INDICATOR 4 *Momentum*

# Stochastic Oscillator Explained: %K, %D and Overbought Levels

**The stochastic oscillator shows where today's close sits within the recent trading range. It's fast, easy to read and especially useful in sideways markets.**




## What it is

The stochastic was developed by George Lane in the 1950s. His idea was simple: in an uptrend, prices tend to close near the top of their recent range; in a downtrend, near the bottom. The indicator turns that idea into a number between 0 and 100.

## How it's calculated

- **%K:** (current close minus the lowest low of the last 14 periods) divided by (the highest high minus the lowest low), times 100.
- **%D:** a 3-period average of %K. It acts as a signal line.
- Most platforms show the "slow" stochastic, where %K is smoothed once more over 3 periods. That's why you'll often see the setting written as 14, 3, 3.

## Default settings

- **14, 3, 3.**
- **Levels:** 80 (overbought) and 20 (oversold).

## How to read it

- **Above 80:** the close is near the top of the recent range. Buyers are strong, but the move may be stretched.
- **Below 20:** the close is near the bottom of the range.
- **%K crossing %D:** a change in short-term momentum.

## Three practical ways to use it

1. **Crossovers in the extreme zones.** A bullish signal is when %K crosses above %D while both are below 20, then climb back above 20. A bearish signal is a cross below %D above 80, followed by a move back under 80.
2. **Trading with the trend.** In an uptrend, use oversold readings as pullback entries and ignore overbought ones. In a downtrend, do the opposite. This avoids fighting the main direction.
3. **Divergence.** A lower low in price with a higher low in the stochastic suggests selling pressure is fading. It's the same idea as RSI divergence, but the stochastic reacts faster.

## Common mistakes

- **Treating 80 as a sell signal.** In strong trends, the stochastic can stay above 80 for a long time.
- **Using it alone in fast trends.** Because it's sensitive, it gives many early signals.
- **Ignoring the timeframe.** A signal on a 5-minute chart means much less than one on a daily chart.

## Works well with

- **Moving averages** to define the trend first.
- **Bollinger Bands** to spot stretched prices at the bands.

## Quick summary

- The stochastic shows where the close sits within the recent range, from 0 to 100.
- 80 and 20 mark the extreme zones; %K and %D crossovers give signals.
- Best in ranges or for pullback entries in the direction of the trend.

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