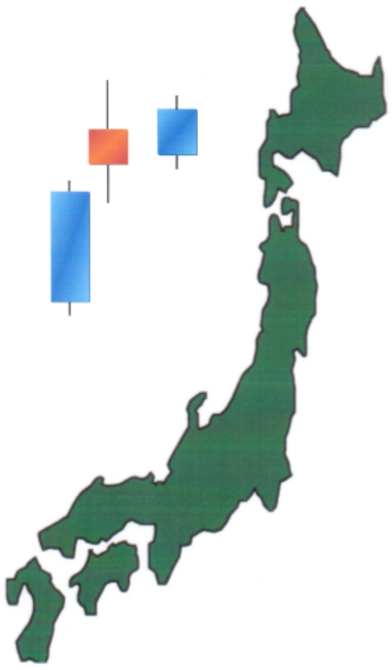
An Introduction to Japanese Candlesticks Course



Chapter 1: Introduction

The Key To SuccessfulTrading is Knowledge

Trading systems that can generate only profitable trades do not exist. A trader's decisions are of ten made as a result of personal experiences, their feelings, their judgement and their ability to assimilate the massive flow of information to which they are subjected in the modern trading environment. (Fundamental data release, news events, and major technical levels etc.).

Technical Analysis is an invaluable decision support tool available to traders. Candle Charts are one of the most unique and precise methods of all the known pattem recognition techniques (Understanding Candlestick Charts should be a must for any trader).

Candlestick charts give a somewhat unique insight into globalmarket sentiment. They give the analyst the ability to interpret individual segments of price action.

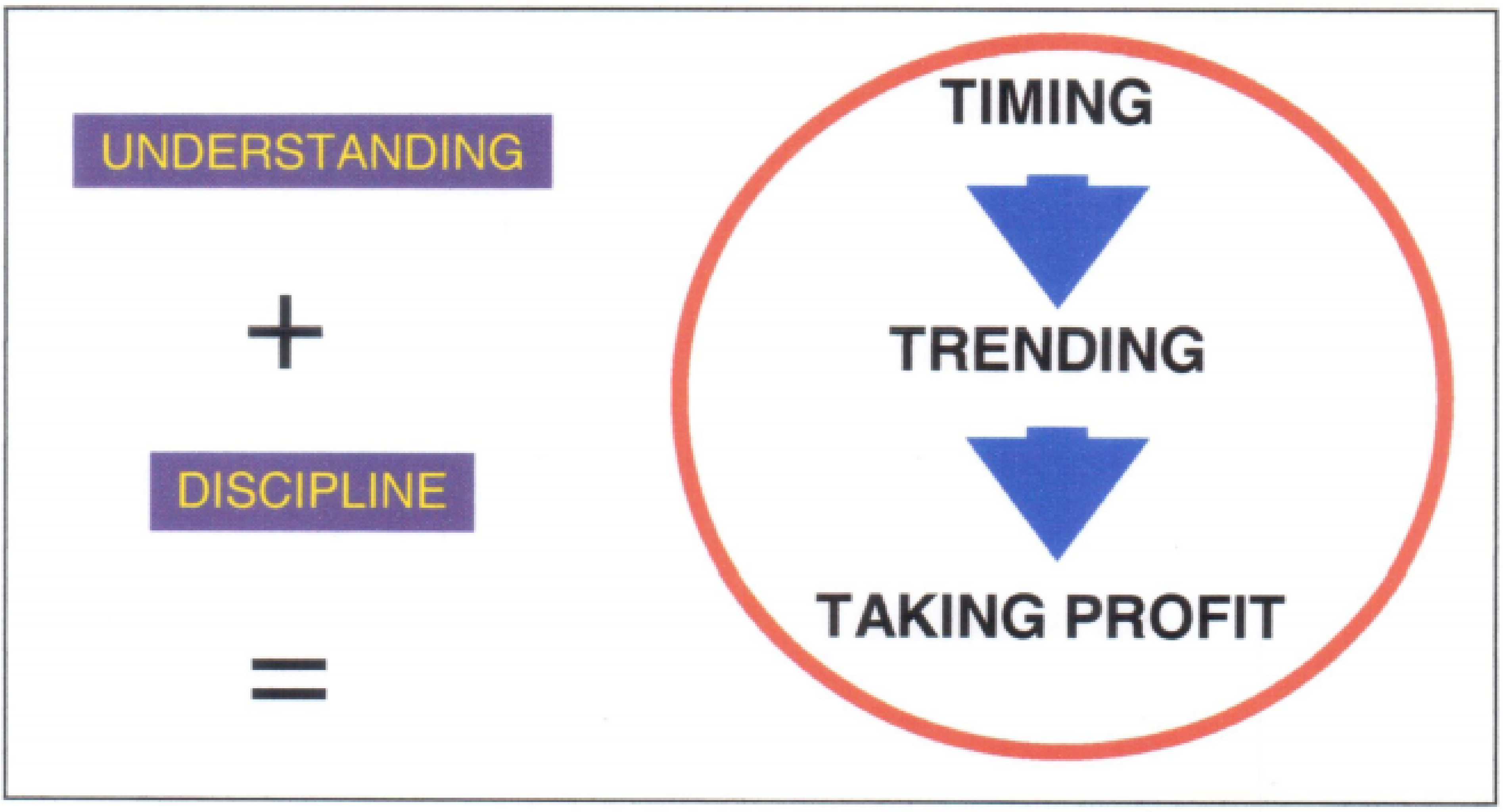
As I have already said, a trading system does not exist that yields only profitable trades, this is because the system would have to react with extreme flexibility to deal with all the factors driving market volatility.

For the time being analysts use tried and tested techniques to forecast future price fluctuations both for trading and strategic purposes.

Candlestick charting is probably one of the oldest forms of technical analysis (dating back to the mid 16th century)

The Japanese Candlestick is currently enjoying somewhat of a resurgence, as traders begin to discover the simplicity of this method, which was first used over four centuries ago.

What the Candle Chart will do for you!



The History

By the early 15th century the Shogun Tokugawa managed to pacify the sixty daimyo feudal lords to create a unified country. This allowed more freedom of trade between the provinces as well as towns such as Edo and Osaka. (Osaka was to become the centre of this trading activity). Even today the traditional greeting in Osaka is "Mokarimakka", which translated means "are you making a profit.

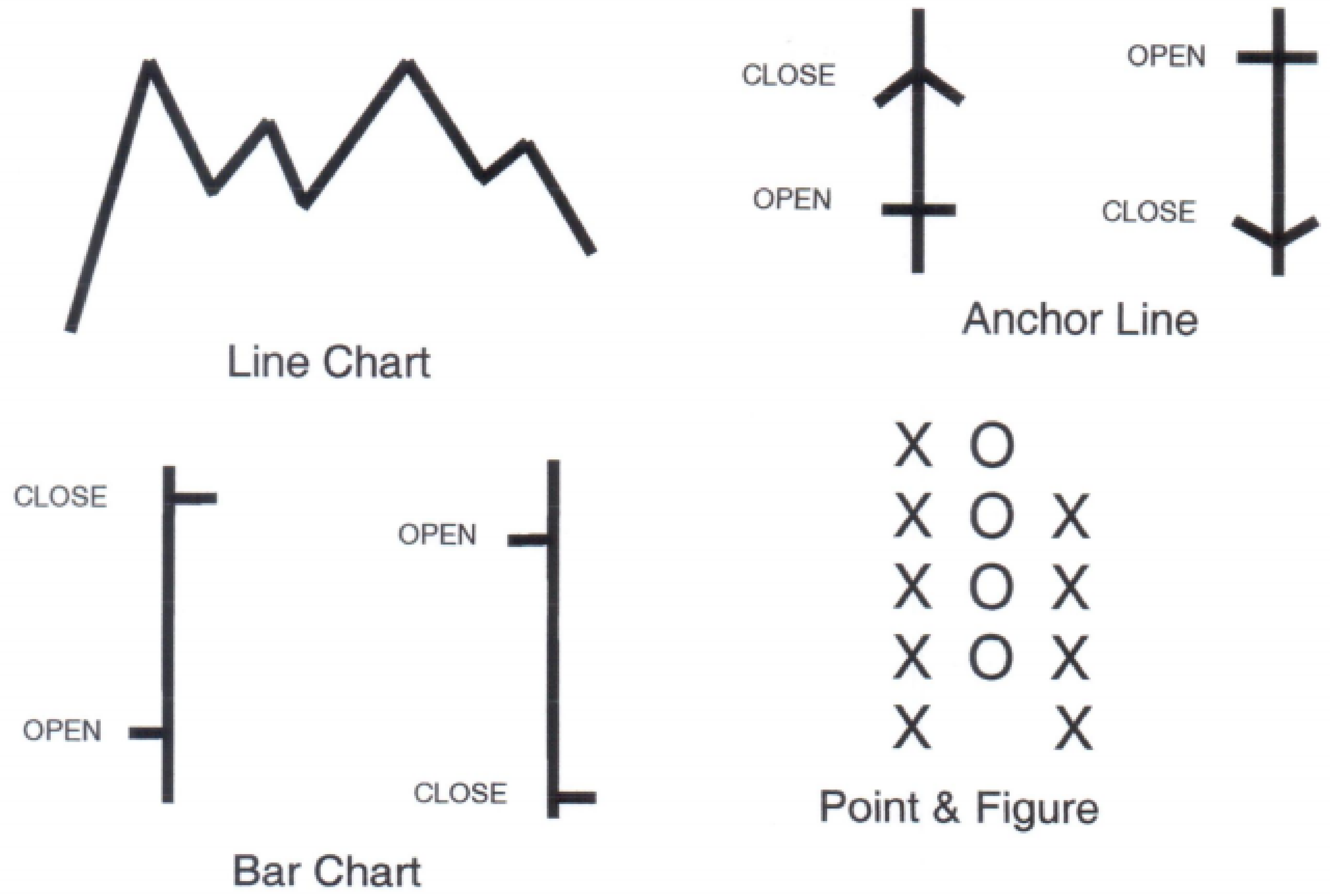
Early records show that charts where first used in Japan in the early 16th Century. This technique was first used to record the price fluctuations in the rice exchanges of feudalJapan. Rice was essentialto the Japanese economy and was used as a unit of exchange as wellas being the primary dietary staple of the Japanese people.

There were as many as 1300 rice traders working in Osaka at the Dojima Rice exchange. As trade developed, receipts from rice warehouses were accepted as payment and hence the first futures contracts were effectively traded.

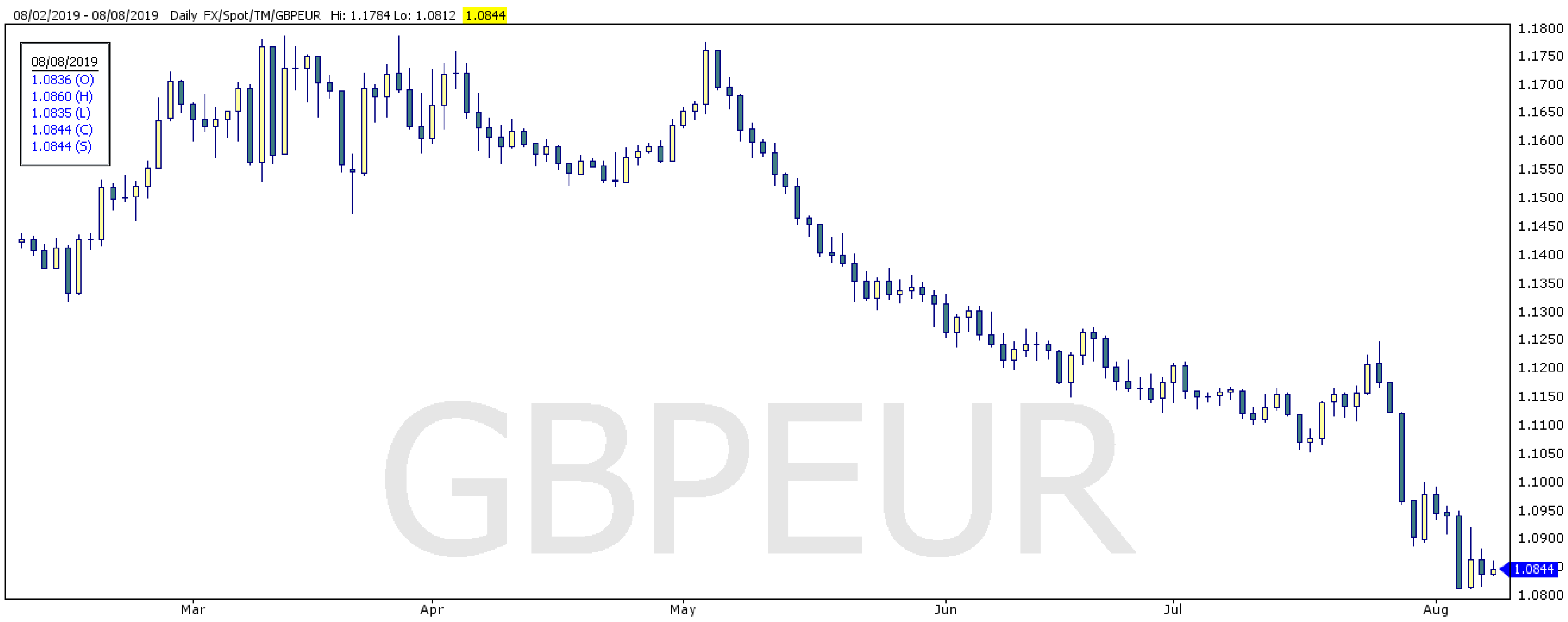
Sokyu Honma (1716 - 1803) was a brilliant rice merchant who is widely acknowledged as being the grandf ather of Candlestick Charting.

Honma was such a successfultrader that he was eventually elevated to the status of bushi or samurai which was practically unheard of in his day (merchants were regarded as being very low on the social ladder). Honma developed a series of rules which were called the "Soba samni no den" or the Sakata constitution.

The Different Charts To Be Aware Of

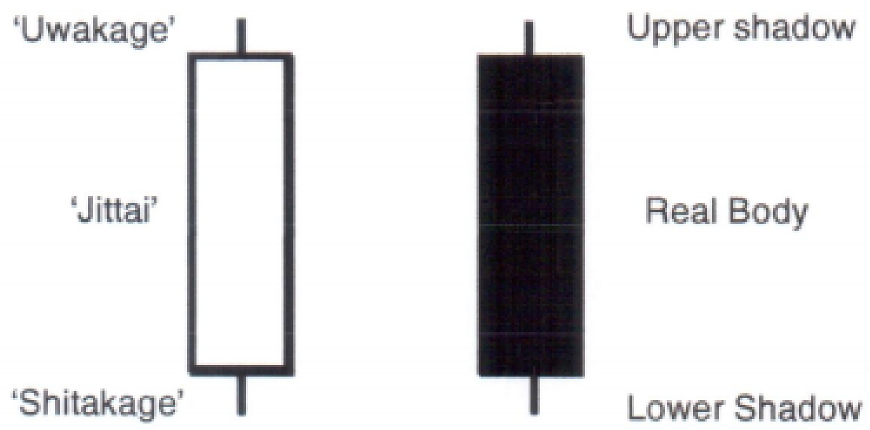


A Candle Stick Chart

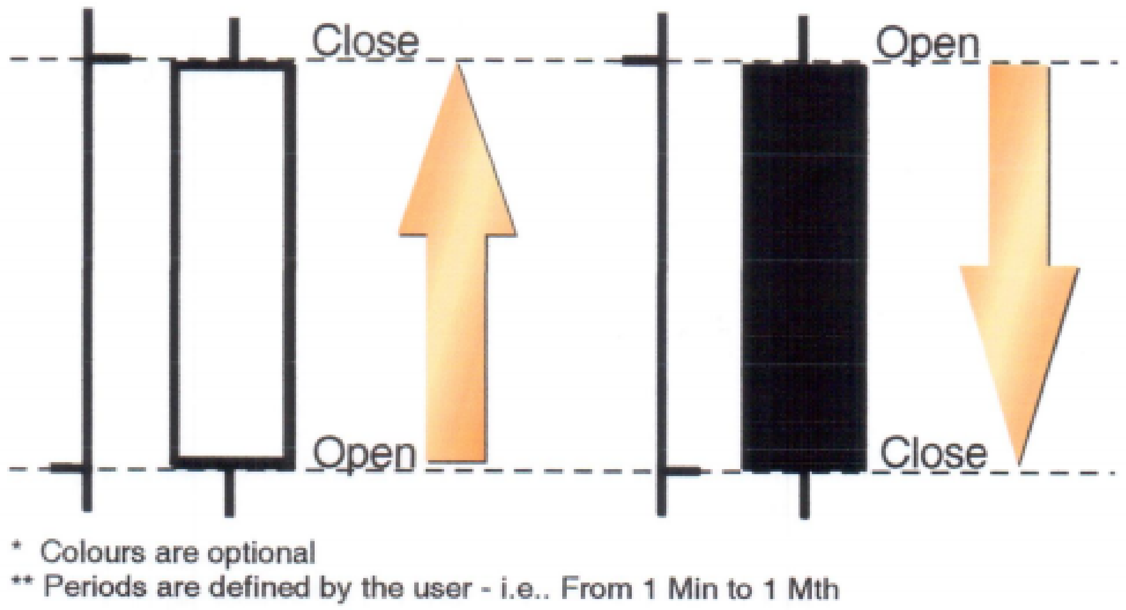


What is a Candlestick?

A Candlestick is a graphical representation of the High, Low, Open and Close therefore is identical to the more common bar chart

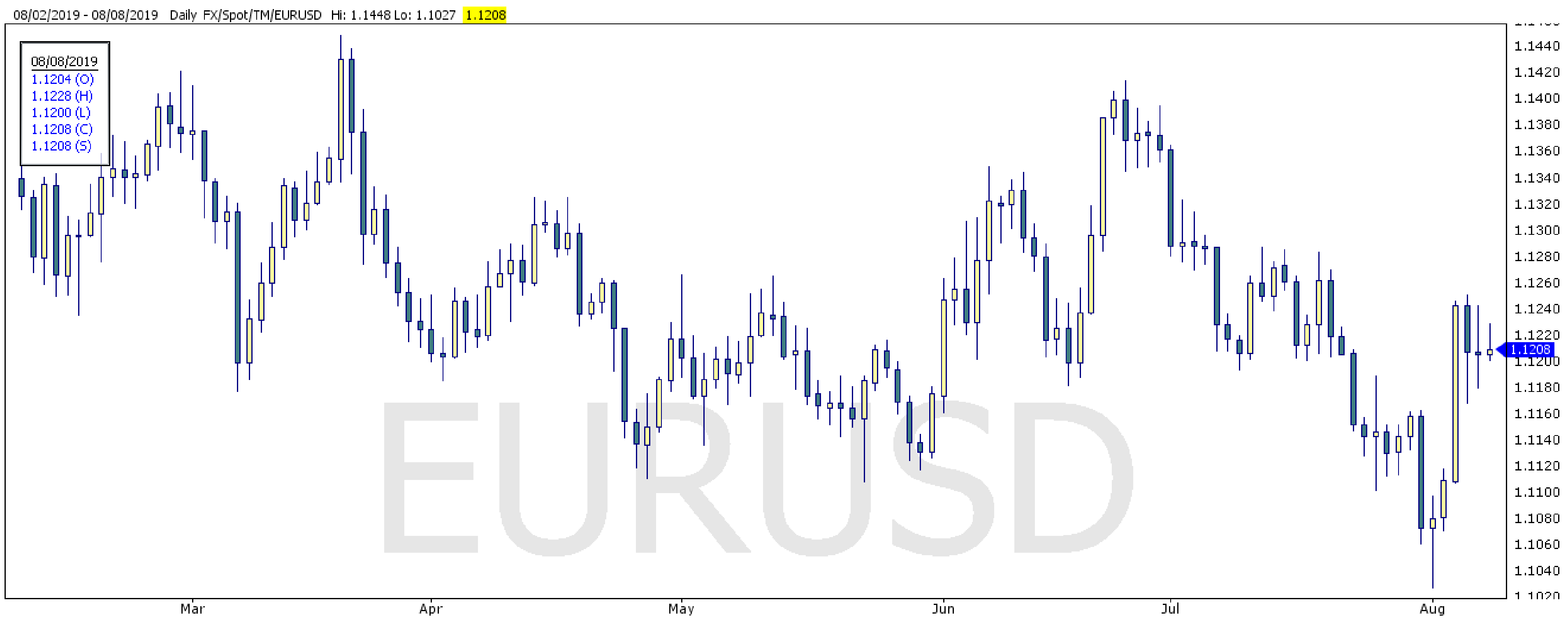


The Candles are colour coded, a light 'candle represents a higher closing relative to the opening of the particular session period". A down candle is generally darker, i.e. when the session closes lower than the opening price for that period it will become a redo candle.



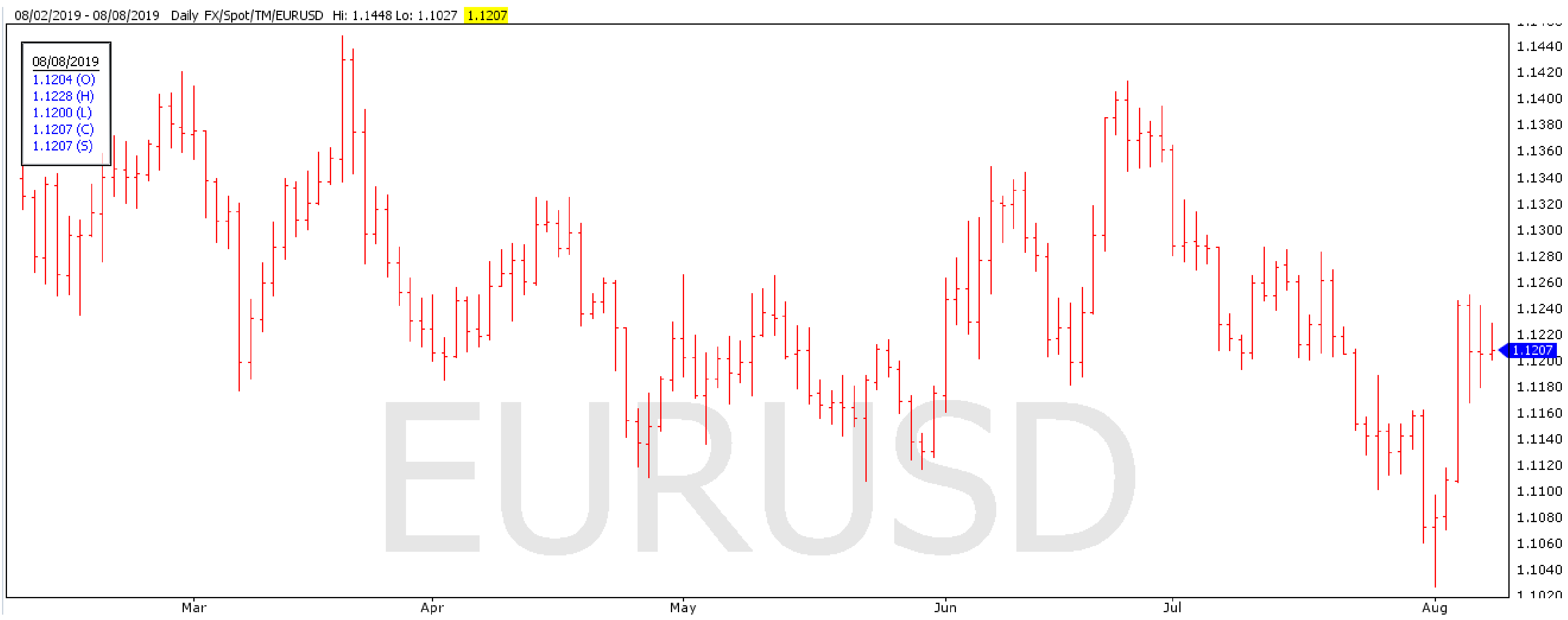
The Candle Chart Vs. Bar Chart

Candlestick Chart



Even though the bar and candle chart are graphical representations of the same inf ormation they completely different.

Bar Chart



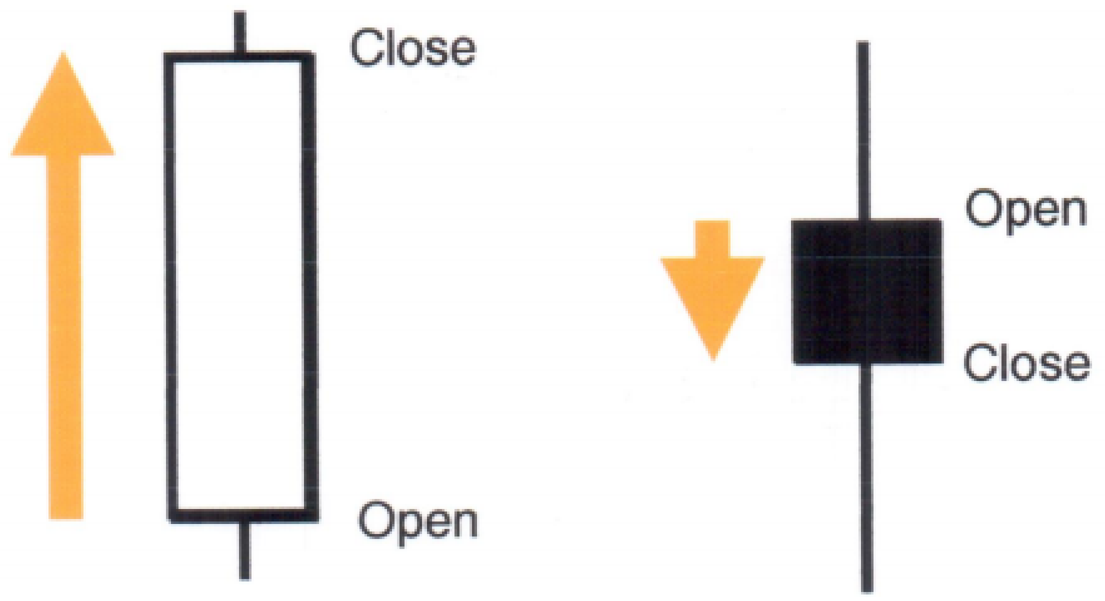
"Jittai" - The Real-Body

The size of the real-body can give us important clues to market sentiment. The Real-Body is the area between the open and the close of the candle

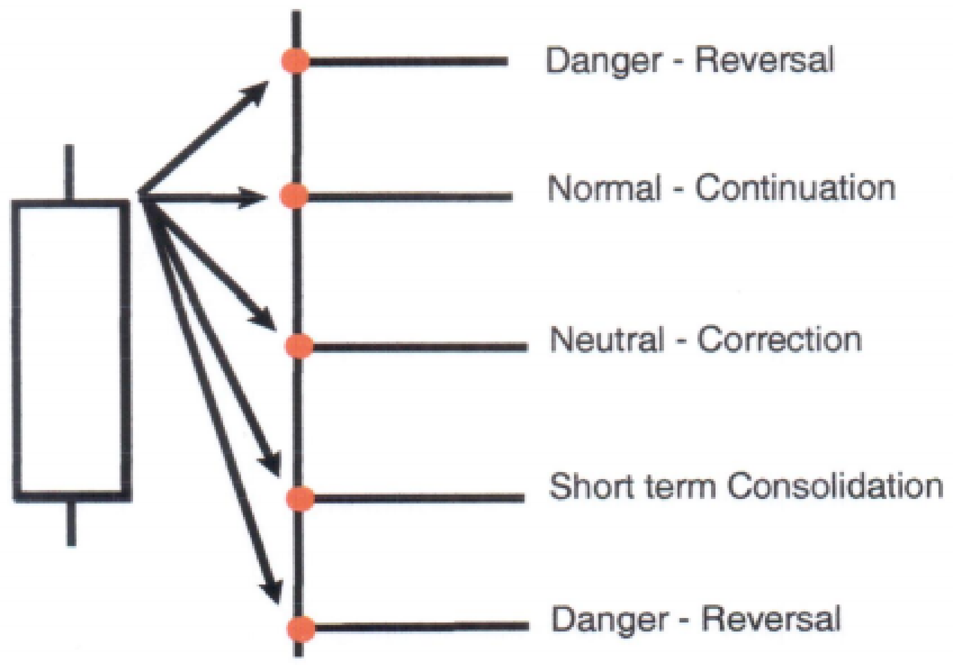
This is the area where most of the trading activity occurred and theref ore it sometimes known as the true value area. (This is not unlike Steidelmeyer's theory of Market Profile© where it is important to establish the point of control of the market to determine price equilibrium)

The closing price is the single most important piece of information that you have at your disposal: it is the price that will indicate the direction of the next session opening. Most technical indicators will use the closing price as a basis for calculation of buy/sellsignals. Important signals willbe generated on this one piece of inf ormation alone. Corrective and reversalpoints (see classification)

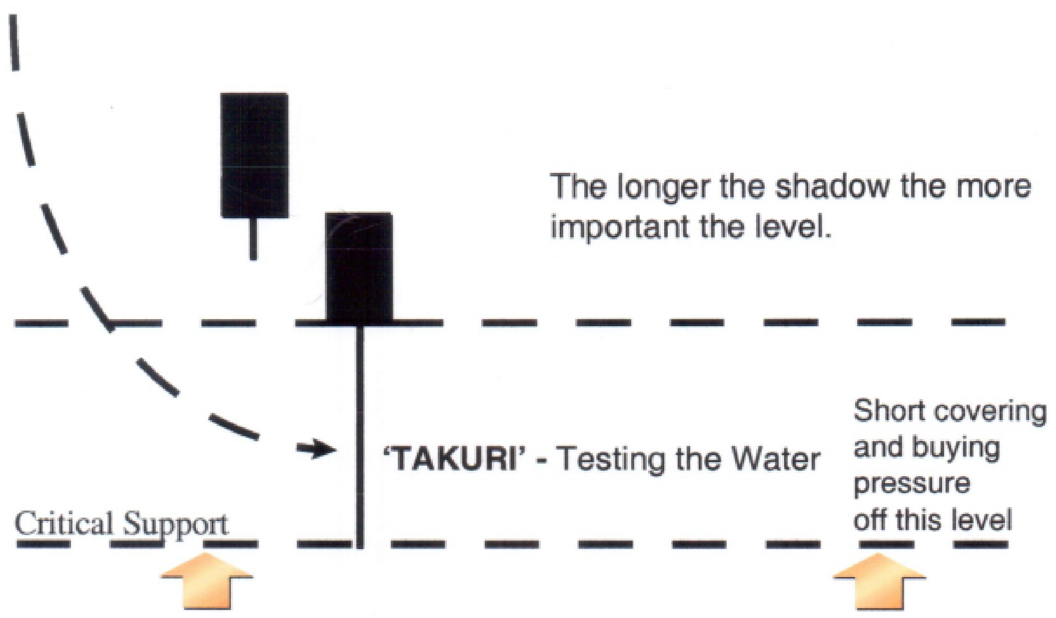
The colour of the real-body can quickly underline the directionalchanges in any given market over any given time frame.



The impact of opening versus previous closing.

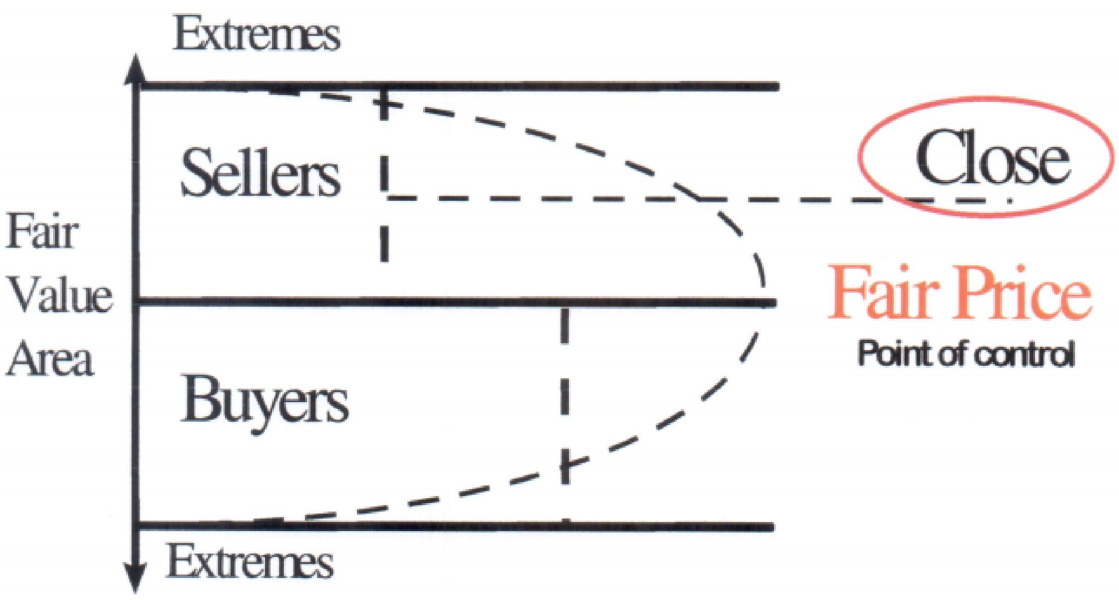


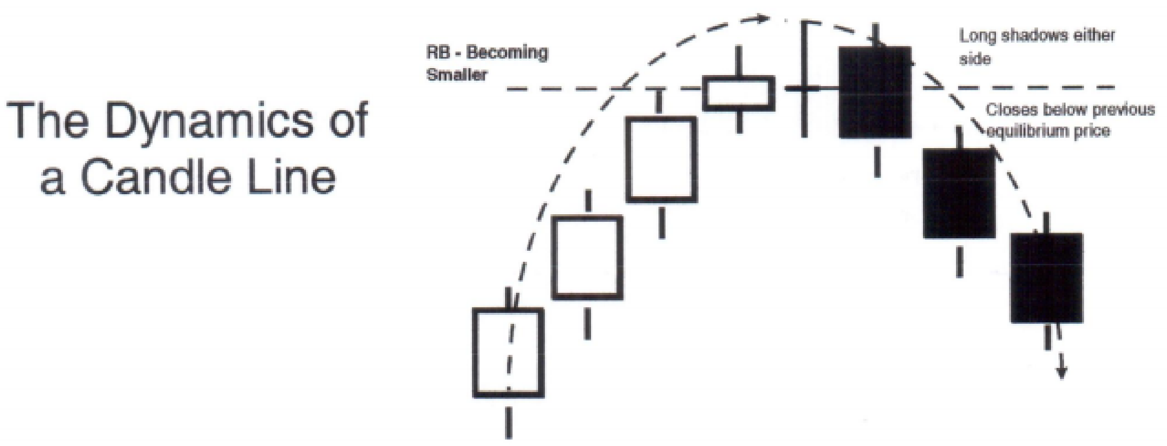
"Uwakage - Shitakage " Shadows



The 50% Level Market Profile

To understand the importance of the 50% levelIt is necessary to understand the concept of Fair Price and Market Profile e. For any given distribution there willbe a level, which is accepted by the market, i.e. an equilibrium level, called the Fair Price. A close above the Fair Value area is a usefulhint.





A nomlalcandle is called a strong line, this simply means that it is a positive continuation of either a bullish or bearish move.

The smaller the real-body the weaker the candle, typically this is when the market consolidates and uncertainty exists in the market with traders squaring positions and looking for a potential reversal or corrections

Lengthening shadows herald the existence of weakness in a trend

Significant penetration into the previous line is a potentialrevenalonce confimlation has occurred

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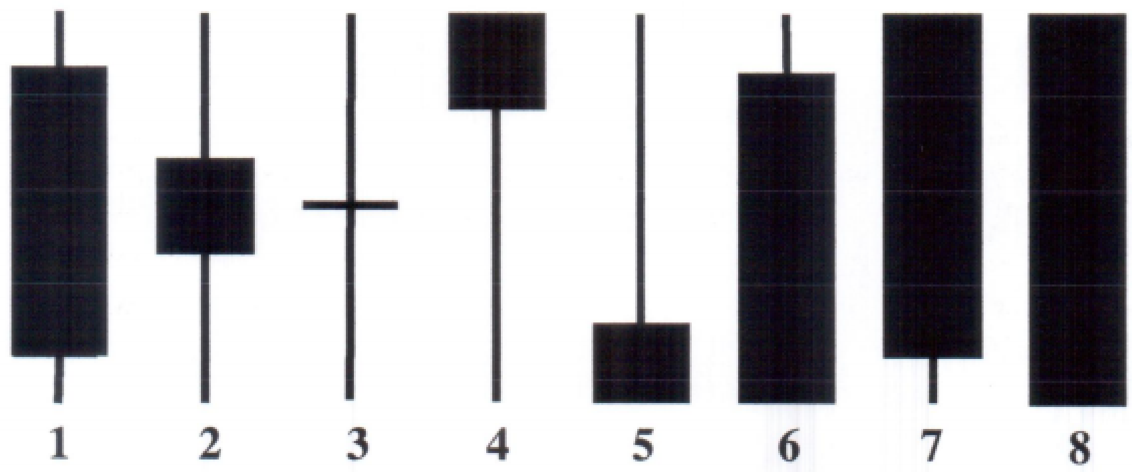
Chapter 2: The Classification

The Original Eight



A New Perspective

A market can only form one of eight candles during each specific time period.

Interpretations may vary in different markets but the basis remains the same.

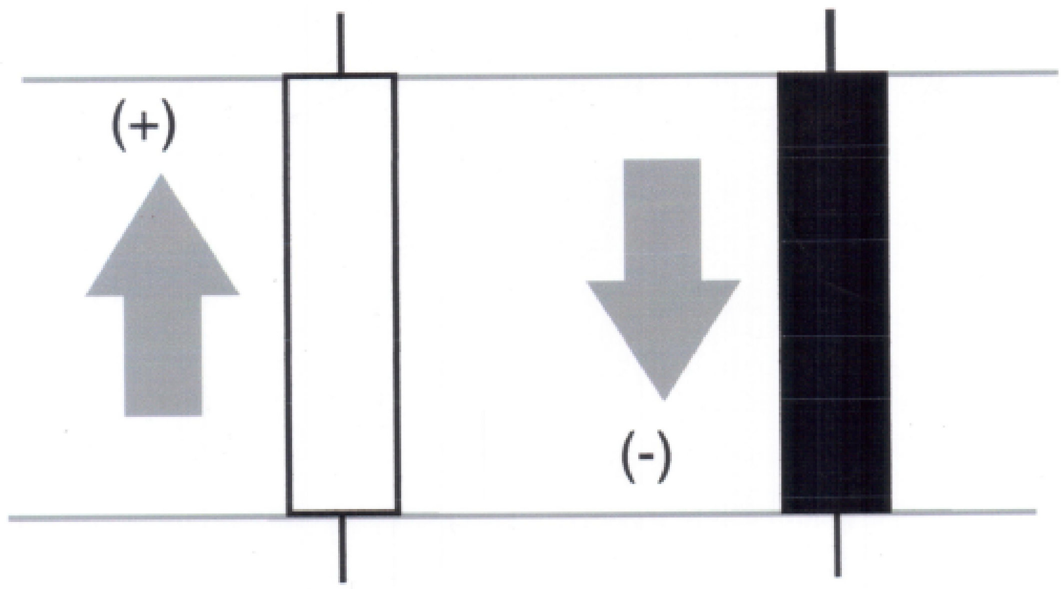
There are no other possibilities.

Once you understand the eight candles, apply them to the markets you are trading.

"This is the key to the technique"

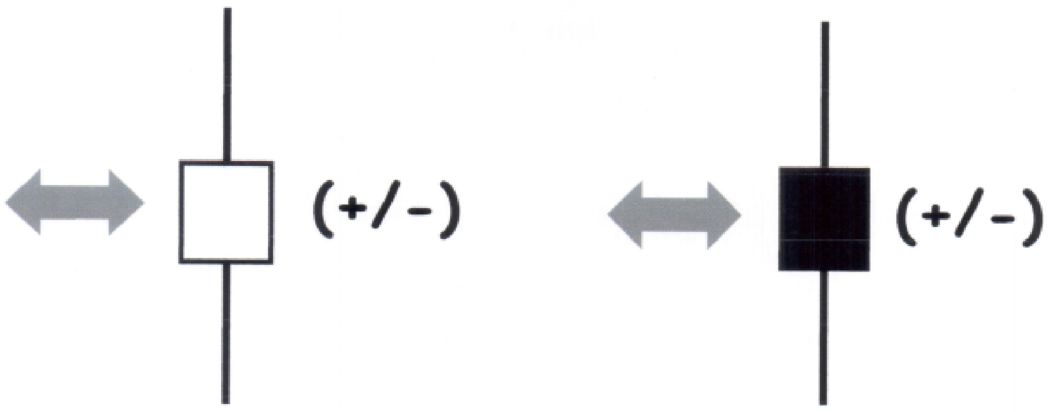
1. The Standard Line

The standard line is generally considered to be a continuation candle. They are recognised by the strong real-bodies and smalllower and upper shadows. They will not provide you with any specific clues in terms of a potentialchange in market direction. They indicate that the market's directionalconviction is good.



The Standard Candle

2a The Koma - Spinning Top

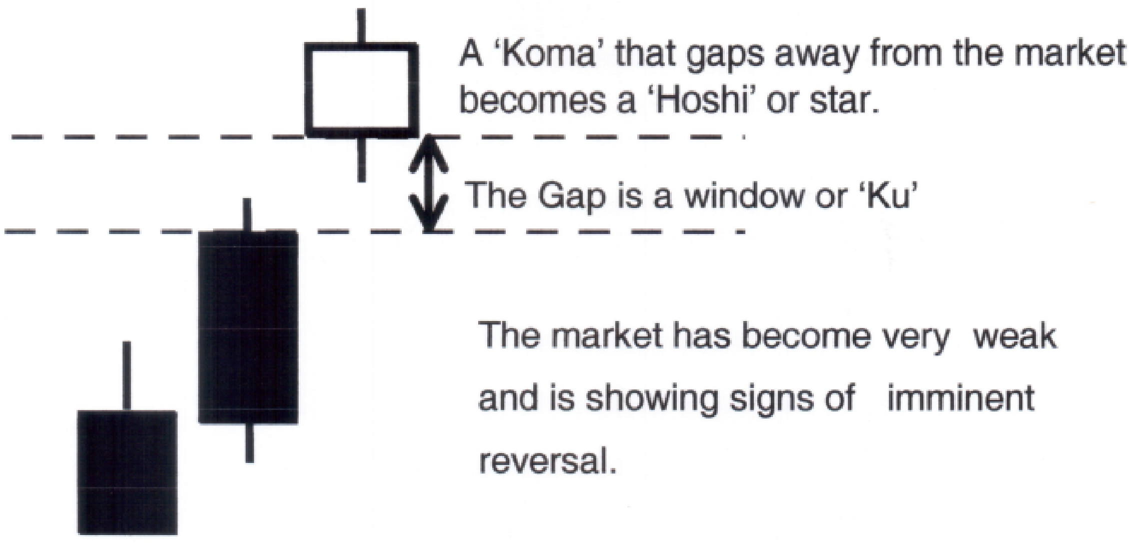


The Spinning Top is a neutral pattern and is distinguishable by its small real-body and long upper and lower shadows.

Generally the market is considered to be consolidating when this pattern is formed. The market has very little directional conviction

Koma - Spinning Top

2b The Star - Hoshi

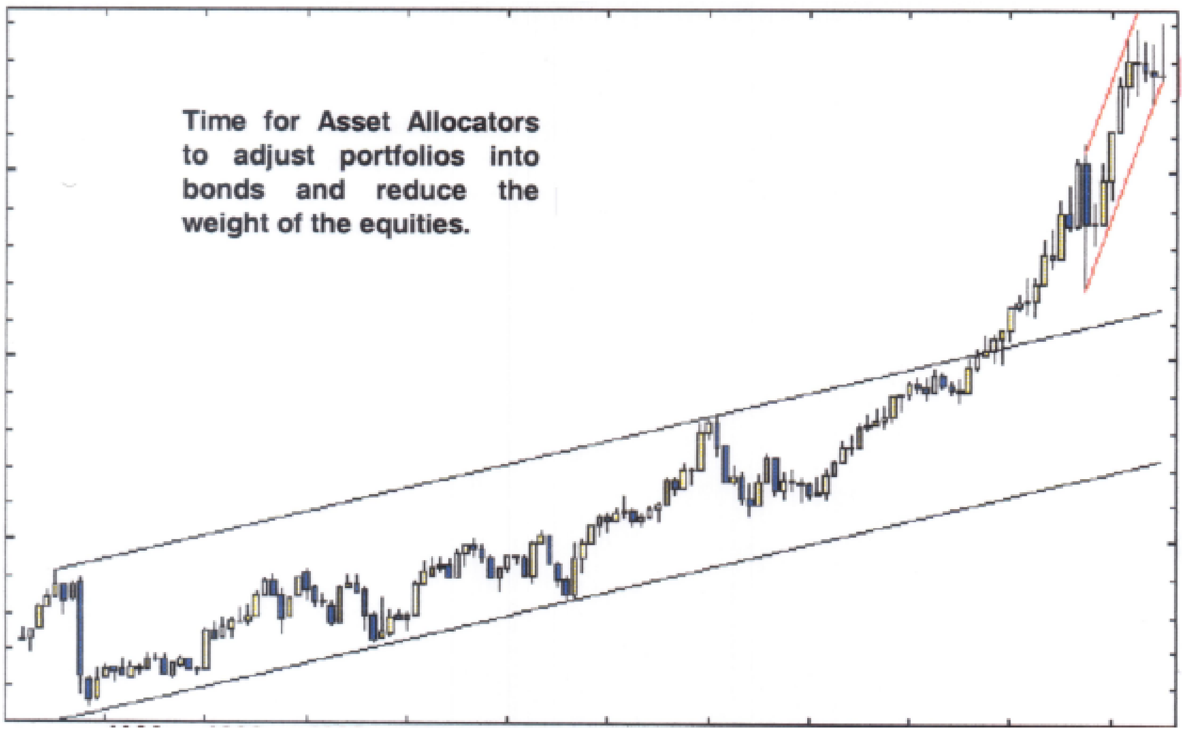


A potential top reversal pattern

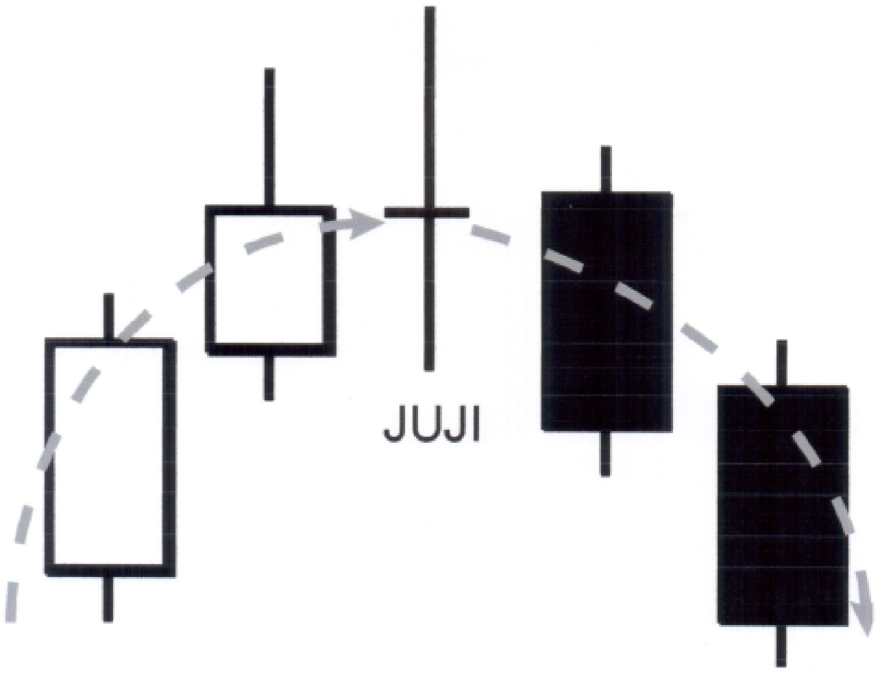
3. The Doji - Reversal

The Doji is very important, it is considered to be a reversalcandle. The Dali represents the area where the Bulls and the Bears meet. (Where the Open and Closing prices are equal, in Japanese Doji means 'the same as'). Originally there were four types of Doji but you willonly observe and be affected by the first three.

A potential top reversal pattern



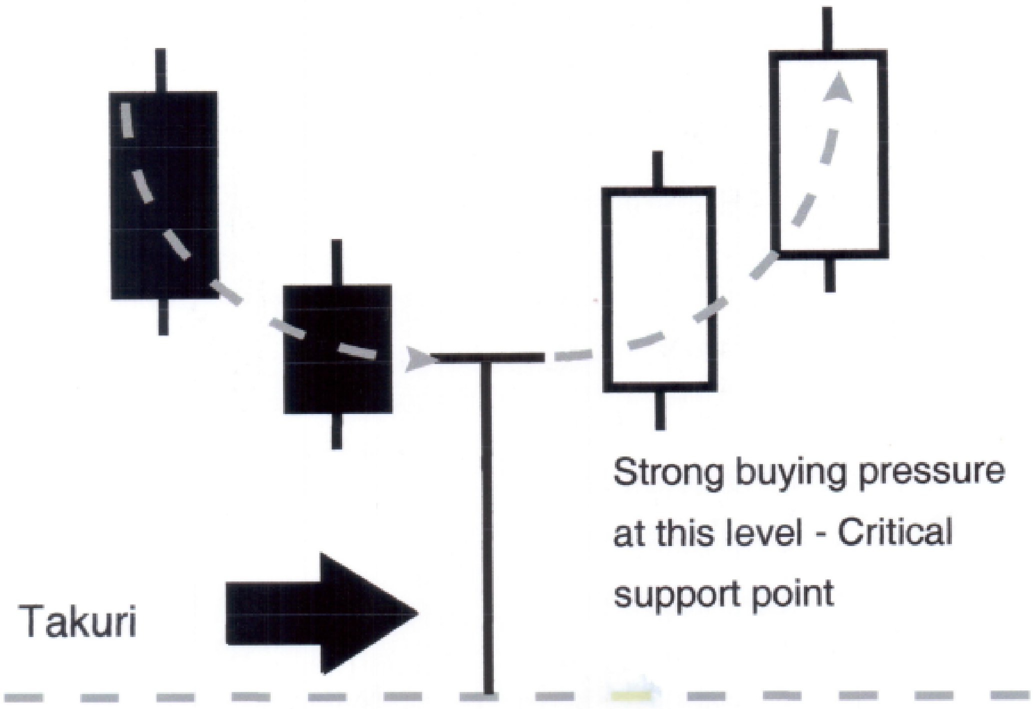
The Long Legged Doji- (also known as the Rickshaw man), shows a potentialtuming point where the upper and lower shadows are long and are of approximately equallength.



Rickshaw Man

3b. The Gravestone Doll- 'Tohba'

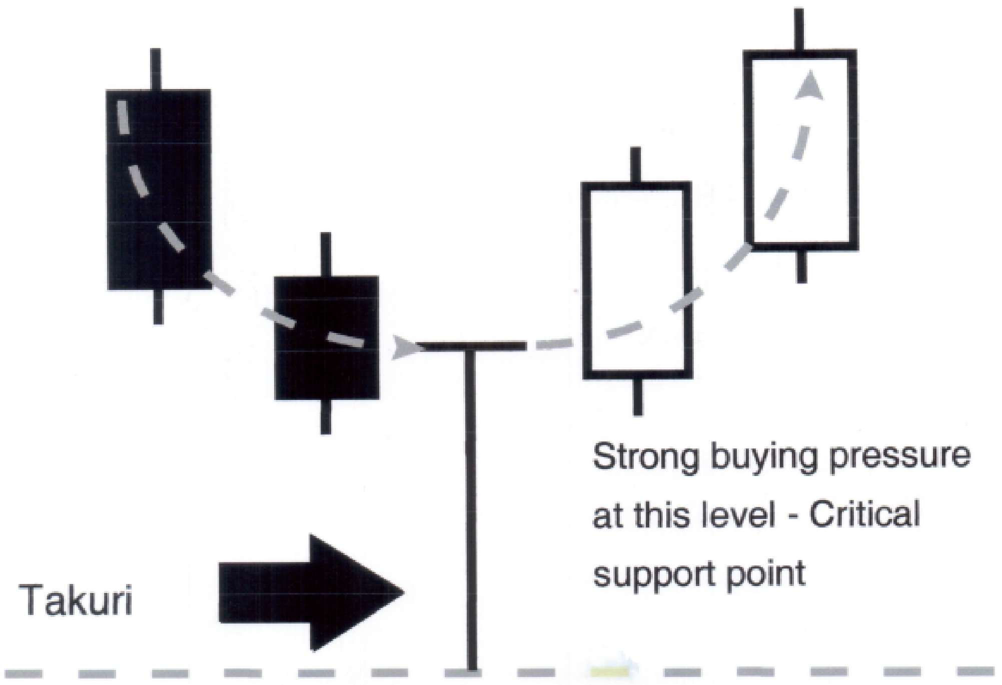
It is called the gravestone because of its shape. The original thinking behind this pattern was that this was a sign of the end of a bullish attack.



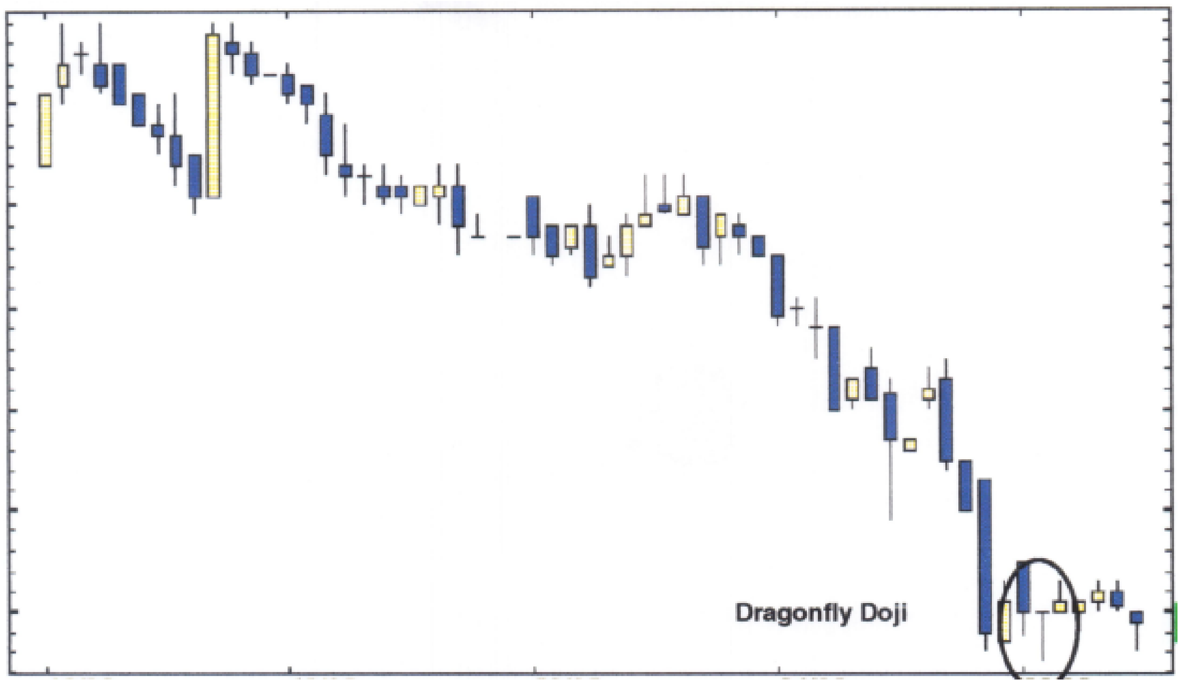
Gravestone Doji

3c. The Dragonfly Dojo- 'Tonbo'

This is the exact opposite of the Gravestone and is found exclusively at a market bottom.

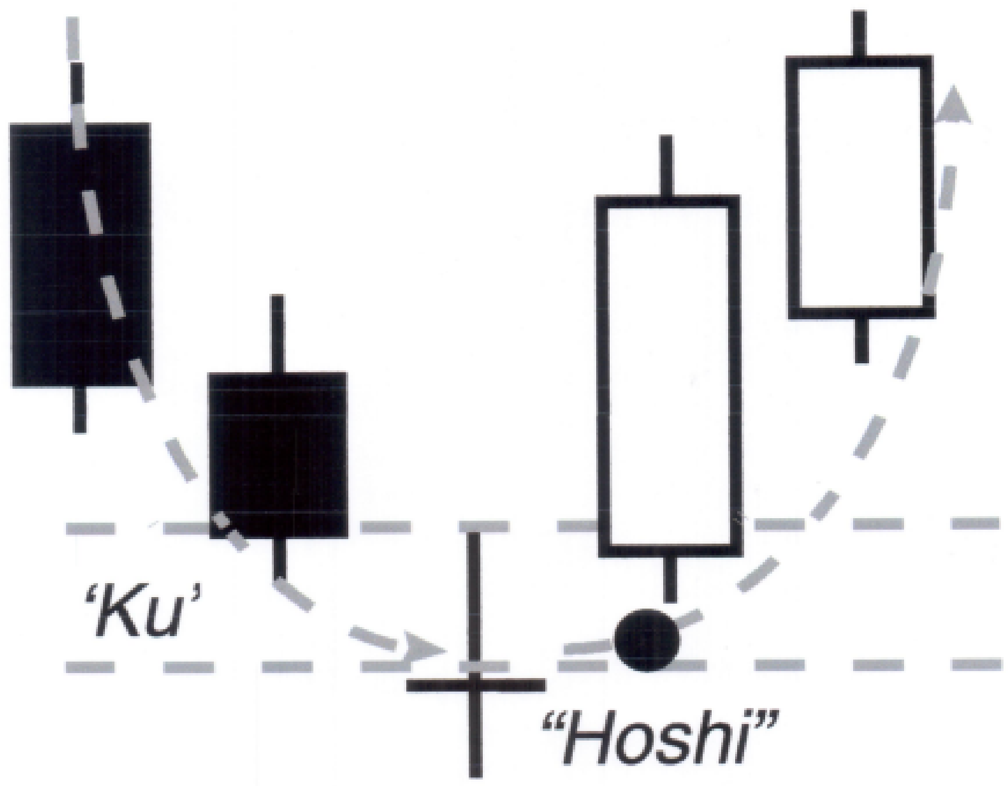


Dragonfly Doji

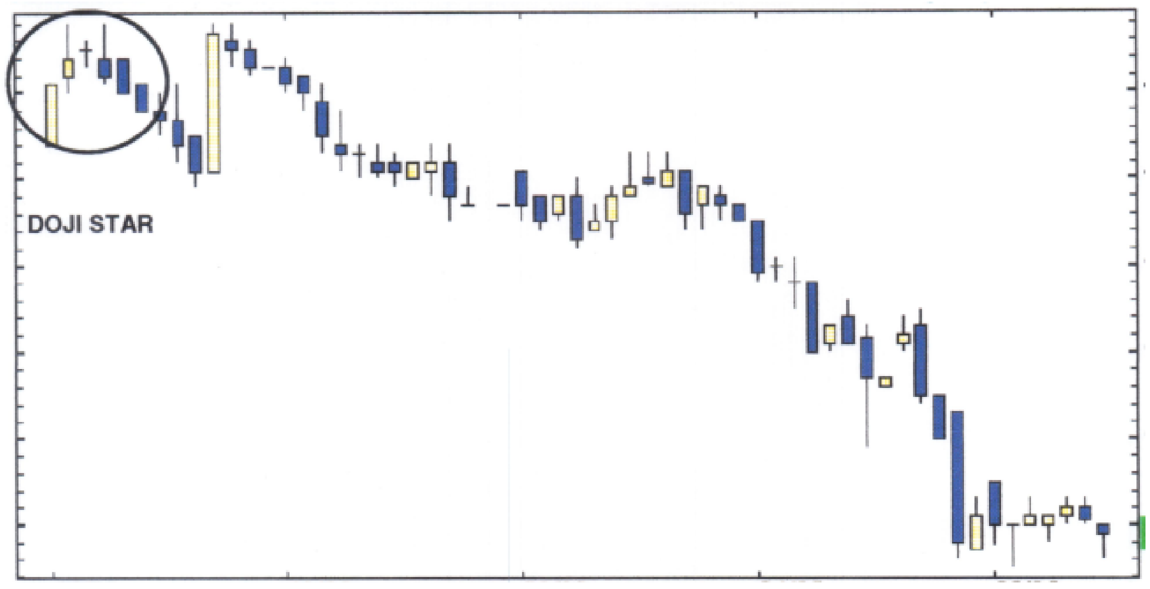


3d The Dojo Star

One of the strongest reversalpatterns, found at tops and bottoms. Is known as a patten of three, though at this stage the Dojo that gaps away from the previous close is warning enough.



Dojo Star



4 The Umbrella - 'Karakasa'

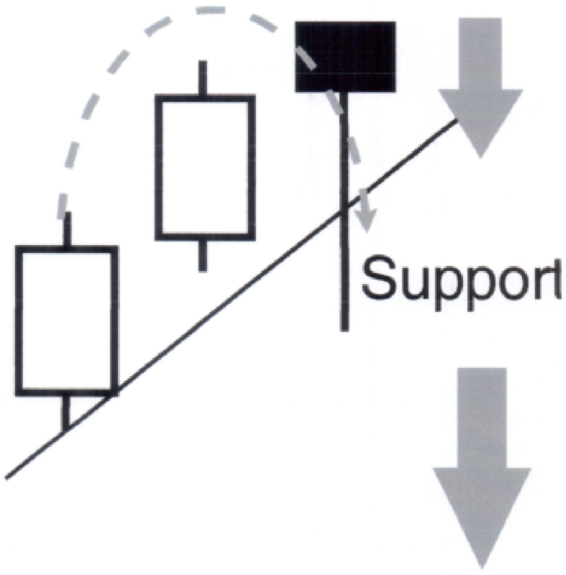
At the top of the market this pattern is called a hanging man, but at the bottom of the market it is known as a hammer. There are two distinctive variations of the umbrella pattern. The Hanging Man at a market top and the Hammer at a market bottom. An umbrella should have a smallreal-body with little or no upper shadow. The lower shadow should be 2/3 times the length of the real-body. The umbrella is widely regarded as a reversalline but confirmation of reversalis required. The colour of the real-body is usually not considered to be important but would recommend that you do pay attention to the direction of the closing as this gives additionalweight to the pattern.

4a Hanging Man

The market has to be in a clearly defined uptrend

The market shows signs of weakness and aggressively tests the downside.

The session however, closes much higher than the recorded low. A close below the support in the next three periods is required for confirmation if reversal. A break of a trend line could also act as a valid confirmation.



Hanging Man Exmaple

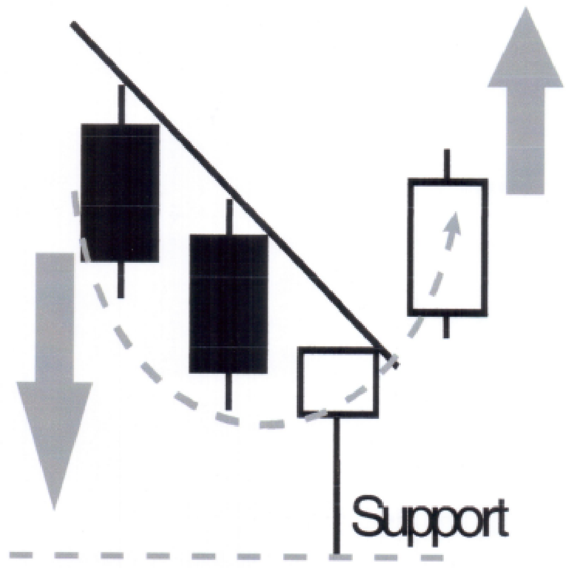
4b The Hammer

The Hammer is a very important bottom reversalpattern.

The colour of the real-body is less important than for the Hanging Man as the market has bounced off a low in a downtrend.

Strong buying has occurred, and indicates a good levelof resistance.

The long shadow is indicative of the strong buying pressure.

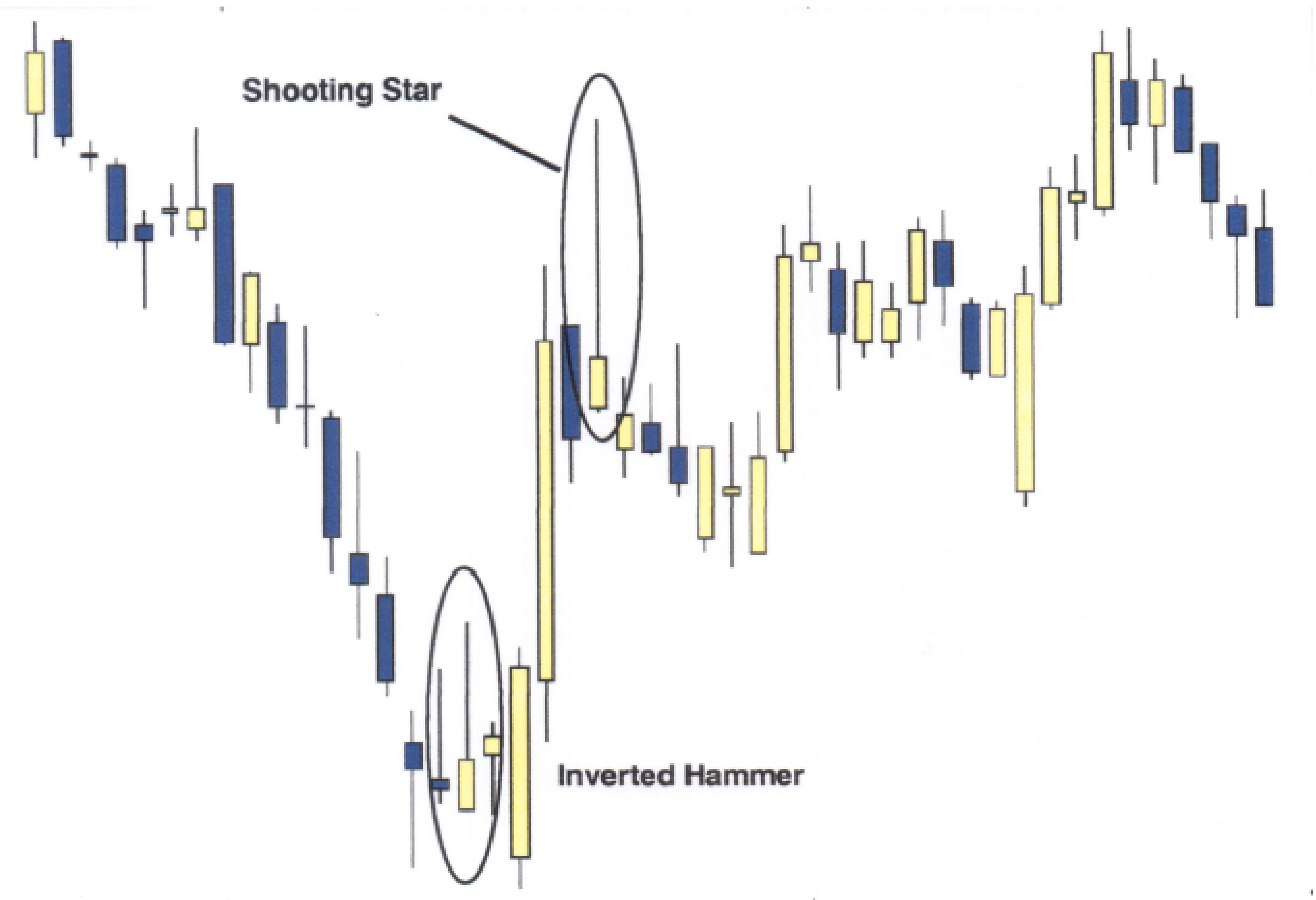


Hammer Example

5 Inverted Hammer -Reversal

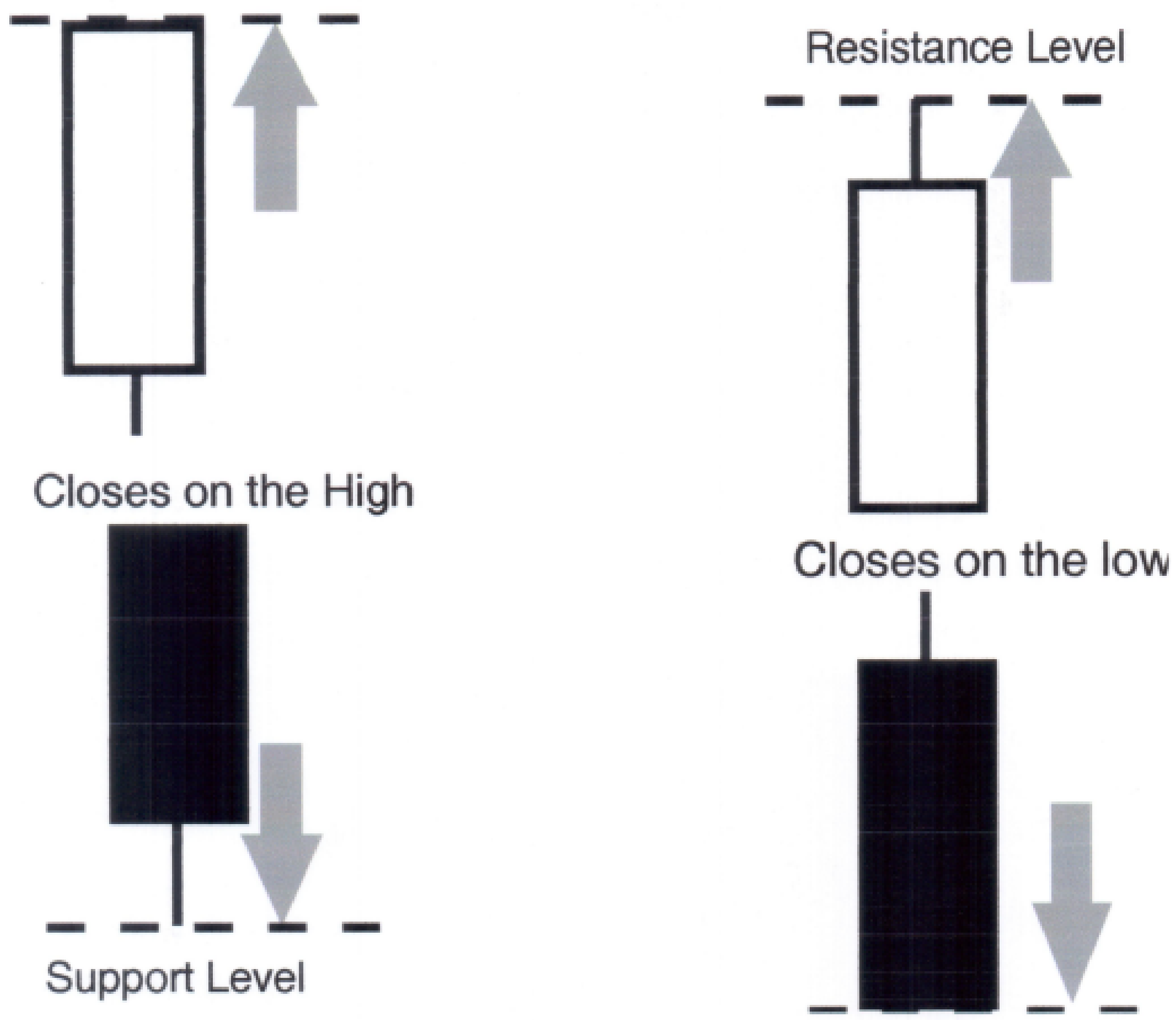
This pattern is the direct opposite of the umbrella lines or Karakasa. The shooting star can be a powerful revenalsignalin an up-trend (but only on a new high). An inverted hammer is indicative of a strong area of resistance; confirmation is sought prior to entering any new long positions

Inverted Hammer Example

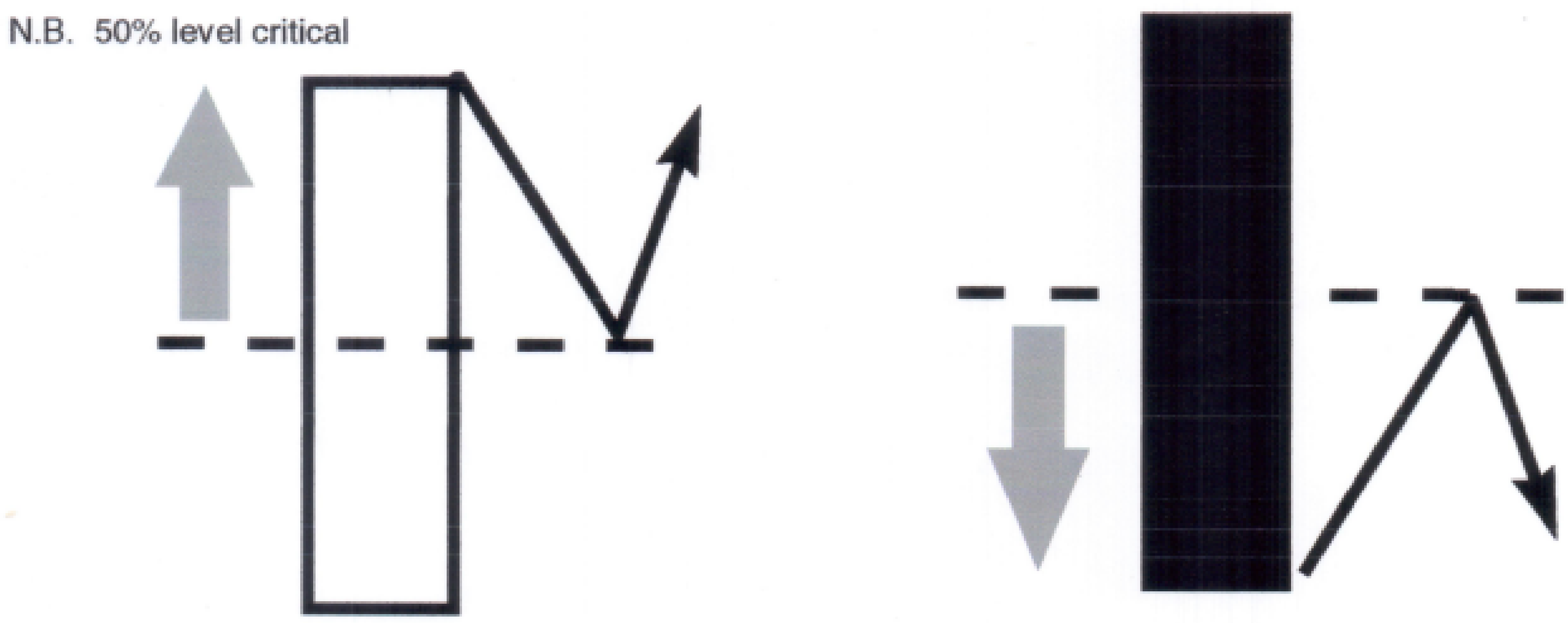


6/7 The Bozu Line

Also known as a Belt Hold Line or Shaven Top or Bottom. These are continuation lines but can show weakness in a trend.



8. The Marabozu

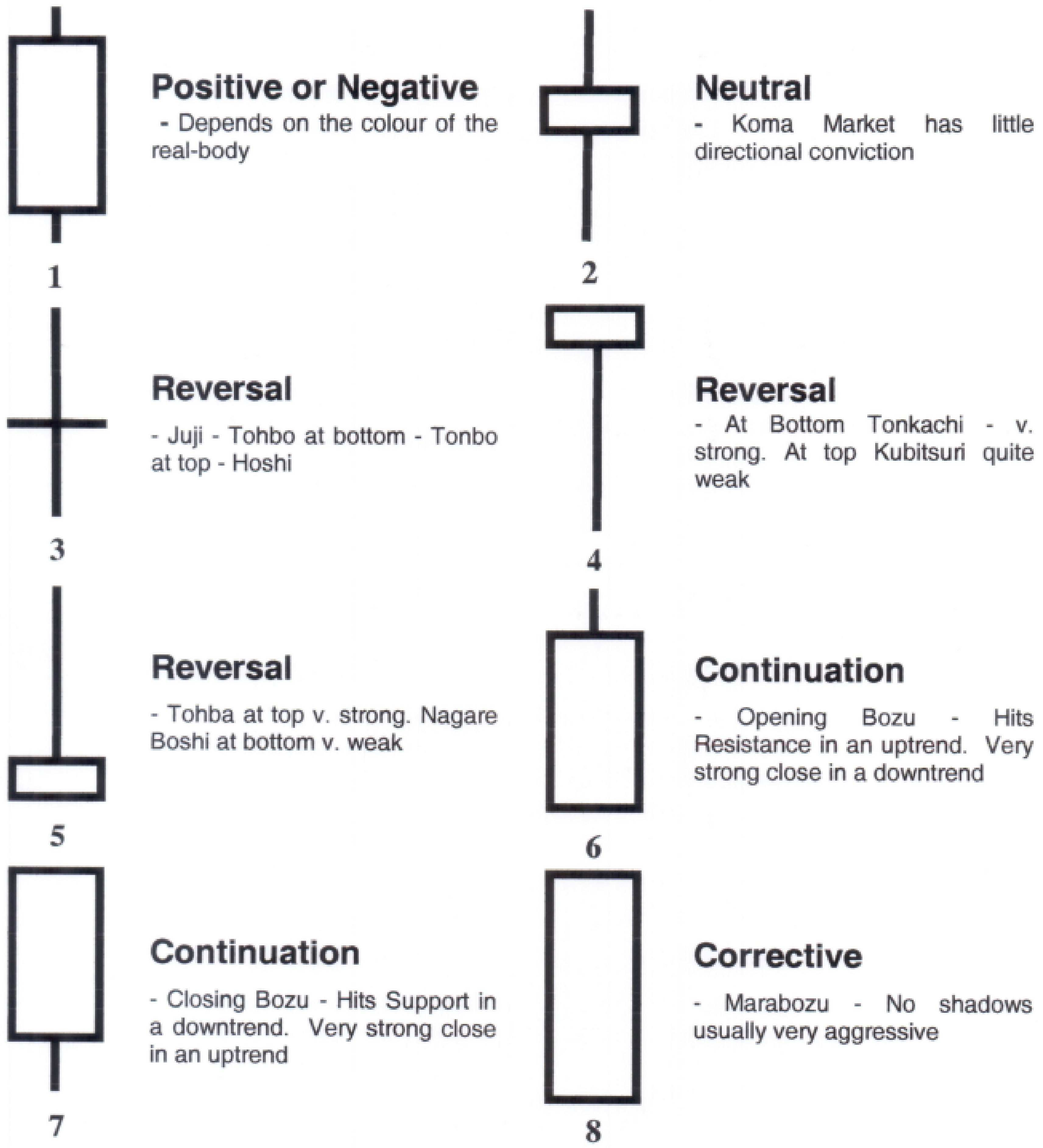


The Marabozu is a Candlestick with no upper and lower shadow. The period opens and closes on the low and high. The Marabozu is very common in short term charts, especially af ter the release of economic data. It is usually corrective to some degree.

The Long Standard Line

The long standard line is easily identifiable as a single candle line. It is 2/3 times the length of a normal standard line (it stands out). Like the Marabozu this line generally corrects and it is quite common to draw corrective retracements along the length of the move in order to be able to ascertain the ability of the trend to continue in its actualdirection and to sustain the momentum of the trend. Because of the abnomlal size of the move a correction or consolidation phase willalways occur after this particular line.

The Classification

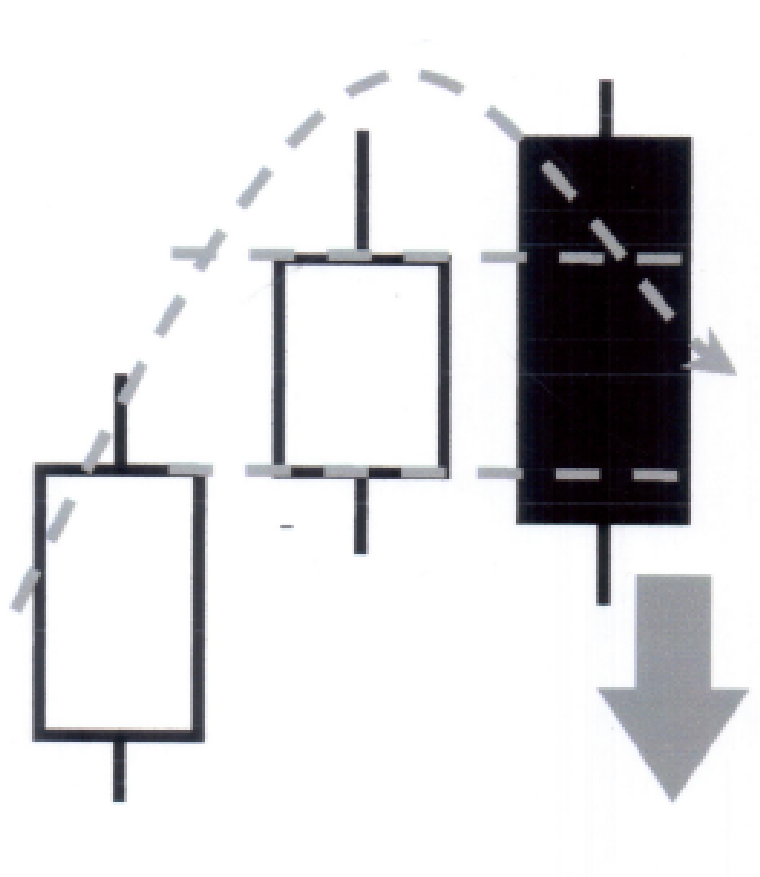


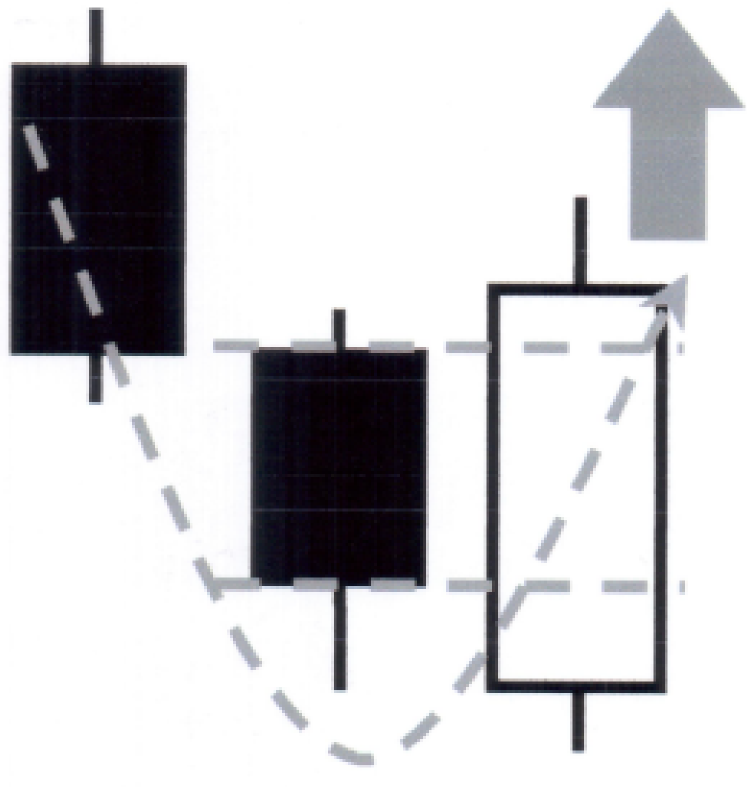
Chapter 3: Reversal Patterns

In section I we looked at the individualclassification of the various candle lines and have assigned a nominalvalue to the moves in terms of positive, negative and neutral. In this section we look at the 2-day (session) reversalpatterns. In this section it is essentialto understand the impact of the opening venus the previous session closing value as this is always a good pointer to the state of the market. We also look at a little known confirmation technique which is derived from combining the open of the first day and close of the second day, this information is then used to create an artificialcandle, and the classification of this is used as a confirmation signal. This is done to achieve a greater understanding of changes in market sentiment.

I -The Tsutsumi Line

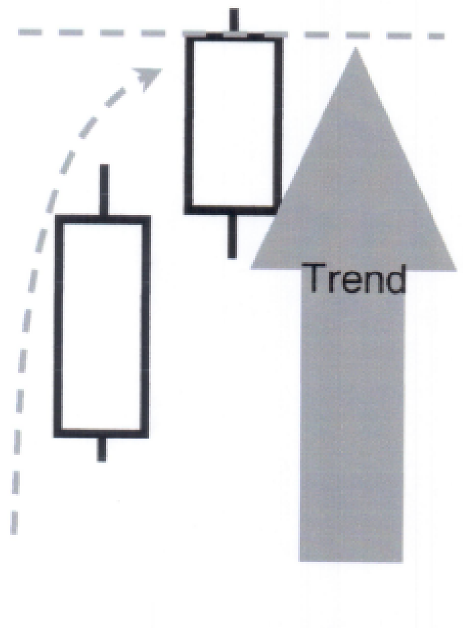
Bearish Tsutsumi Line





Ia. The Bearish Engulfing Line

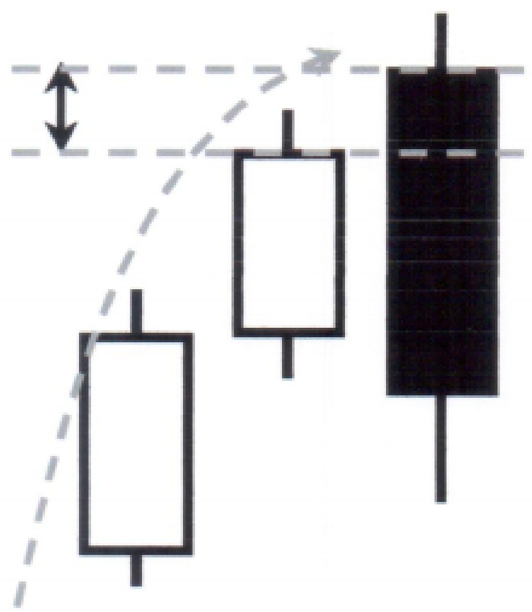
Tsutsumi Line



The Engulfing Line is one of the strongest of all the reversal patterns and is a quick and effective method of spotting a change in market sentiment.

The market has to be in a reasonable trend for this pattem to be validated.

Tsutsumi Line

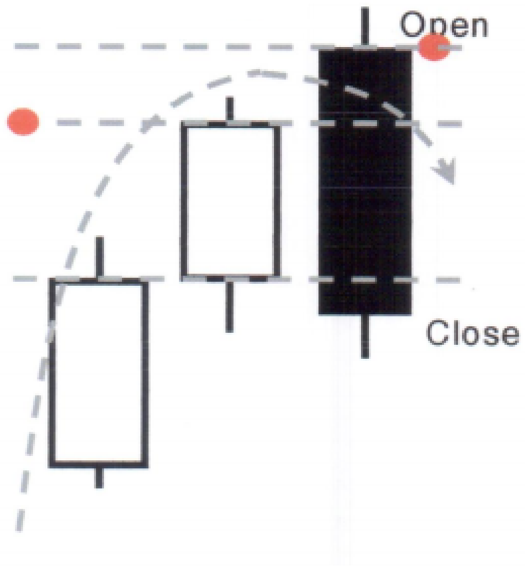


The next period opens higher than the previous close, creating a gap or 'Ku ', (in section 1 we have seen that this phenomenon is usually a sign of market weakness).

The real-bodies are obviously of opposite colours.

Tsutsumi Line

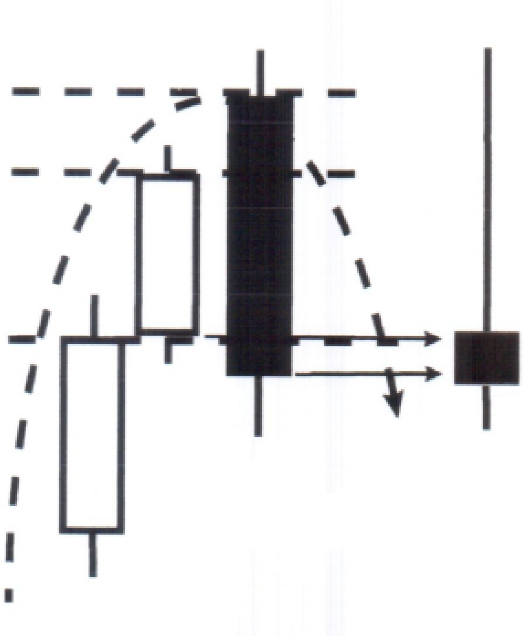
The close of the current candle line is lower than the previous



Tsutsumi Line

session open - engulfing the whole of the last real body.

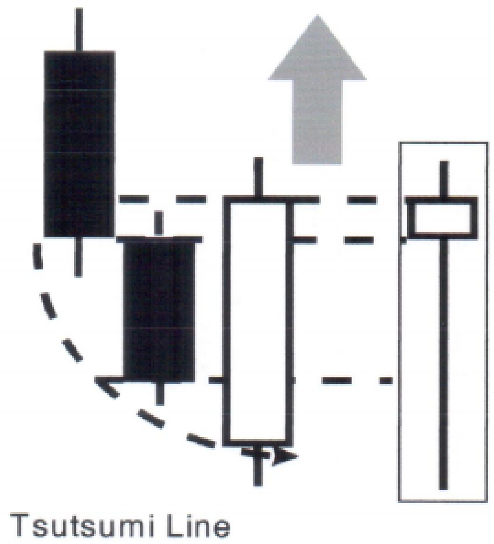
The shadows are not taken into consideration at this stage.



1b The Bullish Engulfing Line

The open of the first day and close of the second day would result in the entire session resembling a Tohba or Shooting Star.

This technique gives additional understanding to the analyst and suggests that this pattem does not require confirmation.



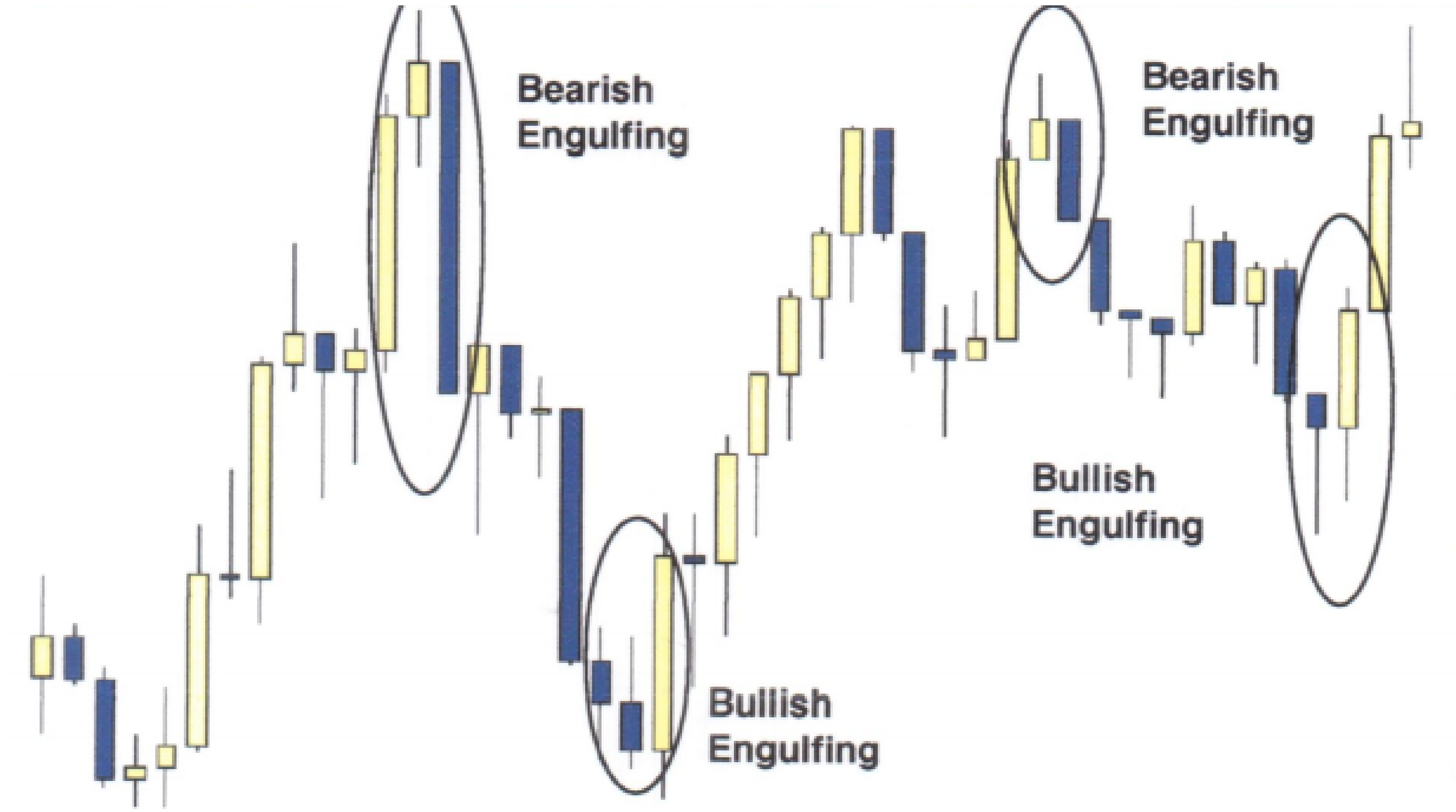
Bullish & Bearish Engulfing

This is the reverse of the bearish engulfing pattem and is very strong with the 2DC forming a hammer

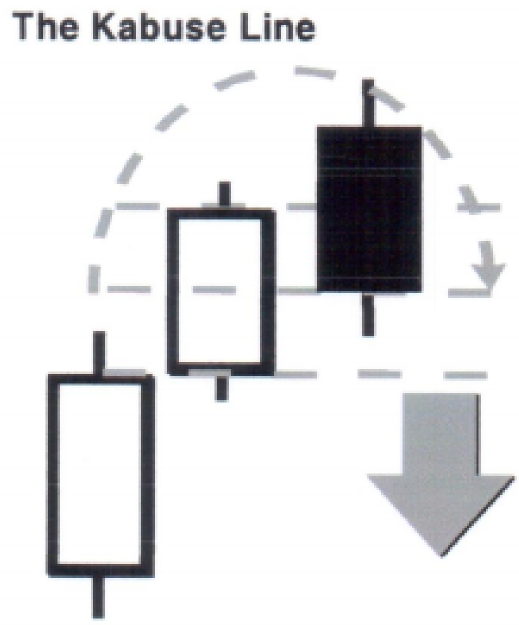
There must be a reasonable trend in place for this pattern to work.

Trading Strategy is to square trades that are positioned with the prevailing trend and get ready to reverse if second day f ollows through - (Confirmation is not necessarily required if all the rules have been adhered to).

(2 Day Candle - Classification = Tonkachi Positive)



2 -The Kabuse Line

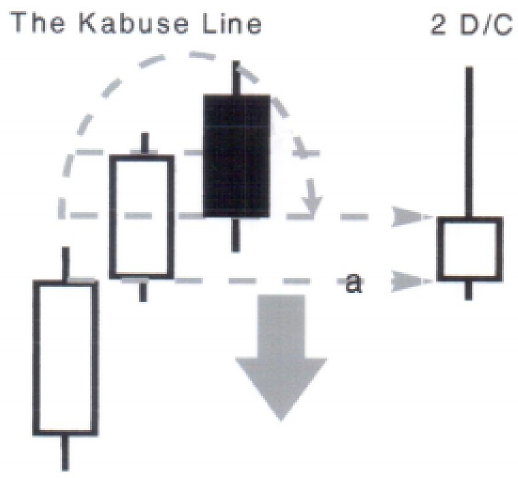


Very similar to the Engulfing pattem but does not engulf the whole of the previous 'Jittai '.

A sustained up-trend is required, with price action of the active session opening higher than the close of the last session and in turn closing well into the previous real-body

The greater the penetration into the previous period the stronger the signal.

Trading Strategy - Close long positions; go short when trend reversal confirmed.

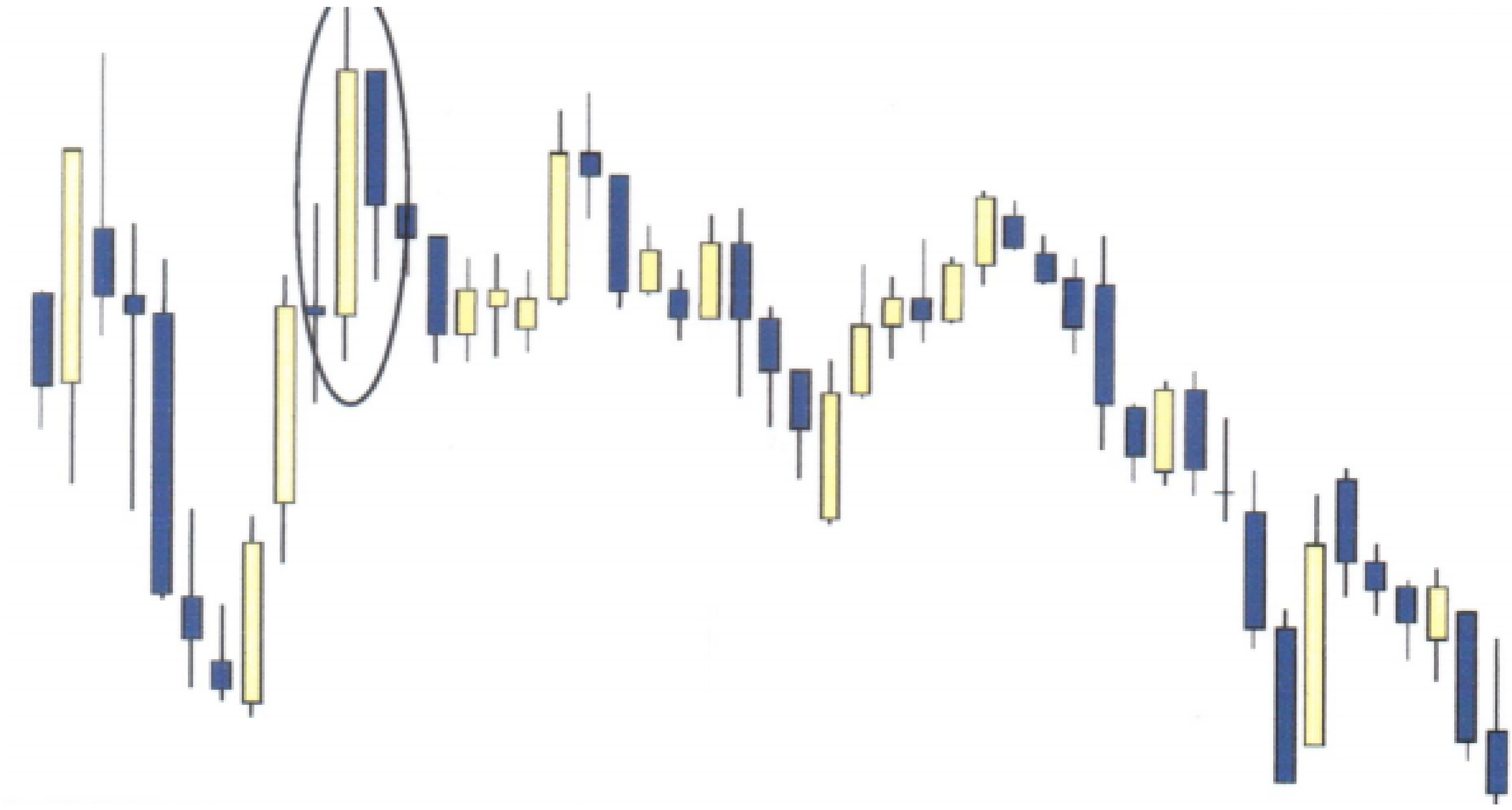


This line is a reversal but is weaker than the engulfing pattem therefore a close below point (a) would act as a confirmation

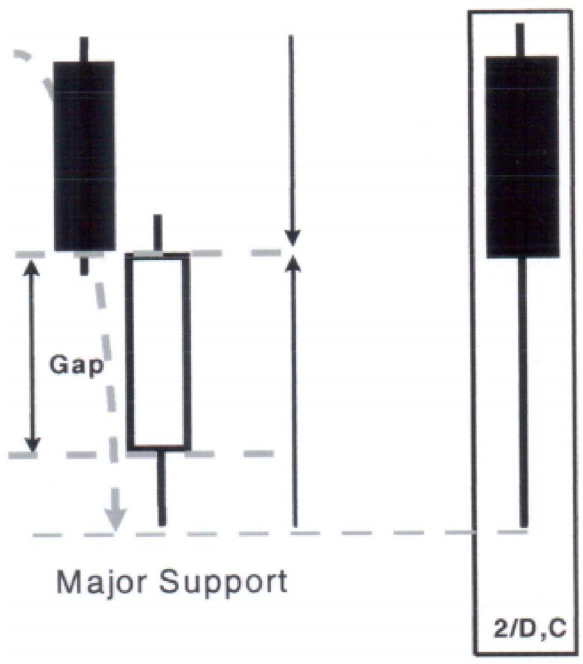
2 Day line - Classification

Star = Negative

Kabuse Line Example



3a Deaisen - Counter Attack Lines

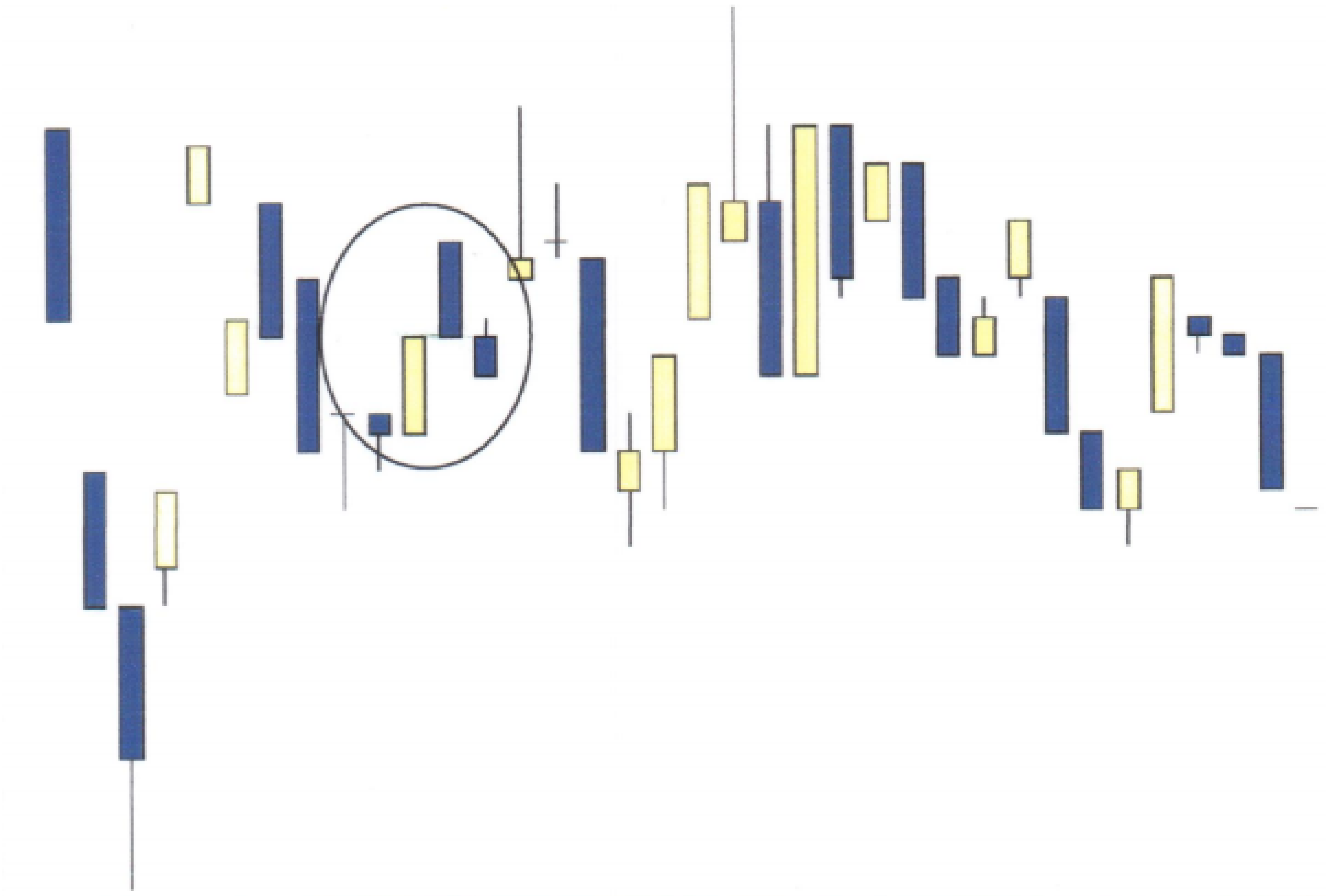


Deaisen is a meeting line - in effect two periods of price action converge, to form a reversal pattern known as the Piecing Line

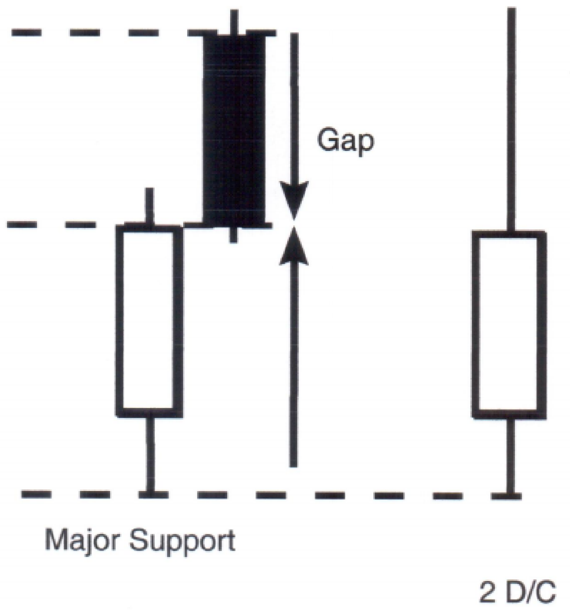
Sashikomi is when a big gap occurs between the close and the opening of 2 sessions with price action retuming to close on the higt] meeting the old price action.

The 2 d/c Shows the long'cTakuri dnd suggests that price action has touched a key support but confirmation is required prior to reversing a position i.e. a new high in the next trading session.

Deaisen - Counter Attack Lines Example



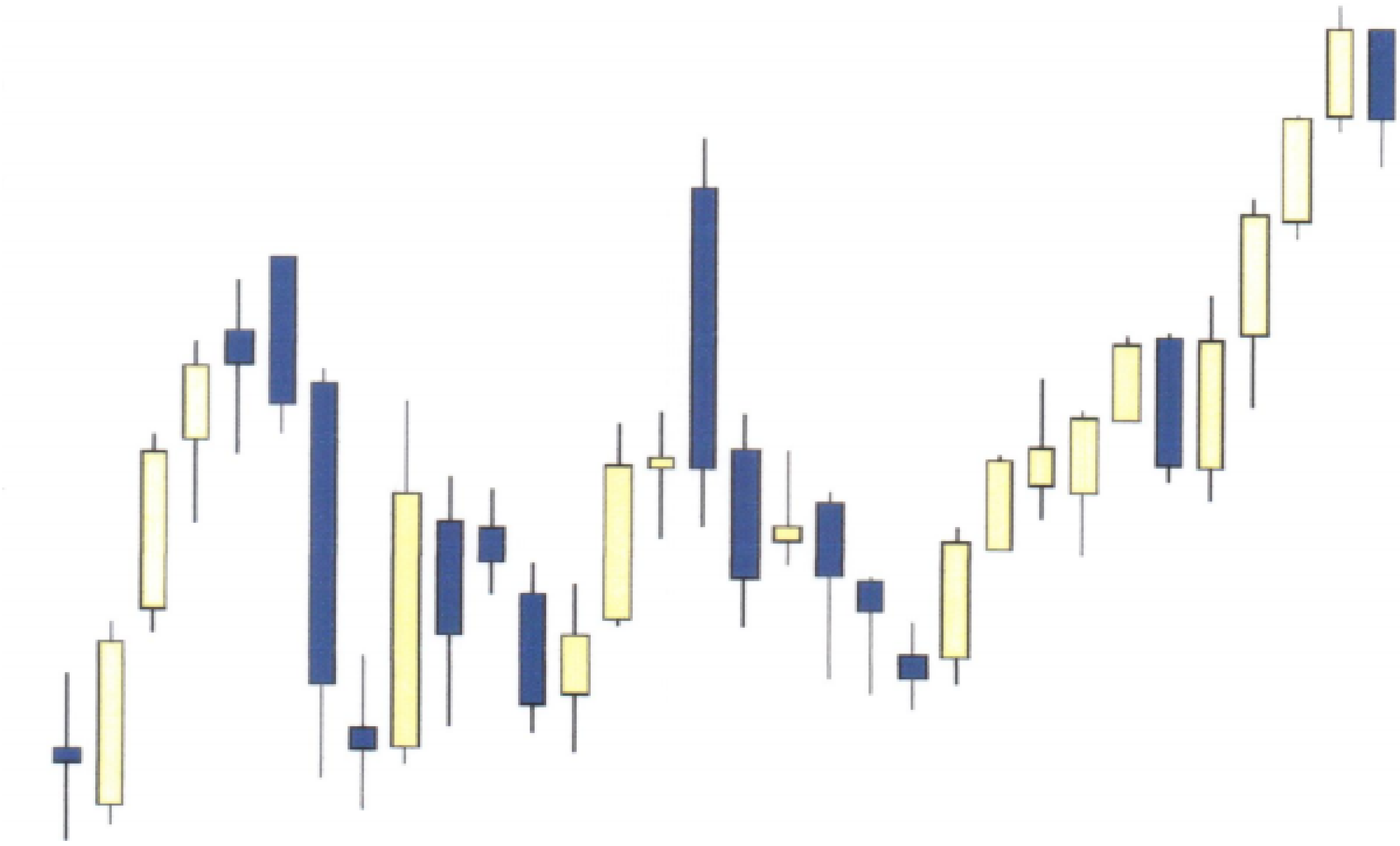
3b Deaisen - Meeting Lines



The Bearish meeting line is found at the top of a trending market.

Price action initially gaps away from the previous close, but closes into the real-body of the previous session.

Deaisen - Meeting Lines



4 The Piercing Pattern

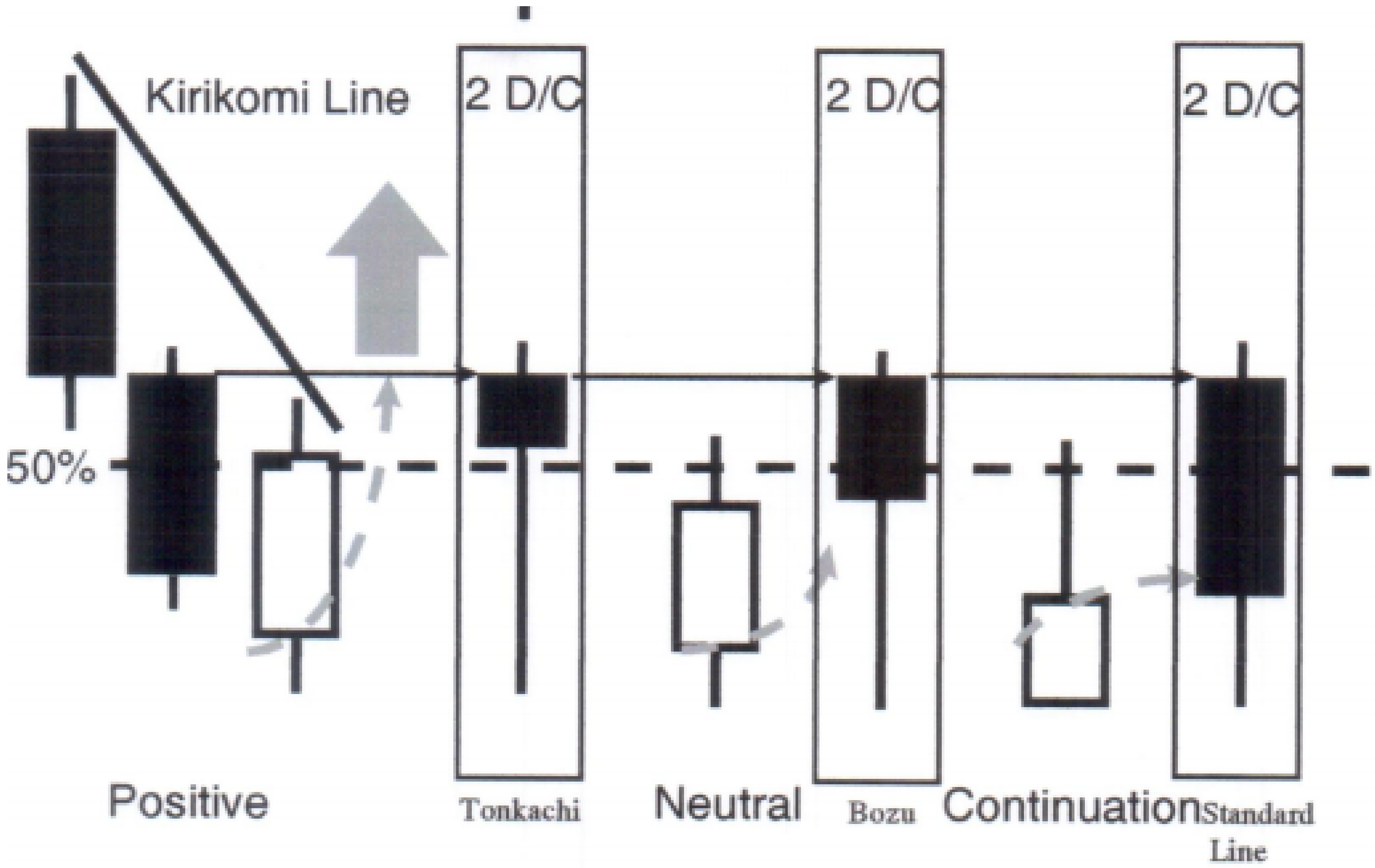
Again similar to the Engulfing pattern but does not engulf the whole of the previous 'Jittai '.

An important feature of this patten is that you must get significant penetration into the previous real-body to walla reversal.

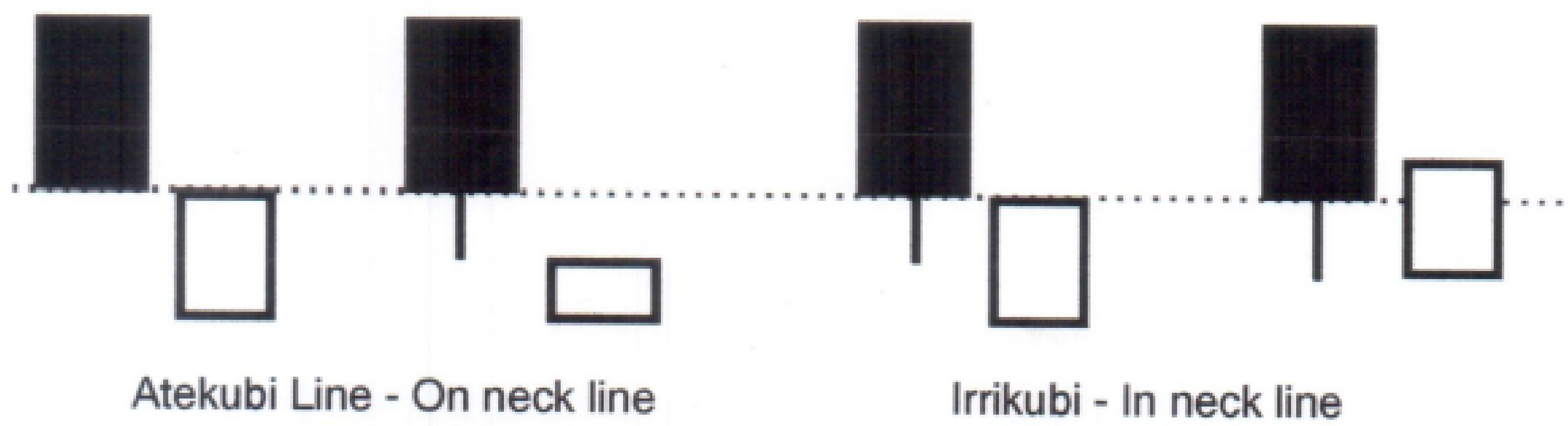
The greater the penetration into the previous 50% period the stronger the signal.

Trading Strategy - Close long positionslgo short when trend reversal confimled.

The importance of a close. well into the previous realbody is highlighted by the 2 d/c

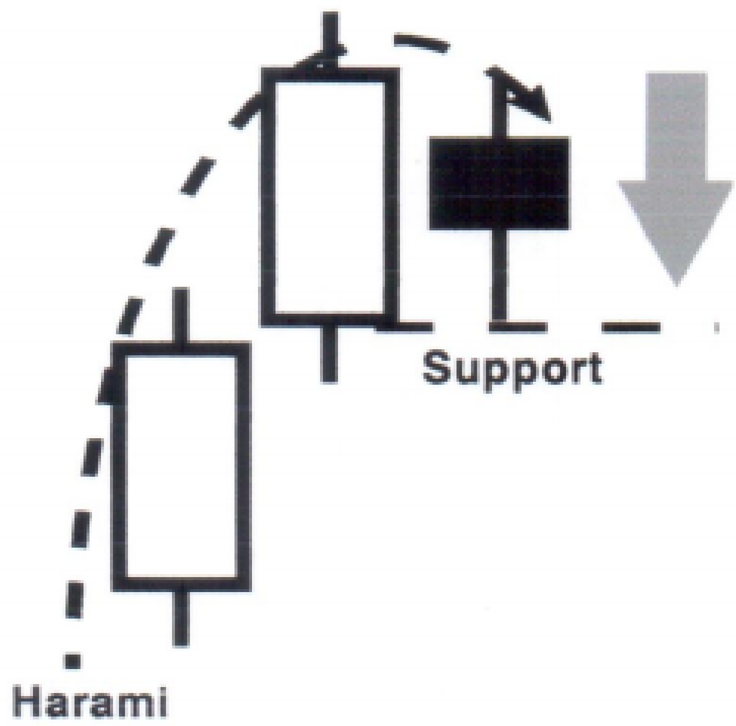


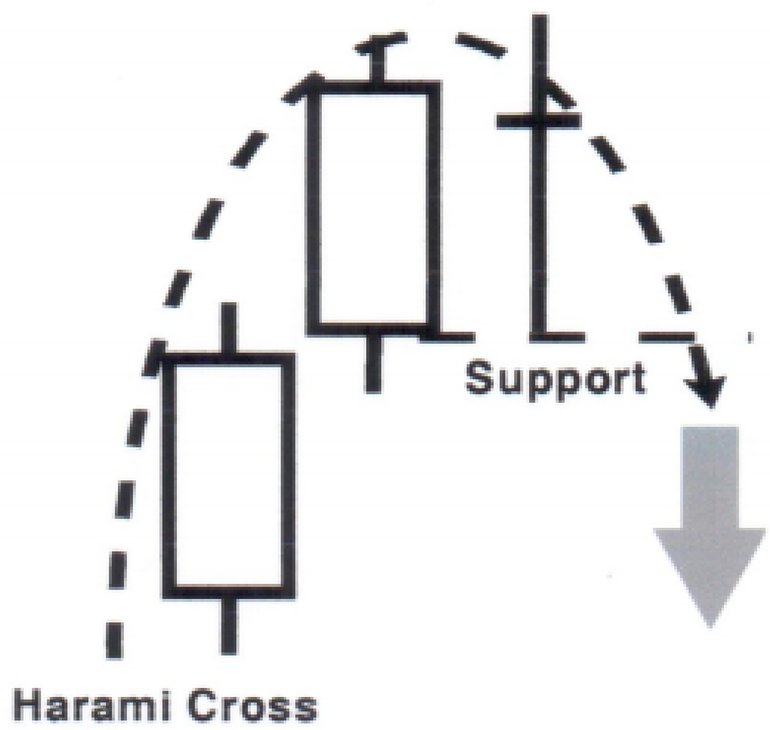
5 Atekubi & Irrikubi Lines



These pattems are variations of the piecing line. They are by nature weaker. The Atekubi is the weaker of the two pattems, and is generally found af ter erratic market moves. Sellers provide strong resistance. The Irikomi line is usually interpreted as a temporary recovery.

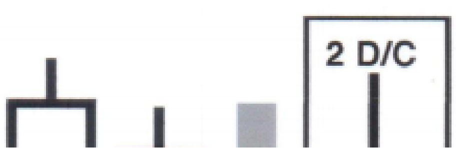
6 The Harami Line

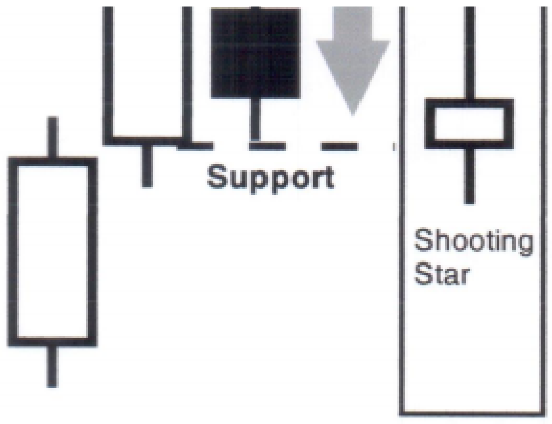




6a The Bearish Harami Line

The Haramiline is also known as an inside day This is because the price action is contained within the previous period's real-body.



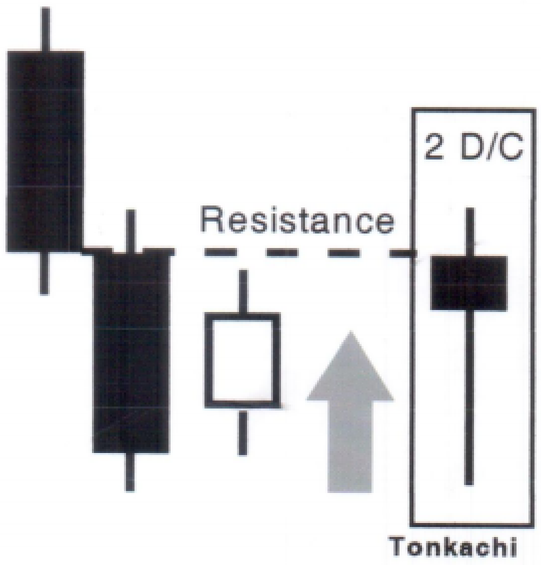


A market must be trending before it can be considered to be a reversal.

The market opens lower than the previous close and becomes corrective as opposed to a reversal signal.

Very often second line is a 'Koma' or spinning top

6a The Bullish Harami Line

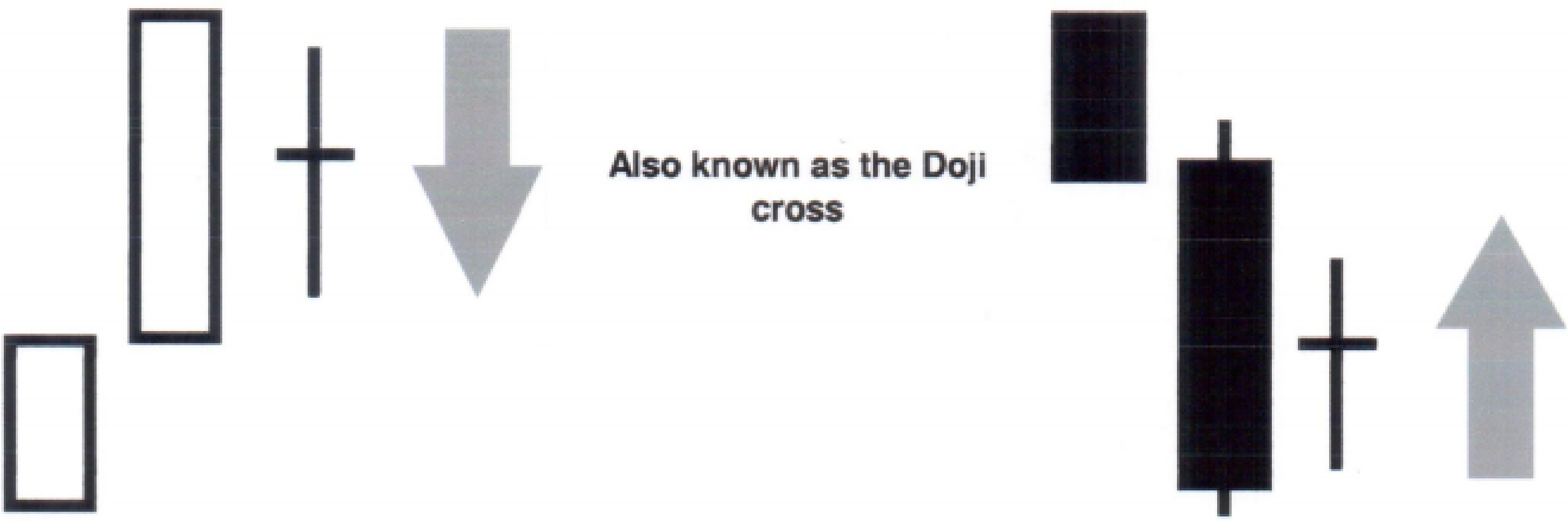


The Harami line does nQ!.m.ake.q new.Hgh so needs tQ be confirmed in the next session if you think that it'ii= heralding a change in market sentiment.

Trading Strategy - Exercise extreme caution when you see one of these pattems, raise your stop-loss level if risk to reward ratio is good enough. If expecting a full trend reversal it is imperative to seek confirmation prior to acting. (This could be a subsequent u/d move).

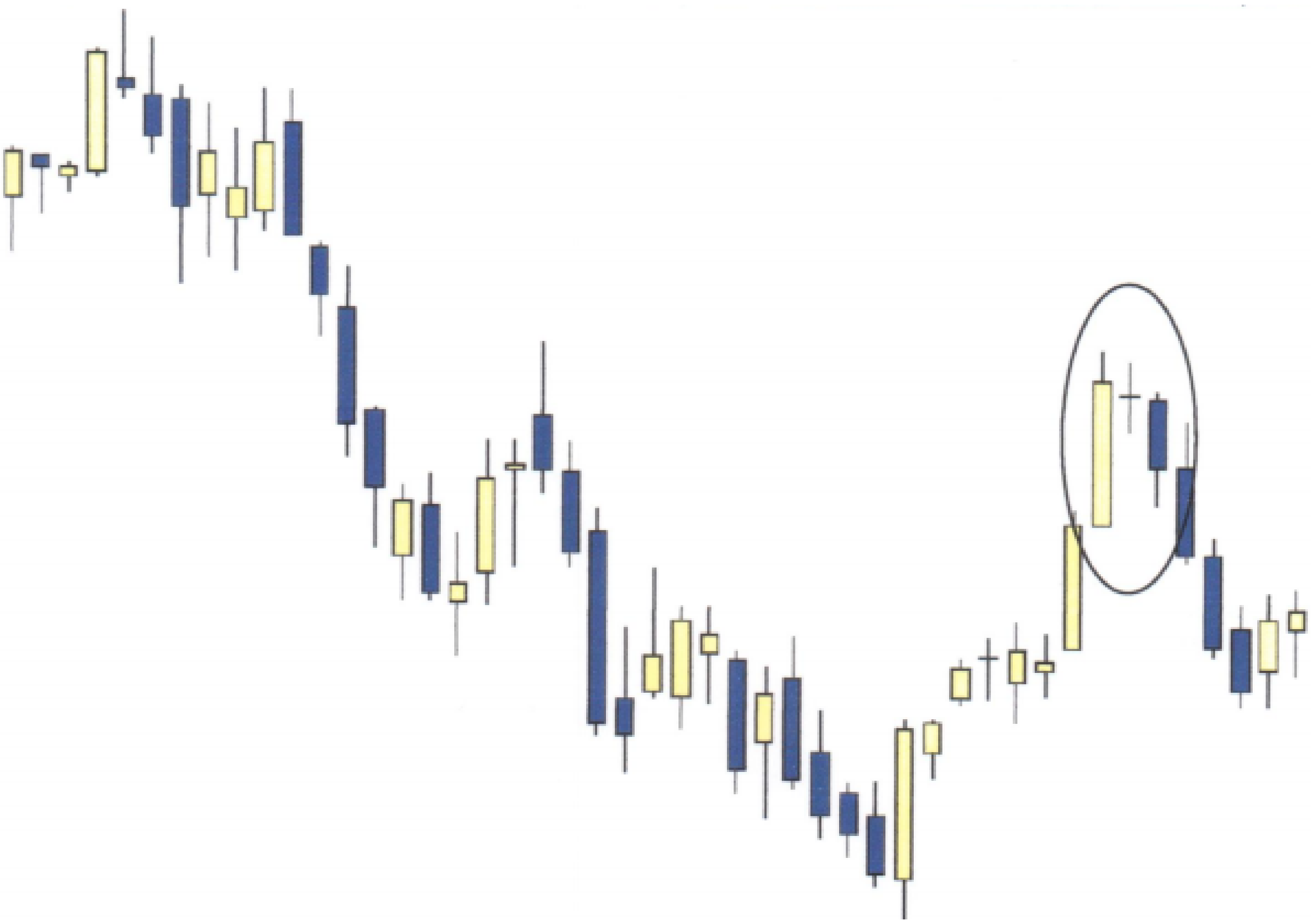
6c. The Harami Cross

Harami Yose Sen



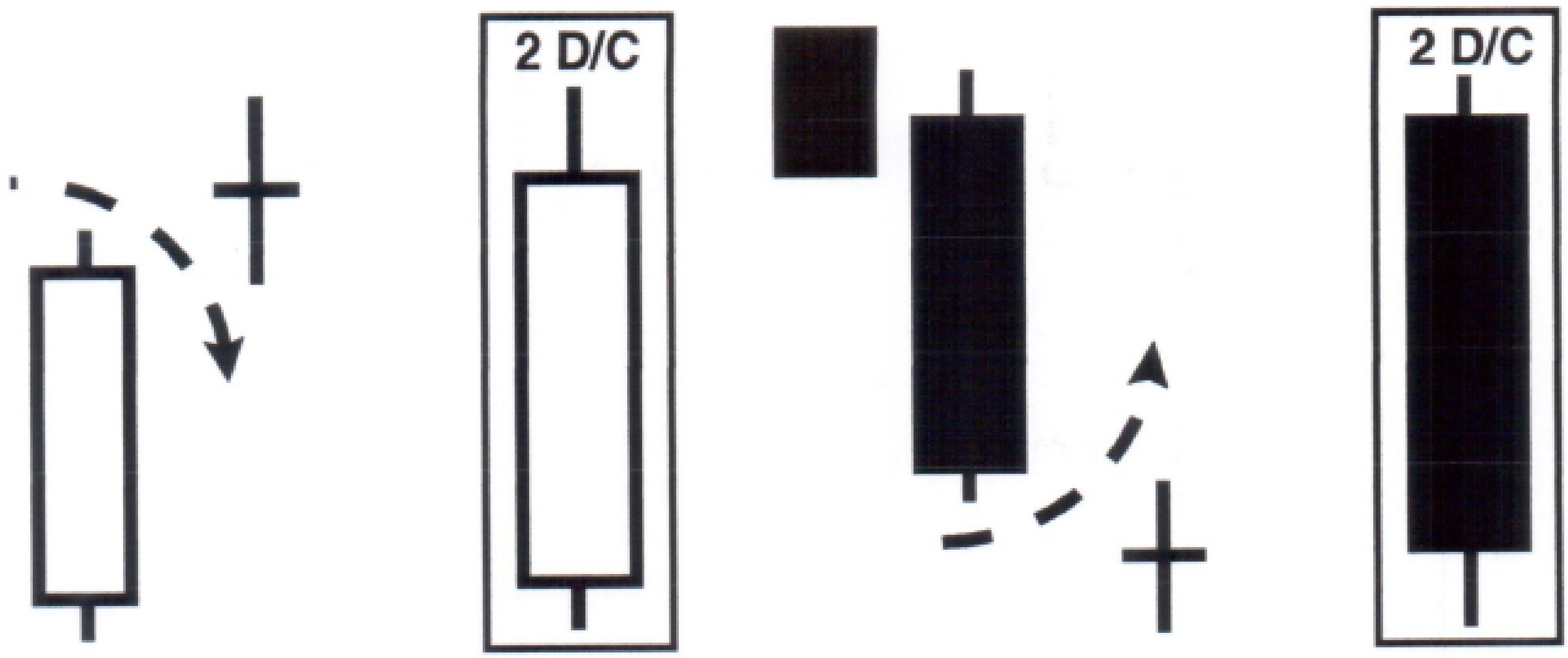
Because the last candle is a Doji this pattem is much more significant than the standard Haramiline. Shadows are excluded (except in the case of Tweezen which willbe covered shortly). Trading Strategy - Close current positions and look for opportunity to stop and reverse where possible

Harami Cross Example

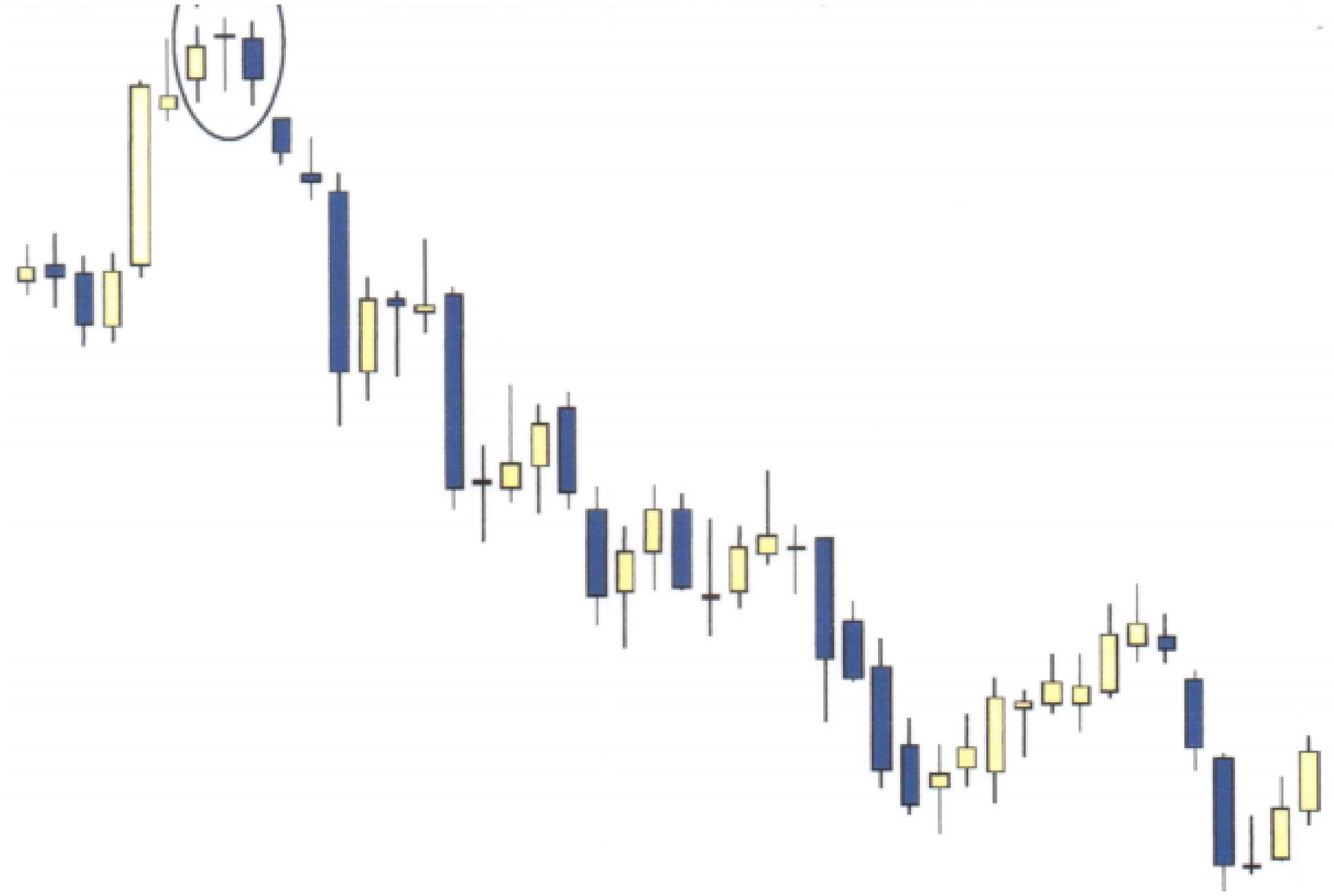


7 The Doji Star

Doji bike

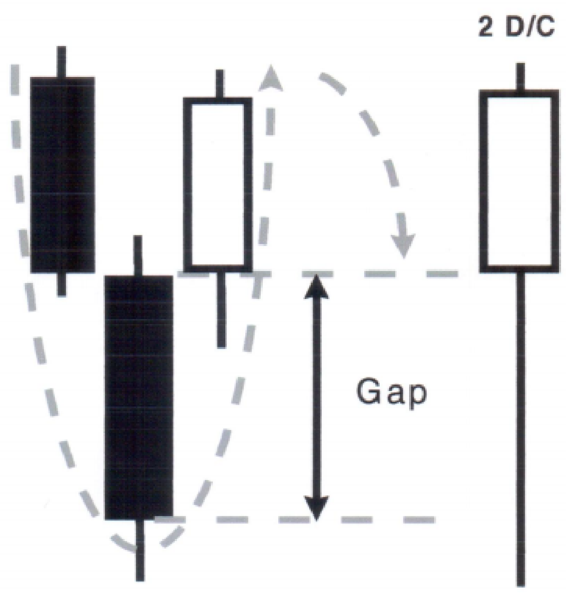


Doji Star Example



8 The Separating Line

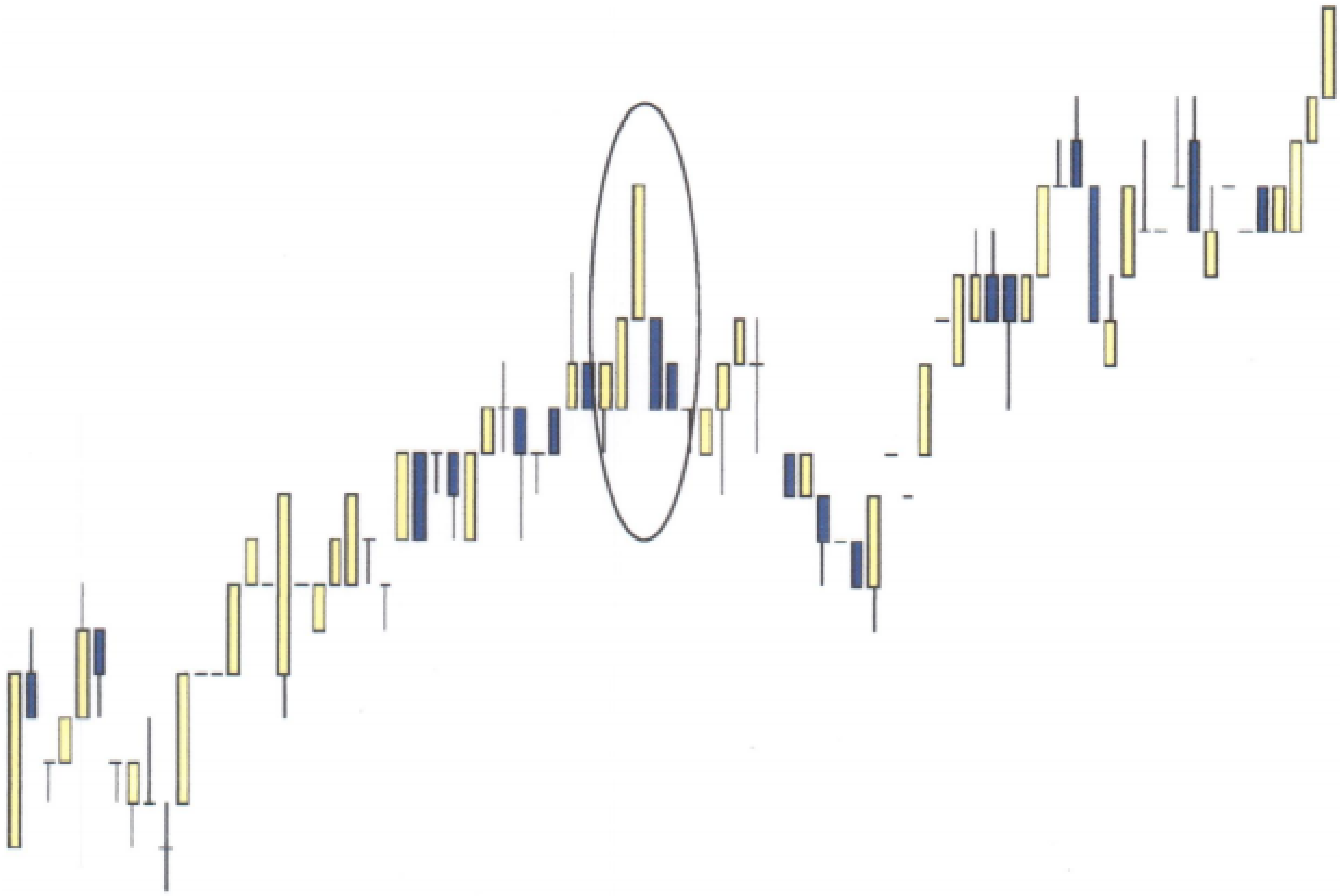
Iki Chigai sen



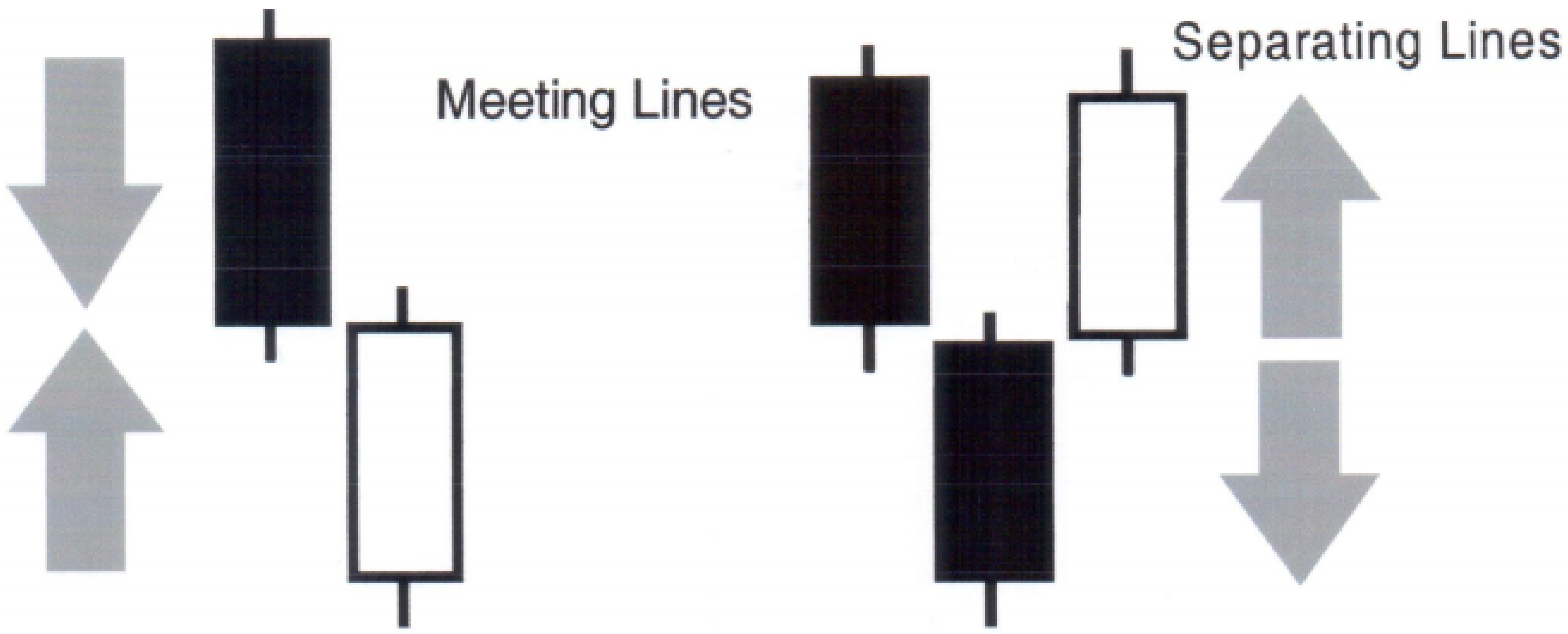
The separating line is a powerful patten and very rare.

The basis for this line starts in a trend. When (as in the example) the market is in a trend and closes lower as expected. The next opening creates a huge counter trend gap and price action closes higher on the aay

Separating Line Example



Separating Line Vs Meeting Line

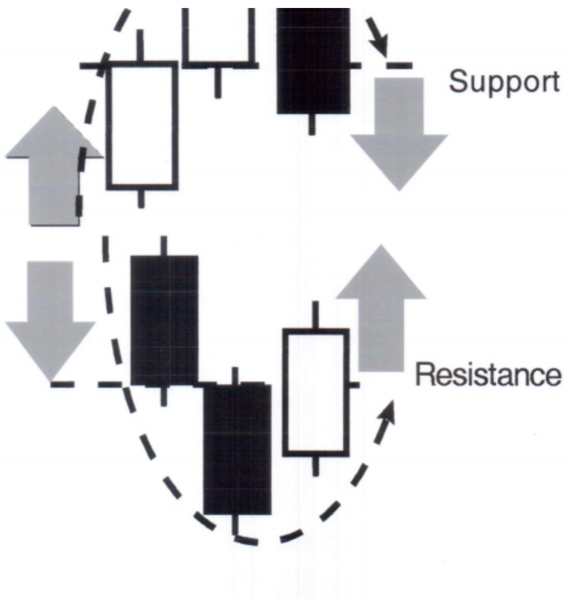


A Separating Line tends to be more explosive at the beginning but tends to correct fairly quickly. Meeting Lines tend to be weaker and the degree of penetration into the previous period move is important

9a Tasuki

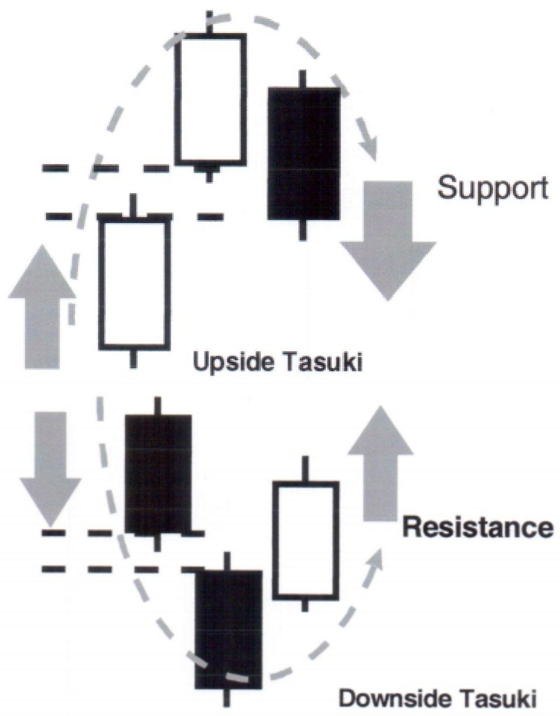
The open of the real-body which opens into the previous days session I haven't found many ref erences to this pattem but it does exist and you should be aware of the Tasuki as FX markets tend to like this pattem.

Shadows are not taken into consideration as we are primarily



concemed by the suggested Harami - but closes lower than the previous session open. This pattem is closely related to the Tasuki Gap. which is a three-line reversal pattem.

9b Tasuki Gap



The Tasuki gap is a fonvn of star, but instead of a spinning top or Doji the gap is preceded by a standard candle. The ambush line is the third confirmation line. which closes the window and forces the change in the trend and sentiment.

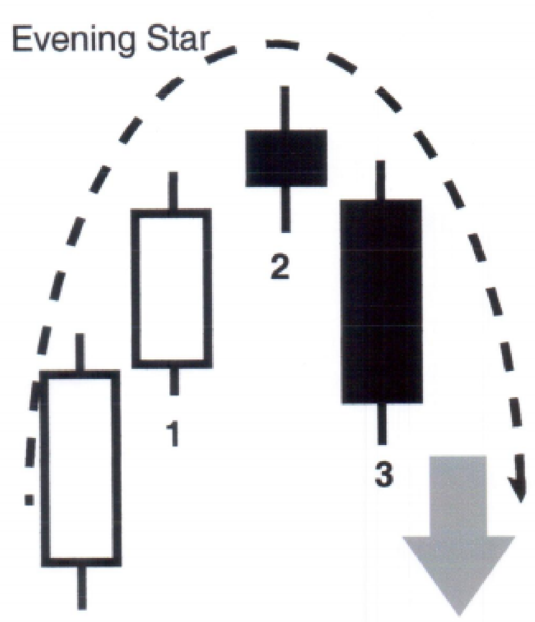
Reversal Patterns

Top Reversal	Bottom Reversal
Doji*** Shooting Star** Hanging Man* Star**	Dojo*** Hammer*** Star**
Bearish Engulfing Pattern*** Tasuki - Gap** Dark Cloud Cover** Harami Lined*	Bullish Engulfing patten*** Tasuki - Gap** Piercing line** Harami line*

NB - The stars indicate the strength of the pattem

Three Day Reversals Patterns

10a. The Evening Star



"Sankawa yoi no myojyo"

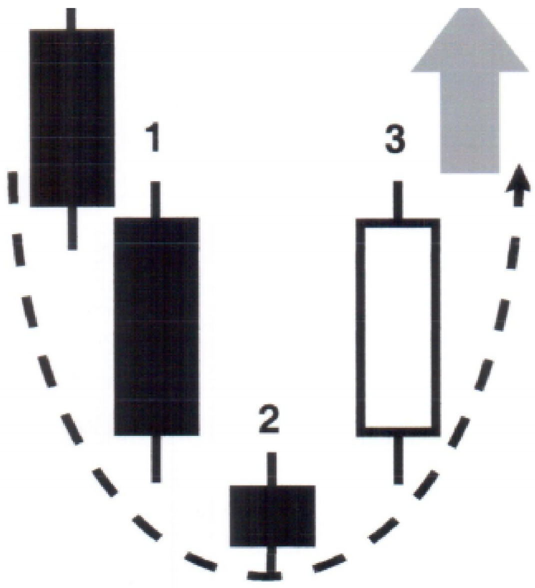
The market has to be trending

The second session is a smallstar that has gapped away from the place action.

The third session is always the opposite colour of session 1.

The related pattem (2d/c) would result in a bearish engulfing line/dark cloud cover so is extremely negative

10b The Morning Star



"Sankawa ake no myojyo"

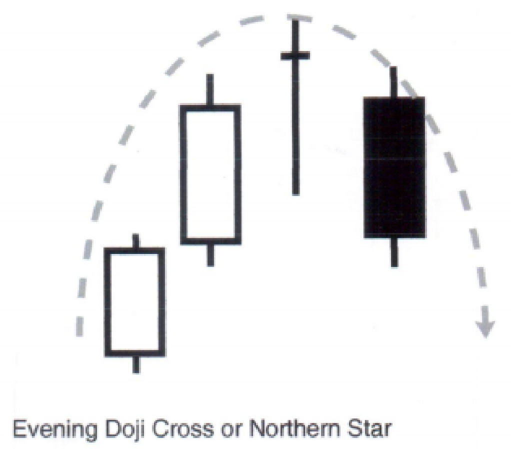
The market has to be trending

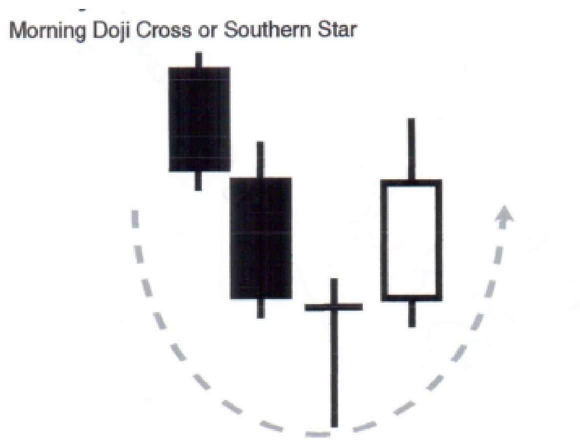
The second session is a small star that has gapped away from the price action.

The third session is always the opposite colour of session 1

The related pattem (2d/c) would result in a bullish engulfing line/piercing pattem, so is extremely bullish.

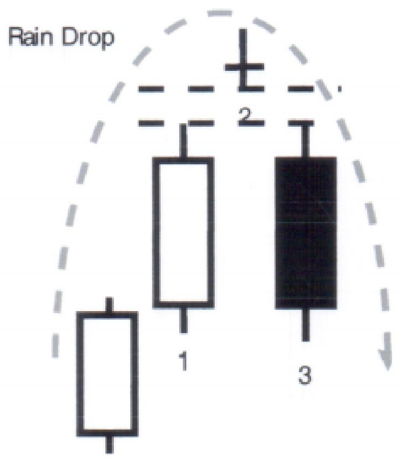
10c The Doji Star

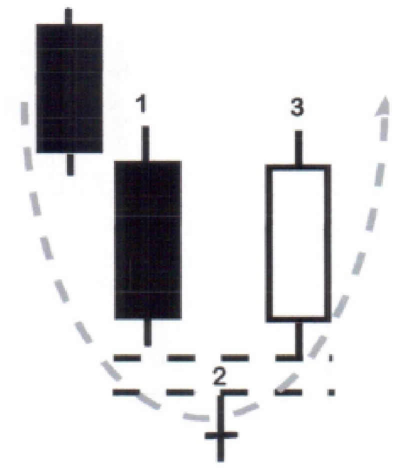




10d Sute Go Rain Drop

Sometimes known as the abandoned baby and is only distinguished by the gap between the Doji star and the last session close. This pattem does not require confirmation and is very powerful.





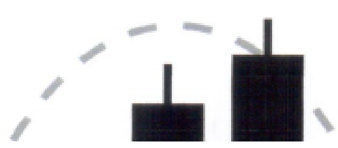
Sute Go Rain Drop Example

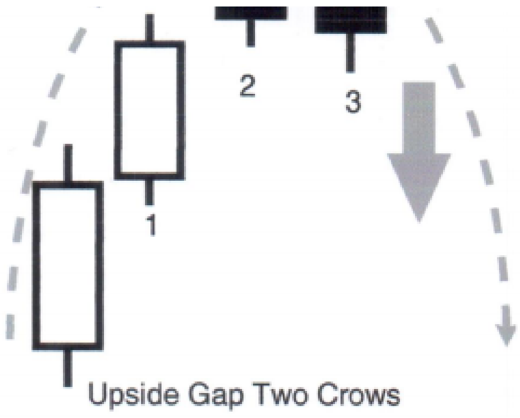
11 Upside Gap 2 Crows

This pattern is extremely rare

Session I is in a downtrend with a lower closing.

Session 2 is a Harami line of sorts but has the lower close so the colour of the real-bodies are the same in sessions I and 2.

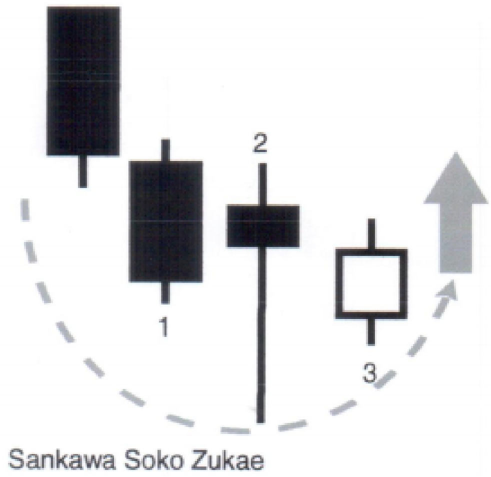




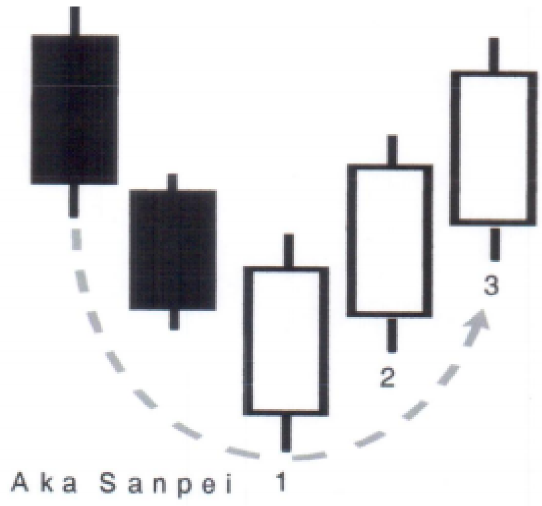
Session 2 has a long lower shadow and in itself is a hammer or Taku ri.

Session 3 is a meeting line sentiment is beginning to change.

13 Three White Soldiers



13. Three White Soldiers



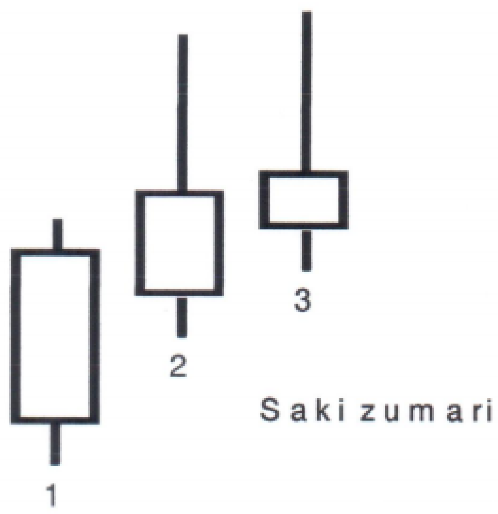
This pattem shows a bullish reversal.

Session 1, 2 and 3 are allbullish standard lines.

Session 1, 2 and 3 are allbullish standard lines. The sessions allopen roughly in the middle of the previous real-body and close higher as bearish sentiment falters

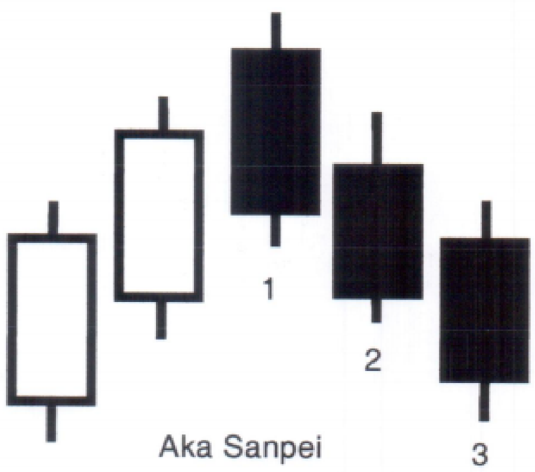
No confirmation is required.

14. Advance Block



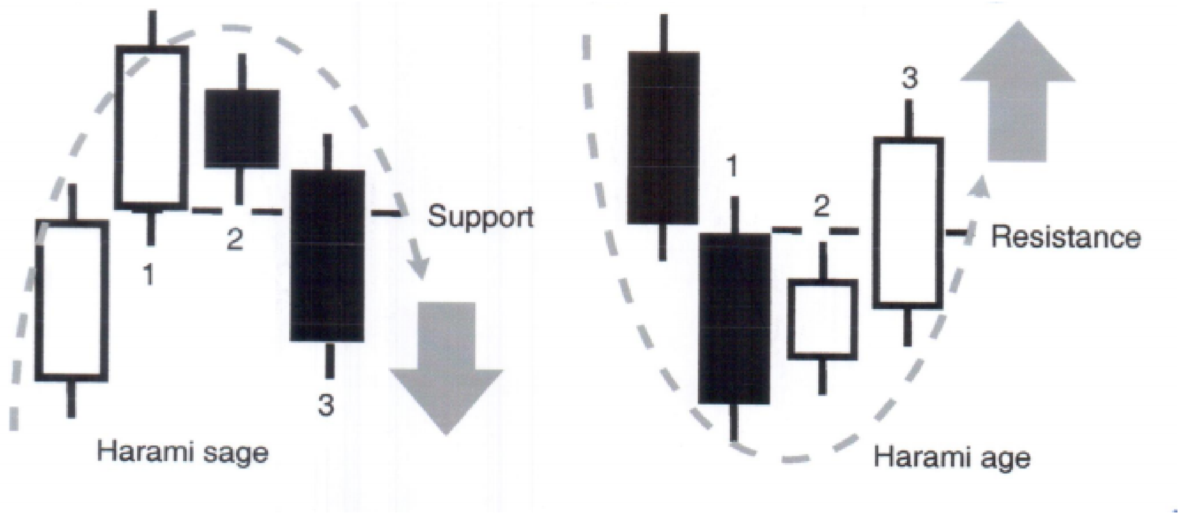
This pattern is potentially a bearish reversaland certainly defines weakness in the current trend. The three white candles in a sustained up trend allopen within the previous session real-body. The advance block is highlighted by the long upper shadows leaning towards a shooting star. Confirmation is required.

15 Three Black Crows

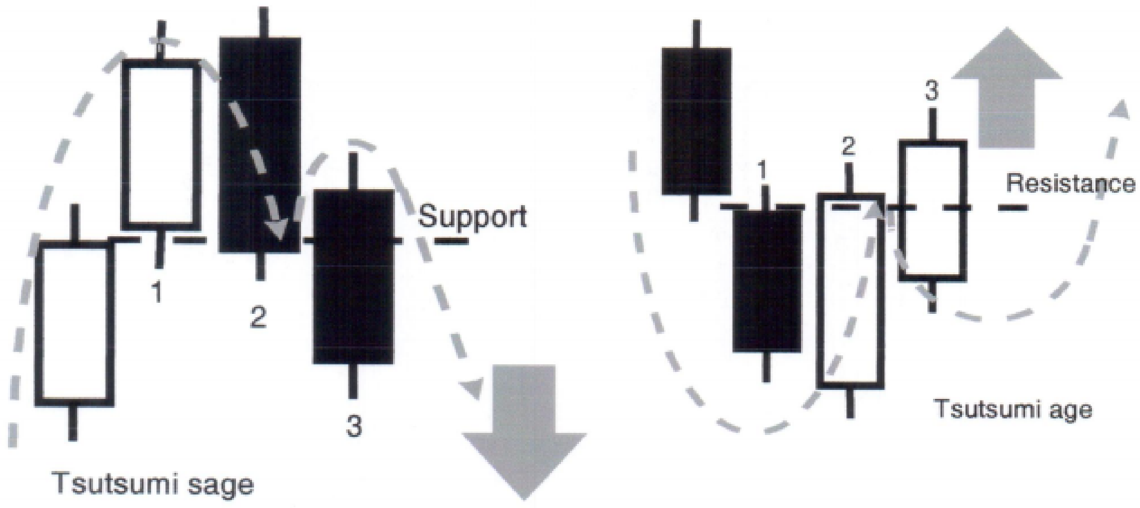


This pattern shows a bearish revenalpattern. Three consecutive down candles are fomied. Each line opens within the previous days realbody and closes on or near its lows, but lower than previous session. No confimlation is required.

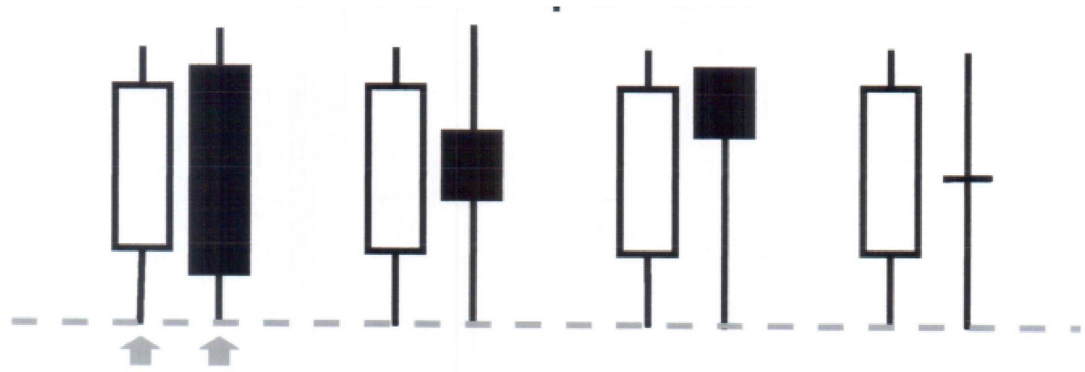
16 The Harami age and Harami sage



17 The Tsutsumiage and Tsutsumi sage

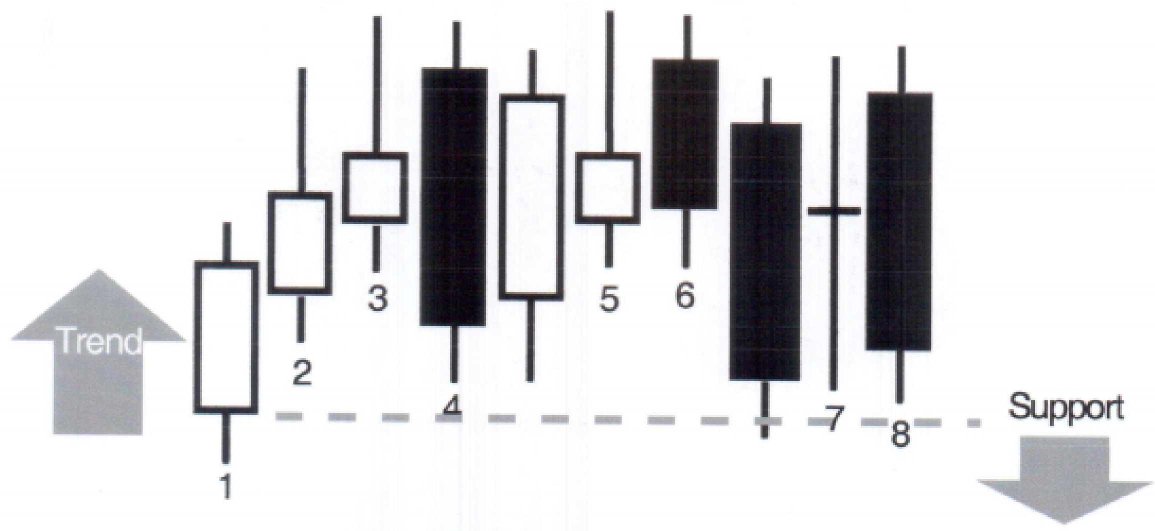


18 The Tweezers Top & Bottom -Kenuki



A Tweezers can be found at a market top or a bottom, and occur where the shadows of two consecutive periods hit the same levelof support or resistance and failto close beyond that level. A tweezers is best used as a confirmation to a reversalpattem i.e.. An engulfing pattem.

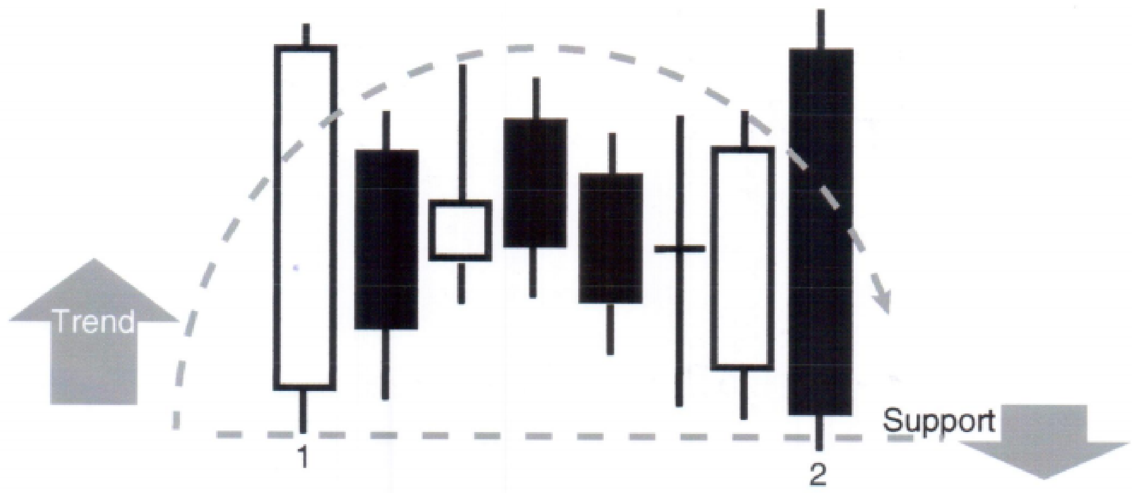
19 High Wave Warning - Takane nochiai



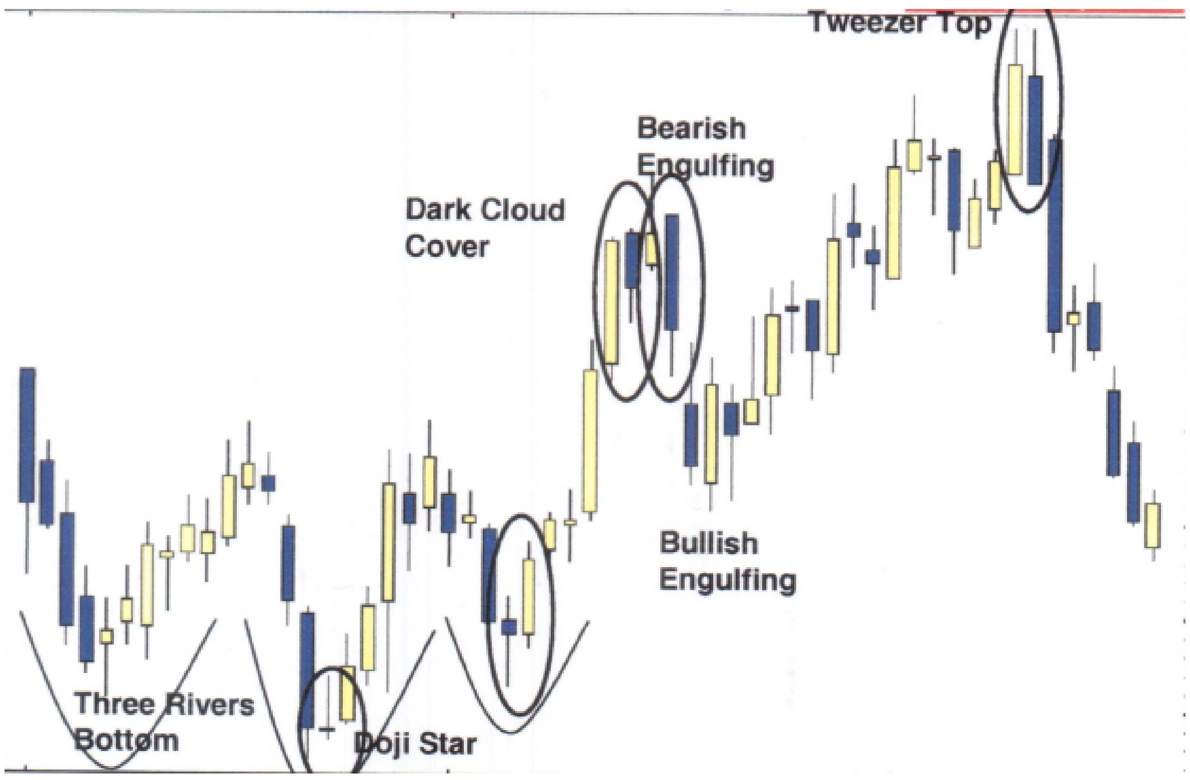
This usually occurs af ter a strong rally; the high wave is made up of a series of spinning tops, dojis and umbrellas.

There are lots of clues to the direction of the breakout, but seek a confirmation line

20 Tower Tops and Bottoms - Ohtenjyou



This pattem would equate to a double top and the break below the support following the second tower and bearish engulfing pattem gives ample waming of the trend reversal.



Chapter 4: Candlestick Analysis

"The Sakata Constitution"

Sokyu Honma 1716 - 1803

The Number Three

Seiki Shimizu wrote in his book, ''Fhe Japanese Chart of Charts', that the number three was very important to the Japanese people, it was said to hold a divine power. The number four was considered to be bad luck.

In Westem culture to a certain extent we have a similar belief, the Japanese expression Sandome no Shojiki is unlike our own saying of three times lucky

In modem day TechnicalAnalysis there are many examples of our use of the number three

Three Trends, Three Gaps, Dow Theory has three phases of trends, Reversal Pattems such as Triple Tops/Bottoms and Head and Shoulders pattems, three types of triangle, three types of continuation pattem etc...

Sakatas Five Methods

Sanku	-	Three Gaps
Sanpei	-	Three Parallel Lines
Sanzan	-	Three Mountains
Sansen	-	Three Rivers
Sanpo	-	Three methods

Sanku

Three gaps, this can be a common occurrence in the Commodities and Future markets.

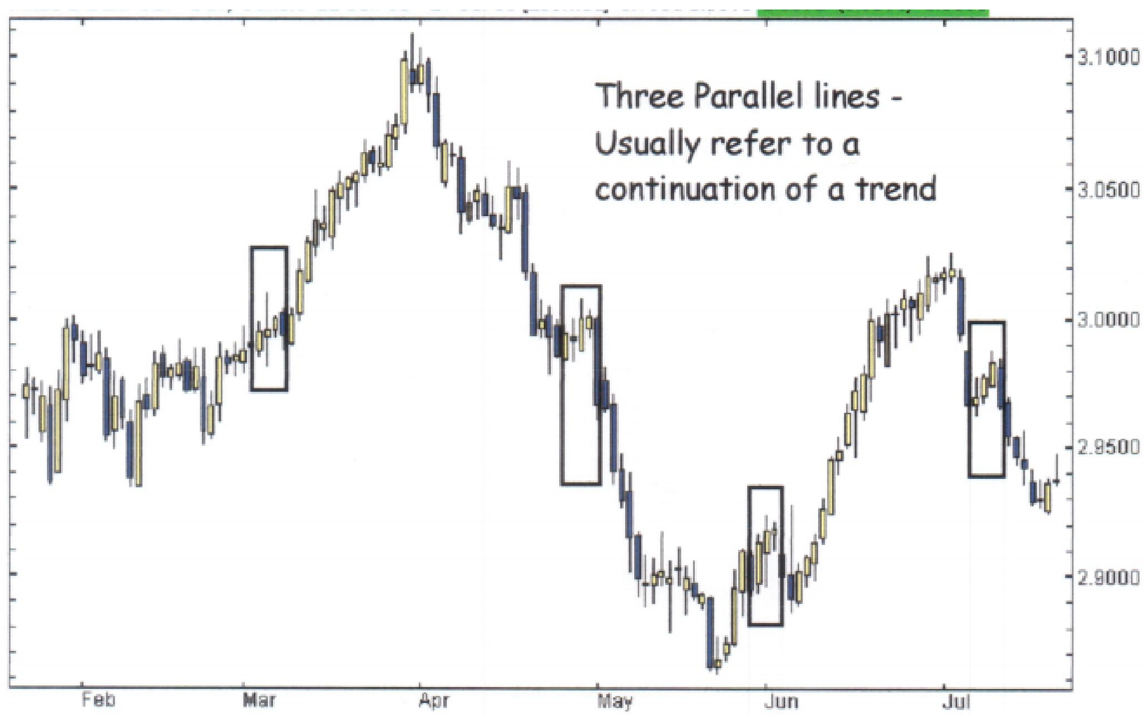
The three common forms of gapping play are the, Breakaway gap, Runaway gap and the exhaustion gap.

Sanku is more precise as it refers to a series of gaps between three consecutive candle lines.

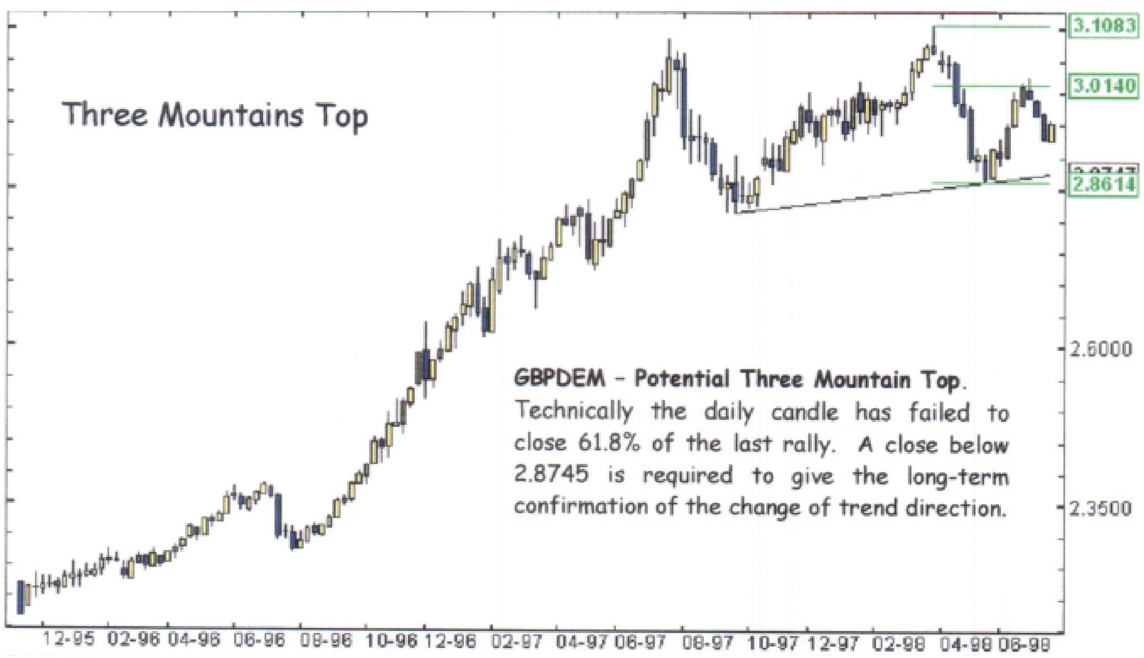
Sanku can be made up of three white soldiers or three crows, but always imply weakness present in the prevailing trends.

Sanku

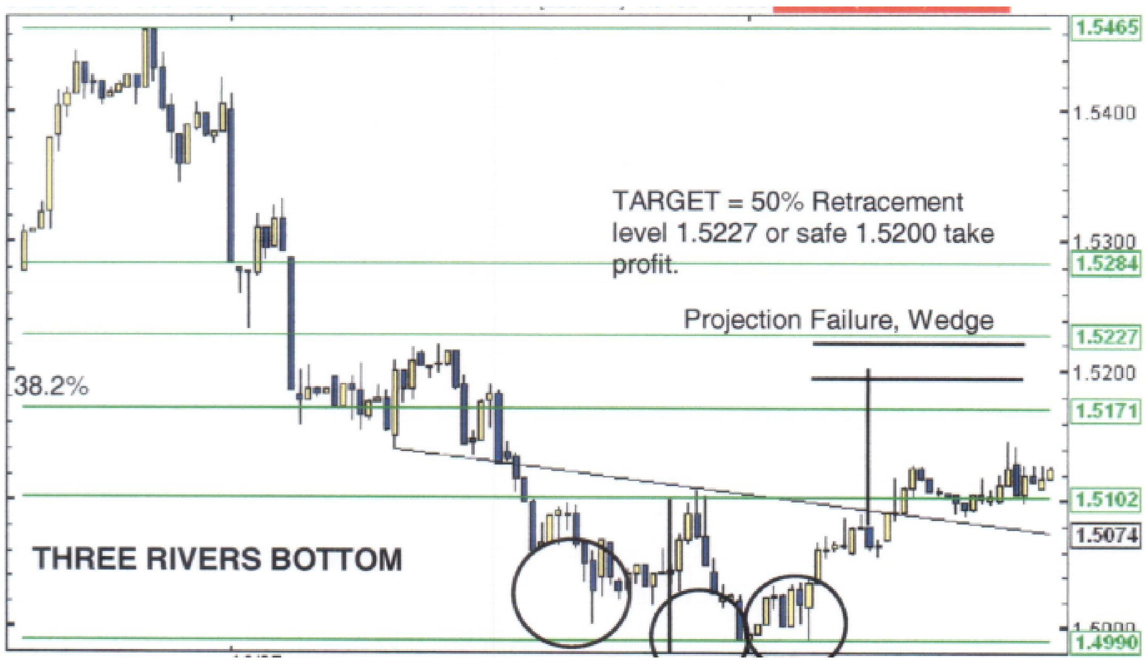
Sanpei



Sansen



Sanzen



Sanpo - Money Management

Three methods

1. When to buy o. Sell
2. When to take profit
3. When to cut a position

Set Your Rules

Oscillators - Ihave always looked at two oscillators - The Slow Stochastic and the Relative Strength Index. lalways use the same parameters for the indicators because Idon't believe in optimisation of an indicator. Instead. Ilean towardsstatisticalanalysis looking solely for consistency over time. It is essentialthat you learn to recognise the strengths and weaknesses of the indicators that you are using

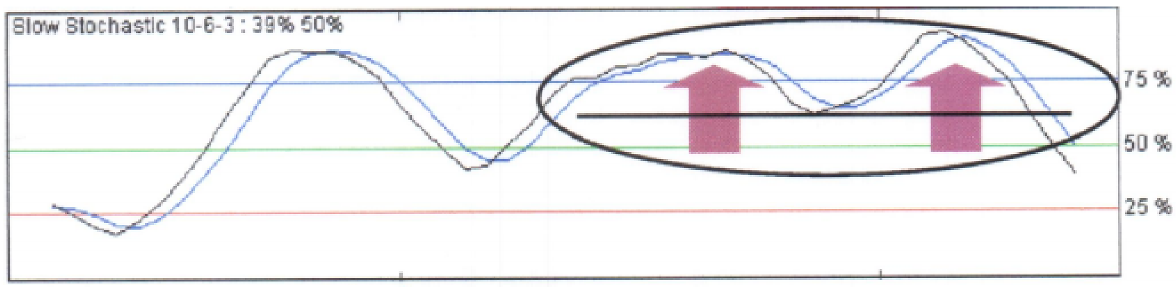
The Parameters that fuse are Slow Stochastic 10-6-3, and RSIof IO

What do look for?

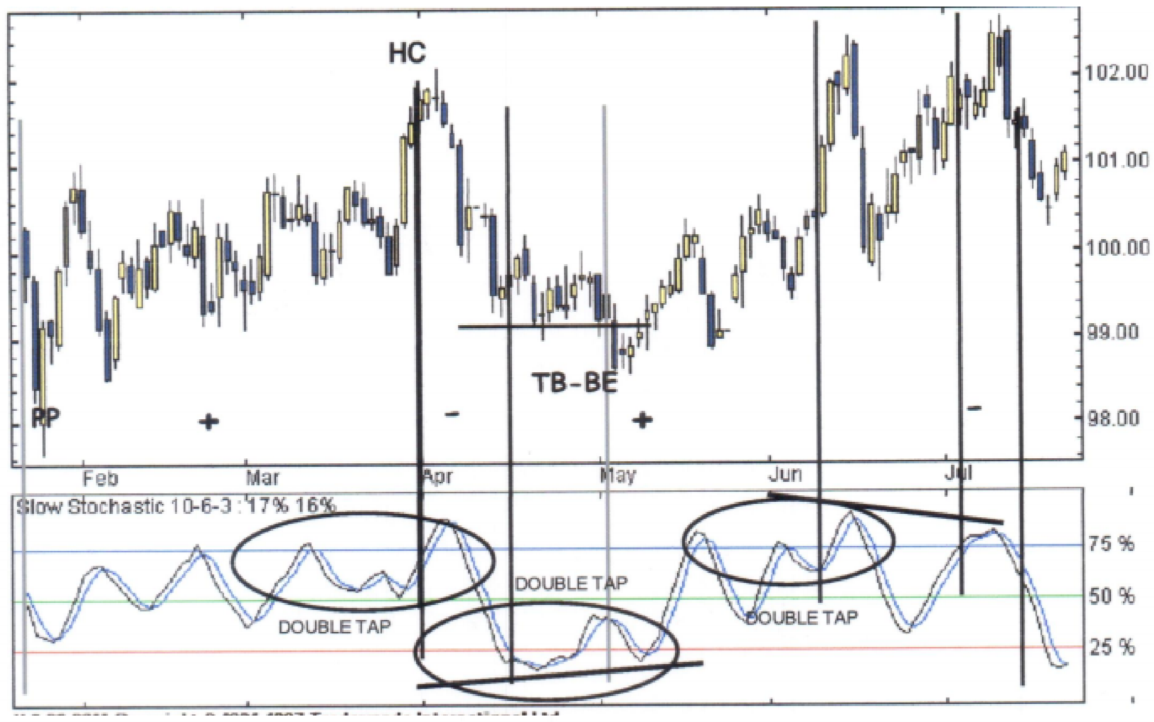
1. A reversal pattem in an extreme zone.
2. Indicator and Price divergence for the longer term trend reversal.
3. The Double Tap.

What is a Double Tap?

A Double tap is a f allure swing - but observations and experience have shown that the swing must remain above the 50% line, and where the second peak is higher. The exception to the second peak rule is where there is obvious price and indicator divergence.



Candlesticks and Oscillators



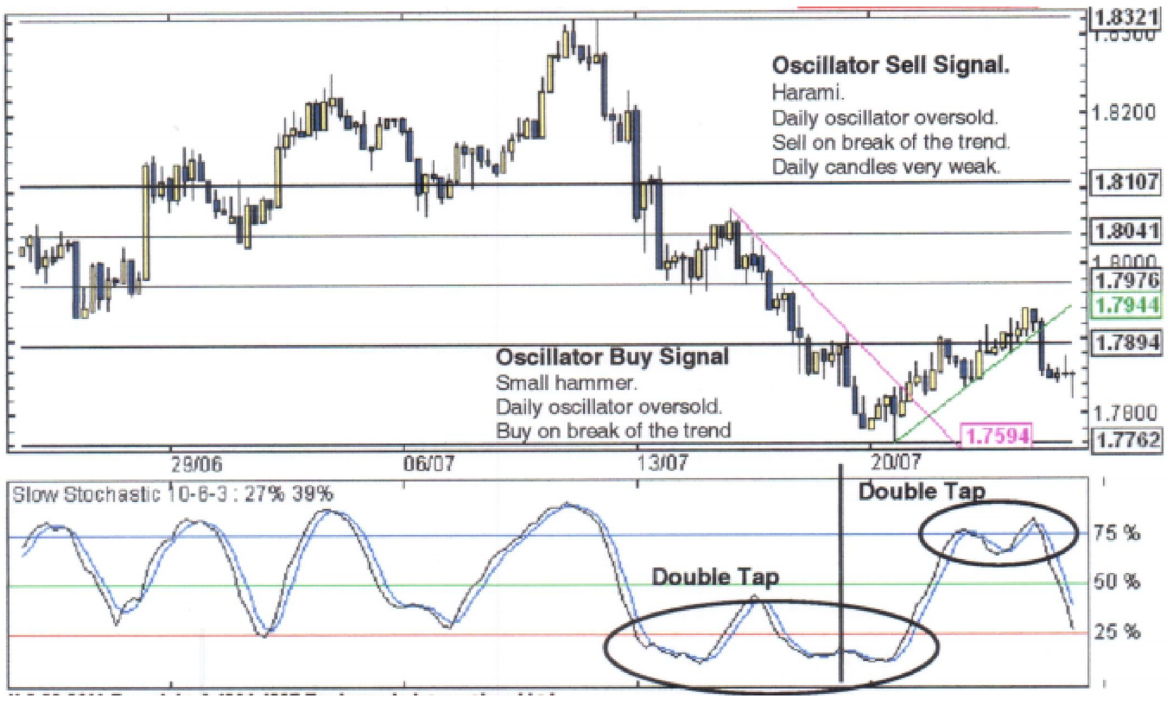
	Piercing Pattern is a bullish reversal signal	**BUY**
Oscillator above 75%	Harami cross Bearish Reversal Signal	**SELL**
Oscillator below 25%	Harami cross Bullish Reversal Signal	**BUY - STOPPED OUT**
Oscillator below 25%	Divergent Reading + Tweezers Bottom + Bullish Engulfing Pattern	**BUY**
Oscillator above 75%	Bearish Engulfing Pattern	**SELL – STOPPED OUT**
Oscillator above 75%	Divergent reading + Strong Bearish engulfing Pattern	**SELL**
Oscillator below 25%	Doji Star	**BUY**

Trading Example

In the last example we can observe the Slow Stochastic oscillator crossing in the oversold zone (below 25%). A lot of people would now consider that from this levelwe should get a reaction

The Candlesticks however show a thrusting pattern - which falls short of the definition of a Piecing line revensalbecause of insufficient penetration into the previous session's real-body. (Irrikubi or in neckline)

The following three sessions are a stalling pattem (Sake zumari) with the three gaps (Sanpo). This indicates a possible bearish reversal contrary to the impression left by the Slow Stochastic, which has crossed in oversold zone. The only time lam a buyer is when a proper reversalsignalis observed or when there is clear price Divergence or a Double Tap.



Oscillator Sell Signal.
Harami.
Daily oscillator oversold.
Sell on break of the trend.
Daily candles very weak.
Oscillator Buy Signal
Small hammer.
Daily oscillator oversold.
Buy on break of the trend
1.8321
1.8200
1.8107
1.8041
1.8000
1.7976
1.7944
1.7894
1.7800
1.7762
1.7594
29/06
06/07
13/07
20/07
Slow Stochastic 10-6-3 : 27% 39%
Double Tap
Double Tap
75 %
50 %
25 %