Chapter 6: Bar by Bar, Ongoing Market Analysis

We now move on to ongoing analysis.

Remember – The analysis we have conducted so far is just our initial assessment of the likely future order flow direction. We will be updating this assessment bar by bar as new data unfolds. The advantage to this is that if we are wrong, we will be able to see it in a very timely manner, allowing us to reassess and adjust our expectations. And if we are right be prepared for any trading opportunity that will present, as price follows our expected path.

Ongoing Market Analysis – Theory

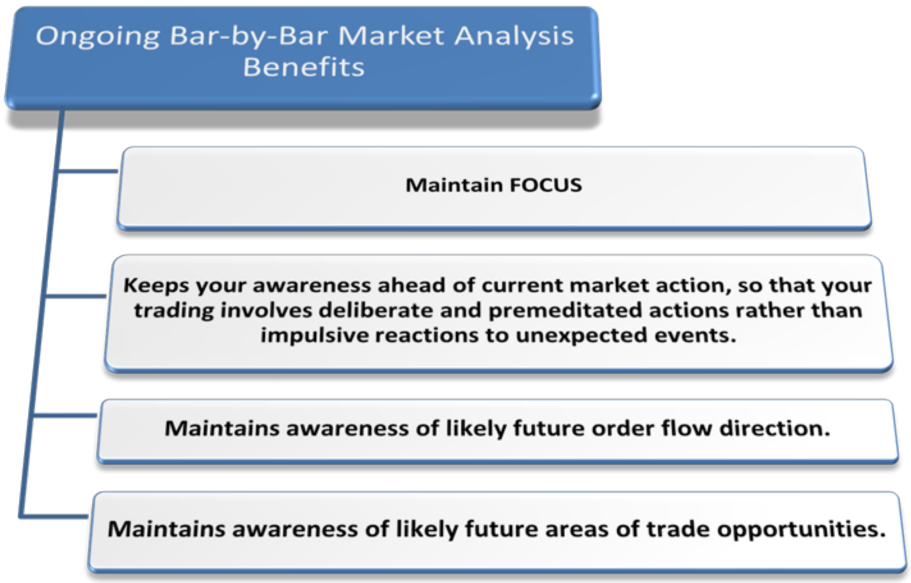
Our initial analysis resulted in an initial assessment of future order flow. Ongoing analysis requires a bar by bar reassessment of our previous analysis, as more price action unfolds on the right hand side of our charts.

New data will arrive, one candle at a time. Each new candle being a source of information; most of which will offer nothing new or relevant; but some of which will alter our analysis, either strengthening or weakening our assessment of market sentiment and future order flow.

Every new candle is potentially significant.

Failing to monitor price with each new candle means we will be forced to be reactionary – surprises by price action developments and chasing price after they've become obvious.

Ongoing monitoring ensures we maintain focus and maintain situational awareness – staying ahead of the current price action – assessing where it's likely to travel, how that will impact the decision making of other traders, and where that will create trading opportunities.

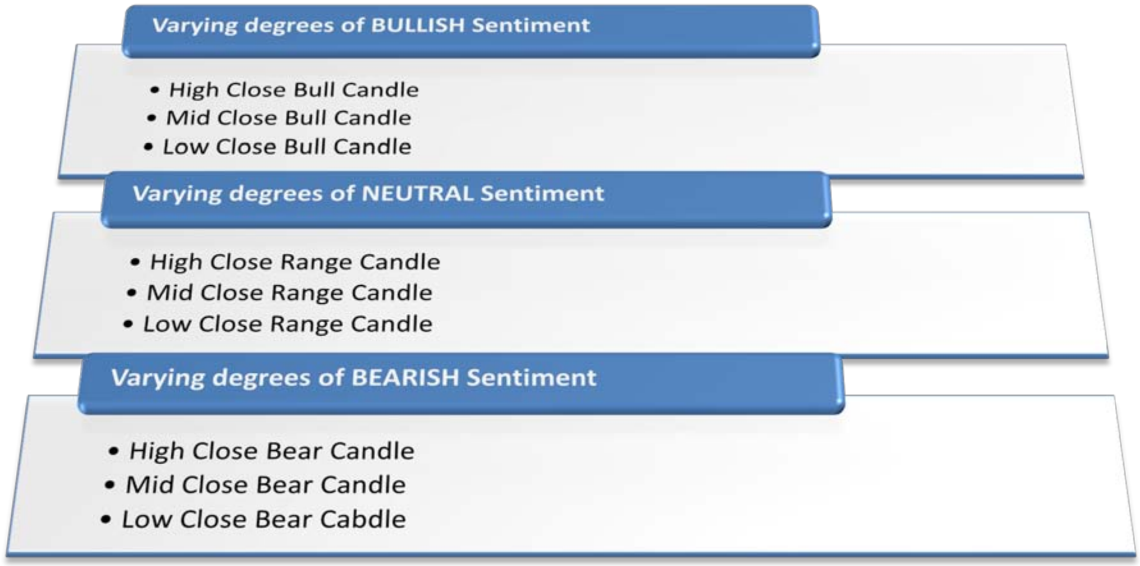


Ongoing price analysis can be conducted on all timeframes; however our main interest is with the trading timeframe. We question every candle, to determine what it means with regards to the shift in sentiment between the bulls and the bears; and whether or not it changes our expectation for the future.

This is a step by step process, the first part of which is assessing the sentiment of the current candle pattern.

Determine Candle Pattern Sentiment

We define each candle as one of nine types, as demonstrated below in the candle classification and sentiment chart.



Candle Classification and Sentiment

Classifying the candle in this way gives us an immediate feel for the sentiment of the short-term candle pattern.

All Bull Candles are bullish, but the sentiment varies slightly depending on its close position (high, mid or low).

All Range Candles are neutral, but the sentiment varies slightly depending on its close position (high, mid or low).

And the same applies to Bear Candles, which are bearish, although varying slightly in sentiment depending on their close position (high, mid or low).

The classification is made through observing the following characteristics of the latest candle:

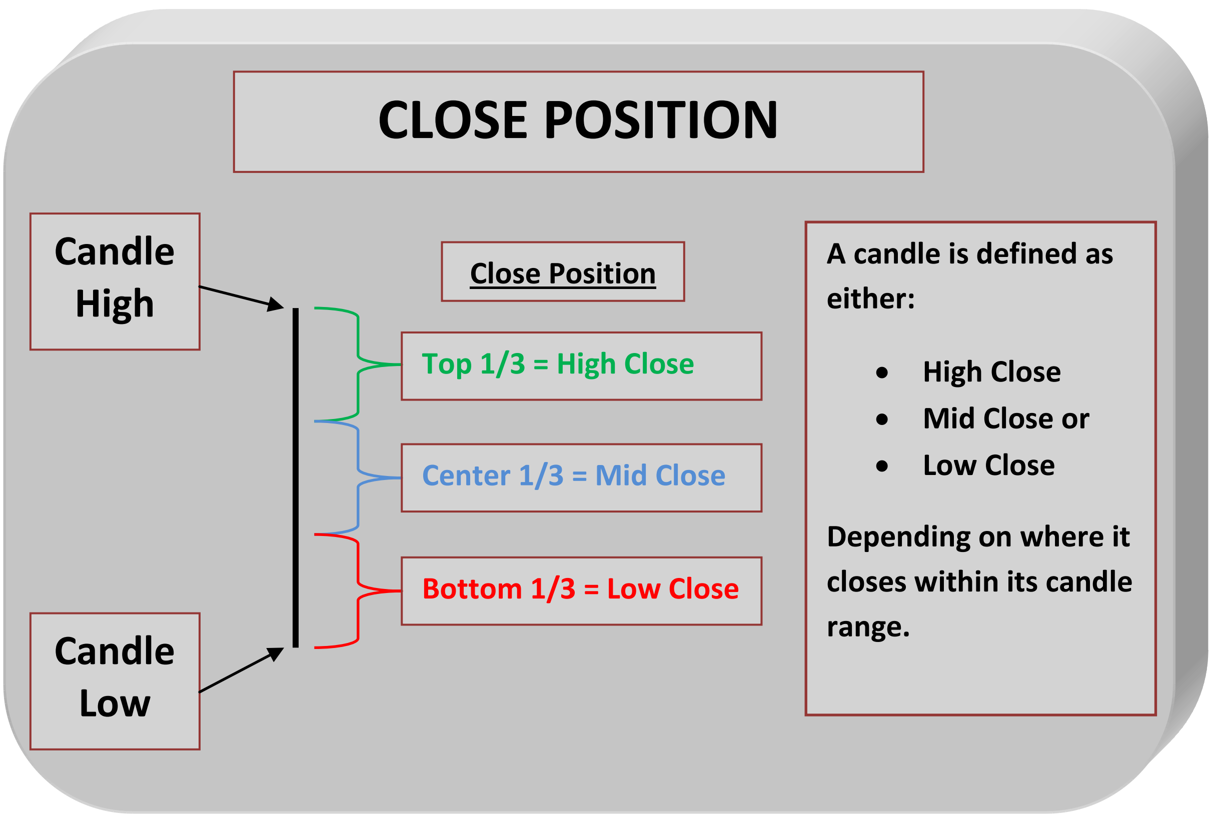
- Close Comparison
- Close Position

Let's learn how to read candles in a way that I consider superior to standard candlestick analysis...

Close Position

The close position allows us to determine the sentiment of a single candle.

We define a candle as a High Close candle, Mid Close or Low Close candle, depending on where price closes within its high to low range.



A **High Close Candle** is one in which the closing price is within the upper third of the candle's range. Examples of high close candles are demonstrated via candles (a) to (f) in the chart below. Note that all candles close in the upper third.

A high close candle displays bullish sentiment, for the period of that candle. However, you'll note different degrees of bullishness within each candle. For example, comparing (a) and (b) we see that (b) was able to drive prices higher from its open, showing very little resistance from the bears, whereas (a) initially fell from its open before being able to fight its way back higher. Candle (a) is potentially a little less bullish than candle (b).

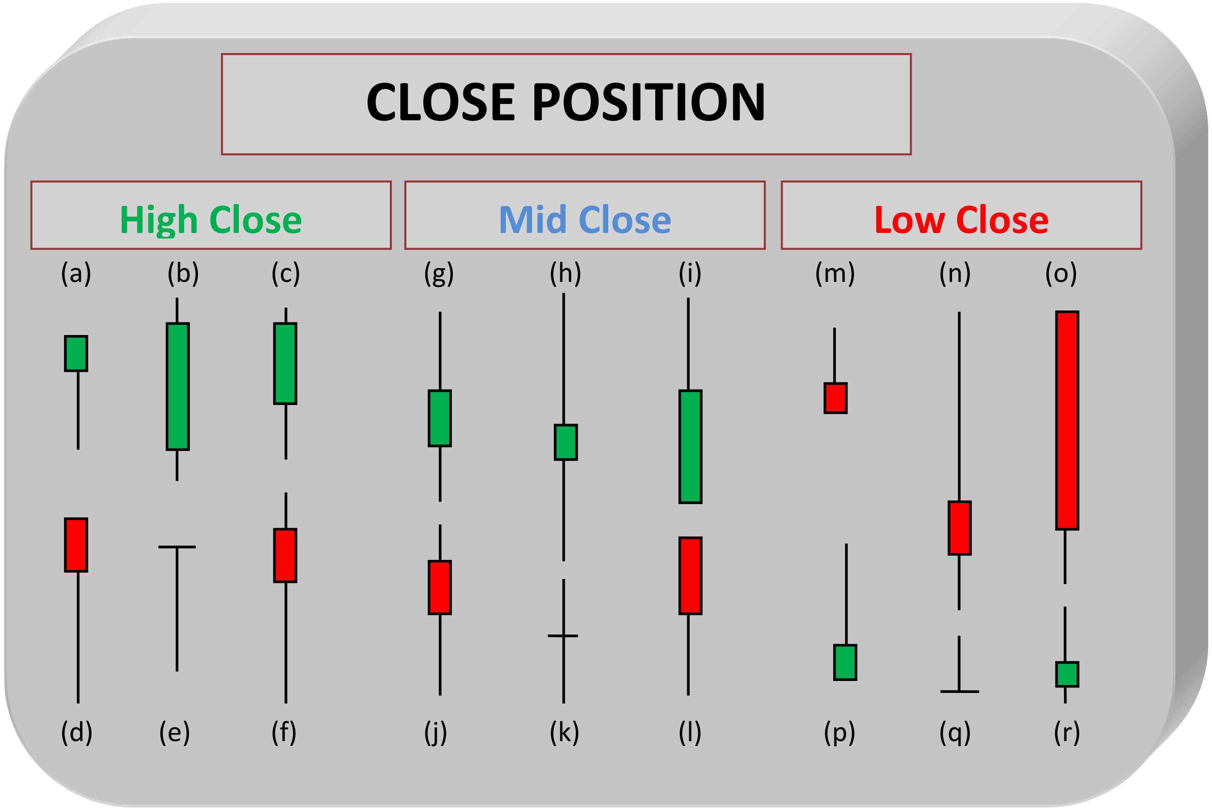
All of these candles from (a) to (f) are bullish; with a small difference in the degree of bullishness.

A **Mid Close Candle** is one in which the closing price is within the middle third of the candle's range. Examples of mid close candles are demonstrated via candles (g) to (l) in the chart below.

The sentiment of a mid close candle is considered more neutral, as price has been driven both higher and lower, before closing somewhere mid range.

Note again the slight difference in sentiment between the candles. Although all are neutral, (i) for example is more on the bullish side of neutral when compared with (l) which is on the bearish side of neutral.

The chart on the following page shows the above referenced closed position examples.



Close Position – Examples

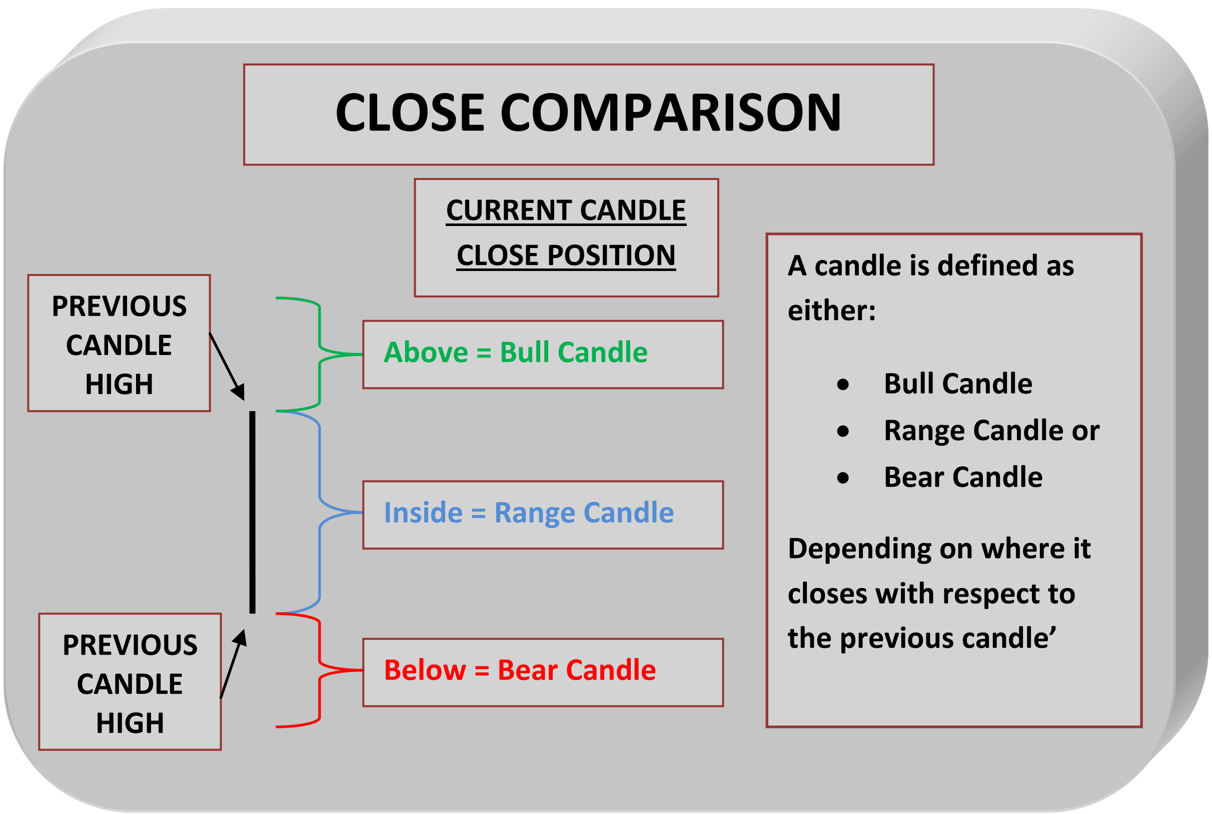
A **Low Close Candle** is one in which the closing price is within the lower third of the candle range. Examples of low close candles are shown in the chart above as candles (m) to (r).

The sentiment of these candles is bearish. Again note the slight difference in sentiment. While all indicate bearish sentiment, candle (m), for example, was only able to achieve a narrow, while candle (o) demonstrated significant bearish pressure which drove price down a significant distance.

Observing and classifying the candle in accordance with the Close Position, provides us with a quick assessment of the sentiment of that individual candle – bullish, neutral or bearish. And the path taken by price within the candle creates slight variations in the degree of bullish/neutral/bearish sentiment.

Close Comparison

We define a candle as a Bull Candle, Range Candle or Bear Candle, depending where price closes with respect to the previous candle's range.



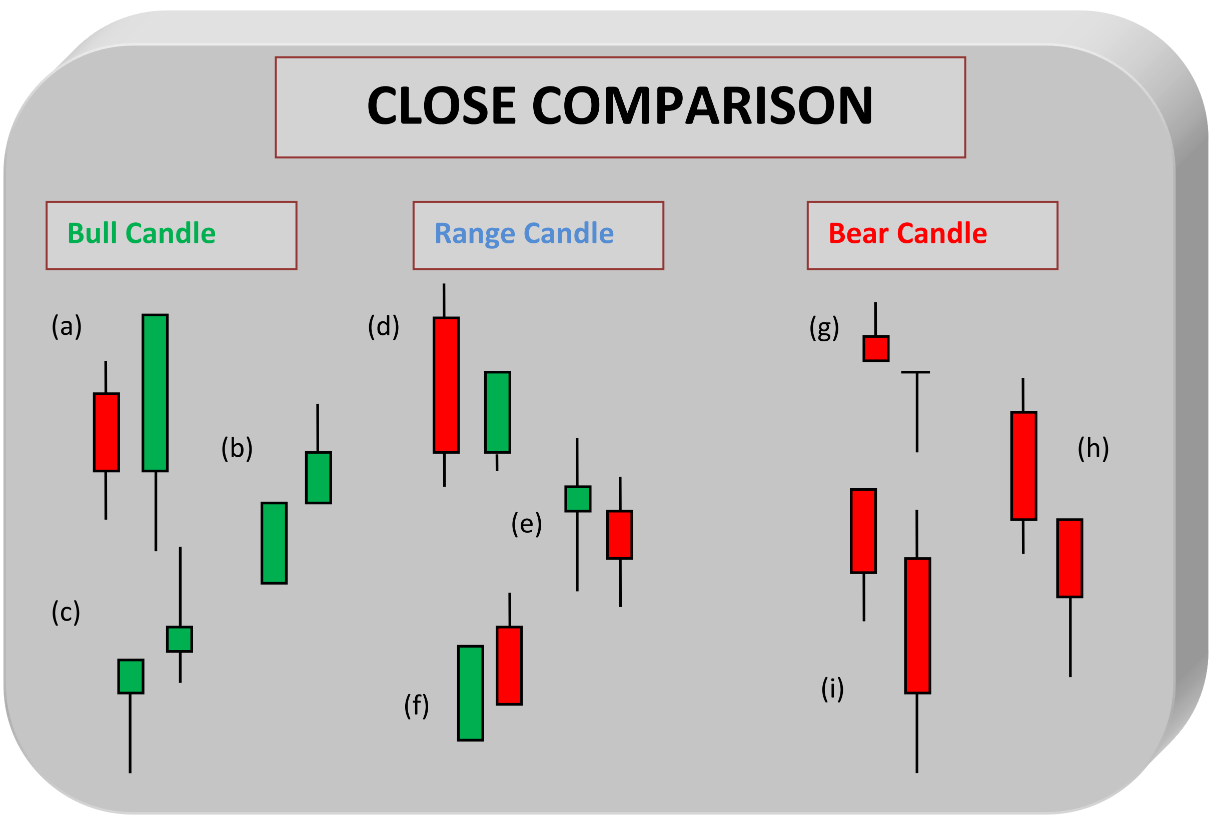
Close Comparison – Definition

A **Bull Candle** is one which closes above the range of the previous candle's range. This is demonstrated via (a) to (c) in the examples shown below. Note that all three candles close above the high of the previous candle. A Bull Candle is considered to be displaying bullish sentiment.

A **Range Candle** is one which closes within the range of the previous candle. This is demonstrated via (d) to (f) in the example below. Note that all three candles close within the range of the previous candle. A Range Candle is considered to be displaying neutral sentiment.

A **Bear Candle** is one which closes below the low of the previous candles range. This is demonstrated via (g) to (i) in the examples below. Note that all three candles close below the low of the previous candle. A Bear Candle is considered to be bearish sentiment.

Close Comparison – Examples



Determining Pattern Classification and Sentiment

Let's determine the sentiment of the latest 2-candle pattern. The starting point is simple. We look at the close comparison:

- Bull Candle = bullish 2-candle pattern sentiment
- Range Candle = neutral 2-candle pattern sentiment
- Bear Candle = bearish 2-candle pattern sentiment

The Close Position (single candle pattern) will then be considered in order to determine the different degrees of bullishness or bearishness.

Refer back to the example on the previous page.

While (a) to (c) all demonstrate a Bull Candle, and therefore bullish pattern sentiment, there are varying degrees of bullishness in each, which become obvious when adding in the Close Position to the pattern definition.

Candle (a) is what I refer to as a **High Close Bull Candle**. Both the high close and the bull candle components represent bullishness. Combined, these two indicate strongly bullish sentiment.

Compare this with (b) which shows a **Mid Close Bull Candle**. Price once again closed above the prior candle, but this time with a neutral close at mid-candle. Although still bullish, sentiment is less bullish than example (a).

In (c) we see a **Low Close Bull Candle**. Yes, it closed above the previous high, but higher prices were clearly rejected driving prices to close near the low of the last candle. We have bullish sentiment (bull candle) combines with a bearish sentiment (low close). This is a weak bullish move.

Combining our close position analysis with our Bull Candle provides us with varying degrees of bullishness.

The same concept applies for our Range Candles, demonstrated via examples (d) to (f) above. A range candle on its own implies neutral sentiment, but by also considering the Close Position we gain some greater insight into the varying nature of that neutral sentiment.

Looking at (d) for example, we see a **High Close Range Candle**. The latest candle is a high close candle, closing right on the highs. Individually this appears bullish, but comparing it with the previous candle we see the fact that the high close candle is simply retracing approximately 50% of the previous strongly bearish low close candle. Combined, this is probably slightly on the bearish side of neutral.

Likewise with example (f), a **Low Close Range Candle**; this combination is more on the bullish side of neutral.

While example (e), a **Mid Close Range Candle**, is clearly neutral with price testing higher and lower twice now before settling closer to mid-range of both candles. Neither side is showing dominance.

A Bear Candle is one which closes below the lows of the previous candle. On the surface, that sounds bearish, but the degrees of bearishness will vary when also considering our Close Position analysis.

Example (i) is a **Low Close Bear Candle**, demonstrating extremely bearish sentiment, as both the Close Position and the Close Comparison components imply bearishness.

Contrast that with example (g), a **High Close Bear Candle**, which has clearly rejected the lower prices and closed up at its highs. Still bearish, but showing some signs of bullish order flow opposing our bearish sentiment. This 2-candle pattern displays weak bearish sentiment.

Whereas example (h) is somewhere in-between, demonstrating a **Mid Close Bear Candle**. Once again we have some bullish order flow pushing price off the lows and opposing our bearish sentiment, but to a lesser degree than example (g).

The next step… considers our 2-candle pattern sentiment in the context of our current market price action.

But What About Candlestick and Price Bar Reversal Patterns?

If you are a fan of candlestick reversal patterns, or bar reversals, take note of these as well. They're an excellent way to determine sentiment. My goal, through defining every candle based upon its Close Position and Close Comparison, is to have you assessing sentiment after every candle. Reversal patterns don't allow you to do this. For this reason, I believe this form of analysis is superior to simple candlestick analysis.

Candle Pattern Sentiment Wrap-up

The process of ongoing price action analysis starts with determining the sentiment of current candle pattern. We do this through the process of analyzing the Close Position and the Close Comparison applicable to that pattern.

As demonstrated in the previous examples, this is a quick and effective process that should tale no longer than a couple of seconds.

It provides us with a feel for the short term sentiment of the current candle pattern. Who is in control of price – the bulls or the bears? And to what degree are they in control?

Consider the Context

"Consider the Context" means we consider where the current price pattern appears with respect to the background market environment and price action, and what that means.

The same patterns have numerous meanings, depending on where it occurs in the market.

In considering the context of background market structure and price action, I primarily look at where price is in relation to three main areas – the location within the S/R structure, the location within order flow, and where we are in reference to key swing highs and lows.

Every occurrence of every pattern is unique.

By placing the pattern into context of background structure and price action, we are ultimately attempting to gain a feel for how it impacts upon strength and weakness of the underlying order flow, and how that might impact our expected future order flow.

While many of the elements of a price pattern can be objectively seen on a chart, determining the influence that pattern will have on the future order flow direction is a purely subjective process.

You will get this feel through questioning what you see on the charts.

Where is price in relation to S/R? Where is it in the order flow? Where is it in relation to key swing highs and lows? And what does this mean?

Support and Resistance

- Where is the pattern occurring with respect to higher timeframe support and resistance?

- Has the market shown strength or weakness on approach to the S/R area? Is the current candle pattern sentiment continuing this strength or weakness, or has something changed?
- Is the pattern showing signs of order flow opposing the move into S/R, such as tails rejecting price at or near the S/R level?
- Has the pattern breached the area of S/R? If so, is it now showing signs of acceptance or rejection of this new area?

Order Flow

- Where is the pattern occurring within current order flow?
- Is it on an extension? Is it early in the move, or late and overextended? Has it projected past the previous swing high/low?
- Is it on the pullback? Is it early in the move, or has it continued deeper than anticipated? Is it a single swing pullback, or is this a pattern part of a multiple swing retracement?

Swing Highs and Lows

- Is price testing any areas of swing highs or lows? Of particular impotence are those which lead to a change of order flow definition; how is price reacting at those swing highs or lows?

For an uptrend:

- Pullbacks to previous areas of swing low support should be watched closely. We expect them to hold. Is price action showing signs of the level holding, or is it threatening to break? If it breaks, is price showing signs of rejection (opposing order flow / difficulty continuing) or is price accepting this new area?

- Pullbacks to previous swing highs (within an uptrend) are not as critical, but should still be watched for their reaction.
- Extensions are expected to break the previous the previous swing high. Is price action supporting that premise, or is the candle pattern showing weakness? If it can't exceed the previous swing high, we need to be alert for further signs of weakness which may forecast a complex correction or reversal.

For a downtrend:

- Pullbacks to previous areas of swing high resistance should be watched closely. We expect them to hold. Is the price action showing signs of the level holding, or is it threatening to break? If it breaks, is price showing signs of rejection (opposing order flow / difficulty continuing) or is price accepting this new area?
- Pullbacks to previous swing lows (within a downtrend) are not as critical, but should still be watched for their reaction.
- Extensions are expected to break the previous swing low. Is price action supporting that premise, or is the candle pattern showing weakness. If it can't break the previous swing low, we need to be alert for further signs of weakness which may forecast a complex correction or reversal.

For a sideways trend:

- Is price testing a range boundary?
- Has the market shown strength or weakness on approach to the boundary? Is the current candle pattern sentiment continuing this strength or weakness, or has something changed?
- Is the pattern showing signs of order flow opposing the move into range boundary, such as tails rejecting price at or near the level?

- Has the pattern breached the area of ranges/R? If so, is it now showing signs of acceptance or rejection of this new area?

Does it Support our Premise?

Having considered the sentiment of the pattern, and where it is occurring with respect to our market structure, we now ask whether or not it supports our premise?

By premise, I refer to our expectation for future order flow and the price action that would support that order flow.

Is the pattern meeting our expectations for future price action?

- Yes… We await the next candle.
- No… Decide whether to hold for the next candle, or to reconsider from the start of our Initial Market Analysis.
- Unsure… Just wait… There will be a new candle along shortly.

You'll know when something is not right – the price action will surprise you.

Expecting a slow crawl into an area of resistance, you'll suddenly see a strong impulse right through the area closing on its high.

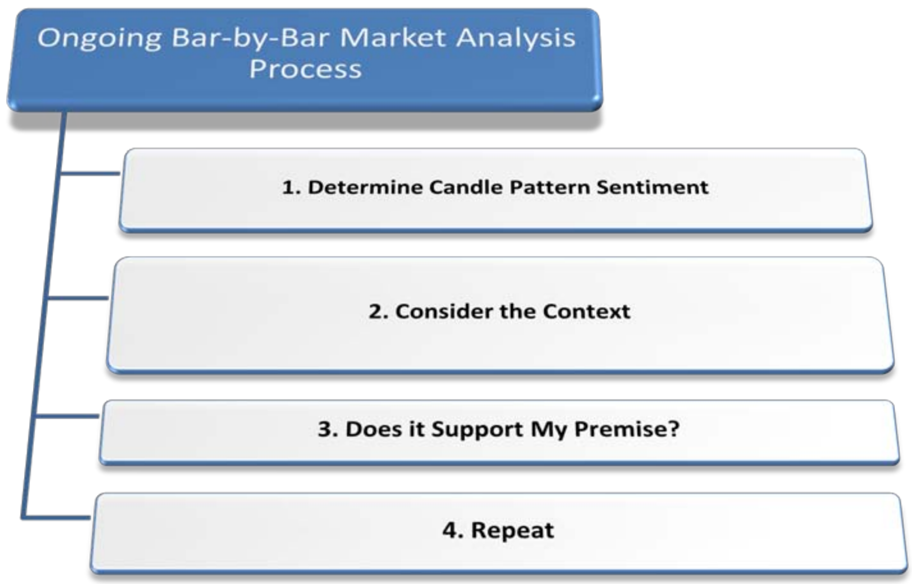
Expecting a breakout of a level, you'll observe a second failure to push through the level. Unexpected weakness!

Expecting continuation of an uptrend, the next price extension stalls at the previous swing high, showing unexpected bearish order flow.

Evidence of something surprising does not necessarily invalidate your plans for future price order flow – but it should put you on high alert and have you watching the following price action closely.

I'll now summarize the process and provide a checklist, as I did with the Initial Analysis.

Ongoing Market Analysis Process Summary



Ongoing Market Analysis Process

Ongoing (Bar by Bar) Market Analysis involves a four step process, as per the figure above. The following checklist will walk you through the actions required for each step.

Ongoing Market Analysis Checklist

Step 1 – Determine Candle Pattern Sentiment

Classify the candle pattern and determine the short-term sentiment.

Actions:

- Classify the candle pattern.
  - High / Mid / Low Close
  - Bull / Range / Bear Candle
- Determine the sentiment of the pattern.

Step 2 – Consider the Context

Every pattern is unique and MUST be considered in the context of the background market environment in which it occurs.

Actions:

- Where is the current price action in relation to key structure features:
  - Support or Resistance
  - Order Flow
  - Swing High and Lows
- What does this mean with respect to the sentiment of the pattern and the potential future price action?

Step 3 – Does it Support My Premise?

Is the market action continuing as expected, or is something indicating we're out of sync with market flow?

Actions:

- Does the current price action and sentiment support our previous expectations of future price action?
  - Yes
    - Await further price information.
  - No
    - Decide whether to hold for the next candle, or to reconsider the Initial Market Analysis.
  - Unsure
    - Wait for further price information.

Step 4 – Repeat

Actions:

- Repeat the process as new information appears on the chart.

KEEP IT SIMPLE

As with the initial analysis process, this ongoing analysis has taken many pages to describe. However, what may appear to be quite a complex process is in actual fact quite simple to perform.

My analysis has developed over the years as an intuitive process.

The complexity appears as a result of trying to get the essence of that process into writing, in as reproducible form as possible.

Once again, the ongoing analysis should take no more than maybe 10-15 seconds. Any more than that and you're trying too hard to find certainty, where there is none.

Experience will rapidly improve your ability to read market flow. And in time you'll do so without checklists. In the meantime, use them as a prompt.

- You already have an expectation of where price is going.
- Is the latest price action supporting that premise, or does it need to be reconsidered?

That's the two sentence summary version of "Ongoing Bar-by- Bar Market Analysis".

Keep it simple! And as before, don't be afraid to get it wrong. This ongoing analysis will be self-correcting.

Practice

Market Analysis should be practiced as much as possible. The practice never ends, as there is always more to learn. It's a process of constant growth and personal development, as we gain more experience in reading the flow of the market through years and years of exposure.

- Experience leads to a better read and a more accurate assessment of future price direction.
- A more accurate assessment of likely future price direction leads to better identification of trade opportunity.
- Better identification of trade opportunity leads to greater profitability.

Live trading provides us the opportunity to continually practice our analysis; and our market review sessions and simulator replays provide the opportunity to compare our performance with hindsight perfection. Replaying the patterns of market behavior reinforces our intuitive ability to read and follow the flow of price.

However, you don't need to be trading live to benefit from this. Practice can be achieved right now through conducting live market analysis (with no expectation of trades). Just follow price action. Determine where it's going next through applying your Initial Market Analysis process. Then adjust your expectation of future price action bar by bar as new candles appear on the right hand edge of your chart.

Take some time out to practice. Just follow price action. Decide where you expect it to go from here; and adjust that through bar by bar ongoing analysis.

Once again, I would like to reiterate the importance of SIMPLICITY. Don't make this more complicated than it needs to be. Just question each bar – does it support your initial assessment? If so, great! If however it does something unexpected, then decide whether to change your expectation for future price direction, or wait for more information. If you are unsure, then just wait. Another candle will be along shortly.

And do not concern yourself with setups or trades, this will come soon enough. Just follow price action.

Conclusion

In chapter 5 and 6 we learnt how to analyze market movement. There was no expectation of how or where to trade – that comes later – these chapters were about just getting in sync with price movement. Seeing where it has been; and getting a feel for where it's going to go.

We observed where price has been through placing our price action into a framework of support and resistance; and identifying the order flow within that framework – either up, down or sideways.

We learnt how to assess the strength or weakness of order flow, through the analysis of momentum, projection & depth and failure to continue.

We learnt how to determine the likely path of price, based upon the six principles for identifying the future order flow direction.

And we learnt how to update our analysis bar by bar; through analyzing the internal sentiment of individual candles or candle patterns, in order to determine whether they support or reject out initial assessment.

Once you are comfortable with this process, it’s time to jump into some structural patterns and ratios.