Stochastics

History

George Lane was the originator of the sochastics in the 1970's. Lane observed that as prices increase in an up trend, closing prices tend to be closer to the upper end of bars and in a down trend closing prices tend to be nearer the lower end of bars. Lane developed stochastics to discern the relationship between the closing price and the high and low of a bar.

Typically used to identify overbought and oversold conditions the indicator consists of two lines: % K and %D. These two lines fluctuate in a vertical range between 0 and 100. Readings above 80 are considered overbought and readings below 20 are considered oversold.

Stochastics can also be use to generate buy and sell signals. When the faster %K line crosses above the slower %D line and the lines are below 20, a buy signal is generated. When the %K lines crosses below the %D line and the lines are above 80 a sell signal is generated.

My Own use Of Stochastics

Well as usual just to be contrary to everyone I don't use the stochastics to signal overbought or oversold although I do take note of the readings. I like to use them as possible buy and sell opportunities after defining a trend. If the trend is up as in the example below on the AUD (Australian Dollar) I like to only take buy signals regardless of the reading as long as the trend remains in place. I ignore the sell signals. I purposefully weaken the stochastics to give me more signals and I use 8,3,3 as my settings.

This gives more signals and shows the hand of the weaker players. The same is true of selling in a down trend. I ignore the buy signals and only take the sell signals. I don't use stochastics on their own as trading method as all the settings I have tried ultimately resulted in to many wipsaws. Experiment with different settings and consider adding this indicator to your trading arsenal.

AUD/USD

Good Trading

Best Regards
Mark McRae

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