Understanding Technical Analysis : Relative Strength Index (RSI)

Understanding Relative Strength Index

Relative Strength Index (RSI) is a technical indicator that is categorised under momentum indicator. Basically, all momentum indicators measures the rate of rise and fall of the financial instrument's price. Usually, momentum indicators are dependent indicators as they are best used with other indicators since they do not tell the traders or analysts the potential direction of the financial instrument. Among the popular type of momentum indicators are Stochastic Indicator, Commodity Channel Index and Relative Strength Index. In this factsheet, we will explore the Relative Strength Index or better known as RSI.

What is RSI?

- Developed by J. Welles Wilder Jr. in his seminal 1978 book, "New Concepts in Technical Trading Systems."
- Measures the speed and change of price movement of the financial instruments.
- As RSI is a type of oscillator, this indicator is represented as a set of line that has values from 0 to 100.
- Generally, a reading below 30 indicates an oversold condition, while a value above 70 signals an overbought condition.

Leading vs Lagging Indicator

RSI is a leading type of indicator. A leading type of indicator is an indicator that can provide the traders or analyst with future price movement. Another example of leading indicator is Stochastic Indicator.

In contrast, a lagging indicator is an indicator that follows the price movement of the financial instruments. Despite their lagging nature in providing trading signals, traders or analysts prefer to use lagging indicators as they are more reliable. An example of lagging indicator is MACD.

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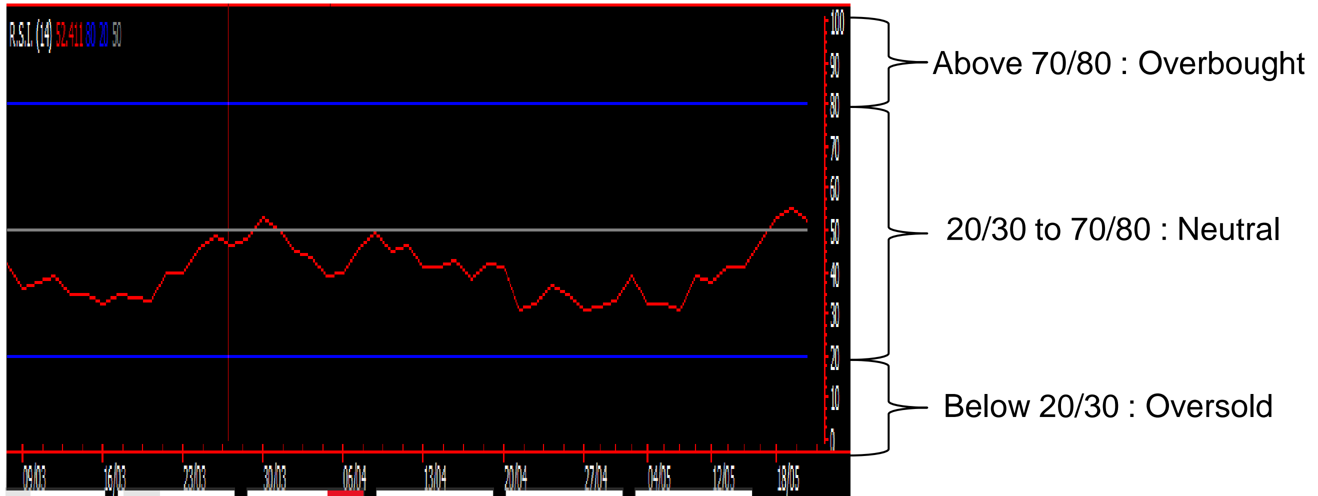
How to Read RSI?

The RSI graph is divided into three zones or regions which are the zone below 20 or 30, the zone between 20 or 30 to 70 or 80 and the zone above 70 or 80.



Overbought is a condition that imply the price of the financial instrument was too far up and a price pullback is expected. As explained before, the financial instrument is considered overbought when RSI is above 70 or 80, which is a sign of a possible trend reversal. Traders can use this oscillator and wait until the RSI falls below the 70 or 80 level to take a short position.

On the other hand, oversold is a condition when the price of the financial instrument was too far down and a price bounce is expected. When the RSI hit the reading below 20 or 30, the financial instrument is viewed as oversold. Traders may consider to take a long position when the RSI rises above 20 or 30 in view the price is accelerating.

Other info on RSI

- RSI indicator can stay in both overbought and oversold region for number of periods when the market is on uptrend or downtrend respectively.
- This might provide some challenges to traders or analysts to gauge a clear market trend.
- In view of this, RSI is often used with other type of lagging indicator which is usually the MACD indicator to provide the traders or analysts a better picture of the potential next price movement.

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