



HowToTrade

MONEY FLOW INDEX (MFI) INDICATOR STRATEGY [PDF]

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What is the MFI Indicator and How Does It Work?

The Money Flow Index is an oscillatory indicator that uses price and volume data to track raw money flow in and out of a trading instrument. On a price chart, as you can see below, it is displayed as a sub-chart with default values of 20 and 80.



The concept on which this indicator runs is simple. Price action is determined by the market's forces of demand and supply. So, the aim is to predict that inflection point where buyers or sellers get too much, triggering a price reversal. That is where the MFI indicator comes into play.

The MFI then uses this concept to predict overbought and oversold levels, from which the price is likely to reverse. Technically, the MFI indicator is similar to the Relative Strength Index (RSI) indicator in functionality, except that the RSI considers only price data. The Money Flow Index calculation, on the other hand, considers volume data in addition to the price data. Some traders even call it “volume-weighted RSI.”

This momentum indicator appears as another chart beneath your price action chart. It has a calibration of 0 to 100, within which the indicator line oscillates. The closer the line is to 100, the higher the buying pressure. And the lower the line falls to 0, the higher the selling pressure. The 50-level line indicates a shift in momentum and is used by traders as another tool to generate trade signals.



The following sections will focus on some Money Flow Index indicator trading strategies.

How to Use the MFI Indicator in Trading?

The MFI indicator usually comes alongside common trading platforms such as MT4, MT5, or TradingView. To find it on MT4 and MT5, you should locate “Indicators” on the top left side menu and go into the volumes folder. You’ll then find the MFI indicator. On TradingView, you can easily search and locate the indicator after you click on the “Indicators” tab at the top of your open chart.

Once you have successfully added the indicator, you’ll be able to see it as a sub-chart below the main chart. The indicator chart is presented as a line graph that oscillates between values of 0 and 100. The default period is 14, though some traders prefer to use higher periods to generate more accurate trading signals. In general, like many other indicators, the higher the period, the more price data the indicator collects; hence, the indicator generates fewer trading signals, but with much more accuracy.

Finally, the indicator in its default state also has a band that spans from the 20 level to the 100 level, with the 50 level as a sign of market equilibrium. These levels form an integral part of the indicator’s trading strategy.

Now that you have your indicator up and running, here are ways to trade it:

1. Overbought and Oversold Regions

You can make trades on the MFI indicator when the indicator crosses the 20 and 80 levels. When the index falls below 20, the instrument is oversold, and you get ready to

buy. However, try not to buy until the indicator returns to the 20-80 band. Conversely, the instrument is overbought when the index exceeds 80, and you should get ready to sell. Once the indicator returns to the 20-80 band, that is your signal to sell. And that's the original MFI trading strategy.



2. Divergence

Another way to use the MFI indicator is to trade the divergences between the indicator and price action. Typically, the index/indicator mimics the movement of the price. But when the price looks to have moved in an opposite direction to the index, that's a divergence. And it often signifies that the price is about to reverse. To learn more about divergence trading, we suggest you [download our divergence cheat sheet](#).

So, once you see such a difference in directions, simply open a position in the opposite direction of the closest trend before the divergence. Check the chart below for clarification.



3. Trend Trading

In addition to the overbought and oversold and the divergence trading strategies, there's another way to use the Money Flow Index indicator in combination with the Moving Average Indicator. This technique is typically used to identify trends and utilize the trend trading strategy.

First, you open the MFI and the MA in the same window. To do this, open your MFI first on your TradingView, as we showed you earlier. At the top left corner of the indicator window, you'll see "MFI 14." Hover on it until some new buttons appear. Keep hovering on each of these new options and select the one that says "More." Finally, on the menu that appears, select "Add indicator to MFI 14." Search and choose your Moving Average (MA) indicator, then change the period of your MA to 30.

Having done all these, you can use this MFI trend trading strategy.



As you can see in the image above, in order to open buy positions, you must wait until both MA and MFI lines are below the 50-level mark of the MFI. Once the MFI line crosses the MA line to the upside in this region, that's your buying opportunity. Similarly, on the selling side, you must wait until both indicator lines reach the upper region of the 50-level mark of the MFI. Then, wait for the MFI line to cross the MA to the downside in that region. That is your selling opportunity.

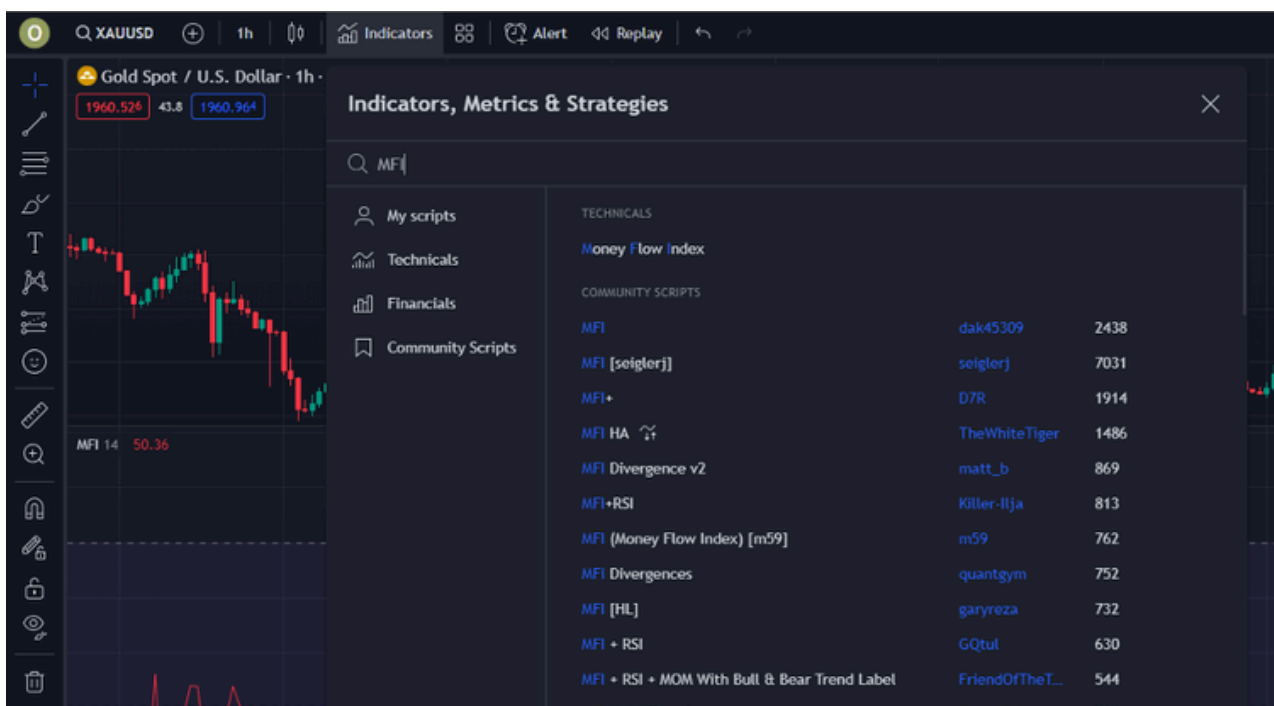
Money Flow Index Indicator Trading Strategy Tutorial

Here's how you would typically look to trade the Money Flow Index indicator:

Step 1: Adding the Indicator to Your Chart

The Money Flow Index is a popular indicator. As such, it often comes custom-built into most trading platforms, including MT4 and MT5. But for now, we'll be sticking to the TradingView trading platform, although the process remains largely the same.

Here's what you need to do – Open your chart and locate the “Indicators” tab at the top left side of the screen. On the search bar that appears, type “MFI.” The indicator should be the first on the list. Click to open it on your chart.



Step 2: Find Buy and Sell Signals and Enter a Trade

We already discussed how to use the MFI indicator to scout trade opportunities. You could use it to spot divergence, identify overbought and oversold levels, or trade trends. For instance, the divergence trading example shown above is a perfect condition where you could get buy and sell signals. Additionally, you could also refer to the strategy involving the MFI in combination with the Moving Average indicator. This strategy is mostly used to identify trends and find trading signals, and is mostly used by [scalp](#) and [day traders](#).

Step 3: Place a Stop Loss and Take Profit Target

Unfortunately, the MFI is not the best indicator to set take profits and stop losses with. However, you can rely on other trade management techniques for these.

For instance, some traders used a risk-reward ratio management system, making their stop losses a certain percentage of their take profit levels. So, if you have a risk-reward ratio of 1:2, your take profit will be twice your stop loss.

Another way to manage your trades is to set your take profits using price action structures, such as support and resistance levels. With supports and resistances, for instance, you close a buy position at the next resistance and a sell position at the next support.

The Money Flow Index Indicator – Pros and Cons

Just as it is with all indicators, the MFI has pros and cons you need to beware of when using it:

The Benefits of the Money Flow Index Indicator

The Money Flow Indicator is a great trading tool that offers a significant success rate when deployed appropriately. It is fairly easy to use and is known as an accurate indicator, especially for short-term traders.

Some of the key benefits of this indicator are highlighted below:

Pros

- The MFI indicator combines price data with volume data and therefore calls trade signals faster than other indicators of its class. The inclusion of the volume data also gives a more reliable perspective of the prevalent market conditions
- The MFI indicator is straightforward to deploy and use, allowing users to invest more time in its profitability than its workability
- It offers trading signals in multiple ways, such as overbought and oversold conditions, divergence conditions, and the beginning of new trends

Limitations of the MFI indicator

While the Money Flow Index has some things going for it, it falls short in some other ways. First, it may provide false signals, and as such, it is best to use other indicators to confirm the signals generated by the MFI indicator. Additionally, due to its parameters of price and volume data, it might stay in overbought or oversold areas for an extremely long time, resulting in traders missing trading opportunities.

In sum, let's look at some of the demerits of using a Money Flow Indicator to take trade positions.

Cons

- The MFI indicator is predisposed to giving false signals. Price action may not go in the direction of the suggested signal
- The indicator may also fail to call signals where it should, resulting in a potentially profitable trading position loss

Frequently Asked Questions About the Money Flow Index Indicator

The following are some of the most frequently asked questions about the MFI indicator.

Which is better, MFI or RSI?

While they each perform similar roles of measuring the level of enthusiasm on an instrument using price data, the MFI includes the volume data of the instrument in its calculations. As a result, the MFI offers a broader picture of the currency pair and is considered a more reliable indicator.

What indicator works best with the MFI?

The MFI can be used with a moving average crossover to determine when to take buy or sell trades. It can also be used with the RSI, Fibonacci support and resistance levels, and other technical analytical tools. Basically, the indicator you combine the MFI with depends on your trading style and strategy.

How do I trade with the MFI?

There are various ways to use the MFI in your trading. You could scout overbought and oversold levels with it. A reading above 80 on the MFI implies that the asset is overbought and you should sell. Similarly, a reading above the 20-level of the MFI means that the asset is oversold, and you should buy.

You could also trade divergences and trends with it. And if you're a more experienced trader, you can develop new ways to use the MFI in your trading.