# Candlestick Charts

Charts used by traders to determine possible price movements based on past patterns. They help traders and investors quickly assess price movements and short-term market sentiment.

* Bullish patterns suggest an upward price trend (buying pressure)
* Bearish patterns indicate a downward price trend (selling pressure).

These patterns are identified through various indicators such as candlestick formations, support and resistance levels, and volume analysis.

Candlestick charting was built on the idea that market prices are influenced by both trader psychology and the balance of power between the bulls and bears.

## Components of a Candlestick

Each candlestick represents a specific period and is made of three components:

1. **Real Body or Body:** This is the rectangular section of the candlestick and shows the range between the opening and closing prices. Long bodies indicate strong buying or selling pressure, while short bodies suggest indecision.
2. **Shadows or Wicks:** These extend above and below the body, marking the highest and lowest prices reached during the period, offering insights into market volatility.
3. **Color:** The colour of the candle provides a quick snapshot of price direction.
   1. A bullish candlestick is typically green or white and means the closing price is higher than the opening price, indicating upward momentum.
   2. Inversely, a bearish candlestick, generally red or black, signals that the closing price was lower than the opening price, reflecting downward pressure.

A graph showing a price chart

AI-generated content may be incorrect.

## How to read a Candlestick?

Similar to bar charts, candlestick charts comprise four price points: open, high, low, and close. The high is marked by the top of the upper shadow or the real body if there is no shadow, while the low price is represented by the bottom of the lower shadow or the real body if there is no lower shadow.

Finally, the **closing price's relationship to the open determines whether the candlestick is bullish or bearish**. If the price closes above the open price, the candlestick is bullish. On the other hand, if the price closes below the open price, the candlestick is bearish. With coloured candlesticks, you can recognize bullish or bearish candlesticks instantly.

By analysing these four price points over multiple candlesticks, traders can identify market sentiment and how the bulls and bears are faring against each other, helping to predict potential price changes.

## Common Candlestick Patterns

## Bullish Patterns

### A group of black rectangles and a plus AI-generated content may be incorrect.Bullish Engulfing Pattern

This pattern consists of two candlesticks. The first is a small, bearish candle followed by a larger, bullish candle. As the name implies, the larger candle completely engulfs the previous candle's body. That is, it opens below the lowest point of the smaller candle's body, but the bulls take over and push the price to a close above the highest point of the previous candle's body. This **indicates a shift from bearish to bullish, reflecting strong buying pressure** that may mark a potential reversal.

### A group of black rectangles AI-generated content may be incorrect.Bullish Harami Pattern

Another bullish candlestick pattern is the bullish harami. This is a two-candlestick reversal pattern. It consists of a large bearish candlestick followed by a smaller bullish candlestick that is completely contained within the body of the previous larger candle. This formation **suggests that selling pressure is weakening, and on the second day, buyers are reasserting control**. Confirmation is seen when the harami is followed by a strong bullish candle.

### A group of black rectangles AI-generated content may be incorrect.Bullish Harami Cross

This is a variation of the bullish harami pattern where the second candlestick is a doji, signifying very little difference, if any, between the open and close. Unlike the bullish engulfing pattern, which shows the bulls gaining the upper hand, the doji reflects a stalemate. This often means selling pressure has faded the bulls are about to take over for a while.

### Rising Three Methods

A group of black rectangles

AI-generated content may be incorrect.This bullish continuation pattern signals a temporary consolidation before the prevailing uptrend resumes. The components include a strong bullish candlestick, followed by three or more smaller, bearish candlesticks that remain within the range of the first candle. Finally, another strong bullish candlestick closes above the most recent bullish candle's close.

The smaller bearish candles reflect a brief period of profit-taking or a pause in buying without much selling pressure. The final bullish candle confirms that buyers have regained control and the price is likely to continue moving higher.

### Morning Star Pattern

A graph of candlesticks with different colored rectangles

AI-generated content may be incorrect.Morning star pattern is a bullish three period candlestick formation that consists of…

* a long red candle followed by…
* a small red or green candle (or doji) that gaps below the close of the previous candle followed by…
* a long green candle (stronger signal if gaps up)

## Bearish Patterns

### A group of black and white symbols AI-generated content may be incorrect.Bearish Engulfing Pattern

This pattern consists of two candlesticks. The first is a small, somewhat bullish candle at the top of an uptrend, followed by a larger bearish candle that completely engulfs the previous candle's body. The bearish engulfing pattern indicates a shift in market sentiment from bullish to bearish, suggesting an impending price decline. It typically marks the end of an uptrend.

### Evening Star

A group of black rectangles and squares

AI-generated content may be incorrect.This is a three-candlestick pattern that appears at the top of an uptrend. The first candle is a long bullish candle. It is followed by a small-bodied candle that signals market indecision. Finally, a strong bearish candle confirms the reversal. This pattern suggests buying momentum is weakening and sellers are taking control. It often leads to a downtrend.

### Bearish Harami

A graph of candlesticks and rectangles

AI-generated content may be incorrect.This is a two-candlestick pattern that signals an uptrend's potential reversal. It comprises a large bullish candlestick that is followed by a smaller, bearish candlestick that is completely contained within the body of the previous candle. The bearish harami signals that buying momentum is weakening, and sellers may be starting to take control. A strong bearish candle would confirm the reversal.

### A graph with black lines AI-generated content may be incorrect.Bearish Harami Cross

This is a variation of the bearish harami, where the second candle is a doji, showing near identical opening and closing prices. This signals strong indecision and weakening bullish momentum. A strong bearish candle would confirm the reversal.

### Falling Three Methods

A graph of different sizes and shapes

AI-generated content may be incorrect.The falling three (3) methods is a bearish continuation pattern that indicates a temporary consolidation before the downtrend resumes. It consists of a strong bearish candlestick, followed by three or more smaller bullish candlesticks that stay within the range of the first candle, and finally, another strong bearish candlestick that closes below the first candle's close. The smaller bullish candles represent a brief pause in selling pressure, but their inability to break higher suggests that bears remain in control. The final bearish candle confirms the continuation of the downtrend.

A white table with black text

AI-generated content may be incorrect.

# Practical Applications of Candlestick Charts

Candlestick charts help traders analyse potential market turning points by more clearly illustrating what's happening in the battle between the bulls and bears than bar charts or line charts. Practical applications include:

* **Trend Identification**: Traders and investors analyse candlestick patterns to determine whether a market is trending, though for this purpose they're best used in conjunction with an indicator such as the Average Directional Index.
* **Confirmation**: Used with other technical analysis indicators as well as support and resistance levels, candlestick formations can flag and confirm short-term market turning points.

# Limitations and Considerations

Candlesticks do have limitations. Their predictive power is limited mostly to the short term, and they are most useful to swing traders. Relying solely on candlestick patterns can lead to misinterpretations and suboptimal decision making. Incorporating additional indicators, volume analysis, support and resistance levels, and even fundamental analysis can help traders and investors make more informed and accurate decisions.

Candlestick charts help traders and investors analyse price movements, market sentiment, and trend reversals. Developed in Japan, they use opening, high, low and closing prices to form predictive patterns. Since patterns can produce false signals, confirming them with support, resistance and other technical tools is essential.