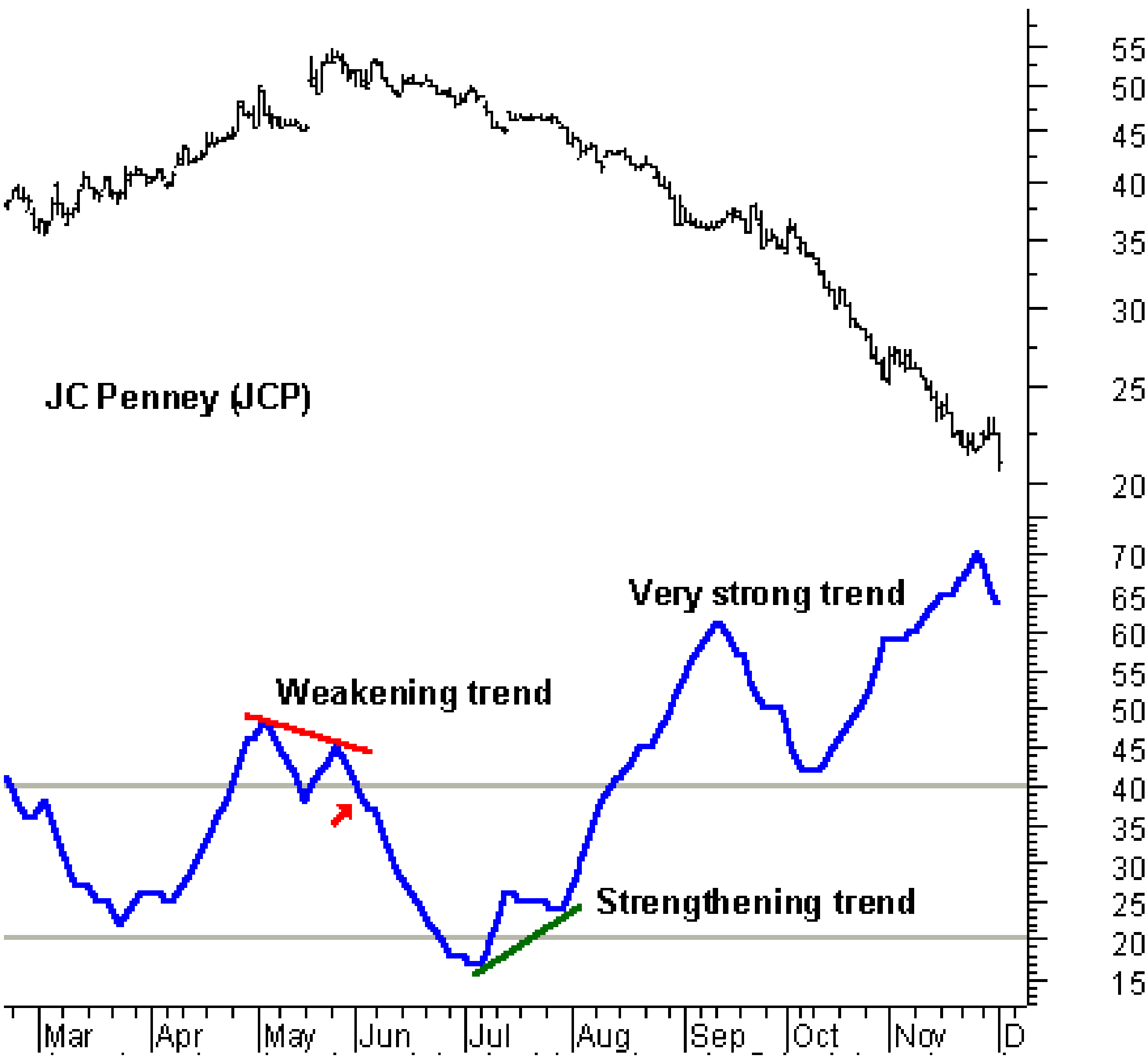
Average Directional Index (ADX)

J. Welles Wilder Jr. developed the Average Directional Index (ADX) in order to evaluate the strength of the current trend, be it up or down. It's important to detemine whether the market is trending or trading (moving sideways), because certain indicators give more useful results depending on the market doing one or the other.

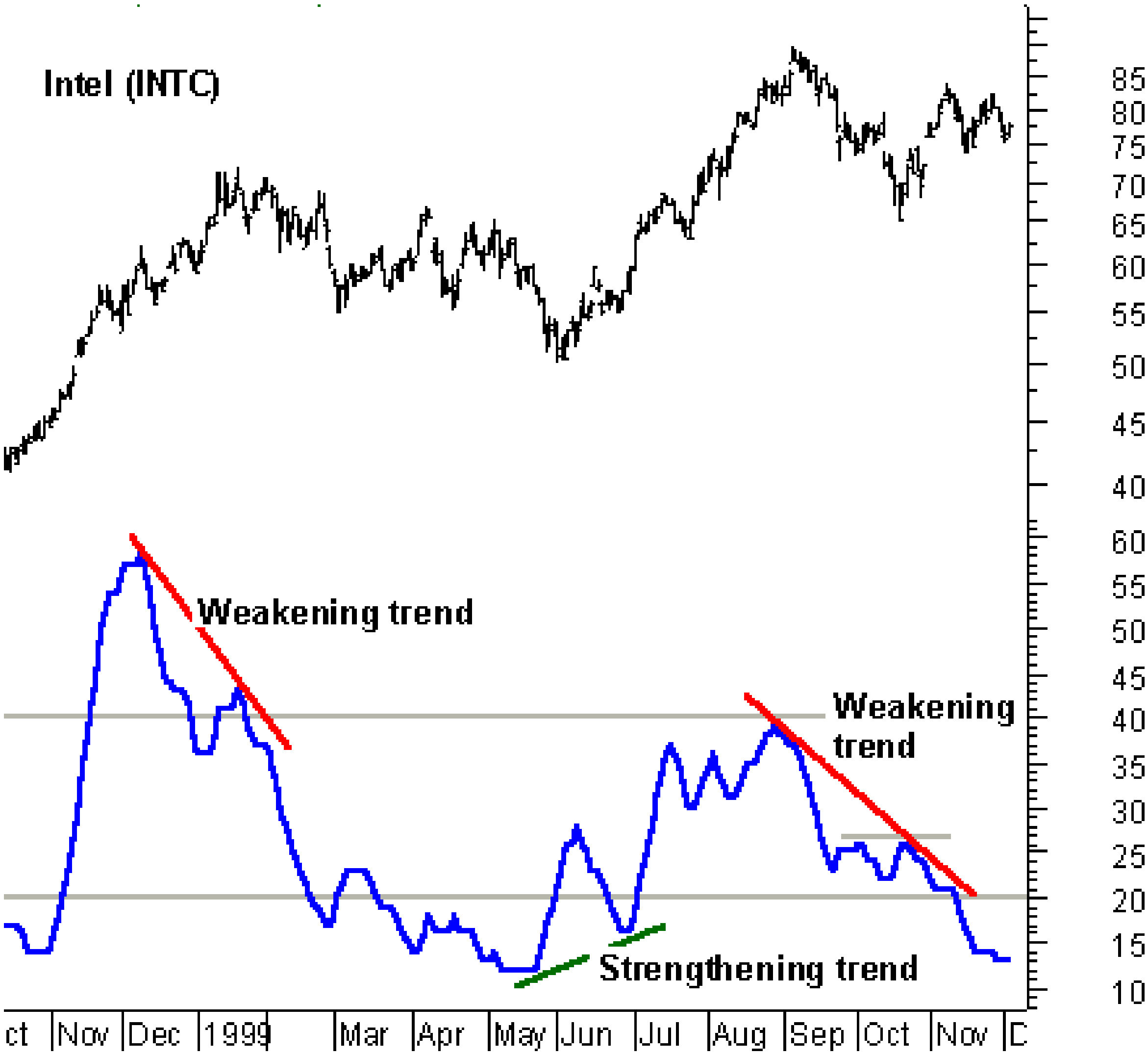
ADX is an oscillator that fluctuates between 0 and 100. Even though the scale is from 0 to 100, readings above 60 are relatively rare. Low readings, below 20, indicate a weak trend and high readings, above 40, indicate a strong trend. The indicator does not grade the trend as bullish or bearish, but merely assesses the strength of the current trend. A reading above 40 can indicate a strong downtrend as well as a strong uptrend.

ADX can also be used to identify potential changes in a market from trending to non-trending. When ADX begins to strengthen from below 20 and/or moves above 20, it is a sign that the trading range is ending and a trend could be developing.



(Click here to see a live example of ADX)

When ADX begins to weaken from above 40 and/or moves below 40, it is a sign that the current trend is losing strength and a trading range could develop.



ADX is derived from two other indicators, also developed by Wilder, called the Positive Directional Indicator (sometimes written +DI) and the Negative Directional Indicator (-DI).

More on ADX can be found in Wilder's book, New Concepts In Technical Trading Systems, written in 1978. Wilder's indicators remain some of the best and most popular indicators today.

Written by Arthur Hill

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