

TRADING STRATEGIES

Lesson 3





Binary Options

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Lesson03

Trading with Strategy in Mind

Using support and resistance lines to trade Binary Options successfully

Support and resistance lines are actually very easy to understand, even if they seem complex at first. Support and resistance lines are simply patterns that emerge when we analyze charts and look for the direction of price movements. These support and resistance lines are used as signals by the majority of traders to enter their trades. For you, knowing at which prices new directions will emerge can be extremely useful for trading Binary Options successfully. Looking at the chart below, this will become quickly apparent.





The daily candlestick chart above shows the AUD/USD. It is easy to spot the support line. The support line indicates the direction of trading over several days. More importantly, the support line shows exactly where traders stopped trading down, as the overall trend upward continued. Most traders would agree that the upward trend would change if the support line was broken (if prices moved down through the support line). Once the support line was broken, most traders concentrated their trades in the new downward direction. As a result, a strong directional bias (trend) downward got underway. This information can be critical for trading Binary Options successfully.

In the example above, if you had identified this support line and traded a PUT Binary Option when the support line was broken, your chances of success would have been very high. Further trades of PUT Binary Options would have had higher than normal chances of success given the downward trend that ensued.

Using technical indicators to trade Binary Options successfully

Technical indicators are mathematical analyses of financial instruments. We can use technical indicators to better understand their behavior. By understanding the behavior of a financial instrument we can predict its movement in the short and even long term, and this can greatly improve our success when trading Binary Options. In the examples provided in this section we will focus on a few of the leading technical indicators: Bollinger Bands, MACD, Stochastic Slow, and Simple Moving Averages (SMA's).

But first, in order to understand the power of technical indicators, we must accept the reason that technical indicators work. The simple fact is that technical indicators are successful because of their popularity among traders. The reason for this is that 'volume generates movement', meaning that the more people trade in a certain direction the more that direction will continue. By trading using these indicators you are essentially trading in the same direction as many other traders. This insight can be very useful when trading short term, especially in Binary Options.



In the examples below we will be using combinations of 2 technical indicators for each trade signal. The reason for this is that when one strategy confirms another, it is more likely to be correct. Another way to think of this is that if many traders follow one indicator and many others follow a different indicator, then when both indicators give us a signal at the same time and in the same direction, then many, many traders will trade in that direction, creating momentum and reinforcing that direction.

Using MACD and 100SMA in conjunction





The chart above is a 1 hour chart of Gold futures, with the price of Gold indicated by the bold black line. We can also see 2 technical indicators, the MACD, shown as verticals lines below the chart, and a 100SMA (simple moving average calculated over 100 data points), shown as a blue line overlaying the chart. For further information on how these indicators are calculated, please refer to the last section “Explanation of technical indicators”.

The 1st trading signal is given by the MACD as it crosses over 0. This is highlighted by the dotted blue line. Many traders use this as a signal that Gold is changing direction. You might be right if you choose at this point to buy a Call Binary Option. However it is much wiser to wait for a confirmation signal, which is a point at which many more traders will enter trades and reinforce this direction. The confirmation

signal is given by the 2nd technical indicator. This 2nd trade signal occurs where the price of Gold (bold black line) crosses over the 100SMA (blue line). We have also highlighted this crossover with a dotted blue line. At this point many more traders who are using this indicator enter in this direction and reinforce your 1st signal. This is a much safer point to trade a Call Binary Option. The result is that in the short term, prices remain above the 100SMA, increasing your chances of success if you traded a Call Binary Option at the 100SMA crossover.



Using Bollinger Bands and Slow Stochastic in conjunction



The chart above is the same 1 hour chart of Gold futures as in the 1st example. Here we show other popular indicators. When they are used in conjunction to confirm each other then usually trading volume is high and the trend will persist.

Our 1st indicator is the Bollinger Bands (green lines) overlaying the chart. These green lines show the average price highs and lows within the trading range. When the price of Gold 'bounces' off the bottom Bollinger Band this is our 1st signal. When this 1st signal is confirmed by a 2nd technical indicator this means that even more traders will enter to reinforce the trading direction.



Our 2nd trading signal is given by the indicator at the bottom which is the Slow Stochastic. The Slow Stochastic is simply a combination of 2 moving averages of different lengths. When they cross over each other this means that a change has occurred in the direction of the price movement of the financial instrument. The crossover is highlighted above by a dotted blue line.

The entry points to trade Call Binary Options are the same as in the 1st example, and the outcome is the same.

As a final point, using multiple indicators to confirm each other is common practice amongst advanced traders and has been proven to be a very effective strategy to trade Binary Options successfully. You may choose any combination of technical indicators that you wish. The combination of indicators shown above is for illustrative purposes, and you may find another combination that works better for you.

Explanation of technical indicators

Bollinger Bands

Bollinger Bands are a technical analysis tool invented by John Bollinger in the 1980's. Having evolved from the concept of trading bands, Bollinger Bands can be used to measure the highness or lowness of the price relative to previous trades.

Bollinger Bands consist of:

- A middle band being an N-period simple moving average (MA)
- An upper band at K times an N-period standard deviation above the middle band
(MA + $K\sigma$)
- A lower band at K times an N-period standard deviation below the middle band
(MA - $K\sigma$)

Typical values for N and K are 20 and 2, respectively. The default choice for the average is a simple moving average, but other types of averages can be employed as needed. Exponential moving averages are a common second choice. Usually the same period is used for both the middle band and the calculation of standard deviation.



MACD

MACD stands for Moving Average Convergence / Divergence, a technical analysis indicator created by Gerald Appel in the late 1970's. It is used to spot changes in the strength, direction, momentum, and duration of a trend in a stock's price.

The MACD is a computation of the difference between two exponential moving averages (EMA's) of closing prices. This difference is charted over time, alongside a moving average of the difference. The divergence between the two is shown as a histogram or bar graph.

Exponential moving averages highlight recent changes in a stock's price. By comparing EMA's of different periods, the MACD line illustrates changes in the trend of a stock. Then by comparing that difference to an average, an analyst can chart subtle shifts in the stock's trend.

Since the MACD is based on moving averages, it is inherently a lagging indicator. As a metric of price trends, the MACD is less useful for stocks that are not trending or are trading erratically.

Note that the term "MACD" is used both generally, to refer to the indicator as a whole, and specifically, to the MACD line itself.

Simple Moving Average

A simple moving average (SMA) is the un-weighted mean of the previous n data points. For example, a 10-day simple moving average of closing price is the mean of the previous 10 days' closing prices. If those prices are: $p_{m-9}, p_{m-8}, \dots, p_{m-1}, p_m$

then the formula is: $SMA = (p_{m-9} + p_{m-8} + \dots + p_{m-1} + p_m) / 10$

When calculating successive values, a new value comes into the sum and an old value drops out, meaning a full summation each time is unnecessary.

$$SMA_{(today)} = SMA_{(yesterday)} - \{P_{m-n} / n\} + \{P_m / n\}$$



In technical analysis there are various popular values for n, like 10 days, 40 days, or 200 days. The period selected depends on the kind of movement one is concentrating on, such as short, intermediate, or long term. In any case moving average levels are interpreted as support in a rising market, or resistance in a falling market.

In all cases a moving average lags behind the latest data point, simply from the nature of its smoothing. An SMA can lag to an undesirable extent, and can be disproportionately influenced by old data points dropping out of the average. This is addressed by giving extra weight to more recent data points, as in the weighted and exponential moving averages.

One characteristic of the SMA is that if the data have a periodic fluctuation, then applying an SMA of that period will eliminate that variation (the average always containing one complete cycle). But a perfectly regular cycle is rarely encountered in economics or finance.

For a number of applications it is advantageous to avoid the shifting induced by using only 'past' data. Hence a central moving average can be computed, using both 'past' and 'future' data. The 'future' data in this case are not predictions, but merely data obtained after the time at which the average is to be computed.

Slow Stochastic

In technical analysis of securities trading, the stochastics oscillator is a momentum indicator that uses support and resistance levels. Dr. George Lane promoted this indicator in the 1950's.

The term stochastic refers to the location of a current price in relation to its price range over a period of time. This method attempts to predict price turning points by comparing the closing price of a security to its price range.

The indicator is defined as follows:

$$\%K = 100 \left\{ \frac{\text{closing time} - L}{H - L} \right\}$$

where H and L are respectively the highest and the lowest price over the last n periods, and %D = 3 period moving average of %K. In working with %D it is important to remember that there is only one valid signal—a divergence between %D and the security with which you are working.

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