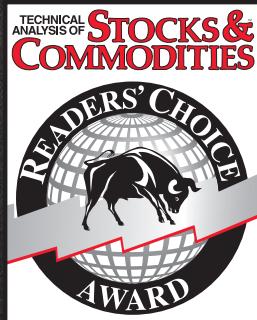


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*Channeling Your Inner Chartist*

# Using Price Channels

*One longstanding and fundamental charting technique is the use of price channels. Here's why so many techniques are based on the concept and why technicians consider them so useful.*

by **Stella Osoba, CMT**

**D**onchian channels are price channels developed by Richard Donchian (1905–1993). Donchian was a pioneer in the field of commodities and futures trading. In 1949 he established the first futures fund. His rule-based trading system became the basis for many modern trend-following systems including the well-known Turtle Trading System.

Price channels, as the name implies, are simply channels that mostly encompass price. The channels are designed to help us see the trend more clearly and trade in the direction of the trend.

## DRAWING DONCHIAN CHANNELS

Donchian channels are comprised of three lines. There is an upper band, a lower band, and a middle line. Each

line is calculated separately. Typically, a 20-day value is used in the calculation of the bands (But any time period can be used depending on your trading timeframe). For the upper band, the highest price in the prior 20 days is used; for the lower band, the lowest price in the prior 20 days is used; and for the middle band, the difference between the readings for the upper band and the lower band is used. The price reading for the current or most recent period is not used in the calculation.

## EXAMPLE

To illustrate using price channels, I will use the stock of ETSY Inc. (ETSY). ETSY is a mid-cap growth stock specializing in the operation of an online marketplace. It is in the consumer discretionary sector. After price made a high of 307.75 on November 26, 2021, the trend changed and price began a long downtrend that continued (Figure 1).

When using price channels, weakness in price is denoted by a fall below the lower line of the price channel, while strength is denoted by a rise above the upper line of the price channel. The fall below the lower price line on December 3, 2021 would have been a signal to go

short in this timeframe. The interpretation is that the fall below the 20-day lower price band is indicative of weakness and selling pressure. Price is making new 20-day lows. It is therefore likely that the trend will continue downwards for a period of time.

### DONCHIAN TRADING TECHNIQUE

The Donchian channel is a technique that aims to keep a trader always in the market, either long or short. You can either use the cross of the middle band to denote when to exit positions, or, to avoid whipsaws, wait to see if there is a cross above the opposite band. The system does not require you to get in at the lows and out at the highs or vice versa. But successful trading will likely mean that you are in the trade for a good amount of the move, as you can see on the chart. Also be aware that this system does not prevent you from whipsaws. Many times, price will move above or below the upper or lower line and not follow through. This is to be expected. But if you can keep your nerves about you, when price does settle into its trend, you will be well positioned to take advantage of it.

*Stella Osoba, CMT, Esq., is an attorney, trader, and financial writer in New York, NY. Her work in financial litigation involving regulatory bodies and large multi-national corporations led to an interest in the financial markets, then technical analysis, and the psychological aspects of market behavior. She earned a CMT charter in 2013 and was a director-at-large on the board of the CMT Association for four years. She frequently writes on the topic of recognizing and applying technical chart patterns for better decision-making in trading. She can be reached at stellaosoba@gmail.com.*



**FIGURE 1: PRICE CHANNEL.** After the price of ETSY Inc. (ETSY) made a high of 307.75 on November 26, 2021, the trend changed and price began a long downtrend that continued.

### FURTHER READING

Hartle, Thom [1992]. “Donchian’s Trading Guides,” sidebar to “Ed Seykota Of Technical Tools,” interview, *Technical Analysis of STOCKS & COMMODITIES*, Volume 10: August.

Penn, David [2002]. “Donchian Breakouts,” *Technical Analysis of STOCKS & COMMODITIES*, Volume 20: February.

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**The channels are designed to help us see the trend more clearly and trade in the direction of the trend.**





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