Divergence

Divergence highlights the relationship between a pair or groups of pairs. It is an easy way of spotting possible strength or weakness among similar asset classes (or different when running a macro analysis). Little to no divergence indicates that the pair is moving in unison with good strength. A divergence suggests that the pair is beginning to lose this unison and is drifting apart.

An easy way to think about this, is to view asset classes as siblings. For example, when you think of $SPY, you associate it with $QQQ. For futures, the same holds true for $ES + $NQ (and $YM …ew). These siblings for the most part, like to move together, but there will be times when they drift apart. This phenomenon is what we call **divergence**. This divergence hints to us a possible reversal might be in play for the pair (the current trend is ending). This divergence is all called smart money technique (SMT) or smart money reversal (SMR).

Why is this important?

→ it helps you identify when there is a reversal in play, when should you be adding or selling into mmxm, playing key levels with confidence, identifying strong structural components of the trend.

How do you determine the importance?

Lets add one more step to the checklist:

→ HTF PoI

→ Liquidity

→ DIVERGENCE*

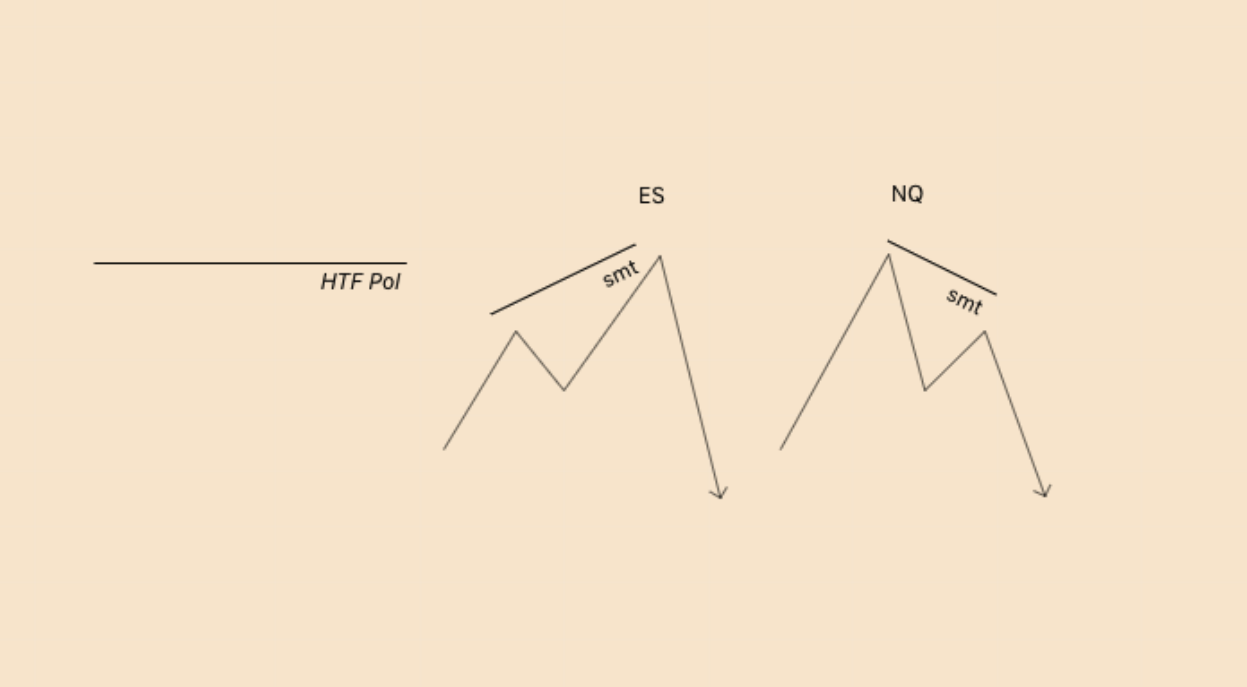
→ Displacement

→ Structure

What does divergence look like?

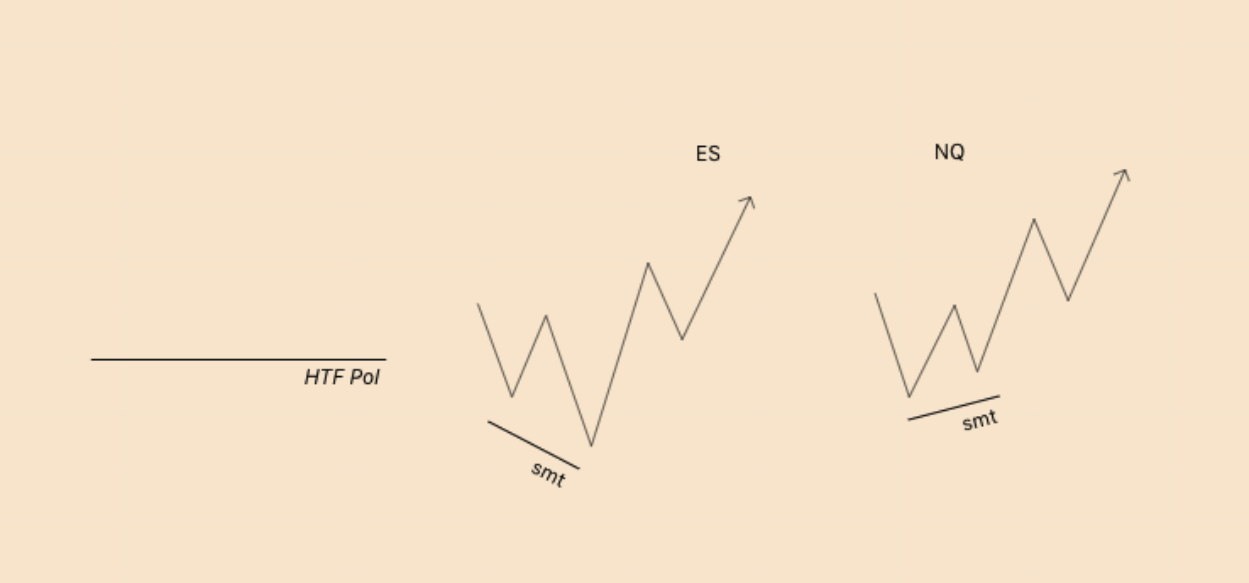
In the pair of interest - for this PDF, $ES and $NQ will be used - you will look for one of the siblings to make a higher high or lower low, while the other sibling fails to do so. Then displacement will guide whether or not a specific mmxm is underway. It's that easy.

Bearish SMT divergence favouring $NQ to the downside:



$ES makes a higher high at our HTF PoI (recall from our MMXM lesson these may be) while $NQ fails to do so.

Bullish SMT divergence favouring $NQ to the upside:



$ES makes a lower low at our HTF PoI while $NQ fails to do so.

These templates highlight SMT divergence. Your confirmation will always come from displacement and market structure.

Lets take a look at some simple examples:

Bearish Divergence

Daily chart showcasing a bearish divergence favouring $NQ to the downside (although $ES can be taken too). $ES manages to take out liquidity and put in a significantly higher high in comparison to $NQ.

Bullish Divergence

Daily chart showcasing a bullish divergence favouring $ES to the upside. $ES takes out liquidity and immediately begins to start an upwards trend putting in higher lows in comparison to $NQ. $NQ struggles to get back above the original HTF PoI. By the time it does, $ES has already made two higher lows.

If you combine SMT divergence with quarterly and seasonal shifts, this can give you a large edge in your trading (especially if you area swing trader). You can use this concept on any timeframe, with larger time frames providing a higher probability setup. One key thing to note, just because there is a divergence present, it does not mean there is a good trade present. Always wait for displacement and your market structure shift to guide your ideas!