

Moving Averages Determining the trend

A Moving Average is quite simply an average measurement of virtually any set of data. For example, we could easily calculate the average maximum temperature this week by simply adding up the maximum temperature for each day, and then dividing it by 7 (7 days in a week).

A *moving* average just keeps rolling forward. For example, a 7 day moving average of our temperature would simply keep calculating the last seven day period – this would then be a 7-day moving average. We simply do the same with prices of shares, indices, gold or whatever we want.

Technical analysis of financial data relies heavily on moving averages. We can look at stock prices, returns, and trading volumes with this tool and easily see if a particular item is trending up, down or sideways.

Moving averages are certainly a great indicator in financial markets. It is one of the most popular indicators, but it can be overused in some cases. Sometimes two or even three different moving averages may be drawn on a chart over different time frames, to help determine trend change.

The chart of the NAB clearly shows how the red 50-day moving average indicated a change in the share price trend.

By using two moving averages, as we have done on the chart of the ASX, it is possible to obtain a clearer picture of when the trend changes by the crossing of the two lines.

However, it's very important to be aware that a moving average is only a "lagging" indicator – it provides an excellent view of what has happened, but tends to do so some time after the trend change has occurred. For this reason, moving averages are not good predictors of future market movements.

