INDICATOR 5 *Volatility*

Bollinger Bands Explained: Squeezes, Breakouts and Band Walks

Bollinger Bands wrap price in an envelope that expands and contracts with volatility. They show you when a market is calm, when it's excited, and when a big move may be coming.



What it is

Bollinger Bands were created by John Bollinger in the 1980s. They consist of a moving average in the middle and two bands above and below it. The distance of the bands depends on volatility, so they adapt automatically to the market.

How it's calculated

- **Middle band:** a 20-period simple moving average.
- **Upper band:** the middle band plus 2 standard deviations of price.
- **Lower band:** the middle band minus 2 standard deviations.

Standard deviation is a statistical measure of how spread out prices are. When prices swing wildly, it rises and the bands widen. When they're quiet, the bands narrow.

Default settings

20 periods and 2 standard deviations. Most price action stays inside the bands with these settings.

How to read it

- **Wide bands:** high volatility. **Narrow bands:** low volatility.
- **Price at the upper band:** strong relative to recent prices. **At the lower band:** weak.
- **The middle band** often acts as support in uptrends and resistance in downtrends.

Three practical ways to use it

1. **The squeeze.** When the bands become unusually narrow, volatility is low, and low volatility tends to be followed by high volatility. Traders wait for price to close outside the bands to signal the direction of the breakout.
2. **Mean reversion in ranges.** In a sideways market, price touching the lower band and turning up can signal a move back toward the middle band. The reverse applies at the upper band.
3. **Walking the bands.** In strong trends, price can "walk" along the upper or lower band for many bars. That's a sign of strength, not a reason to bet on a reversal.

Common mistakes

- **Treating every touch of a band as a reversal signal.** In trends, touches often mean the move is strong.
- **Guessing the direction of a squeeze.** The squeeze tells you a move is likely, not which way it will go.
- **Using the bands alone.** Combine them with a momentum indicator for confirmation.

Works well with

- **RSI** to confirm whether a touch of a band is stretched or strong.
- **ATR** to set stops that match current volatility.

Quick summary

- Bollinger Bands measure volatility around a 20-period average.
- A squeeze often comes before a big move.
- In trends, prices can ride the bands; in ranges, they tend to bounce between them.

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