

Trading with Bollinger Bands

*with
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A Brief Introduction . . .

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A Beginner's Guide to Day Trading Online

A Beginner's Guide to Short Selling (video)

A Beginner's Guide to Short-Term Trading

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How About You?

- Where are you in your trading career?
- What time frames do you trade?
- Do you use fundamental analysis as a decision support tool?
- Do you use technical analysis as a primary decision support tool?
- Do you currently use Bollinger Bands?
- What additional indicators do you use?

Today's Topic...*Bollinger Bands*

- **Where they are used**
- **Time frames**
- **Basic Concepts...how they work**
- **Combining them with other indicators**
- **What they are**
 - Identify price patterns
 - Confirm trends
 - Locate high-probability setups, entries and exits

Bollinger Bands

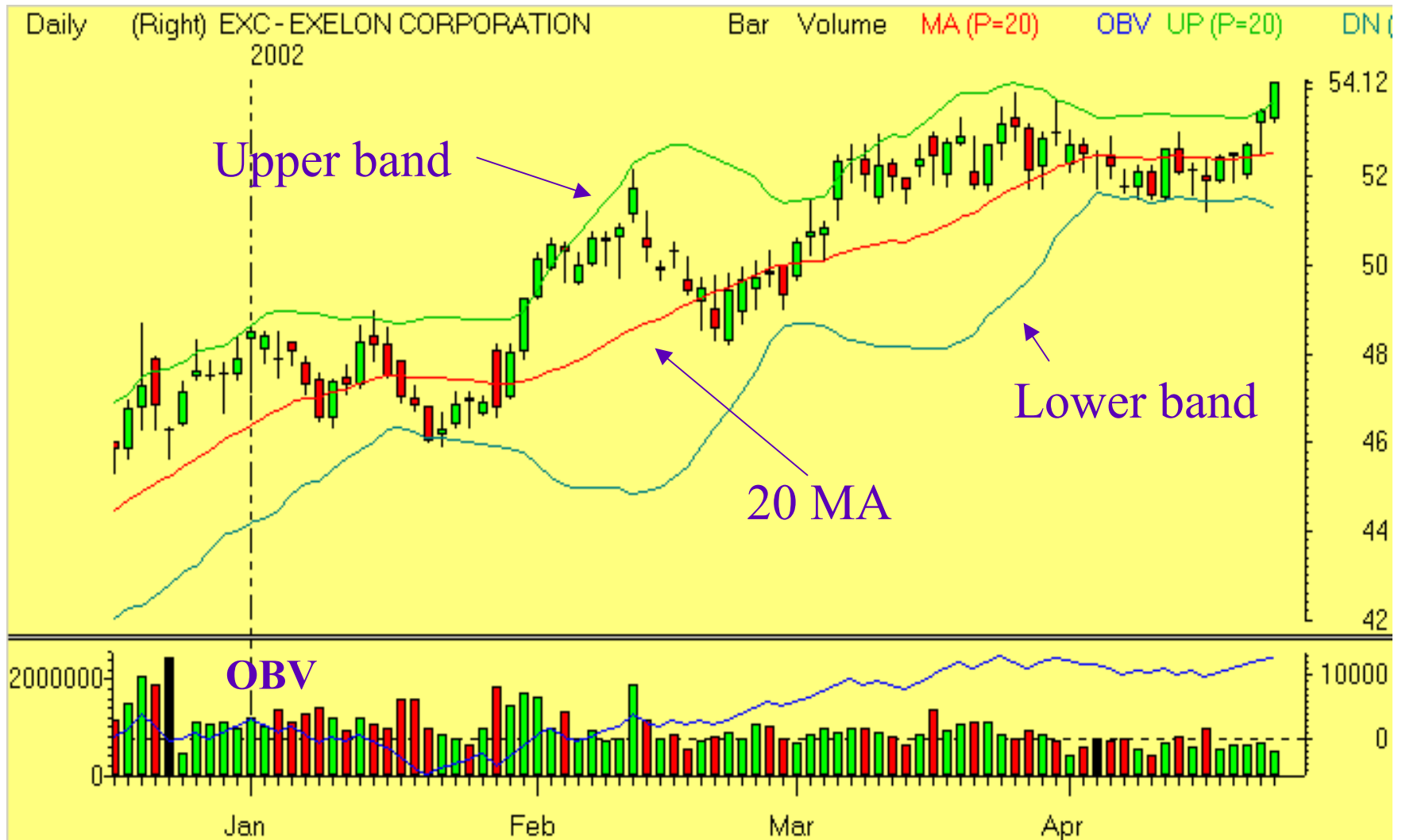
What they are . . .

- Created by John Bollinger in early 1980's
- Consist of upper and lower envelopes, or bands, plotted in and around the price pattern of a stock or index
- Expand and contract according to volatility

Bollinger Bands Ask...

- Question: On a relative basis, are prices high, or low?
- Answer:
 - Prices are high at upper band
 - Prices are low at lower band

Bollinger Bands



Bollinger Bands . . .

- Base: middle band is usually 20-period moving average.
- Upper band: spread above that MA by volatility measure known as “standard deviation.” Default set at 2 standard deviations.
- Lower band: middle band less same volatility measure.

Bollinger Bands...

the formula

FIGURE 4

Bollinger Bands Formulas

$$\sigma = \sqrt{\frac{\sum_{j=1}^N (X_j - \bar{X})^2}{N}}$$

$$\bar{X} = \frac{\sum_{j=1}^N X_j}{N}$$

$$\text{Upper Band} = \bar{X} + 2\sigma$$

$$\text{Middle Band} = \bar{X}$$

$$\text{Lower Band} = \bar{X} - 2\sigma$$

Let's Translate That!



Bollinger Band Applications . . .

- **Decision Support Tool for: stocks, indices, options, commodities, financial futures, currencies, and mutual funds**
- **Effective Time Frames: years, quarters, months, weeks, days, hours, minutes, ticks!**

Three Primary Uses

- Pattern recognition
 - Recognize double tops, head-and-shoulders, double bottoms
- Reversal signals
 - Identify early warning signs of reversals
- Trend analysis
 - Detect trend continuation and conclusion

Bollinger Bands (BB)

Basic Concepts . . .

- Used to compare price and indicator action to arrive at buy and sell decisions
- Confirming indicators should not be directly related to each other
- Price can, and does, walk up the upper BB and down the lower BB

Basic Concepts

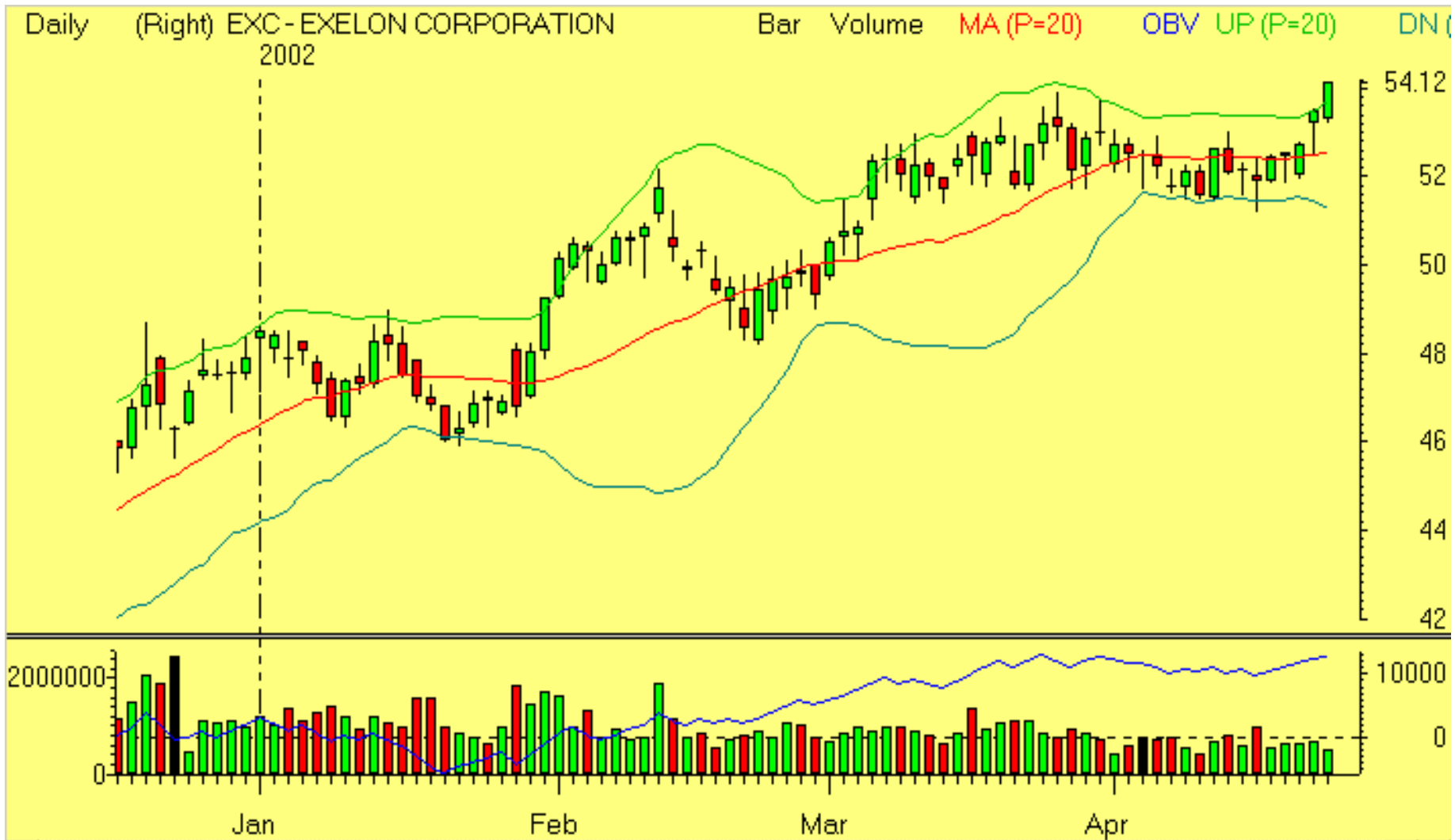


Bollinger Bands (BB)

Basic Concepts . . . continued

- Tags of bands *are not necessarily* buy/sell signals
- Closes outside BBs can be *continuation signals* if confirmed by other indicators
- Contraction (The Squeeze) is followed by Expansion, is followed by Contraction....

Basic Concepts



Basic Concepts . . .

- BBs are based on a simple moving average. Default is 20-period MA with 2 standard deviations.
- Default contains 95% of price action
- Works well on most time frames
- Longer term: 50-period MA, 2.1 std. dev.
- Shorter term: 10-period MA, 1.9 std. dev.

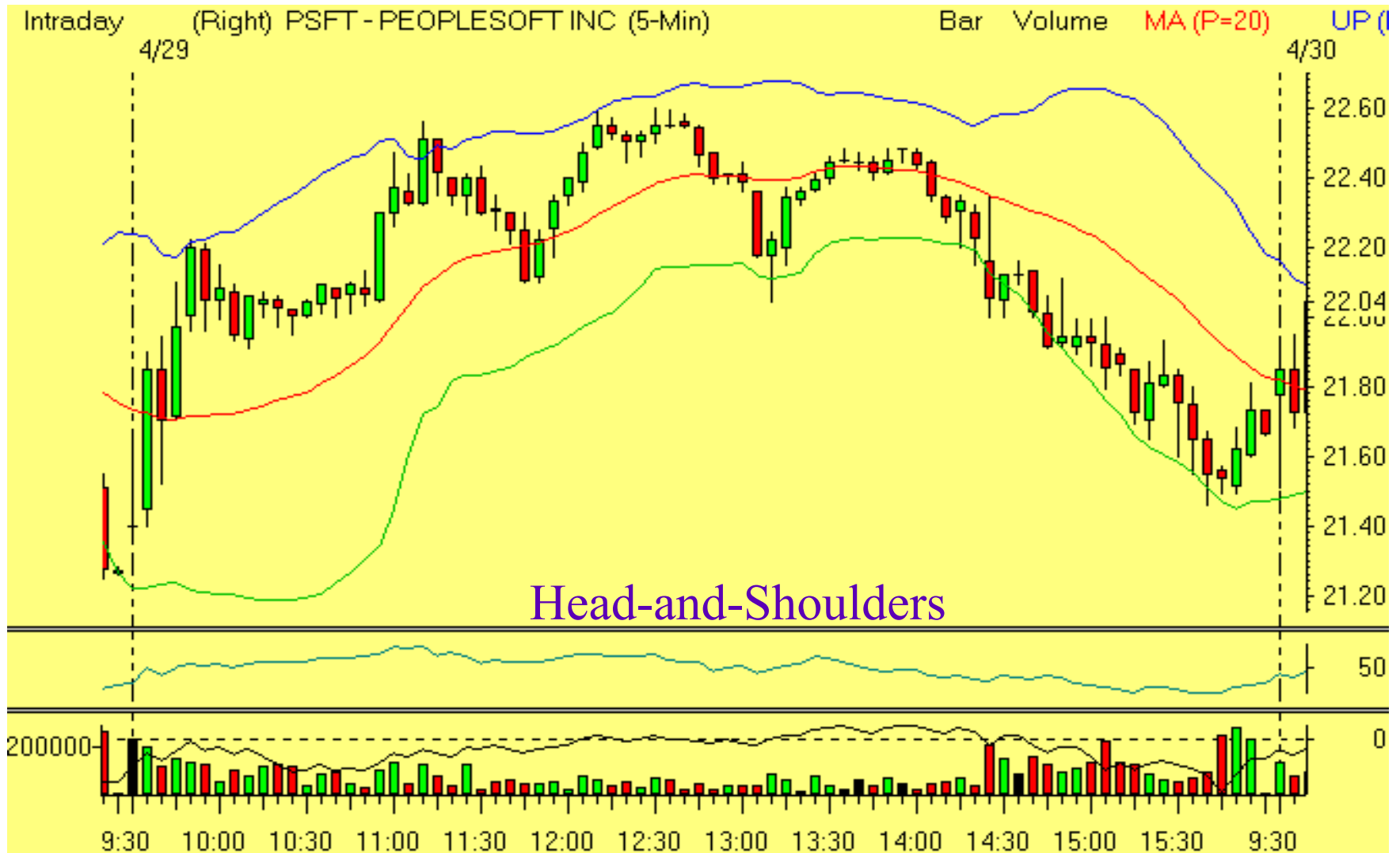
Time Frame: Weekly Chart



Time Frame: 15-Minute Chart



Time Frame: 5-Minute Chart



Strategy: Double Bottom-Bottom Fishing

- Locate stock basing by forming a double bottom (time frame—your choice).
- First bottom may penetrate lower BB.
- Second bottom *may be lower* than prior bottom (!), but *may not penetrate* band.

Strategy: Double Bottom-Bottom Fishing

- Other indicators must show bullish divergence.
- Confirming break to upside must be on high volume.
- Place protective stop just below recent bottom.

Double Bottom-Bottom Fishing



Double Bottom-Bottom Fishing



Shorting Strategy: Double Top Head-and-Shoulders

- Locate stock forming Double (or Triple) Top, or Head-and-Shoulders
- First top, or left shoulder + head, will penetrate upper BB
- Second top, or right shoulder, *may not penetrate* upper band

Shorting Strategy: Double Top Head-and-Shoulders

- Additional indicators show bearish divergence
- **Double Top**
 - **Second pivot: Sell short as stock falls below *low of high day***
 - **Final leg: Sell fall of fall below middle pivot of “M,” or support area**
 - **Low risk: Wait for throwback rally to fail**
- **Head-and-Shoulders**
 - **Sell short as stock breaks neckline**
 - **Low risk: Wait for throwback rally to fail**

Sell Short Double Top



Sell Short Head-and-Shoulders



Strategy: Identify Market Tops



Strategy: Play “The Squeeze”

- Locate a stock in a “tight Squeeze”
- Identify prevailing trend
- Scan additional indicators to prepare for possible entry
- Once in, set trailing stop

Play "The Squeeze"



In Conclusion . . .

- Bollinger Bands help you, the trader and/or investor, to identify price patterns, trend direction, and reversals.
- This knowledge aids you in placing well-thought out, disciplined, low-risk trades.
- Remember...your first priority is *always* to conserve your capital!