Candlestick Trading

For

Maximum Profits

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INTRODUCTION

First things first…I want to thank you very much for requesting Candlestick Trading for Maximum Profits! My goal in this course will be to give those somewhat familiar with candlestick charting a unique approach to trading using candlesticks. For those of you who are new to the practice of candlestick charting this is a great way to learn to use candlesticks to improve your trading!

Before this course most of you probably had done some research on candlesticks, their reversal patterns and what the individual candles represented. Let's be honest, candlestick trading among active traders has almost become a fad! Some use candlestick charts because they simply prefer the appearance. Some others may actually try and use candlesticks to find stock price reversal and some simply don't understand all the *fuss* and prefer to stick to their own method of charting. But one thing is almost certain; if you're an active trader you HAVE heard of candlestick charting.

With this in mind, I'm going to spare you the obligatory lesson in candlestick history except to state that candlestick charting has been around much longer than the U.S. Stock Markets have. Simple reasoning will tell us that if candlestick charting was not a profitable method of trading they would have not have lasted the test of time. Yes, candlesticks can be extremely profitable if a little reasoning is applied when using them.

If you bought this course expecting me to tell you that candlestick charting was some sort of *Holy Grail* of stock trading then you are going to be disappointed. Any experienced trader will tell you there is no such thing. Candlestick charting is the study of price action and how it relates to market psychology. Candlestick charting gives simple and easy to understand visual representations of who is in control of the market. Once mastered, candlesticks and their reversal patterns will begin to quickly tell the trader what the mood of the market is on any tradable stock chart.

Many traders get so caught up in finding the perfect combination of indicators that tell them when to enter and exit a trade they begin missing the art of technical analysis altogether! Price action is what technical analysis was based on in its infancy, well before the home computer and I believe the art has been somewhat lost. It's important to remember that most indicators are just mathematical algorithms of price movement. So why forget about price action itself?

Price action in the form of candlestick charting is what we'll be studying and learning to put into practice. I will use no price based technical indicators throughout this course because I want you to forget about them for awhile. I'm not against the use of indicators by any means if it helps a trader. I would just like you to consider price action only throughout this course because I believe it will put you into a better frame of mind to absorb the material in this book and on the videos.

THE CANDLESTICK PURIST

About a year ago I was on a popular stock trading forum and posted that a certain stock had gapped up from a bottom and formed a “bullish kicking” pattern. I was met by one poster that claimed that my assessment was incorrect and the pattern was not a true bullish kicker because the candles did not form *exactly* as he thought they should. As we argued back and forth the poster quoted a definition from a popular candlestick related website that indicated both candles had to have no shadows (more on this later). Since the formation I had previously pointed to had shadows on both candles it wasn’t a true bullish kicker in this person’s opinion. Never mind the stock had a tremendous gap and fit every other criteria of the bullish kicker you could think of. Never mind the stock reversed and made quite a percentage gain. According to this very technically minded posters strict definition, he was right and I was wrong.

Folks, please don’t get so caught up in the exact letter of the rules that you end up not being able to see the forest through the trees! It’s the spirit of the rules that are important. The example above might be extreme but this person was missing the point of candlesticks altogether in my opinion.

The stock market is so much more volatile in recent years that some strict definitions won’t work anymore. Actually, now that I’m thinking about it, candlestick charting was developed for trading commodities and not stocks in the first place. My point is to not become so closed minded that you begin to miss out on what trading with candlesticks can offer the trader.

THE EMAIL

It’s been three years at the time of this writing since I produced the first version of *Candlestick Trading for Maximum Profits.* In the course of that time I have received plenty of emails from students, potential students and just plain seekers of information. Of all the emails I have received there is one that still stands out in my mind. The following is an excerpt from that email:

“*I’ve been studying candlesticks for some time now and although they are aesthetically pleasing to the eye I can find no proof that they actually work*.”

Unfortunately, when I first read the email I didn’t realize how *loaded* this person’s statement was. In fact I don’t even remember my exact response sorry to say. The statement in the email began coming back to mind time after time and since I publish a course on candlestick trading it began eating at me. *“Why was this person having problems understanding candlesticks?”* I thought to myself. I mean I really wanted to know why! With all of the books, websites and other information readily available to the trader, why was this person having such trouble?

Well, that started me on a two month quest. A quest to find out what kind of training and information was available in addition to my course that was leaving this person with the belief that candlestick charts were nothing more than "*aesthetically pleasing*". I began purchasing popular books, studying websites and even purchased a competitive course on the study of candlesticks. Much of the information was very well written and of good quality. Some others left me thinking a better job could have been done. Regardless of the quality of the material two things stood out that I considered detrimental to making candlestick charting easy and profitable.

The first was the lack of a common sense approach to candlesticks and reversal patterns altogether. Just because you find any specific reversal pattern does not mean the price of any given stock will reverse! To me this is so obvious that I say just that in the homepage on my website and have done so for three years! We can't just assume that because a certain candlestick reversal pattern appears on a chart that the price will actually reverse. Why? Because candlesticks represent price movement and obviously prices move every day. Furthermore, it's not unlikely to any candle formation anywhere on the chart. What we are looking for is certain formations at price levels where a reverse is more probable than others.

The second, and this might go back to the candlestick purist, is the more advanced candlestick patterns. There are many candlestick patterns that are very rare and obscure. All one has to do is to read an advanced candlestick book to find definitions of these patterns. I'm not saying that learning the advanced patterns is a bad idea. What I'm saying is don't get so caught up in candlesticks themselves that you cause yourself more grief than needed. There are more than enough major candlesticks and reversal patterns to give you all the trades you need. Train yourself on the major patterns and become skilled at spotting them. Then you can read about all the advanced candlestick patterns you want.

Candlestick Trading for Maximum Profits focuses on the major candlesticks, reversal patterns and most importantly where to find them for the best chance at profit. Some of the stocks you learn to find will be swing trades and some will be long term (over two weeks) holds. Same holds for forex, futures ,ETFS, etc...

While the system I will teach you will be based on end of day prices, it also works wonderfully well for intraday traders as well. All the intraday trader needs to do is apply the strategies on the chart of their favorite time frame.

LET'S GET STARTED!

It's time to get started with the course itself! I believe the best way to study this course will be to go through the material in its entirety first, and then begin to put the system into motion one step at a time. This way you will have a pretty good idea what you are trying to accomplish as an end result of the training.

Let's get started!

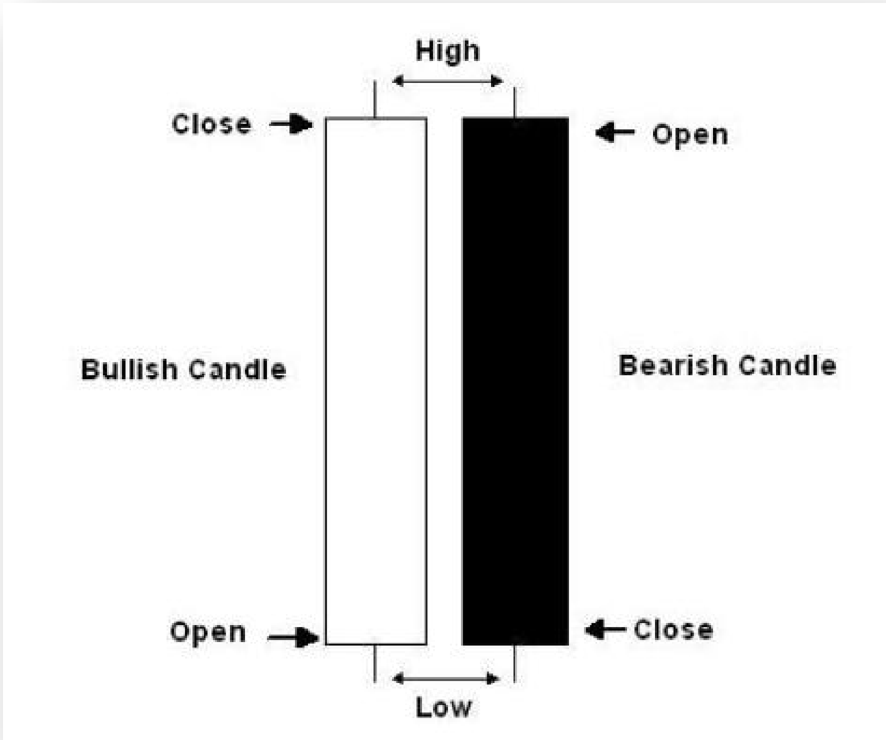
THE BASIC CANDLE

The chart symbols used in candlestick charts are fairly easy to understand. Candlestick charts get their name from the symbol used to represent the trading range in which you are charting (daily, weekly etc…). These visual representations are called candles. As with the bar chart, individual candlesticks plot the open, close, high and low of the individual trading range. We will use the daily time frame from here on out unless stated otherwise.

An individual candle will usually plot price movement in one of two ways usually being up or down. A candle that plots price movement in a positive or upward direction is called a bullish candle. Conversely, the candle that plots price movement in a negative or downward direction is referred to as a bearish candle.

If you find yourself becoming confused between dark and light candle bodies, try to remember to look at each as if we were talking about the weather. A dark body has a stormy or bearish overtone and a clear body has a bright or bullish outlook.

The following illustration shows a depiction of both a bullish and bearish candle. Traditionally, candles are plotted in white (clear) and black (filled) bodies however plotting a bullish candle in green and a bearish candle in red has become popular in many charting services and software programs. Additionally most of these services and programs also allow the user to format the candle properties to allow the use of any color the trader prefers. To avoid confusion we will use the traditional black and white candles.

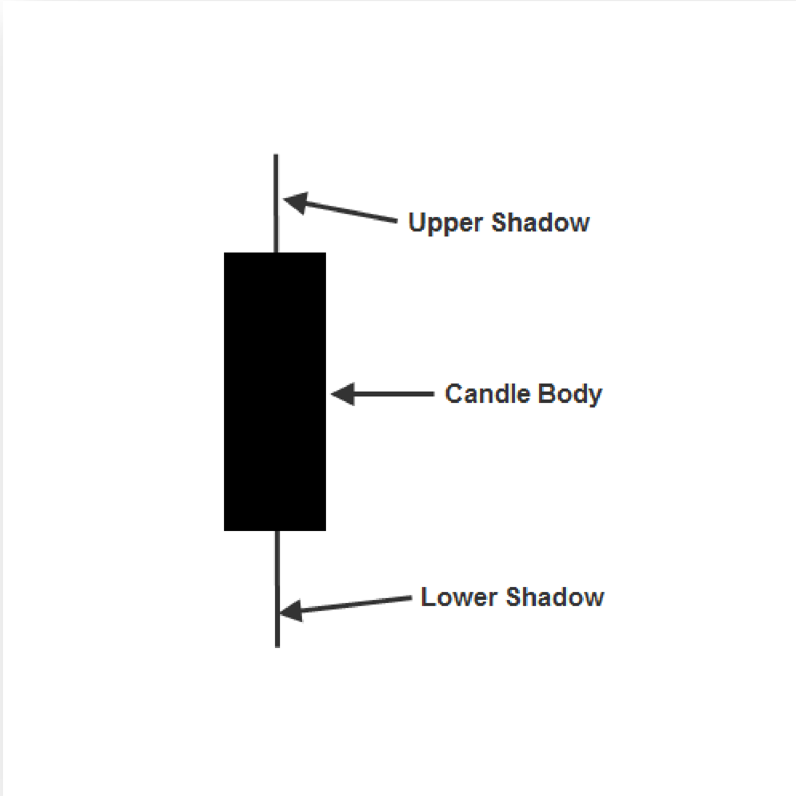


Notice the bullish (clear or white) candle opens at the bottom and moves upward to close at the top representing upward price movement. On the contrary, the bearish candle (black or filled) opens at the top and moves to close at the bottom representing prices moving lower.

PARTS OF A CANDLE

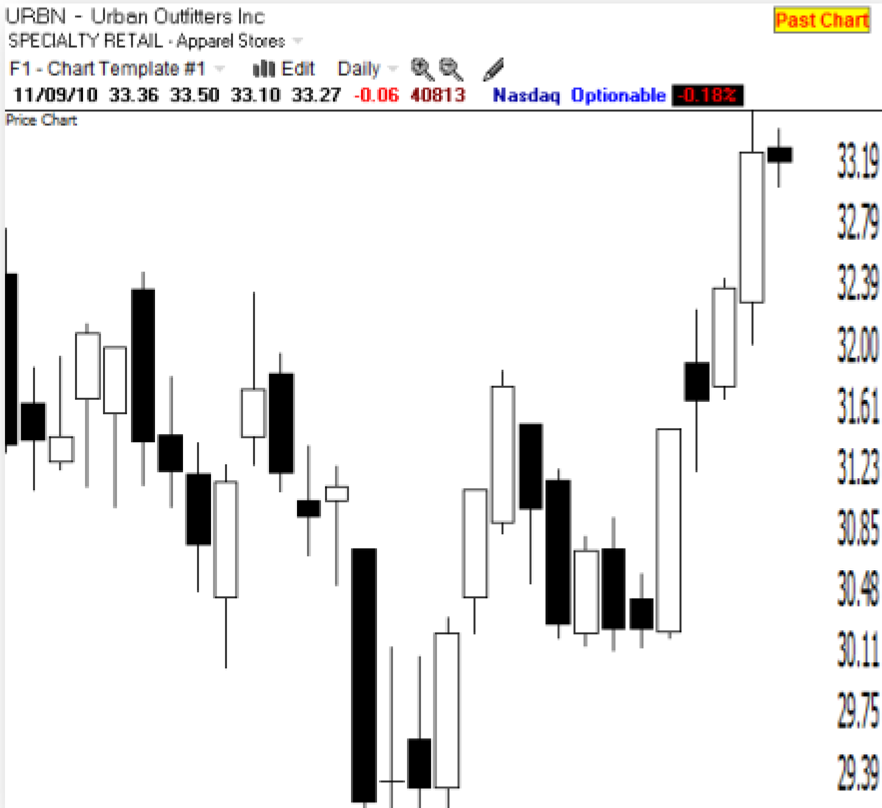
The candle is a very simple representation of price movement and we will be referring to different parts of the candle throughout this course. While not hard to remember, it will be important for you to understand what I am describing when learning reversal patterns and scanning strategies.

Below is a simple representation of a bearish candle which I will use to teach you the components of a candle. While I am using a bearish candle in this example the bullish candle will be the same as far as the parts are concerned.



The wider part of the candle, usually the center portion, is known as the *body* of the candle. The body of the candle represents the distance between the open and closing price in any chosen timeframe. The two lines extending from the top and bottom of the body of the candle are referred to as *shadows*. The shadows represent the price movement between the high and the low of the candle that the price moved beyond the open and close. Most candles have shadows but generally the shadows have no significant impact when it comes to analyzing price movement with a few important exceptions. We'll cover these exceptions as we move on through the course.

Candles will vary greatly from one another in size when plotted on a chart. Some will have long bodies and others will be short. The shadows will also vary in size. Below you can see how candles are plotted on a daily stock chart of URBN.



As you can see, as the prices move from one day to another the candles are unique in their individual size and shadow length. Some are long, some are short, and most have shadows while a few others don't. Candles are generally completely different from one another and most have little meaning to the trader.

THE STORY A CANDLE TELLS

While this may seem basic to some traders with some experience with candlesticks, I want to make sure everyone understands what the candle actually represents and the story it tells us. The daily candle signifies the struggle between two old foes in the stock market, the Bulls (buyers) and the Bears (sellers).

Bulls and Bears, or buyers and sellers are what make the price of any stock go up or down. When buyers are coming into a stock the demand for the equity goes up and so does the price. On the other hand, when sellers take over the price will go down due lack of demand. The stakes are huge and capital involved immense which can shift the balance of power between the two forces at a moment's notice.

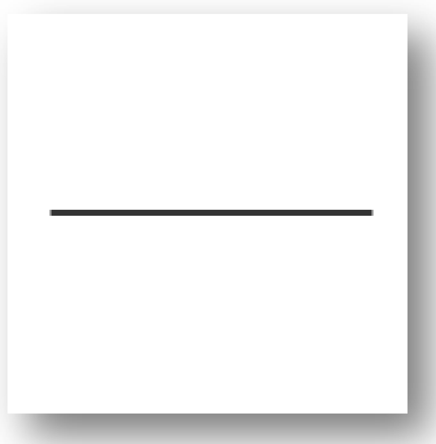
For example, let's imagine the Bulls have been in control of XYZ Company stock for a few weeks. The price has gone up nicely but is beginning to slow. Doubts are beginning to creep into the minds of the Bulls and they begin to consider taking some profits. The Bears also notice the lack of buying pressure and begin to short (sell) the stock causing decreased demand. As the price moves lower the bulls that were previously supporting the price of the stock begin to actually join the Bears in selling and the balance tips to an oversupply of the XYZ stock and prices begin to tumble.

We can reverse the previous scenario for the stock that has been selling off for a period of time and prices have been declining due to selling pressure by the Bears. The Bulls enter when the price decline slows and begin buying causing demand and the price of the stock begins to rise. In order to cover their short positions, the Bears will have to join the Bulls and become buyers thus causing demand and prices to rise.

It's a huge psychological game and candlesticks give a visual representation of this daily struggle. Remember that all price movement is due to supply and demand. Try and visualize candlesticks as a clue of the daily battle between the Bulls and Bears. We can then look at the larger picture of the candlestick chart and try to judge who is winning the war.

THE FIRST TICK

Candlesticks, candlestick charts and reversal patterns have become so common that it's easy to take the story they tell for granted. To illustrate my point I we will refer to the first tick of the day on a daily candle. Shortly after the market open the first sale is plotted on the chart for the day. Below is what this candle will look like with the first tick.



Never mind where it opened for now. I want you to think of it as the first punch thrown for the day between the Bulls and the Bears. Obviously this first tick tells us nothing because it's just a straight horizontal line.

As we move through the trading day this candle is likely to move up and down several times. At times it may appear as a bullish candle. Later in the day it could sell off and leave us with a long upper shadow and a bearish body. It could really do anything at all! Those of you who have watched intraday charts have likely watched this exact scenario happen many times. As the Bulls and Bears battle for control this candle will change its appearance many times throughout the day.

My point here is two-fold. First, the candle as it is forming is a visual representation of the battle taking place between buyers and sellers as it is happening. Second, and most importantly, we don't know who won until the trading day has ended and the candle has finished forming!

We can't trade or base any assumptions about the candle until it has completed its trading cycle. What may look like a bullish or bearish candle in the middle of the trading day may very well finish exactly the opposite by the end of the day. Don't make the mistake of making trading assumptions based on any candle until it has finished forming.

IMPORTANT CANDLES

As we have already learned, candlesticks come in a variety of sizes and many mean nothing at all. There are some very important individual candles and learning what they are and how to spot them is crucial in becoming proficient at trading candlesticks successfully.

These individual candles many times make up the two and three day reversal patterns we will study throughout this course and some are important on their own depending on where we find them on the chart.

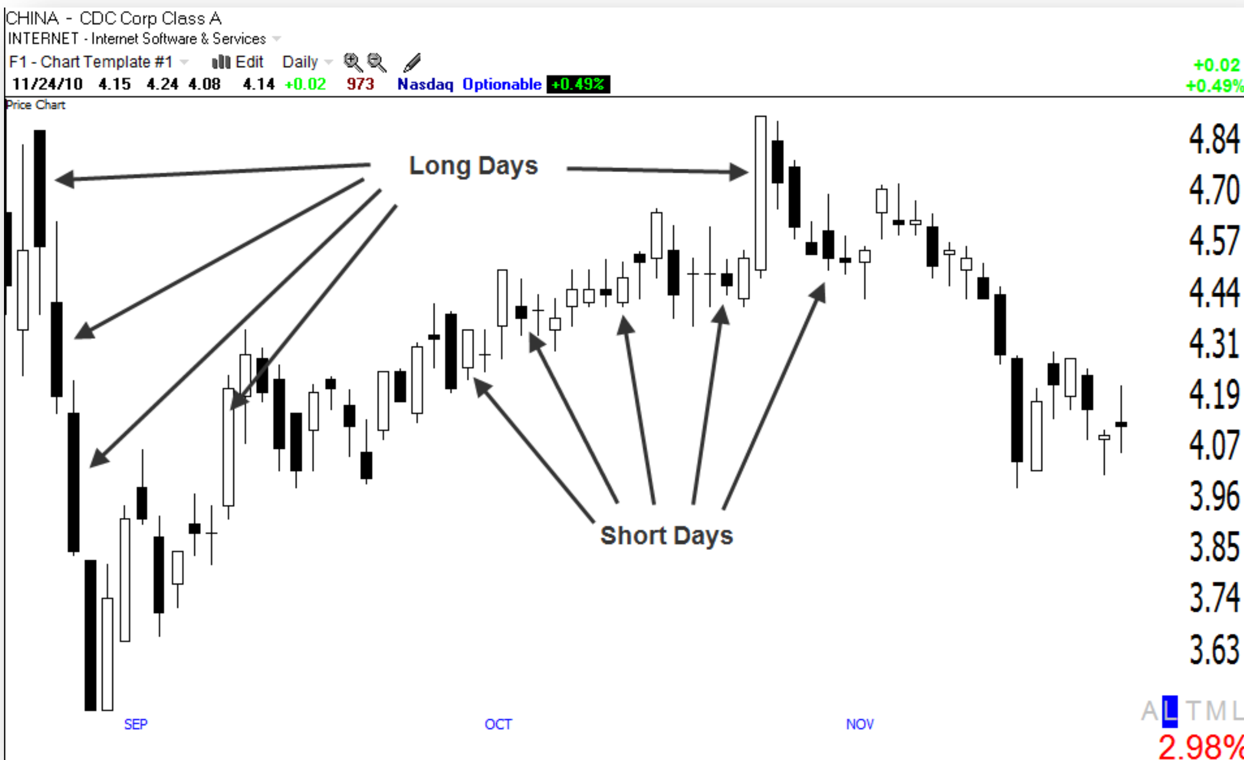
In this section we will learn these individual candles and examine a few examples of them on a chart to help you remember them.

LONG AND SHORT DAYS

Long days are simply candles with a long body that represents a large price move from open to close. Long days can be found in many places on a candlestick chart. To determine if a candle is a long day it has to be compared to the average daily range in the stock chart you are studying.

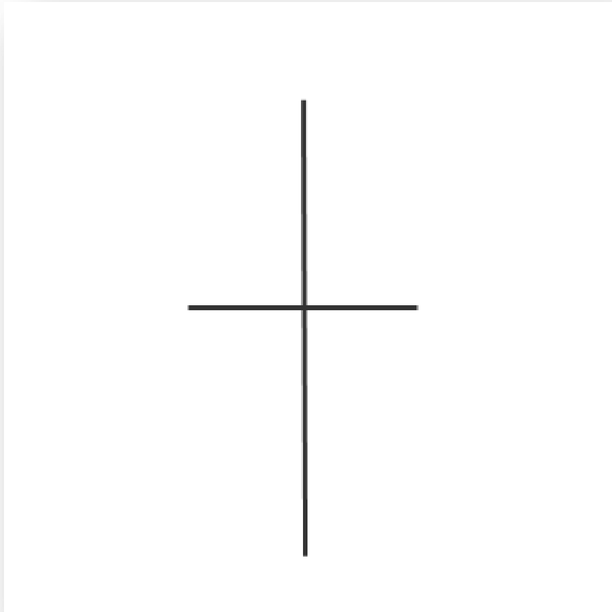
Some stocks have a normal daily range of $2 – $4, while other stocks move much less. To determine if a candle is a long day it has to be compared with the average size of the other candles on the chart. A long day is most useful in determining the strength of a move and confirming trend direction. Factors that enhance the signals of the long day would be small shadows and high trading volume for the day.

Short days on the other hand are generally equal to or less than the average daily range on the chart. Many short days signify nothing more than just another trading day with no importance at all. However, as we'll see later, that some short days can carry significant importance.



THE DOJI

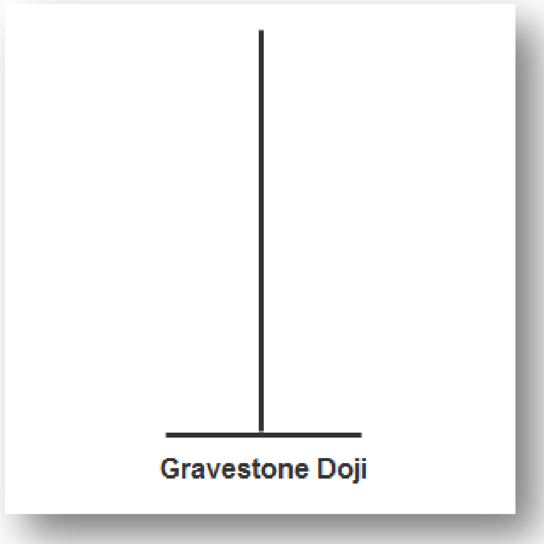
The doji may well be one of the most important individual candles we will study. The true doji has only a horizontal line for a body as the open and closing prices are close to or exactly the same. The doji has an appearance similar to a cross as the upper and lower shadow extends from the small body. Below is an example of the doji candle.



The doji is an important single candle due to the fact that it signifies indecision in the market, at least for that trading day. When the candle opens the price moves up or down forming the upper or lower shadow then the opposite direction forming the other shadow and finally closing at or near the same price it opened at.

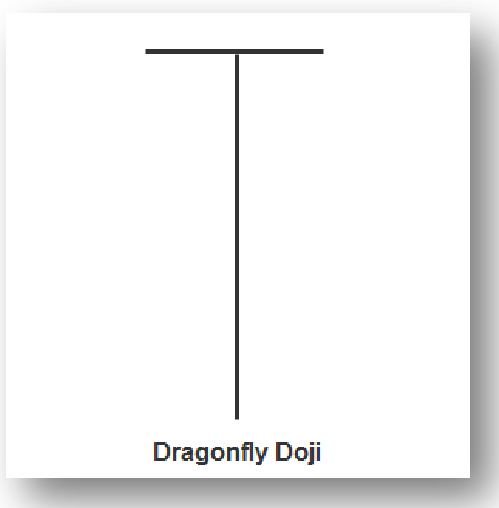
The psychology behind the Doji shows that buyers and sellers were even for the day with neither side being able to get the upper hand to move the price of the stock. In an oversold market the Doji has very bullish implications and in an overbought market it has very bearish overtones. All Doji signals are enhanced by a long daily range (shadows) and overbought or oversold market conditions.

GRAVESTONE DOJI



The Gravestone Doji illustrates price action that opens and closed at the bottom of its daily range giving the bears a slight upper hand for the day. The Gravestone Doji can be considered very bearish at a top or at levels of technical resistance.

DRAGONFLY DOJI



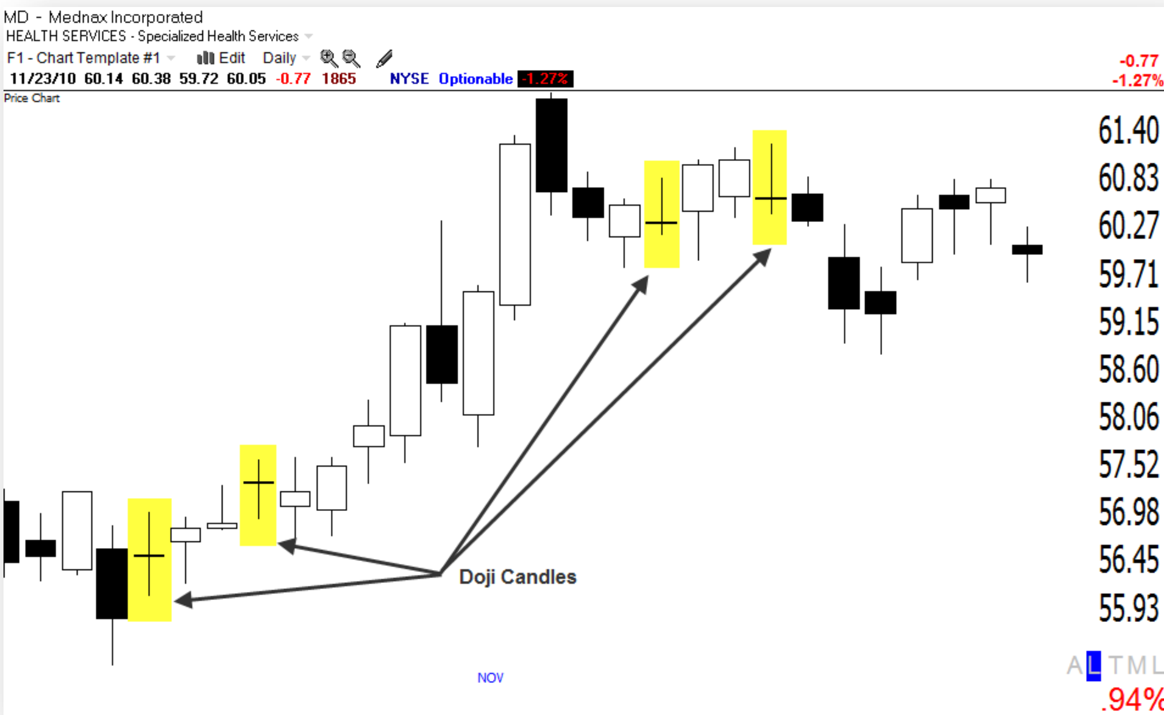
The next variation of the doji is called a Dragonfly Doji and the body of this candle forms at the top of the shadow as seen above.

The Dragonfly Doji illustrates price action for the day that finishes at the top of its daily trading range giving the Bulls the slight upper hand for the day. The Dragonfly Doji is a very bullish candle when forming at a bottom.

LONG LEGGED DOJI

The long legged doji is a doji that could have either a very long shadow on the top or bottom of the body of the candle. The long legged doji signifies extreme uncertainty between buyers and sellers on that specific trading day.

Just as with any version of the doji candle, high trading volume for the day or the candle forming at a level of technical support or resistance gives us a stronger signal from this candle.



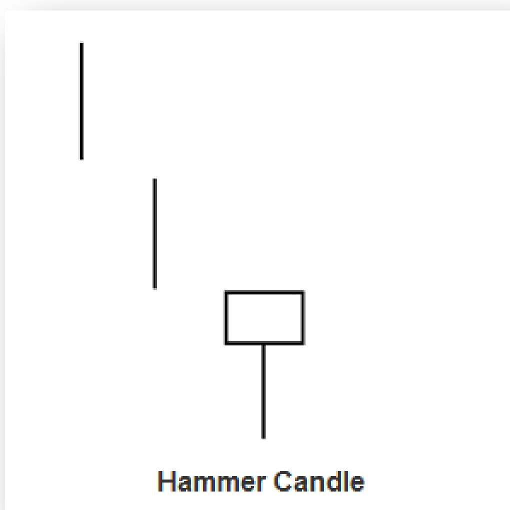
In the above daily chart of *MD* you can see four different scenarios where the doji candle formed. Notice the differences between the four doji's and where the body forms in relation to the shadows.

THE HAMMER CANDLE

The Hammer, which is similar to the Doji, is a single candle that also represents a possible change in trend direction. Also similar to the Doji, the Hammer has a couple of variations in shape. A hammer has a long daily range compared to the difference between the closing and opening price. The Hammer will have either a white or black body, with the white body being somewhat more bullish or a dark body being slightly more bearish.

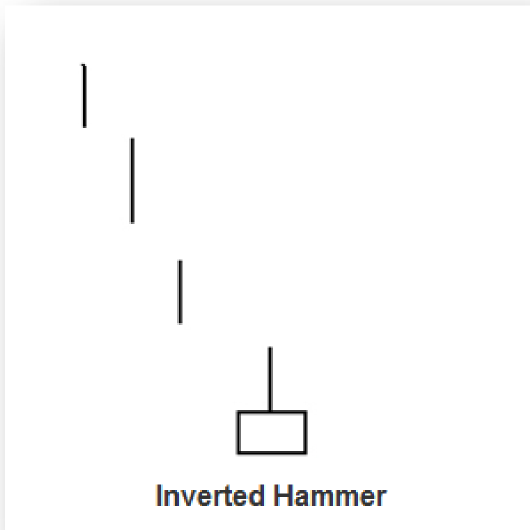
The significance of a Hammer candle is its long shadow compared to the size of its body. It depicts either buyers or sellers started the day off moving prices their desired direction. Once prices moved up or down a significant amount, depending whether the initial pressure was selling or buying, the opposite side got the upper hand and were able to push prices the other direction which may show the force of the trend was weakening. On the day of a hammer, the signal will be improved by higher trading volume and the length of the prior trend. A Hammer can have either bullish or bearish overtones depending were it forms. If prices were moving in an uptrend, the length of the shadow warns of selling pressure. Even though the bulls were able to push prices back to the top of the daily range, the fact that they *had to* tells us the trend may be weakening. The reverse is true if the hammer forms at the bottom of a downtrend.

TRADITIONAL HAMMER CANDLE



Above we see an example of the traditional Hammer Candle. It’s important to note that this example shows a clear bodied hammer but a dark or filled body is just as common. In the example above, sellers were able to push prices lower for a period of time which formed the lower shadow. Buyers rebounded later in the day pushing prices back up to close above the opening price. If this hammer candle had formed at the bottom of a downtrend, the fact that the bulls took control would be a bullish sign and would signify the downtrend may be slowing. We would then begin to look for signs of a trend reversal in the coming days. On the contrary, if the hammer formed after a period of rising prices we could interpret this candle as a bearish sign due to the fact the bears had taken control in the first place.

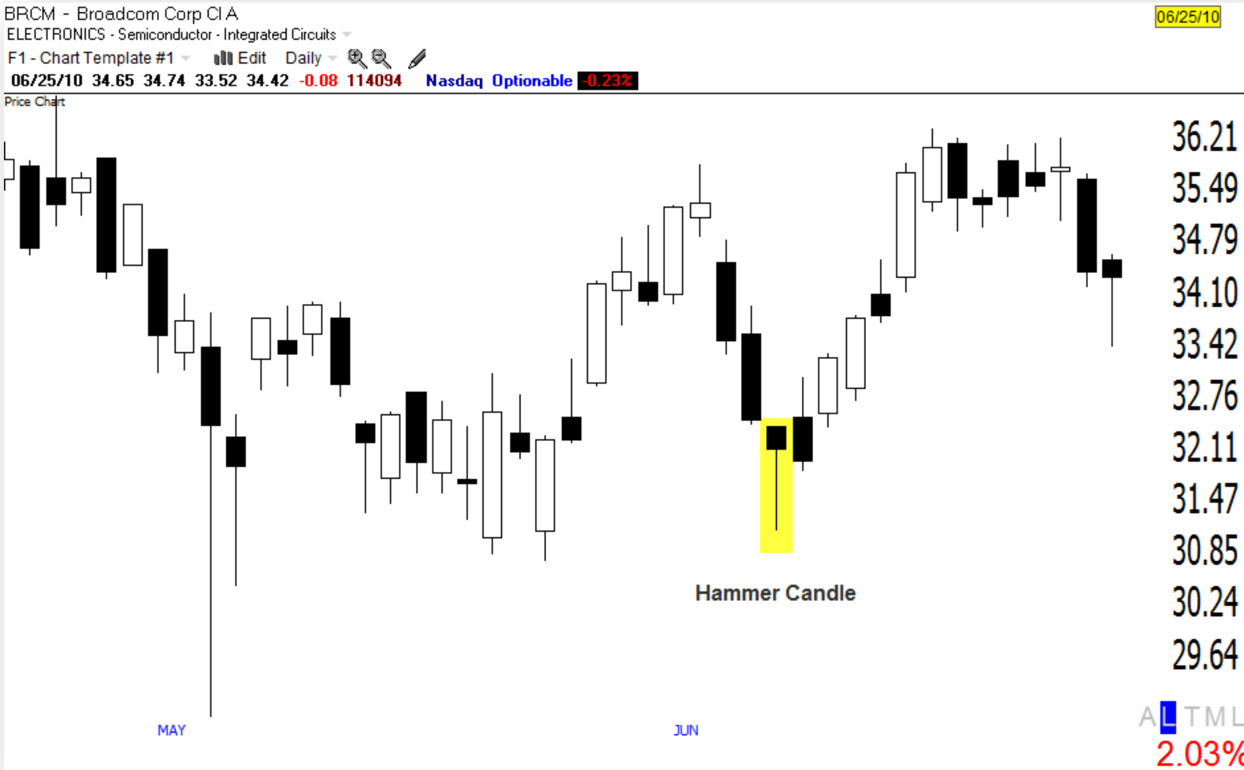
THE INVERTED HAMMER



The above image illustrates an Inverted Hammer candle. Technically speaking the inverted hammer usually has the same psychological implications as a traditional hammer with one exception.

When we find the inverted hammer at the top of a trend it can give us a very bearish signal. After the bulls have moved prices in an uptrend, the day of the inverted hammer will signal that at the beginning of the trading day the bulls continued moving prices higher but were met with stiff resistance from sellers. The bears were able to push prices back down close to the opening price leaving the upper shadow. The longer the upper shadow gives us a more bearish signal in this situation.

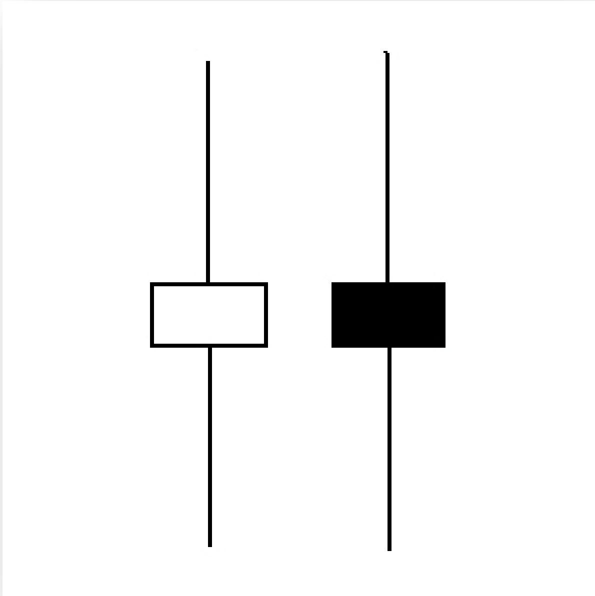
When we find the inverted hammer at the bottom of a trend it will signify buyers beginning to enter the market. While the prices have been moving lower for a period of time, buyers enter on the day of the hammer pushing prices higher. Even though the bears were able to push prices back down leaving the upper shadow, the fact that they *had to* gives a very bullish signal and we would begin to look for signs of a reversal.



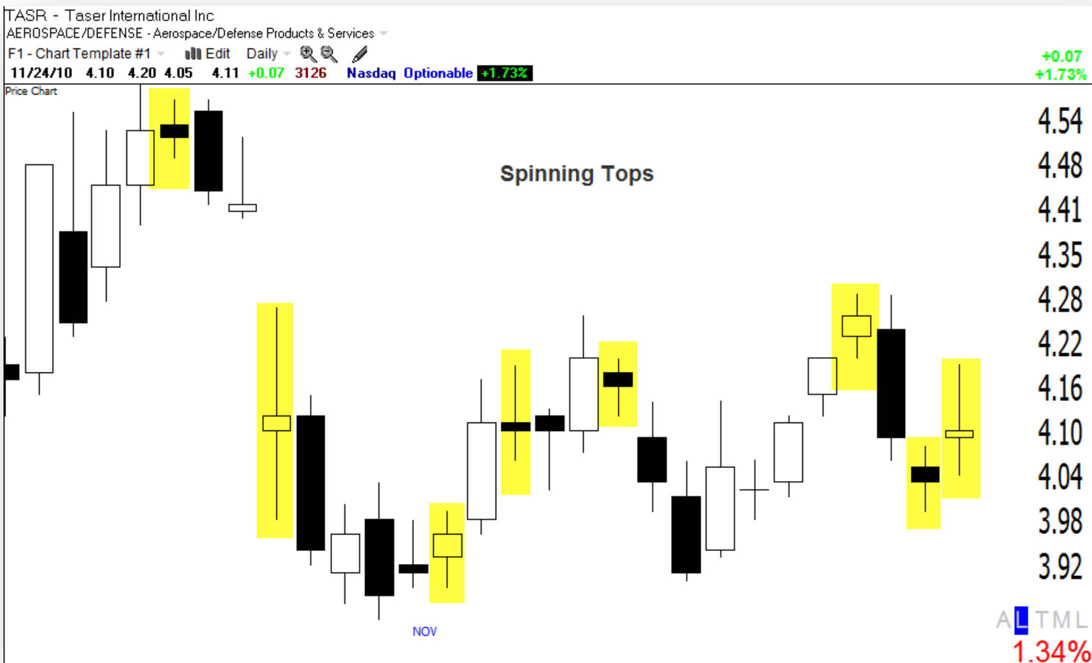
The above chart illustrates the traditional hammer at a point of critical support which gave an indication of the rally in *BRCM*. Notice the rather long lower shadow which gave us an additional signal. This long shadow represents just how far buyers were able to push prices back up for the day, especially at the point of technical support.

SPINNING TOPS

Spinning tops are candles that have a small body compared to the size of the shadows. For a candle to be defined as a spinning top it must not only have long shadows, but must have shadows at both ends of the body. Spinning tops may or may not offer information depending on their place on a stock chart. In a market that is trending sideways a spinning top can usually be considered neutral. However, after a big move in price in either direction a spinning top can have the same reversal implications as the doji, especially if it is accompanied by a spike in trading volume, a level of support/resistance or forms within a few days of a doji.



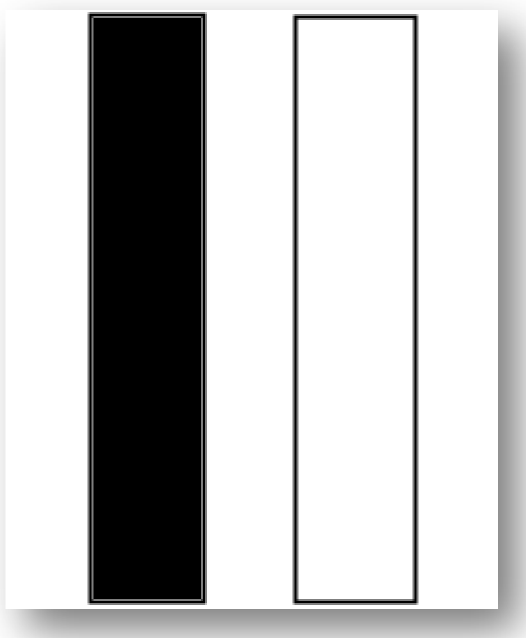
In the image above we see an example of what we can expect the spinning to look like. The candle gets its name from the resemblance to a child's toy top. The spinning top is a fairly common candle and many times it means nothing at all. But since it can have reversal implications at times it's important to commit this candle to memory.



The above illustration shows various spinning top candles on the chart of *TASR*. As I mentioned previously, spinning tops are a fairly common and only a few will have important reversal implications. For now I just want you to see the spinning top on a candlestick chart. We'll get into separating the two later in the course videos.

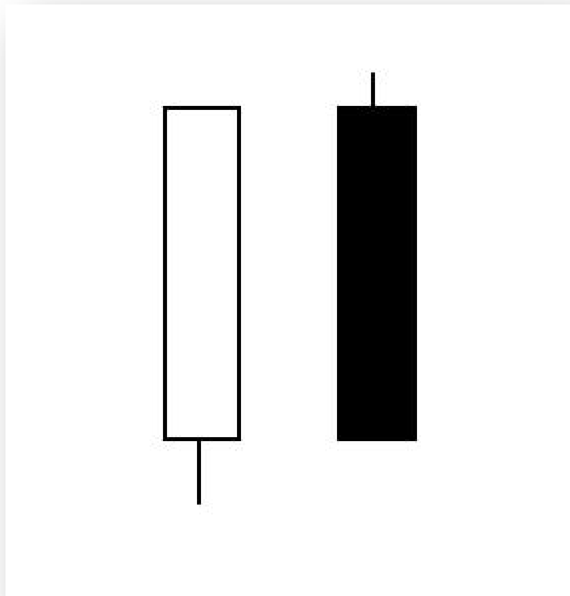
MARUBOZU VARIATIONS

Another candle that separates itself from the pack is the Marubozu and variations of the Marubozu. While rare, the true Marubozu has a full body with no shadows and has a markedly longer body than the average daily price range of the stock being studied. Below is an illustration of the Black and White Marubozu. Notice the lack of shadows; the Black Marubozu opens on its high for the day and closes on the low. Conversely, the White Marubozu opens on its low for the day and closes on the high.



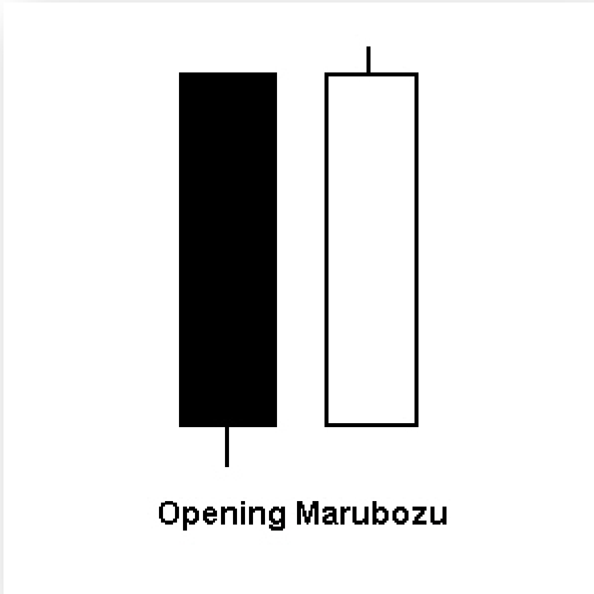
The Black Marubozu can be both a very bearish candle when found in a topping pattern, and a bullish warning candle when found at the end of a long down trend, cautioning us that selling may be peaking. The White Marubozu on the other hand rarely proves to be anything other than very bullish, with buying starting right at the open and continuing throughout the day until the closing bell.

CLOSING MARUBOZU



Above we have an illustration of a Black and White Closing Marubozu which are more common than the true Marubozu. A Closing Marubozu will close with no shadow; meaning that a White Closing Marubozu will close on its high and the Black Closing Marubozu will close on its low. The opening end of both the white and black closing Marubozu can have shadows of various lengths but the shorter the better.

OPENING MARUBOZU



The Opening Marubozu is also more common than the true Marubozu. The Opening Marubozu is defined exactly opposite of the Closing Marubozu. The White Opening Marubozu will have its low price for the day at the open and will close with a shadow on the top showing some selling into the close. The Black Opening Marubozu opens on its high and will close with a shadow showing a little buying into the close.

No matter which variation of the Marubozu we may find it should always be a long day candle. While I'll not illustrate the Marubozu on a chart we will see examples in the video portion of the course. I would like to point out that the trading system used in *Candlestick Trading for Maximum Profits* won't specifically target the Marubozu since they are so rare. We will target long days in general and if one happens to be a Marubozu variation then so much the better. For those of you that want to target this candle I will provide a scanning system for you to find them in the video handbook.

CANDLESTICK REVERSAL PATTERNS

So far we've learned which one-day candles carry significance and require memorization. Many of these one-day candles will make up two and three day reversal patterns which we will study in this section.

The candlestick reversal patterns we will look at are extremely important as they are the backbone of this course and candlestick trading itself. These two and three day reversal patterns can give us a unique insight to trader psychology in a very short period of time.

One of the most powerful aspects of any type of technical analysis is its ability to gauge the psychology of any tradable stock or index. Major Candlestick reversal patterns are no different and can tell us the psychology of any market in as little as two days, or at least warn the investor of an impending change.

It's important to remember that a well established trend will usually not turn on a dime and reverse itself in the opposite direction. Candlestick reversal signals tell us when the trend is losing steam. The prices may continue in the direction of the trend but usually not with the same vigor as they had before.

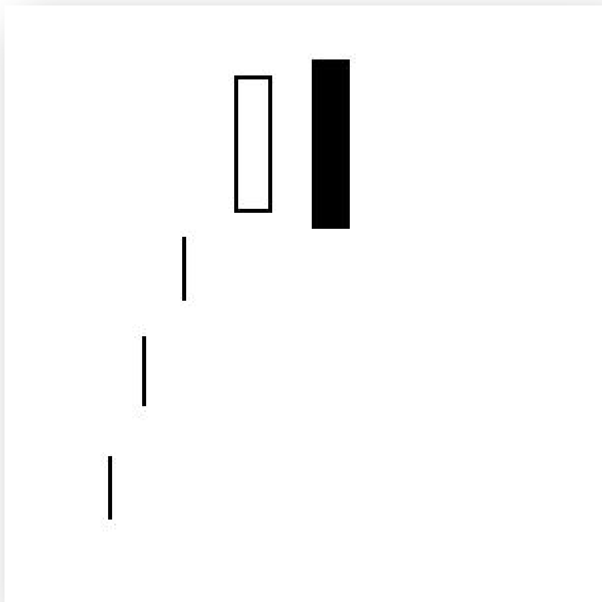
The major reversal patterns we will use and study are as follows:

- ✓ Bearish Engulfing
- ✓ Bullish Engulfing
- ✓ Hanging Man
- ✓ Bullish Piercing
- ✓ Dark Cloud
- ✓ Harami Pattern
- ✓ Shooting Star
- ✓ Morning Star
- ✓ Evening Star
- ✓ Bullish Kicker
- ✓ Bearish Kicker

In this written portion of the course I will outline each of the above reversal patterns with examples, psychology and signal enhancements. You will want to commit these reversal patterns to memory until you can spot them quickly on a candlestick chart. The best way to learn these reversal patterns is to look at many stock charts concentrating on trend tops and bottoms looking for candlestick patterns that have become familiar to you. The video portion of the course will also help in the memorization of these patterns.

Candlestick patterns are completely visual allowing them to be quickly noticed. I think you'll be pleasantly surprised just how quickly you'll learn them.

THE BEARISH ENGULFING PATTERN

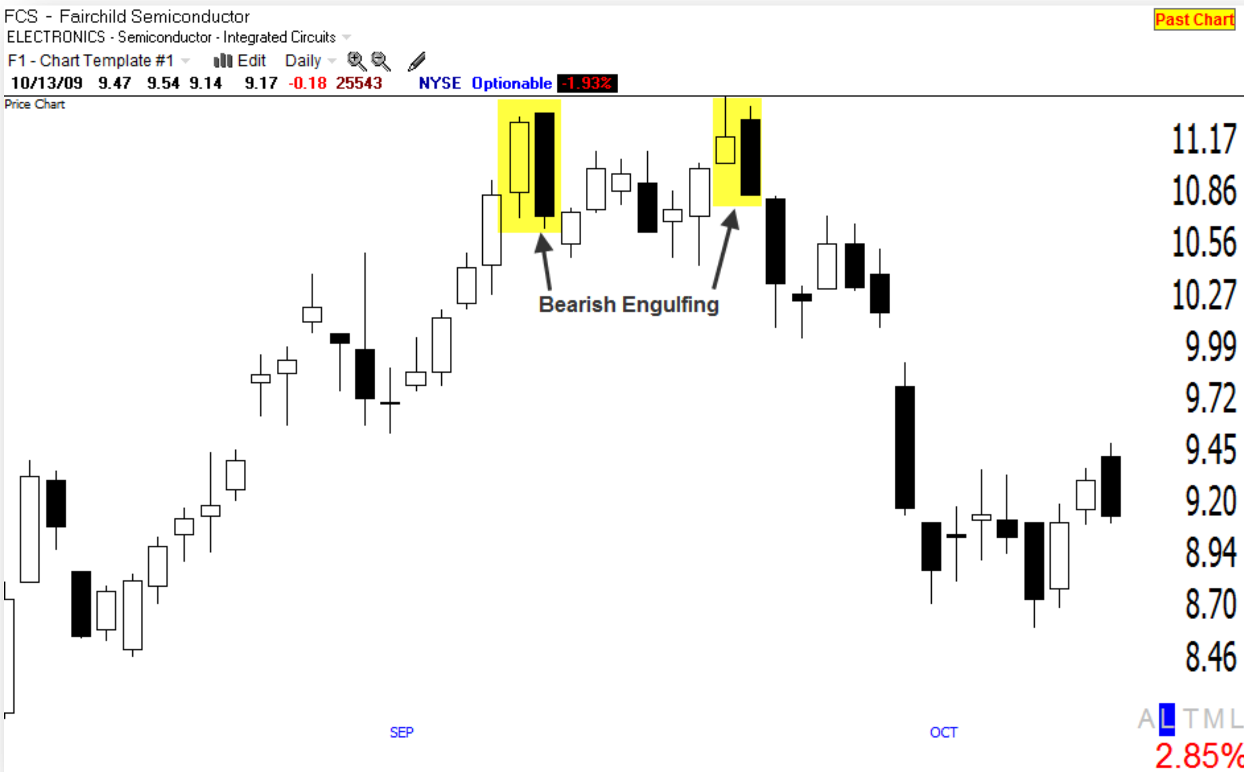


The Bearish Engulfing reversal pattern is made up of a clear body the first day and a dark body on the second. On the first day a white body forms and the price on the second day gaps up and opens higher than the close of the first day. The price on the second day then drops and closes lower than the open of the first day completely engulfing the body of the first day's candle.

We look for this formation in an overbought market to signal us of a major change in investor psychology. After a good strong uptrend, the engulfing candle of the second day shows heavy selling in a larger proportion to the buying of the first day. To make this signal stronger we would look for:

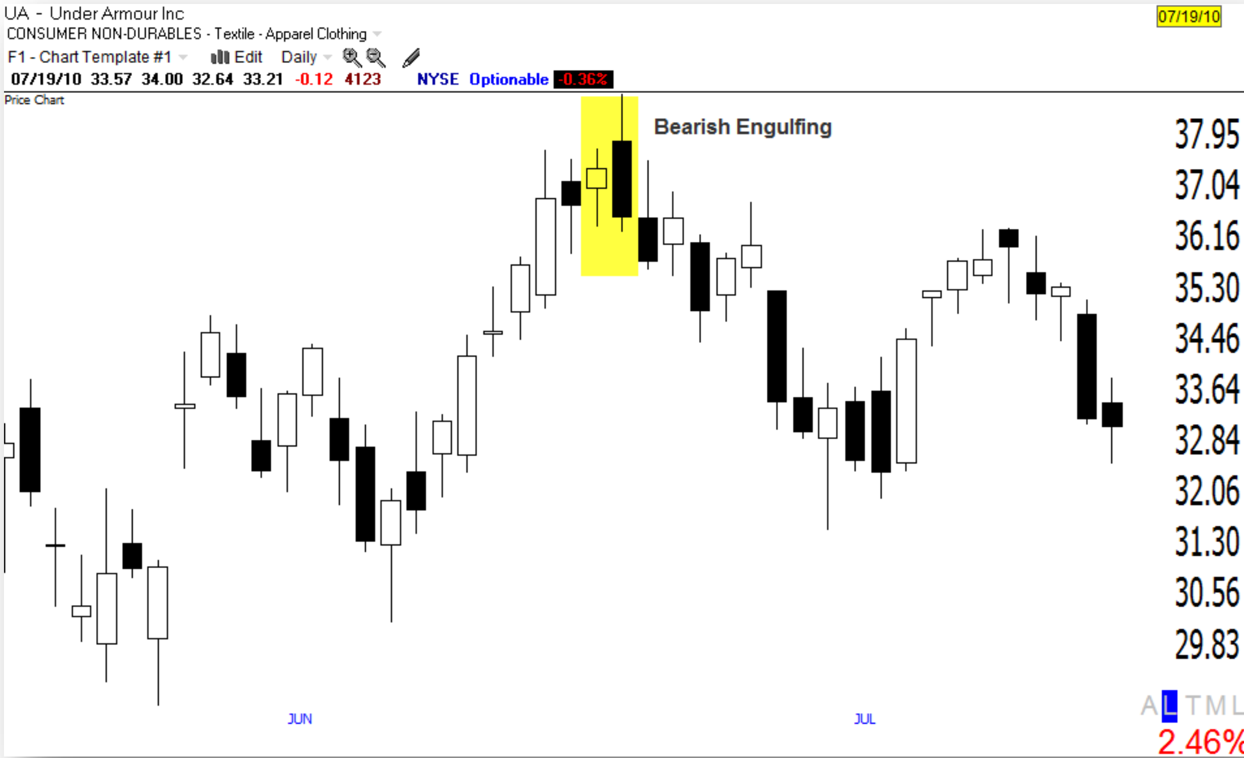
- Heavy trading volume on the second day.
- A large body engulfing a small body.
- A large body engulfing the body *and* the shadows of the first day.

- A temporary run-up in price that was greater than the angle of the uptrend that proceeded it.
- Either candle hitting a point of price resistance such as an upper trend line, major moving average or other technical resistance.

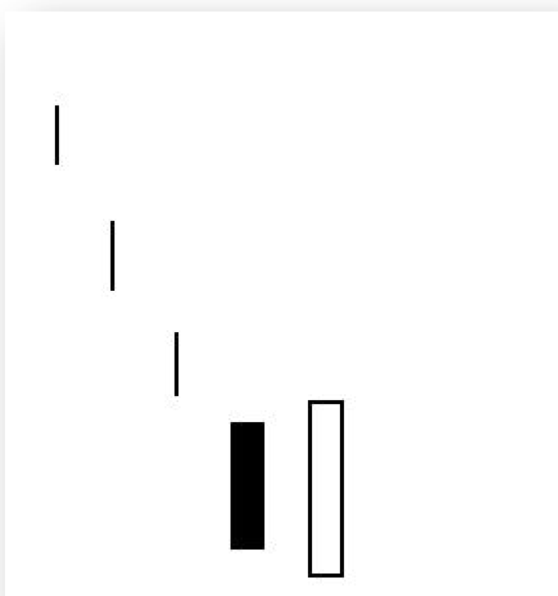


In the above example we see a double top with two Bearish Engulfing formations that spelled the end of an uptrend in *FCS*. Of course it's not necessary for a trend change to contain more than one reversal formation but it certainly didn't hurt in this example. Notice how we had a large bodied candle on the second day engulfing a relatively small bodied candle of the first day in the second Bearish Engulfing formation. This generally enhances the patterns signal strength telling us that the first candle, which is the last candle plotted by the Bulls really ran out of strength quickly and was met by overwhelming selling pressure the next day.

In the illustration below we see another example of the Bearish Engulfing formation on a chart of *UA*. This formation signaled a decline in price and would have made a nice profitable swing trade. What sticks out about this Bearish Engulfing pattern is we had a large bodied candle engulfing a small bodied candle which generally indicates a stronger signal.

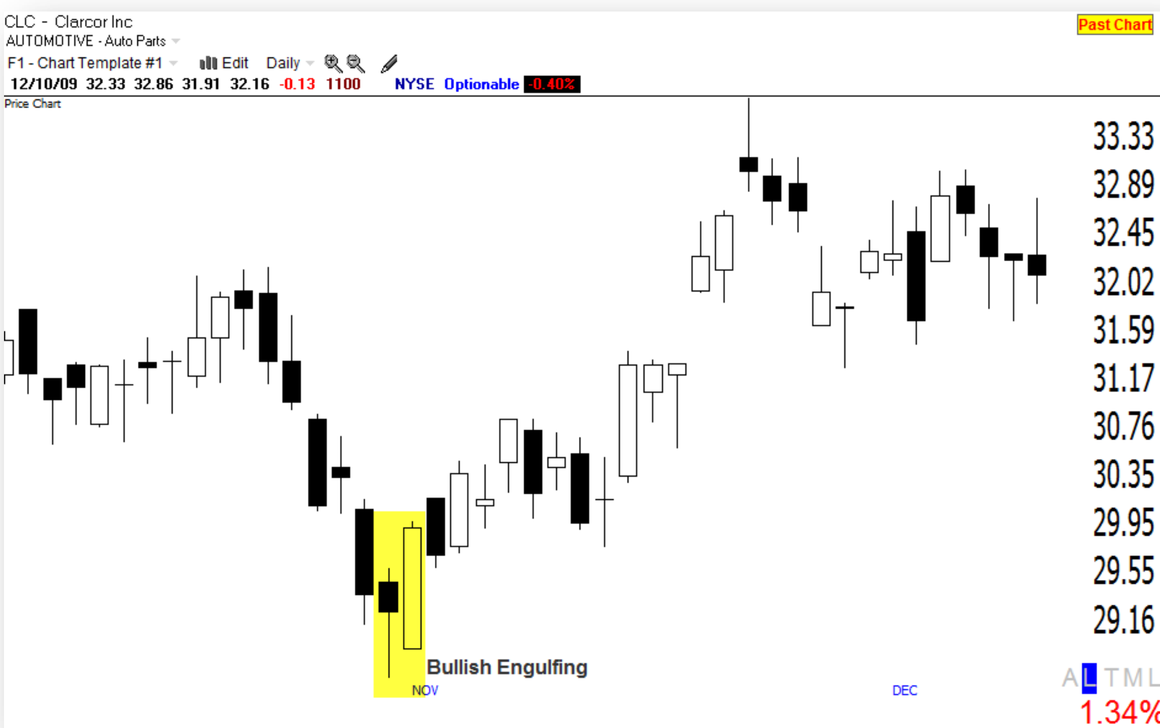


THE BULLISH ENGULFING PATTERN



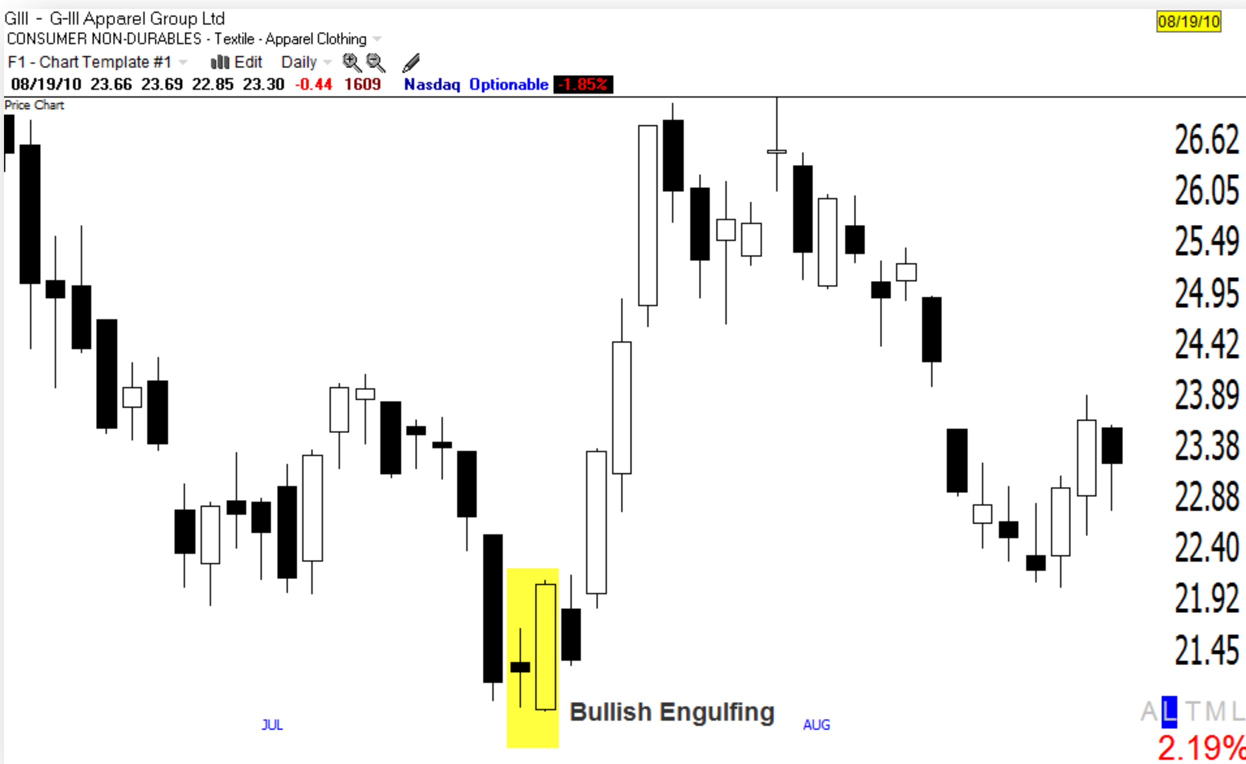
The Bullish Engulfing formation is a very strong bullish two day reversal signal. The Bullish Engulfing pattern consists of a black candle on the first day with the price gapping down on the second day, opening lower than the close of the first day. The price then rallies and the clear candle of the second day closes higher than the first day's opening price completely engulfing the first day's body. A look at the psychology behind this formation reveals the sellers, or the supply of stock, declining as prices move lower. When the price gaps down on the second day, buyers begin entering the stock with force. The pattern reveals a change in investor sentiment from selling to buying. There are a few things we look for to indicate an even stronger signal:

- High trading volume on the second day with low trading volume on the first.
- A large body engulfing a small body.
- Prices heavily oversold with prices falling faster than the angle of the trend preceding the formation.
- The body of the second day engulfing the body *and* the shadows of the first day.
- The pattern forms at any technical price support area such as, a trend line, major moving average, or horizontal support.

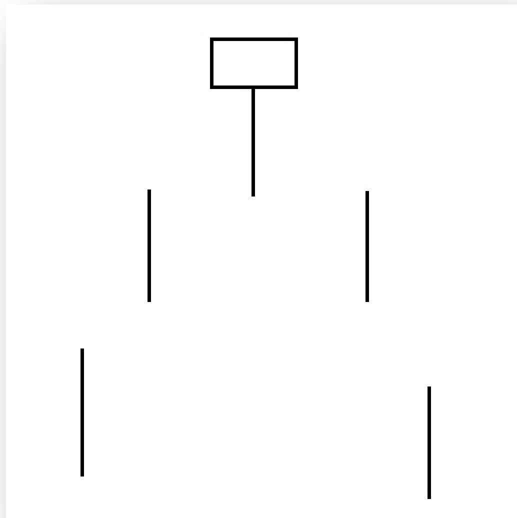


The above candlestick chart illustrates a Bullish Engulfing pattern that kicked off a rally in the price of *CLC.* This is a nice example of a large bodied candle engulfing one with a smaller body which generally indicates a bit stronger signal. Notice also that the second day's candle is an Opening Marubozu. This indicates that after a healthy gap down to start the second trading day, buyers stepped in immediately and moved prices higher throughout the day. Another enhancement to the Bullish Engulfing pattern above was we had a large bodied candle engulfing the body of the first day's candle.

In the illustration below we can see another example of the Bullish Engulfing pattern on a chart of GIII. In this example we not only had a large candle engulfing the body of a small bodied candle, the engulfing candle actually engulfs the body and the shadows of the first day's candle. This makes this example of the Bullish Engulfing pattern even more bullish as it generally indicates a stronger signal.



HANGING MAN

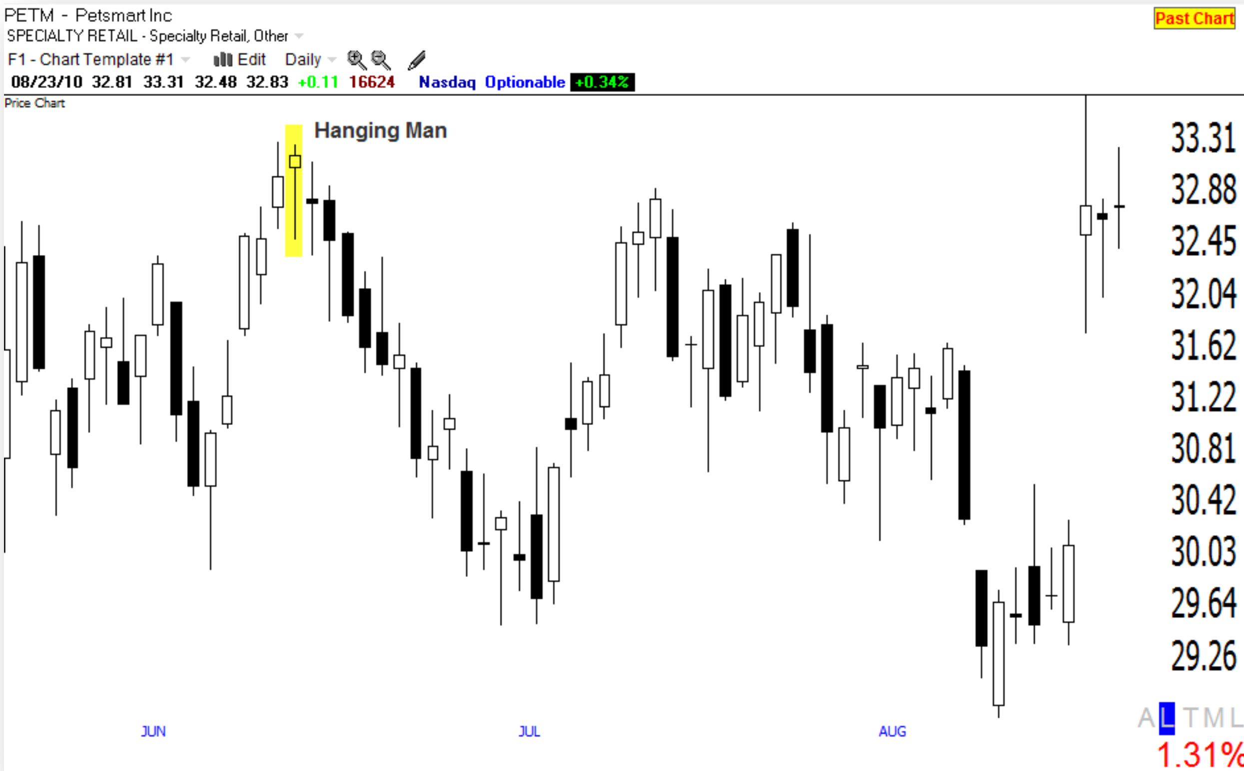


The Hanging Man formation gets its name from the patterns unique appearance on the chart of a man hanging at the peak of an uptrend. The pattern is made up of three candles with the second (center) candle being a hammer that has gapped up above the preceding candle. On the third day, prices decline below the shadow of the previous day's hammer completing the formation.

When we see this formation we can observe selling coming in the day the hammer forms. Remember that a Hammer Candle is bearish at the top of an uptrend. On the day of the hammer candle prices gap up then begin to sell off. The buyers are able to regain control and push prices back up towards the opening price or beyond forming the lower shadow and small body of the hammer.

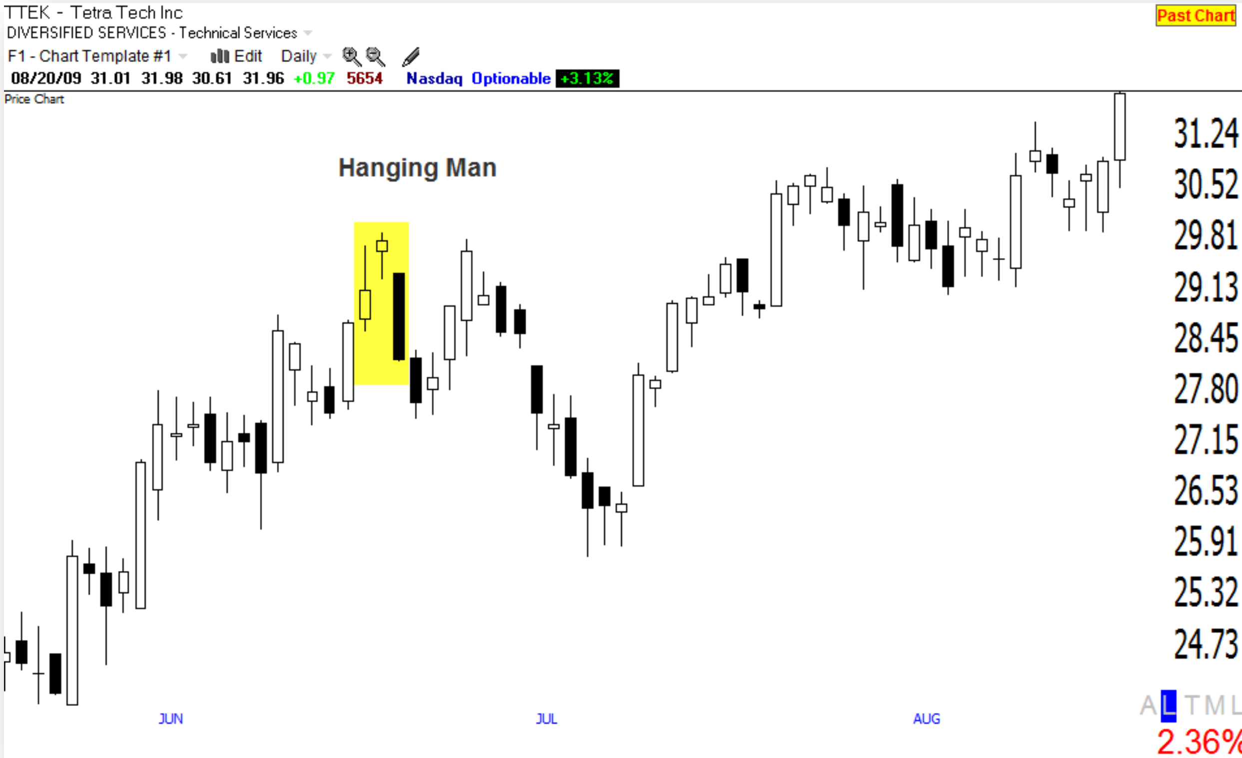
Even though the buyers were still around on the second day the initial selling is seen as a warning the trend may be slowing. The third day's dark candle is seen as conformation of this warning. There are a few things we can look for that will make this pattern more significant:

- A long shadow on the hammer candle indicating how much selling pressure was present.
- High trading volume on the second and third day.
- Long bodied candles on the first and third day.
- The pattern forms at a point of technical resistance such as a major moving average, upper trend line, or horizontal resistance.



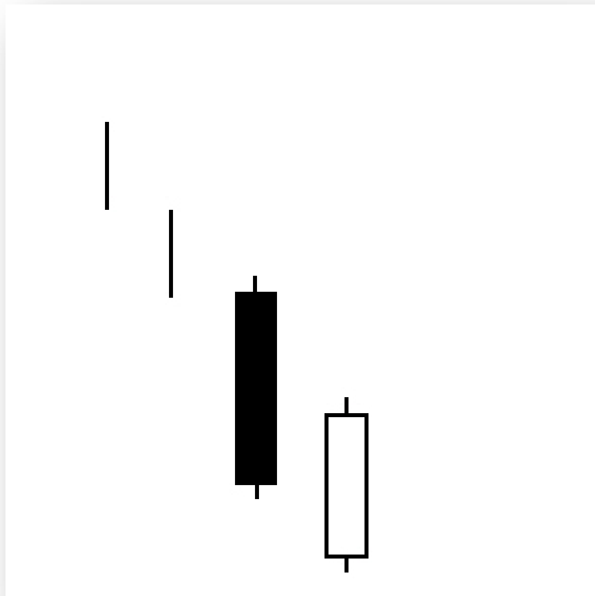
In the above chart of *PETM* we can see an example of the Hanging Man reversal pattern. In this example the second day (hammer day) had a very long lower shadow which actually had a lower low than the previous day's low. While the hammer ended up being a clear bodied candle, the long lower shadow indicates the sellers were able to push prices very low for the day. The third day's candle gaped down forming a doji/spinning top candle.

We would preferably like to see a longer bodied dark candle on the third day to help us confirm the change in trend. In the above example confirmation came for us two days after the hammer candle with a long bodied bearish candle. Reference what I wrote in the introduction about *"the spirit of the law vs. the letter of the law".* The above example may not fit the exact definition of some purist's idea of a hanging man but in the spirit of the rules we end up with a successful trade!



To make the purist's happy I'll illustrate a more traditional Hanging Man formation in the above chart of *TTEK*. While this example did not end up signaling a total change in trend direction, it did give the first warning of a nice swing trade to the short side that began just over a week later.

THE BULLISH PIERCING PATTERN

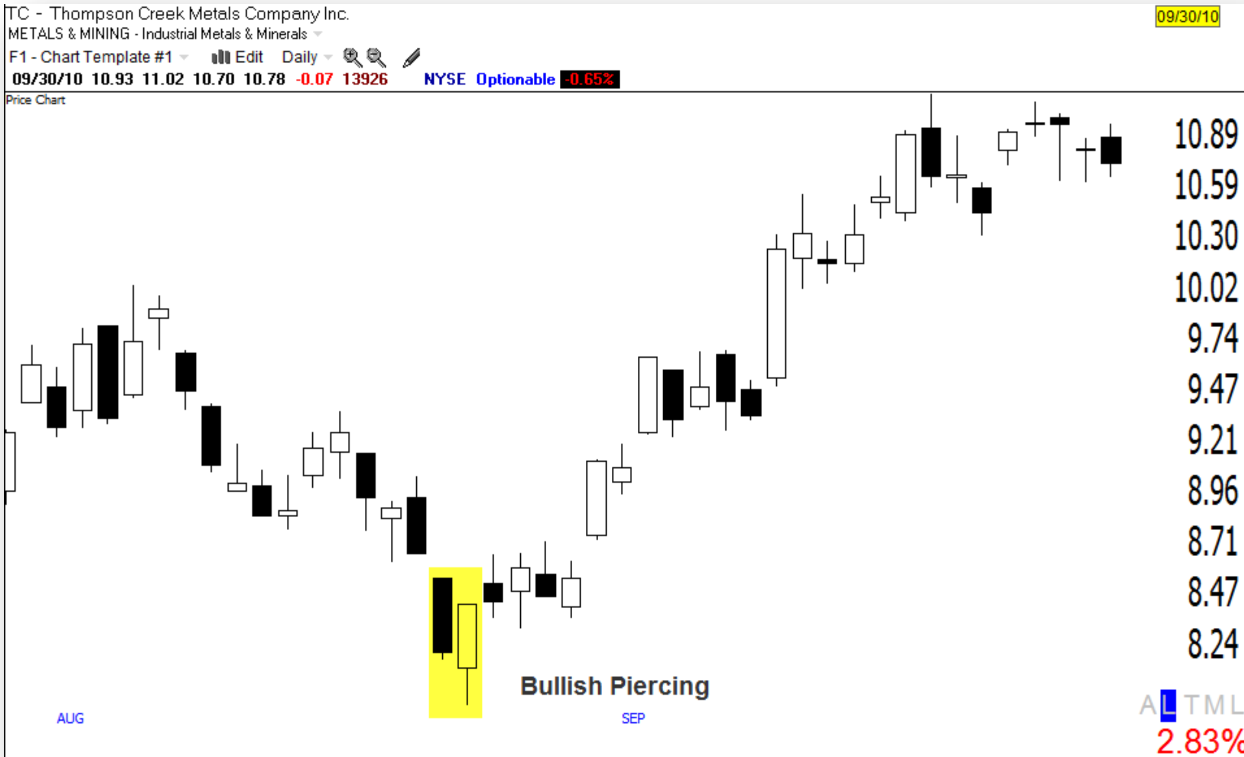


The Bullish Piercing pattern, also referred to a Piercing Line, is a two day formation that consists of a longer than average black candle on the first day followed by a white candle that has a significant gap down at its open and rebounds to close into the body of the first candle.

This pattern forms in a very bearish climate after a significant downtrend with the long black candle of the first day demonstrating heavy selling and fear. The gap down on the second day indicates fear is still present, but throughout the second day selling dries up and buyers come in with vigor sending prices back into the body of the first day's candle. Even though this is a very strong reversal signal it should be confirmed by the following day's candle.

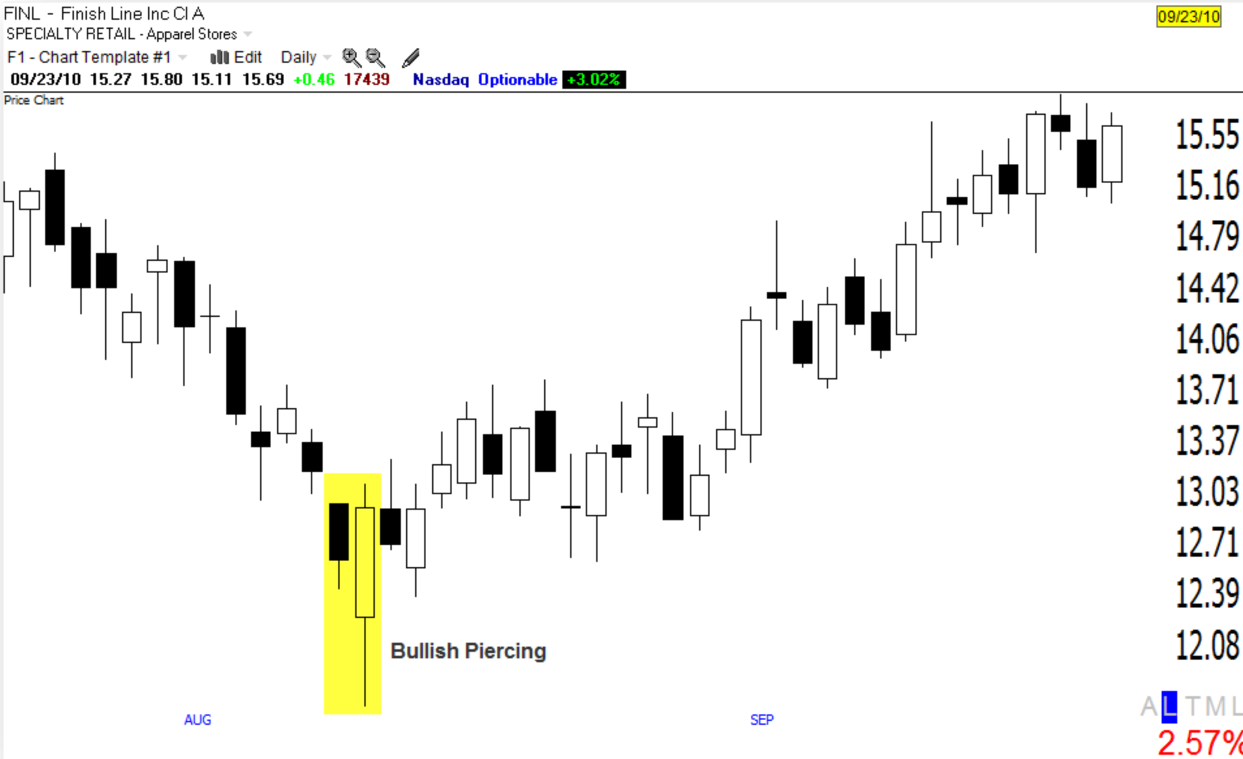
There are some factors that we can look for to strengthen the signal:

- Higher than normal trading volume on both days.
- A large gap down to open on the second day.
- The distance the first candle is penetrated by the second day's candle.
- The pattern is formed at an area of technical support such as a major moving average, trend line, or horizontal support.

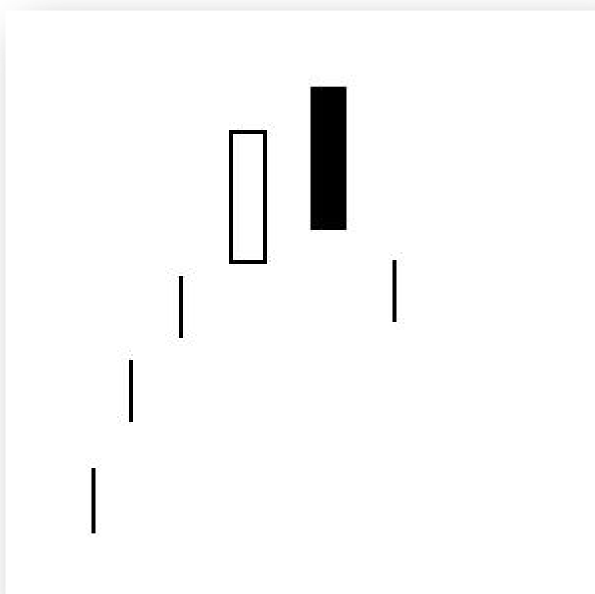


The above image illustrated a Bullish Piercing pattern that formed on the chart of *TC* and signaled a nice rally in price. The first day's candle was an Opening Marubozu meaning it sold off from the start and closed very close to its low for the day. On the second day prices gapped down and continued lower as indicated by the shadow at the bottom of the bullish candle. However, buyers stepped in and raised prices to close the second day's candle above the midpoint of the first day's candle which is a very bullish sign. The fact the second day's candle closed at its high for the day is also very bullish.

Below we have another example of the Bullish Piercing pattern on a chart of *FINL*. In this example we see the second day's candle with a huge gap down and lower shadow. But before the second day was over selling dried up and the Bulls stepped in and pushed prices higher than the open of the first day's bearish candle. We know this by the length of the upper shadow of the second day's bullish candle. The bullish candle of the second day closed inside the body of the first day's candle to complete the pattern.



DARK CLOUD FORMATION

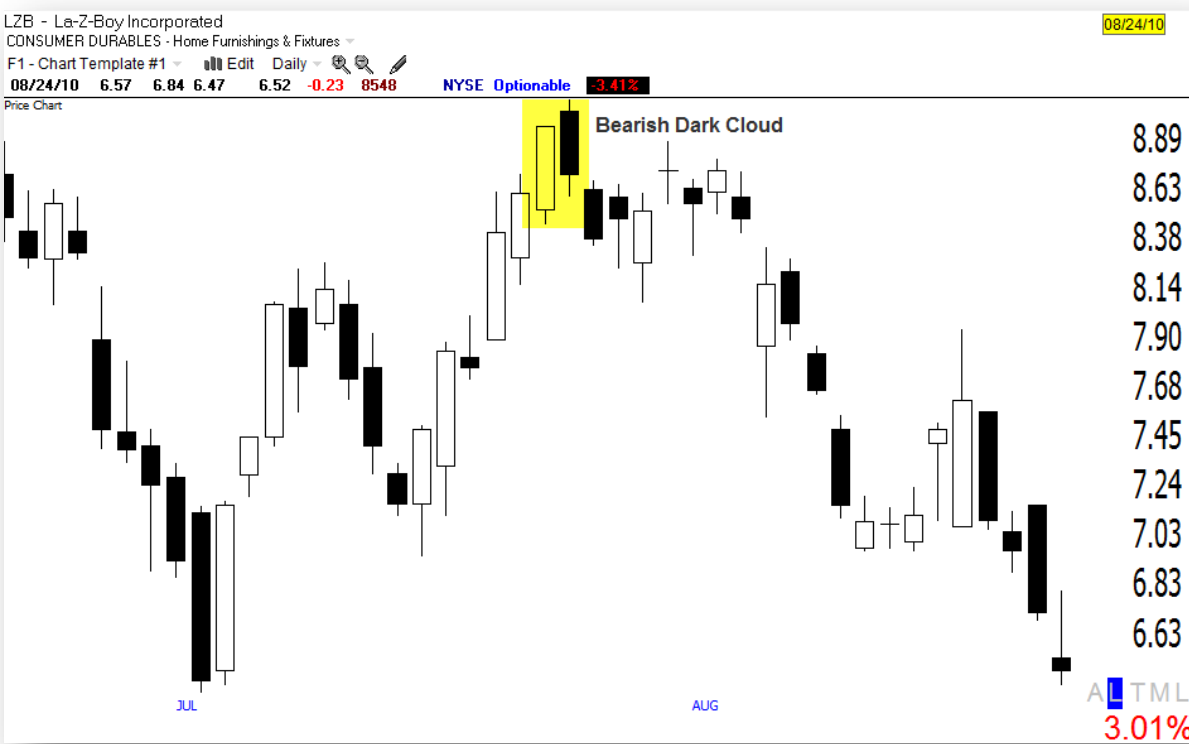


The above illustration represents the Dark Cloud formation which is the bearish counterpart of the Bullish Piercing pattern. This two day reversal formation is made up of a white (or clear) body on the first day, followed by a dark candle on the second day that gaps up and comes back down into the body of the first day's candle. While the Dark Cloud is a strong reversal signal, conformation is required by the next day's candle to determine its strength.

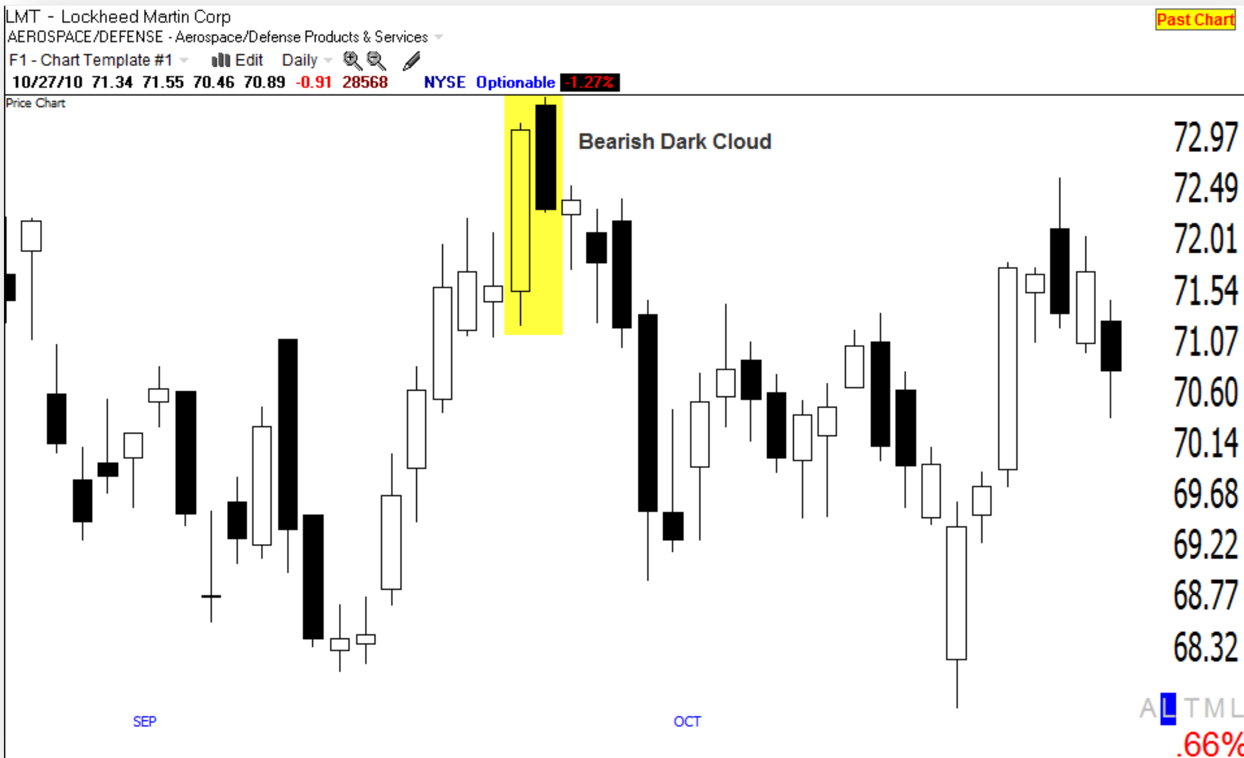
The Dark Cloud pattern forms after a substantial uptrend has been in place. On the first day's white candle buying has peaked. The small number of buyers that are left the next morning cause the price to gap up above the close of the first day and sellers begin to step in bringing prices back down into the body of the first day's candle.

We can watch for a couple of indications that will help us determine the strength of the Dark Cloud formation:

- High trading volume on both trading days of the candle formation.
- The size of the gap up in price on the second day.
- The distance the second day's dark candle penetrates the white body of the first day.
- The bigger the candles on both days the better.
- The pattern forms at a major technical resistance such as an upper trend line, horizontal resistance or major moving average.



The above illustration shows us a Dark Cloud formation that signaled a nice price decline in *LZB*. After the first day's bullish candle prices gapped up the second day and began selling off almost immediately as indicated by the short shadow of the second day's candle. Before the second day was over prices declined well into the body of the first day's candle…a nice bearish signal.



Above we see another example of the Dark Cloud formation in the top of a sideways consolidation or trending pattern on the chart of *LMT*. The first day's candle was very bullish but after gapping up to open the second day's bearish candle buying had run its course and sellers stepped in. The second day's bearish candle sold off well into the body of the first day's bullish candle giving us a nice warning that prices would move lower.

THE HARAMI PATTERN

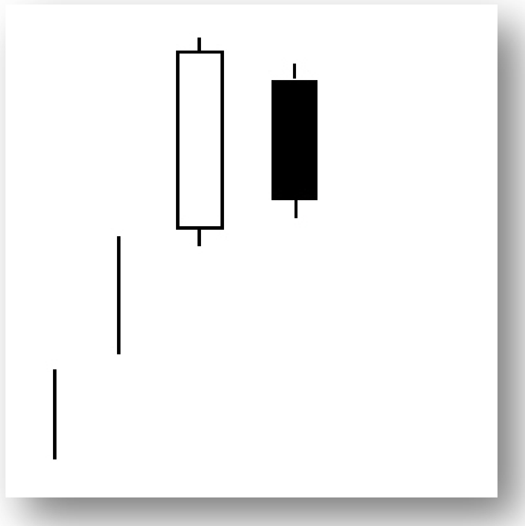


Figure 1 Bearish Harami

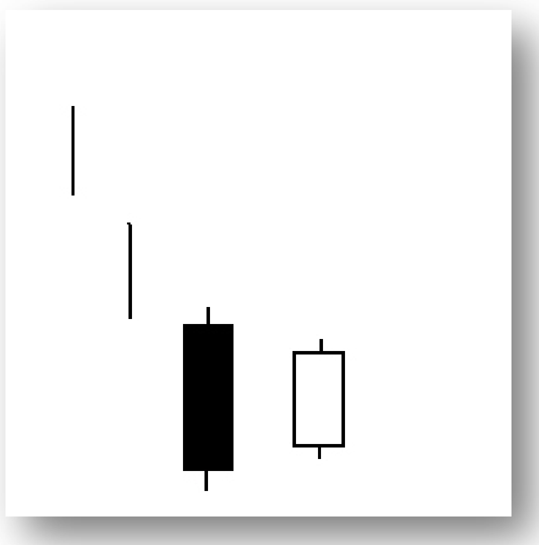


Figure 2 Bullish Harami

The Harami pattern can be both bullish and bearish. Figure 1 illustrates a Bearish Harami and a Bullish Harami is seen in Figure 2. Both Harami patterns are two day reversal signals made up of a long candle on the first day with a smaller bodied candle on the second day forming within the body of the first day's candle. Although the Harami is a strong reversal signal, conformation of the signal is required.

The Bearish Harami reversal signal is seen after a significant rise in price. With a white candle forming on the first day, the price gaps down on the second day to open below the close of the first. The price falls throughout the day, closing lower, but still above previous day's opening price.

The Bullish Harami reversal signal occurs after a sizeable downtrend. A large black candle forms on the first day, the price gaps up the next morning as buyers step in. They are able to move prices higher all day, but not high enough to overtake the opening price of the previous day's candle.

There are a couple of things we can watch for to make the Harami pattern stronger:

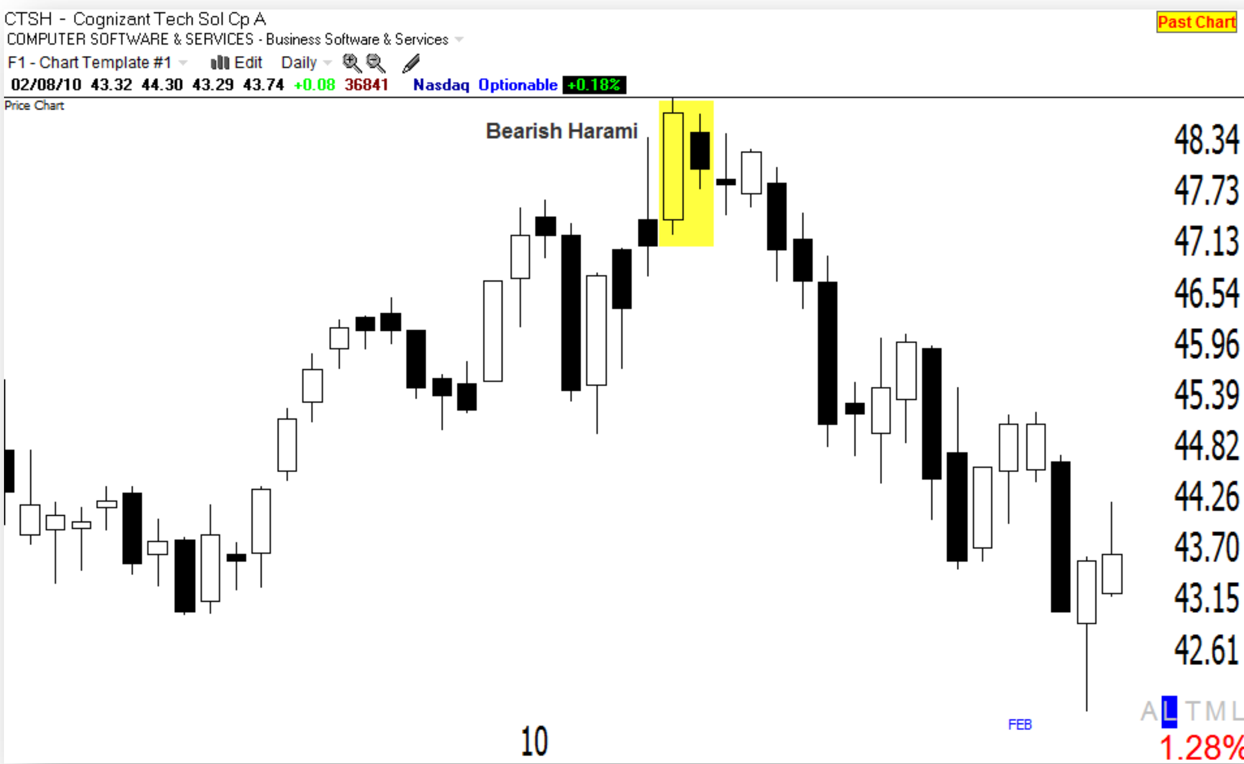
- High trading volume on the second day.
- The longer both days' candles are the better.
- The more the second day's candle closes into the body of the first, the more strength the signal shows.
- The pattern forms at a major technical resistance (Bearish) or support (Bullish).

In the above chart of *LFUS* we see a Bullish Harami pattern that not only signaled the end of a downtrend but also a rally in the price of the stock. As you can see, the final long black candle of the first day was the end of selling pressure as prices gapped up the next day and began to rise, but not higher than the opening price of the previous day's candle.

Confirmation of a reversal in the above Bullish Harami pattern came two days later as prices closed higher than the high of both candles forming the pattern.

Below we see an example of a Bearish Harami pattern in the chart of *CTSH*. Prices rose throughout the first bullish day's candle. The gap down on the second day and prices closing lower than the open but higher than the open of the first day's bullish candle completed the pattern.

Confirmation of this Bearish Harami came three days after the pattern completed itself with prices closing below the low of each of the candles that made up the Bearish Harami itself.

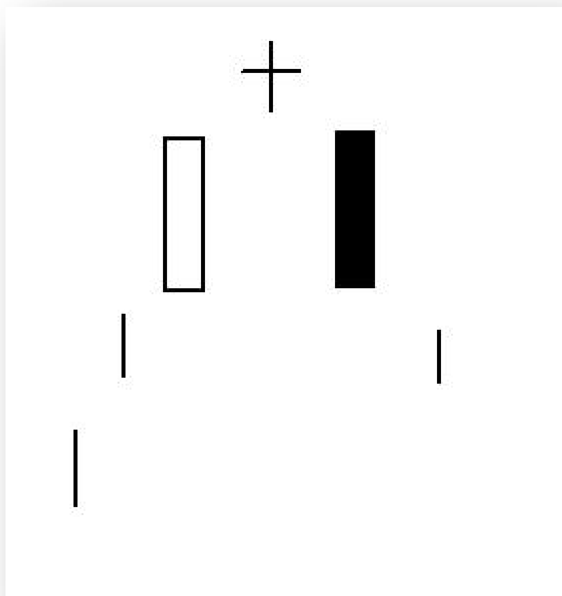


More than any other candlestick reversal pattern we will be using, the Harami requires the reversal to be confirmed by future price movement. Of course there are many ideas and opinions on entering trades themselves, I like to use a price break below the lowest low of a

Bearish Harami and above the highest high of Bullish Harami. This helps eliminate entering a position and finding it was merely a continuation of the previous trend.

When we get to the candlestick trading system we will cover a method of filtering most of the invalid signals but I still recommend confirmation on the Harami pattern.

THE SHOOTING STAR

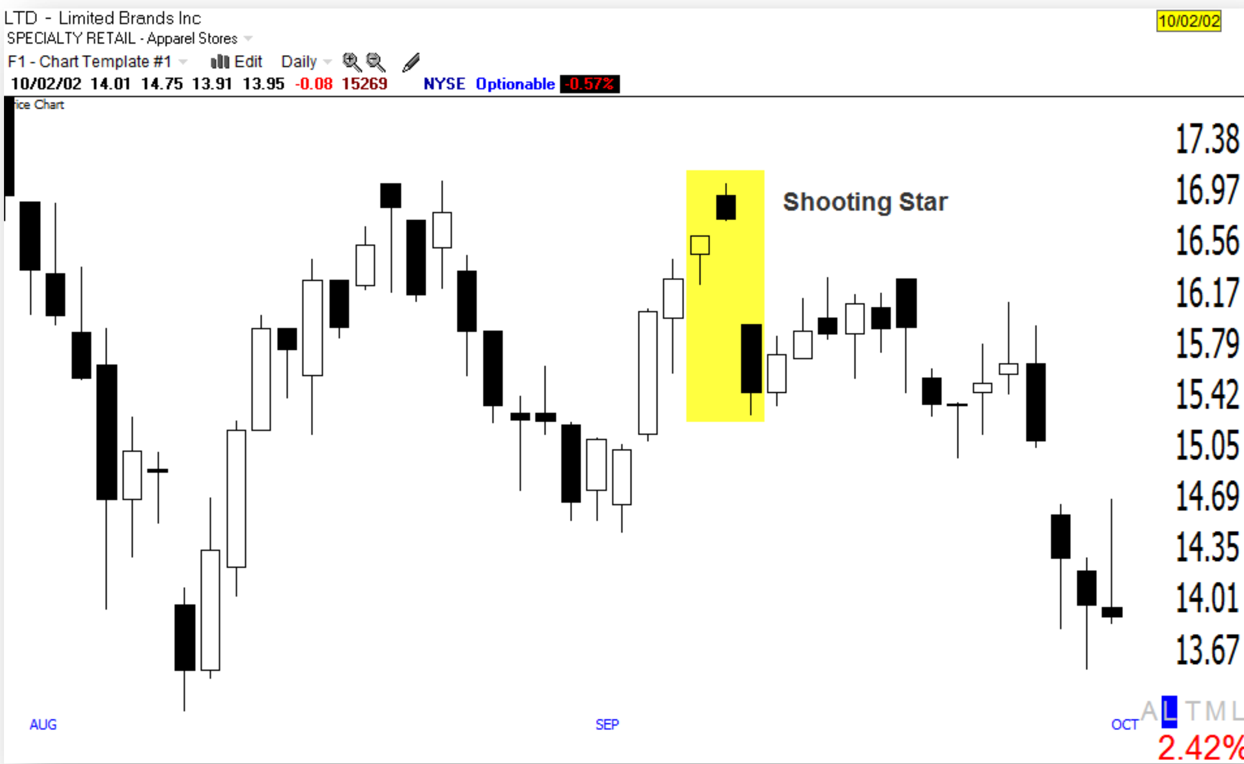


The Shooting Star pattern is a three day pattern consisting of a white (or clear) bodied candle on the first day, followed by a small bodied black or white candle on the second day that gaps up above the first day's close. The final day of the Shooting Star will complete the pattern with a longer than average black (or filled) candle that gaps down below the body of the second candle, closing well into the body of the first candle of the formation.

After a substantial uptrend, buyers carry prices higher as the first day of the formation reveals itself. At the beginning of the second day there are enough buyers left to cause a gap up in price but demand for the stock decreased as sellers move in to take their profits and cause the formation of a candle with little price movement (small body). The third days dark bodied candle forms as the sellers overtake buyers causing an oversupply in the stock being traded and prices gap down and quickly decline throughout the day, eliminating most or the entire move of the previous two days.

There are a few indications you can look for to reinforce the signal:

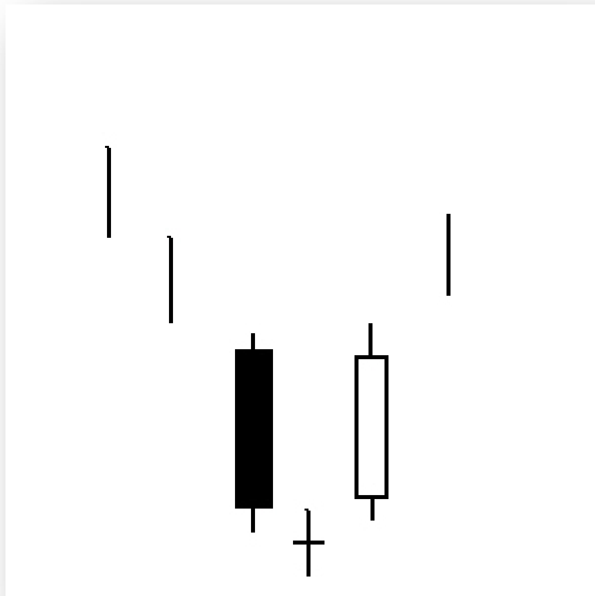
- High trading volume on all three days of the Shooting Star formation.
- Very long candles on the first and third day of the formation.
- The third day penetrates the first days candle by greater than 50% or more.
- The pattern forms at a point of technical resistance such as an upper trend line, major moving average, or horizontal price resistance.



Above we have an illustration of a Shooting Star formation on a chart of *LTD*. Notice how the small candle of the second day gaps up and forms the peak of the uptrend. The final day gaps down completing the pattern and kicks off a decline in prices.

The true Shooting Star pattern is relatively uncommon among stocks that are heavily traded but they are a strong bearish signal never the less.

THE MORNING STAR

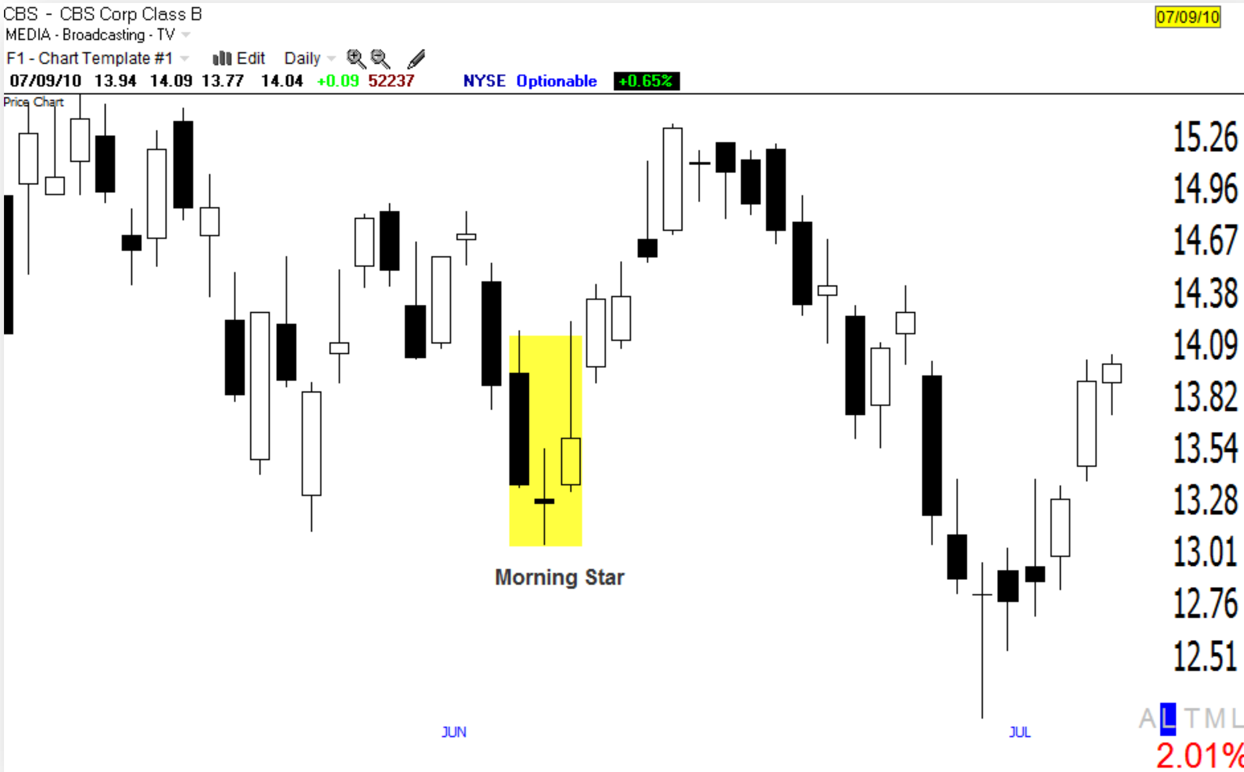


A Morning Star is a three day reversal pattern that starts off with a dark candle on the first day, followed by a black or white candle that gaps down in price but trades into the range of the first day's candle (shadow). The final day of the formation reveals a white candle gapping up in price and closed well into the range of the candle of the first day.

After a substantial downtrend, the first days candle reveals strong selling. On the second day sellers open the day lower but are losing steam as buyers step in and absorb the supply of stock causing a small trading range for the day. The third day reveals buyers taking control as demand for the stock increases dramatically, causing the last candle to trade well into the body of the first day's candle and wiping out losses for the period.

A few things we can look for to help strengthen the signal:

- The length of the downtrend preceding the formation.
- High trading volume on all three trading days of the formation.
- The length of the first and last candle. The longer the better.
- The distance the third candle trades into or above the candle of the first day.
- The pattern forms at a point of technical support such as a major moving average, trend line, or horizontal support.

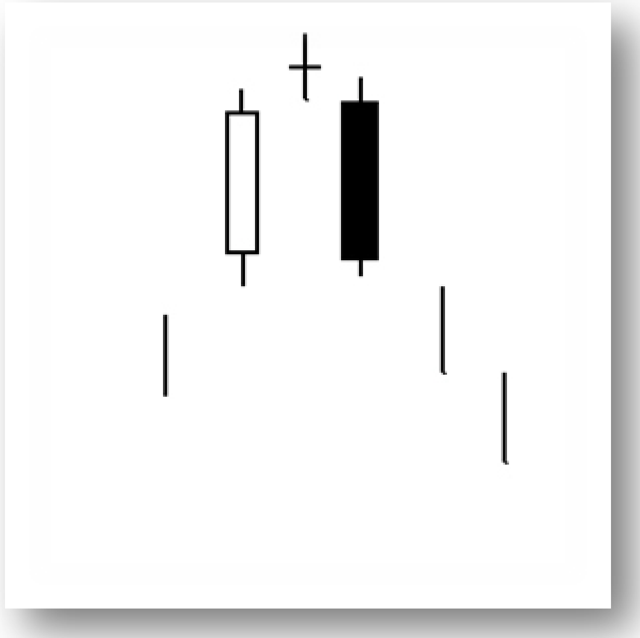


In the above illustration we see a Morning Star pattern that formed on a chart of *CBS* and led to a nice rally in price. The first day's dark bearish candle led to a gap down the second day and selling dried up as buyers stepped in. The second day's candle also is a near doji which indicated some indecision for the day but by the third day buyers where committed and moved prices higher.

Notice also that this Morning Star formed at the same level of the previous low which gave it some technical support. This is one of the few criteria we will learn to look for as we progress through the course.

Above we see another example of the Morning Star pattern that formed on a chart of XLNX. Notice that the third day's candle is not nearly as large as the first day's. It actually took a few days for the price to confirm the signal but once it did there was a nice rally in price.

THE EVENING STAR



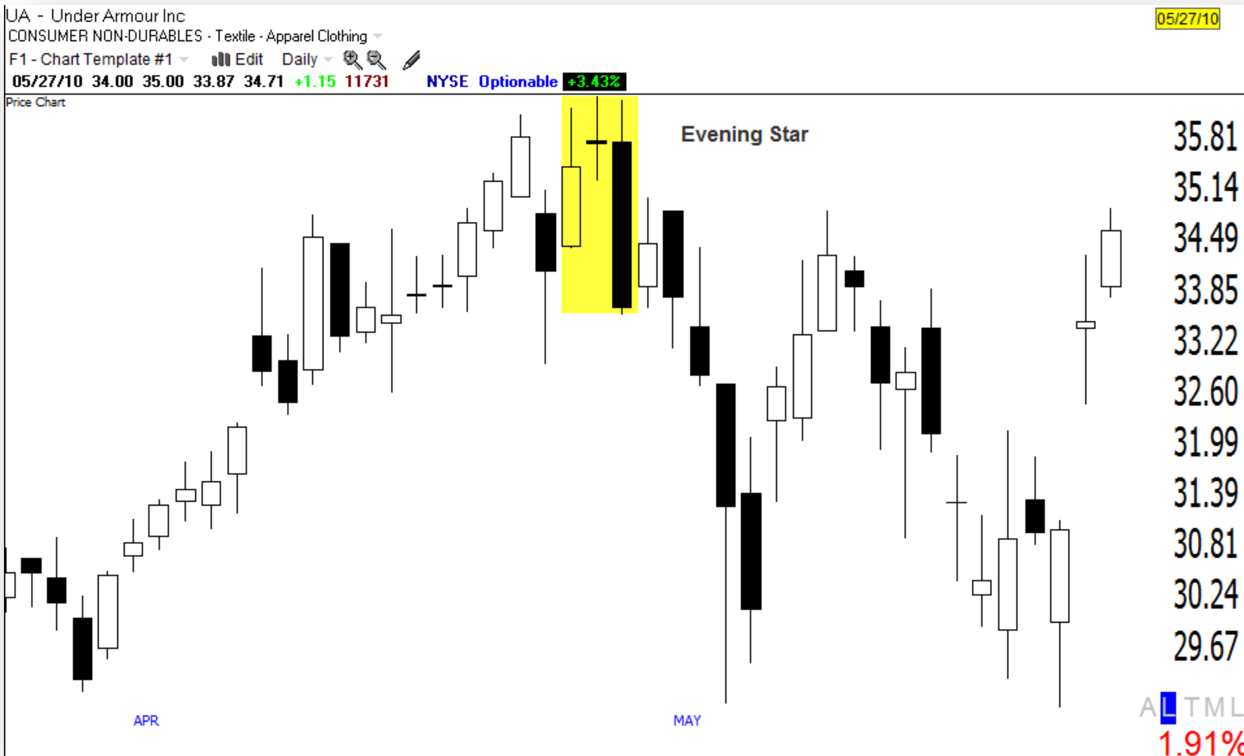
The Evening Star is a three day pattern that consists of a longer than average white (or clear) bodied candle on the first day followed by a smaller black or clear candle that gaps up to open above the close of the first day. The third candle is a longer than average black (or filled) bodied candle that gaps down to open below the body of the second candle and trades well into the body of the first candle. While the bodies of all three candles may be separated from one another, the trading range of all three days will trade into one another which are represented by the shadows.

After a substantial uptrend in price buyers carry prices higher on a very bullish day completing the first day's candle. The following day buyers are still strong enough to open the stock above the close but sellers come into the stock and supply and demand even out causing the small bodied candle on the second day. The third and final day of the pattern reveals the demand for the stock at current prices has dried up and sellers step in causing prices to sell off. Prices plummet throughout the day well into the body of the first candle, eating up much of the gains of the last three days.

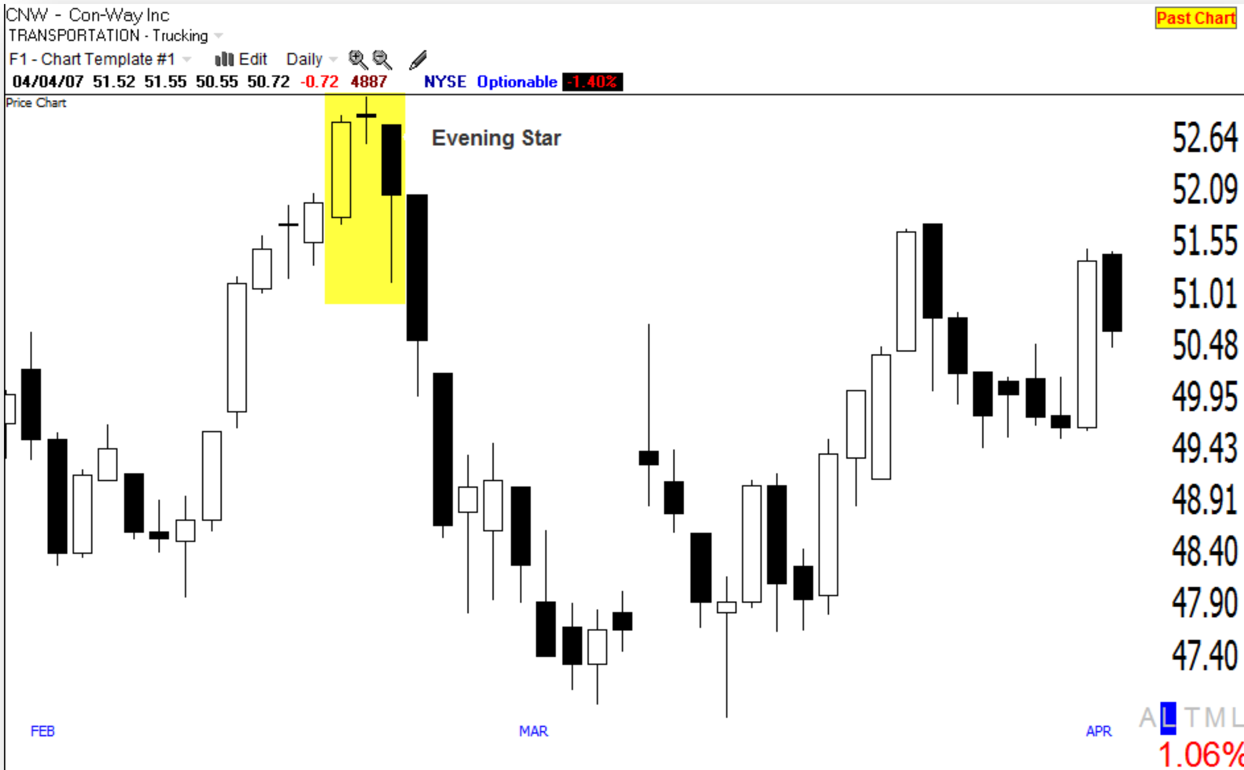
There are a few things we can look for to strengthen the Evening Star reversal signal:

- High trading volume on all three days.
- The length of the first and last candle of the formation.
- The distance in which the third candle penetrates the body of the first day's candle.

- The length of the uptrend preceding the Evening Star formation.
- The pattern develops at a point of technical resistance such as a major moving average, upper trend line, or horizontal resistance.



Above we have an example of an Evening Star pattern on a chart of *UA* that led to a nice decline in prices and would have made a nice swing trade. The bullish candle of the first day was a larger than average bullish candle and gapped up to open the candle of the second day. The second day's candle was actually a doji which indicates indecision in the market and in this particular example showed that buyers had run out of steam. The third day's candle was a very bearish black candle and confirmed the reversal as it completed the Evening Star reversal pattern.

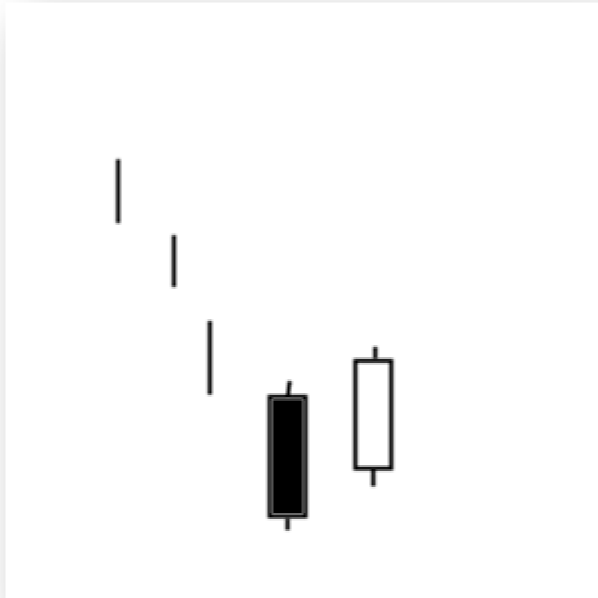


The above chart illustrates another example of the Evening Star pattern in a chart of *CNW*. Once again we have a larger than normal bullish white candle on the first day that gapped up to form the second day's candle. On the third day the price gapped down again and we see a large bodied bearish black candle confirming the formation.

Just as in the first example of this formation the second day's candle happens to be a doji. When looking for the Evening Star reversal pattern we need not have a doji as the middle candle. We *would* like a small bodied candle such as a hammer, spinning top or any short day in general but it doesn't have to be a doji. A doji just makes the pattern that much more strong.

Technically, an Evening Star candle pattern with a doji as the center candle is called an *Evening Doji Star*. To keep things simple as we move on to scanning for reversals I will generally be referring to any Evening Star as just that.

THE BULLISH KICKER

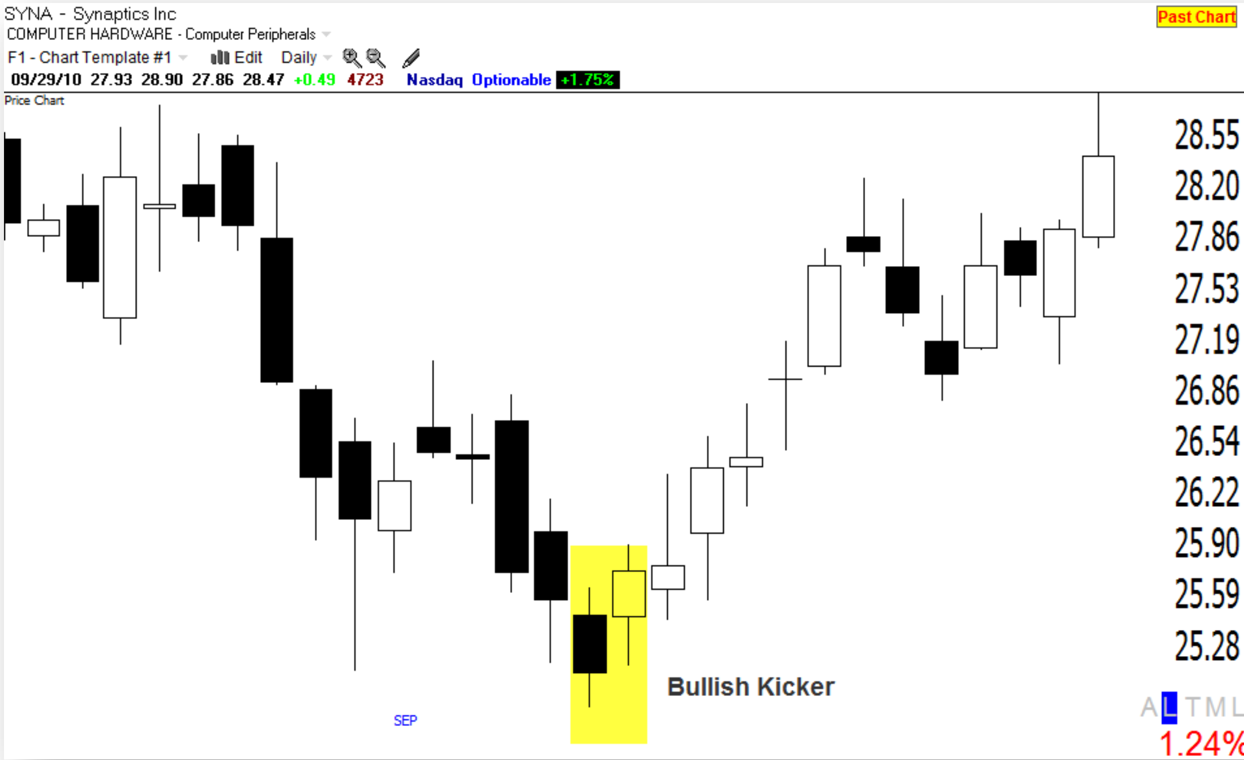


The Bullish Kicker is a two day reversal pattern that can be extremely strong but sometimes hard to trade. The Bullish Kicker consists of a bearish dark candle on the first day of the formation that forms after period of falling prices. The second day should be a very bullish candle that gaps up to open from the close of the previous day's candle and closes above the high of the first day's candle.

What makes the Bullish Kicker sometimes difficult to trade is the size of the gap between the first and second day's candle. Many times a Bullish Kicker will have a very large gap, sometimes above the open of the second day's candle. Many times gaps this large will retrace themselves and the price will come back to fill the gap to test it for support. This makes taking a long position a little tricky sometimes. We will take a look at these gaps later in the course and look at how to trade them.

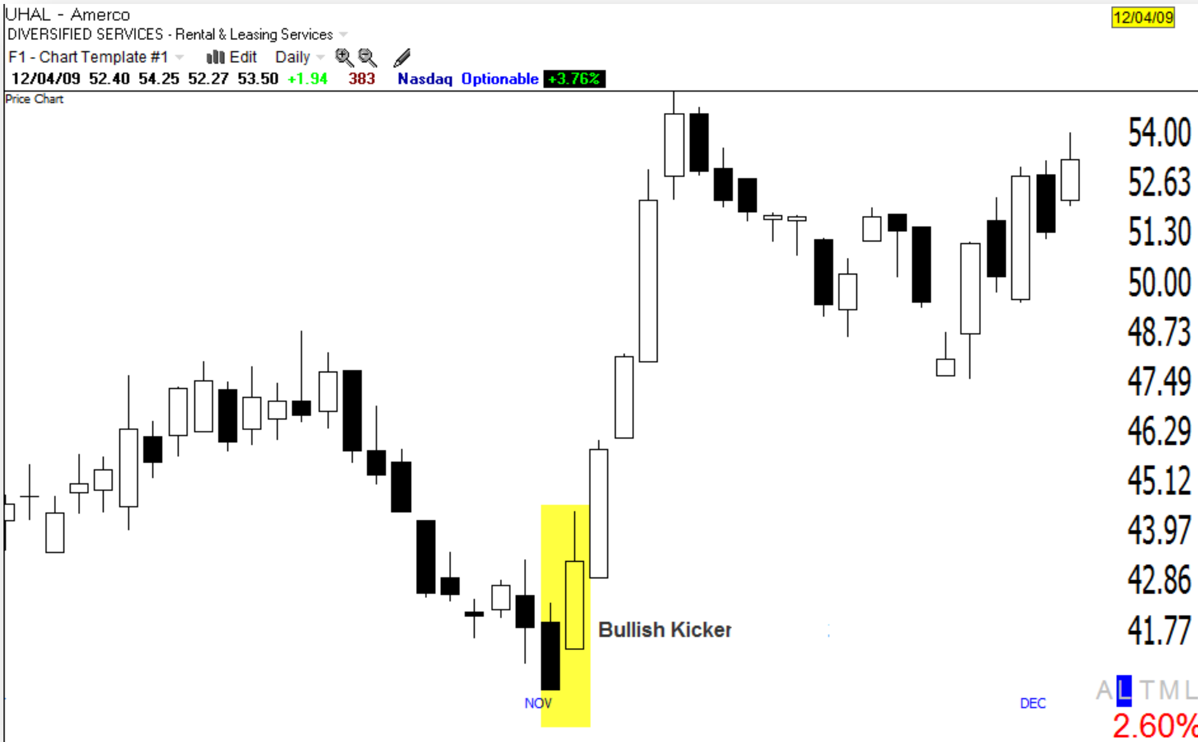
There are a few criteria we can look for to strengthen the Bullish Kicker signal:

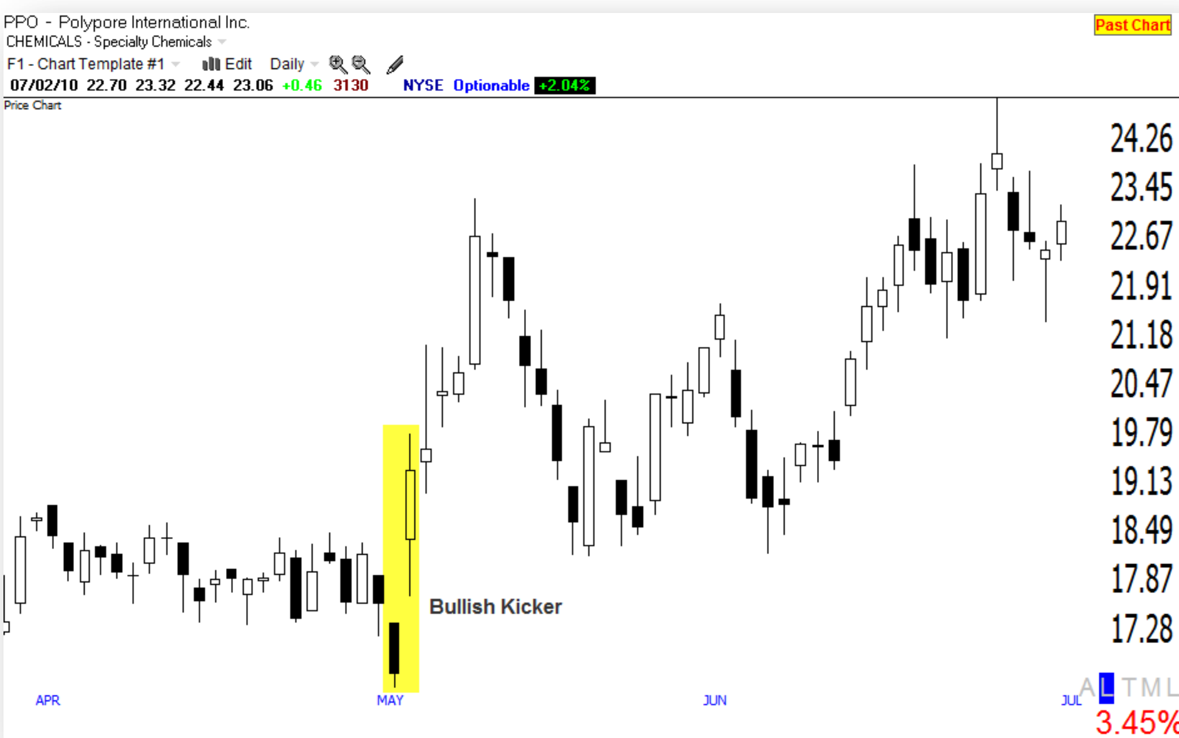
- The length of the second day's candle.
- High trading volume on the second day.
- The distance from the close of the first day to the open of the second day.
- The pattern forms at a point of technical support such as a major moving average, trend line, or horizontal support.



In the illustration above we see a Bullish Kicker signal that alerted us to a nice rally in the price of *SYNA*. After a period of falling prices we see the final black candle form in the downtrend which led to a gap up the next day. As you can see, the second day's candle or the kicker candle opened well above the candle of the first day's open and continued higher before closing.

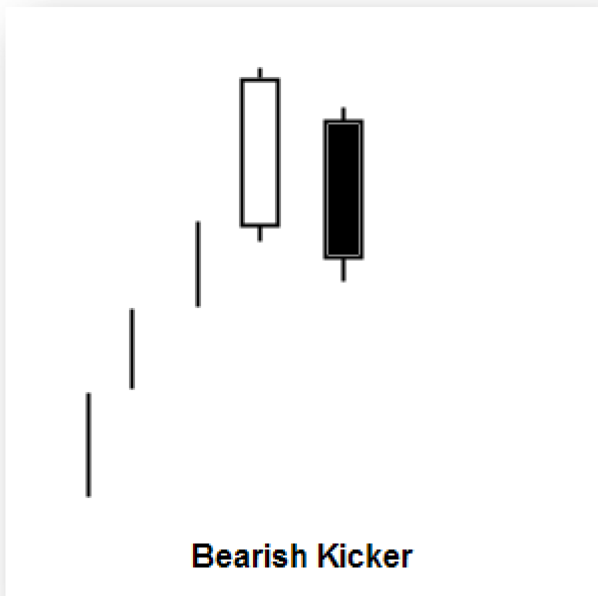
Below is another example of the Bullish Kicker that formed on the chart of *UHAL*. This led to a quick, strong rally in prices and really and shows you just how powerful this pattern can be. As you can see the second candle of the pattern was a nice long bullish candle which closed well above the bearish candle of the first day.


UHAL - Amerco
DIVERSIFIED SERVICES - Rental & Leasing Services
F1 - Chart Template #1
Edit
Daily
12/04/09 52.40 54.25 52.27 53.50 +1.94 383
Nasdaq Optionable +3.76%
12/04/09
Price Chart
54.00
52.63
51.30
50.00
48.73
47.49
46.29
45.12
43.97
42.86
41.77
Bullish Kicker
NOV
DEC
ALTML
2.60%


PPO - Polypore International Inc.
CHEMICALS - Specialty Chemicals
F1 - Chart Template #1
Edit
Daily
07/02/10 22.70 23.32 22.44 23.06 +0.46 3130
NYSE Optionable +2.04%
Past Chart
Price Chart
24.26
23.45
22.67
21.91
21.18
20.47
19.79
19.13
18.49
17.87
17.28
Bullish Kicker
APR
MAY
JUN
JUL
ALTML
3.45%

The Bullish Kicker in the above chart of *PPO* illustrates an example of the pattern with a very large gap between the first and second day's candles. Kicker patterns with large gaps can be hard to trade for an end of day trader due to the fact that many times price comes back to fill the gap between the two candles. In our example above prices rose nicely but this is not always the case.

THE BEARISH KICKER

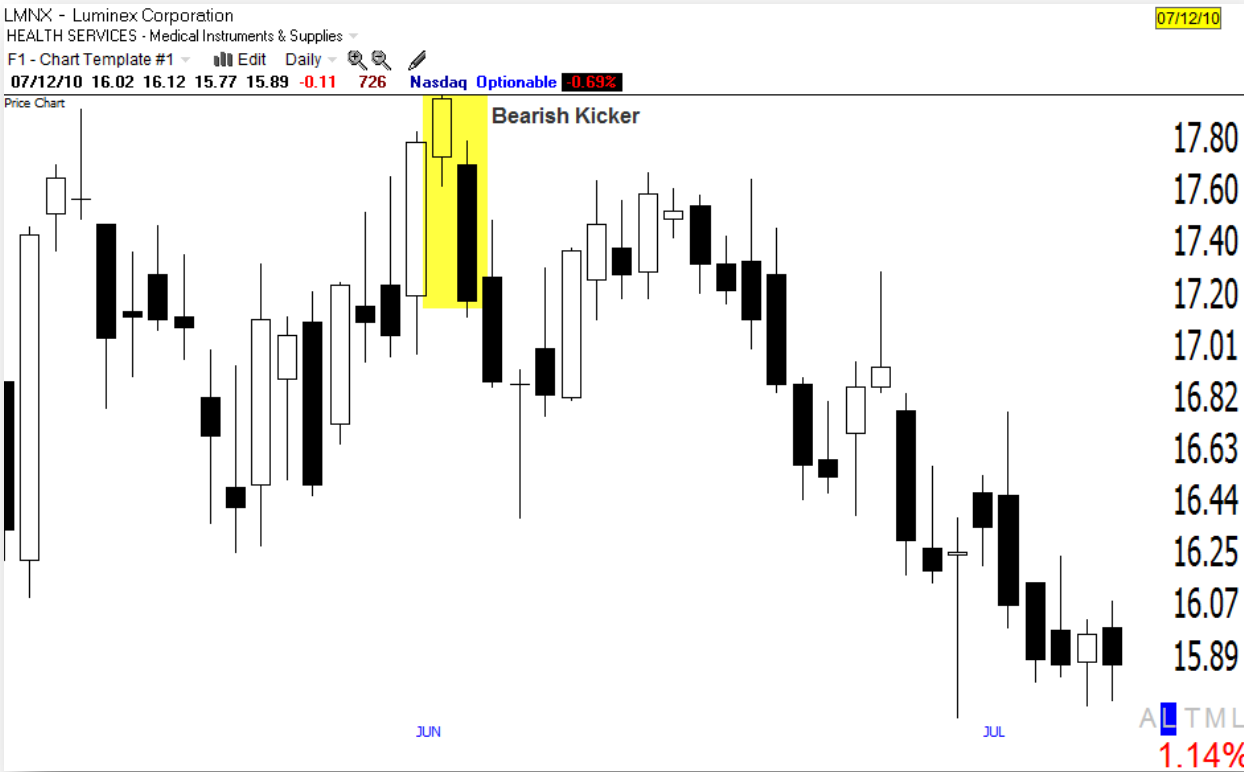


The Bearish Kicker is the bearish counterpart to the Bullish Kicker with a kicking or gapping candle. With the Bearish Kicker we are looking for the pattern to form at the top of a trend and show bearish price action rather than bullish price action at the bottom of a trend.

The Bearish Kicker is a two day reversal pattern that can also be hard to trade for an end of day trader depending of the size of the gap. After a period of rising prices we look for the pattern to form after a bullish white candle which will be the first day of the pattern. The second day gaps down to open below the close of the first day's candle and sells off during the day to close below the open of the first day's bullish candle.

The following criteria will enhance the Bearish Kicker signal:

- The length of the second day's candle. The longer the better.
- High trading volume on the second day.
- The distance from the close of the first day to the open of the second day.
- The pattern forms at a point of technical resistance such as a major moving average, trend line, or horizontal resistance.



The above chart of *LMNX* illustrates a Bearish Kicker pattern that signaled a top at horizontal resistance. While it did not signal an immediate trend change it forewarned us a change was imminent. Notice the gap down from the bullish candle of the first day to the open of the second day's candle. The second day's bearish candle gapped down to open below the close of the first day's and sold off throughout the day resulting in a nice long black candle.

REVERSAL PATTERN WRAP-UP

There you have it! These are the most common candlestick reversal patterns and those which we will use throughout our course. While not an exhaustive list of every uncommon and obscure reversal pattern in candlestick methodology, these are the most common, most profitable and will give any trader all the stocks they could possibly trade.

Why not an exhaustive list? Much of this course is devoted to finding these patterns at crucial price levels through the use of scanning software. What good would it be for me to give you instruction on scans that would only produce trades once in a blue moon? We will soon be moving to scanning the market at the end of each trading day and not only find these more common reversal patterns but also finding them where they will be profitable.

Before we move into the video portion of the course I would like to address a few considerations you may want to take note of while learning to trade with candlesticks.

OTHER CONSIDERATIONS

While most of the time candlesticks and their reversal patterns will be enough to help us find profitable trades and discard poor trades, there are a few considerations you can use to fine tune your assessment of candlestick price action. Remember, candlestick charting is a visual representation of market psychology. We are not only learning to trade with candlesticks but also to use candlestick charts to gauge what the current market climate is and when it changes.

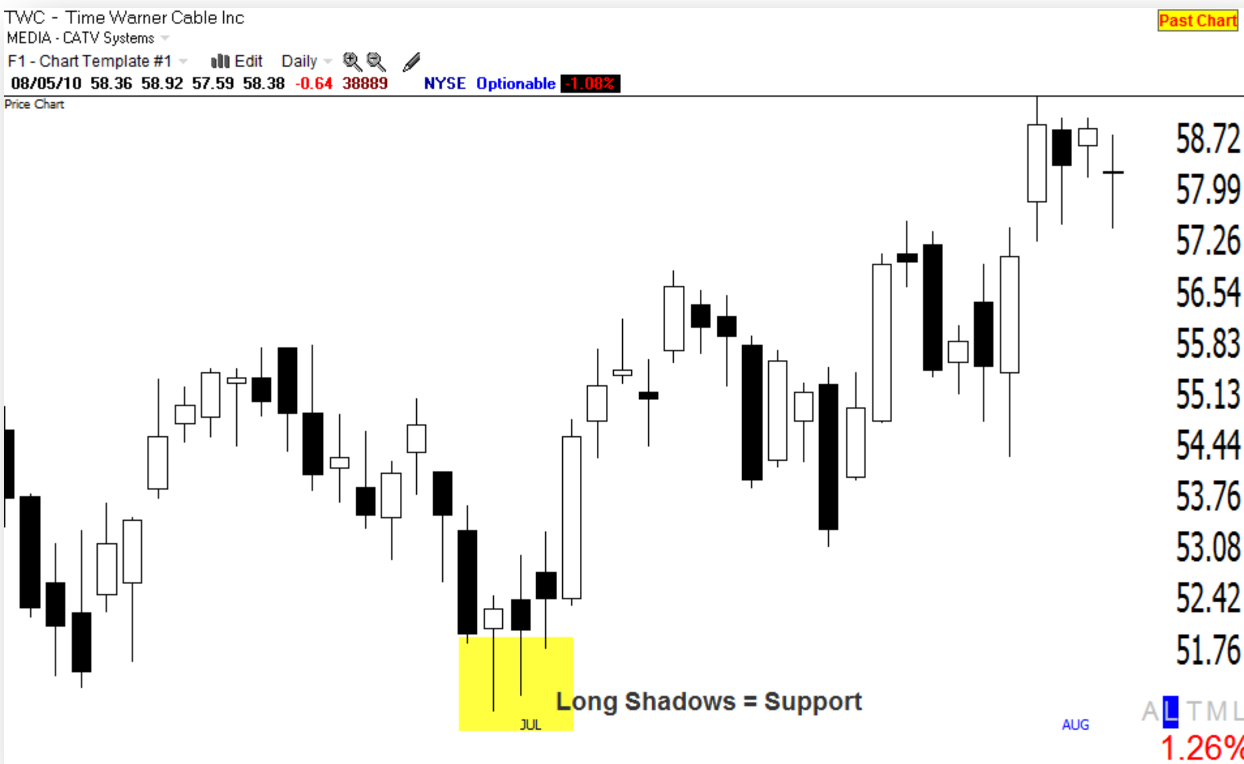
There will be situations when a chart tells us something and plenty of times when it won't. If you can't see trading opportunities in one chart then move on to another stock. There will be plenty!

There are a couple of situations that demand a little more than reversal patterns alone. The first, Long Shadows, can give us a little more insight to possible reversals. The second, Gapping Stocks are best left alone and not traded.

LONG SHADOWS

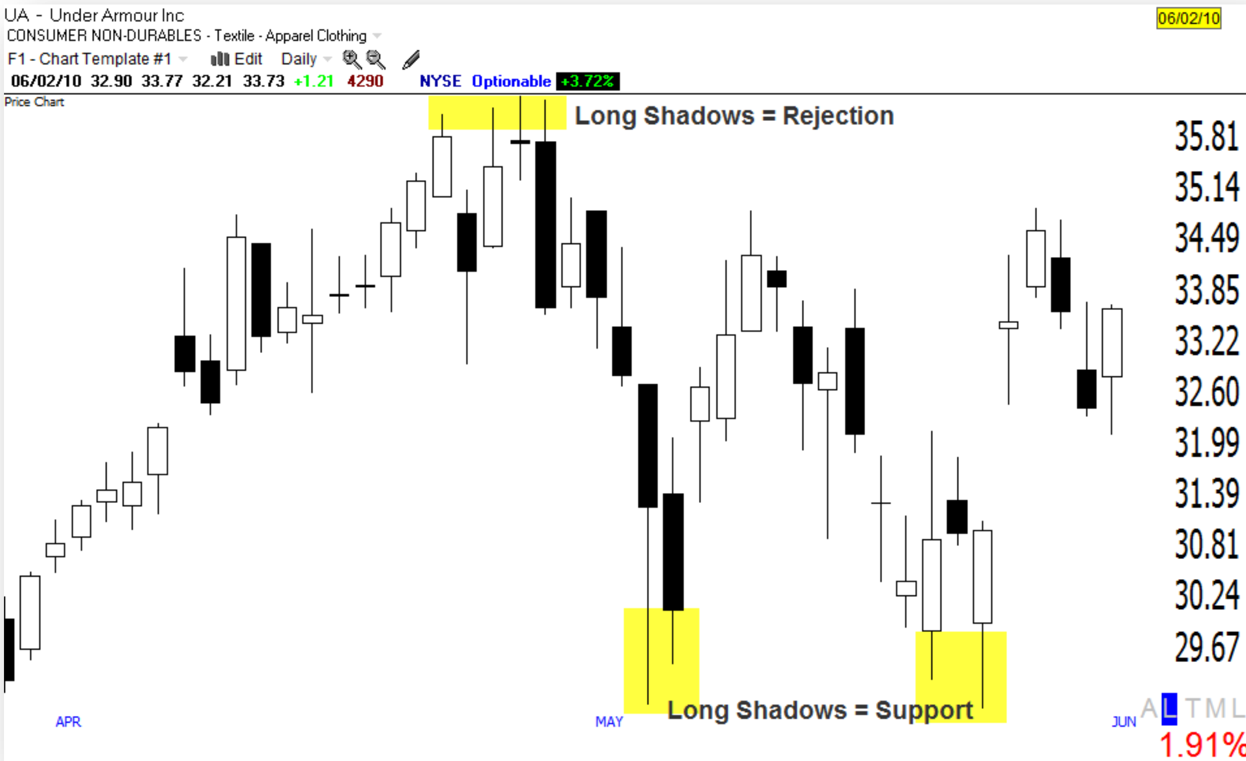
While market tops and bottoms are forming we can learn a lot by candles with very long shadows. Long shadows represent buyer/seller rejection or support in any individual candle. For example, when a candle extends its trading range and the opposite market force is applied it forces prices the other direction and a shadow is left at whichever end of the candle the force came from.

Long shadows represent extreme support or rejection and may be interpreted as a warning of possible reversal whether a reversal pattern forms or not. Below are some examples:



In the above chart of *TWC* I've highlighted two candles with long lower shadows. The lower shadows that appeared in these two candles represent support by buyers. Bears or sellers tried pushing prices lower to continue the short bearish trend for two days. On both days they were met by buyers at a level of support which pushed prices higher as indicated by the long lower shadows at almost the same price levels. This gave buyers confidence to enter the stock and push prices back up.

The sellers were in charge and their confidence was high as indicated by the long bearish candle preceding the two highlighted candles. The buyers were lacking the confidence to enter long positions and let prices fall for awhile. What we can see by the two highlighted candles is a change in investor psychology! We can literally read the story by looking at the chart! As the support level held for two days in a row and the bears were being rejected the bulls gained the confidence to jump in and move prices higher.

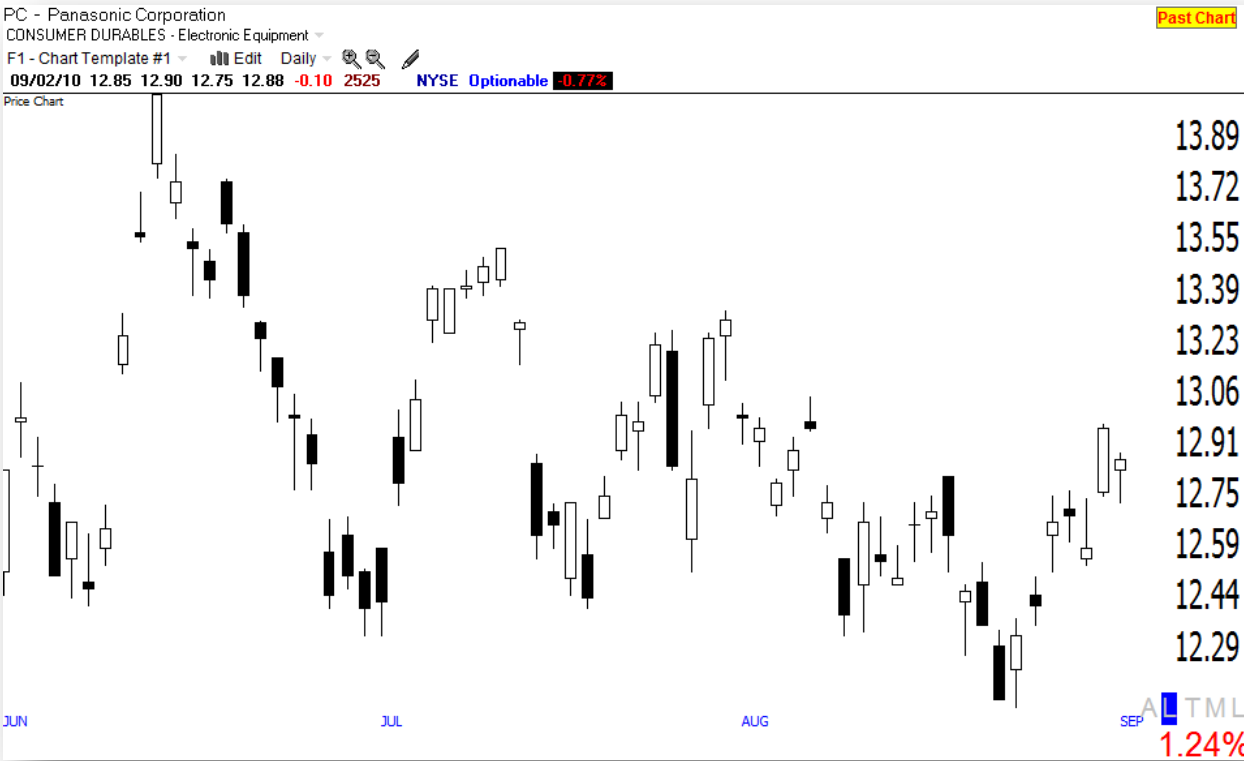


In the above chart of *UA* we can see three different examples of long shadows and the narrative it gives us about the psychology of the market. At the height of the bullish trend we three, almost four candles with long upper shadows. The bulls were having a field day and had pushed prices higher for quite awhile. Sellers finally began testing the waters and we can see at the peak of the uptrend started overcoming buyers by rejecting daily price moves leaving long shadows on the daily candles. We can look at the long shadowed candles and watch the bears lose confidence and the bulls gain it one by one until the final candle shows us sellers overtaking buyers.

At the bottom of the same chart we see two areas of price support indicated by long shadowed candles which show us where buyers regained control and pushed prices back up. Again you can watch the psychology of the market change right on the chart!

GAPPING STOCKS

While most stocks form easy to read candles there will be many times when the charts will be totally ambiguous and not tell you a thing. We know when there is not a story in the chart we should move on to the next one. There are a few stocks that I call gapping stocks that, in my opinion, will never provide clear insight into market psychology.



Above is an example of a heavily gapping stock. As you can see the price action jumps all over the place and even though the candles form properly they are plotted so far apart the story can be hard to read if it can be read at all.

Most charting software plot price movement from market open to market close and the candles are representations of those trading hours. Gapping stocks are generally heavily traded after hours or during overseas market sessions. When our markets close the price is recorded as the closing price for the day. As gapping stocks continue to be traded after hours and during overseas market hours the price is usually much different when it opens again during our market open. This makes gapping not only hard to read but also dangerous to trade.

IN CLOSING

Remember, it is a good idea to find indicators that help identify the main reversal patterns in your respective charting platform. These are readily available for Tradestation, Ninja Trader, MetaTrader, Metastock, etc...

Of course, you might want to further investingage our fully developed trading systems for Options, Forex, Futures and Stocks. Make sure you watch for emails from www.netpicks.com We take some of what you learned here, but add all the additional layers needed for a successful trading plan.

Even though candlesticks are a simple trading method to learn, you won't learn them overnight. Practice a little and look at some charts. See if you can begin to spot the different candles and reversal patterns even if you can't remember their names. Recognition is the most important aspect of candlesticks when starting out.

It's truly been my pleasure to write this portion of the course. I really enjoy seeing a trader have that "ah-ha moment" the minute it starts to make sense.