



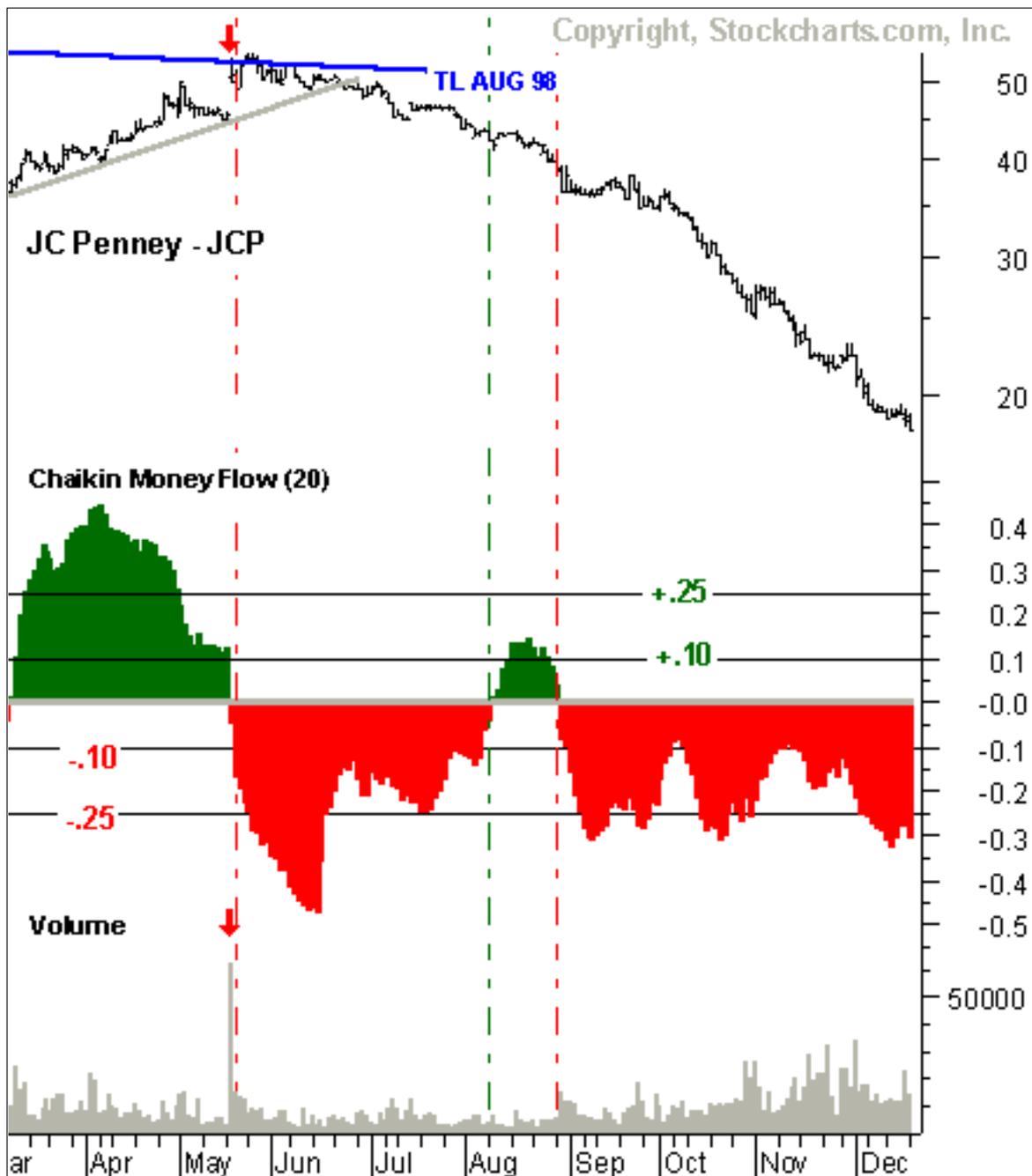
Chaikin Money Flow Part 2

Distribution Indications

The Chaikin Money Flow oscillator generates bearish signals by indicating that a security is experiencing selling pressure, or is perhaps under distribution. As with the bullish signals, there are three items used to determine whether or not a security is experiencing selling pressure and the degree of selling pressure.

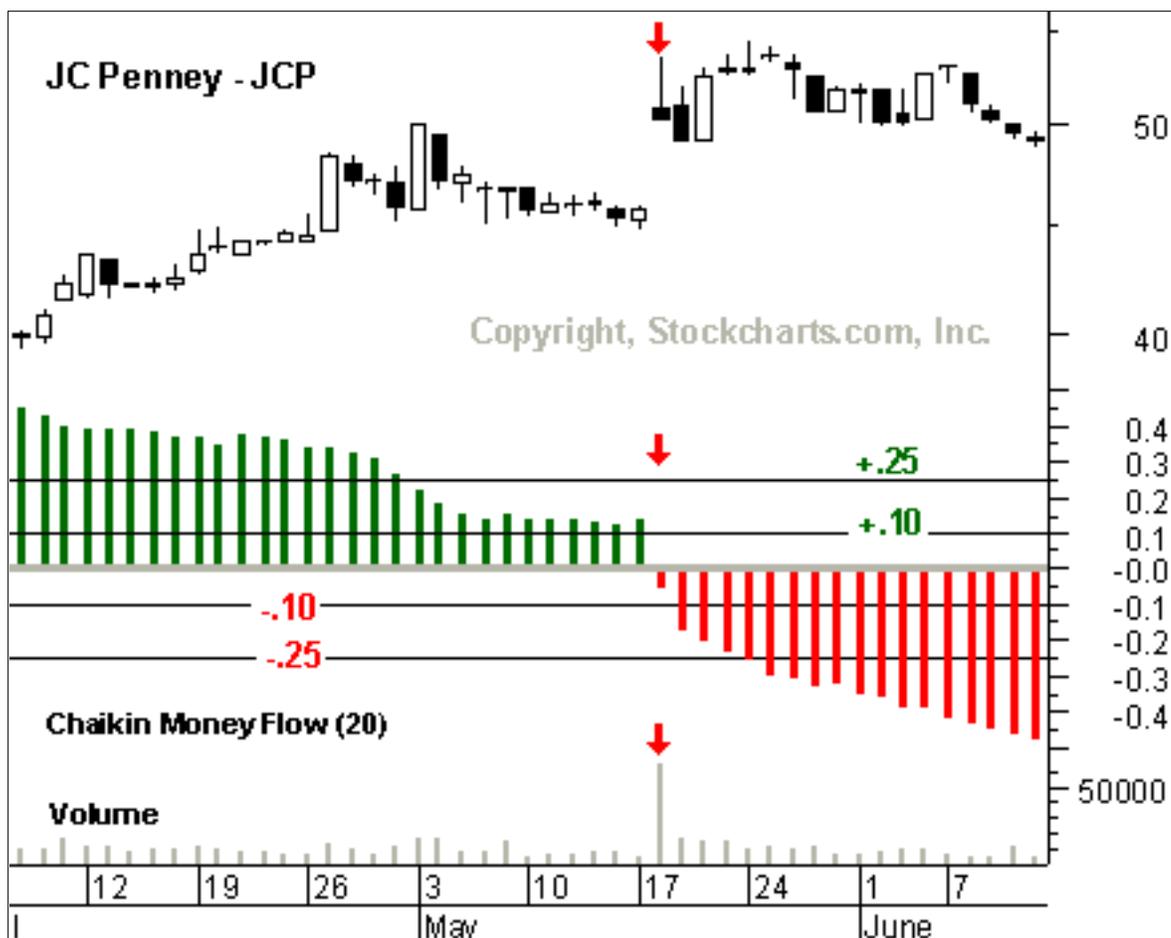
1. The first and most obvious bearish signal is when Chaikin Money Flow is less than zero. A negative reading indicates that the security in question is under selling pressure or experiencing distribution.
2. The second potentially bearish signal is the length of time that Chaikin Money Flow has remained negative. The longer the oscillator remains negative, the greater the evidence of sustained selling pressure or distribution. Extended periods below zero indicate that sentiment towards the underlying security is bearish and there is likely to be downward pressure on the price as well. The length of time can be determined by measuring the percentage of time that the indicator remains below zero. If Chaikin Money Flow is negative to 3 out of 4 weeks, then it would be experiencing selling pressure 75% of the time.
3. The third potentially bearish signal is the degree of selling pressure or distribution. This can be determined by the oscillator's absolute level. Readings on either side of the zero line or within 10 percent of both sides (plus or minus .10) are usually not considered strong enough to warrant a bullish or bearish signal. Once the indicator moves below -.10, the degree selling pressure begins to warrant a bearish signal. (A move above .10 would be significant enough to warrant a bullish signal). Any further movement would increase the degree of selling pressure and the bearish or bullish inclination. Marc Chaikin considers a reading below 25 percent (.25) to be indicative of strong selling pressure. Conversely, a reading above .25 is considered to be indicative of strong buying pressure. These levels are general guidelines and establishing important levels will depend on the characteristics of the individual security and past readings for Chaikin Money Flow.

J C Penny



J. C. Penny (JCP) is an example of a stock that experienced distribution for many weeks before the price actually fell. Once the price began to fall, the indicator remained in negative territory for an extended period of time. From March to May, Chaikin Money Flow had been positive (green). On 18-May, the stock gapped up on the open, but the indicator abruptly fell and turned negative (red arrows). The stock advanced intraday on the 18th, but fell by the close to end the day near the lows. Based on the previous close, the stock advanced. However, from the perspective of Chaikin Money Flow, the stock closed near the low for the day on heavy volume, which is regarded as selling pressure.

J C Penny



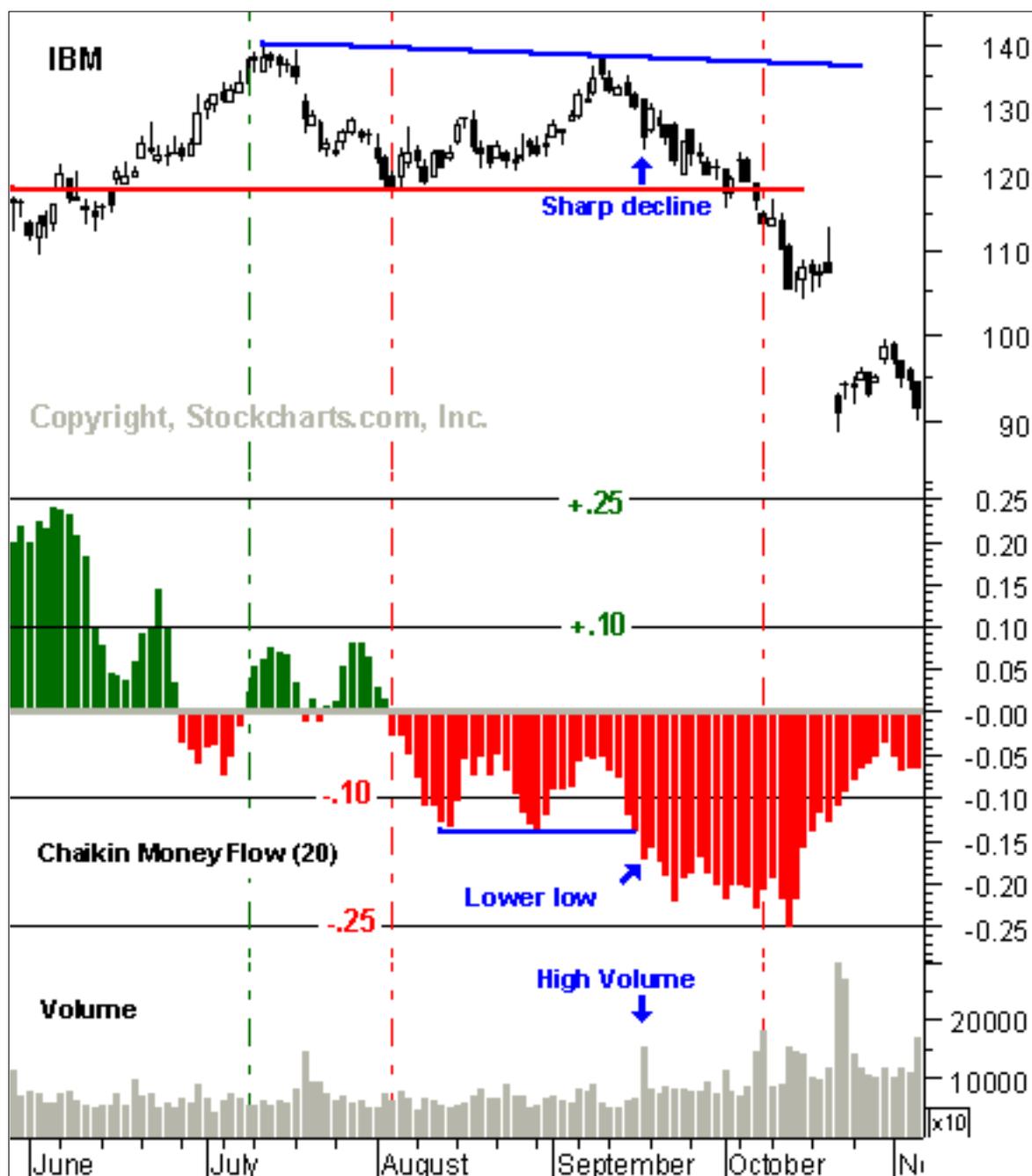
To prove that this abrupt change was not a fluke, the indicator declined further over the next several weeks and remained negative for almost 3 months, indicating that selling pressure was strong in the stock. Not only did the selling pressure remain for an extended period, but also the degree of selling pressure increased. Chaikin Money Flow reached a low of $-.468$ (negative 46.8 percent) while the stock was near its highs around 50. The stock began to confirm the selling pressure and worked its way down in June and July.

There were a few weeks in August when the indicator turned positive. This might have been seen as bullish, but it lasted a mere 3 weeks and Chaikin Money Flow only managed to get as high as $+.1270$. Furthermore, the price action of the stock never confirmed this strength and it is likely that other price and momentum indicators were bearish as well. The positive readings did not last long and by early September, Chaikin Money Flow was trading below $-.25$ and the stock was trading around 36. This was a solid signal that selling pressure in the stock remained heavy and there would likely be downward pressure on the price before long. The stock subsequently declined below 20 and Chaikin Money Flow has not been positive since late August.

All three indications of selling pressure were prevalent in JCP:

1. Chaikin Money Flow turned negative before the stock declined.
2. The indicator remained negative for 6 out of 7 months (85% of the time).
3. Almost all of the negative readings were below $-.10$ and many times the indicator dipped below $-.25$.

IBM



IBM provides an excellent example of a reaction rally that had failure written all over it. When the stock peaked in July, Chaikin Money Flow was already well off of its highs. The indicator was still positive and mildly bullish, but could not surpass $+ .10$ to even partially confirm the high. The indicator formed a double top in July with both peaks well below $+ .10$. After the decline in late July, the stock began to find support and rallied in August, but Chaikin Money Flow would have none of it. The indicator broke below $- .10$ twice and remained negative for almost the entire month. When the stock reached its September reaction high, Chaikin Money Flow was still negative.

After the September high in the stock, things began to fall apart. On 17-Sept, the stock declined with heavy volume and Chaikin Money Flow recorded a new reaction low. Each of these items is marked with a blue arrow on the chart. By this time, selling pressure had been evident for over a month. Chaikin Money Flow had been negative the whole time and had progressively weakened. The sharp decline in the stock on the heaviest volume in over 4 months indicated something was not right. The final straw came when support at 118.5 was broken and Chaikin Money Flow was trading below $- .20$.

Chaikin Money Flow and other Indicators

It is best to choose indicators that complement each other. In a recent interview with [Technical Analysis](#)

of [Stocks and Commodities magazine](#), Marc Chaikin advises against using indicators that have common characteristics. It would be redundant to analyze both [Momentum](#) and [MACD](#). These are both momentum oscillators that are based on the closing price and reflect the rate of change. Their signals will not be exactly the same, but it would be a waste of valuable time to analyze both. Chaikin singles out the Stochastic Oscillator, [CCI](#) and [RSI](#) as similar indicators. All three are banded momentum oscillators that are good for detecting overbought and oversold conditions. Buy and sell signals are also generated in much the same fashion. All three are excellent indicators, but it would be a waste of time to follow all three when one will be sufficient.

Chaikin Money Flow can be used to identify the tradable trend. If Chaikin Money Flow has been above zero for most of the past three months, then prudence would dictate that the tradable trend is up. The oscillator is indicating that buying pressure prevails. It would not be sensible to attempt a short sale if the tradable trend is up. By identifying the tradable trend, traders can ignore bearish signals and only pay attention to signals that concur. If Chaikin Money Flow indicates that buying pressure prevails, then positive divergences, bullish moving average crossovers, bullish centerline crossovers and bullish oversold crossovers would be potential buy signals. (A bullish oversold crossover occurs when an indicator advances above the oversold line. This would be a move from below 30 to above 30 for RSI). All bearish signals would be ignored, at least as long as Chaikin Money Flow indicated that buying pressure reigned.

One possible combination of indicators would be the following:

- Chaikin Money Flow - A non-trend-following volume indicator to identify buying and selling pressure.
- RSI - A momentum indicator used to identify potential overbought and oversold levels.
- Moving averages - A trend-following indicator to identify the underlying trend in the stock.
- Price relative - A comparative indicator to identify the strength of the stock relative to a major index.

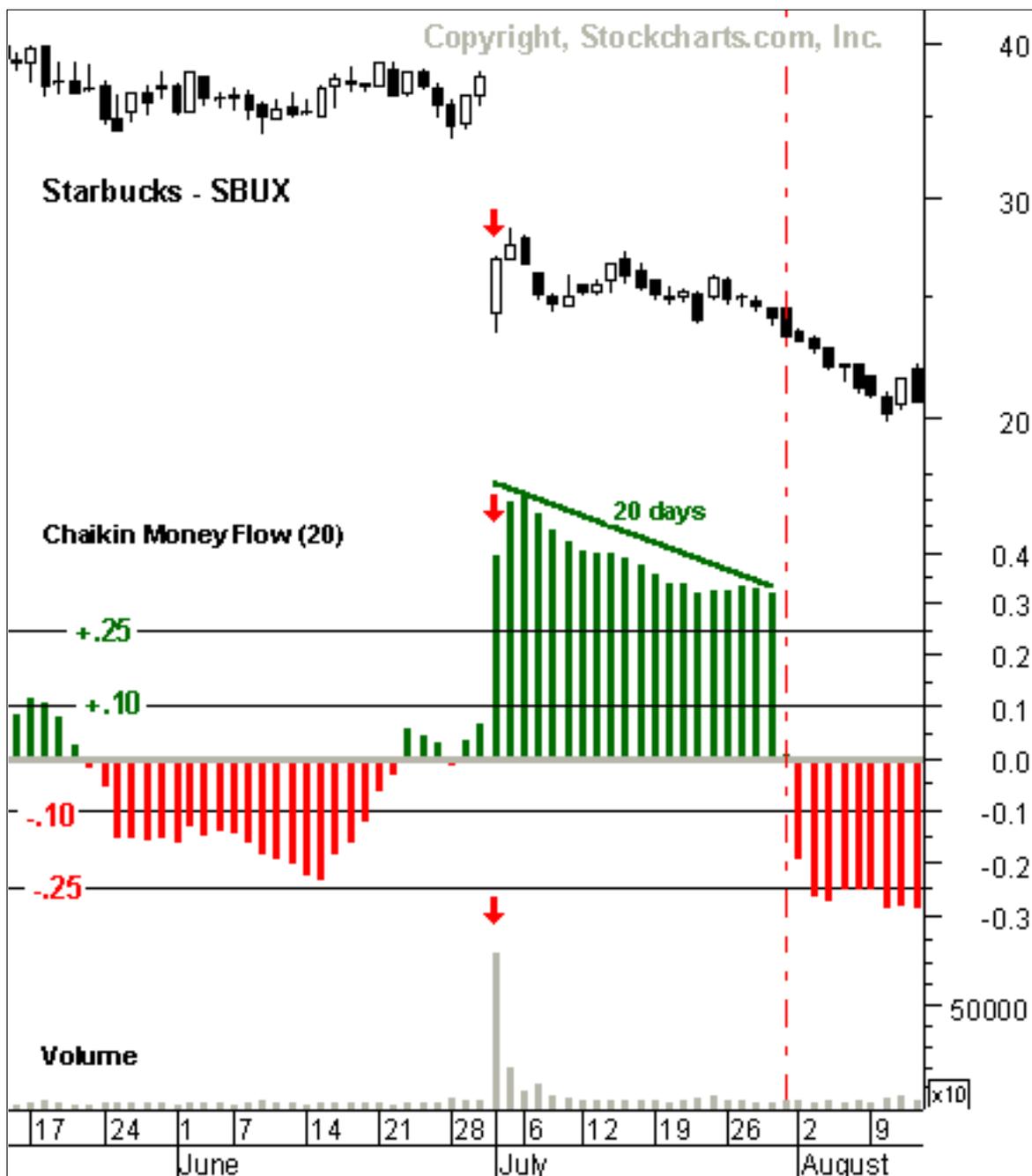
These four indicators have little in common and complement each other very well.

Conclusion

Chaikin Money Flow is an indicator that is best used in conjunction with other aspects of technical analysis. This is usually the case with indicators, but probably even more so in this case. The oscillator is unlike a momentum oscillator and is not influenced by the price change from day to day. Instead, the indicator focuses on the location of the close relative to the range for the period (daily or weekly). This is the strength of Chaikin Money Flow, but can also be its weakness.

Because Chaikin Money Flow does not reflect the change in price from day to day or week to week, large opening gaps are sometimes not reflected in the indicator. Sometimes the indicator moves in the opposite direction of the gap and creates a misleading picture.

Starbucks



Starbucks (SBUX) formed a large down gap on 1-July with extremely heavy volume. Even though the stock opened more than 10 points lower, it managed to close on the high for the day. Strong closes indicate accumulation and the heavy volume amplified this message to cause a large jump in the indicator. The strength was a bit misleading and the indicator slowly declined over the next 20 days. On the 21st day, the data from 1-July was removed and the current day's data added. This caused an immediate drop in the indicator. Chaikin Money Flow was well below zero the next day and more accurately reflected the selling pressure taking place in the stock.

Even though Chaikin Money Flow can be used on an intraday, daily or weekly basis, it was designed with daily data in mind. One day is an unambiguous time period with measurable volume and a specific open, high, low and close. This definability may lessen in the future, with the proliferation of after-hours trading, but determining the location of the close relative to the high and low is still fairly straightforward. When dealing with weekly or monthly data, the beginning and end are less precise. This imprecision can affect the location of the close relative to the high and low for the period. Weekly is obviously more definable than monthly, but less definable than daily. This is something to consider when analyzing Chaikin Money Flow with periods other than daily.

Chaikin advocated a 21-day time frame for Chaikin Money Flow. If Chaikin Money Flow is to be used on a weekly chart, a shorter time frame will probably work better. A 21-day period represents about one

month of trading and will allow for some smoothing. A shorter timeframe may prove too choppy, but a longer time frame may lag too much. Each security will have its own optimum time frame.

Keep in mind that the short-term trend is not as important as the absolute level. As long as the indicator remains above zero, it is considered bullish. It is also important to gauge the length of time that the indicator remains positive. If the indicator is positive for 7 out of 9 weeks, then buying pressure is the order of the day. The two negative weeks are a blip on the radar, and should not be taken out of context.

[Part 1](#) | Part 2

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