

The ZigZag Bollinger Method (ZZBB)

SUMMARY

The ZZBB is a discretionary method of trading that evolved from concepts posted on a Forex Factory Thread called “The Similarity System” created by Eurussdd.

Over a period of just over 1 month, one particular technique was tested and enhanced in a live scenario using a Demo trading account. I call this Attempt #1. The result was to turn \$5000 into \$25,000 in just over 3 weeks.

Sceptical of the results, I created Attempt #2 and associated this with a Trade Explorer and my own thread, “Similarity Trading – The ZZBB Method”. Whilst the initial results were not great at all, the various techniques and methods are still promising.

The evidence shows that it needs to be incorporated into other complementary trading techniques and hopefully this document can serve to discuss this further.

DISCLAIMER

The author of the original method / technique is the poster who goes by the username Eurussdd.

Any further enhancement is the amalgamation of work done by myself and other posters in the Forex Factory thread.

The method outlined in this document does not purport to provide trading advice or recommendation.

VERSION

1.0 First Version

THE ZZBB TRADING PLAN

Direction

Two things set directional bias:

- Current ZigZag alignment
- 300EMA

Alignment

When the 4H, 1H, 15M swings are all in alignment, the trading bias is stronger. Therefore:

- When ZZ Bottom is confirmed, bias is Bullish and trades are Long
- When ZZ Top is confirmed, bias is Bearish and trades are Short

When the 4H and 1H are not in alignment, it is harder to co-ordinate your lower timeframe bias and you will find that indicator repaints occur a lot more because price will be trying to resolve higher timeframe swing.

300EMA

When price is above the 300EMA the bias is Long. When price is below the 300EMA the bias is Short.

The 300 exponential moving average works best over longer-term timeframes.

When price transitions from either Long to Short, the effect on Zig Zags becomes less predictable.

Trading Approaches

Based on the above criteria, there are a number of ways to approach individual trading plans:

- With Trend – take the 15M, 5M and 1M timeframes and find the combination that is in alignment with the 4H or 1H and trade with it.
- Countertrend - take the 15M, 5M and 1M timeframes, take the highest timeframe bias and then trade against it until they are in alignment
- Use the 300EMA line as support or resistance on each tradable timeframe: 1M, 5M, 15M, 30M, 1H, 4H
- Use the Stochastic Close Outside of Bollinger Band (COBB) to provide higher probability of a swing being confirmed.

- Combine other established tools such as Fibonacci Retracements, Pivot Points, MACD and RSI to boost confidence in direction and turning points.
- Using the Dissimilarity Indicator by Ralome which produces zones of dissimilarity (DS) as Price Targets in addition to the other plans

ZZBB KEY CONCEPTS

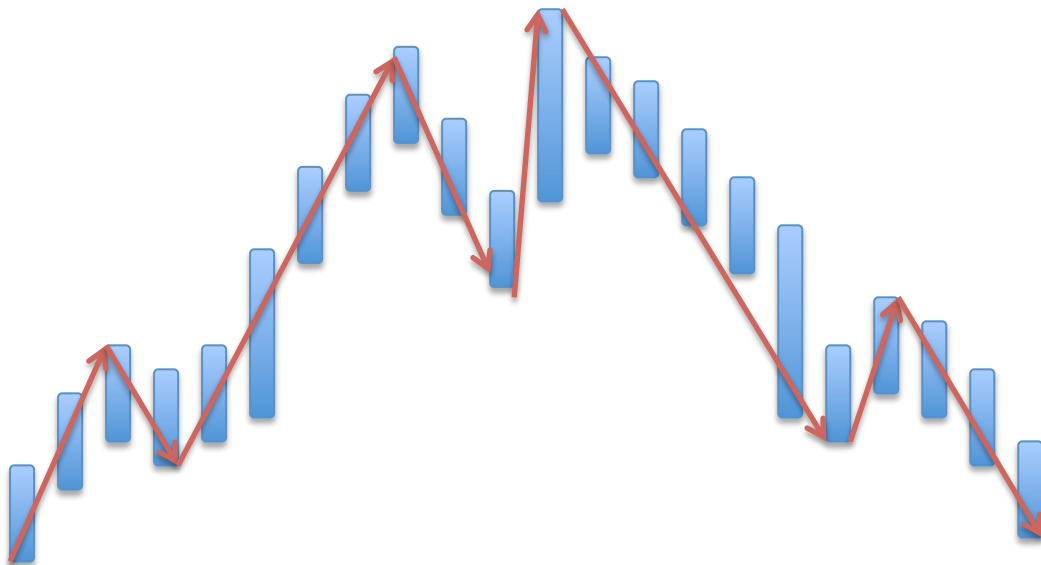
Swings

Price creates a pattern on a chart by going in 1 of 3 directions:

- UP
- DOWN
- SIDEWAYS

Within each of these direction movements is the “holy grail” of all price movements: The Change In Trend

When price is going UP and then changes so that it is going DOWN, it usually creates a TOP. The change from an up direction to a down direction is called a swing top.



In the same way, but upside down, when price is going DOWN and then changes so that it is going UP, it usually creates a BOTTOM. The change from an up direction to a down direction is called a swing bottom.

In the drawing above, the red arrows going up show that the direction stops at the highest bar until the next bar's lowest price is lower than the previous bar's lowest price. When that happens – a SWING TOP IS FORMED.

When the arrow is pointing down, the direction stops when the next bar's highest price is higher than the previous bar's highest price. When that happens a SWING BOTTOM IS FORMED.

Trading with Swings

Enter a Long/Buy trade at a Swing Bottom; close the trade at a Swing Top.
Enter a Short/Sell trade at a Swing Top; close the trade at a Swing Bottom.

KEY CONCEPTS DISCUSSION

Stating The Obvious

Trading with Swings sounds so simple. It is.
But its simplicity is what makes applying the concept in real trading so difficult.

Firstly, price does not always behave like that shown above. Price can be violent and fast. Price can be the slow and lazy. Price can create patterns one day or one week and then be completely random the next.

Price never travels in Straight Lines unless it's crashing or reacting to news – and this method does not attempt to address these.

Secondly, being able to read Swing Tops and Bottoms is extremely hard because when you are looking at a screen IN REAL TIME.... You DO NOT KNOW WHEN or AT WHAT PRICE A CHANGE IN TREND WILL OCCURR.

That's the absolute basic weakness of swings. This needs to be understood.

So Why Should I Care About Swings?

The great thing about swings is that it lets you know WHAT KIND of change in trend is supposed to come next.

It seems crazy and stupidly simple, but once a Swing Bottom has occurred and been confirmed then you know that a Swing Top MUST COME NEXT.

If you knew that in advance, you would instantly be able to make a trading decision and act on it with more confidence. So, in our example a Swing Bottom has just been confirmed, and you know that a Swing Top must come next so you could decide:

1. To Trade with the Trend (go Long)
2. Trade at the Counter Trend (wait for Swing Top confirmation and Short)
3. Do Nothing

At this BASIC LEVEL of analysis, you could definitely have a tradable strategy. Not that it would be profitable.... but it would be a trading strategy.

The edge that is required is having some way of knowing when the next swing is likely to occur and be confirmed.

ZigZag Indicator

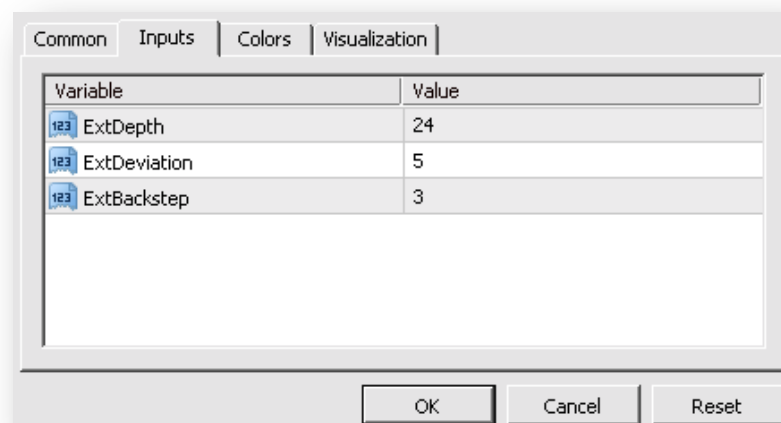
A ZigZag is basically a straight line that connects a Swing Top to a Swing Bottom. When they are all connected, it visually forms a zigzag.

Here is the latest 1H chart with the ZigZag Indicator superimposed on another MT4 indicator called Semafor3 that produces the Coloured Circled Numbers. Here I use *3* as indicators of ZigZag Tops (ZZTop) and ZigZag Bottoms (ZZBot).

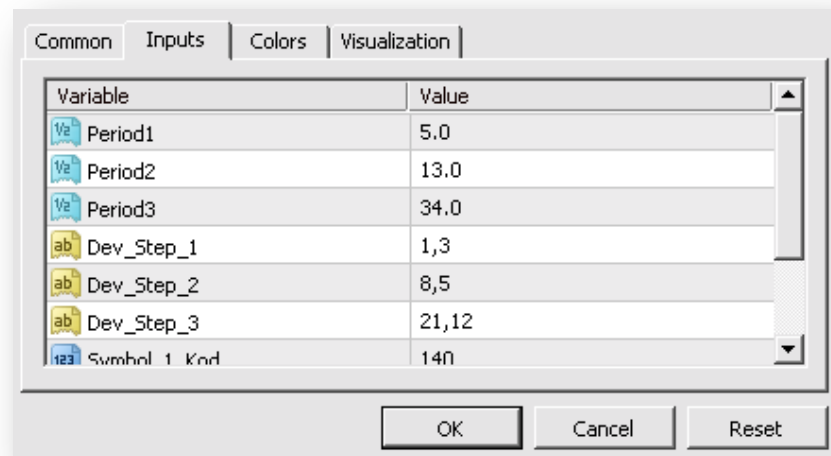


Interpreting ZigZags depend on the Timeframe that you are looking at. Don't forget this! A ZigZag on a 4H is different from a 5M zigzag.... and will have different implications for trading, even if the shapes are the same.

The MT4 platform has a ZigZag indicator that calculates this for you. My settings are:



The **3_Level_ZZ_Semafor** indicator has the default settings below:



Repainting

Now before I delve into this topic, I did a lot of research on ZigZag indicators. It's actually quite complicated to produce what a Kindergarten Child can do with their eyes.

As I mentioned above, the problem with swings is that you must continue to draw the line until the next bar breaks the trend. You have no idea what the next bar will do.

What is certain is that price action moves in waves (but I won't go into an Elliot Wave discussion here) in a way that frequently creates tops and bottoms.

These waves may not necessarily be the swing top or bottom we are looking for.

Price could go for a rest and go sideways before continuing the trend... this will cause loads of repaints. This sideways movement can last a short time, or it could be days, weeks or months.

Because of

It is this repainting problem that Eurussd discovered a partial solution to using Bollinger Bands. By combining the ZigZag with another indicator that reacts to price in a related way that the zigzag does, then we can combine the two together and find where they are similar and where they indicate dissimilarity.

BOLLINGER BANDS

From the posts in the original thread, the Bollinger Bands were applied to both the Price Chart and Stochastic chart.

When set to 24 and 2 standard deviations, then the Bollinger Bands present a boundary for when we expect price / stochastic to remain stable.

But from the discussion on ZigZags we know that price ebbs and flows from Top to Bottom and back to Top and so on.

The Key Usage of the Bollinger Band is to visually display when Price / Stochastic has reached its maximum extreme. That is, price literally goes outside the boundaries.

At this extreme point the likelihood of a reversal Change In Trend is high. But we have to acknowledge that not every incident where price/stochastic goes over the boundary means that a price reversal will occur.

When combined with ZigZags, you're able to see that swing turning points occur when the price and stochastic are outside the Bollinger Band.

In the example below from a recent post, I am highlighting that the Bottoms are mostly outside the Bollinger Bands and the Stochastic (2nd window) all have the red line outside the Bollinger Band in addition to the red line being below the blue line.



I would say that 90% of turning points have the price/stochastic outside the Bollinger Bands and there are 10% where the turning points occur inside the BBs. To me that's a pretty good percentage.

BOLLINGER DISCUSSION

Combined With Stochastic

Price can and does exceed the Bollinger Bands many times without creating a swing point.

But that does not mean you cannot use BBs as a swing confirmation indicator. In fact I look for prices to exceed the BB as a good confirmation for a turn.

What can also happen is that the Stochastic can also exceed its own Bollinger Band. This was one of the 2nd examples of “similarity” that Eurussd put up on the original thread.

That is, the Price & BB window should be identical to the Stochastic & BB window. Whenever there was Dissimilarity (DS), it marked a price level in which price action would return to once Similarity (SM) returned.

One of the many examples Eurussd highlighted was that Price and Stoch both closed outside of the Bollinger Bands whenever a valid swing was produced.

Hence you had a combined indicator that can provide greater confidence. When you start to stack these indicators together it can be a better probability.

For example for the EURUSD forex pair:

- There is a confirmed ZZT on the 4H
- There is a confirmed ZZB on the 1H
- ZZ Top is formed on the 15M
- Semafor 3 prints at the ZZTop
- Price closes outside of Bollinger Band
- Stochastic closes outside of Bollinger Band
- The ZZ Top that just formed on the 15M is now also on the 1H
- Price is 150 points above 300EMA
- Below current price about 70 points away is a DS Zone that is 30 pips tall.

In this hypothetical case, we have a strong ZZTop signal that we can short.

If we do enter at current price, we could get a possible 70-pip target to the DS zone then exit. Or we could short and play for 100 pips which closes the entire DS zone.

Either way, the trade plan is a short because we have aligned indicators.

THE 1H DAILY PREDICTION METHOD

Synopsis

I devised this method after Eurusdd made a comment in a post on the thread. He mentioned that we all had the ingredients to be able to predict daily direction within 1 hour of the day. I asked whether he meant we had all the indicators on the chart and he simply said yes.

As a result, I had observed all of the indicators that appear in this document:

- 300EMA
- 1H timeframe
- Price and Bollinger Band
- Stochastic and Bollinger Band

The trading rules that I then developed came about from observing price action going back to 1st January 2013. I had posted that I had a success rate of 70%

The trading rules are below.

1H Chart Can Predict Future Day's Trend

- 1H timeframe
- 300EMA
- ZigZag set to 24,1,1
- Price in BB set to 24
- Price with 1EMA in BB
- Stoch 75,1,1 in BB set to 24

Rules

- If PRICE > 300EMA
 - ZigZag is also above 300EMA and slopes UPWARD
 - At Midnight + 1
 - if last ZigZag swing is a ZZBOT and it is sloping upward and Price stays on top half of BB then UP DAY
 - if StochBB is above 50 line,
 - if Stoch COBB and pierces 50 line for the first time it will bounce and will coincide with a ZZBOT
 - if PRICE starts to cross the BBMID AND THE ZIGZAG
 - and StochBB to also cross the BBMID then DOWN DAY
 - look for a possible intra day swing back over the ZZ line and a closeswing and a ZZTOP then UP DAY

- If PRICE < 300EMA
 - ZigZag is also below 300EMA and slopes DOWNWARD
 - At Midnight + 1,
 - if Price is in lower half of BB then DOWN DAY
 - also, if last ZigZag swing is a ZZTOP and it is sloping upward
 - if StochBB is below 50 line,
 - if Stoch COBB and pierces 50 line for the first time it will bounce and will coincide with a ZZBOT

Post Analysis

Since this first Demo Test in July/August, I have observed the realisation of an idea or thought that occurred during the tests – “What would happen when price approaches the 300EMA and crosses it?”

Well this happened in late August/September on the 1H chart. And instantly, the ability to predict daily direction was extraordinarily difficult.

This means that TRENDING PRICES make the above method work. But CHANGES IN TREND (FROM ABOVE 300EMA TO BELOW 300EMA) create disruptive and unpredictable patterns.

This means that just because it crossed south of the 300EMA doesn't mean I can simply reverse all the signals. As of this writing, Price is potentially going to retrace back towards the 300EMA on the 1H.

As a result of this turbulence I have also started looking at the 4H. Surprisingly, the 300EMA coincided with a Fibonacci Retracement Level 50%. I had not observed this before – but price rejected this price level with great strength.