Simple Moving Average (SMA) Explanation & Trading Strategies [Video]

Before you dive into the content, check out this video on moving average crossover strategies. You’ll also learn how the SMA is formed. The video is a great precursor to the advanced topics detailed in this article.

The SMA – Not Always So Simple

Why the simple moving average? Once you begin to peel back the onion, the SMA might be simple to calculate, but isn’t as simple to trade.

Not surprisingly, the simple moving average is a popular technical indicator. Perhaps the most popular indicator in all of trading. But like most indicators, it isn’t a cure-all for
If you’re familiar with the indicator, it isn’t so difficult to see why it can be challenging to trade with simple moving averages. After all, just a quick Google search will turn up dozens of day trading strategies.

But how do we know which ones will work?

That is our goal in this post — to show you everything you need to know about simple moving averages. We’ll cover various trade examples, charts, and videos. In addition, we’ll cover the simple moving average formula, popular moving averages (5, 10, 200), real-life examples, crossover strategies, and personal experience with the indicator.

By then end, you should be able to identify the system that will work best for your trading style.

**Simple Moving Average Formula**

The simple moving average formula is the average closing price of a security over the last “x” periods. Calculating the SMA is not something limited to technical analysis of securities. This formula is also a key tenet to engineering and mathematical studies.

To that end, this detailed article from Wikipedia [1] delves into formulas for the simple moving average, cumulative moving average, weighted moving average, and exponential moving average.
Example
Let’s look at a simple moving average formula example. The last five closing prices for XYZ stock are:


Quite simply to calculate the simple moving average formula, you divide the total of the closing prices by the number of periods.

5-day SMA = 143.24/5 = 28.65

As you can see, the SMA is just simple math.

In fact, every indicator is based on math. However, the SMA is not a proprietary calculation with trademark requirements.

It is simple addition and division, for the entire world to share.

Popular Simple Moving Averages
Theoretically there is an infinite number of simple moving averages. In fact, some traders like to throw a myriad of these averages onto the charts in an SMA “cloud.”

This may work for some traders. However, generally speaking, the more popular indicators will work better for you. It is critical to use the most common SMAs as these are the ones many other traders will be using daily.
Along those lines, we do not advocate you following the crowd. Nonetheless, it is essential to know what other traders are looking at for clues.

According to Toni Turner, author of the *A Beginner’s Guide to Day Trading Online*, the major popular moving averages used by most traders are the 10, 20, 50, 100 and 200. \(^2\)

**Examples of the More Popular SMAS**

The 5 – SMA – For the hyper trader.

The shorter the SMA, the more signals you will receive when trading. The best way to use a 5-SMA is as a trade trigger in conjunction with a longer SMA period.

5-period simple moving average

The 10 – SMA – popular with short-term traders; great for swing traders and day traders. Mark the difference between the 5SMA shown above and the 10SMA shown below on the same chart.
10 period simple moving average
The **20 – SMA** – the last stop on the bus for short-term traders.

Beyond the 20SMA, you are looking at primary trends.

20 period simple moving average
The **50 – SMA** – used by traders to gauge mid-term trends.
50 period simple moving average

The 200 – SMA – welcome to the world of long-term trend followers. Most investors will look for a cross above or below this average to represent if the stock is in a bullish or bearish trend.

200 period simple moving average

And just for the sake of visualizing their differences, let’s compile all 5 onto one chart. This way you can see how they represent a multitude of time-frames and trading styles:
Combined SMAs

As you can see, a chart can get busy quickly with too many indicators. But this gives you an idea of how to properly view the most popular simple moving averages.

**SMA Trading Basics**

Now that you can see the foundation of how the SMA is formed, it is time to put together some basic strategies and rules.

In general, you’ll find two overarching criteria for trading the SMA. Either join the primary trend, or fade it. In other words, trading the **front side or back side** of the trade.

Trading SMA Trends

Let’s look at some of these rules in depth and the accompanying examples.
Longing the Primary Trend

1. Look for stocks that are breaking out strongly.
2. Apply the following SMAs: 5, 10, 20, 40, 200 to see which time period is “minding” price the best.
3. Once you have identified the correct SMA, wait for the price to test the SMA successfully. Then look for price confirmation that the stock is resuming the direction of the primary trend.
4. Enter the trade on the next bar.

Fading the Primary Trend

1. Locate stocks that are breaking down strongly.
2. Select two simple moving averages to apply to the chart (ex. 10 and 20).
3. Make sure the price has not touched the 10 SMA or 20 SMA excessively in the last 10 bars.
4. Wait for the price to close below both moving averages in the counter direction of the primary trend on the same bar.
5. Enter the trade on the next bar.

Strategy #1 – Example of going long with the primary trend

Below is a play-by-play for using a moving average on an intraday chart. In the example, we will cover staying on the right side of the trend after placing a long trade.

Recently, SGOC had a breakout around midday and continued to push higher. A breakout trader would use this as an opportunity to jump on the train and place their stop below the low of the consolidation.

We discuss this setup in our post on Volatility Contraction Patterns.
Simple Moving Average Example

At this point, you can use the moving average to gauge the strength of the current trend created during the opening range or VCP pattern. In this chart example, we are using the 10-period and 20-period simple moving average.

**Simple Moving Average – When to Sell**

Now looking at the chart above, how do you think you would have known to sell at the $12.30 level using the simple moving average?

What’s the magic formula?

In all honesty, you wouldn’t have a clue.

Far too many traders have tried to use the simple moving average to predict the exact sell and buy points on a chart. A trader might be able to pull this off using multiple averages for triggers, but one average alone will not be enough.

To that point, save yourself the time and headache and use the averages to determine the strength of the move, not proper buy and exits.

Now take another look at the chart pattern below. Do you see how the stock is starting to rollover as the average is beginning to flatten out?
Simple Moving Average Example
A breakout trader would want to stay away from this type of activity. Now again, if you were to sell on the cross down through the average, this may work some of the time. But in the long run, you’ll likely end up losing money.

Why would you lose money? Because the majority of the time, a break of the simple moving average just leads to choppy trading activity.

Flat Simple Moving Average
Remember, if trading were that easy, everyone would be making money hand over fist. Take this chart of AAPL as an example of the chop you might expect.

The Holy Grail Setup
Next, let’s take another look at the simple moving average and the primary trend. This is often referred to as the holy grail setup, popularized by Market Wizard Linda Raschke.

Perhaps you’ve seen this strategy in books and seminars.
Essentially, you buy on the breakout of a pullback to the 20sma. Sell when the stock crosses down beneath the price action.

Below is an intraday chart of Apple. Look at how the price chart stays cleanly above the 20-period simple moving average.

Simple Moving Average – Perfect Example

Isn’t that a beautiful chart? You buy on the original breakout at $144 and sell on the close at $144.60.

A quick $0.65 profit in one day and you didn’t to do much for it.

**Strategy #2 – Example of going against the primary trend**

Another simple moving average trading strategy is to go counter to the trend.

Believe it or not, one of the higher probability plays is to go counter to extreme **gap** moves.

Regardless of the time in history, (60s flat line, late 90s boom, or volatility of the 2000s), it’s a safe assumption that gaps will fill 50% of the time. So, off the bat no matter how new you are to trading, you at least have a 50% shot of being on the right side of the trade using this approach.

But remember this: another validation a trader can use when
going counter to the primary trend is a close under or over the simple moving average.

In the example below, SGOC had a solid gap of approximately 40%. After the gap, the stock trended up strongly.

SGOC trend change through simple moving average

There is one caveat: you must be careful with countertrade setups. If you are on the wrong side of the trade, you and others with the same position will be the fuel for the next leg up.

Thankfully that wasn’t the case with SGOC. Let’s fast forward a few hours on the chart.

SGOC countertrend trade

Whenever you go short, and the stock does little to recover and the volatility dries up, you are usually in a good spot. Notice how SGOC continued lower throughout the day; unable to put up a fight.

Now let’s jump forward one day.
 Guess what happened?

SGOC Gap Fill
You got it, the gap filled.

**Strategy #3 – Simple Moving Average Crossover**

Moving averages by themselves can give you a great roadmap for trading the markets.

But what about moving average crossovers as a trigger for entering and closing trades?

When considering this, you need to understand that the moving average by itself is a lagging indicator. **If you layer in the idea that you have to wait for a lagging indicator to cross another lagging indicator, there is an obvious delay.**

If you look around the web, the most popular simple moving averages to use with a crossover strategy are the 50 and 200
sma. When the 50-simple moving average crosses above the 200-simple moving average, it generates a golden cross.

Conversely, when the 50-simple moving average crosses beneath the 200-simple moving average, it creates a death cross.

These two strategies are particularly applicable for long-term investing. However, they can be modified for daytrading. We’ll run through some basic daytrading crossover strategies.

Day Trading Moving Average Crossovers

Two Simple Moving Average Crossover Strategies

In order to day trade crossover, the first decision you have to make is to select two moving averages that are somehow related to one another.

For example, 10 is half of 20. Or, the 50 and 200 are the most popular moving averages for longer-term investors. Or, taking the 20 and 50 as near and intermediate term indicators.

The second thing of importance is coming to understand the trigger for trading with moving average crossovers. A buy or sell signal is triggered once the smaller moving average crosses above or below the larger moving average, respectively.

1. Buying on a Cross Up

In the below charting example of SGOC from 7/12/2021, the 10-period SMA crossed above the 20-period SMA. After that, you will notice that the stock had a nice intraday run from $13.61 up to $29.05.
10/20 Moving Average Crossover
Isn’t that just a beautiful chart?

The 10-period SMA is the blue line, and the purple is the 20-period. In this example, you would have bought once the red line closed above the blue which would have given you an entry point slightly above $13.80.

2. Selling a Cross Down

Let’s look when a sell action is triggered. In this example, a sell action was triggered when the stock gapped down the next morning.

Moving Average Crossover
Now in both examples, you will notice how the stock conveniently went in the desired direction with very little friction.

This won’t always be the case. If you look at moving average crossovers on any symbol, you will notice more false and sideways signals than high return ones. This is because most
of the time stocks move in a random pattern.

Remember this: it is the job of the big money players to fake you out at every turn to separate you from your money.

With the rise of hedge funds and automated trading systems, for every clean crossover play you find, you’ll probably see another dozen or more that don’t play out well.

For this reason, you need to have a firm understanding of candlestick patterns and price and volume analysis to confirm your moving average strategies.

**Simple Moving Average Trading Strategy Case Study Using Cryptocurrencies**

If you have been looking at cryptocurrencies any time in the last few years, you are more than aware of the violent price swings. With this in mind, we decided to do a case study to answer a few questions.

Are there any indicators that can give a trader an edge, or is Bitcoin so volatile that, in the end, everyone loses at some point if you try to actively trade the contract?

We decided to see how the SMA would hold up against Bitcoin.

For this study, we are using the golden cross and death cross strategies, which consists of the 50-period and 200-period simple moving averages. For those of you not familiar with these strategies, the goal is to buy when the 50-period crosses above the 200-period and sell when it crosses below.

To make things more interesting, the study will cover the 15-minute time frame so that we can get more signals.

The study starts on January 26th, 2018 and runs through March
29th, 2018.

Will you Take Every Trade?

As you can imagine, there are a ton of buy and sell points on the chart. To be clear, we are not advocates for staying in the market all the time. You can get crushed during long periods of low volatility.

BTC-Golden Cross

The golden cross/death cross strategies on a 15-minute chart generated several trade signals in a little under two weeks.

First Trade Signal

The first trade was a short at 10,765, which we later covered for a loss at 11,270. Herein lies the problem with crossover strategies. If the market is choppy, you may suffer from “death by a thousand cuts.”
Second Trade Signal

Thankfully the second signal produced a massive short trade from 10,500 down to 8,465.

That move down is beautiful, and you would have reaped a huge reward, but what is not reflected on this chart are the whipsaw trades that occurred before this particular day.

Do you think you have had what it takes to make every trade regardless of how many losers you would have encountered?

You Will Always Feel Like You Were Sold a Lemon

The other telling fact is that on the second position you would have exited the trade 2,450 points off the bottom. Herein lies the second challenge of trading with lagging indicators on a volatile issue.

By the time you get the trade signal, you could be showing up to the party late.

Third Trade Signal

The next move up is one that makes every 18-year-old kid believe they have a future in day trading – simply fire and forget.
BTC-Golden Cross

More Trade Signals

After this sell signal, bitcoin had several trade signals leading into March 29th, which are illustrated in the below chart.
BTC-Golden Cross Multiple Times

Notice how bitcoin is not too choppy, but the gains/losses are small. If you go through weeks of trading results like this, it may become difficult to execute your trading approach flawlessly. Giving up all of those gains, can make you feel beaten down.

However, due to the volatility of bitcoin, it’s apparent that your gainers are far larger than the losers.

In Summary

Much to our surprise, a simple moving average allows bitcoin to go through its wild price swings, while still allowing you the ability to stay in your winning position. The below infographic visualizes the details of this case study.
Can the Golden Cross Strategy Tame the Ever Volatile Bitcoin Futures?

January 24, 2018 - March 29, 2018

Value of $10k Invested using the golden cross strategy

TradingSim
My Personal Journey Day Trading
Simple Moving Averages

Now that you have all the basics, I’d like to walk you through my experience day trading with simple moving averages.
My Journey Day
Trading with
SIMPLE MOVING AVERAGES

Three Lines
- I somehow figured three averages would equal more profits

Newbie
- Baby in the simple moving average game
- I am fixated with the 10-period simple moving average

Buy/Sell Signals
- I am now ready to test my skills
- I realized buy and sell triggers solely based on moving averages do not work

Settings
- I ran hundreds of tests to find the optimum simple moving average settings

More Indicators
- If I could only validate my simple moving average trade signals, I would have a higher winning percentage - WRONG!

Displace
- I then begin displacing my optimized moving averages in hopes of predicting trend changes
- This often led to jumping the gun and mounting losses

Finding Balance
- At the end of my journey, I landed back right where I started - only one moving average
- I have come to the realization that the moving average is a guide post of the trend, but not the end all be all

Magic Number
- I now exclusively use the 20-period moving average with default settings
- This allows me to see the bigger trend without making too many knee jerk decisions
You could be saying to yourself, “Why do I care about this guy’s experience? Mine will be different?”

In theory, yes, but there are likely parallels between our paths, and I can hopefully help you avoid some of my mistakes.

#1 – Newbie

It was spring 2007, and I was just starting in day trading.

In my mind, volume and moving averages were all I needed to keep me safe when trading. I read all the books and browsed tons of articles on the web from top “gurus” about technical analysis.

From what I could see, price respected the 10-period moving average “all” the time.

I didn’t understand at this point that you see what you want to in charts, and that, for every winning example, there are likely dozens that will fail.

If the stock closed below the simple moving average and I was long, I thought I should look to get out. But, if the stock could stay above the average, I should just hold my position and let the money flow to me.

Example

Let’s walk through a few chart examples to get a feel for my delusions of grandeur.
Riding the simple moving average
I saw hundreds, and I mean *hundreds* of charts with this pattern.

The pattern I was fixated on was a cross above the 10-period moving average and then a rally to the moon.

I remember feeling such excitement of how easy it was going to be to make money day trading this simple pattern.

Now, shifting gears for a second; anyone that knows me knows that I have a strong analytical mind.

I love review numbers and then run them all over again to make sure everything nets out.

Hence my second phase on this journey.

**#2 – Three Lines**

By the summer of 2007, I am placing some trades and trying different systems, but nothing with great success.

I continue using the 10-period simple moving average, but in conjunction with Bollinger Bands and a few other indicators.

It’s not quite a “spaghetti chart” just yet, but it’s definitely a little busy.
Too many indicators on a chart
So, after reviewing my trades, I, of course, came to the realization that one moving average is not enough on the chart.

The need to put more indicators on a chart is almost always the wrong answer for traders, but we must go through this process to come out of the other side.

I felt that if I combined a short-term, mid-term and long-term simple moving average, I could quickly validate each signal.

To that end, I would use the short-term to pull the trigger when it crossed above or below the mid-term line. The long-term line I would use to ensure I was on the right side of the trend.

Did that just confuse you a little?

**Example**

Let’s illustrate this strategy on the chart.
Three Simple Moving Averages – My Journey

In the above example, the blue line is a 5-period SMA, the red line is a 10-period SMA, and the purple line is a 20-period SMA.

You are welcome to use any setting that works best for you. The point is that each moving average should be a multiple or two from one another to avoid chaos on the chart.

I used the shortest SMA as my trigger average. When it crossed above or below the mid-term line, I would have a potential trade.

The sign I needed to pull the trigger was if the price was above or below the long-term moving average.

Going back to the chart, the first buy signal came when the blue line crossed above the red while the price was above the purple line. This would have given us a valid buy signal.

Then after a nice profit, once the short line crossed below the red line, it was our time to get out.
Did this mean we should have gone short?

No. Notice that the price was still above the purple line (long-term), so no short position should have been taken.

The purple (long-term) prevents us from always being in a long or short position like in the cryptocurrency case study mentioned earlier.

Looking back many years later, it sounds a bit confusing, but I do have to compliment myself on just having some semblance of a system.

How do you think this all played out?

Don’t worry; I’m going to tell you now.

#3 – Buy and Sell Signals

At this point of my journey, I feel I am still in a good place.

It’s around late summer at this point, and I was ready to roll out my new system of using three simple moving averages.

It became apparent to me rather quickly that this was much harder than I had originally anticipated.

First off, it was tough trying to figure out which stocks to pick.

Once I landed on trading volatile stocks, they either gave false entry signals or did not trend all day.

This level of rejection from the market cut deeply. I remember staring at the screen thinking, “Why is this not working?”

Charts began to look like the one below, and there was nothing I could do to prevent this from happening.
What do you think I did next?

That’s right, my analytical side kicked in, and I needed to review more data.

#4 Settings

Anyone that has been trading for longer than a few months using indicators has likely started tinkering with the settings. Well, I took that concept to an entirely different level.

I was using TradeStation at the time trading US equities, and I began to run combinations of every time period you can imagine.

I would then run TradeStation’s report optimizer to see how things would have worked out. Here are a few examples of just a few crazy settings I tried:
As you can see, these were desperate times. I was running all sorts of combinations until I felt I landed on one that had decent results.

Now, one point to note, I was running these results on one stock at a time.

The goal was to find an Apple or another high-volume security I could trade all day using these signals to turn a profit.

Similar to my attempt to add three moving averages after first settling with the 10-period as my average of choice, I did the same thing of needing to add more validation checks this time as well.

Instead of just moving forward with the settings I had discovered based on historical data (which is useless the very next day, because the market never repeats itself), I wanted to outsmart the market yet again.

My path to this trading edge was to displace the optimized moving averages.
This must be painful to read; it surely is painful for me to relive this experience.

It’s important to note that I was feeling pretty good after all this analysis. I felt that I had addressed my shortcomings and displacing the averages was going to take me to the elite level.

#5 Displace

For those of you not familiar with displaced moving averages, it’s a means for moving the average before or after the price action.

You can offset the number of periods higher to give the stock a little more wiggle room.

Conversely, you can go negative on the offset to try and jump the trend.

I’m not going to belabor the concept in this article, though, as the focus of this discussion is around simple moving average trading strategies.

The point is, I felt that using the averages as a predictive tool would further increase the accuracy of my signals. This way I could jump into a trade before the breakout or exit a winner right before it fell off the cliff.

To illustrate this point, check out this chart example where I would use the same simple moving average duration, but I would displace one of the averages to jump the trend.
Displaced Moving Average Sell Signal

The reality is that I would jump into trades that would never materialize or exit winners too soon before the real pop.

This, of course, left me feeling completely broken and lost. I don’t say that lightly.

I mean the feeling of despair was so real; you feel like quitting, to be honest.

I think this feeling of utter disgust and wanting to never think about trading again is part of the journey to consistent profits.

AL Hill

Going back to my journey, at this point it was late fall, early winter and I was just done with moving averages.

#6 More Indicators

Technical indicators and systems lead to more indicators to try and crack the ever-elusive stock market.
This is the awful curse of technical analysis.

I too fell victim to this horrible symptom of pain from the markets.

This was by far my darkest period of the journey with moving averages.

Not regarding losses, but just in feeling lost with my trading system and overall confidence.

I would try one system one day and then abandon it for the next hot system. This process went on for years as I kept searching for what would work consistently regardless of the market.

This included me trying every indicator from Bollinger Bands, MACD, slow stochastics — you name it, I tried it.

If you get anything out of this article, do not make the same mistake I did with years of worthless analysis. You will make some traction, but it’s a far better use of your time to zone in on yourself and how you perceive the market.

#7 — 20 Period Simple Moving Average

After many years of trading, I have landed on the 20-period simple moving average. At times I will fluctuate between the
simple and exponential, but 20 is my number.

This is because I have progressed as a trader from not only a breakout trader but also a pullback trader.

I use the 20-period moving average to gauge market direction, but not as a trigger for buying or selling.

**It all comes down to my ability to size up how a stock is trading in and around the average.**

At times a stock will crack right through the average, but I don’t panic that a sell-off is looming. I just wait and see how the stock performs at this level.

It’s funny to think that I have essentially reverted to exactly what I was looking at over ten years ago – one average.

You may ask “Are you upset that it took you this long to come to this conclusion?”

Absolutely not. It wasn’t all death and gloom along the way, and the simple moving average is just one component of my trading toolkit.

In other words, mastering the simple moving average was not going to make or break me as a trader.

However, understanding how to properly use this technical indicator has positioned me to make consistent profits.

**Disadvantages of Trading with the Simple Moving Average**

There are three disadvantages that come to mind for me when trading with simple moving averages.

The first two have little to do with trading or technicals.
Both disadvantages deal with the mental aspect of trading, which is where most traders struggle.

The problem is rarely your system.

1. Closing Position Remorse

This is something I touched on briefly earlier in this article, essentially with a lagging indicator, you will never get out at the top or bottom.

Thinking back to our cryptocurrency example, there were times where we left over 10% or more in paper profits on the table because we did not exit the position until the SMA cross.

You might be thinking, well if we make money that is all that matters. And that’s true, if only your brain worked that way.

You could fall into the trap of doing look backs on your trading activity and languishing at all the loss revenue from exiting too early.

How do you fight this demon? How do you let go of the potential that never was meant to be?

The more results you have for your trading system, the more you’ll be willing to trust it, despite the drawdowns.

Otherwise, you try to let go. You stop obsessing about what you did not receive and start being thankful for what you have.

The Emotional Toll of Letting Winners Run

The other very real disadvantage is the intestinal fortitude required to let your winners run.

You are going to feel all kinds of emotions that are telling you to just exit the position. Or that you have made enough. Or that the pullback is going to come, and you will end up
You must find some way of just charging through all of that and letting the security do the hard work for you. We have been conditioned our entire lives to always work hard towards something.

The market is a lot like sports. A lot of the hard work is done at practice, not during game time.

When you are in a winner, you must let them run.

The Lag

The obvious bone of contention is the amount of lag for moving averages. This becomes even more apparent when you talk about longer moving averages.

In this Forbes article, ‘If You Want to Time the Market, Ignore Moving Averages’, Michael Cannivet highlights the issue with using moving averages [4].

First, Cannivet points to a study by Meb Faber. According to the study of Cambria Investment Management from 1901 to 2012, exiting stocks when the S&P 500 closed below its 200-day moving average, “would have more than doubled your ultimate
returns – and cut your risks by at least a third” \(^5\).

However, Cannivet highlights that if hedge fund managers bought when the S&P 500 SPDR ETF closed above its 200-day moving average and shorted when it closed below its 200-day moving average, this would have net a loss of 20.4% from the period of June 2014 to June 6, 2019.

The takeaway here is to use the longer averages to gauge if a stock is in a bullish or bearish trend. However, with the pace of trading in today’s environment, realize the lag can prove detrimental to your bottom line.

**Simple Moving Average versus Exponential Moving Average**

We would be remiss not to discuss this, as the comparison of the simple moving average to the exponential moving average is a common question in the trading community.

The formula for the exponential moving average is more complicated as the simple only considers the last number of closing prices across a specified range.

The exponential moving average, however, adjusts as it moves to a greater degree based on the price action. To learn more about the exponential moving average and its calculations, please visit our article – ‘Why Professional Traders Prefer Using the Exponential Moving Average’.

Now shifting our focus back to the comparison of the two averages, the bottom line is the exponential moving average will stay closer to the price action, while the simple moving average has a slower/smoothed arc.

To see an actual example of how the formulas differ, check out this article from [dummies.com].\(^6\)
Example 1

It is going to come down to your preference. If you like clean charts, stick to the simple moving average. If you feel that you need to try and capture more of your gains, while realizing you may be shaken out of perfectly good trades- the exponential moving average will suit you better.

Below is a charting example that illustrates how each average responds to price.

Are you able to guess which line is the exponential moving average? If it’s not obvious, the red line is the EMA. You can tell because even though the SMA and EMA are set to 10, the red line hugs the price action a little tighter as it makes its way up.

As you can see from the chart, the difference in the values isn’t very dramatic.

10SMA vs 10EMA

The price will ultimately respect the line in the same way whether you are using the SMA or EMA. The only time there is a difference is when the price breaks.

What’s slightly confusing is that when the price does break,
it will likely penetrate the SMA first. This is because the SMA is slower to react to the price move and if things have been trending higher for a long period of time, the SMA will have a higher value than the EMA.

**Example 2**

I know that sounds a bit confusing so let’s look at a different chart example.

![](image)

**Price Closing Above SMA First**

As you can see, the EMA (red line) hugs the price action as the stock sells off. But then something happens as the price flattens.

The slower SMA is weighing all the closing prices equally. Therefore, it continues to decline at a faster rate.

Conversely, the EMA accounts for the most recent price movement and begins to climb upwards pulling away from the stock’s price as it is in a bottoming formation.

This pulling away by the EMA ultimately results in price breaking the EMA after a close above the SMA.

So, you may be asking yourself, “Well when will the EMA get me out faster?” The answer to that question is when a stock goes parabolic. The EMA will stop you out first because a sharp
reversal in a parabolic stock will not have the lengthy bottoming formation as depicted in the last chart example.

Simple Moving Average Trading Strategies Recap

Hopefully by now you understand that the simple moving average is not an indicator you can use as a standalone trigger.

That doesn’t mean that the indicator can’t be a great tool for monitoring the direction of a trend or helping you determine when the market is getting tired after an impulsive move.

Think of the SMA as a compass. Road signs, if you will. If you want detailed coordinates, you will need other tools, but you at least have an idea of where you are headed. With that in mind, here are the four key points to remember when trading with SMAs:

1. The fewer SMAs on the chart, the better.
2. Do not make buy or sell signals based on the price closing above or below the simple moving average.
3. You should use the simple moving average, as the indicator is arguably the most popular technical
analysis tool.
4. Focus on observing how the stock interacts with the simple moving average, as this is often a head fake tool for algorithms and more sophisticated traders.

Additional Resources

- Here are a few additional moving average blog posts to get a broader understanding of the averages: (Displaced Moving Average, Exponential Moving Average, Triple Exponential Moving Average).
- Test out the strategies detailed in this article using the Tradingsim platform. We have been able to help countless traders improve their results by providing a risk-free environment to practice trading on the most realistic market replay platform in the world.
- Here is another great article titled ‘How to Profit From Moving Averages’ which details strategies using the 50 and 200-day moving averages.

Hopefully we’ve helped with your understanding of how simple moving averages work. Like with any strategy, we hope you’ll test them out in a simulator before putting real money to work.

Best of luck, and here’s to good fills!

External References

5. Faber, Meb. A Quantitative Approach to Tactical Asset Allocation [Study].