
# Bollinger Band Divergence

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**RUSS HORN FOREX MASTER METHOD's**

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# Preface

I know that many traders use the Bollinger Bands in their day to day trading. When a trader is comfortable with a certain indicator, it can be difficult to let it go for something else. The beauty of the Forex Master Method is that we can include the Bollinger Bands in our studies.

Bollinger Bands can show divergence. This manual will show you how to identify BB Divergence and how you can incorporate it into the FMM system.

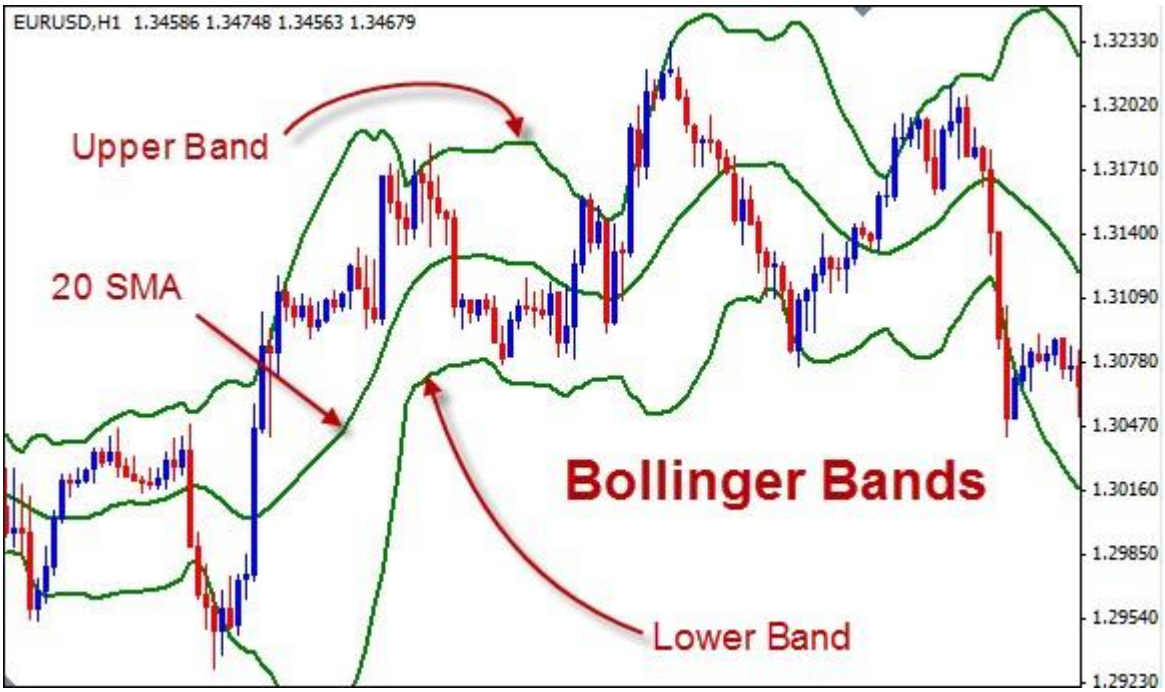
It's important to note that this manual goes hand in hand with the Forex Master Method (FMM) system. We will NOT abandon FMM rules and signals. Directional Bias (DB) will show how to incorporate trend trading into FMM as total package.

# What are Bollinger Bands

In the 1980's, John Bollinger developed an indicator that enveloped price. 90% of the market action was maintained inside this envelope with price breaking out occasionally. This envelope, or Bands, was designed to show the trader what the market volatility was like. A wider band meant more volatility while a narrower band meant a quieter market.

The standard Bollinger Band consists of a 20 period SMA as a center band with a band on either side of price enveloping the market movement.

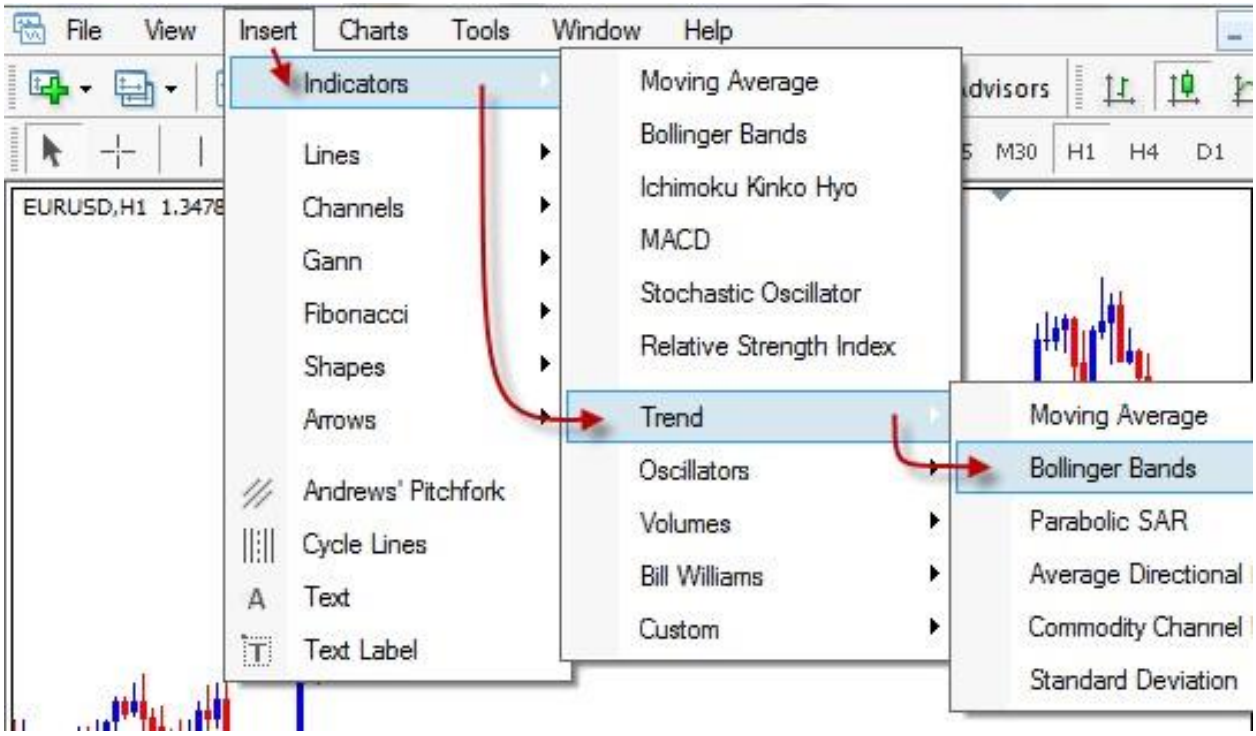
There are several ways to trade a Bollinger Band, but the method we are specifically going to look at will be spotting Divergence within the bands.



# Applying the Bollinger Bands to Your Chart

On your MT4 platform, to add the Bollinger Bands, click:

Insert > Indicators > Trend > Bollinger Bands

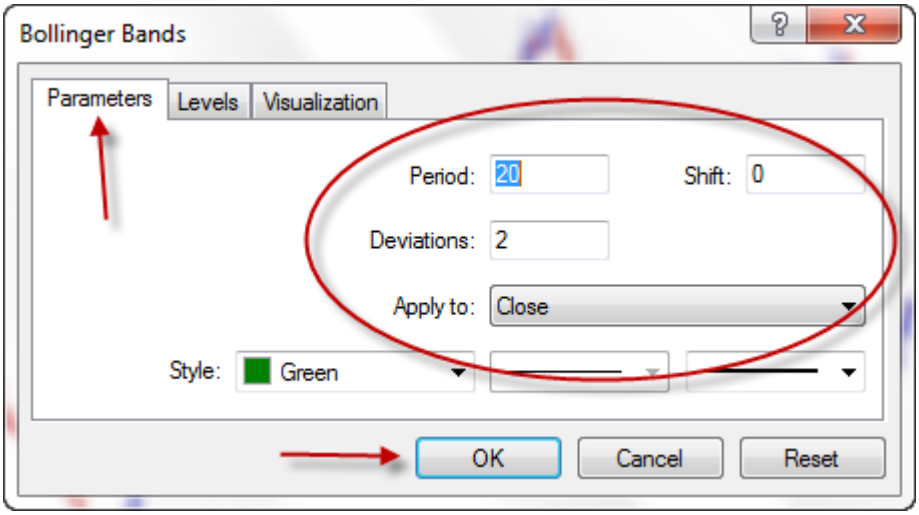



The Bollinger Band selection may not be the second on the list like in the example above, it could be lower. Either way, that's the one you want to click.

A Bollinger Bands properties box will appear. Under the Parameters tab, make the settings:

Period: 20
Shift: 0
Deviations: 2
Apply to: Close

Then click: OK




You will now have Bollinger Bands on your charts that look similar to those on page 7.

The next thing is to identify divergence within the bands.

# The Bollinger Bubble

I don't know for sure if there is a real technical term for what I am calling the Bollinger Bubble, maybe there is. If so, I am not aware of its name, and the term "bubble" seems to suit it just fine.

As price starts to move in a direction, the Bollinger Bands will widen in both directions. As price begins to slow down and move sideways, the bands narrow again. This formation isn't perfectly round, but it does look a lot like a bubble.


What we are looking for as far as divergence is concerned will be happening along one edge of a bubble. We won't consider a high in one bubble and a second high in a following bubble. Both highs or lows must be within the same bubble on the same side, either the top edge or the bottom edge.

# Identifying Bollinger Band Divergence

Divergence inside of the Bollinger Bands happens along the outside bands. Bearish divergence will happen along the top band and bullish divergence will happen along the bottom bands.

The kind of divergence we see in the bands is Regular Divergence.

## - Bearish Divergence

Bearish Divergence happens along the top band of the Bollinger Bands.

Since we are looking for Regular Divergence, we will be looking for price to make a reversal. Price will be making higher highs, display divergence and then fall off downwards.

We will be looking for:

1. Price to close outside the upper Bollinger Band.
2. Price to pull back inside.
3. Price to make a high that is higher than the first high that closed outside the bands.
4. This new high must preferably close inside the upper Bollinger Band.

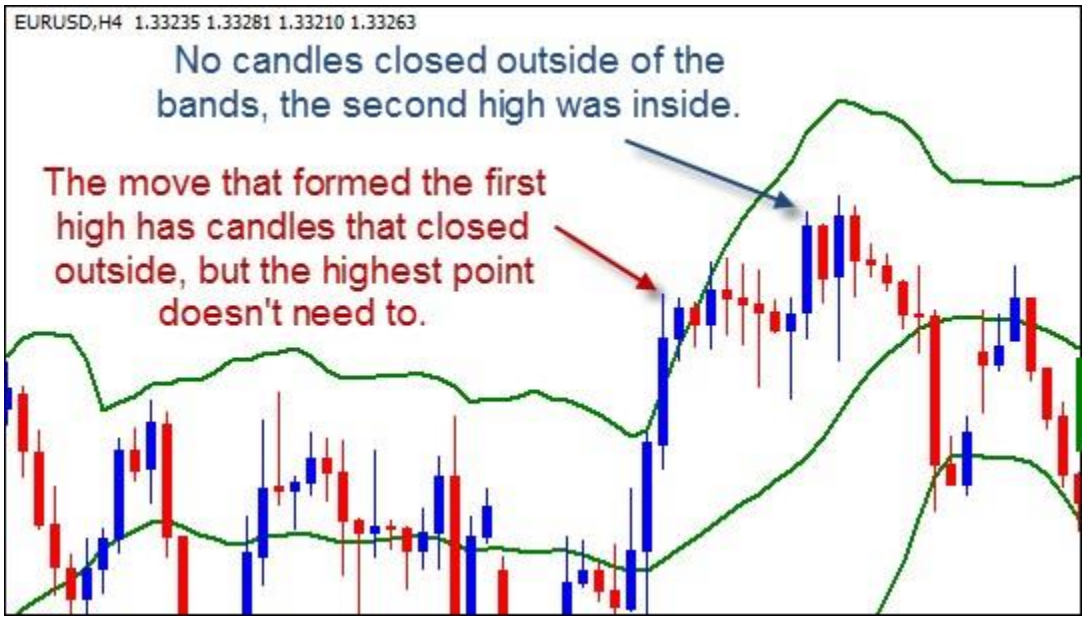
Are you thoroughly confused now? No worries, I will demonstrate.

In the example below you will see that price makes an initial high with some of the candles closing outside of the upper band. It's important to note that the top of the high doesn't have to be as far outside of the band, but candles on the way up do.

Next, price pulls back inside the bands and then continues up to make a second high. This new high is a higher high as it's higher than the first. This second high never closed outside of the bands, although it was higher than the first high.

That is Bollinger Band Divergence.


You can see in the example below how the candles are closing outside the upper band during the formation of the first high, but not at any time during the formation if the second high.




Once you see a second high forming, we are looking to the upper band to see how the price reacts to it. If there is no close outside the bands, we are getting ready for a Divergence setup. We will draw a trend line and watch the Stochastic or the

Moving averages for a crossover. The trigger for a short trade is the same as if we see the divergence on the MACD or the Stochastic Oscillator.

Below is how the setup is broken down and actually traded. All the same rules apply, nothing as far as the FMM rules change. The trendline is drawn and you can see where the candle closed below the trendline. At the same time both the moving averages cross and the stochastic Oscillator makes a clear crossover triggering a short position.


Below is another example of Bearish Bollinger Divergence.


## - Bullish Divergence

Bullish Divergence happens along the bottom band of the Bollinger Bands.

Since we are looking for Regular Divergence, we will be looking for price to make a reversal. Price will be making lower lows, display divergence and then take off upwards.

We will be looking for:

1. Price to close outside the lower Bollinger Band.
2. Price to pull back inside.
3. Price to make a low that is lower than the first low that closed outside the bands.
4. This new low must preferably close inside the low Bollinger band.


# What Doesn't work

Earlier, I described the Bollinger Bubble. This bubble is the widening and then narrowing of the outer bands. These bubbles generally contain a single move (or sets of moves) of price without too much consolidation.

Once price consolidates, slows down and moves sideways, the bands will constrict. What we don't want to do is look for a close along the outer band in one distinct bubble and then make a comparison to another close in the next distinct bubble.


I use the word “distinct” as the bubbles may contract and expand slightly without any clear delineation, or “waist” between the end of one bubble and the start of the next. The highs and lows can be divergent in such an environment.


Below is a screenshot of both kinds of Bollinger environments.


# Variations of the Divergence Setup

When it comes right down to the Bollinger Divergence setup, what is important is the proximity of price to the outer band. You can have both highs or lows making closes outside the bands or inside the bands.

## - Inside Variation

Below is an example of bullish divergence that never makes any closes outside of the Bollinger Band. What is important is that the fist high or low is closer to the band than the second high or low.


## - Outside Variation

The outside variation occurs when the first high or low closes outside the bands followed by a higher high or a lower low that also closes outside the bands. What makes it divergent is when the second close outside the bands is less than the first. Even though it closes outside, it can't close as far outside, price is losing its momentum, or its power to keep forging forward.

The outside variation happens very rarely. To be honest, it took some digging through my charts to find the example I used above.

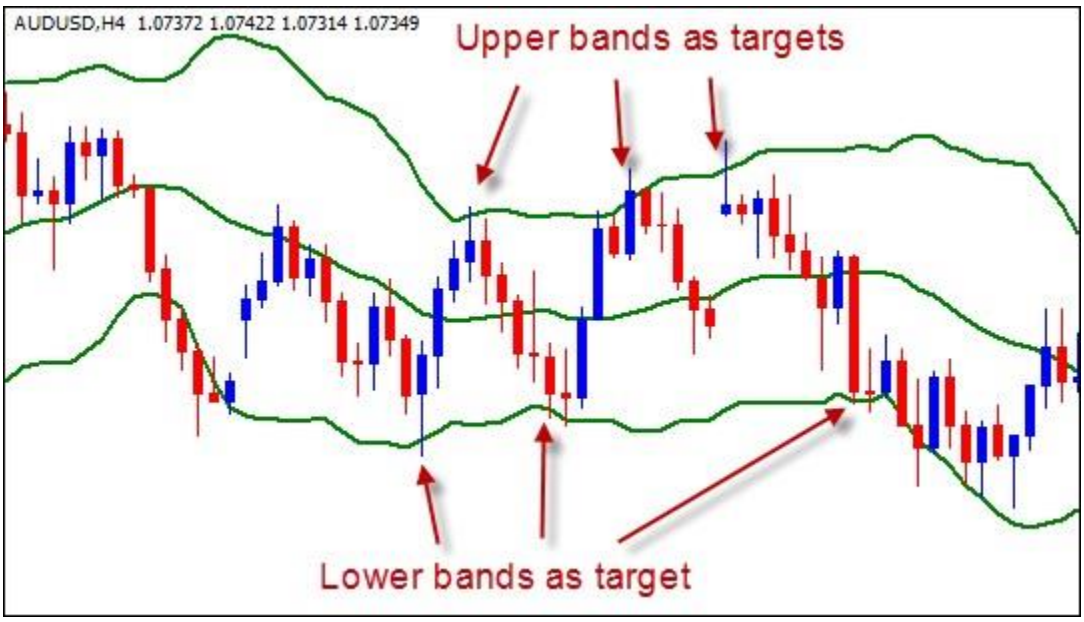
With either variation there is one concept that makes it work, and that is that the second push of price no longer has the momentum or force to meet the outer bands in the same way it did before.

# Bollinger Exits

If you are using Bollinger bands in your trading, you can take advantage of the bands for exit points. There are a couple of ways to use the bands to exit a trade.

## - Bollinger Targets

In a range bound market, the price will often touch the outer wall of the Bollinger Bands and turn around. This makes the outer bands very reasonable targets. If you find that price is in a range on the daily timeframes, the 4 hour timeframe trades will have very precise targets with a high probability of success. You will be able to use this Multi Time Frame technique with great precision on a variety of timeframes. Daily and 4 hour, 4 hour and 1 hour, 1 hour and 15 minute, 15 minute and 5 minute.




## - Bollinger Inside Close

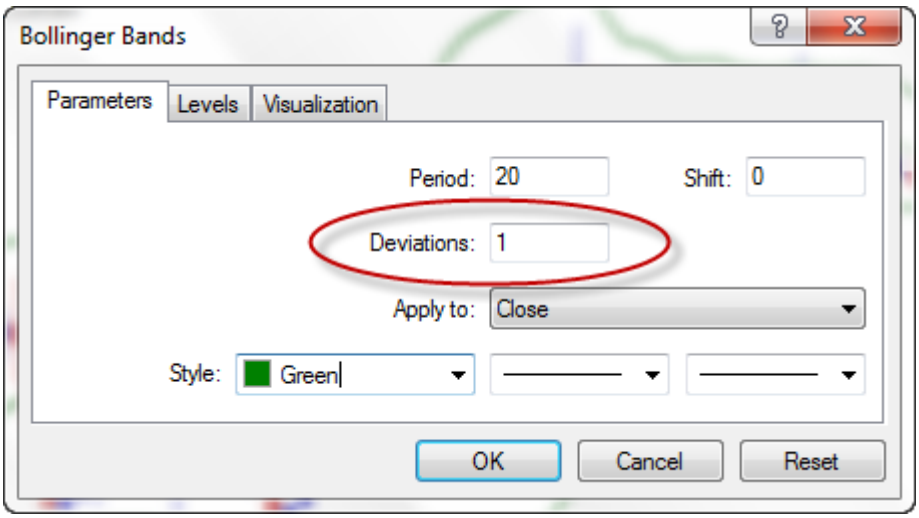
The second method of exiting a Bollinger trade is best used when the market has some power behind it. Once the market is on the move and closes outside the outer bands, it can have the potential to make several consecutive closes outside the bands. Your exit then would be when the market closes back inside the outer band.

In the example below, we assume that there was a signal to go long. Price is a rocket ship and moves upwards with some powerful momentum. Once price closes back inside the bands, the momentum has essentially been spent and will likely need to take a break. A great time to exit the trade is at the first sign of weakness. This doesn't happen all the time, but it does happen.


## - Bollinger Double Band

The Double Band method is becoming more and more popular. As I mentioned in the Inside close method, it doesn't happen all the time. The market needs to be in a very aggressive mood, and it's not generally feeling that way.

More often than not, in a trending phase, the price will hug the inside of the outside band. What can be done in this case is utilize the addition of a second Bollinger Band. Still the same 20 period, but this one will have a deviation of 1.



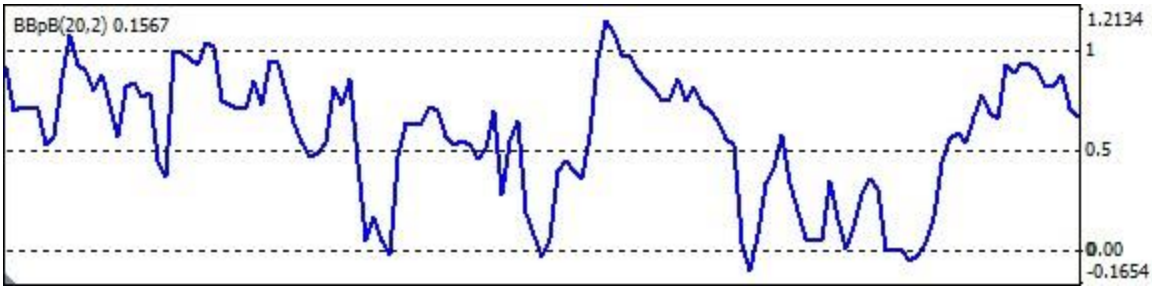

Below you will see the new Bollinger Band added to the first. You can already see in the example how the process will work. It will allow you to hang onto a moving market a little longer.


Exit the short trade when price closes above the lower inside band, close the long trade when it closes below the upper inside band.


# Bollinger Percent B Indicator

To help clean up the charts, and to help spotting divergence a little easier, an indicator has been developed. It is called the “Bollinger Percent B” indicator. It

looks a lot like an RSI or CCI or any number of any other single line oscillators, but this one is unique to the Bollinger Band.




There are three important levels to be aware of on the Bollinger Percent B indicator.

- First level:
  The **0.00 level** at the bottom of the indicator. This level represents the bottom Bollinger Band on the price chart.
- Second Level:
  The **0.05 level** in the middle of the indicator.

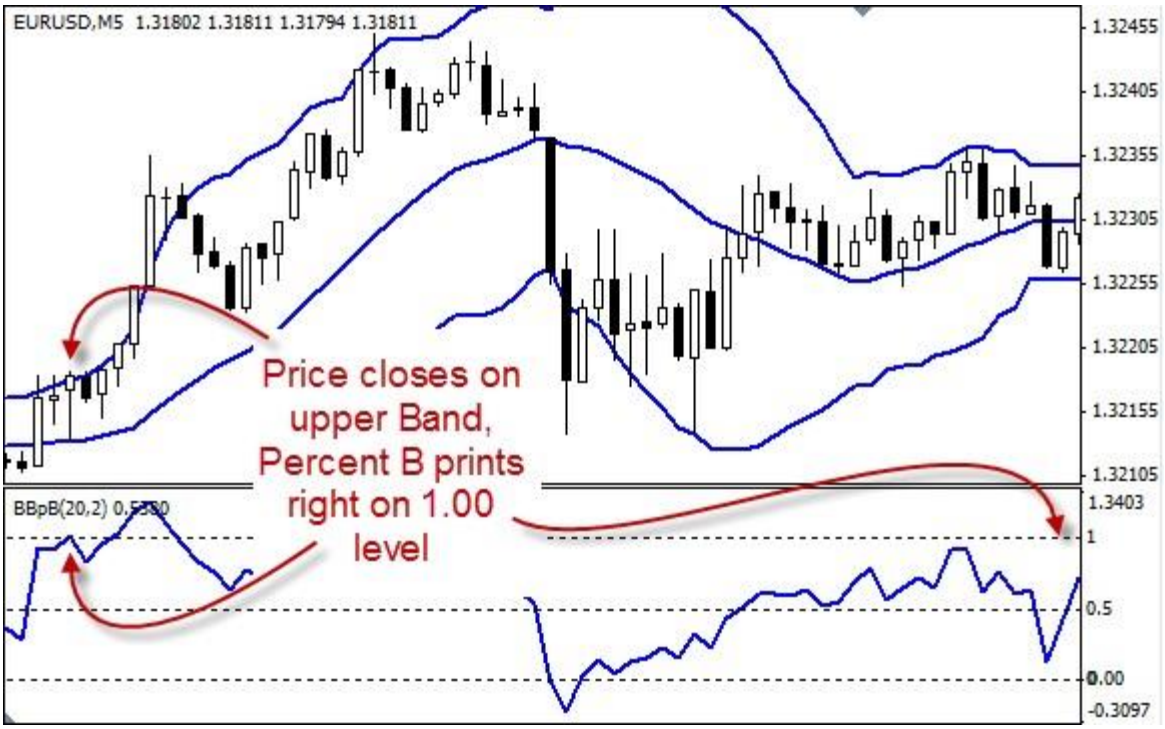
  This represents the middle band on the Bollinger Band on the price chart.
- Third Level:
  The **1.00 level** at the top of the indicator.
  This represents the upped Bollinger Band on the price chart.

The indicator line represents the close of the candles in relation to the Bollinger Bands you have on your price chart.

When a candle closes right on the lower Bollinger Band, the Bollinger Percent B indicator line will be right on the 0.00 level.

When a candle closes above the upper Bollinger Band, the indicator line will be above the 1.00 level.

When price is closing in between the middle and lower band, the indicator line also will be in between the 0.00 and 0.50 levels.




In the example above you see how price closes on the upper Bollinger Band, and as a result, the Bollinger Percent B indicator it at the 1.00 level.

Below is an image showing how the indicator levels compare to the actual Bollinger Bands. We also see that the blue indicator line represents the closing price of each candle and its positioning compared to the Bollinger bands.

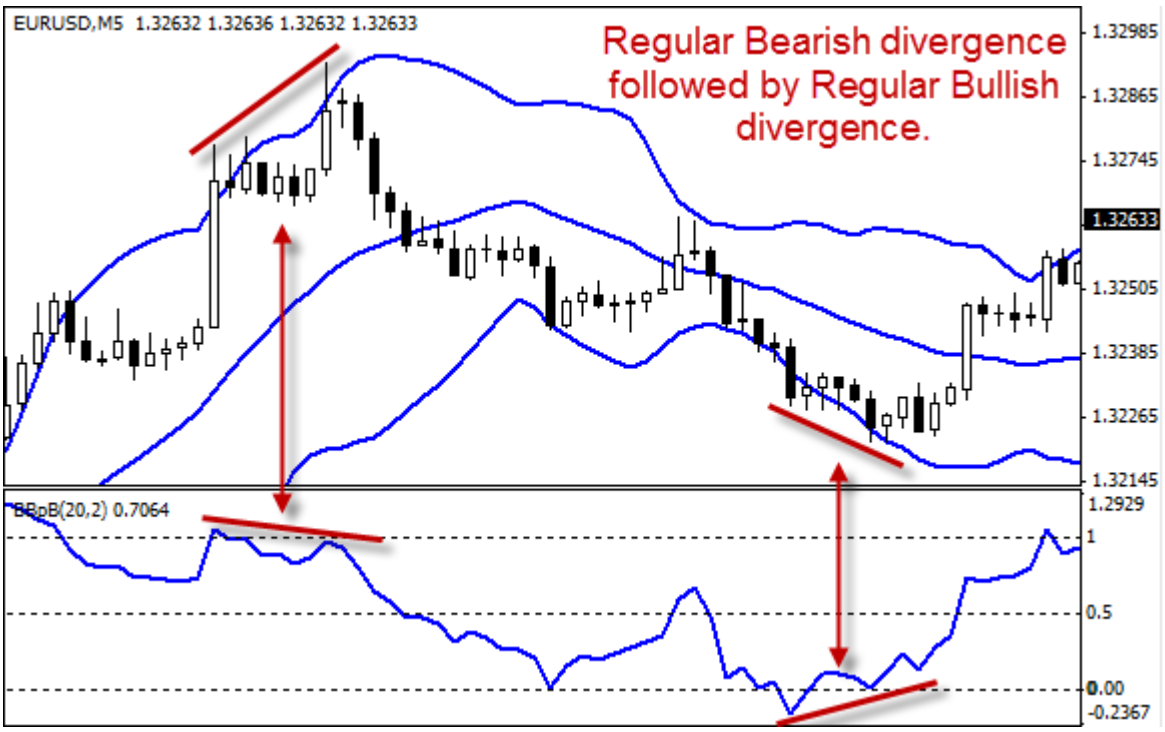

The Bollinger Percent B is really a very simple indicator, it does help us to see the divergence a little easier.

One more image of a few levels to compare.

- When price closes at the upper band, the indicator line sits at the upper 1 level.
- As price closes at the middle line, the indicator is at the middle 0.5 level.
- When the price closes at the bottom Bollinger Band, the indicator line rests on the bottom 0.00 level.


## - Bollinger Percent B Divergence

Below are a couple of chart examples on the EURUSD 5 minute chart. First we see Regular Bearish Divergence followed by Regular Bullish Divergence. In this image we see both the Bollinger Bands and the Percent B indicator. This will help you see and understand where the divergence is coming from.




Below is the same example as on the previous page. This time we removed the Bollinger Bands for the price chart. The image becomes a lot cleaner and less cluttered, especially if we are intent on adding moving averages and drawing trendlines on the price chart.


Below is an image with no markings on it what-so-ever. Can you see the Bollinger Percent B divergence? Scroll down to see the answer.

Answer:


EURUSD,H1 1.32621 1.32646 1.32608 1.32642
1.31245
1.31035
1.30830
1.30625
1.30420
1.30215
1.30010
BBpB(20,2) 0.7391
1.3481
1
0.5
0.00
-0.1969

# Conclusion

The Bollinger exits might have been a little above and beyond, as they aren't exit methods I use in the FMM system, but then again, the Bollinger Bands themselves aren't part of the original method.

The fact remains that Bollinger Bands are very good at showing off divergent setups, and if the bands are part of your trading arsenal, you now know how to incorporate them into the FMM method.

Don't abandon the other aspects of FMM. The trendlines, the crossovers and the targets are all still valid, nothing changes in these regards. The last thing I want to do is over complicate or clutter your trading charts. Remember, more isn't always better. When I use the bands, I make sure they are a very light color so they don't get in the way of anything else I may be looking at.

Thank you very much for your time and your consideration.

Best of luck to you in your trading and in your life as a whole.

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