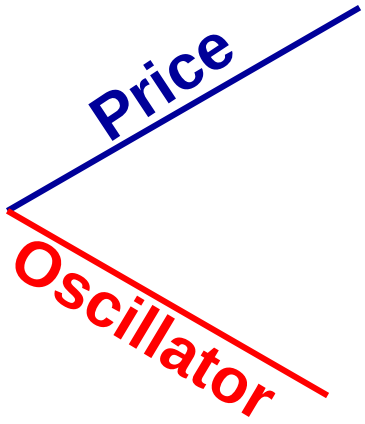
Jan Arps' Traders' Toolbox
Serious tools for serious traders

Red Devils, Hunchbacks, and Lobster Tails – A Revolutionary New Way to Look at Divergence

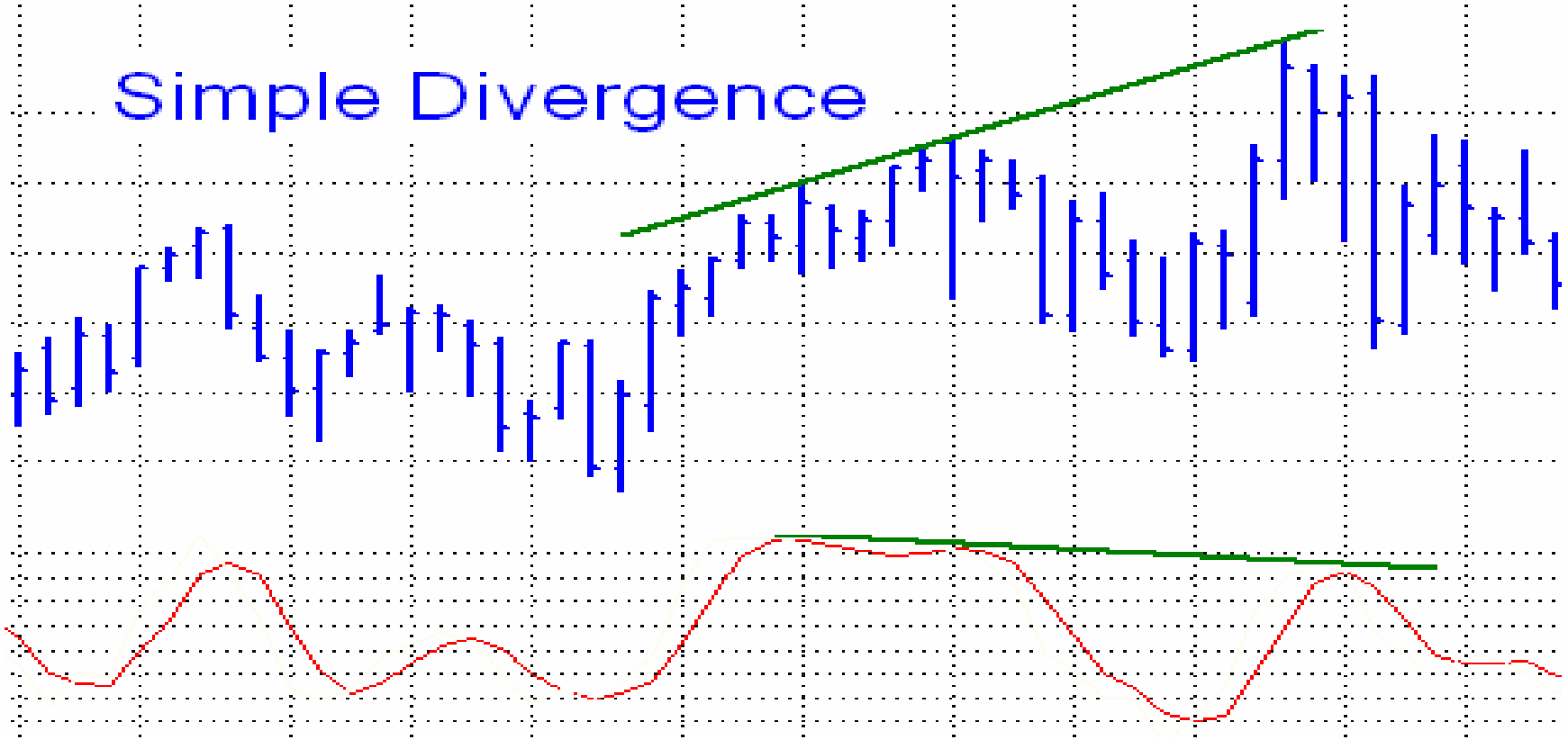
Jan Arps, President
Jan Arps' Traders' Toolbox
www.janarps.com

What is divergence?

- Divergence, simply stated, is when the price and the oscillator are moving in the opposite directions.

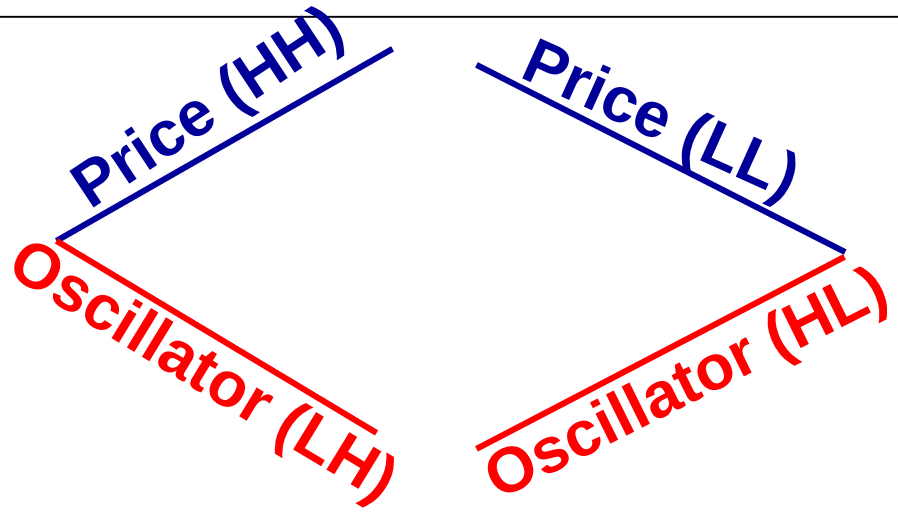


Simple Divergence

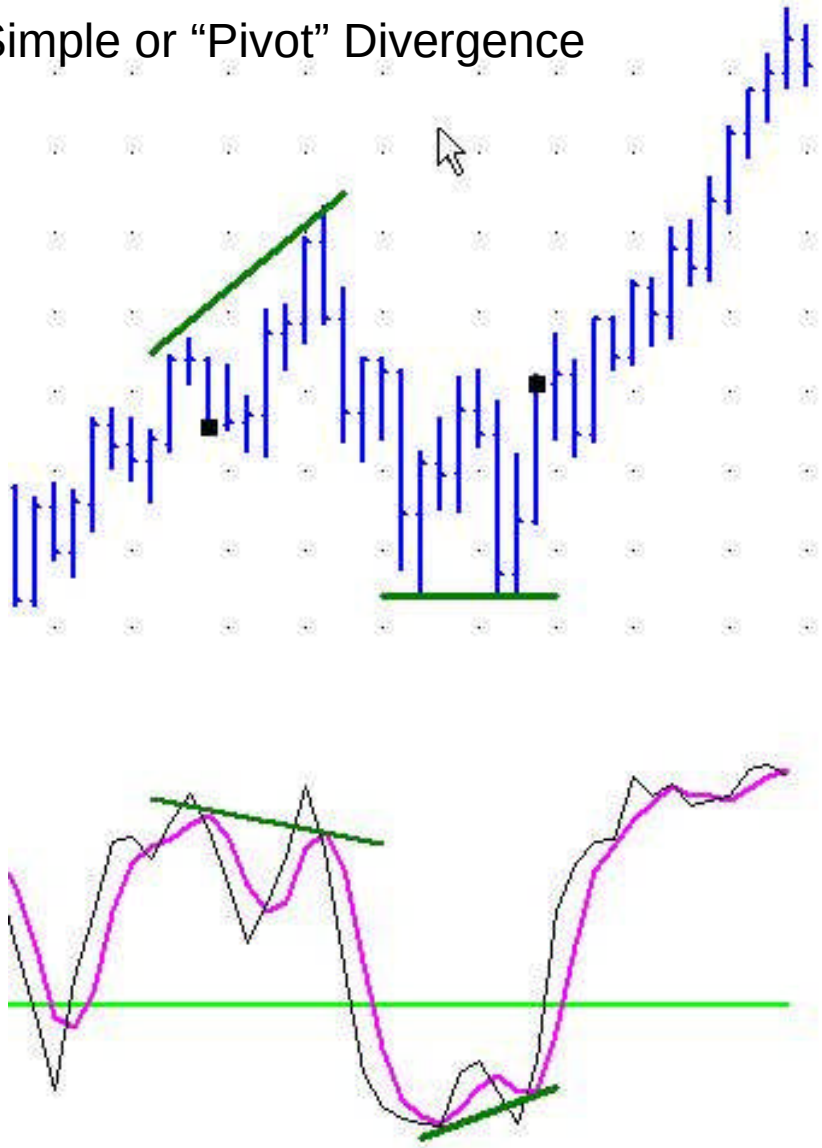


Pivot Divergence

- Suggests Potential Trend Reversal
  - Price makes Higher Highs (HH); Oscillator makes Lower Highs (LL)
  - Price makes Lower Lows (LH); Oscillator makes Higher Lows (HL)



Simple or “Pivot” Divergence



Divergence Analysis and Types of Oscillators

- Stochastics
- RSI
- CCI
- MACD

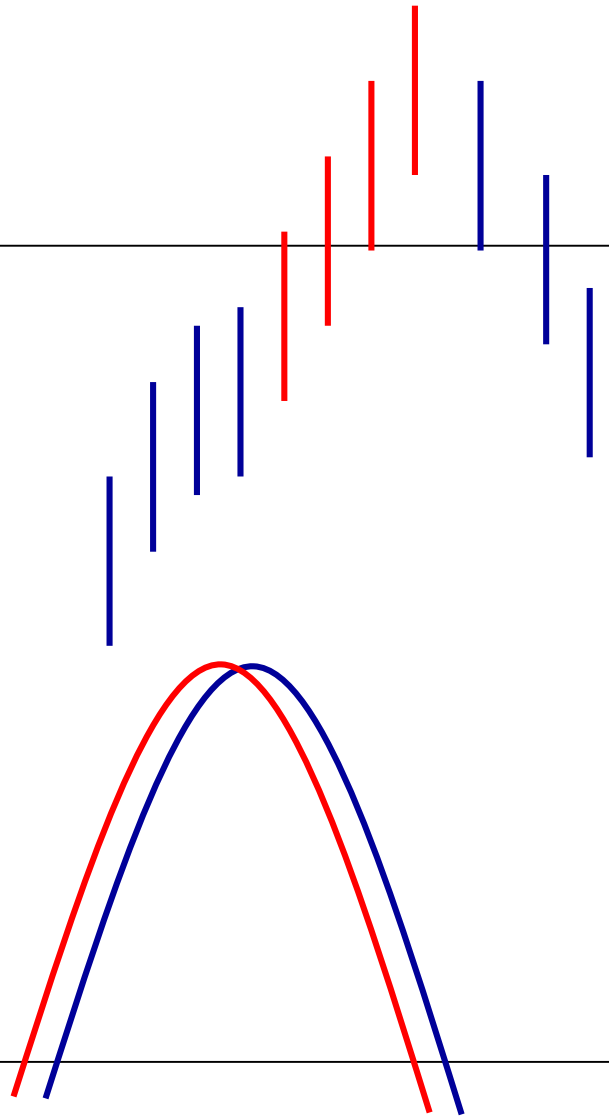
Divergence Bumps

- Bumps are in the oscillator, not necessarily the price
- On the oscillator look for
  - Rising Bottoms
  - Falling Tops

Identifying Oscillator Bumps

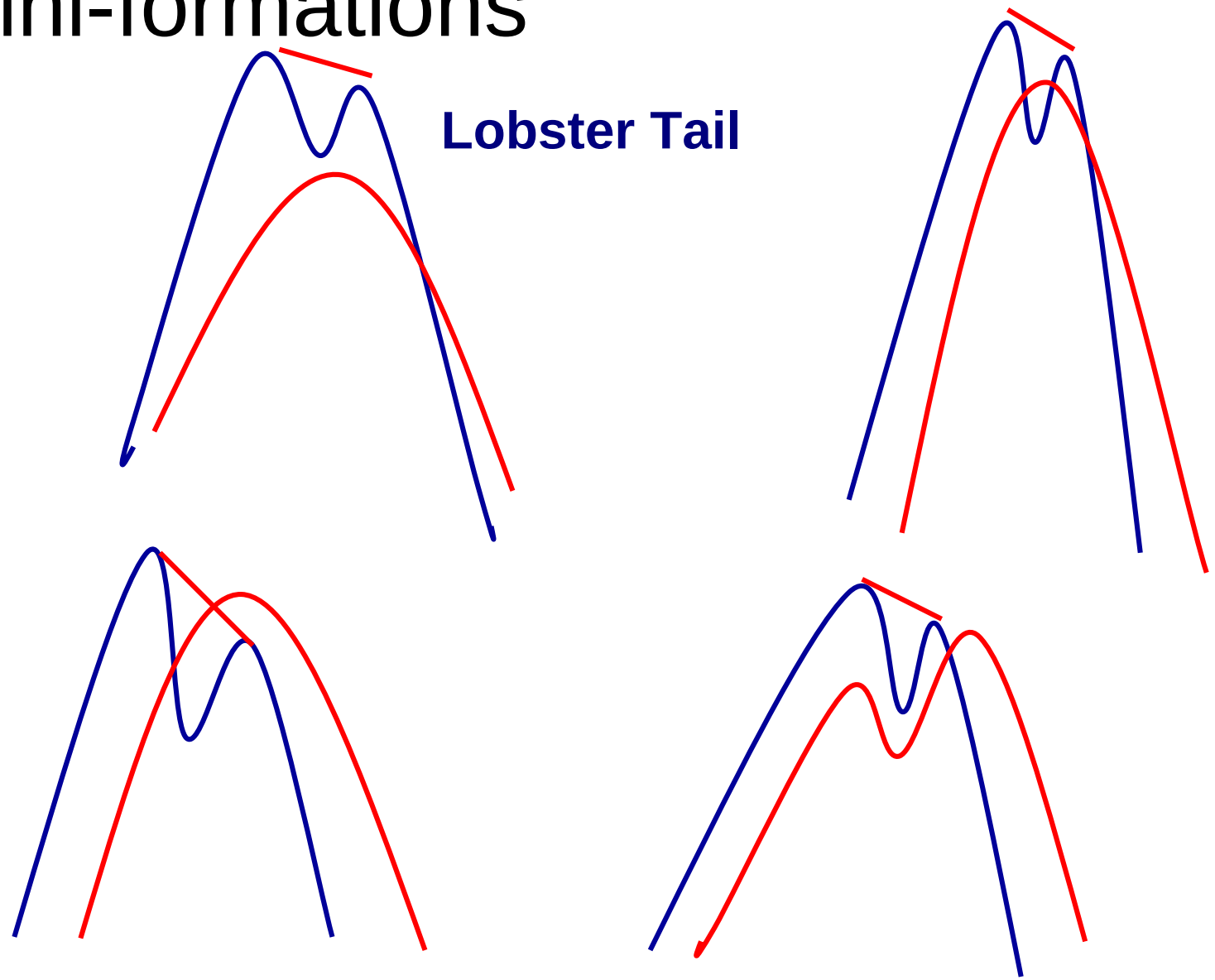
- Roundovers
- Crossings

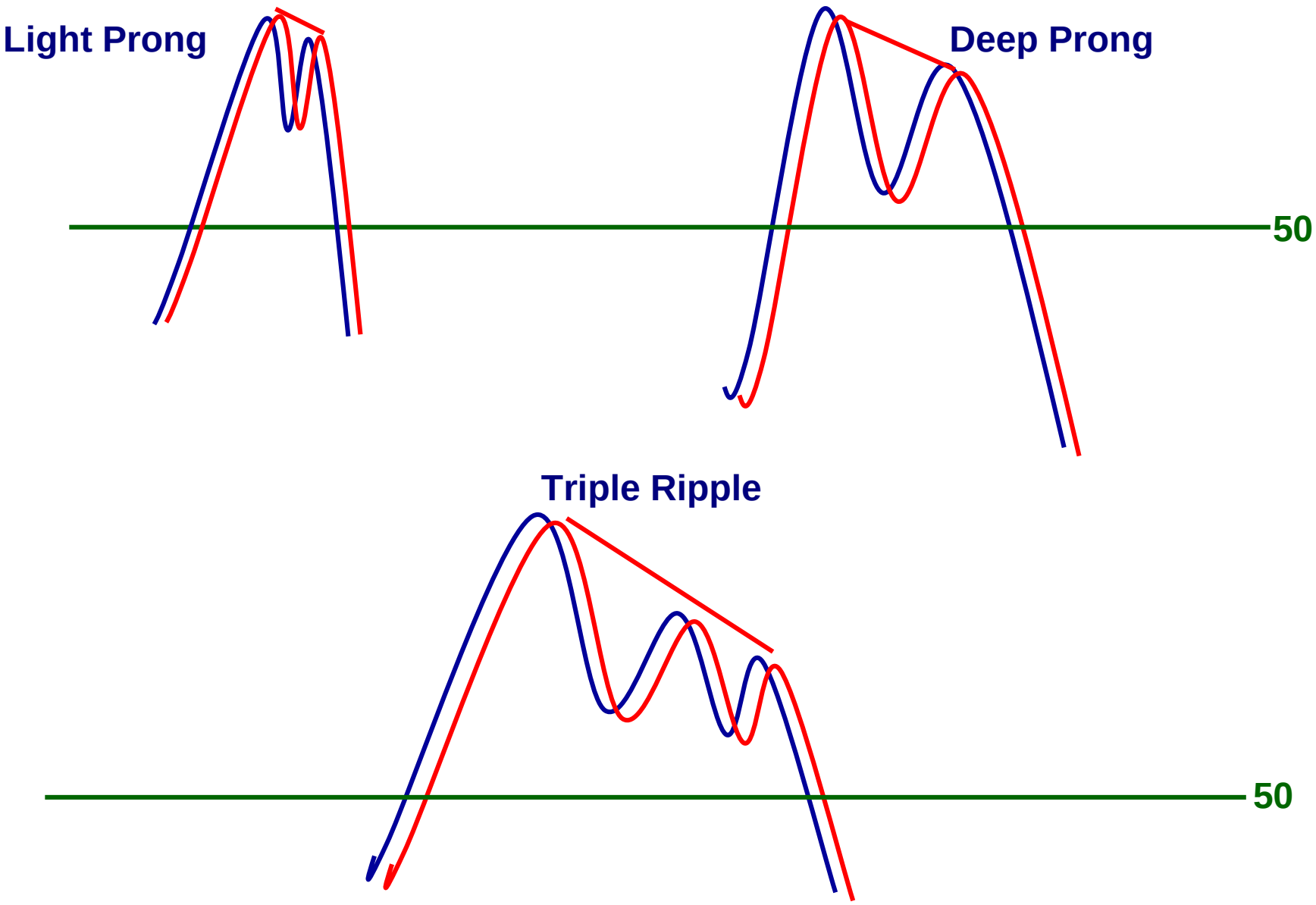
- Peeloffs
- Roundovers
- Crossings



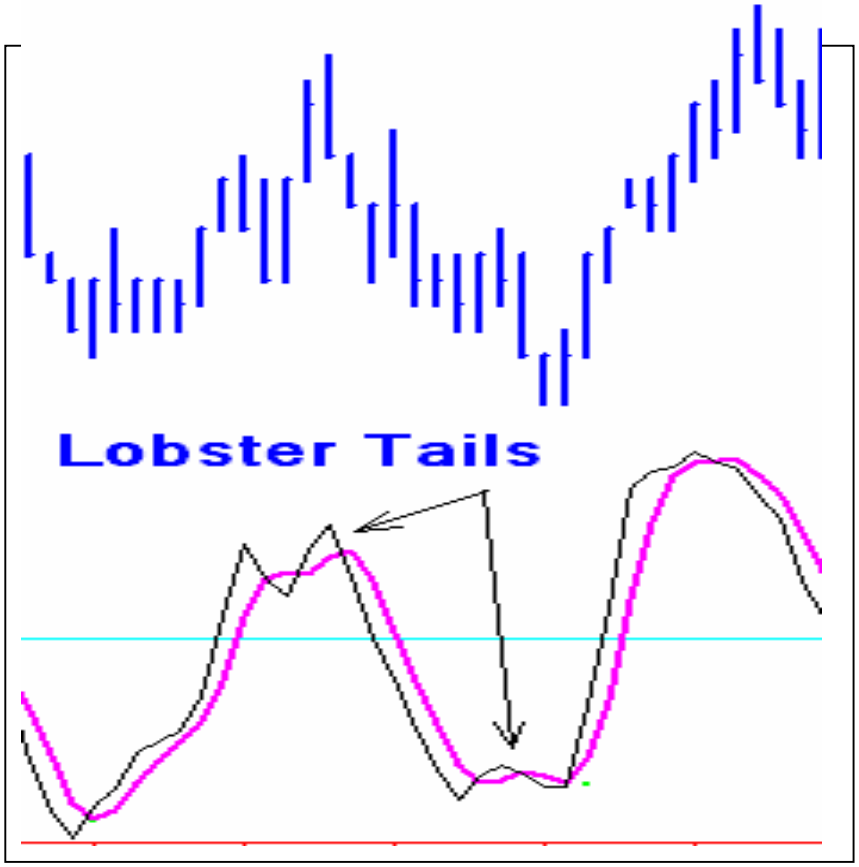
Mini-formations

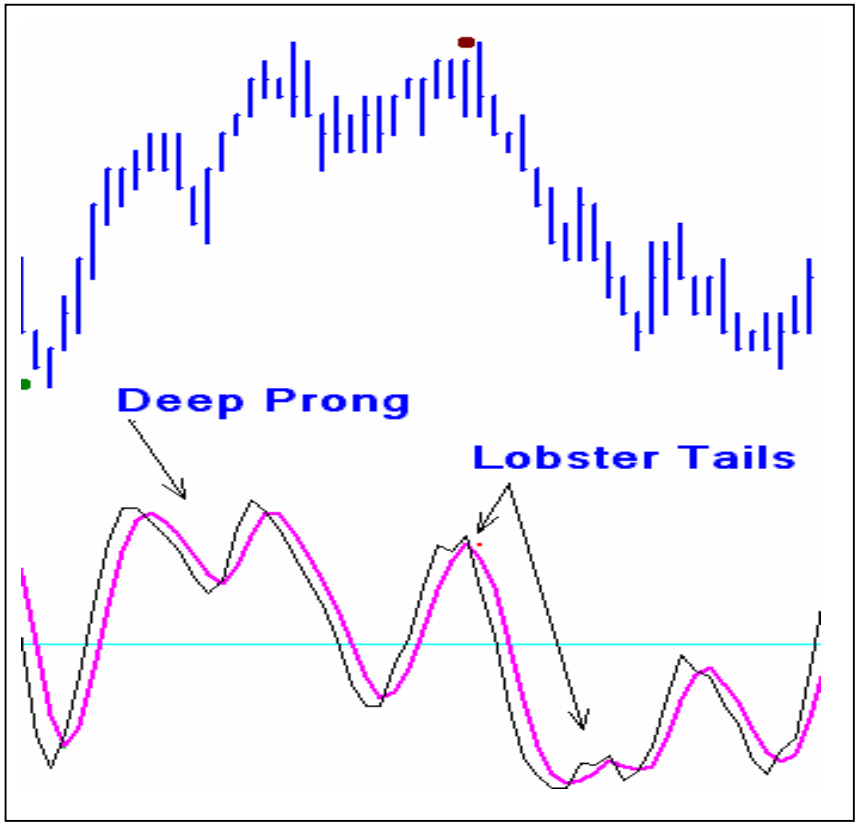
Lobster Tail



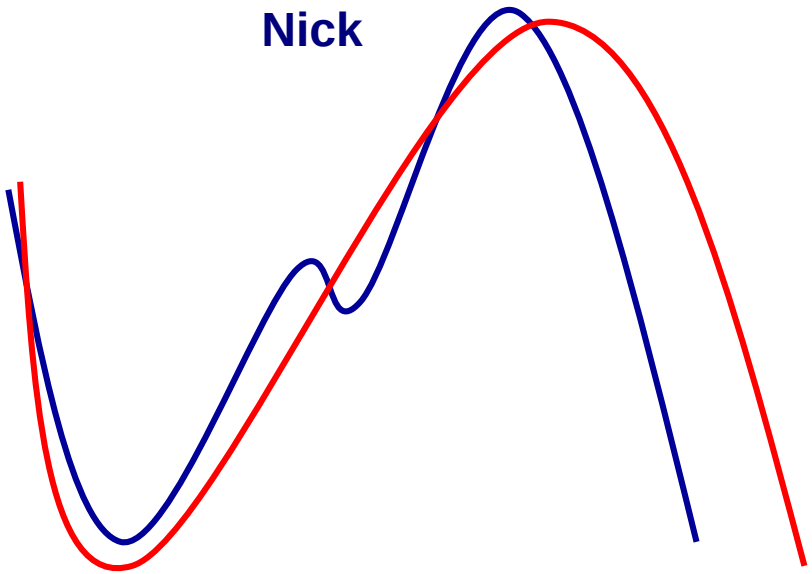

Light Prong
Deep Prong
50
Triple Ripple
50

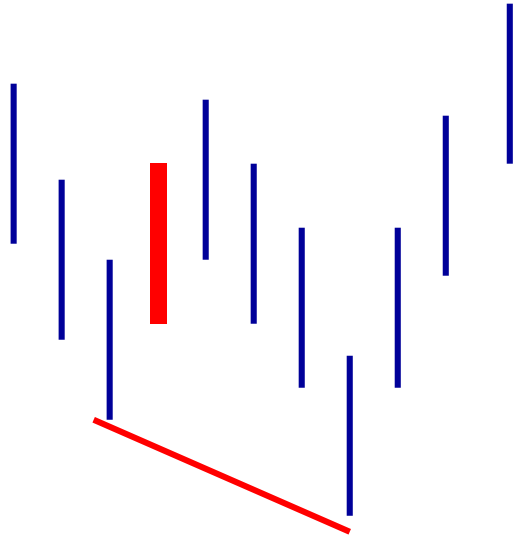
Lobster Tails and Deep Prongs



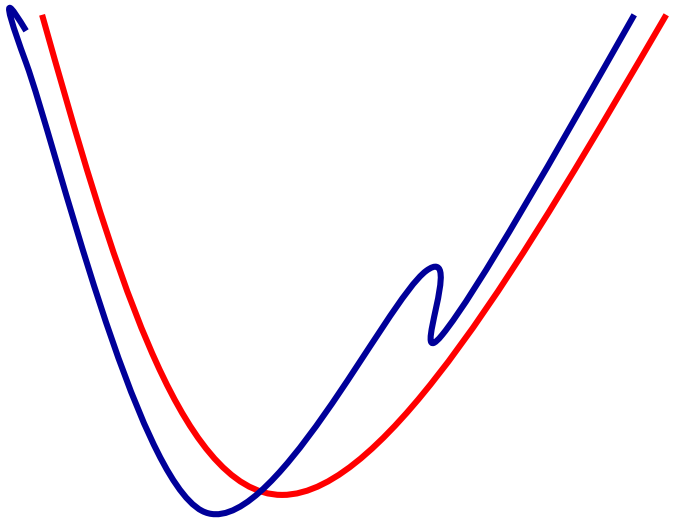


Nick





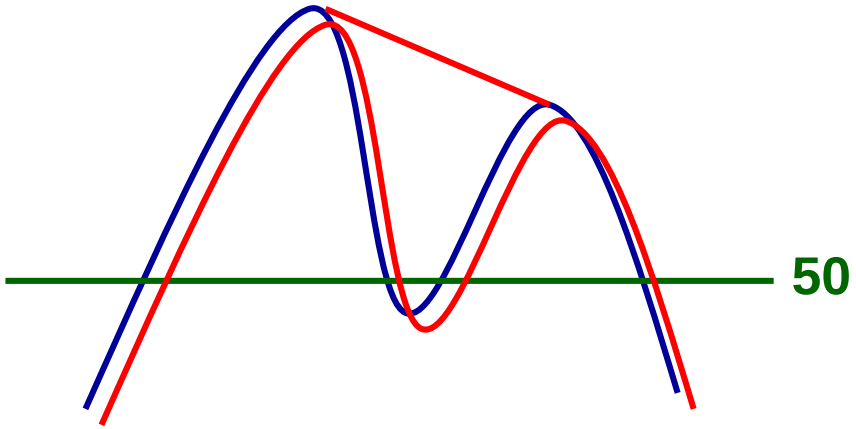
Invisible form of a Peel Off



Double Bumps

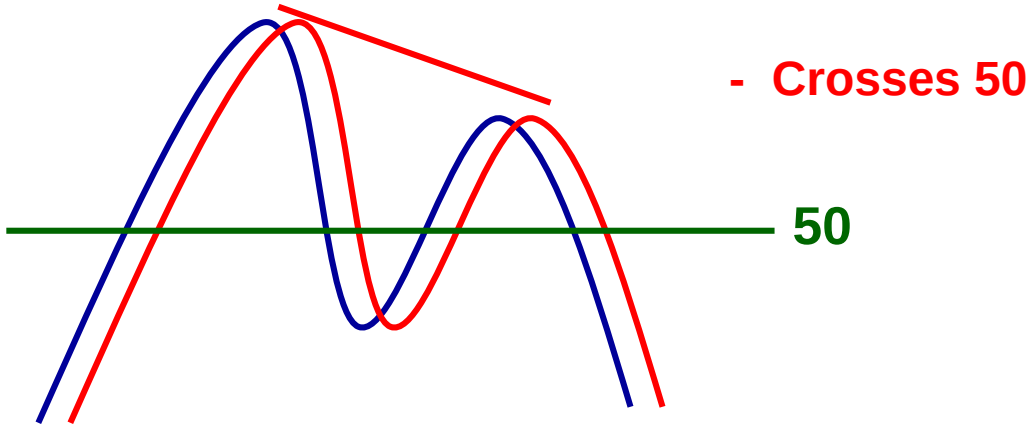
- Deep Dip Doubles

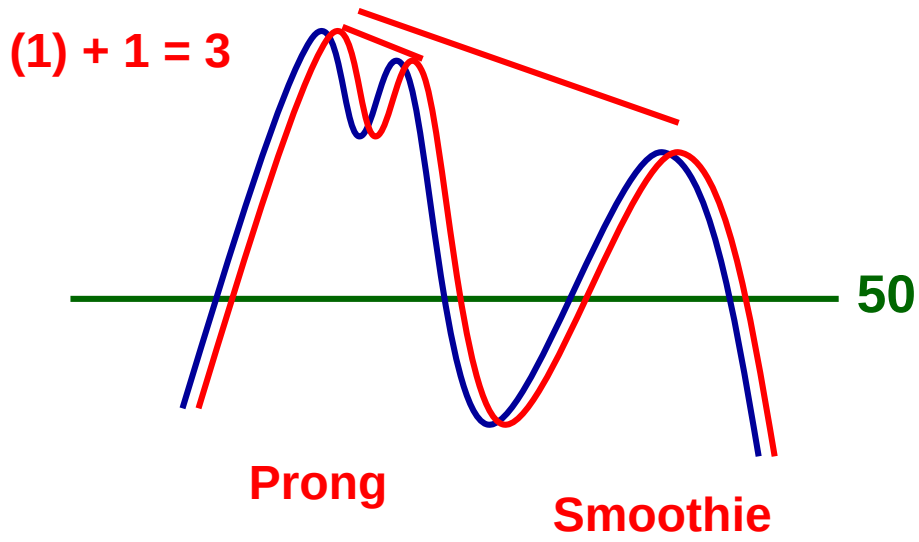
  Cross the 50 line



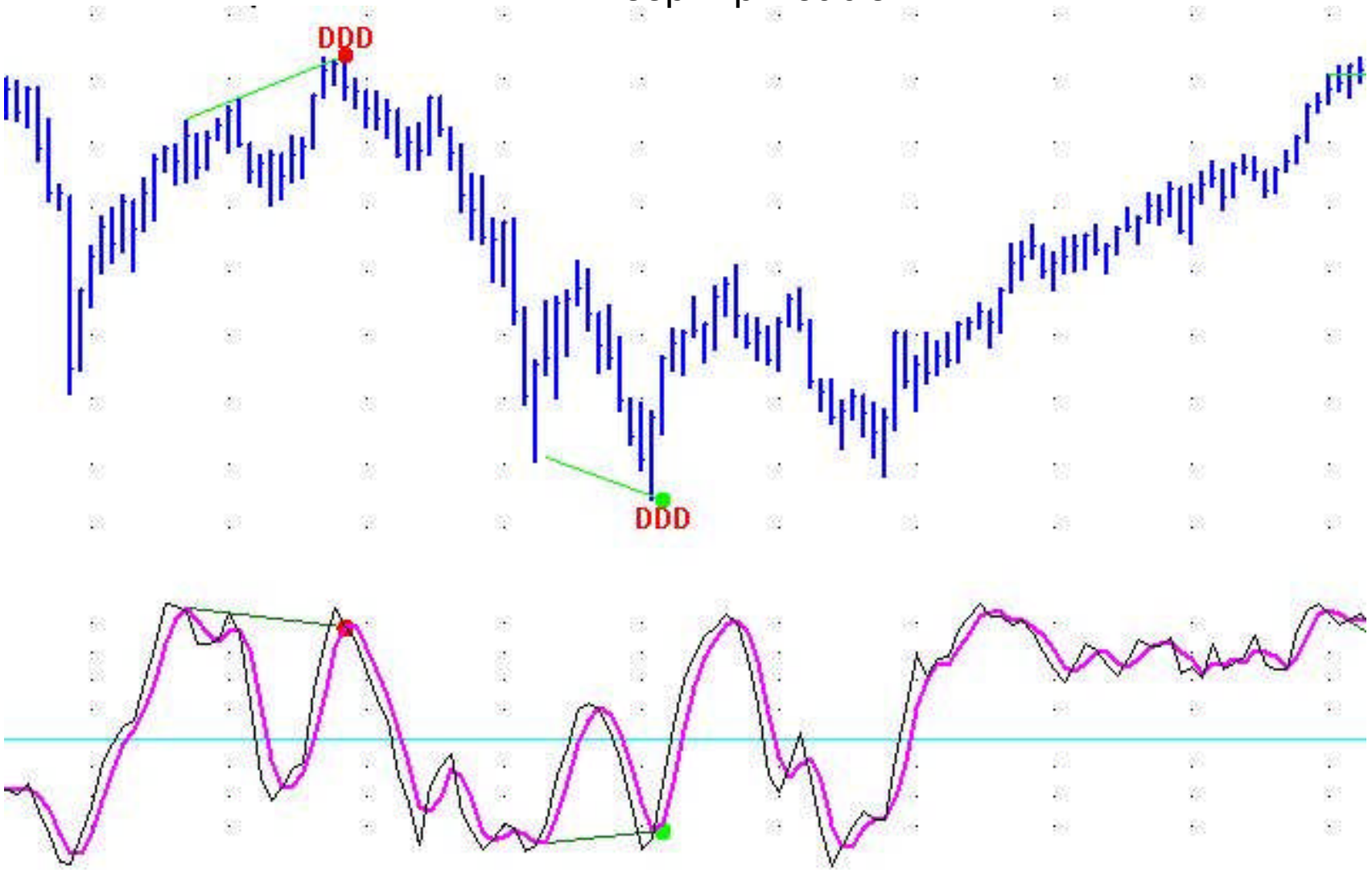
Deep Dip Double

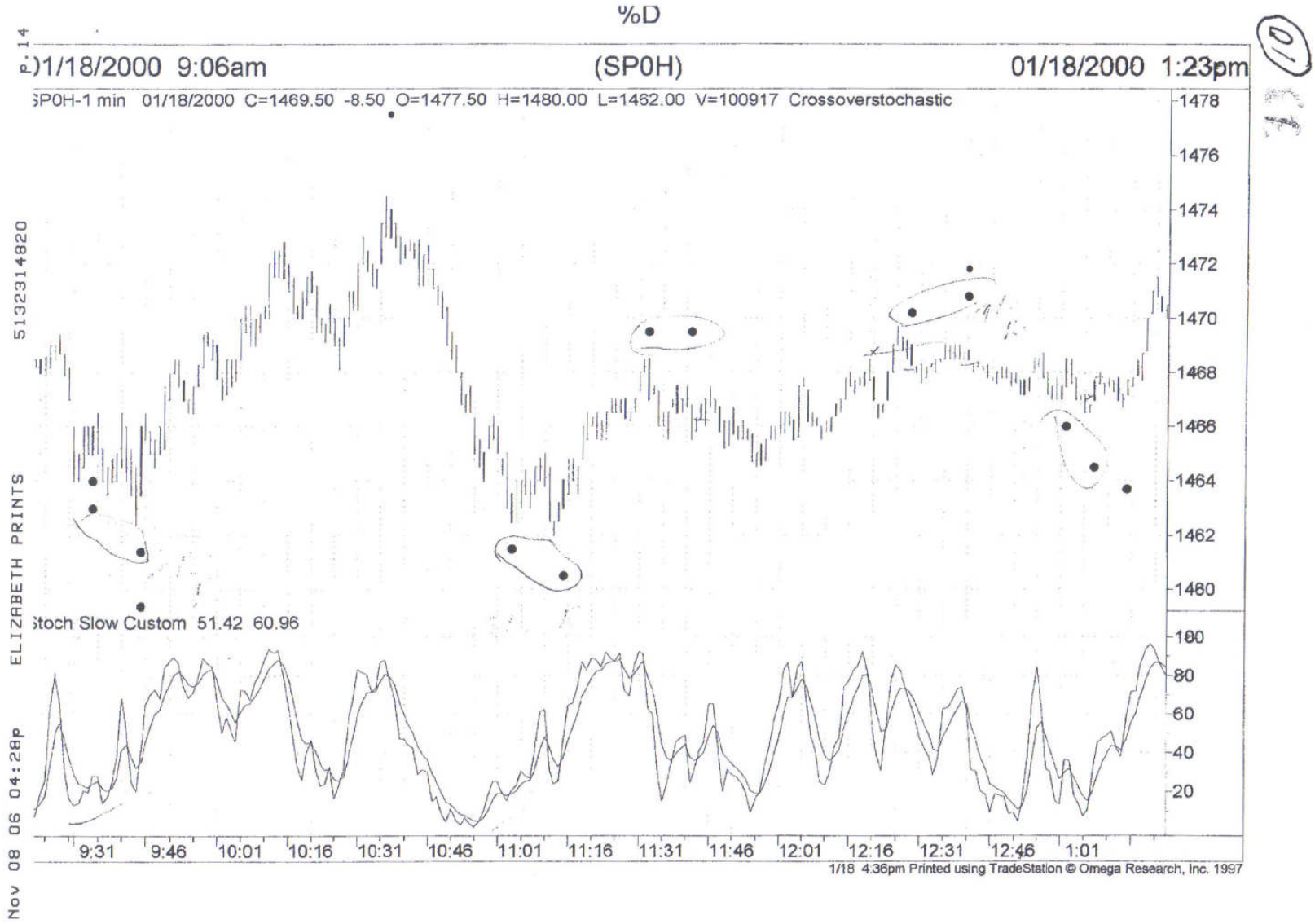
Pure





Deep Dip Double

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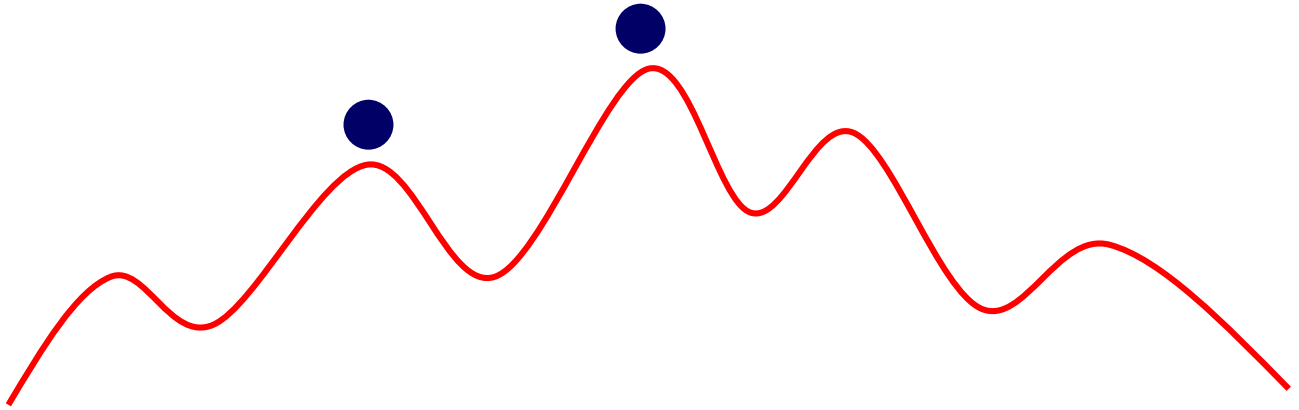


- **A Triple Divergence includes a double.**

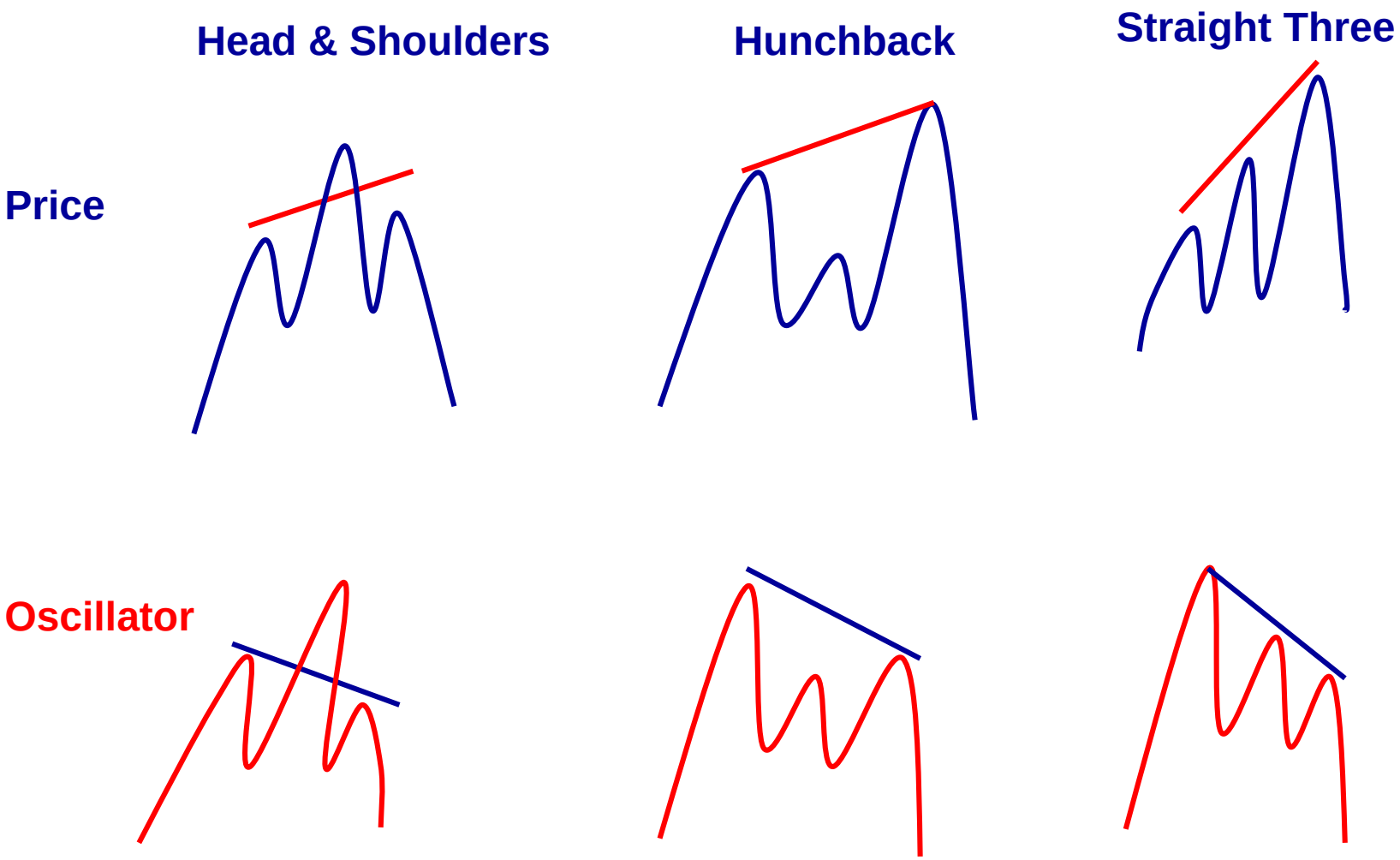
•This double dot I call “Snakebite”.

•If trading two-bump divergences, it is usually safer to wait for the second divergence dot.

Triple Bumps

- Divergences usually come in some form of three
  - Head & Shoulders
  - Head & Shoulders – Inverse
  - Hunchbacks
  - Straight Three
  - Sweet Pea

Three-Bump Divergence



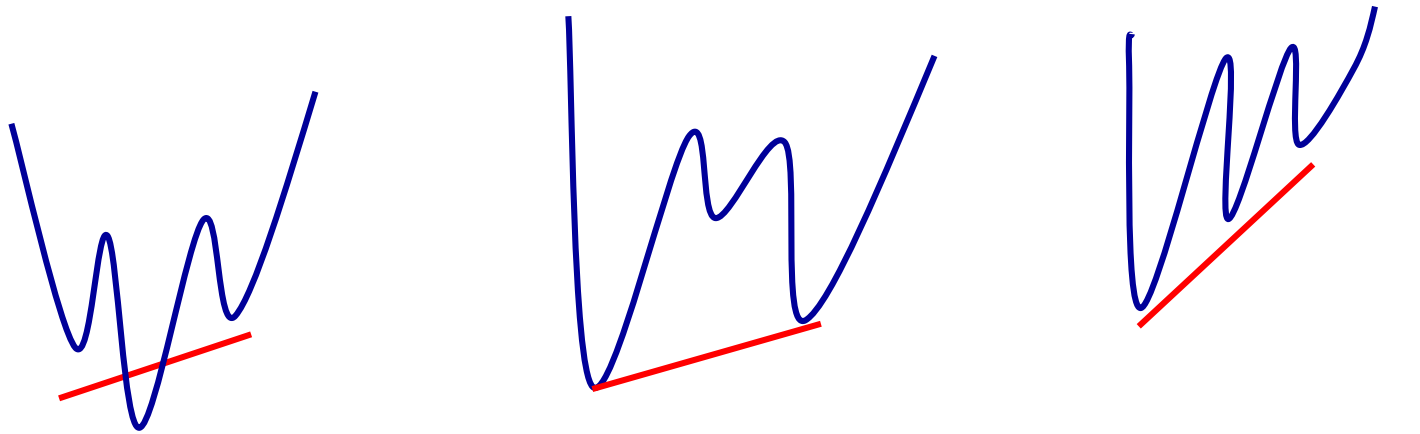
Three-Bump Divergence - Inverse

Head & Shoulders

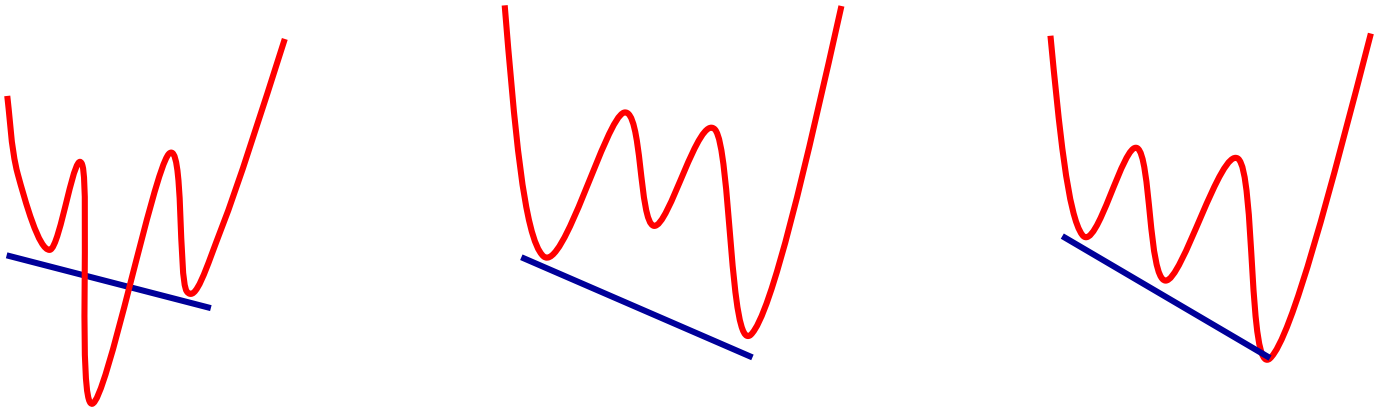
Hunchback

Straight Three

Price

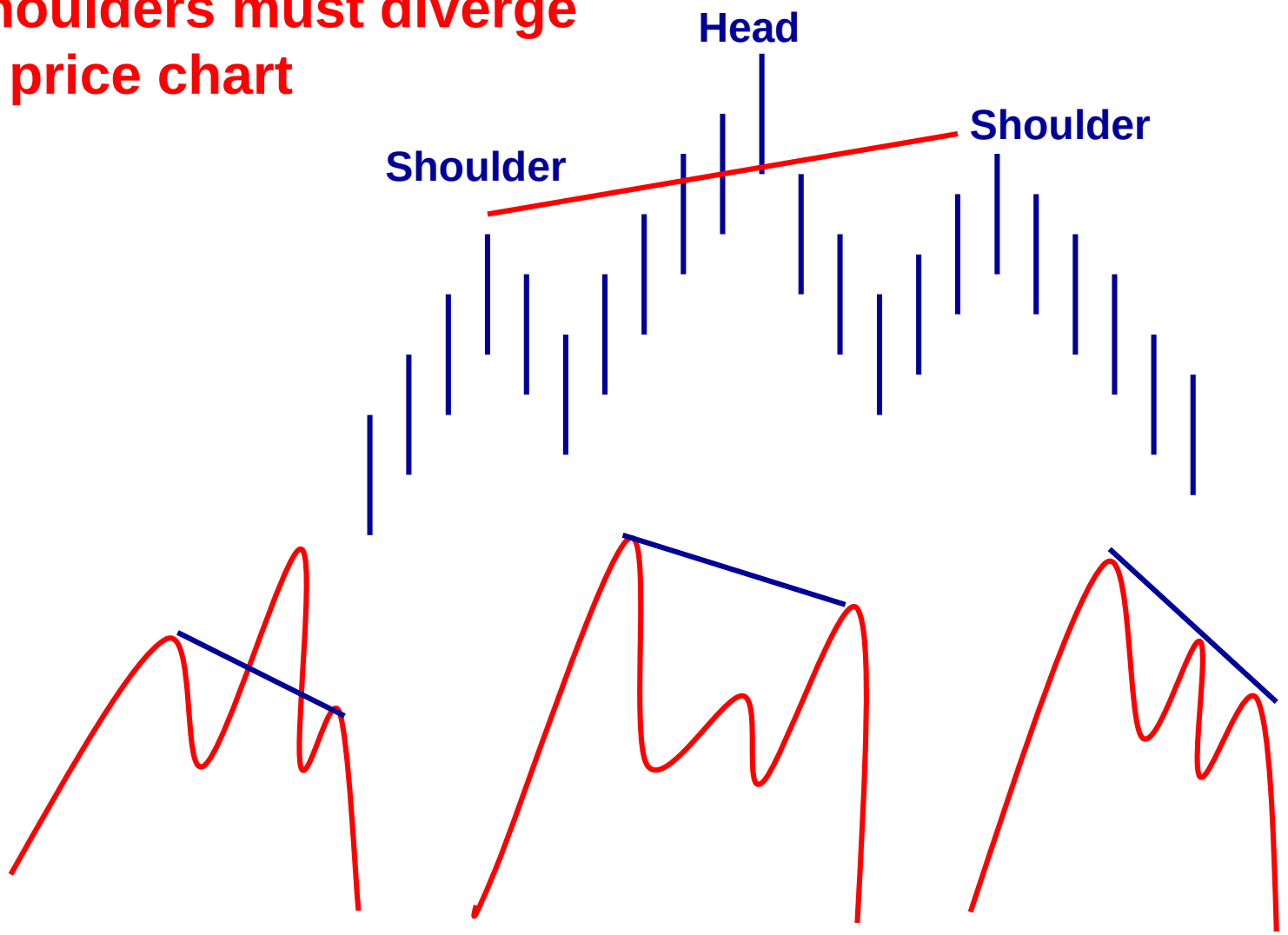


Oscillator

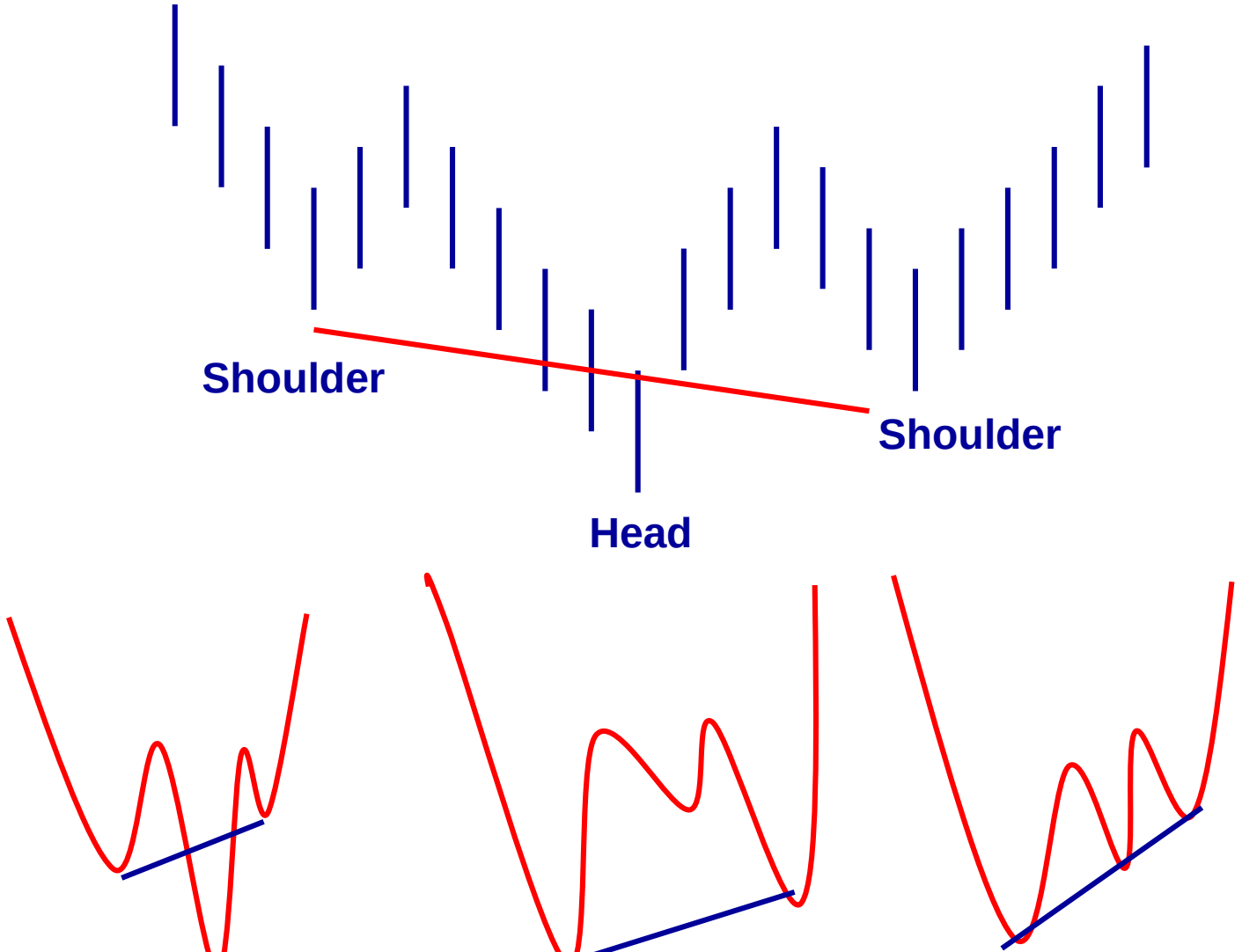


Head and Shoulders Divergence

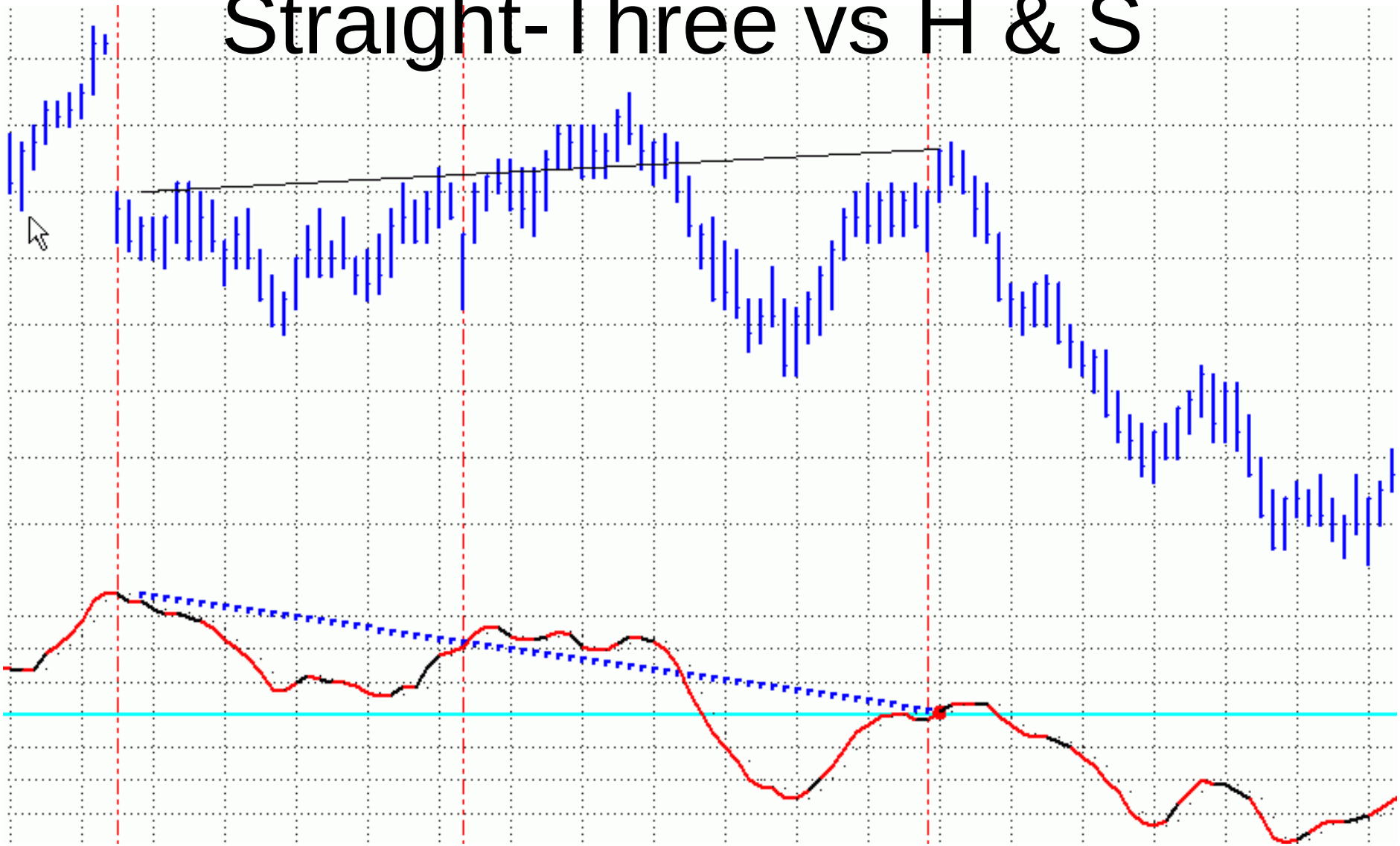
Shoulders must diverge in price chart



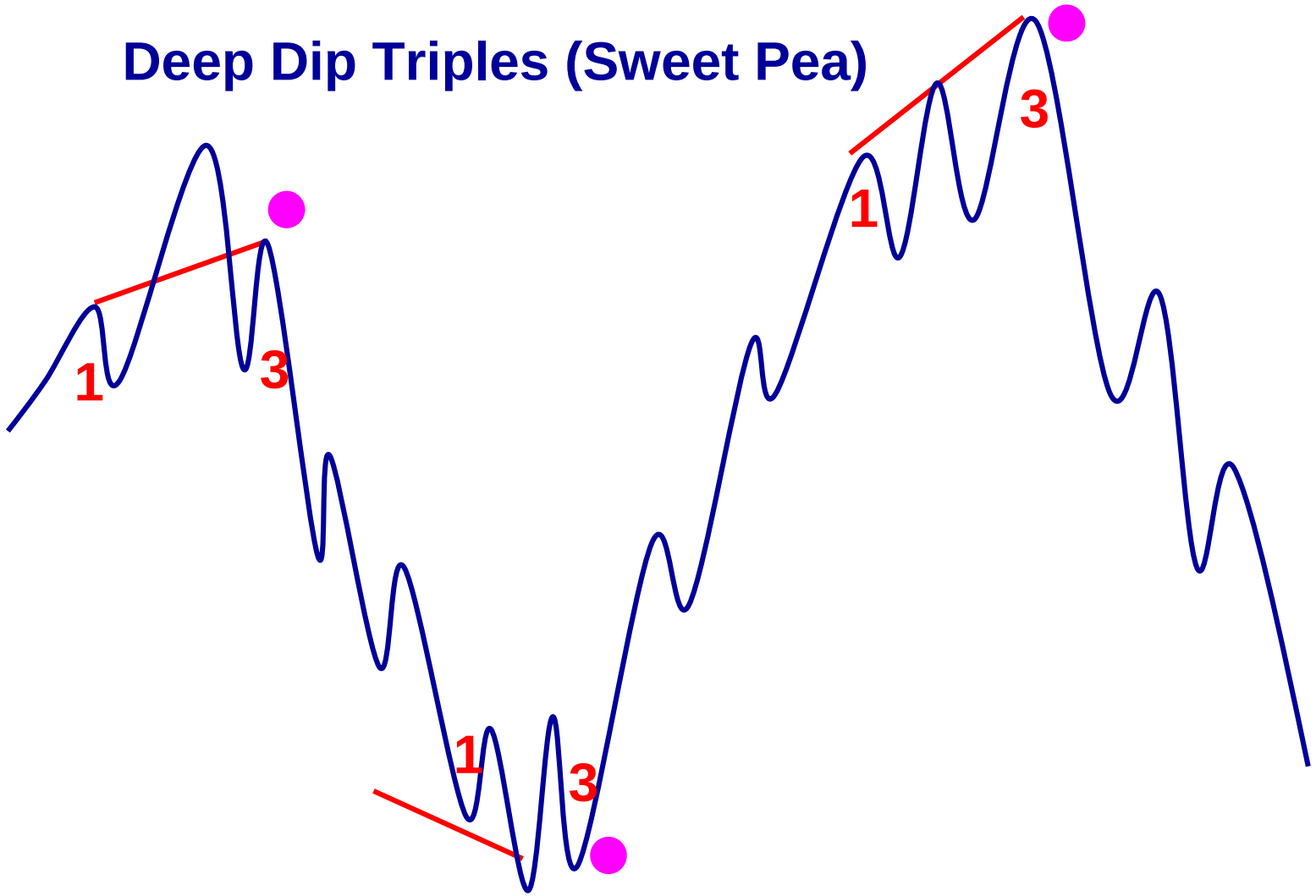
Head and Shoulders Divergence - Inverse



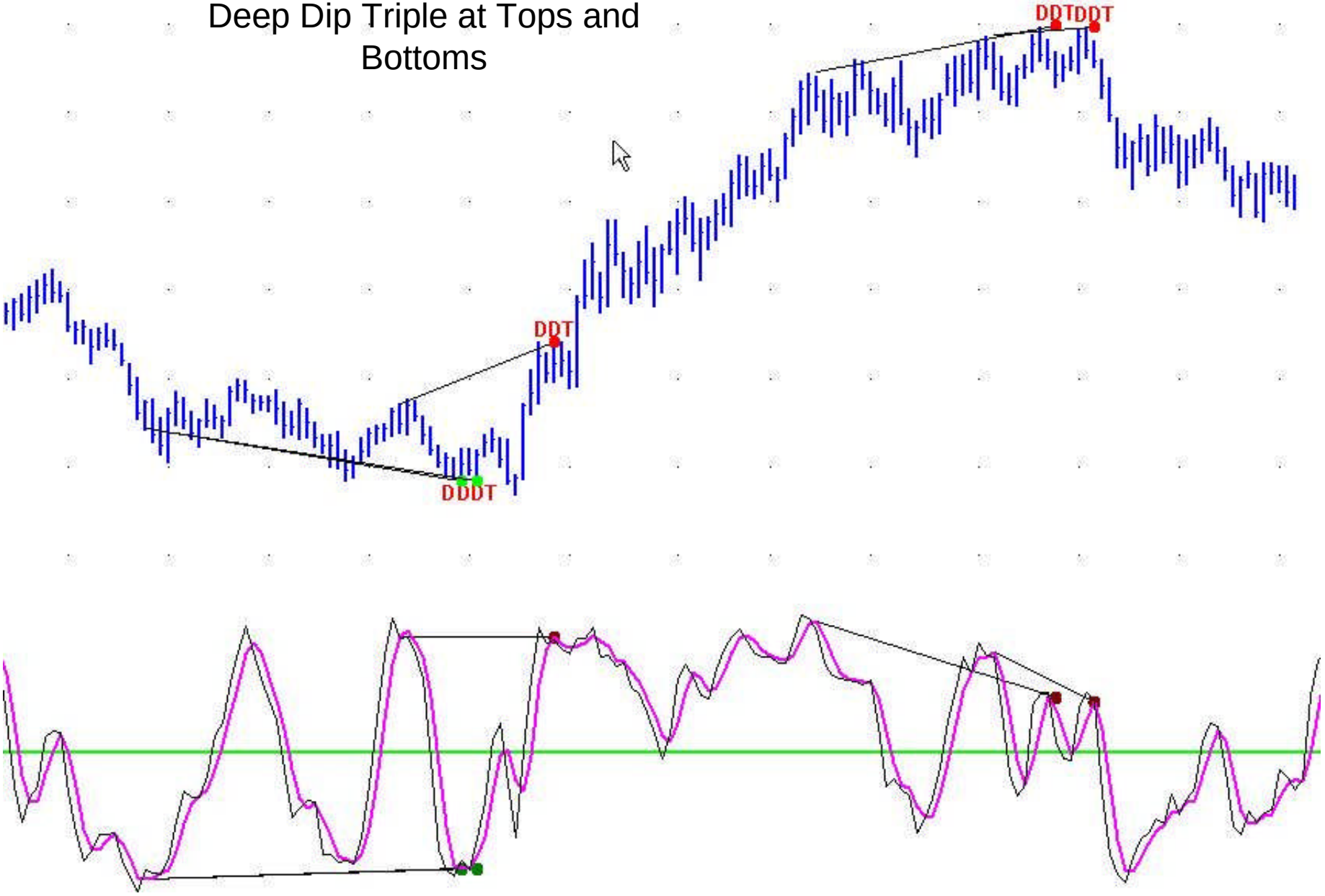
Straight-Three vs H & S



Deep Dip Triples (Sweet Pea)

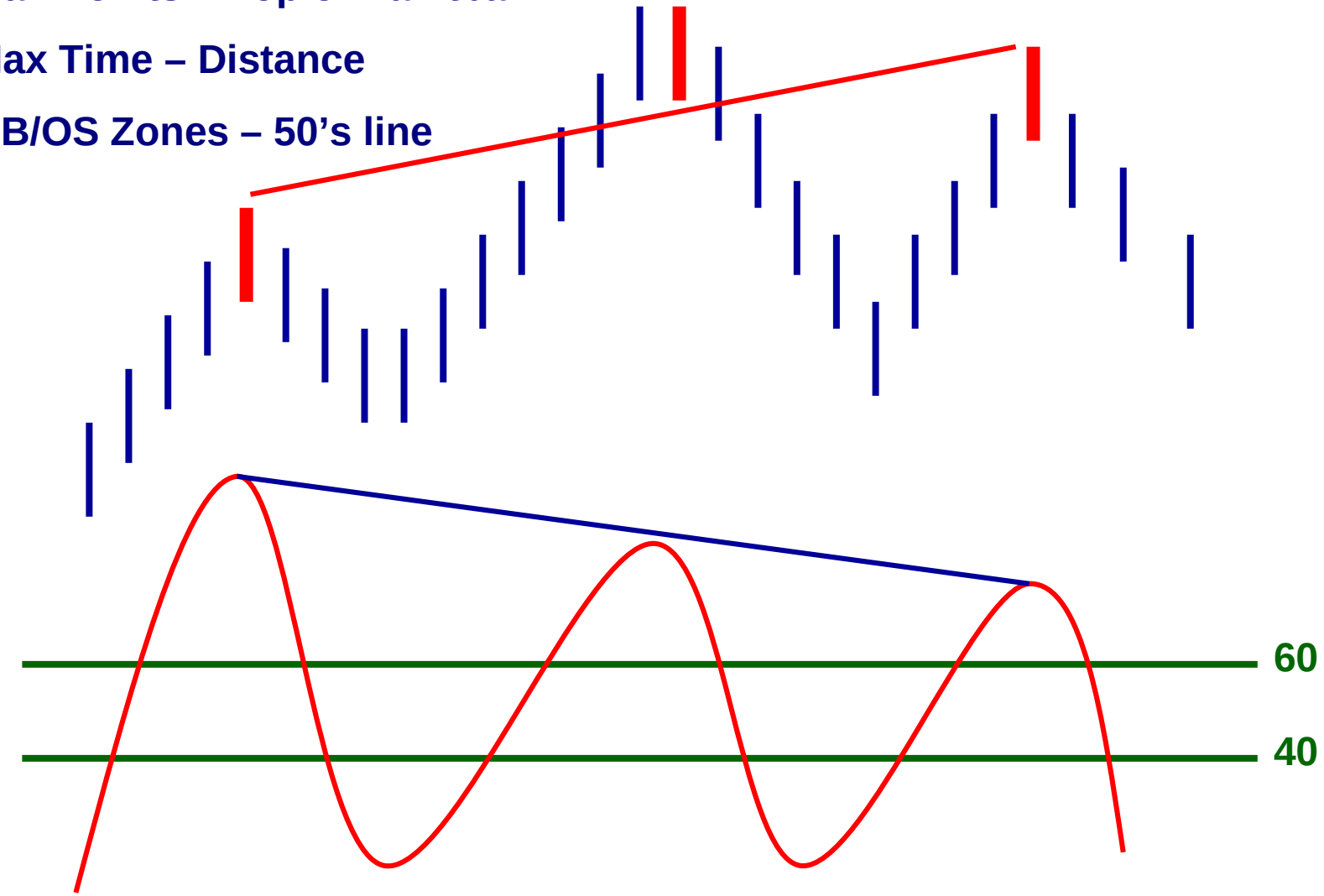


Deep Dip Triple at Tops and Bottoms



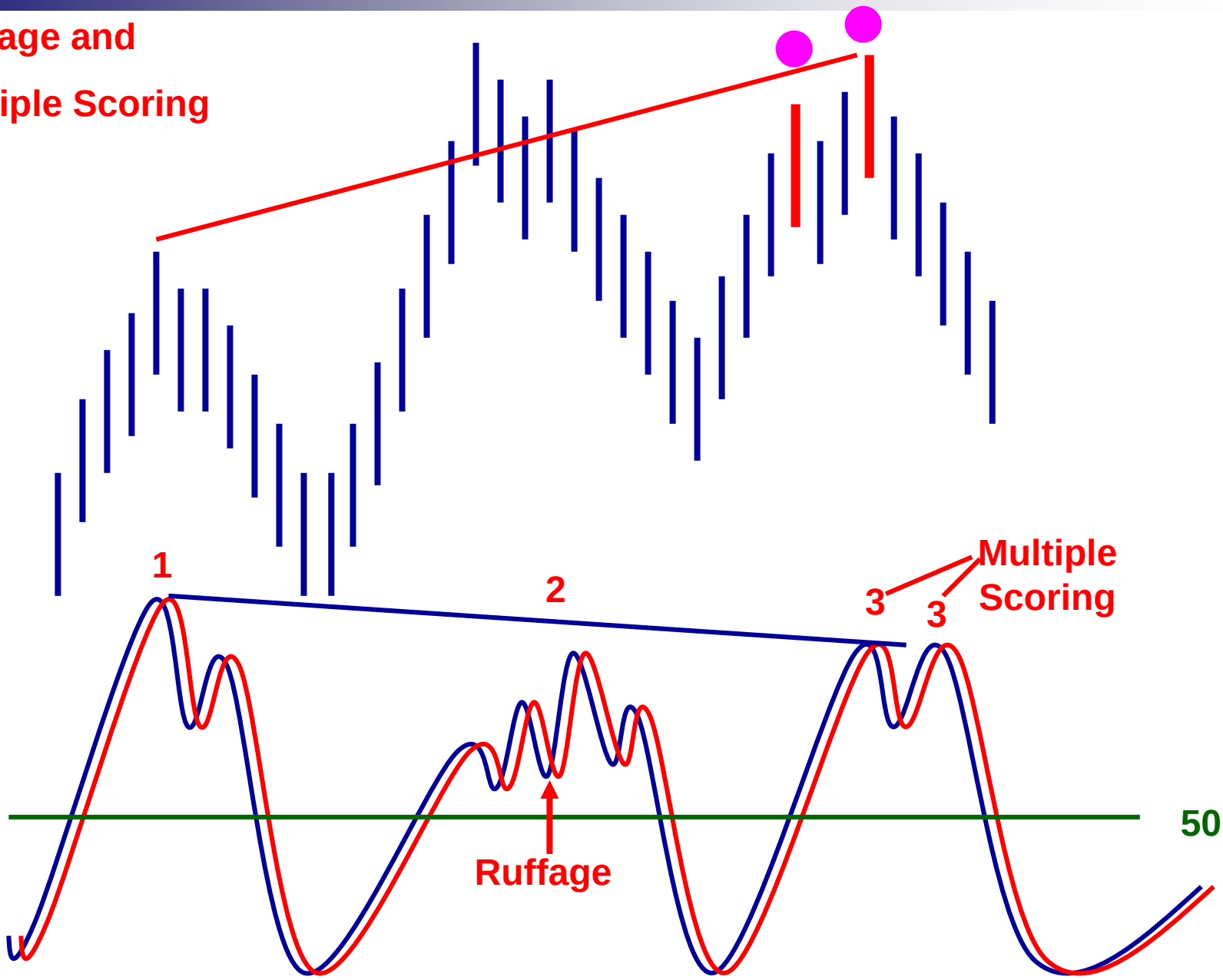
Additional Filters

- Max Points – Top of Paintbar
- Max Time – Distance
- OB/OS Zones – 50's line

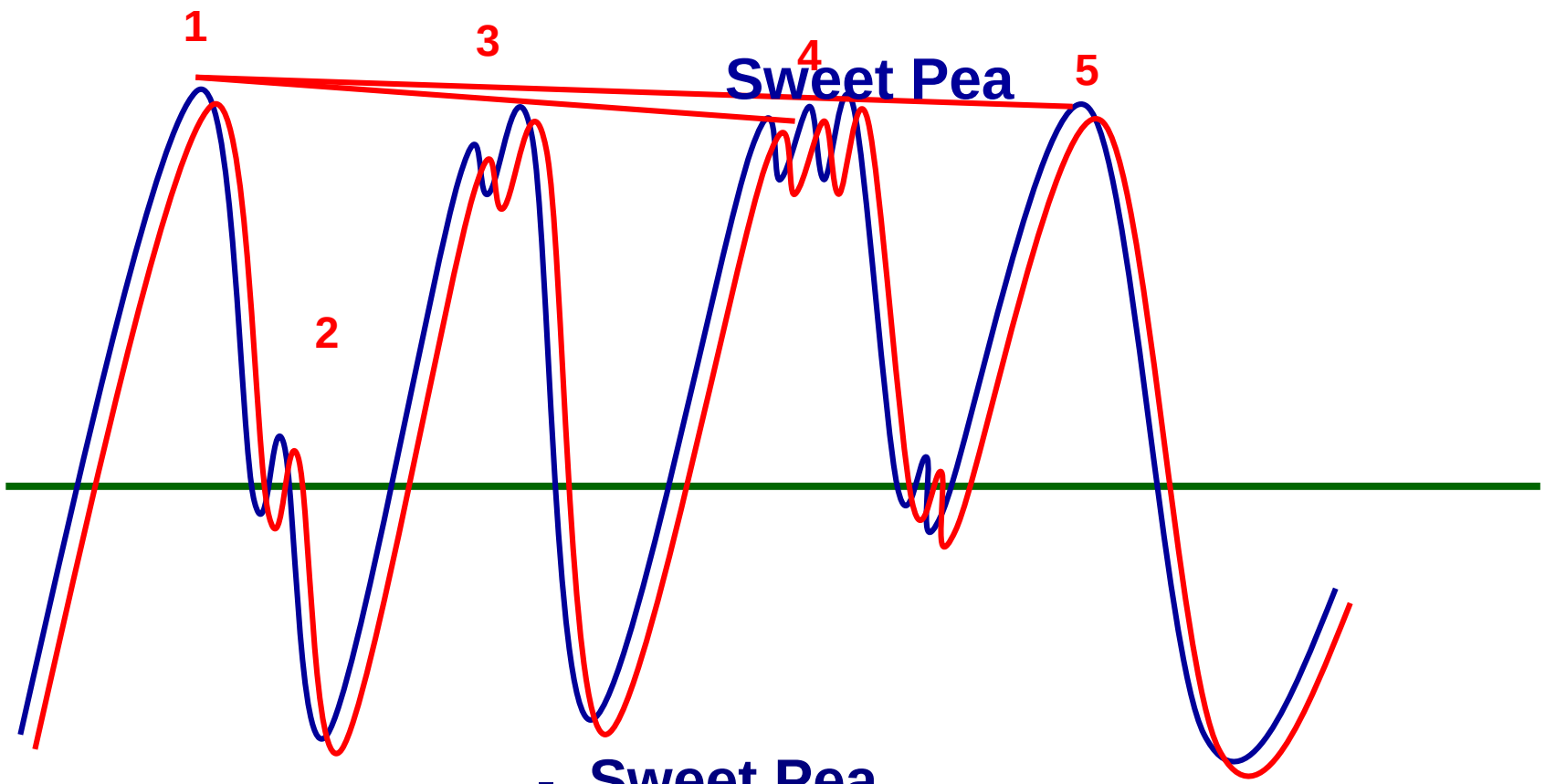


- Ruffage and

- Multiple Scoring



Quad and Quint Bumps



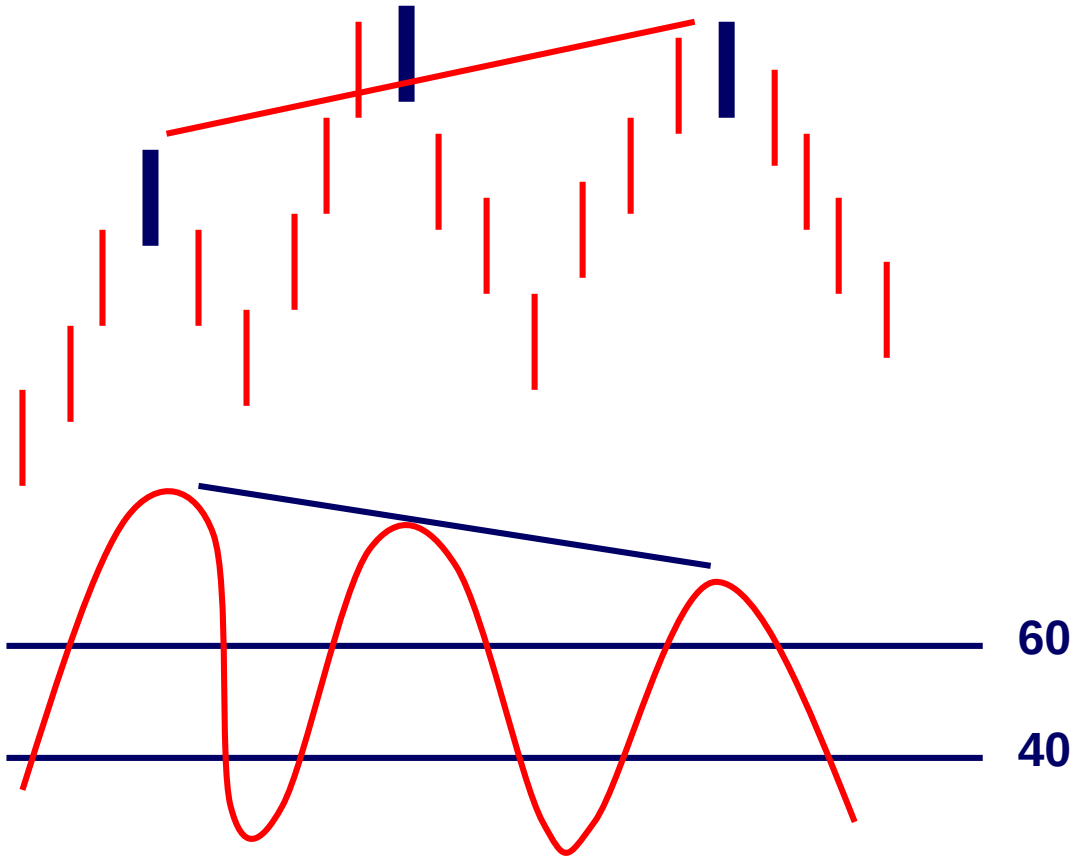
- Sweet Pea

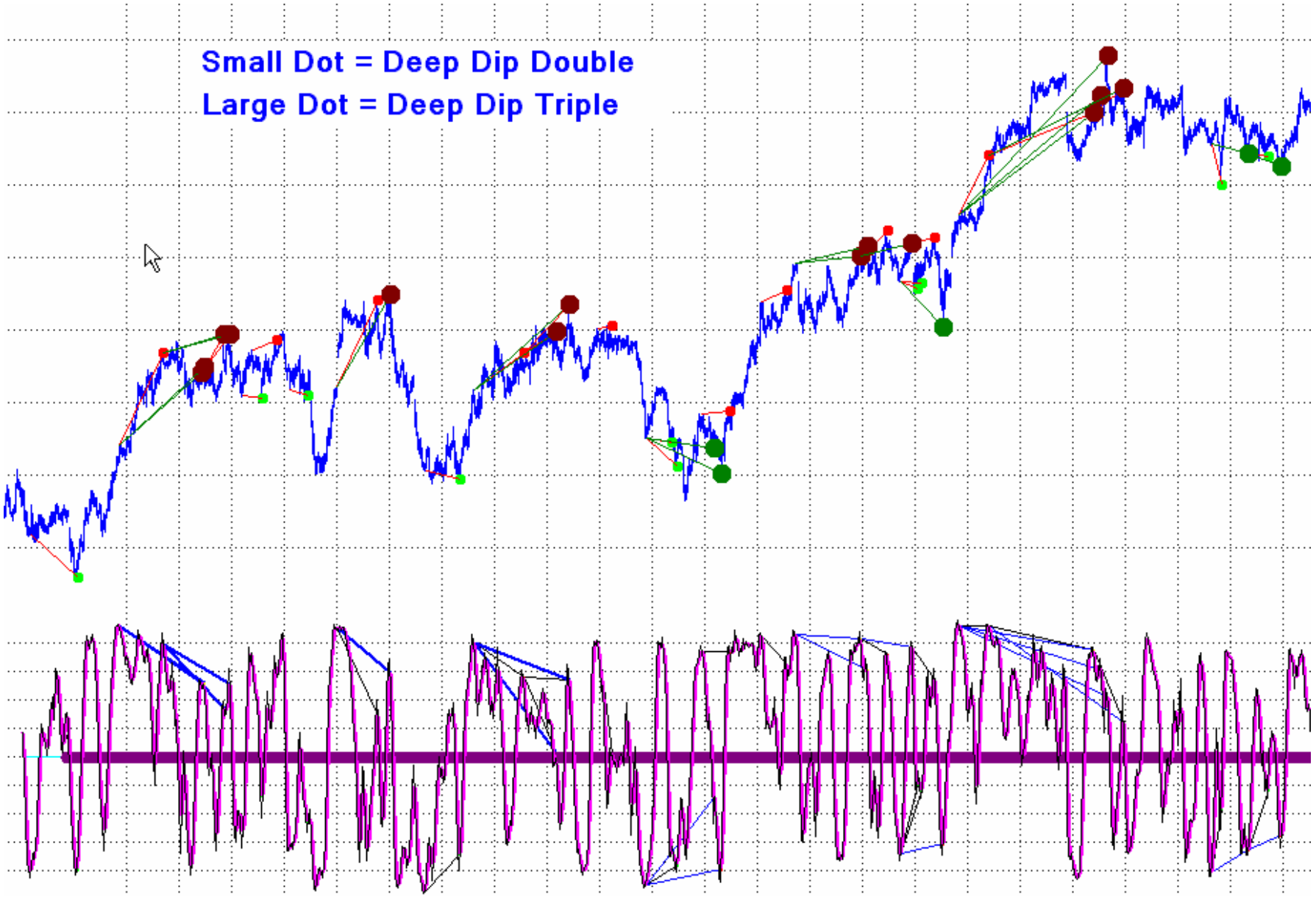
-Deep Dip Quad

- Deep Dip Five

Sweet Pea 3

- Max Points – Top of Paintbars
- Max Time – Distance
- OB/OS Zones – 50's Line



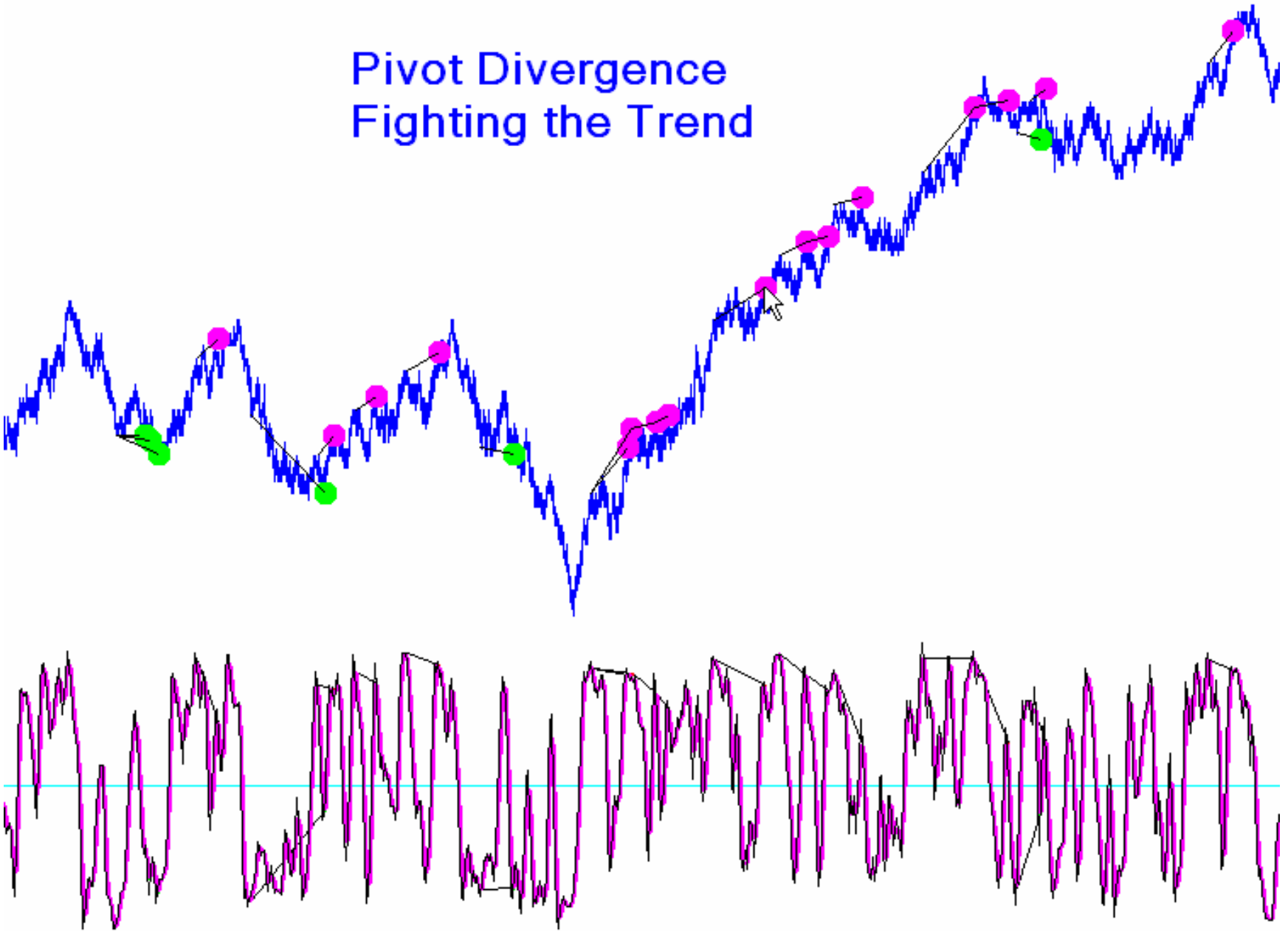

Small Dot = Deep Dip Double
Large Dot = Deep Dip Triple

Conclusion

- Divergence is a powerful tool to identify potential reversals in price direction.
- Look for divergent peaks and valleys first in the oscillator, then at corresponding points in the price
- Divergences don’t have to occur just between two adjacent bumps – triple, quad and five bump divergences can be highly effective.

Divergence Issue

- The biggest problem with divergence analysis is to avoid fighting the trend.

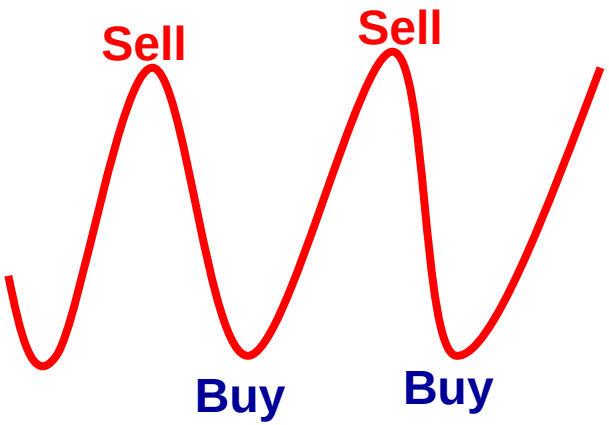

Pivot Divergence
Fighting the Trend

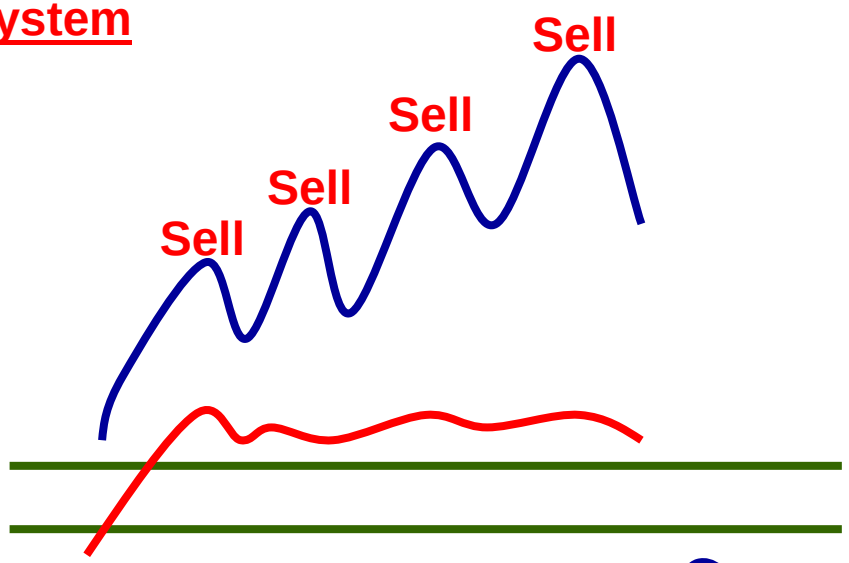
Oscillating Market

Momentum Market

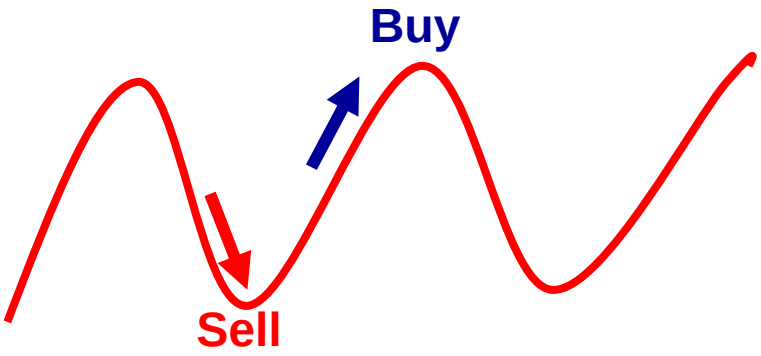
“A body in motion tends to stay in motion”

Oscillator System

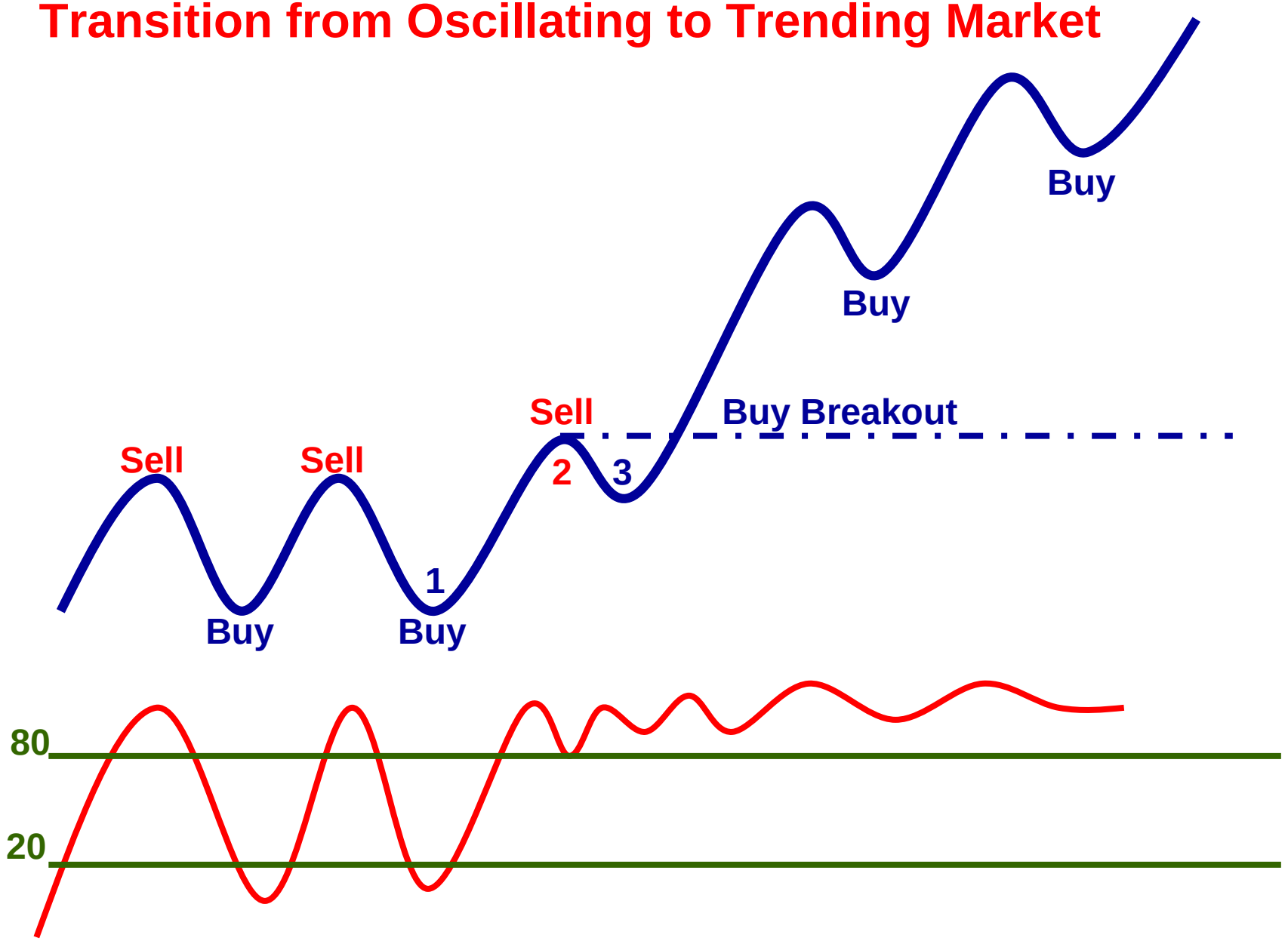




Momentum System



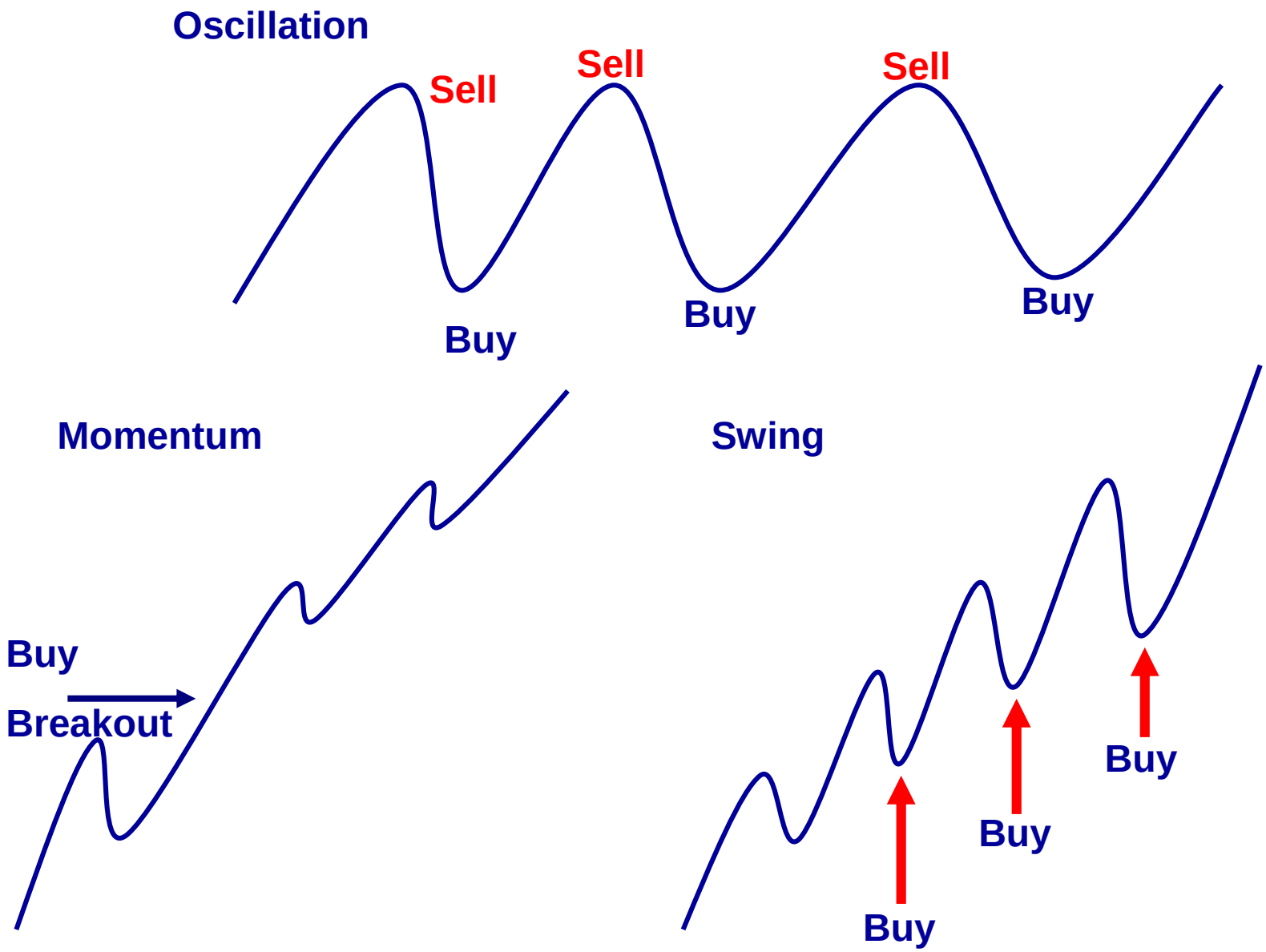
Transition from Oscillating to Trending Market



How to Deal With Trend

- Retracement Divergences are the safest – trade with the trend.

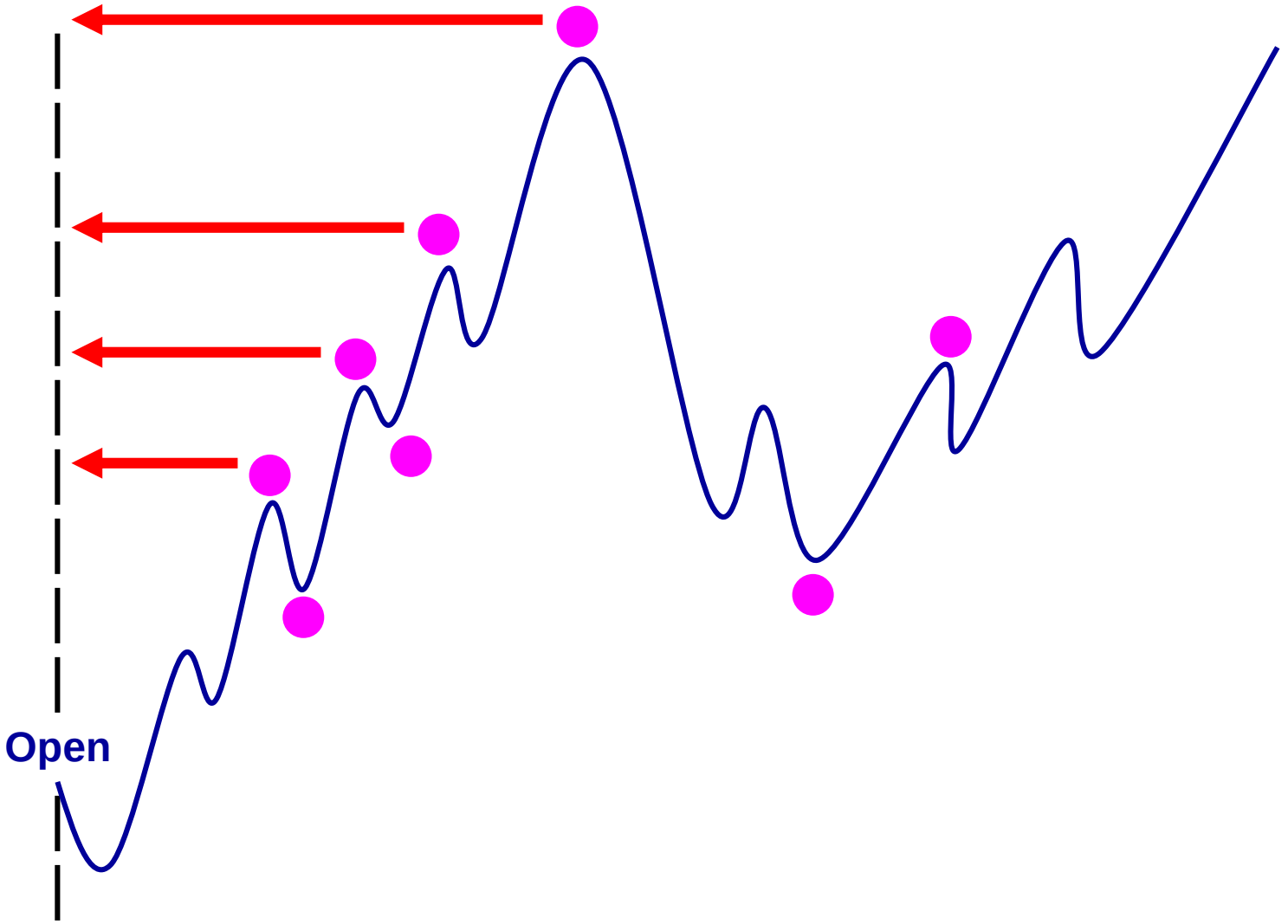
Three Forms of Trading



How to Deal With Trend

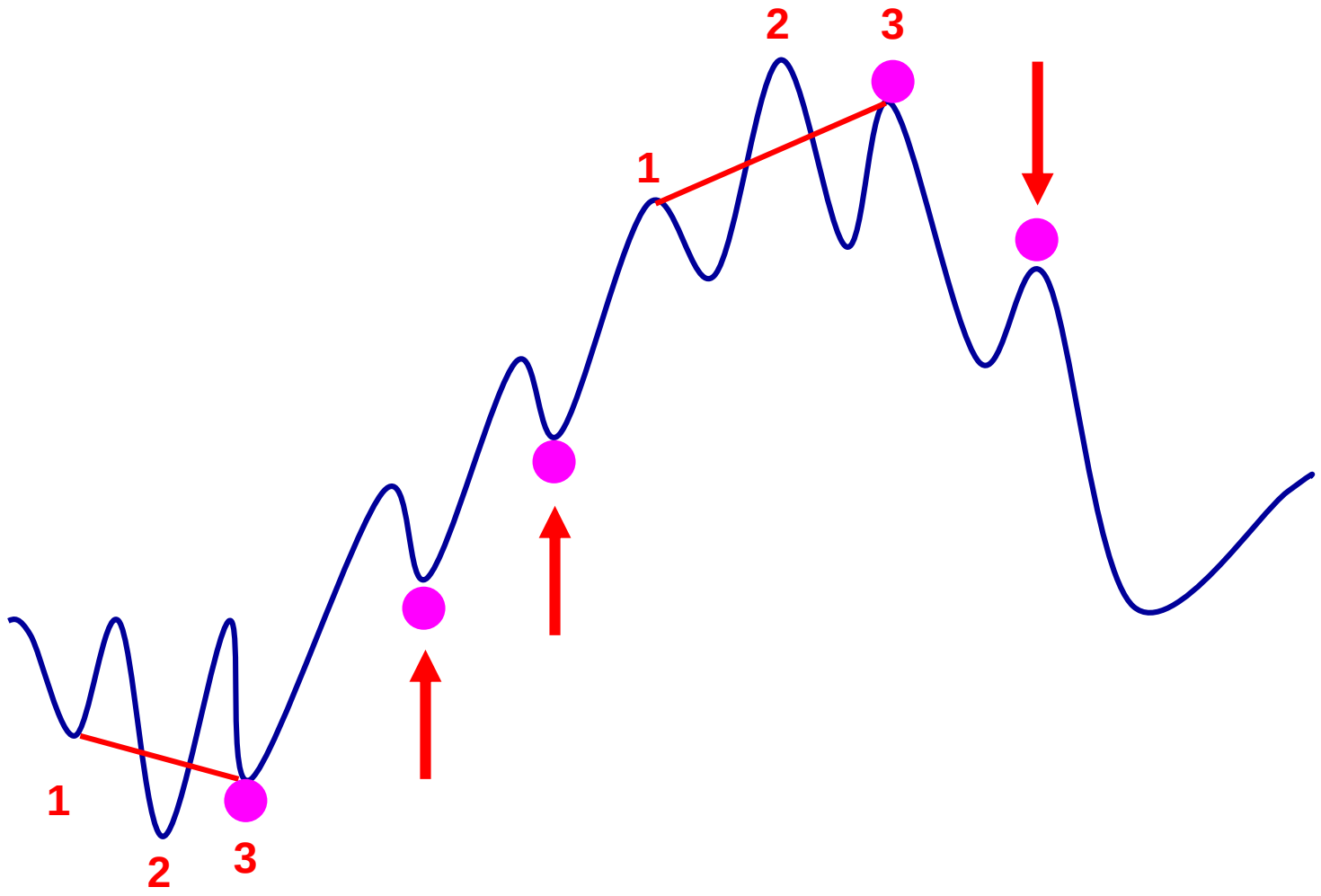
- Avoid new daily highs
- Avoid divergences with “air behind it”

Red Devil: “Air Behind It”



Dealing With the Trend

- Sweet Pea calls the trend with a triple divergence
- Trade the Red Devils until Sweet Pea Triple Divergence ends the trend



- **Sweet Pea calls the trend.**
- **Red Devils after the Triple Sweet Pea**

Conclusion

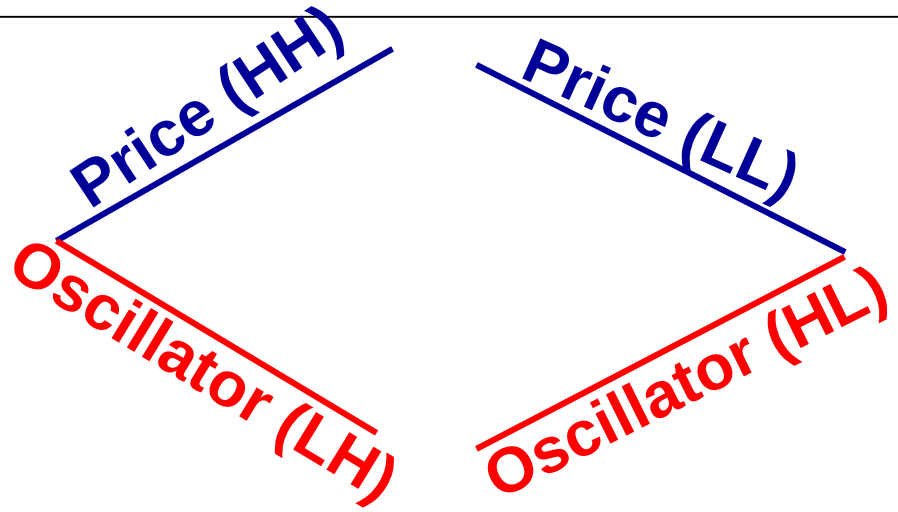
- The biggest problem with divergence analysis is to avoid fighting the trend.
  - Only trade pullbacks in the trend.
  - Use other tools to identify possible weakness in the trend leading to trend reversals.
  - Use Sweet Pea at trend reversals and Red Devils to trade the swing pullbacks after Sweet Pea defines the trend.

Two Types of Divergence

- Pivot Divergence – also known as Basic Divergence
- Trend Divergence – also known as Hidden Divergence

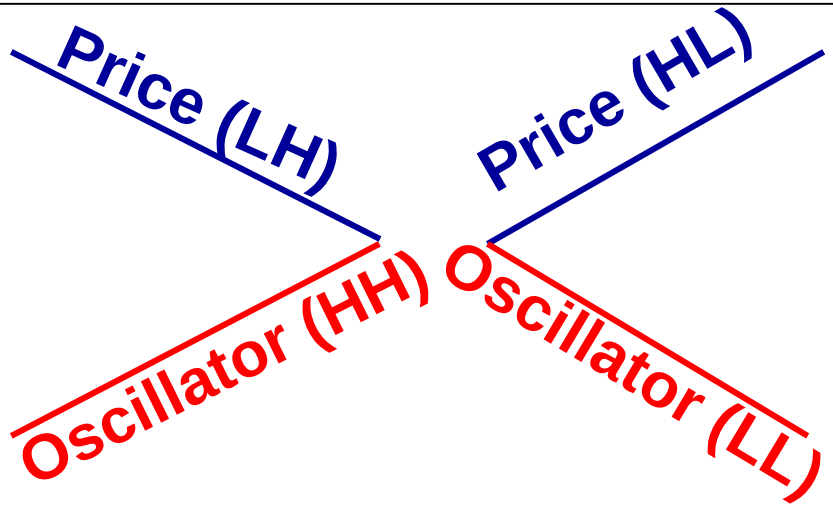
Pivot Divergence

- Suggests Potential Trend Reversal
  - Price makes Higher Highs (HH); Oscillator makes Lower Highs (LL)
  - Price makes Lower Lows (LH); Oscillator makes Higher Lows (HL)

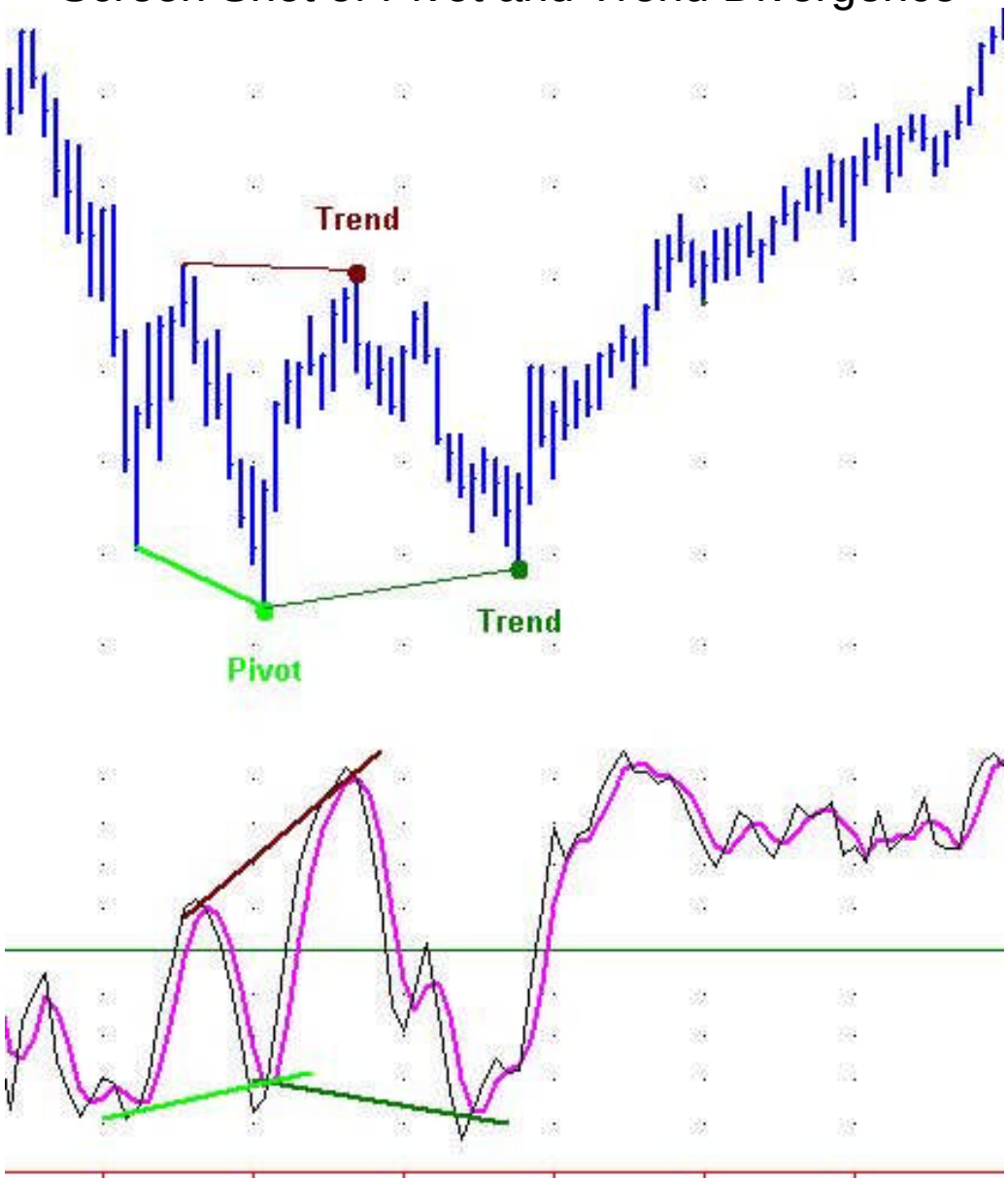


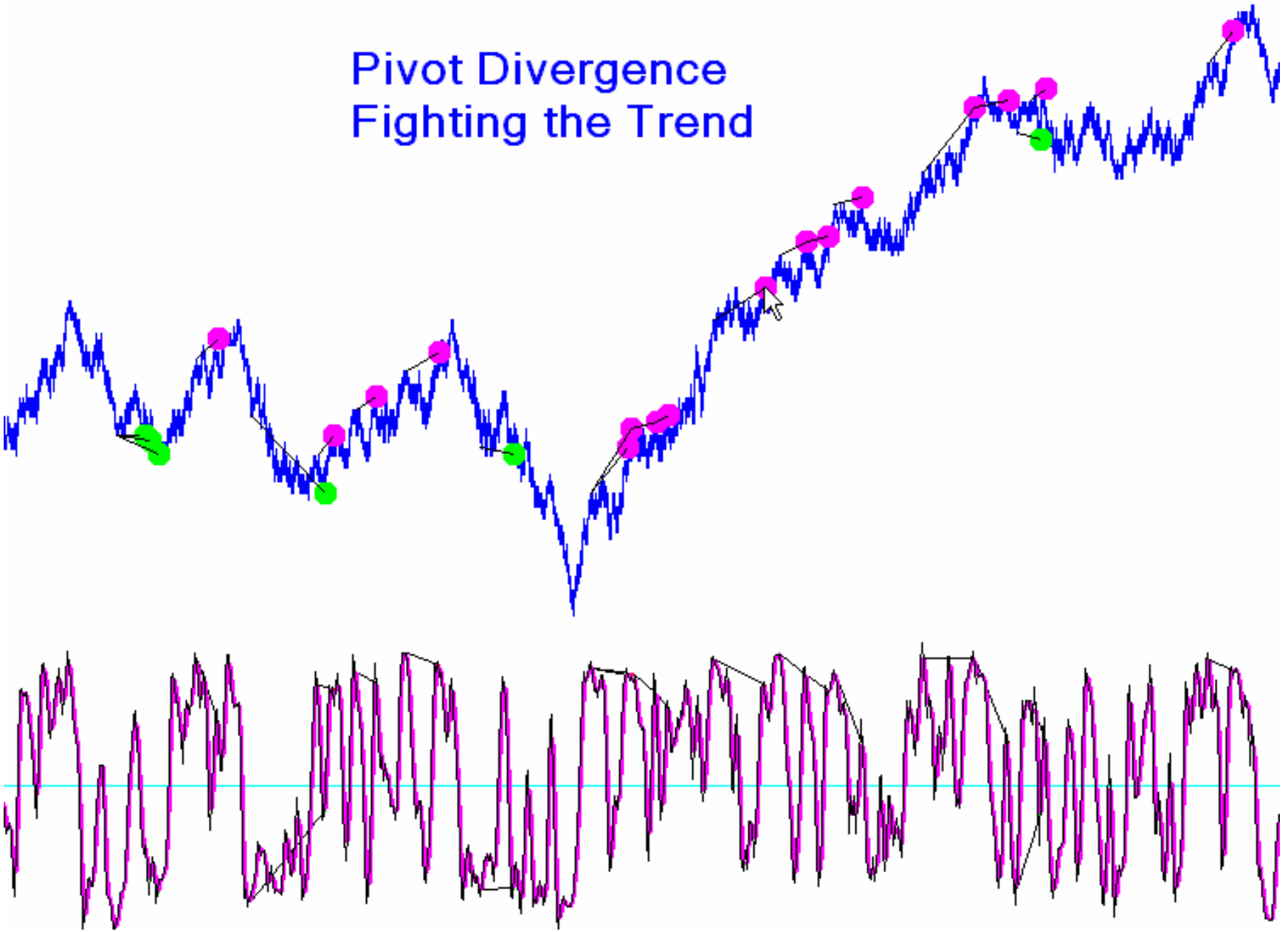
Trend Divergence

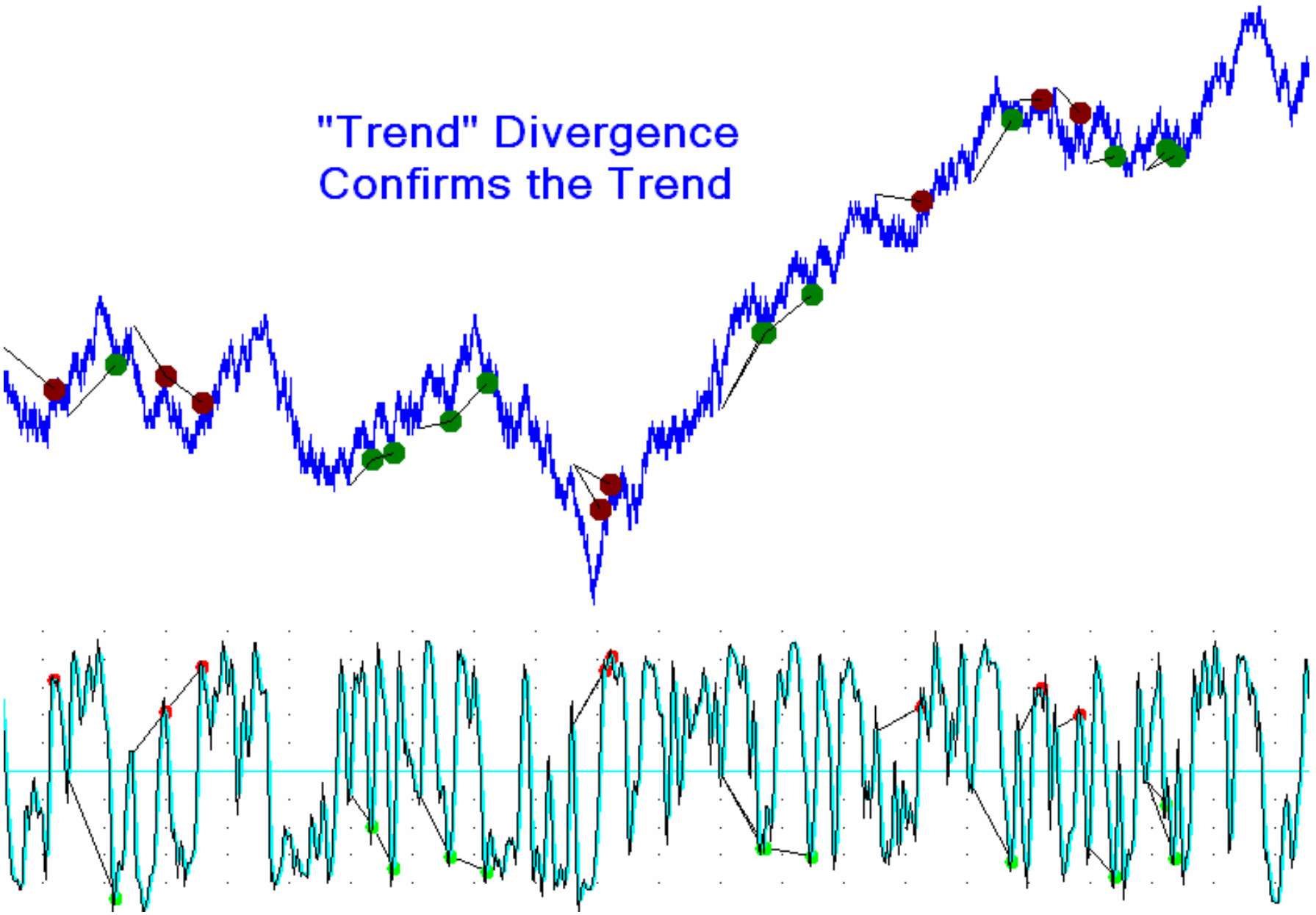
- Suggest Continuation of a Trend
- Price makes Lower Highs (LH); Oscillator makes Higher Highs (HH)
- Price makes Higher Lows (HL); Oscillator makes Lower Lows (LL)

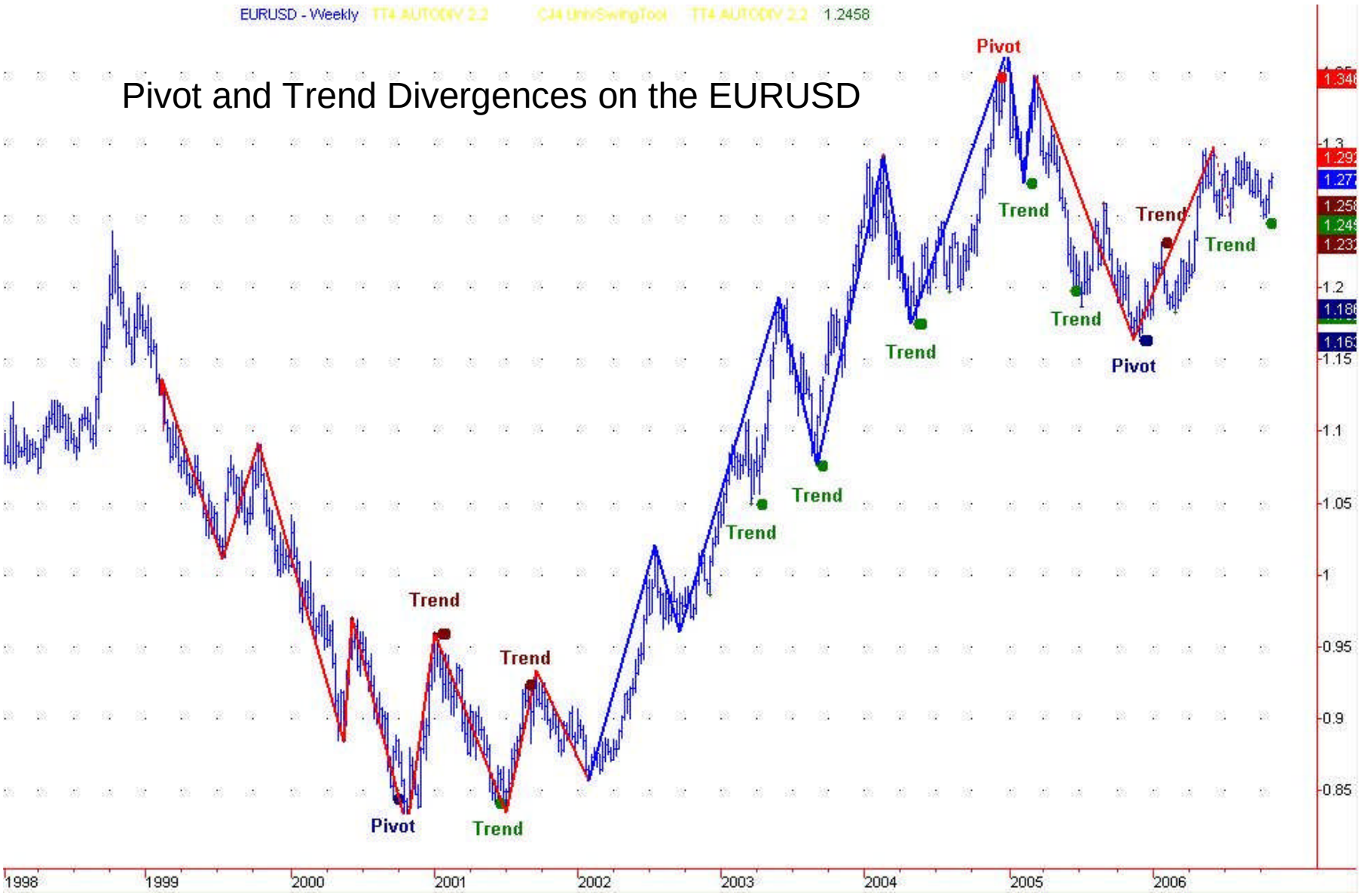


Screen Shot of Pivot and Trend Divergence




Pivot Divergence
Fighting the Trend


"Trend" Divergence
Confirms the Trend


EURUSD - Weekly
1.2458
Pivot and Trend Divergences on the EURUSD
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Pivot
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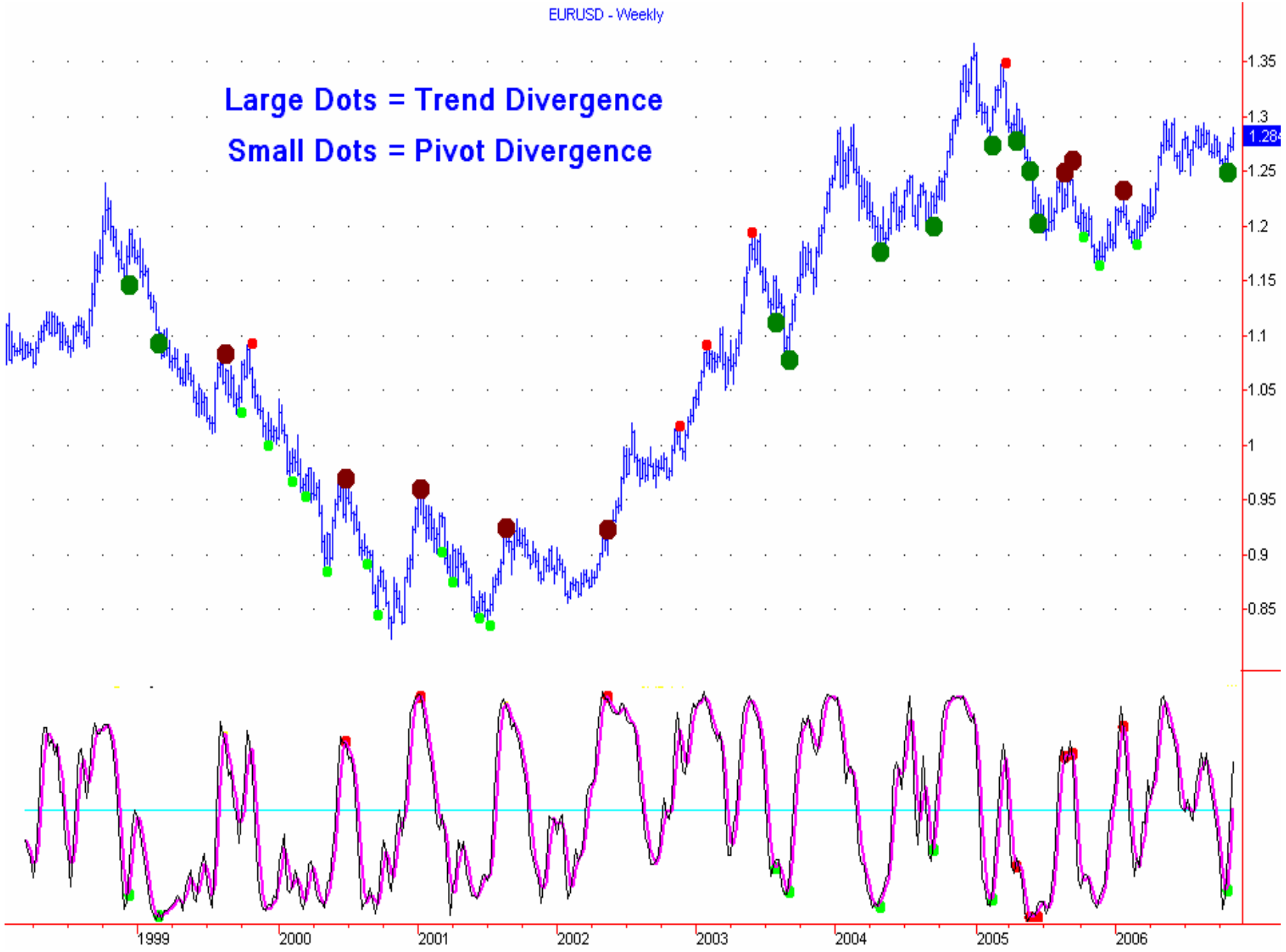
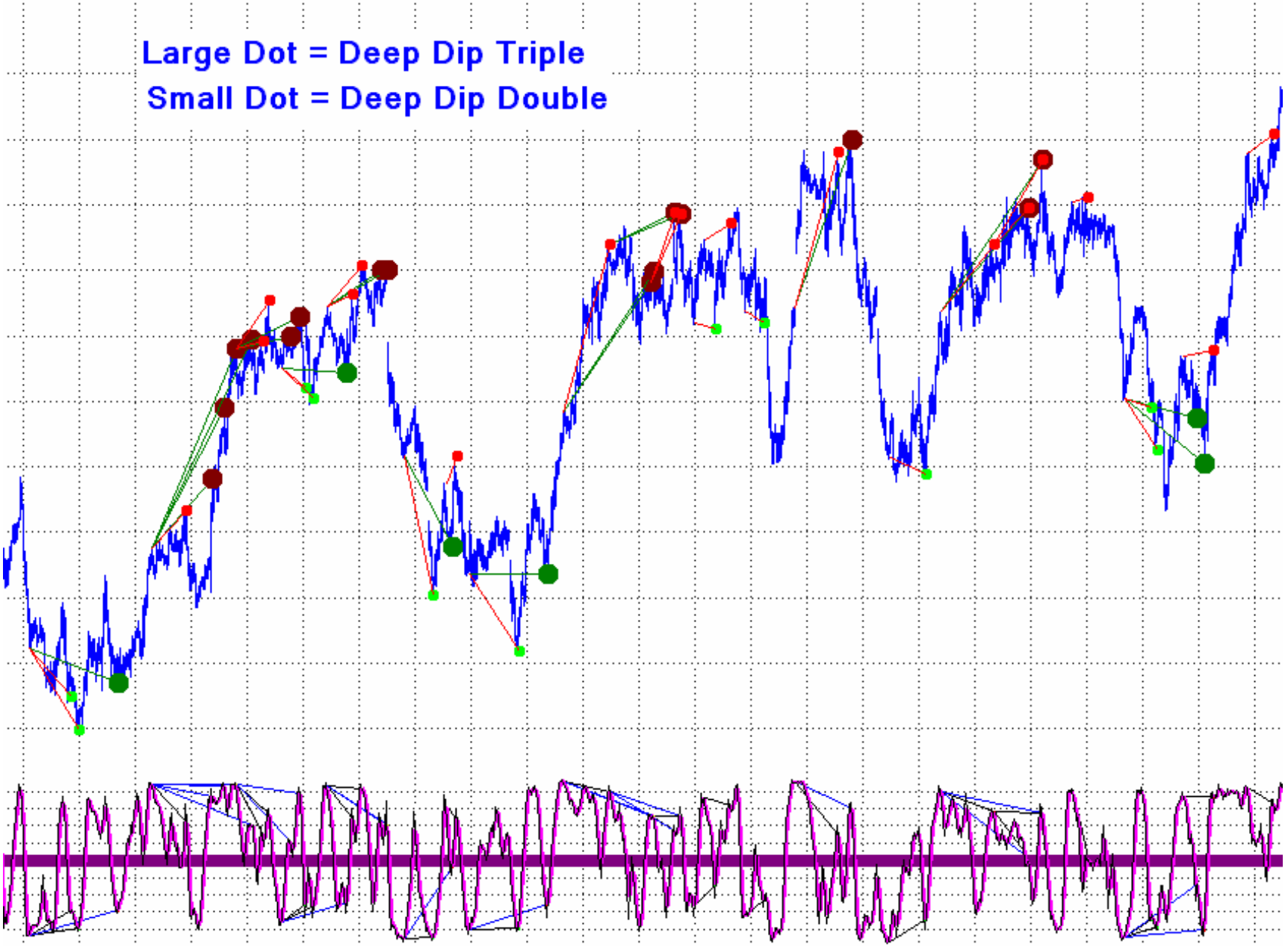
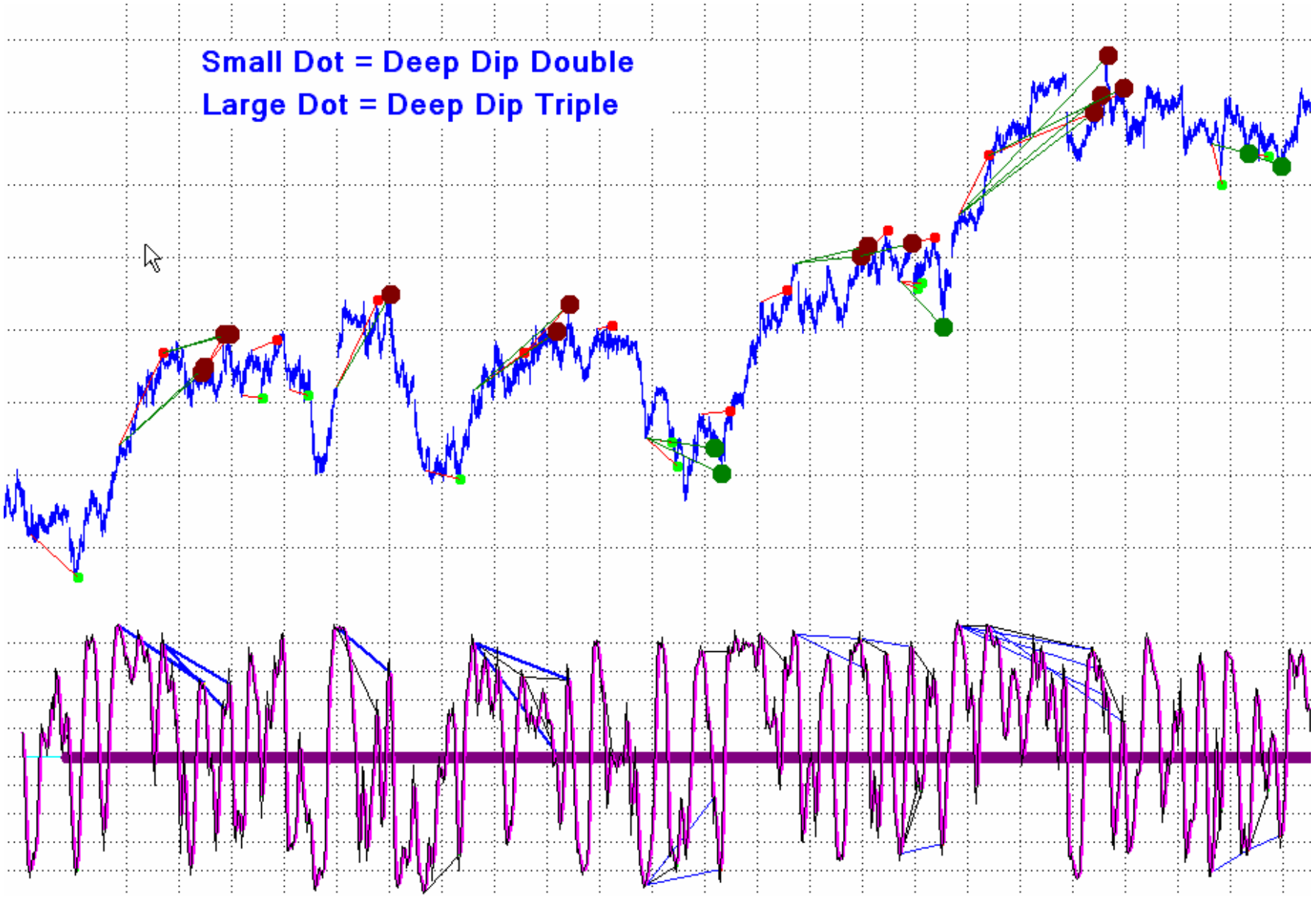
2005
2006

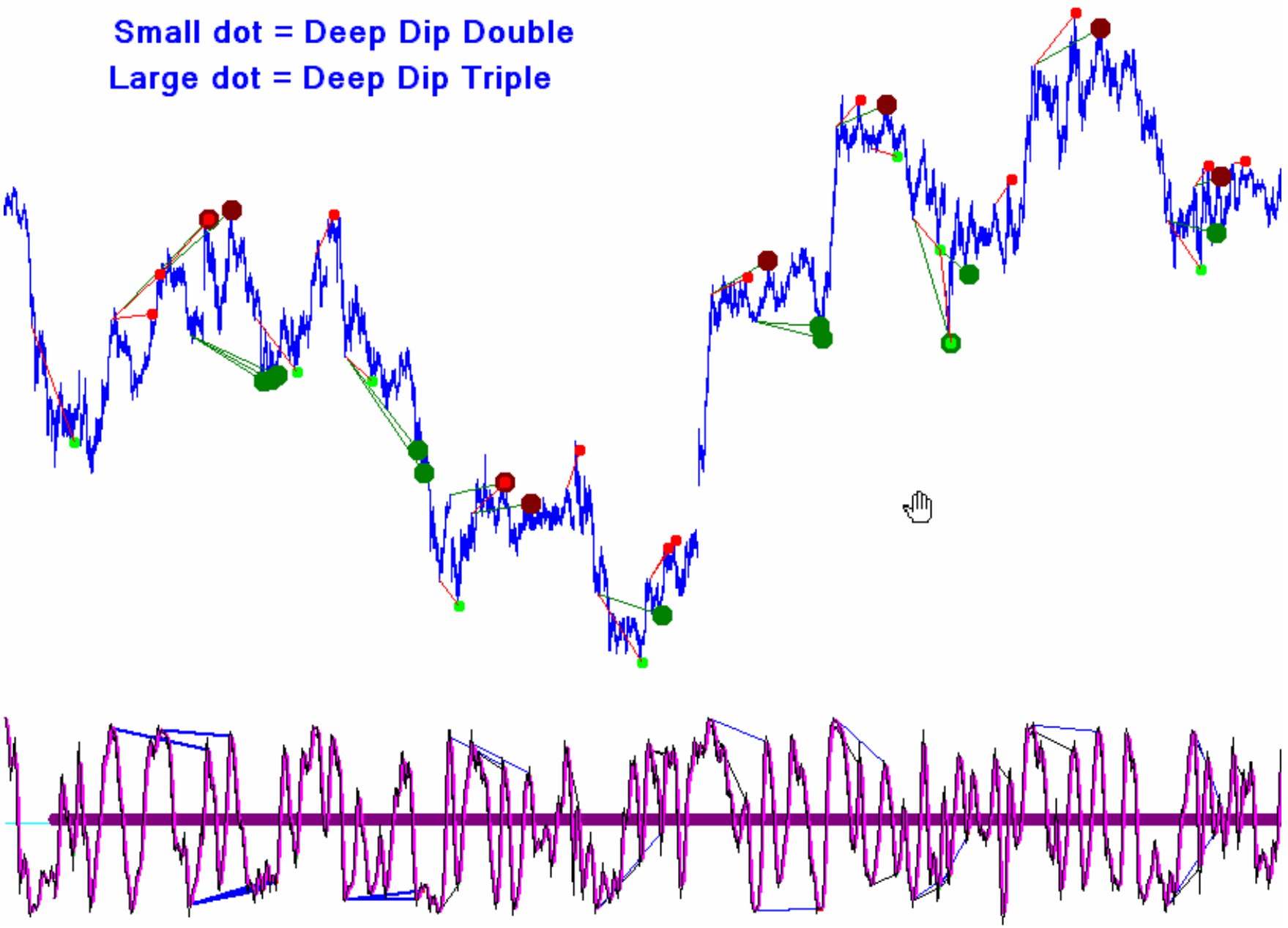

EURUSD - Weekly
Large Dots = Trend Divergence
Small Dots = Pivot Divergence
1.35
1.3
1.28
1.25
1.2
1.15
1.1
1.05
1
0.95
0.9
0.85
1999
2000
2001
2002
2003
2004
2005
2006

Conclusion:

- By turning standard divergence analysis “inside out” and looking for “Trend” or “Hidden” divergence patterns, we achieve a powerful ability to trade divergences in the direction of a strong trend.


Large Dot = Deep Dip Triple
Small Dot = Deep Dip Double


Small Dot = Deep Dip Double
Large Dot = Deep Dip Triple


Small dot = Deep Dip Double
Large dot = Deep Dip Triple