2 Simple Ultimate Oscillator Trading Strategies

Ultimate Oscillator Overview

Take a guess what type of indicator the ultimate oscillator is? That's right, an oscillator.

It was created by none other than Larry Williams the king of oscillators. Larry is also known for the Williams %R and the Stochastics oscillators. To learn more about Larry and his other indicators, check out his Wikipedia page here.

The indicator was first released in 1976 and at the time, "ultimate" was a really catchy way to brand a new indicator. Remember at this time, Larry had already released a number of other indicators and he needed to make sure this one stood out.

How to Calculate the Ultimate Oscillator

The one immediate standout for the ultimate oscillator is that it factors in 3 input periods 7, 14 and 28. This is different from other oscillators that have one input period, for example, 14 that looks back over "x" range.

The indicator is centered around two key inputs – buying pressure and true range.

Ultimate Oscillator Formulas

[1]

Buying Pressure (BP) = Close – Min (Low or Previous Close)

True Range (TR) = Max (High or Previous Close) – Min (Low or Previous Close)

Average 7 Periods = Sum of BP over the last 7 periods / Sum of TR over the last 7 periods
Average 14 Periods = Sum of BP over the last 14 periods / Sum of TR over the past 14 periods
Average 28 Periods = Sum of BP over the last 28 periods / Sum of TR over the past 28 periods

Ultimate Oscillator = 100 * [(4 * Average 7 Periods) + (2 * Average 14 Periods) + Average 28 Periods] / (4 + 2 + 1)

What is Buying Pressure?

The buying pressure is all about seeing how well a stock closes relative to its current low and the previous low. This lets you know if there is any buying interest in the security. If the close is near the low point of both the current and previous period, then that's an indication there is little to no buying pressure.

What is the True Range?

The true range measures the high to low range of the current high or prior close to the current low or prior close. [2]

How is the Ultimate Oscillator Plotted?

The indicator oscillates between 0 and 100. When the indicator is said to have a high reading over 70 and a low reading below 30.

Ultimate oscillator

Above is a 5-minute chart and you can see the clear overbought and oversold readings on the chart. Seems simple enough right?

Just buy when the indicator is below 30 and sell when the indicator is over 70? Wrong.

Since we know this is a bad idea, let's walk through 2 strategies you can test out.

Strategy #1 – Exploit the Divergence

Let's first start with how to use the indicator with trending markets. This is where [oscillators]() have the toughest time forecasting market direction.

A stock could give a sell signal as the indicator goes well above 70, but this does not mean the stock is going to roll over immediately. A stock can remain in an overbought state for an extended period of time.

Overbought Stays Overbought

This is where oscillators can really get you in trouble. An overbought stock can stay just that – overbought. Now in defense of the ultimate oscillator, you are going to face this reality regardless of your oscillator of choice. It's just the nature of the beast.

The reason is that a stock can oscillate from overbought to the midline around 50 indefinitely. This is great if you are long and riding the trend higher.

However, if you are short, it can lead to the death of a thousand cuts as the stock drags higher, slowly draining your account value.

This can also play out on the downside as well. If you step out front and catch a falling knife, it can just continue lower and if you are long it's not a good feeling.

The Setup

So, how do you use the oscillator when the stock is trending hard? Simple, you don't assume just because the ultimate oscillator is above 70 you should go out there and start shorting.

So, instead of just selling because the stock is overbought on the oscillator, use it as an opportunity to see if you can jump on board with the trend.

Divergence is About Timing

It's going to feel counterintuitive, but if a stock makes a high and then breaches that high again, it could be ripe for a breakout trade. The problem is that the ultimate oscillator may have a lower reading on the break of the recent high.

All of the experts will tell you that you should sell the divergence, but it's not that simple. While divergence is in play, who knows when the divergence will lead to a selloff.

Therefore, you could try buying the break and then using a stop management system to protect yourself and then ride the wave higher. Even in the example above, there was a clear divergence but the stock nevertheless climbed higher.

Remember It’s About Timing

Again, please do not read this and say divergence means buy or sell. You have to size up the trade. But what I am saying is that if a divergence presents itself, it does not mean it is going to instantly playout in the market. The divergence could be a result of the fact the first move was so strong, it reflects a significant change in trend that is not meant to be exceeded by the indicator on the short-term.

Strategy #2 – Buy or Sell the Panic

One of the hardest things to do is to buy the panic. I don’t have the right mindset to jump out in front of the train, but if you do it can prove valuable.

It’s rather simple, you are buying as everyone is panic selling and once the panic selling subsides, the stock will make some sort of run higher.

This does not mean it will exceed the days high if you are day trading, but it does mean you are likely to see a move.

The Setup

One strategy you can use when trading with the ultimate oscillator is to identify a panic selling point at support. You want to see a spike down in the ultimate oscillator to extreme levels. It’s not enough for the oscillator to hit 45. You need to see it tank.

Then wait for the stock to reclaim the level. You then buy the break back into that level and place your stop below the recent low.

The stop is critical because if the stock rolls over and goes lower, you have to take your lumps in order to live to fight another day.

Chart Example

Here is a chart example of the stock VRAY. The stock was in a clear trading range for 5 days before having a panic selloff on the sixth day. This panic selling quickly subsided and the stock was able to regain the prior support level. Guess what happened next?

That's right, the stock stabilized and moved higher. Ultimately the next day the stock shot up in a parabolic fashion

Buy the Panic

In Summary

While the name may make you feel it's beyond reproach, the ultimate oscillator is just like any other indicator. It has its strengths and weaknesses. As you can see from this article we took a different approach rather than reciting the same strategies repeated over and over again on the internet. It doesn't mean those can't work but in trading, you will need to find an edge.

It's not enough to just sell divergence or place a buy order just because the indicator goes below 30. You have to be smarter than that and you are.

How Can Tradingsim Help?

Interested in exploring the ultimate oscillator further but need a place to test your ideas? You can use Tradingsim to practice trading with the indicator using real tick data for the past 2 years.

You can test the strategies detailed in this article as well as make up your own.

External References

1. Bhandari, Bramesh. (2017). Trading the Ultimate Oscillator. futuresmag.com
2. True Range and How it Differs From Range. macrooption.com