

## Technical Analysis for Beginners. Dow Theory

In general, technical analysis can be defined as a method of price prediction based on mathematical calculations instead of economic reports. This method has been created for applicable needs in getting profit on stock and currency market. Initially technical analysis was divided into several techniques and only in the 70-ths all these methods were united into an integral approach with common psychology, axioms and ruling principles.

Technical analysis is a way to forecast probable price movement with the help of market movement charts reflecting the history of fluctuations. Practical usage of technical analysis determines several axioms.

### Axiom 1

Every price formation factor, - economical, political, psychological has been taken into account and reflected on the chart. Once news is issued, market prices will move to reflect this new information.

### Axiom 2

Price movement has got its direction. This suggestion has become a basis in all the techniques of technical analysis. The main purpose of technical analysis is defining of probable rate movement (trends in other words) and to apply acquired knowledge in trading. The definition given by Dow says that during bullish trend each consequent peak and fall is higher than the previous one. This suggestion is the main fundamental principle of technical analysis. Trends are classified into three types: bullish (upside movement), bearish (downside movement) and sideways trading (the price remains practically unchanged). Each of the given types is rarely encountered in its pure form, as straight price actions occur not very often in the market.

A certain trend is seen until some signs delivering opposite direction appear. According to Dow, trends exist in spite of market noise. However, in real practice it is not easy to determine whether a reversal is a starting point for a new trend or just a temporary movement. Contemporary technical tools permit traders to define it with easy, however, different traders interpret trend signals differently.

### Axiom 3

Analysts predict if a certain rule worked in the past, this rule may be applicable in future as the price is formed mostly due to human psychology. These are the main fundamental ideas of technical analysis:

Rate takes everything into account, therefore, everything needed to master this field is to study price charts. The aim is to find out trends at their initial phases, to recognize a trend and to use the knowledge in further development making right decisions. And the last idea is that if something worked in the past, it will probably work in future.

The Dow theory denotes the "main movement", the "medium swing" and the "short swing". The "main movement" is a prevailing component as it may last for several years. The "medium swing" is a correction to the main movement and should last from ten days to three months. The "short swing" or minor movement fluctuations may last up to three weeks.

According to the theory market moving averages must confirm each other and every trend should be confirmed by volume. Dow assumed that volume confirmed every price trend.

Many modern technical analysts treat Dow Theory's definition of a trend as the main basics of contemporary technical analysis.

## About the Author

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