STOCHASTIC

The stochastic oscillator is a momentum indicator developed by George Lane that can show you when investor's sentiment changes from being bullish to bearish and from being bearish to bullish. It measures price momentum to identify overbought/oversold conditions, which gives entry or exit decisions. When stoicism forms narrow top, it indicates weakness bulls and when it forms a narrow bottom it indicates a weakness bear.

The stochastic indicator is plotted as two lines, %K and %D. The range of the stochastic oscillator is between 0 and 100. The lower reversal zone is the area of the indicator that is below 20. When %K is above 80, it shows the prices may be overbought and may be reversing trend shortly. When %K is below 20, it shows the prices may be oversold and may be reversing trend shortly. When %K line crosses above %D line , buy signal is generated and When %K line crosses below %D line , a sell signal is generated.

Calculations:

% K = 100 [{C - L (n)} / {H (n) - L (n)}] where C is the current close,

L (n) is the low of the (n) period, and H (n) is the high of the (n) day period.

% D = a moving average of % K for the specified period.

When to use…

Stochastic can be used with several interpretations: among them are divergences, crossovers, and overbought/oversold. Signals of stochastic are to be used in conjunction with trend following indicator. In a strong trending market stochastic can fail completely. When the %K line rises above the %D line it is considered bullish, and when the %K line falls below the %D line, it is considered bearish. A buy signal is generated when either line dips below and then rises above 20, or a bearish signal is generated when either line rises above and then dips below 80.

You can eliminate some false signals by using only the signals that correspond to the direction of the intermediate- to long-term trends.