Divergence Trading Guide

Complete Framework for Price vs. Indicator Divergence

Introduction

Divergence occurs when price and an indicator move in opposite directions. It's one of the most reliable warning signals that a move may be exhausting.

This guide covers divergence identification, validation, and trading across multiple indicators.

Part 1: What Is Divergence?

Definition

Divergence is a disagreement between price action and an indicator reading. When they "diverge," it suggests the current price movement may not be sustainable.

Why Divergence Works

Price = What happened Indicator = Momentum/conviction behind it

When price makes new highs but momentum doesn't, fewer traders are driving the move. The move is losing steam.

Part 2: Types of Divergence

Regular Divergence (Reversal Signals)

Regular Bullish Divergence

```
Price:       \          Lower low
              \
Indicator:   /          Higher low
            /
```

Meaning: Selling pressure decreasing **Signal:** Potential reversal up
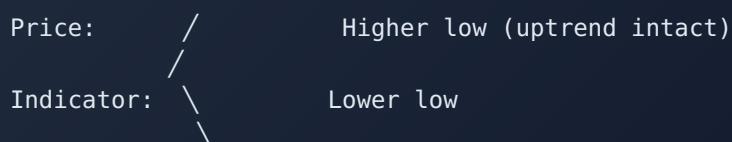
Regular Bearish Divergence

```
Price:       /          Higher high
            /
Indicator:  \           Lower high
             \
```

Meaning: Buying pressure decreasing **Signal:** Potential reversal down

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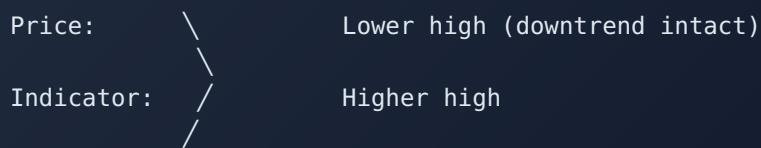
Hidden Divergence (Continuation Signals)

Hidden Bullish Divergence

```
Price:       /          Higher low (uptrend intact)
            /
Indicator:  \           Lower low
             \
```

Meaning: Pullback absorbed, buyers still present **Signal:** Trend continuation up

Hidden Bearish Divergence

```
Price:      \          Lower high (downtrend intact)
             \
Indicator:   /          Higher high
            /
```

Meaning: Rally absorbed, sellers still present **Signal:** Trend continuation down

Summary Table

TYPE	PRICE	INDICATOR	SIGNAL
Regular Bullish	Lower low	Higher low	Reversal up
Regular Bearish	Higher high	Lower high	Reversal down
Hidden Bullish	Higher low	Lower low	Continue up
Hidden Bearish	Lower high	Higher high	Continue down

Part 3: Indicators for Divergence

Most Common Divergence Indicators

INDICATOR	DIVERGENCE QUALITY	BEST FOR
RSI	Excellent	Overbought/oversold extremes
MACD	Very good	Momentum divergence
Stochastic	Good	Shorter-term divergence
OBV/Plutus Flow	Excellent	Volume-based divergence
CVD (Delta)	Very good	Order flow divergence
Harmonic Oscillator	Very good	Multi-factor momentum

Signal Pilot Divergence Tools

Pentarch: - Not a divergence indicator directly - But TD often appears WITH divergence - WRN/CAP often appear WITH divergence

Plutus Flow: - OBV divergence detection - CVD (delta) divergence - Built-in divergence alerts

Harmonic Oscillator: - Vote-based momentum - Divergence when votes decrease while price extends

Part 4: Divergence Detection

Step 1: Identify Price Swings

You need clear swing highs/lows to compare.

```
For bullish divergence:
Find at least 2 clear swing lows

For bearish divergence:
Find at least 2 clear swing highs
```

Step 2: Compare to Indicator

Draw a line connecting the swing points on BOTH price and indicator.

```
Price:
    ————\
         \
          \———   ← Lower low

Indicator:
    ——————————   ← Higher or equal low (divergence!)
```

Step 3: Validate the Divergence

Not all divergences are tradeable. Apply filters:

FILTER	REQUIREMENT
Minimum swings	At least 2, ideally 3
Time span	10+ bars between swings
Indicator extreme	Should be at or near extreme (30/70+)
Obvious visually	If you have to squint, it's not valid

Part 5: Divergence Quality Assessment

Strong Divergence Characteristics

FACTOR	STRONG	WEAK
Number of swings	3+ swings	2 swings only
Time span	20+ bars	5-10 bars
Indicator level	At extremes (80+/20-)	Mid-range (40-60)
Trend context	Counter to extended trend	Within choppy action
Volume	High volume on signals	Low volume
Multi-indicator	Multiple indicators diverge	Single indicator

Divergence Quality Score

Rate each factor 1-5:

FACTOR	SCORE	NOTES
Swing count	___	2 swings = 1-2, 3+ = 4-5
Time span	___	<10 bars = 1-2, 20+ = 4-5
Indicator extreme	___	At 30/70 = 4-5, at 50 = 1-2
Trend exhaustion	___	Extended trend = 4-5
Volume support	___	High vol = 4-5
Total	___/25	

Interpretation: - 20-25: High quality, trade aggressively - 15-19: Good quality, standard trade - 10-14: Moderate, reduce size - <10: Weak, avoid or wait

Part 6: Trading Divergence

The Cardinal Rule

Divergence is a WARNING, not an entry signal.

You must wait for price confirmation before entering.

Confirmation Methods

CONFIRMATION	DESCRIPTION
Candle pattern	Hammer, engulfing, star at the divergence point
Trendline break	Price breaks micro trendline
Indicator cross	RSI crosses above 30, MACD cross, etc.
Pentarch signal	TD fires (bullish) or WRN fires (bearish)
Price level reclaim	Price closes back above/below key level

Entry Strategy

```
1. Identify divergence
2. Wait for confirmation signal
3. Enter on confirmation close
4. Stop below divergence low (bullish) or above high (bearish)
5. Target 2R or structure level
```

Part 7: Stop Loss & Targets

Stop Placement

For bullish divergence:

```
    Stop = Below the lowest low in the divergence pattern
    Buffer = Add 0.5-1 ATR below that level
```

For bearish divergence:

```
    Stop = Above the highest high in the divergence pattern
    Buffer = Add 0.5-1 ATR above that level
```

Target Setting

Method 1: Fixed R:R

```
    Target = 2R or 3R from entry
```

Method 2: Structure-Based

```
    Target = Previous swing high/low
    Target = Key support/resistance level
```

Method 3: Measured Move

```
    Target = Distance of the divergence range projected
```

Part 8: Multi-Timeframe Divergence

Why Multi-TF Matters

Divergence on higher timeframes is more significant.

YOUR TRADING TF	CHECK DIVERGENCE ON
5m	15m, 1H
15m	1H, 4H
1H	4H, Daily
4H	Daily, Weekly

Multi-TF Strategy

Best setup: 1. HTF shows divergence (Daily) 2. Intermediate TF shows divergence (4H) 3. Trading TF gives entry signal (1H) 4. = High conviction trade

Example: - Daily RSI bearish divergence forming - 4H MACD showing bearish divergence - 1H: Wait for Pentarch WRN or breakdown - = Short with confidence

Part 9: Divergence Across Indicators

RSI Divergence

Characteristics: - Works best at extremes (below 30, above 70) - 14-period standard - Very reliable at major turning points

Adjustment for trends: - In uptrends, look for divergence at higher range (50-80) - In downtrends, look for divergence at lower range (20-50)

MACD Divergence

Characteristics: - Uses MACD histogram or signal line - Slightly lagging but reliable - Good for swing trading timeframes

Best practice: - Compare histogram peaks, not just crosses - Look for decreasing histogram with increasing price

Plutus Flow (OBV/CVD) Divergence

Characteristics: - Volume-based, very reliable - Shows actual buying/selling conviction - Often leads price

Best practice: - OBV divergence is powerful at major levels - CVD divergence shows real-time buyer/seller exhaustion

Harmonic Oscillator Divergence

Characteristics: - Multi-factor momentum - Vote count can diverge from price - Useful for confirmation

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Part 10: Common Mistakes

Mistake 1: Trading Divergence Alone

Problem: Enter as soon as divergence appears **Reality:** Divergence can persist for many bars **Fix:** Always wait for price confirmation

Mistake 2: Ignoring the Trend

Problem: Regular bullish divergence in strong downtrend **Reality:** First divergence often fails in strong trends **Fix:** Use hidden divergence with trend, or wait for trend break

Mistake 3: Forcing Divergence

Problem: Adjusting swing points to "find" divergence **Reality:** If it's not obvious, it's not valid **Fix:** Divergence should be visually clear

Mistake 4: Wrong Timeframe

Problem: Trading 1m divergence for a swing trade **Reality:** Lower TF divergence is noisy **Fix:** Match divergence TF to trade duration

Mistake 5: Single Indicator

Problem: Only using one indicator for divergence **Reality:** Multiple divergences = stronger signal **Fix:** Confirm with 2+ indicators

Part 11: Divergence + Signal Pilot

Pentarch + Divergence

DIVERGENCE	PENTARCH CONFIRMATION
Bullish divergence	TD fires
Bullish divergence	No signal
Bearish divergence	WRN or CAP fires
Bearish divergence	No signal

Janus Atlas + Divergence

DIVERGENCE	JANUS CONFIRMATION
Bullish divergence	Sweep of lows
Bearish divergence	Sweep of highs

Plutus Flow Built-In

Plutus Flow has divergence detection: - Automatically marks divergences - Shows OBV vs price divergence - Shows CVD vs price divergence - Alert options for divergence

Part 12: Divergence Checklist

Identification Checklist

- [ ] At least 2 clear swing points identified
- [ ] Price and indicator moving in opposite directions
- [ ] Divergence is visually obvious (no squinting)

- [ ] Indicator at or near extreme levels
- [ ] 10+ bars between swing points

Validation Checklist

- [ ] Current trend is extended (room to reverse)
- [ ] Higher timeframe doesn't contradict
- [ ] Multiple indicators showing divergence (ideal)
- [ ] Volume supports the divergence thesis

Entry Checklist

- [ ] Price confirmation present (candle pattern, signal)
- [ ] Entry price defined
- [ ] Stop loss placed beyond divergence extreme
- [ ] Position sized appropriately
- [ ] Target defined (structure or R-based)

Part 13: Summary

Core Divergence Principles

1. **Divergence = Warning, not signal** — Wait for confirmation
2. **Quality matters** — Not all divergences are equal
3. **Higher TF = More reliable** — Daily divergence > 5m
4. **Multiple confirmations** — More indicators = stronger
5. **Trend context matters** — First divergence in trend often fails

The Divergence Trader's Mindset

```
"Price makes a new high, but momentum doesn't. Something's wrong."

"I see divergence. Now I wait for the market to confirm it."

"Divergence is a clue, not a command."

"The best divergence setups are obvious."
```

Quick Reference

```
REGULAR DIVERGENCE = REVERSAL WARNING
- Bullish: Lower low price, higher low indicator
- Bearish: Higher high price, lower high indicator

HIDDEN DIVERGENCE = CONTINUATION SIGNAL
- Bullish: Higher low price, lower low indicator
- Bearish: Lower high price, higher high indicator

ALWAYS WAIT FOR CONFIRMATION
```

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