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SCHAFF TREND CYCLE INDICATOR TRADING STRATEGY [PDF]

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Scaff Trend Cycle Indicator Trading Strategy

The Schaff Trend Cycle indicator identifies market trends by integrating time and moving averages, allowing traders to gain insights into cyclical patterns. It can be used to identify potential buying and selling opportunities.

In this Schaff Trend Cycle PDF, you'll learn about this indicator, how it works, and how to use it in your trading.

What is the Schaff Trend Cycle (STC) Indicator and How Does It Work?

The STC indicator has garnered widespread acclaim due to its capacity for generating more precise signals compared to conventional indicators like the MACD and Stochastics. It is a leading oscillator developed by Doug Schaff, intricately weaving elements of both time and moving averages to furnish traders with a comprehensive outlook on trends. Like many other indicators, it is displayed as a sub-chart below the main price chart.

Unlike its counterparts fixated solely on price actions, this oscillating indicator acknowledges the cyclical nature of trends, aligning with the principles of the Wyckoff theory, which posits that markets progress through recurring phases of accumulation, uptrend, distribution, and downtrend. In other words, currency trends accelerate and decelerate in cycles.

The STC algorithm is as follows:

Schaff Trend Cycle = 100 x (MACD – %K (MACD)) / (%D (MACD) – %K (MACD)).

This calculation is based on the following inputs:

1. The default period for the short-term exponential moving average is set at **23 days.**
2. The default period for the long-term exponential moving average is set at 50 days.

The calculation involves determining the 23-period and 50-period exponential moving averages (EMA) along with the MACD values using the following process:

1. Calculate EMA1: EMA1 = Exponential Moving Average (Closing Price, Short Length).
2. Calculate EMA2: EMA2 = Exponential Moving Average (Closing Price, Long Length).
3. Determine MACD: MACD = (EMA1 – EMA2).

Next, the calculation proceeds to derive the 10-period Stochastic values from the previously calculated MACD values as follows:

1. **Calculate %K (MACD): %K (MACD) = Stochastic Value %K (MACD) with a period of 10.**
2. **Calculate %D (MACD): %D (MACD) = Stochastic Value %D (MACD) with a period of 10.**

After obtaining these values, you can input them into the STC formula mentioned earlier to yield the desired results. By merging short-term and long-term moving averages, the indicator adeptly captures the innate cyclical patterns inherent in trends. While price fluctuates, the STC indicator oscillates within a defined range, showing the underlying shifts in momentum.

What sets the STC indicator apart from its counterparts like the Moving Average Convergence Divergence (MACD) and Stochastics is its ability to promptly and accurately identify trends. While the MACD and Stochastics have established their significance in trading, the STC indicator has a unique advantage. Seamlessly blending the concepts of time and moving averages, the STC indicator empowers traders to capitalize on emerging trends with precision.

From a practical standpoint, the STC indicator functions as a reliable compass for traders navigating the forex market or any other financial market. It is good at recognizing trends and generating timely buy and sell signals, thereby empowering traders with informed decision-making capabilities.

How to Use the Schaff Trend Cycle (STC) Indicator in Trading

To use the STC indicator the right way, you must first understand its values, and how to interpret the indicator's values.

- When the STC indicator's signal line crosses above the '75' mark, it indicates that the asset is in overbought conditions. This level signifies a potential sell signal, hinting at a probable trend reversal that might trigger a downward movement in the asset's price. This serves as an opportunity to contemplate selling or initiating a short position, safeguarding against a potential market correction.

- Conversely, as the signal line of the technical analysis indicator goes below the '25' threshold, it shows another facet of trading dynamics – the asset is now in an oversold condition. This pivotal level paints a different picture, one that suggests a possible bounce back in the asset's price. For savvy traders, this is an invitation to consider initiating a long position or covering existing shorts. By doing so, they position themselves to capitalize on an anticipated upward correction in the asset's value.

- Within the spectrum of STC indicator readings lies a middle ground, where the signal line flits between the '25' and '75' levels. This range serves as a subtle yet powerful cue – a signal of trend formation. This phase is crucial for traders as it calls for a comprehensive analysis of market conditions to decipher whether a bullish or bearish trend is underway. Armed with this insight, traders can align their trading decisions with the ongoing trend, thus enhancing their odds of success. Additionally, the indicator can be even more powerful when used in combination with volume indicators, such as the volume price trend indicator, or volume-weighted moving average.

The indicator not only identifies potential buy and sell signals but also presents an opportunity for traders to optimize their trading strategies, leveraging overbought and oversold levels for profit and cautiously navigating the delicate nuances of trend formation.

Schaff Trend Cycle Indicator Trading Strategy Tutorial

By now, you pretty much know what the STC is and how to use it. So, let's move on to the next step and learn how to trade financial instruments using the STC indicator.

To demonstrate, we'll use TradingView, although the indicator works the same on any other trading platform. There are many STCs on TradingView. The one we'll be using in the rest of this piece is the one developed by "everget," and we'll use its default settings. While you can use any timeframe of your choosing, we'll be using the 1-hr timeframe here.

A. Trend Continuation

Trading market continuation with this technical analysis indicator is straightforward. This strategy is based on the STC's habit of oscillating from one extremity to the other. For instance, the signal line goes below the 25 level (oversold condition), comes back up, rises above the 75 level (overbought condition), and then returns below the 25 again. This cycle goes on in perpetuity.

However, where the trade opportunity arises is where the indicator doesn't completely return above or below the 25 or 75 level before turning in the opposite direction. Here's how you would trade it.

1. After pulling up your STC, simply wait for the indicator to not complete its cycle below or above the 25 and 75 levels. How you would know is that the indicator line makes a U-turn within the 25 and 75 levels. It simply means the previous trend is continuing.

2. Your trade entry is simple. Buy when the indicator makes a U-turn to the upside within the 25 and 75 levels. And sell when the indicator makes a U-turn to the downside within the same levels.

3. Place your stop loss beneath the most recent swing low that birthed that continuation trend in long positions. For short positions, place the stop loss above the most recent swing that birthed the continuation move.

4. As for your take profit, you could use a risk-reward ratio of 1:2. Take partials off at 1:11 and move your stop loss to break even. You could also use the reversal of the indicator signal to take your profit. Bear in mind, though, that this may get you out of trades too late.

B. Trend Reversal

We will only need the STC and the Moving Average Convergence Divergence (MACD) to catch trend reversals.

Since we've seen that we can expect reversals at overbought and oversold levels, that's exactly where we will be focusing on. Again, recall that values above 75 denote overbought territory, while values below 25 indicate oversold territory.

1. When the oscillating indicator signals an impending trend reversal by showing the STC's signal line in the overbought or oversold level, your next step is confirmation through the MACD. This alignment serves as a powerful indication of an imminent trend reversal.

2. Buy when both signal bullish reversals and sell when both signal bearish reversals.

3. Place your stop loss beneath the closest swing high or low before the reversal signal.

4. Ideally, a risk-reward ratio of 1:2 should do. However, you can ride the trade until you get another trend reversal signal on your MACD or STC.

Benefits and Limitations of Schaff Trend Cycle Indicator

Let’s quickly review the benefits and limitations of using this technical indicator.

Benefits of Using the Schaff Trend Cycle Indicator

The STC indicator’s unique focus on cyclical patterns aligns well with the inherent nature of trends, offering traders a deeper understanding of market dynamics. By factoring in both time and moving averages, the STC indicator generates signals that are often more accurate compared to other indicators like MACD and Stochastics.

Similarly, the indicator’s signal line has the ability to detect trends faster than the MACD, enhancing the trader’s ability to enter and exit positions with precision.

Pros

- The Schaff Trend Cycle (STC) indicator gives strong cyclical trend insights
- It offers enhanced signal accuracy
- Timely trend detection
- Helps to easily confirm trends

Limitations of the Schaff Trend Cycle Indicator

The STC indicator, like other oscillators, can be susceptible to whipsaw or false signals during periods of market consolidation or erratic price movements. Also, in markets lacking clear trends, the indicator might struggle to provide meaningful insights, leading to confusion for traders. Hence, relying solely on the STC indicator may not yield comprehensive trading signals. It’s best utilized in conjunction with other technical and fundamental analysis tools.

Cons

- The Schaff Trend Cycle (STC) indicator sometimes has a whipsaw effect
- The indicator is poor in range-bound markets
- The indicator can not be used as a standalone tool
- It is subject to market volatility