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How to trade with stochastic oscillator

The Stochastic Oscillator is an indicator that allows for huge versatility in trading. It was developed by George C. Lane in the late 1950s and is one of the most popular indicators used in Forex, indices, and stock trading. In this article, we will explain what the Stochastic Oscillator is and how it is used. You will also learn the best Stochastic indicator settings for day trading and swing trading as well as several trading strategies which utilise the Stochastic indicator. We can use the Stochastic indicator for the following activities and purposes: The basic premise of the indicator is that momentum precedes the price, so the Stochastic Oscillator, being a momentum indicator, could signal the actual movement just before it happens. What is the Stochastic Indicator? The Stochastic Oscillator is a momentum indicator, which compares a specific closing price of an asset to its high-low range over a set number of periods. It is a range-bound oscillator, operating between 100 and 0 by default. There are two lines shown on the indicator itself – the slow oscillating %K line and a moving average of the same %K that we refer to as %D. Slowing is usually applied to the indicator's default setting of a period of 3. This is what the default setting looks like on the MetaTrader 5 trading platform: Source: Admiral Markets MetaTrader 5 - Stochastic Oscillator settings This is what the Stochastic indicator looks like on the default setting when applied to a price chart: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - GBPUSD Daily Chart. Date Range: 25 July 2019 - 25 August 2020 Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. The Stochastic Oscillator Formula The Stochastic Oscillator is measured using the %K and %D lines %K = $100 [(C - L14) / (H14 - L14)]$ C is the current closing price L14 is the lowest price when looking back at the 14 previous trading sessions H14 is the highest price when looking back at the 14 previous trading sessions %K tracks the most recent market rate for the currency pair %D = 3-period simple moving average (SMA) of %K. It is also called the 'stochastic slow' due its slower reactions to market price changes, as compared to %K. The time periods referred to are the standard periods used, however, this can be changed for different needs in the settings of the indicator - as seen in the image of the settings above. Stochastic Divergence Understanding Stochastic divergence is very important. When the price is making a lower low, but the Stochastic is making a higher low – we call it a bullish divergence. If the price is making a higher high, but the Stochastic is making a lower high – we call it a bearish divergence. Divergence will almost always occur right after a sharp price movement higher or lower. Divergence is just a cue that the price might reverse, and it's usually confirmed by a trend line break. The example below is of bullish divergence with a confirmed trend line breakout: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - GBPUSD H1 Chart. Date Range: 10 June 2020 - 9 July 2020 Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. This is an example of bearish divergence with a trend line breakout: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - USDCHF H1 Chart. Date Range: 24 April 2020 - 23 May 2020 Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. Trade With MetaTrader Supreme Edition Boost your trading capabilities by accessing the latest technical analysis provided by Trading Central, access global opinion widgets, receive FREE real-time news, benefit from superior chart capabilities, and so much more! Click the banner below to download MetaTrader Supreme Edition! Stochastic Day Trading With the Admiral Keltner This Stochastic day trading system uses the following indicators with the following settings: Admiral Keltner (requires MetaTrader Supreme Edition - MTSE) Stochastic (15,3,3) Admiral Pivot (D1) – recommended (also requires MTSE) The correct setting for the Admiral Keltner indicator reads as follows: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - Admiral Keltner Indicator Settings The system is traded on M5-minute time frames, which is suitable for trading major Forex pairs (EUR/USD, GBP/USD, USD/JPY, USD/CHF, AUD/USD), and also including GBP/JPY, AUD/JPY, NZD/JPY, and GBP/NZD. The clear benefit of the Admiral Keltner is that it shows the correct price range, confirmed by the stochastic momentum breakout. The system relies on the OB/OS (overbought/oversold) stochastic zones and is traded on a H1 chart. The rules are as follows: Long Trades: Close of candle below the bottom Keltner line and signal line on the Stochastic at or below 20 An up bar with the signal line on stochastic still at or below 20 PSAR below the candle Short Trades: The candle close above the top Keltner and signal line on the Stochastic at or above 80 A down bar with the signal line on the Stochastic still at or above 80 PSAR below the candle Stop-Loss: For long trades - 5 pips below the next Admiral Pivot support For short trades - 5 pips above the next Admiral Pivot resistance Target: For long trades, targets are the pivot points next to the upside For short trades, targets are the pivot points next to the downside The Stochastic is a great momentum indicator that can identify retracement in a superb way. Don't forget the basic principle of trading – in an uptrend we buy when the price has dropped, and in a downtrend we sell when the price has rallied. This is exactly what the Stochastic is pinpointing – when the price is ready to be sold and/or bought. Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - GBPUSD H1 Chart. Date Range: 18 August 2020 - 25 August 2020. Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. Stochastic Scalping Strategy This scalping system uses different Stochastic indicator settings to the day trading strategy. The point of using the Stochastic this way is the momentum bounce, which is reflected with a unique Admiral Pivot set on hourly time frames. Indicators: Stochastic (13,8,8) with levels 80,50,20 Admiral Pivot (set on H1) Time frame: M5 for entries and M30 for trend direction Pairs: EUR/USD (focus), GBP/USD, GBP/JPY, USD/JPY, AUD/USD, EUR/JPY, USD/CHF Long entries: The Stochastic on the M30 time frame should be just above 20 or just above 50 - signalling an uptrend. Move to the M5 time frame The Stochastic should cross 20 or 50 from below; then place your long entry Short entries: The Stochastic on the M30 time frame should be just below 80 or just below 50 - signalling a downtrend. Move to the M5 time frame The Stochastic should cross 20 or 50 from above; then place your short entry Stop-loss: 5 pips below the previous M30 candle for long entries. 5 pips above the previous M30 candle for short entries. Target: Targets are Admiral Pivot points set on a H1 chart. H1 pivots will change each hour, that's why it is very important to pay attention to the charts. This is a pure scalping system. Pro Tip: We follow the blue line on the Stochastic indicator in this scalping system. In the chart below, the Stochastic Oscillator has just crossed below 80 from above. We are looking for short entries: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - EURUSD M30 Chart. Date Range: 21 August 2020 - 25 August 2020. Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. We move to the M5 time frame and wait until the Stochastic crosses 20 or 50 from below. The long entries, highlighted below, are made as soon as the Stochastic blue line crosses 20 and 50. Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - AUDUSD M5 Chart. Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. Stochastic Crossovers in the Overbought/Oversold Zone Explained Contrary to many scalping and day systems that rely on a single Stochastic line (usually the faster one - the solid line in previous examples) identifying Overbought/Oversold (OB/OS) conditions and crossovers is slightly different. Generally, the zone above 80 indicates an overbought region, and the zone below 20 is considered an oversold region. A crossover signal occurs when both Stochastic lines cross in the overbought or oversold region. An oversold sell signal is given when the oscillator is above 80, and the solid blue line crosses the red dotted line, while still above 80. Conversely, an overbought buy signal is given when the oscillator is below 20, and the solid blue line crosses the dotted red line, while still below 20. 80 and 20 are the most common levels used, but can also be modified as required. For OB/OS signals, the Stochastic setting of 14,3,3 works pretty well. The higher the time frame, the better, but usually, a 4h or a Daily chart is the optimum for day traders and swing traders. The advantage of identifying overbought/oversold crossovers is that traders could jump in a trade early and ride the move from the earliest point. The drawback of this approach is that the price can remain in the OB/OS zone for a long time, making crossovers futile until the Stochastic indicator actually breaks 80 or 20. Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - USDJPY Daily Chart. Date Range: 3 March 2020 - 25 August 2020. Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. Swing Trading With the Admiral Pivot This strategy uses the following indicators applied on the chart: SMA (150) Admiral Pivot (set on monthly pivot points) Stochastic (6,3,3) with levels at 80 and 20 RSI (3) with levels at 70 and 30 This is a swing trading trading strategy, suitable for part-time traders and traders who don't like to sit watching charts all day. It is traded on a daily time frame. Buy: The price needs to be above the 150 SMA The RSI needs to be either below 30 or crossing 30 from below The Stochastic needs to cross 20 from below Enter a long position Sell: The price needs to be below the 150 SMA The RSI needs to be either above 70 or crossing 70 from above The Stochastic needs to cross 80 from above Enter a short position Pro Tip: The price needs to be close to the SMA before placing an entry. Targets are daily pivot points shown by the Admiral Pivot indicator. Traders can also opt to use a trailing stop. For uptrends, a trailing stop is activated for the first time when the Stochastic reaches 80. For downtrends, a trailing stop is activated when the Stochastic reaches 20. For starters, traders can move trailing stops in the following way: For uptrends, a trailing stop is placed below the previous bar's lowest price and is moved with each new price bar For downtrends, a trailing stop is placed above the previous bar's highest price and is moved with each new price bar Additionally, traders might want to move trailing stops: If a trader is in a buy position and the Admiral Monthly pivot resistance is broken, you could move your stop-loss a couple of pips below the resistance, securing the profits If a trader is in a sell position and the Admiral Monthly pivot support is broken, you could move your stop-loss a couple of pips above the support, securing the profits A Stop-loss is placed just above the most recent swing high (for short entries) and just below the most recent swing low (for long entries). Sell Entry Example: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - USDCHF Daily Chart. Date Range: 30 August 2019 - 25 August 2020. Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. Buy Entry Example: Depicted: Admiral Markets MetaTrader 5 with MTSE Add-on - EURUSD Daily Chart. Date Range: 30 August 2020 - 25 August 2020. Captured: 25 August 2020. Disclaimer: Charts for financial instruments in this article are for illustrative purposes and does not constitute trading advice or a solicitation to buy or sell any financial instrument provided by Admiral Markets (CFDs, ETFs, Shares). Past performance is not necessarily an indication of future performance. Conclusion The Stochastic Oscillator in Forex trading is often used with the RSI, the MACD, the CCI, and even the ADX indicator. The trading strategies that we've used above can also be a unique way to look into the markets. The Stochastic Oscillator works best when using the standard MetaTrader indicator that you can find on both the MT4 and MT5 platforms. Some custom-made Stochastic indicators may cause slowdowns, and may even use different Stochastic formulas. It is highly advised to open a demo trading account first and practise these strategies, so that you can successfully apply them later on your live trading account. Risk Free Trading With A Demo Account Professional traders that choose Admiral Markets will be pleased to know that they can trade completely risk-free with a FREE demo trading account. Instead of heading straight to the live markets and putting your capital at risk, you can avoid the risk altogether and simply practice until you are ready to transition to live trading. Take control of your trading experience, click the banner below to open your FREE demo account today! 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