CHART CODE ACADEMY

Decode The Market Code

RSI INDICATOR

BEYOND OVERBOUGHT & OVERSOLD

What RSI actually measures, why treating 70/30 as simple sell/buy signals fails in strong trends, and how to read regular and hidden divergence — the real skill professionals use RSI for.

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Chart Code Academy — Stock Market Training Institute

Deepak Kevadia — Founder & Mentor, BSE NISM Certified

Boisar · Palghar · Maharashtra, India

www.chartcode.in | +91-95121 00588 | chartcode.in@gmail.com

About This Guide

RSI is one of the most widely used indicators in technical analysis, and also one of the most commonly misread. This guide goes beyond the textbook "70 overbought, 30 oversold" rule — covering how RSI actually behaves inside a trend, regular and hidden divergence explained with diagrams, RSI as a trend-strength tool, and how to combine it responsibly with price action.

It closes with the most common RSI mistakes and a five-point checklist to run through before acting on any RSI signal you spot.

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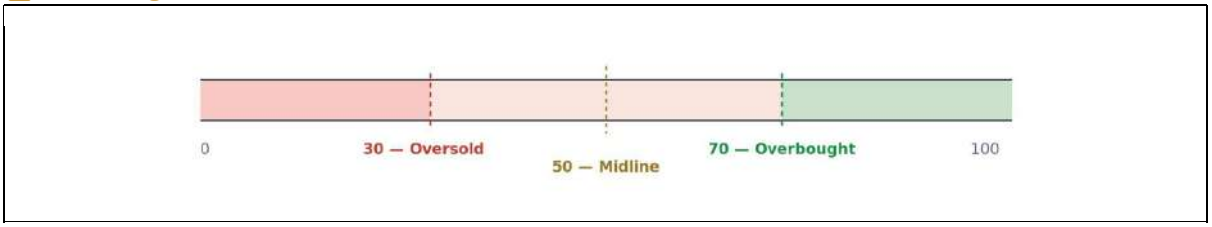
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What Is RSI and How Is It Calculated?

RSI, the Relative Strength Index, is a momentum oscillator that measures the speed and size of recent price changes on a scale of 0 to 100. It doesn't measure price itself — it measures how strongly and how quickly price has been moving, which is a genuinely different piece of information than the price chart alone gives you.

Under the hood, RSI compares the average size of recent up-moves to the average size of recent down-moves over a set number of periods — 14 periods by default. A stock that's been rising steadily with few, small pullbacks produces a high RSI reading; one that's been falling sharply with few bounces produces a low one.

Visualising It: The RSI Scale



RSI oscillates between 0 and 100, with 70 and 30 marked as the traditional overbought and oversold thresholds, and 50 as the midline.

The Basic Overbought/Oversold Read — And Why It's Not Enough Alone

The textbook introduction to RSI says: above 70 means overbought, sell; below 30 means oversold, buy. It's not wrong exactly — but treated as a standalone rule, it's one of the most reliably costly mistakes a beginner can make with this indicator.

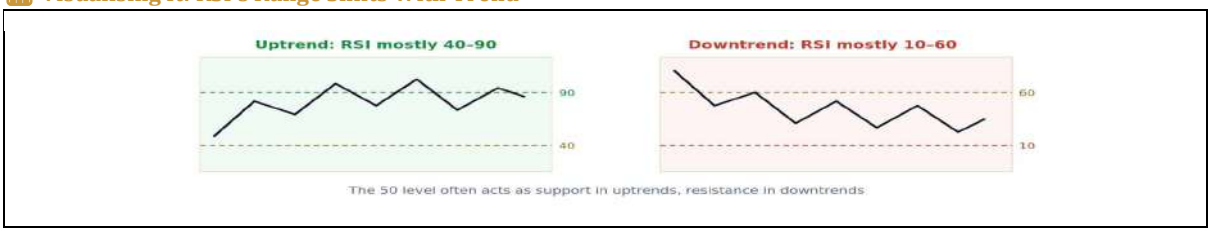
> **THE PROBLEM IN ONE SENTENCE**
>
> RSI can stay above 70 for a long stretch during a genuinely strong uptrend, and selling every time it crosses 70 means repeatedly exiting — or shorting into — one of the strongest trends on the chart.

The fix isn't to throw out overbought/oversold entirely — it's to stop reading it in isolation, and start reading RSI the way this guide covers next: in the context of the prevailing trend, and alongside divergence, which is a far more nuanced and genuinely useful signal than a simple threshold cross.

Reading RSI in a Trend, Not Just a Range

One of the most underused ideas in RSI analysis: the indicator tends to trade in a different range depending on the underlying trend, and that shifted range itself is useful information.

Visualising It: RSI's Range Shifts With Trend

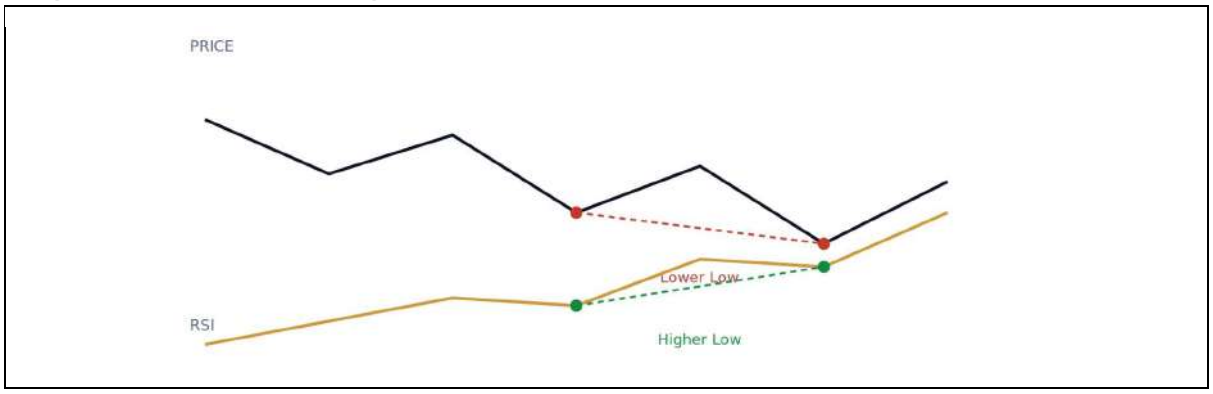


During a strong uptrend, RSI tends to oscillate mostly between 40 and 90; during a strong downtrend, mostly between 10 and 60.

A genuinely useful practical rule follows from this: in an uptrend, watch how RSI behaves around the 40–50 zone on pullbacks — holding above it is a sign of trend health, while a clean break below can be an early warning the trend is weakening. The same logic applies in reverse for downtrends around the 50–60 zone.

Bullish Divergence

Regular Bullish Divergence POTENTIAL REVERSAL (UP)



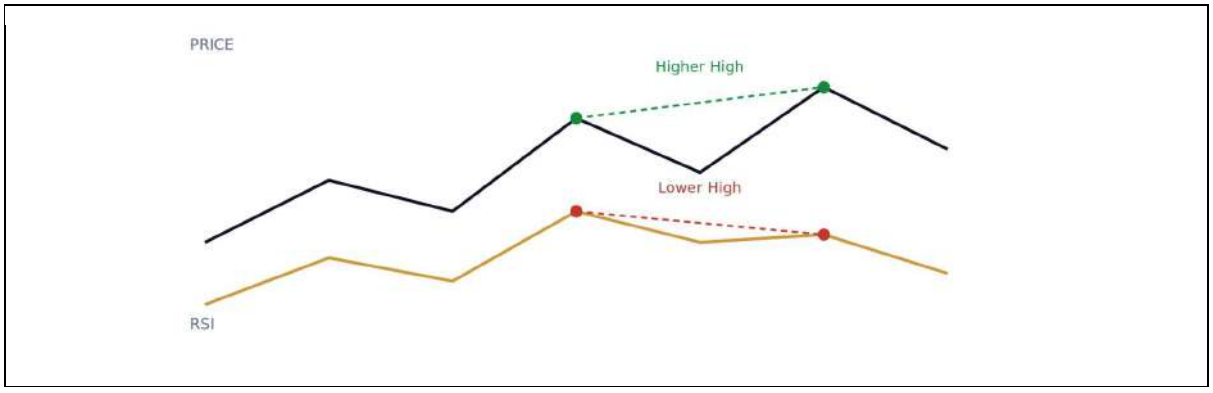
Price makes a new, lower swing low, but RSI makes a higher low at the same time — momentum to the downside is quietly weakening even as price prints a fresh low. This disagreement between price and momentum is a classic early warning that a downtrend may be losing strength.

HOW TO READ IT

Divergence alone is a warning sign, not an entry trigger — many traders wait for a confirming candle or a break of a short-term trend line before acting.

Bearish Divergence

Regular Bearish Divergence POTENTIAL REVERSAL (DOWN)



The mirror image: price makes a new, higher swing high, but RSI makes a lower high — upward momentum is quietly fading even as price prints a fresh high. This is a classic early warning that an uptrend may be running out of steam.

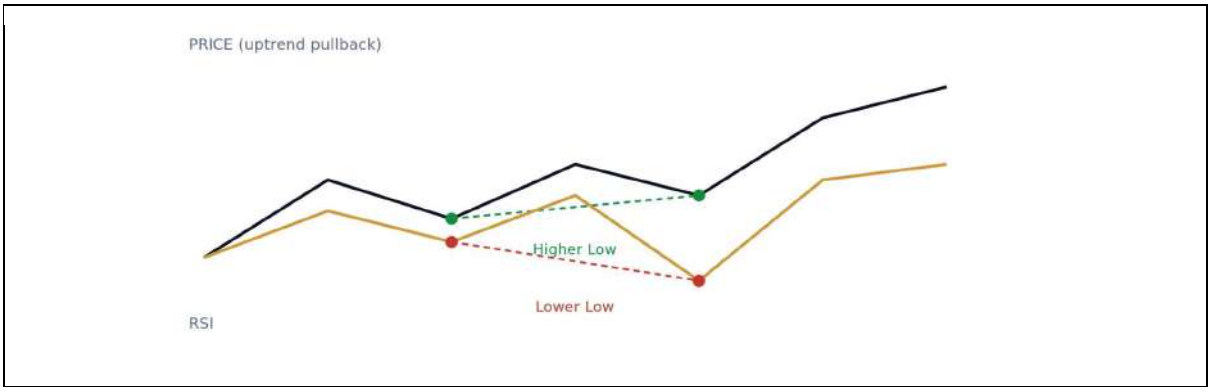
HOW TO READ IT

Just like bullish divergence, treat this as a caution flag to tighten risk management on existing longs, not an automatic signal to short.

Hidden Divergence — The Continuation Signal Most Beginners Miss

While regular divergence hints at a potential reversal, **hidden divergence** works the other way around — it hints that the existing trend is likely to continue. It's less commonly taught, which is exactly why recognising it is a genuine edge.

Hidden Bullish Divergence POTENTIAL CONTINUATION (UP)



During an established uptrend, price makes a shallower pullback (a higher low), but RSI dips to a lower low on that same pullback — momentum looks weaker than price does, yet the trend structure itself hasn't

broken. This is often read as a sign the pullback is just a pause, not a reversal, and the uptrend is likely to continue.

HOW TO READ IT

Hidden bullish divergence appearing near a known support zone, within a clear uptrend, is generally considered a stronger continuation signal than the same shape appearing in choppy, directionless price.

THE MIRROR VERSION, BRIEFLY

Hidden bearish divergence works the same way in reverse: during a downtrend, price makes a weaker bounce (a lower high), while RSI makes a higher high on that bounce — a sign the downtrend is likely to resume.

Type	Price Action	RSI Action	Typical Signal
Regular Bullish	Lower low	Higher low	Possible reversal up
Regular Bearish	Higher high	Lower high	Possible reversal down
Hidden Bullish	Higher low	Lower low	Possible continuation up
Hidden Bearish	Lower high	Higher high	Possible continuation down

Using RSI as a Trend-Strength Tool

Instead of asking "is RSI overbought?", a more useful question in a trending market is often "is RSI still confirming the trend?" A simple, practical framework many traders use:

- **RSI consistently above 50** — generally supportive of an ongoing uptrend.
- **RSI consistently below 50** — generally supportive of an ongoing downtrend.
- **RSI oscillating tightly around 40–60** — often reflects a genuinely range-bound, directionless market.

Read this way, RSI stops being a simple "too high, too low" gauge and becomes a rolling health check on the trend itself — arguably a more durable use of the indicator than chasing every overbought or oversold cross.

RSI Settings & Timeframes

Setting	Effect	Trade-off
Shorter period (e.g., 9)	More sensitive, reacts faster to price changes	More signals, but also more false ones
Default period (14)	The most widely used, balanced setting	A reasonable default across most timeframes
Longer period (e.g., 21–25)	Smoother, slower to react	Fewer false signals, but also more lag

There's no single "correct" period — it's a genuine trade-off between sensitivity and reliability, and many traders simply stick with the default 14-period setting across timeframes rather than constantly tweaking it.

Combining RSI With Price Action

RSI is derived entirely from price, which means it will never tell you anything price itself hasn't already hinted at — its real value is in making that hint easier to see, not in replacing chart reading altogether. RSI divergence appearing right at a known support or resistance zone carries meaningfully more weight than the same divergence appearing in open, unstructured space.

📌 Combining RSI divergence with support/resistance and trend context, instead of trading it in isolation, is exactly the kind of layered reading we build hands-on in our structured courses at Chart Code, offline in Boisar or live online anywhere in India.

Common RSI Mistakes

01
Selling every overbought reading
Exiting or shorting purely because RSI crossed 70, without checking whether a strong trend is still intact.

02
Trading divergence with no confirmation
Acting the instant divergence appears, instead of waiting for a confirming candle or structural break.

03
Confusing regular and hidden divergence
Mixing up a reversal signal with a continuation signal leads to trading in exactly the wrong direction.

04
Using RSI completely alone
Treating RSI as a standalone system, without any support/resistance or trend context to confirm it.

05
Constantly changing the period setting
Switching RSI settings after every losing trade, chasing a "perfect" configuration that doesn't exist.

06
Ignoring the broader trend entirely
Reading RSI the same way in a strong trend as in a sideways range, when the healthy range genuinely shifts.

Your RSI Reading Checklist

Before acting on any RSI signal, run through this five-point check:

✓ **Trend Context**
Is the market trending or range-bound, and does that change how this RSI reading should be interpreted?

✓ **Regular or Hidden?**
If this is divergence, have you correctly identified whether it points to reversal or continuation?

✓ **Price Structure Confirmation**
Does a nearby support/resistance zone or chart pattern support the same read as RSI?

✓ **Confirming Candle**
Has price actually confirmed the signal, rather than acting the moment divergence first appears?

✓ **Defined Risk**
Do you know exactly where this read would be proven wrong, and have you placed a stop-loss there?

Frequently Asked Questions

Q. What is a good RSI setting for intraday trading?

The default 14-period RSI is the most widely used setting across nearly every timeframe, including intraday, and is a reasonable starting point. Some intraday traders use a shorter period, like 9, for extra sensitivity, but a shorter setting also produces more false signals, so it's a genuine trade-off rather than a simple upgrade.

Q. Is RSI above 70 always a sell signal?

No, and treating it that way is one of the most common RSI mistakes. In a strong uptrend, RSI can stay above 70 for extended periods while price keeps climbing, so selling purely because RSI crossed 70 often means exiting a strong trend far too early.

Q. What's the difference between regular divergence and hidden divergence?

Regular divergence tends to signal a potential trend reversal, and forms when price and RSI move in opposite directions at swing extremes. Hidden divergence tends to signal a potential trend continuation, and forms when price makes a shallower pullback than RSI would suggest during an existing trend.

Q. Can RSI divergence fail?

Yes, regularly. Divergence is a warning sign worth watching, not a guaranteed reversal signal — price can continue trending for a long time even while RSI diverges, which is exactly why divergence should be combined with support/resistance or a confirming price pattern rather than traded in isolation.

Ready to Read RSI Like a Professional?

Spotting divergence is step one. Combining it with trend and price structure is step two. Chart Code Academy runs structured stock market courses — offline at our Boisar training centre, and live online for students anywhere in India — covering everything from these fundamentals to advanced Technical Analysis, F&O, and Smart Money Concepts.

Get in Touch

CHART CODE ACEFMEY
Website: www.chartcode.in
WhatsApp / Phone: +91-95121 00588
Email: chartcode.in@gmail.com

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