

Master the Candlesticks



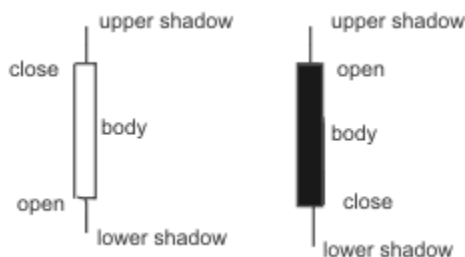
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CANDLESTICKS CHARTING

As we mentioned before candlesticks behold some trend signals. In this chapter you will learn how to correctly evaluate trends using candlestick charts.

Always remember: candlesticks should be used in longer term time periods, preferably daily, in order to be more valid about the trend signals.

Candlesticks consist of the body and the shadows. Body gives information of the direction of the market. White body indicates that the price of the currency pair closed higher than it opened and black body the opposite. Shadows show the high and low of the price for the given period.



REVERSAL CANDLESTICKS

We will refer to the most common of candlesticks which you should use in order to identify trends.

DOJI

When the opening and closing price are identical we have a Doji candlestick. These candlesticks have no body (or almost no body) at all. They may mean the end of a trend. Market reverses but may not reverse immediately due to pressures to the opposite side that after a while lose their steam.

In order for Doji To have reversal significance:

- ❖ Doji should be drawn on daily chart
- ❖ It must occur on relative low or high of the market
- ❖ If it occurs in the midway of a trend the signal is neutral(rickshaw man candlestick)
- ❖ We should have confirmed signals of other indicators such trendline resistance etc

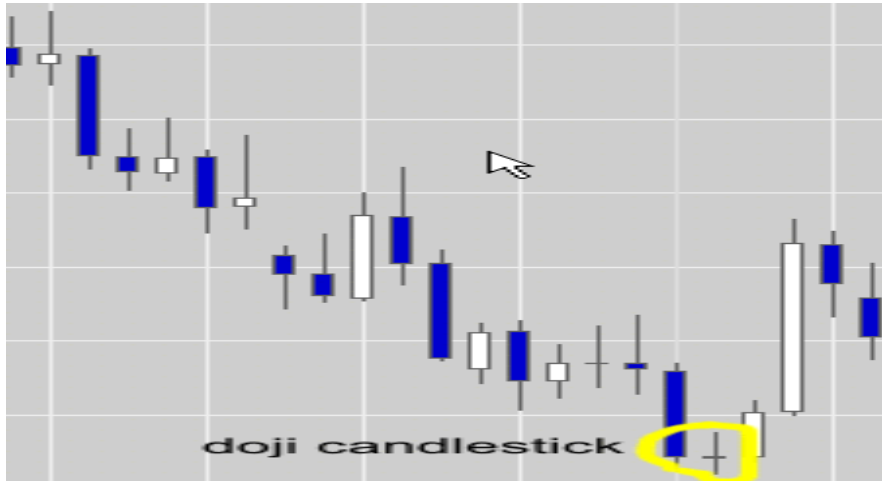


Figure 1 A Doji candlestick signaling reversal

HANGMAN

The signal is “sell at top”. It is called hangman because

traders that haven't seen it will be hanged that is caught to the violent reversal of the market. Signal is sell at top



Figure 2 A hangman candlestick

HAMMER

Same as hangman, but with black body. Occurs at the bottom of the trend and “hammers” all the traders that missed the market reversal. Signal is buy at the bottom.

EXTRA CAUTION: The same as dojis apply but you should also remember that the body of the candlestick is relatively small. (not bigger than one half or one third of the shadow).

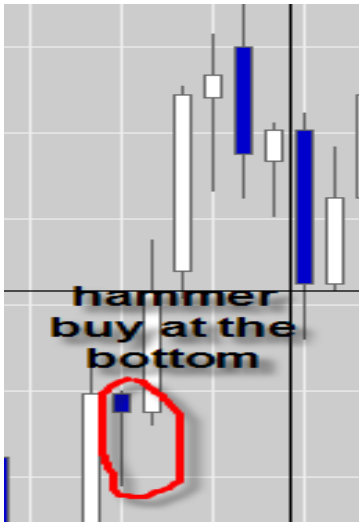


Figure 3 A hammer candlestick

Let's now look some combinations of candlesticks that give us extra signals.

TWO DAY CANDLESTICKS COMBINATIONS

Two consecutive candlesticks with the same body color show trend continuation.

Two consecutive candlesticks with different body color give us some signals.

BULLISH SIGNALS

PIERCING CANDLESTICK (kirikomi)

It consists of a white candlestick that opens the second day lower than the previous low of a long black candlestick and closes at or above the 50 percent of the previous day range of the candlestick. This formation gives us a strong bullish signal.

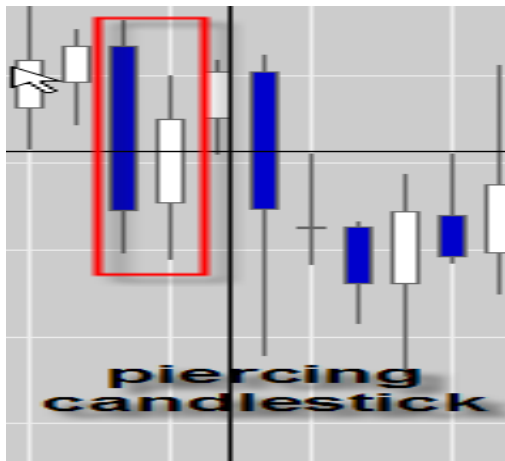


Figure.4 A piercing candlestick

UPSIDE GAP CANDLESTICK (TASUKI)

This pattern occurs in strong up trends. It is a second day black candlestick that closes an overnight gap opened on the previous day by a white candlestick.

Gaps are not often in Forex market but when they occur mean a strong trend in the direction they happened. Market will always close them but not always the following days of the gap. When this candlestick appears it means that the gap was closed the day after it happened and market should continue its uptrend. This pattern is rare at Forex markets.

BULLISH ENGULFING CANDLESTICK

It is a strong bullish signal. It consists of a second day long white candlestick whose **body** surrounds the previous day's black body.

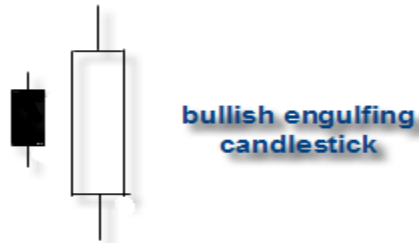


Figure.5 A bullish engulfing candlestick

BEARISH SIGNALS

The most bearish candlestick signal is the dark cloud cover (kabuse). It is the opposite of kirikomi and consists of a second day black candlestick that opens above the previous day's high and closes midway through the previous day's white long body.

One could watch three types of dark cloud cover:

- ❖ Long black candlestick which closes under the 50% of the previous white candle shadow up
- ❖ Black candlestick closing exactly at 50% of the previous white candle.
- ❖ Long black candlestick which closes under the 50% level of the original white candlestick shadow down

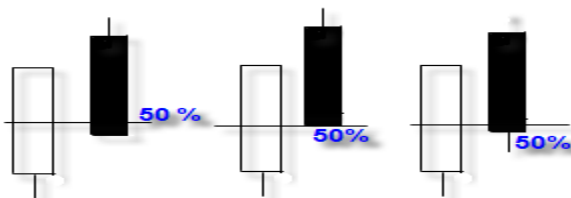


Figure.6 Schematics of dark cloud cover

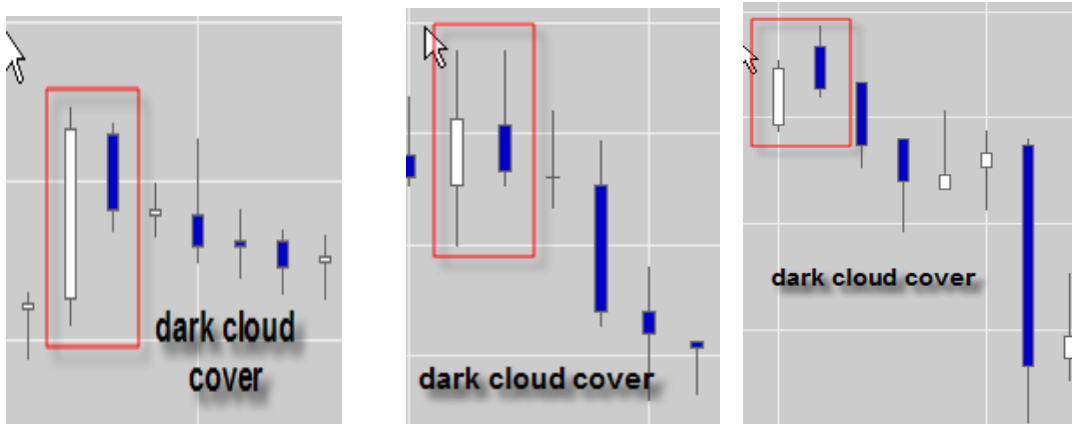


Figure 6 Dark cloud cover candlesticks in real market environment

BEARISH ENGULFING CANDLESTICK

It is a second day long black candlestick whose body engulfs the previous day's small white body closing lower than the low of the first day. **La8os paradeigma**



Figure.7 A bullish engulfing candlestick

BEARISH TASUKI

It is a long white candlestick that has a low above 50% of the previous day's long black body and closes marginally above the previous day's high. It is assumed that second day's rally is only temporary and driven by profit taking. Downward trend is likely to continue next day.

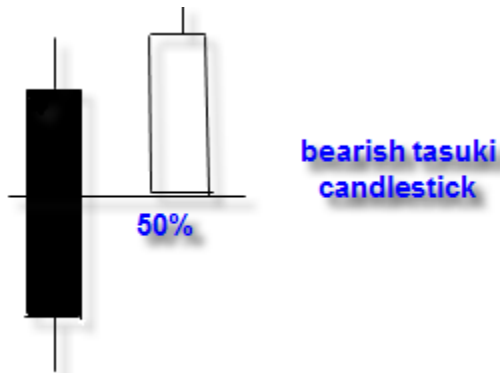


Figure.8 Bearish tasuki candlestick

WAIT AND SEE CANDLESTICKS

HARAMI

It is the opposite of the engulfing candlestick pattern. Second day's candlestick occurs within the previous day's body. Two consecutive candlesticks may have opposite directions but it doesn't matter which is first. Market is ambiguous until further information become available.

EXTRA CAUTION: when the engulfed candlestick is a Doji then the harami pattern becomes a reversal signal. Direction should be the opposite of first day's direction.

HOSHI CANDLESTICK (STAR PATTERN)

Identical to the harami candlestick. It consists of a tiny body appearing the following day outside the previous day's body. It is not important if the star reaches previous day's shadows as soon as it is outside the body. The direction of the consecutive candlestick is also irrelevant. Signal is wait and see.

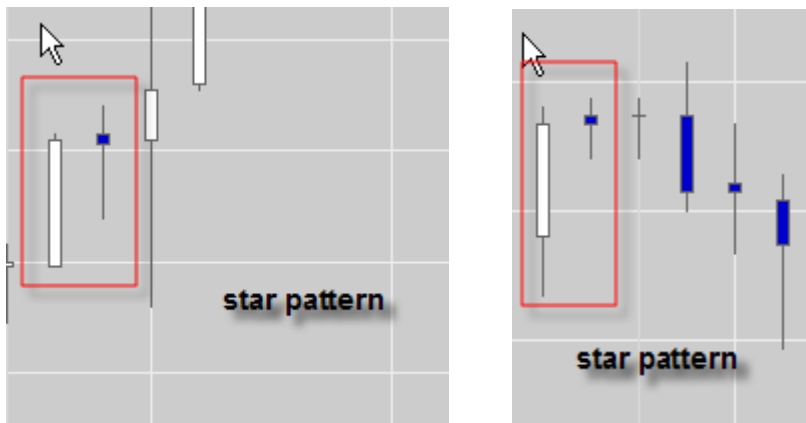
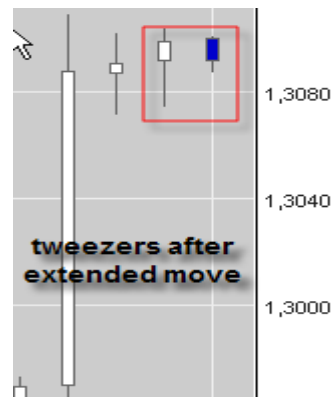
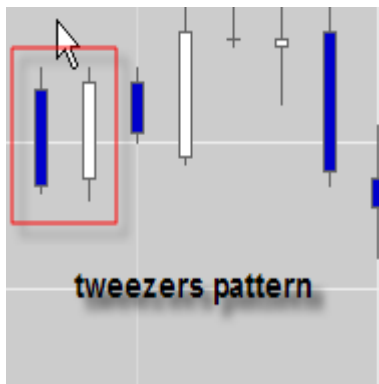


Figure 9 Star pattern candlestick

KENUKI (TWEEZERS) CANDLESTICK

Here the two consecutive candlesticks have the same high or the same lows. In an upward trending market tweezers top occurs when highs are the same. The opposite happened in a tweezers bottom. EXTRA CAUTION: Wait and see interpretation changes to reversal when the pattern occurs after an extended move. *Figur .10* below shows tweezers candlestick in real market.



SAKATA'S 5 METHODS

“Sakata’s 5 methods” strategies are more than 200 year old. The patterns are mostly reversal formations.

THREE MOUNTAINS (SANZAN)

The same as triple top formation but in candlesticks. When the middle mountain is higher than the other two the formation becomes a three Buddha formation which is the alike the head and shoulders formation.

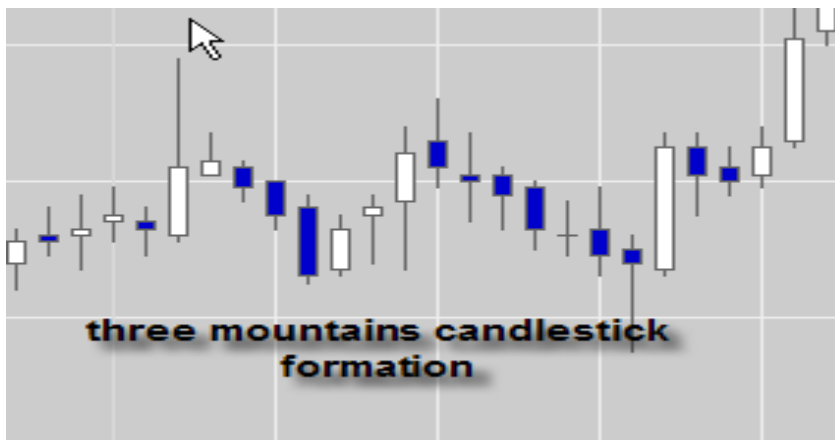


Figure 11

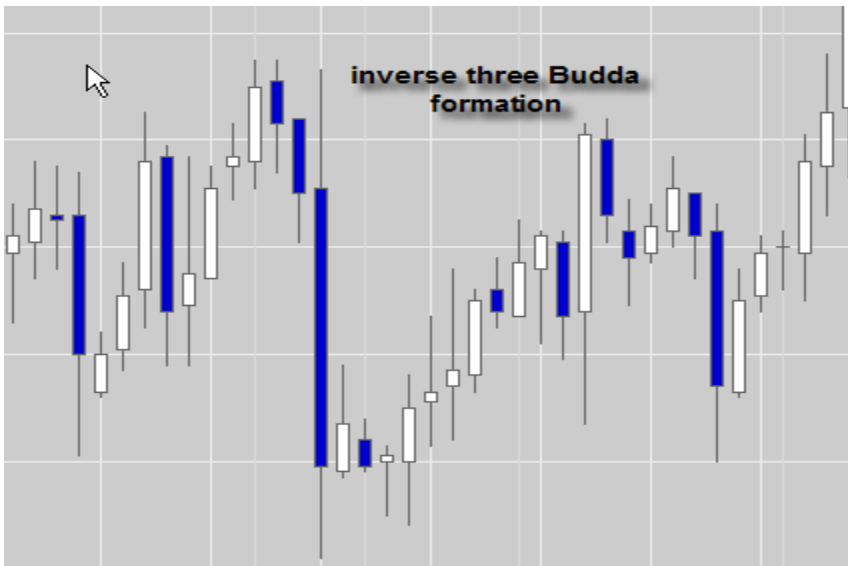


Figure 12

Other formations are the “Three Rivers (sansen)” and the “Three Gaps (Sangu)”. These patterns occur in market with gaps, mostly futures. Not useful in Forex market where gaps are relatively rare.

THREE PARALLEL CANDLESTICKS (SAMPEI)

It refers to the similarity of direction and velocity of three consecutive candles. It is a reversal formation signaling reversal after an extended rally. When bullish the formation is called the three soldiers. When bearish it is called the three crows (inverted three soldiers).

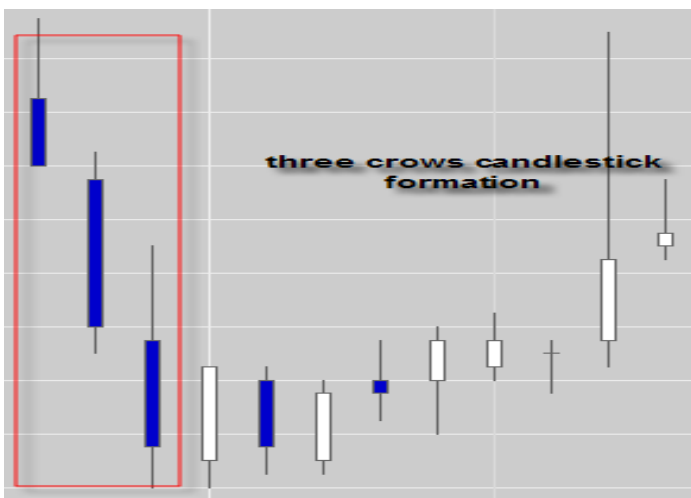


Figure 13

THREE METHODS (SAMPO)

Three candlesticks of the same velocity and direction after an opposite direction candlestick. The last candlestick does not go significantly further from the high or low of the first candlestick before the formation. This formation advises trader to pause its trade because market does not go straight up or down. When SAMPEI does not happen after and extended rally but midway through a trend it provide us an exit signal before the continuation of the trend takes place. It is basically a continuation pattern signaled after a short reversal.

Have you found interesting this tutorial? Of course. But I must warn you that candlesticks may be time lagging sometimes. Why not take a shortcut? Want to learn how? Click here to learn....