

# Stochastic secrets

By [RedTrader](#) and contributors, 07-10-08

## A. Preamble

The purpose of indicators appears to be misunderstood by a certain class of traders. An indicator comes in help to a trader in the next ways:

- › If we consider the fact that a classic indicator (Stochastic, RSI, Bollinger bands, moving average, ADX etc.) is used by a big percent of the active traders, we can point to the conclusion that all of them, seeing at a certain time a certain signal (or almost the same signal) of the classic indicator they use, will be tended to act in the same way. This is the result of the so called mass psychology. So, an indicator, helps a trader by offering him a tip regarding what the majority sees and, as a result, is tended to do;
- › If the indicator is coupled to a profitable strategy, it's signal(s) contribute to a much bigger certainty;
- › In some strategies it offers a better price or an advantageous moment for the trade opening.

## B. Quotes

*"The losers teach you, the winners feed you."*

[Titus](#)

*"If for a song, a certain instrument will make the song complete, for a trader, an indicator would ennoble the trading style."*

[RedTrader](#)

*"Stochastic helps you to <<listen>> to the market."*

[Aiyahmarklah](#)

P.S. Every indicator has it's limitations.

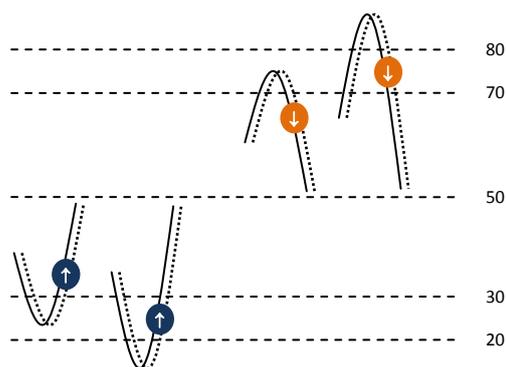


### C. Stochastic settings

Values	Parameters	Levels
K% = 3	MA = simple Price field = Low/High	80
D% = 2		70
Slowing = 3		50
		30
		20

(Assuming that the trader, respects the basic rules of trend trading).

- > if it moves under 30 but not under 20, wait to get over 30 and then buy;
- > if it moves under 20, wait to get over 20 and then buy (on a lower volatility it's recommended to get over 30).



### D. Entry points

#### 1. Classic crossing (cc)

Characteristics:

- > it occurs over the 70 or 80 level/under the 30 or 20 level;
- > has only one intersection;
- > after the intersection, it returns in the 70-30 (80-20) interval.

Interpretation:

- > if it moves over 70 but not over 80, wait to get under 70 and then sell;
- > if it moves over 80, wait to get under 80 and then sell (on a lower volatility it's recommended to get under 70);

#### 2. Knotted crossing (kc)

Characteristics:

- > it occurs over (or on) the 70 or 80 level/under (or on) the 30 or 20 level;
- > makes a *knot*<sup>1</sup>;
- > after the knot, it returns in the 70-30 (80-20) interval.

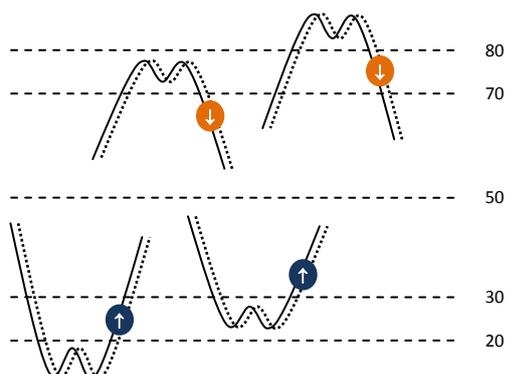
<sup>1</sup> *Knot* = a series of (usual) 3 consecutive intersections, disposed horizontally or angled, occurring outside or on the 30-70 interval, intersections from which only the last is reliable.

Interpretation:

- > if the knot forms above 70 but not over 80, wait to get under 70 and then sell;
- > if the knot forms above 80, wait to get under 80 and then sell;



- > if the knot forms under 30 but not under 20, wait to get over 30 and then buy;
- > if the knot forms under 20, wait to get over 20 and then buy.



Interpretation:

- > after the signal over the 70 level it's received, then, on a bigger time frame a) there should have been received a classic crossing buy type signal (§ D.1.) or b) the stochastic should be in the continuation status (§ E.3.);
- > after the signal under the 30 level it's received, then, on a bigger time frame a) there should have been received a classic crossing sell type signal (§ D.1.) or b) the stochastic should be in the continuation status (§ E.3.).

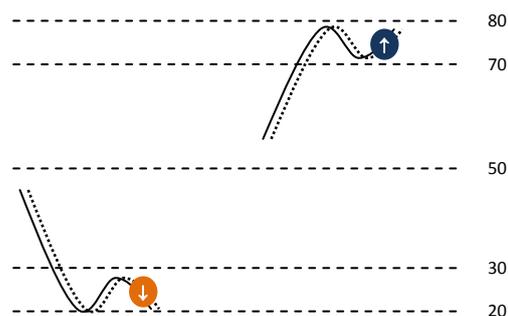
### 3. Reversed crossing outside the 30-70 interval (outside rc)

The reversed crossing differs from the knotted crossing in this way:

- > **between the first and second intersection there is a free space (no other intersections) that corresponds on the chart with at least 2 closed candles/bars .**

Characteristics:

- > occurs over the 70 level/under the 30 level;
- > has 2 intersections;
- > between the first and the second intersection there is free space;
- > the second signal is opposite to the first.



Specifications:

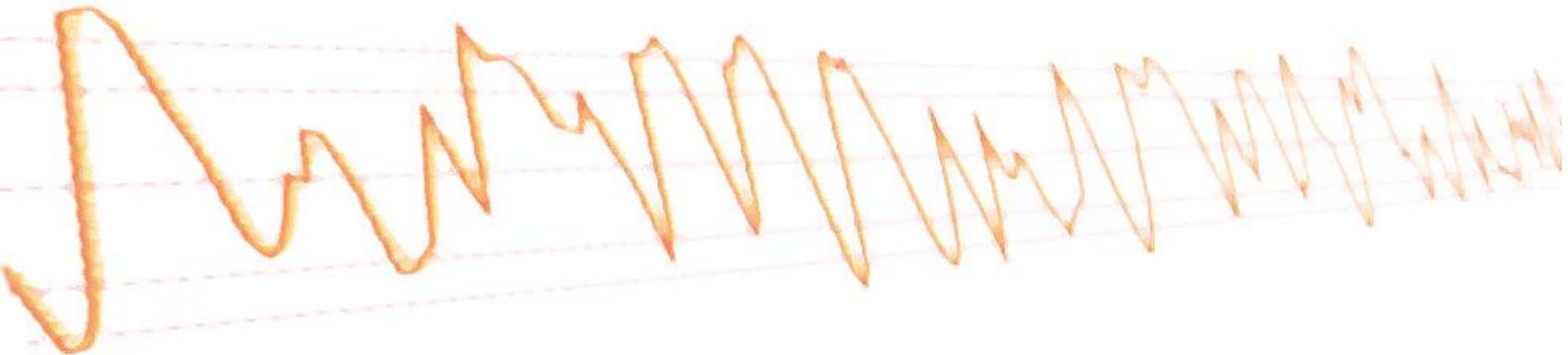
- > for recommended close points see § F.

### 4. Reversed crossing inside the 30-70 interval (inside rc)

**Read first the bolded text from § D.3.**

Characteristics:

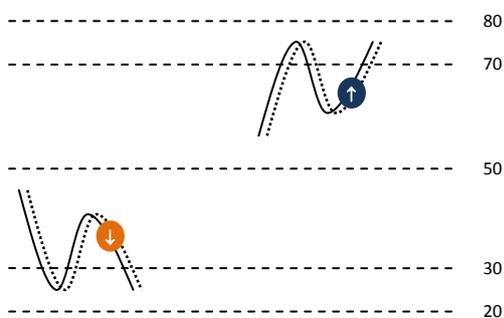
- > occurs under the 70 level/over the 30 level;



- > has 2 intersections;
- > between the first and the second intersection there is free space;
- > the second signal is opposite to the first.

Interpretation:

- > after the signal under the 70 level it's received, then, on a bigger time frame a) there should have been received a classic crossing buy type signal (§ D.1.) or b) the stochastic should be in the continuation status (§ E.3.);
- > after the signal over the 30 level it's received, then, on a bigger time frame a) there should have been received a classic crossing sell type signal (§ D.1.) or b) the stochastic should be in the continuation status (§ E.3.).



Specifications:

- > recommended if the correction received a classic crossing but the impulse didn't, with the scenario that stochastic couldn't give as well a classic crossing signal and reversed crossed in the 30-70 area;
- > because the outside rc tends to be stronger than the inside rc, more attention and a good money management are required.

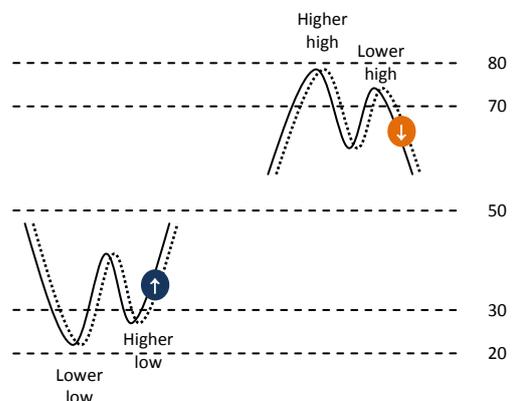
### 5. Power peak (pp)

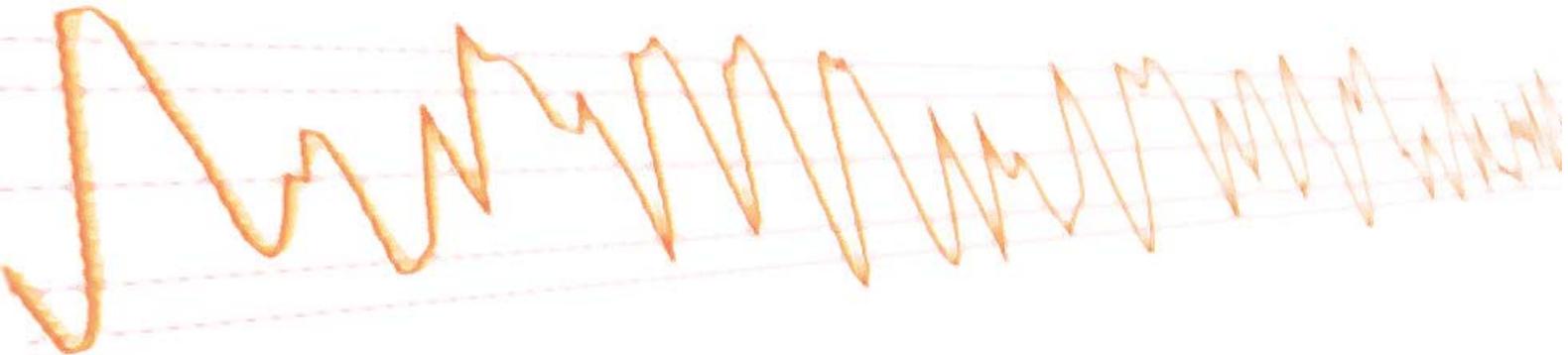
Characteristics:

- > consists of 2 classic crossings (as a result, occurs over the 70 level/under the 30 level);
- > on a flat or a descending trend (when sell is expected), the first intersection will be a higher-high and the second intersection a new lower-high;
- > on a flat or a ascending trend (when buy is expected), the first intersection will be a lower-low and the second intersection a new higher-low.

Interpretation:

- > if on a flat or descending trend, it gives a cc signal over the 70 level, but the price remains in consolidation, wait for another cc signal under or on the 70 level and then sell;
- > if on a flat or ascending trend, it gives a cc signal under the 30 level, but the price remains in consolidation, wait for another cc signal over or on the 30 level and then buy.





## 6. Divergence

As many other oscillators, stochastic also shows divergences.

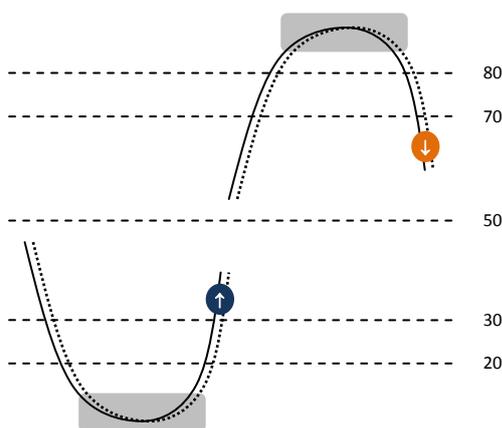
## 7. Arc

Characteristics:

- › outside the 30-70 interval, it makes an arc (a long loop which stays outside a long while).

Interpretation:

- › on a flat or descending trend, after it comes under 70, sell;
- › on a flat or ascending trend, after it comes over 30, buy.



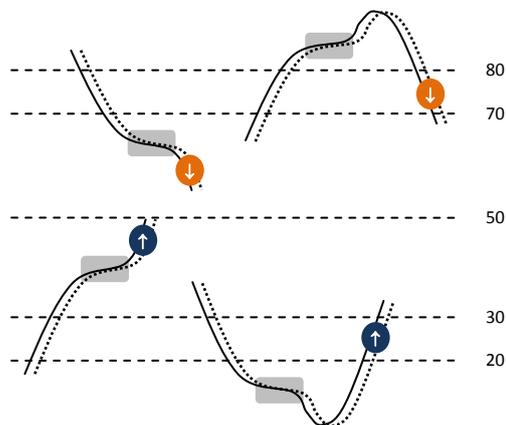
## 8. Minus

Characteristics:

- › the stochastic lines (%K and %D) merge, forming a single straight line, which can be horizontal or angled.

Interpretation:

- › if it occurs inside the 30-70 interval, a) look for a signal on a lower time-frame or b) wait until the lines unmerge and open a position in that direction (which should be the same as the direction indicated before the merge) – otherwise don't open any position;
- › if it occurs outside the 30-70 interval a) if you have an active position, lock a profit and wait the eventuality of continuation of the previous move or b) treat it like a cc crossing.



Specifications

- › This procedure requires a bigger stop loss.



## E. Waiting moments

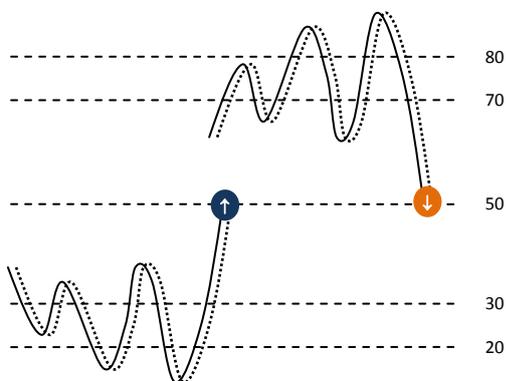
### 1. End of low noise (eln)

Characteristics:

- › a period when in the 30 level/70 level area many contradictory signals were received.

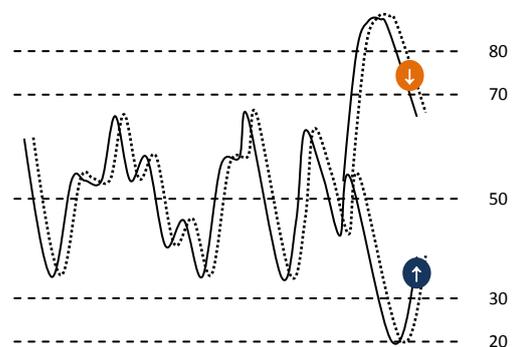
Interpretation:

- › wait until stochastic touches the 50 level and then you can a) wait for signals specified in §D. or b) if it comes from level 30, buy and if it comes from level 70, sell.



Interpretation:

- › wait for stochastic to touch the 80 level, and after that wait for signals specified in §D.;
- › wait for stochastic to touch the 20 level, and after that wait for signals specified in §D.;



### 2. Continuation status

Interpretation:

- › assuming that at least one trade is open and has its locked profit, as long as on a bigger time-frame, an opposite signal is not received, the trader should wait for the price to move in his/her favor.

### 1. End of high noise (ehn)

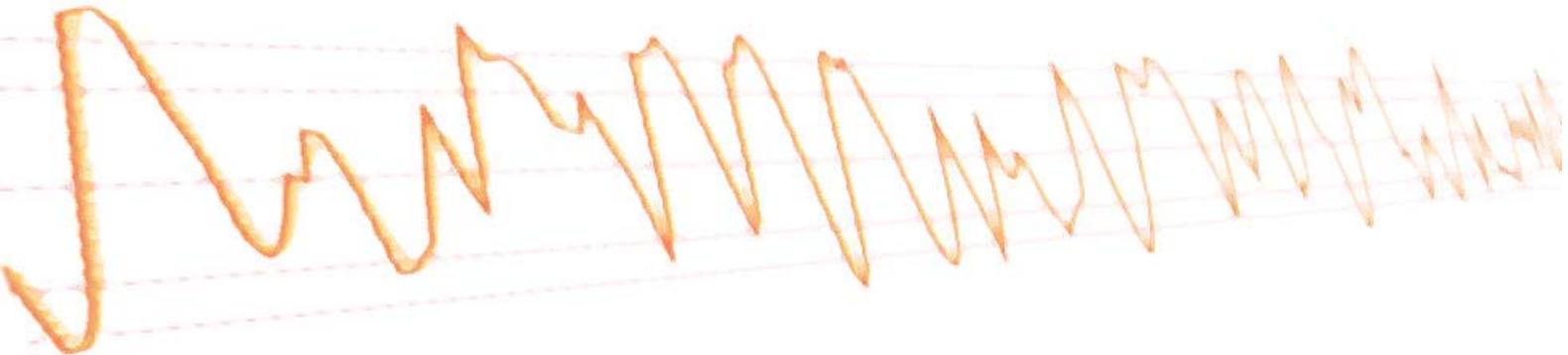
Characteristics:

- › a period when inside the 30-70 area, many contradictory signals were received.

## F. Closing points

### 1. The opposite signal

Interpretation: › assuming that at least one trade is open and has its locked profit, after on a bigger



time-frame, an opposite signal was received, the trader should think about a) readjusting the amount of locked profit or b) close the trade and wait for a reversal.

## G. Other stochastic settings

Values	Parameters	Levels
K% = 5	MA = simple Price field = Low/High	80
D% = 3		20
Slowing = 3		

Values	Parameters	Levels
K% = 4	MA = simple Price field = Low/High	80
D% = 2		50
Slowing = 3		20

Values	Parameters	Levels
K% = 14	MA = simple Price field = Low/High	80
D% = 3		50
Slowing = 3		20

Values	Parameters	Levels
K% = 14	MA = simple Price field = Low/High	80
D% = 4		
Slowing = 7		20

Values	Parameters	Levels

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Values	Parameters	Levels
K% = 30	MA = simple Price field = Low/High	80
D% = 4		20
Slowing = 4		

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Values	Parameters	Levels
K% = 8	MA = simple Price field = Low/High	80
D% = 3		20
Slowing = 3		

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