indicator.

Many traders like to watch for extreme readings in the TICK, such as when the TICK registers greater than 1,000 or less than -1,000 as a sign that the market has become "overextended" and is ripe for a retracement. Some traders take profits on a long position when the TICK registers above 1,000 and aggressive traders might even put on a short-sale position intraday at those TICK extremes.

The TICK moves in stride with the price action of the major stock market ETFs like the SPY, DIA, QQQQ and the major futures such as the @YM Dow-Mini and @ES (S&P mini). There are even special TICK indexes, such as the "TIKI" to show the movement of the Dow 30 stocks (with a reading of plus or minus 22 being an 'extreme' move) or special TICK index for the 500 stocks in the S&P 500 Index.

However, I wanted to highlight a non-conventional use of the TICK known as the concept of the "TICK Divergence" which can also be used to spot potential intraday turning points in the market.

What is a TICK Divergence?

Generally, we expect to see a rising TICK correspond with a rising price swing in the market and vice versa. We also expect new intraday price highs to register new TICK highs as well, which serves as a confirmation of the new intraday high. The same is true with intraday lows - price swing lows should be met with new TICK lows on the session.

On the instances where we are met with a new price high in the intraday market such as the SPY or @ES and we find that the TICK is registering a lower value than on a prior price swing high, then that sends a signal of non-confirmation that should pique our interest and call us to action.

A Negative TICK divergence occurs when price forms a higher intraday high yet the TICK forms a lower high, relative to the most recent price and TICK highs.

A Positive TICK divergence occurs when price forms a lower intraday high while the TICK forms a higher low, relative to the most recent price and TICK highs.

Let's see an example (file "TICK Divergence Sept 8"):

In this example from October 8, 2009, we see the @ESZ09, or the December S&P 500 e-mini contract on a 5-minute candle chart and underneath that, we see the NYSE TICK (symbol $TICK in most platforms) presented in a bar chart (used just like an indicator).

Near 10:30am CST, we see that the e-mini registered a new intraday high of 1,066.25 while the corresponding high in the TICK (compare 'bars to bars') registered 1,134 (1,134 more stocks were "ticking up" at that moment in time than were "ticking down"). That was a confirmation, and a sign that everything was on track to expect higher prices.

However, once new intraday price highs formed an hour later at 11:30am CST, we see that the e-mini traded at 1,067.25 while the TICK at the same moment only managed to register a high of 967, or that now 967 stocks were 'ticking up' versus 'ticking down'.

Price formed a slightly higher swing high, yet it did so on fewer stocks "ticking up," which served as a non-confirmation of the 11:30am price highs and sent a warning signal that odds were decreasing of further upside potential.

For savvy traders, this gave a quick opportunity to "get short" at the intraday price highs that were not confirmed with intraday TICK highs.

Trade Entry

Traders would put a stop at least one point above the suspected high of 1,067.25 and play for a price retracement down to a prior support level at a minimum, or a true trend reversal at a maximum, depending on what else he or she was seeing in the day structure or trading opportunities.

Trade entry could be confirmed by any sort of reversal candle such as a doji, bearish engulfing, shooting star, or other candle. It would help increase the odds for a successful trade if the new price high and TICK divergence occurred near or above the standard Bollinger Band or Keltner Channel indicators (both of which are types of volatility bands). It would also enhance the odds of a successful trade if the divergence occurred at a prior resistance level from a prior day's session, or from some sort of resistance level on a higher timeframe (such as a Fibonacci retracement).

Aggressive traders would enter as soon as the 5-minute candle closed and they noticed that the divergence had become "locked" in place.

Conservative traders might wait to see if they could find reversal candles or other short-sale entry signals as mentioned above. They may even wait to see that the lows of prior candles were being broken before putting on the short-sale position.

These rules would be reversed if you were trying to buy for a retracement up off of a positive TICK divergence.

Let's see an example of a Positive TICK Divergence and the resulting price move higher.
(file: TICK Div Sept 25)

Here we see September 25th with the @ESZ09 (December S&P e-mini contract) on the 5-minute frame with the NYSE TICK underneath the price action.

Just before 11:30am, the @ES traded at a low of 1,036.75 while the TICK (lowest low of the day) registered -1,183 (meaning 1,183 more stocks were "ticking lower" at that time versus those ticking higher). Again, we expect new price lows to be confirmed by new TICK lows.

One hour later, just before 12:30pm CST, we see that price did form a new swing low at 1,036.25 though as we look at the reading from the TICK at that same bar, we see the TICK registering -855. Though price pushed to a new intraday low, fewer stocks participated in the new index low, which was a non-confirmation of that price low.

We also see that price formed a long-legged or "dragonfly" doji and then after two more down-bars, price formed a strong bar that resembled a "Bullish Engulfing" candle. Aggressive traders would have entered long after the doji formed near 1,038 while conservative traders might have waited for "proof" that the peak of the "bullish engulfing" candle gave them at 1,039.50. In either case, the stop would be placed at least one point under the absolute lows of 1,036.25.

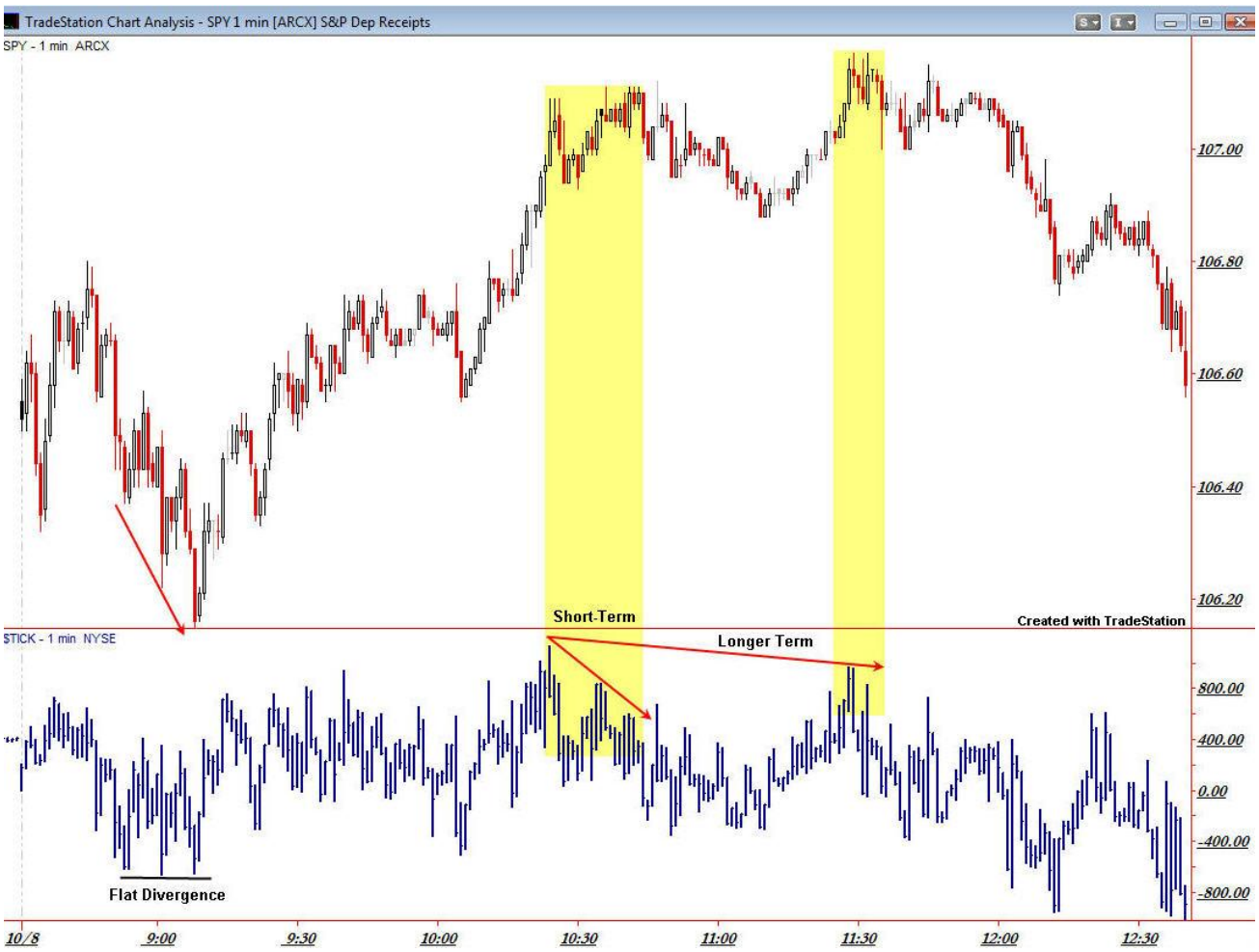
Price rose up to the 1,044 level before forming a Negative TICK divergence this time at the swing highs of 1,045.00 before reversing back to the downside.

This day shows us at least two examples of the TICK Divergence concept in a one-day period.

Some days have no TICK divergences at all while others might have one or two examples. Thus, you are not likely to find this set-up triggering every single trading day, but it should keep you on your guard when you do observe a divergence in real time.

An example on the SPY ETF 1-minute chart (File: TICK Div Oct 8 SPY)

Let's see one more example, this time dropping all the way down to the 1-minute chart and let's look at the SPY (S&P 500 Exchange Traded Fund) instead of the futures contract. The concept is exactly the same.



This time we see three examples of the concept.

We see a "Flat Divergence" at 9:00am CST which is a weaker signal than a true divergence, but it still can serve as a non-confirmation of new price lows intraday and forecast a potential price reversal, such as what happened on the morning lows.

Price then formed an internal or 'short-term' TICK divergence with price in the SPY ETF.

On the 10:30am highs, price traded at $107.03 while the TICK registered the high of the day (along withh price) at 1,134. This is the exact same example we saw in the prior chart of the @ES futures, only now we are using the SPY ETF on the one-minute chart. Price then made an immediate new small high of $107.11 while the TICK clearly registered a lower high value of 839.

In this case, price only formed a slight retracement or pullback before rising to a new price high at 11:30am where the SPY registered $107.17 with the TICK failing to confirm that new intraday high, as it gave a reading at 11:30am of 967.

In this case, we have a shorter term (or internal) TICK divergence that was contained within a larger-term divergence (clearly seen on the 5-minute chart). In this instance, these levels were the highs of the

day and savvy traders were able to take advantage of the intraday reversal thanks to an understanding of how to employ TICK Divergences into their trading arsenal.

Caveats

By their very nature, any sort of divergence trade is going to be a counter-trend move to play for some sort of 'mean reversion,' and because the trade is counter-trend, it is best to take a stop-loss in the event that price continues to rise after you entered. In strong trend days, price can form false divergences as it continues to move higher, leaving you to rack up losses if you remain short to fight a rising market (or long to fight a falling market).

As such, divergences are best found on normal trading days as opposed to powerful trend days that might start with a large opening gap and show one-sided movement all day long.

Like any trading technique, there is no guarantee a divergence will result in a small retracement or even a full trend reversal. Do not become overly anxious or excited when you observe a divergence by itself.

Most divergences tend to produce small profits due to a pause or simple retracement in a prevailing trend. Other divergences can lead to true trend reversals, but experience shows that we have to monitor price closely after trade entry - watching for any signs that would be unfavorably to our position.

In your observations, you will likely find that many intraday highs or lows form on some type of divergence (be it a TICK divergence, momentum divergence, volume divergence, or some other oscillator divergence) but not all divergences lead to true trend reversals.

There will be more divergences that form shallow retracements than those that form true trend reversals - don't set your expectations too high.

While certainly not the Holy Grail of intraday trading, understanding how TICK divergences can help you spot potential retracements or intraday trend reversals earlier than the crowd and can increase your probabilities of successful short-term intraday trades.

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