John A. Bollinger CFA, CMT – Market Master

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John Bollinger is a modern-day market master. Unlike many traders who started their working life studying economics or engineering, John graduated with a degree in visual arts, majoring in cinematography. He later moved into the field of market analysis and was one of the pioneers of technical analysis using a computer, after buying his first microcomputer in 1977.

John Bollinger is today one of the world's most respected technicians. He is President of Bollinger Capital Management and is a Chartered Financial Analyst and a Chartered Market Technician.

The Birth of Bollinger Bands

Contrary to what many people believe, the Bollinger Bands technical indicator was not named after the champagne drunk by an ecstatic trader while closing out a big winning trade. In fact, it was named after its developer, John Bollinger.

The Bollinger Bands indicator was created in the early 1980s. It was created in an attempt to overcome the problems associated with trading envelopes which were very popular at that time; particularly the problems associated with determining the most appropriate bandwidth to use with these fixed-width bands.

Bollinger noted that the most appropriate bandwidth for a particular market would change with time. He therefore explored ways in which the bandwidth could be determined automatically.

John Bollinger combined the measurement of volatility (standard deviation) with a moving average. The result was a set of two variable-width trading bands that would automatically adapt to the volatility of the market.
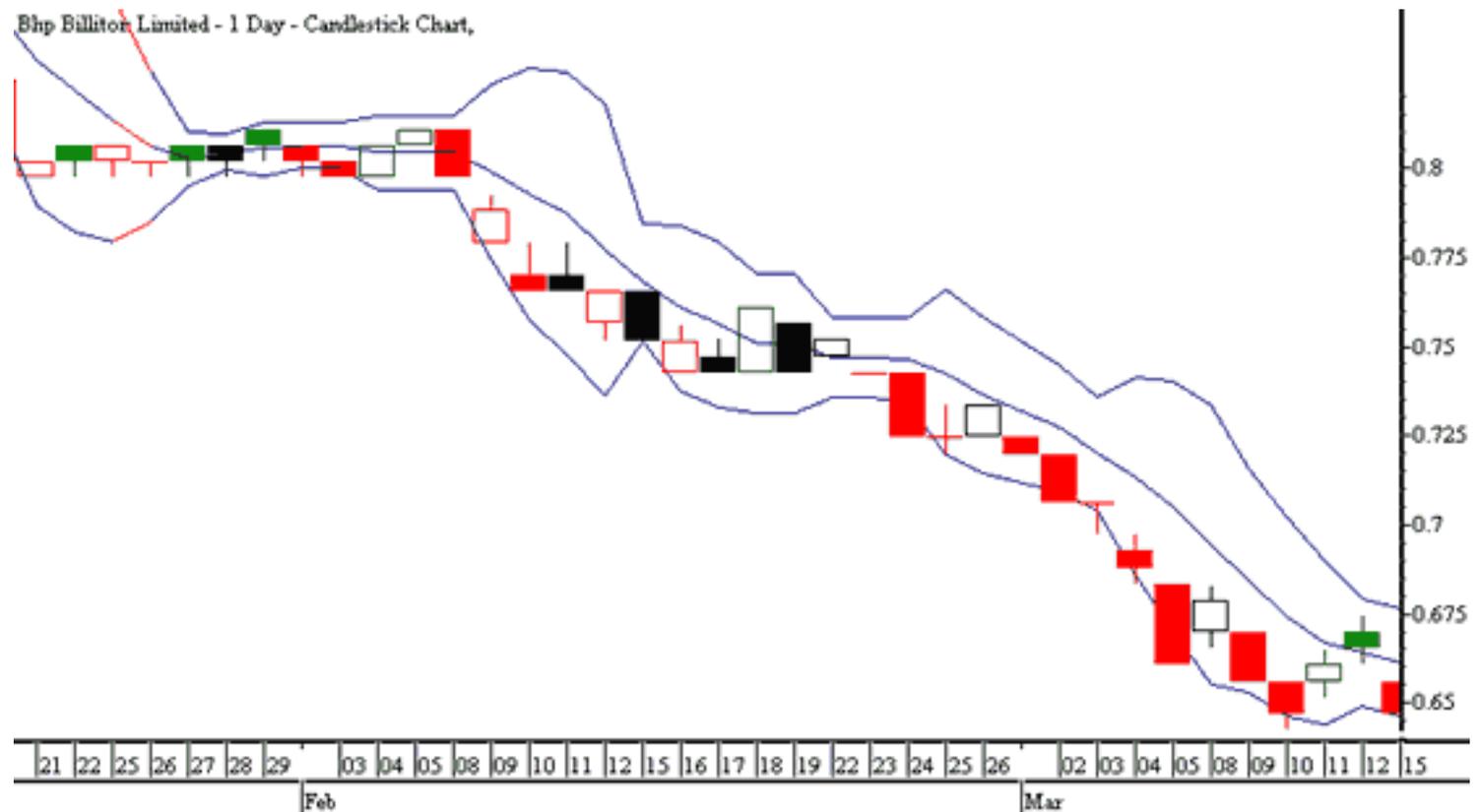
What Are Bollinger Bands?

There are literally hundreds of technical indicators that are used by technical traders to help them to analyse and trade markets. Many are of little use, many give similar indications to other indicators, and a few are of great value. Bollinger Bands is one such 'great value' indicator.

Whereas trading envelopes surround the market action with two bands which are drawn a fixed percentage above and below a moving average of the market's closing price, Bollinger Bands expand and contract as the market volatility increases and decreases.

For intermediate-term trends, Bollinger Bands consist of a series of three bands:

- The middle band is a 20-day simple moving average of a market's closing price.

- The upper band is drawn by adding two standard deviations to the middle band.

- The lower band is drawn by taking two standard deviations away from the middle band.

For short-term trends, a 10-day moving average and a standard deviation of 1.5 is more appropriate. For long-term trends, a 50-day moving average and 2.5 standard deviations are usually used.

The above Market Analyst chart shows Bollinger Bands on BHP Billiton Limited. We interpret the market's action relative to the bands as follows:

- When the market action moves above the top band or below the bottom band, it suggests that the present trend shall continue.

- If a market moves from one band towards the moving average, it is likely to continue to the other

band.

- Powerful moves often commence after the market's volatility has become very low and the bands have tightened around the market action (as happened in early February).

What Do the Bands Tell Us?

Bollinger Bands allow us to see, at a glance, if prices are high or low in relative terms. Because the bands track market volatility, prices are relatively high when prices are at the upper band and relatively low when they are at the lower band.

John Bollinger has also derived two indicators from Bollinger Bands:

The first one is %b, and tells us where we are within the band – at 1.00, we are at the upper band, and at zero, we are at the mower band. At 0.5, we're dead in the middle. The second indicator is bandwidth. It is the upper band, minus the lower band, divided by the middle band.

(Gapalakrishnan, J., *John Bollinger of Bollinger Bands Fame*, 'Technical Analysis of Stocks and Commodities Magazine', May 2002, p. 58.)

Trading With Bollinger Bands

Bollinger Bands give us valuable information about whether or not prices are relatively low, or high. They can, however, be used in conjunction with price action and reaction, and other technical indicators, to give traders high probability trading signals. The powerful signals that usually follow Bollinger band squeezes make Bollinger Bands an important tool for all traders, but option traders in particular.

Conclusion

John Bollinger is a modern-day market master. His ongoing contribution to technical analysis has assisted many traders to gain a more realistic view of the market they are trading. In particular, his Bollinger Bands indicator has been a technical tool that continues to be of immense value to many traders.

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