

LANE'S STOCHASTICS

by George C. Lane, M.D.



In 1954, I was fortunate to join Investment Educators as a "gopher". I carried luggage, ran the projector, made charts and took attendance for the owner, Ralph Dystant, and for the technical "guru", Roy Larson.

When Mr. Larson (who was getting on in years) retired, Mr. Dystant became the guru for the stock market and I took the No. 2 spot teaching commodities. Mr. Dystant had a heart attack and, for a time, I taught both stocks and commodities.

Some 43 members of the Chicago Board of Trade, Chicago Mercantile Exchange and MidAmerica Commodity Exchange went through our series of basic, intermediate, advanced and post graduate courses. They were sharp, experienced traders, who took an aggressive approach to their professional training.

When you teach something, you really have to understand how it works. Fortunately for me, I was forced to learn the field of commodities thoroughly just to stay ahead of these students.

Ours was the first school to teach a heavy course in Elliott Wave. Our conventions featured such notable speakers of the day as Bolton, Marchal, Jeff Drew, etc...

These were research days: 20 hour days, all calculating done by hand. The staff expanded to five. I shall not mention names, as they are all well-off financially, still trading, and don't wish to be bothered.

In our research, our indicators were running all over the page, so we developed the technique of expressing them as a percentage of 100.

We developed %A, found it didn't work. We went on to research and to follow 28 oscillators. As we progressed through the oscillators we were developing, we expressed them as percentages as well; thus: %D, %K, %R.

Larry Williams has taken our %R and refined it, improved it, and made it one of the more successful trend methods.

In the sixties, we pioneered using the computer to test our oscillators. At that time, computers were vacuum tube models filling large rooms. My, how our computer has shrunk — land, oh, how its capabilities have increased!

One of the thrills of my life has been to find out that another of our members has been testing %D with an econometric indicator developed at University of Michigan (where we perfected %D) and has found it to be predictive.

How to Use Lane's Stochastics:

This method is based on the observation that as price decreases, the daily closes tend to accumulate ever closer to their extreme lows of the daily range. Conversely, as price increases, the daily closes tend to accumulate ever closer to the extreme highs of the daily range. This concept also holds if you are working in either a weekly or monthly degree.

In working with %D it is important to remember that there is only ONE valid signal. That signal is a **divergence between %D and the stock with which you are working.**

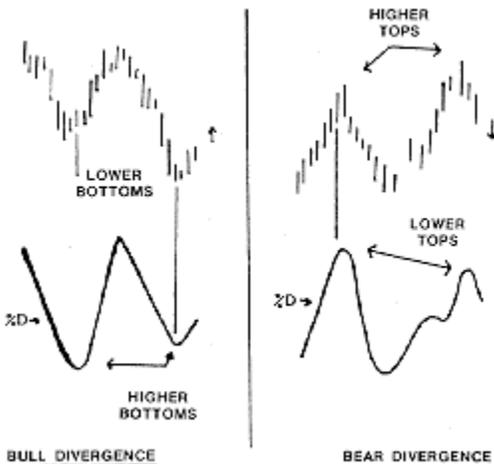
All other signals are only guideposts, or warnings that an important signal is near. The following is a brief description of the various types of formations encountered on the %D chart. We have also provided small diagrams of graphic interest to illustrate the significance of each formation.

I. DIVERGENCE

As previously stated, **this is the only signal which will cause you to buy or sell.**

Briefly stated, when a stock has made a high, then reacts, and subsequently goes to a higher high, while the corresponding peaks on %D make a high then a lower high, a **bearish divergence has been indicated.** A sell signal is upon you.

Conversely, when a stock has made a low, then rallies and subsequently moves down to a lower low, while the corresponding low points of %D have made a low, and then a higher low, you have a **bullish divergence.**

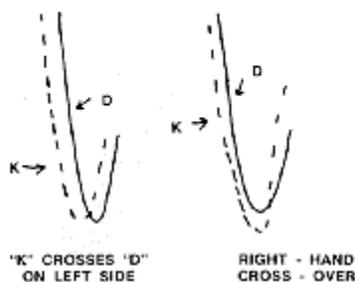


The signal to ACT on this divergence comes when the "K" (dash-line) crosses on the right hand side of the peak of the "D" (solid-line) line, in the case of a top; or on the right hand side of the low point of the "D" line in the case of a bottom.

II. TYPES OF CROSSOVER.

A right hand cross over is the most desirable.

CROSS-OVERS

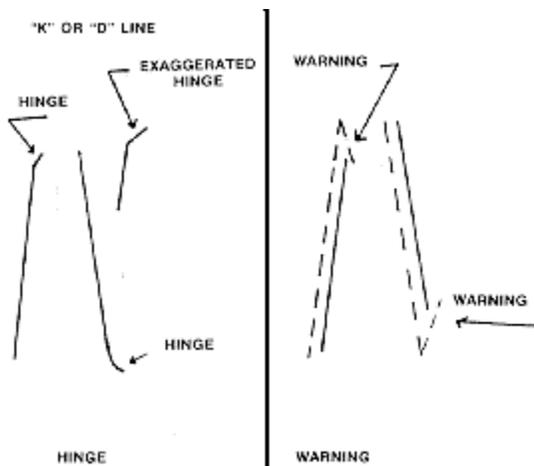


III. HINGE.

A reduction in the velocity of movement in either "K" or "D" indicating a reverse of trend the next day.

IV. WARNING.

When the "K" line has been declining each day and then one day reverses sharply (from 2% - 12%) this is a warning that you have only one or two more days of downward movement before a reversal.



V. "K" REACHING THE EXTREMES OR 0% OR 100%.

When the "K" line declines to a value of "0" this does not denote an absolute bottom on the stock. On the contrary, it signifies a pronounced weakness.

IMPORTANT. After "K" initially reaches "0" it will rebound, usually to about 20% - 25% and then come back toward "0". It may not always reach "0" the second time, but should at least come close. (Your experience and observation will indicate closeness to you.) Normally, It will take from 2 days to 5 days for "K" to come back this second time, depending on the velocity of the issue with which you are working.

The importance of it all is that you can **DEPEND** upon its coming back toward zero.

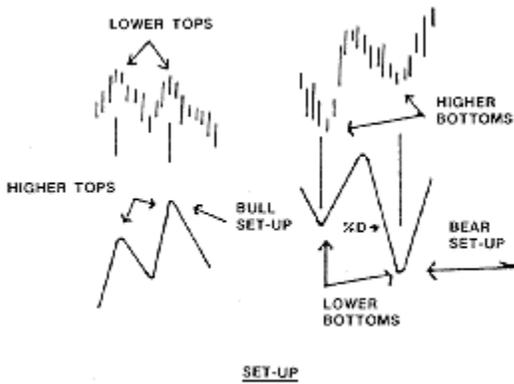
On the second time against "0" you can expect at least a minor rally to start.

*The reverse of these rules apply at tops using 100%. As in the case of the low, expect a sell-off or correction after the second attempt at 100% by the "K" line. It **must be remembered** that 100% **does not mean** that the stock is as high as it can go, nor does 0% mean that we have reached the culmination of the downward move - in fact, they mean just the *opposite*. You will have a reaction or hesitation at that level - then the resumption of the trend - of that degree - which is still in force.*

VI. SET-UP.

This is another form of divergence. The primary function of this signal is to forewarn of a coming important top or bottom. If a corresponding low is made on a stock and on %D and then a swing to the upside occurs; IF on the sell-off the correction of the stock is normal (in proportion making a higher bottom) but %D falls to new lows exceeding its prior low - *a bear divergence set-up is signified.*

This means that the next swing up will probably provide an important top. The reverse of this holds true for tops.



VII. FAILURE.

When "K" has crossed up through the "D" line and then pulls back a few percentage points the next day, but fails to re-penetrate the "D" line on the downside, we call this a failure - and denotes strength or a continuation of upward progression. The same holds true on the downside.



VIII. DIVERGENCE ON THE "K" LINE ONLY.

Many times we observe a divergence on the "K" line only. These divergences will necessarily be a few days apart. Great care must be exercised to match exactly the particular days in question. The significance of this signal is not great, for it merely suggests a minor reaction. If you happen to get this signal in conjunction with a major divergence on the "D" line, you will have an additional aid in timing.

In my opinion, Stochastics should be used in the following manner:

1. *Keep either*

A. *Monthly*

B. *Biweekly (Tuesday to Tuesday)*

2. *Weekly (Every Tuesday)*

3. *Daily*

4. *Keep either*

A. *45 Minute (grains)*

B. *30 Minute (meats)*

C. *Vari-Periods (for the greedy not the needy)*

Period 1... 9:30- 9:35

Period 2. .. 9:35- 9:45

Period 3... 9:15-10:45

Period 4...10:45-12:00

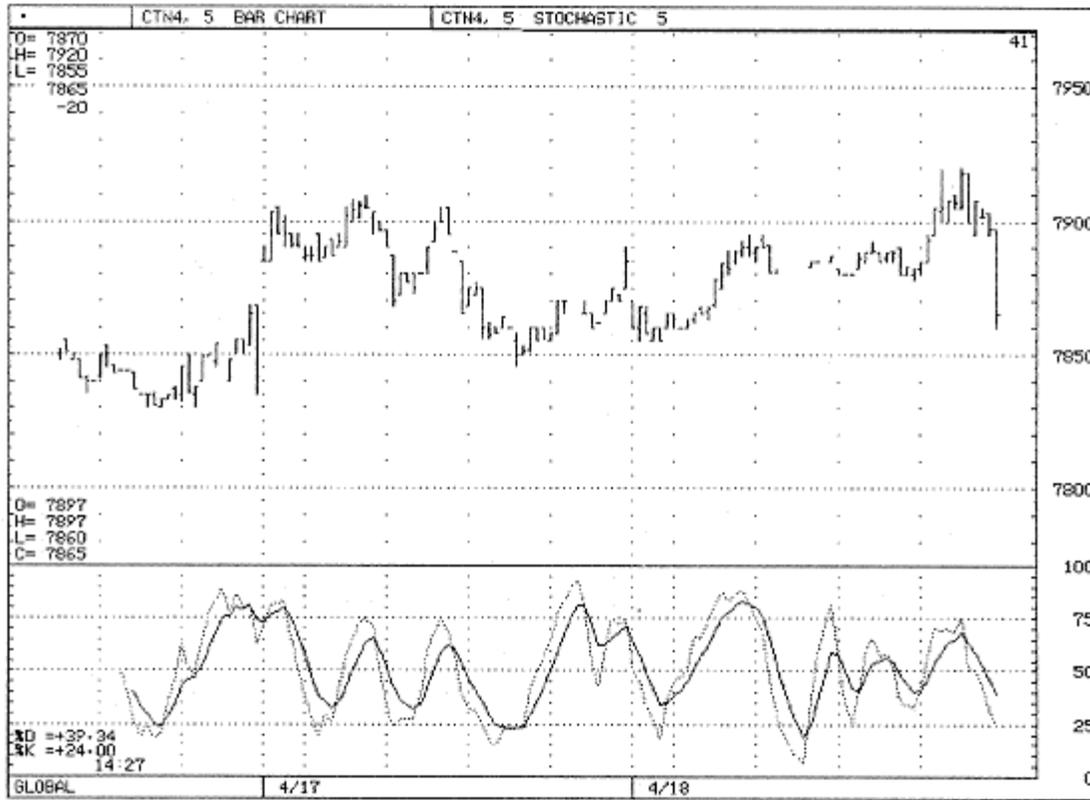
Period 5...12:00- 1:00

Period 6... 1:10- 1:15

My experience is that the 6 equal volume Vari-Periods method earns \$25,000 - \$30,000 more per year than using 6 equal-time periods would bring.

When in doubt, trade in the direction of the longer-term Stochastic. Keep the larger picture in mind

Keeping monthly, weekly and daily Stochastics on 20+ commodities was a tedious, time-consuming job. Now, it's easy Ñ Thanks to Compu-Trac and other computer programs!



Above is a 5 minute bar chart of July 1984 Cotton futures (New York Cotton Exchange) as recorded by a Commodity Quite-Graphics TQ-20/20 satellite system. Cotton's 5 period Stochastic is plotted below the bar chart through the close of April 18, 1984.