Module 5 – Chapter 4 – Bollinger Bands

The Bollinger Bands were developed by John Bollinger in the 1980s as a tool to help traders identify potential price volatility and relative high or low prices in relation to previous trades. These bands provide a relative definition of high and low prices and can be used to identify potential overbought or oversold conditions.

What it is and what it shows

Bollinger Bands consist of three lines:

Middle Band - A simple moving average (typically a 20-period SMA)

Upper Band - Middle band + (multiplier x standard deviation)

Lower Band - Middle band - (multiplier x standard deviation)

Standard settings involve a 20-day period with a 2 standard deviation multiplier, but these can be adjusted based on the asset and timeframe being traded.

The key features of Bollinger Bands are the spacing between the bands and their relative position to the current price. When the bands contract, it can indicate a period of low volatility, often referred to as the "squeeze." When they expand, it suggests increased volatility.

How to trade it

There are several strategies and signals that traders use with Bollinger Bands:

1) **Bollinger Bounce**: One of the most common strategies is the 'Bollinger Bounce', which capitalizes on the nature of the bands to act as support and resistance levels. Prices tend to bounce back from the outer bands.

Example: If a stock's price touches the lower band and begins to turn upward, traders might consider it as a buying opportunity, expecting the price to bounce back toward the middle band.

2) Bollinger Squeeze: A squeeze denotes a period of low volatility and is considered by traders as a potential indicator of future increased volatility and possible trading opportunities.

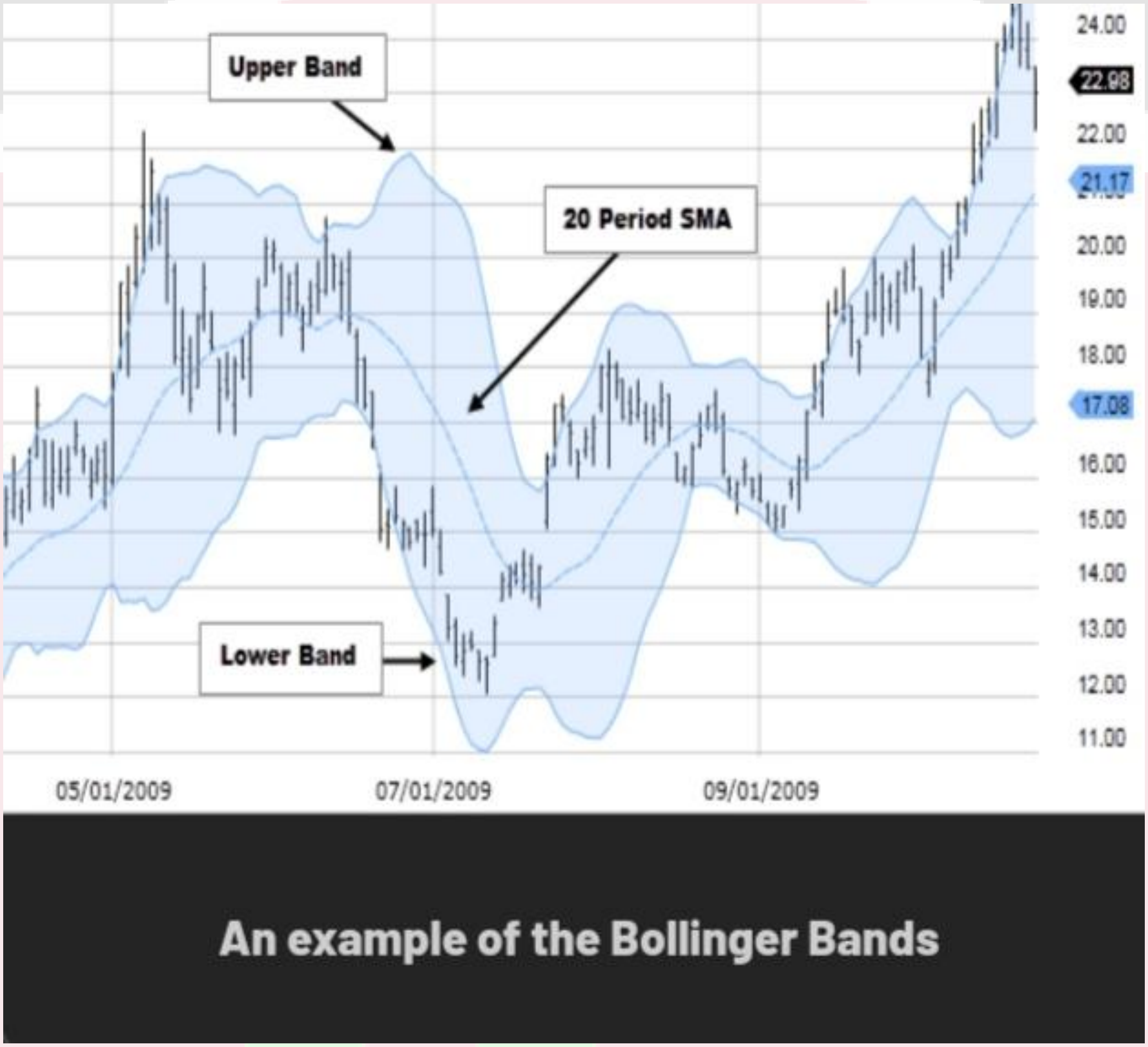
Example: If the bands squeeze together tightly, it could be an indication that a breakout, either upward or downward, might be imminent.

3) **Riding the Bands**: In a strong uptrend, price might ride the upper band, and during a downtrend, it might ride the lower band. This can be a signal that the current trend is strong and might continue.

4) **Bollinger Band Breakouts:** Traders might buy or sell securities when the price breaks and closes outside of the bands.

Example: If a stock's price closes above the upper Bollinger Band, some traders might view this as a sign to sell, anticipating a pullback toward the middle band. Conversely, a close below the lower band might prompt a buy order.

When utilizing Bollinger Bands, it's always recommended to use them in conjunction with other technical indicators or methods to confirm signals and make more informed trading decisions.



An example of the Bollinger Bands

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