

THE RSI TECHNICAL INDICATOR

What is RSI?

Relative Strength Index or RSI is a price momentum oscillator used widely in Technical Analysis of stock prices. This series strives to explain practical application of RSI without going into nuance of mathematics in constructing RSI.

RSI being a momentum oscillator measures the momentum in price and oscillates within a predefined range of 100 to 0. High reading implies strong positive momentum and low reading suggests strong negative momentum. However RSI values are relative to stock trend and hence higher RSI value in a sideways market indicates overstretched price whereas higher RSI value in Trending stock indicates strong momentum.

Thus RSI should be applied in conjunction with the current state of stock as RSI behaves differently in trending stock and in range bound stock as shown below through examples.

RSI Behaviour in Sideways stock

Weekly Chart of ACC



- ❖ Above chart shows price movement of ACC from March 2014 till May 2020.
- ❖ Most of the time Price movement was confined within a Range as highlighted by horizontal lines.
- ❖ It is observed that Price reversed from upper horizontal line when RSI reached values of 60- 70.
- ❖ Price reversed from lower horizontal line when RSI reached values of 40-30.
- ❖ The upper band of 60-70 becomes Overbought levels for RSI which leads to Price correction.
- ❖ The lower band of 40-30 becomes Oversold levels for RSI which leads to Price rally.

RSI Behaviour in Trending stock

Weekly Chart of YES Bank



- ❖ Yes Bank weekly chart demonstrates how RSI can capture the Trending moves in stock.
- ❖ RSI went below 40 on 10th May when Price was 163.85 and remained below 40 throughout the down move which saw Price plummeting to 5.65 which was a decline of 96.55 %.
- ❖ Thus sustainable down move was captured by realizing that RSI will remain oversold in down move and thereby not considering the oversold levels as indication to jump into buying.

Summary

- ❖ RSI remains range bound in sideways market with generally 60-70 as upper band and 40-30 as lower band.
- ❖ RSI will remain in oversold range in down trending stock and will remain overbought in up trending stock.
- ❖ Thus RSI behaviour can provide insight into Trending/Trendless state of Stocks and Indices.