How to Read Moving Average

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A moving average is a widely used indicator in technical analysis and day trading. Moving averages help to smooth the price data in a chart, and can be used to help identify price trends or identify potential support and resistance levels while trading.

There are two main types of moving averages: Simple Moving Averages and Exponential Moving Averages – SMA and EMA for short.

Simple Moving Averages are also referred to as arithmetic moving averages. To calculate an SMA, you take the sum of the closing prices over a given period of days, then divide it by the number of days in that period. For example, for a 5-day SMA, just take the sum of the closing price data over the last 5 days, then divide it by 5. And since it's a MOVING average, it's constantly updated: old data is removed when new data becomes available. If your SMA is based on a short time frame, it'll be more volatile but it will closely follow the source data. And if you base your SMA on a long time frame, it displays a smoother moving average.

Exponential Moving Averages, also called "exponentially weighted moving averages," work a little differently from Simple Moving Averages. EMAs place greater weight on the most recent data points than SMAs, which means they react more significantly to recent price movements.

Both kinds of moving averages are calculated using data from previous days, making them "lagging indicators" — in other words, they only display changes that have already occurred. Because of that, traders and analysts commonly use moving averages alongside other kinds of indicators to get the best understanding of market trends.

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