

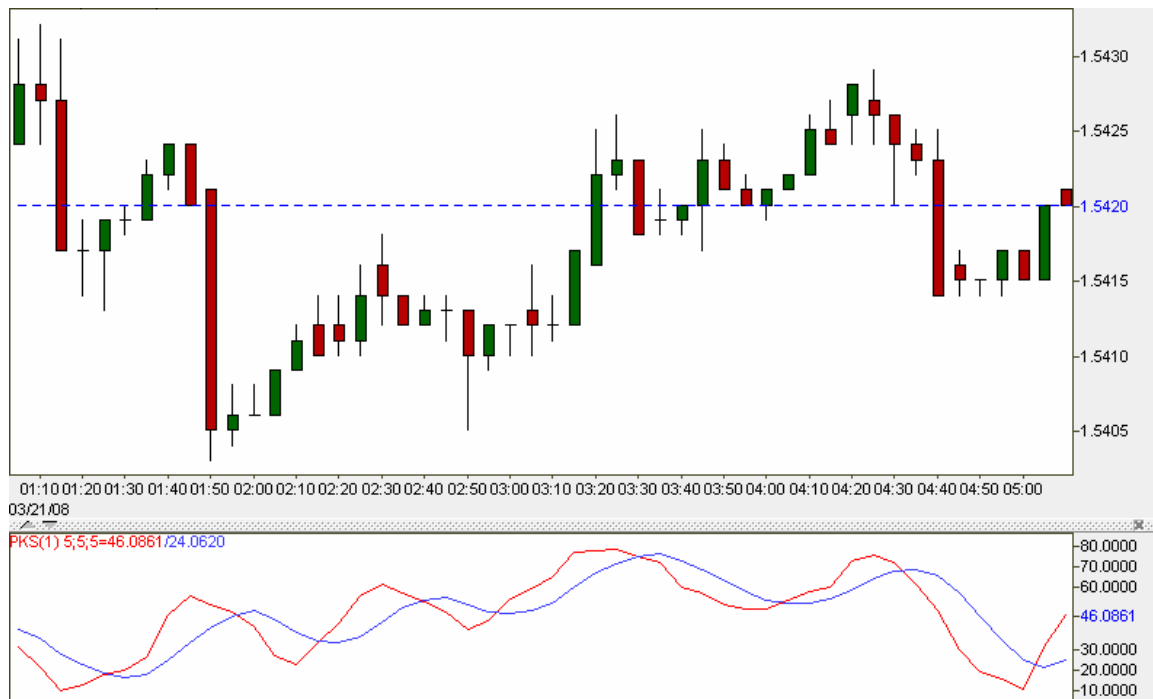
Lesson 8

Indicators, part II: The Oscillators

Oscillating indicators get their name due to their tendency to oscillate within a range of values. They can signal when price is at extreme levels and due for a reversal.

Stochastics

Stochastics consist of a fast line and a slow line, and oscillate between 0 and 100. Levels above 80 are said to be *over-bought* and levels below 20 are referred to as *over-sold*. When the red line crosses above the blue we know that the bulls are overpowering the bears. When the red line crosses below the blue, on the other hand, we know that the bears are beginning to overpower the bulls.



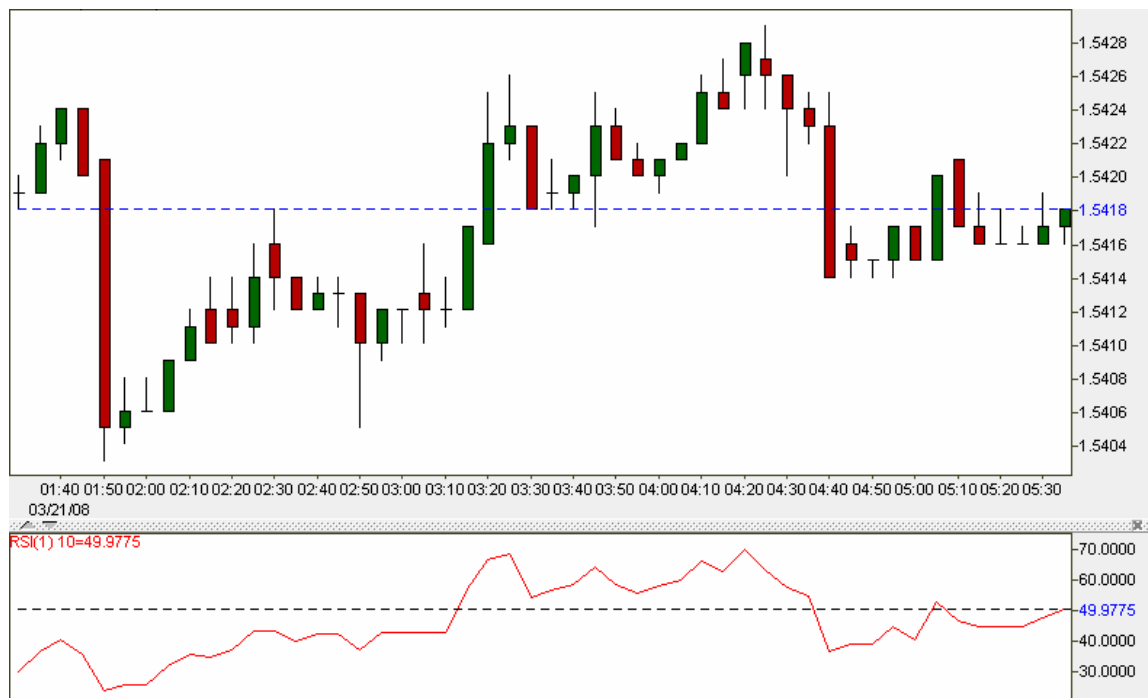
It is best to enter long positions when stochastics first cross above 20, returning from over-sold conditions. This indicates the greatest amount of “room” left for an upward move. As stochastics near 80, we know that we are closer to the end of the move rather than the beginning of it, and may consider staying out of the trade if not already in it from before. As the stochastics begin to turn and cross, we are given a signal to close any remaining long positions.

As they cross back below 80 and return from over-bought conditions, we may look to enter short. If the stochastics are closer to 20 than to 80, we may wish to think twice about entering into any new short positions. Once they cross, we would also look to close any short positions already open from before. Then, as the stochastics break above 20, the cycle repeats and we begin looking to enter long once again.

RSI

The *Relative Strength Index* is similar in its function to stochastics, except it uses 30 to indicate over-sold conditions and 70 to indicate over-bought.

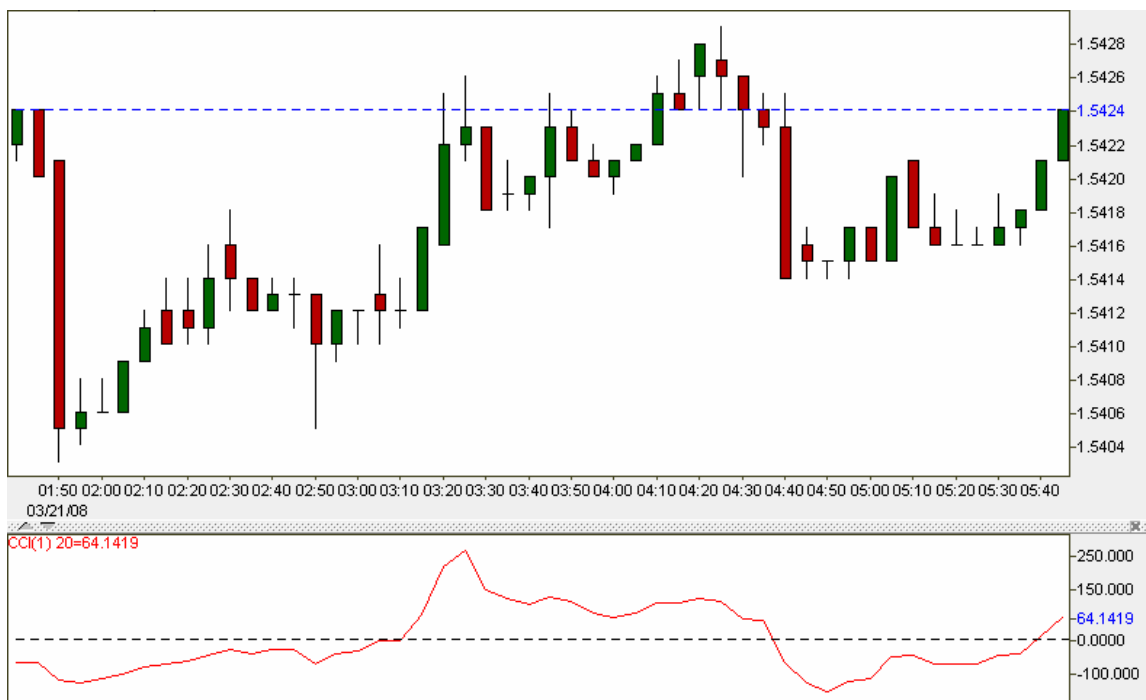
RSI signals a potential long when it breaks above 30, and a potential short if it comes from above and breaks below 70. In addition, levels above 50 confirm an up trend, while levels below 50 indicate a down trend.



CCI

The *Commodity Channel Index* is another oscillator, but unlike the others it has 0 in the middle, and ranges from -300 to +300. Levels above +200 are thought to be over-bought; meanwhile levels below -200 are considered over-sold.

One can consider entering long when the CCI hooks up from any level -200 or below, or going short when it hooks down from +200 or above. In addition, if the CCI drops towards 0 but bounces back up from it instead of crossing below, then look to enter long. Likewise, if CCI is rising up towards 0 from underneath it and then bounces back down without crossing above, that usually signals a potential short. These are known as *continuation* patterns.



Fractals and the Alligator Indicator

Fractals are simple markers which highlight candles which are extremes – that is candles which make a new high but have lower ones on either side, or candles which make a new low, but have higher candles surrounding them. Fractals indicate likely reversal points, and are even more powerful when filtered with the *alligator* indicator.

The alligator is made up of three lines, forming its mouth and tongue. When the alligator opens its mouth, a new trend is emerging, and we can continue to trade this trend until we see signs that the alligator's jaw is about to snap shut. After the alligator eats, he sleeps – but the longer he sleeps the hungrier he gets again. It is because of this sleep and hunger cycle that the alligator indicator is sometimes considered part of the oscillator family.

Longs should be kept open if a fractal appears but is below the alligator's tongue, and short positions can remain open if the fractal is higher than the alligator's tongue.

