Raoul Hunter

A complete guide to using Price Action, in all its forms, to trade Forex

Forex Trading with Price Action

DEDICATION

This is dedicated to my long suffering family who have had to put up with me getting up at all hours of the night to do my trading; something they have done with minimal complaint.

Disclaimer

Trading is Speculative and Risky:

Trading in Foreign currency is highly speculative. It is only suitable for those users financially able to assume losses significantly in excess of margin. It is not an appropriate investment for retirement funds.

Past Results Performance Disclosure:

Past results are not necessarily indicative of future results and cannot be guaranteed to perform as such.

General Risk Disclaimer:

All Trading involves risk.
Leveraged trading has large potential rewards but also large potential risk. Be aware and accept this risk before trading.
Never trade with money you cannot afford to lose.
All statistics are derived from historical performance and are not a guarantee of future results.
No account may achieve profits or losses similar to those discussed. There is no guarantee that even with the best advice available you will become a successful trader.

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Chapter 1 - Overview

There are two basic types of analysis in used in Forex today. The first is Fundamental Analysis where a trader would use economic figures, financial data and world events on which to base their trading decisions. This technique focuses on the news and related international events and their effect on the market.
The second, Technical Analysis, is where traders focus on chart data to assist in their market analysis. For example, they will utilise indicators of many techniques, Support and Resistance lines, Moving Averages, etc. to analyse the historical data.
This technique tends to ignore the fundamental factors of a currency pair and primarily analyses the currency's price history. It endeavors to predict the future direction from the historic data.
As you would expect, between Fundamental and Technical Analysis, hundreds, if not thousands of trading strategies have evolved; some strategies even use a hybrid combination of Technical and Fundamental data.

Price Action Trading

Price Action trading is considered part of Technical Analysis but without the use of additional tools or indicators. What differentiates it from most forms of technical analysis is that its main focus is the relation of a currency's current price to its past price as opposed to any values derived from that price history.
Price Action as a Technical Analysis approach to trading is gaining in popularity. Strategies based on this are becoming increasingly popular in the market today because they are easy to use and setup, they work as well and produce excellent results.
This popularity is based on three major factor. It is simple, quick to learn and understand. Anyone can get to grips with Price Action without intensive studying.

The second reason is that generally Price Action requires no indicators! There is no requirement to understand and interpret the results of various indicators. The side benefit of this is that you have incredibly clean charts
– they are basically blank without an indicator's interpretation lines or diagrams. This naturally makes it a lot quicker to analyse and locate potential orders. To be honest I think that a successful trader should still use Support and Resistance lines to further confirm a price movement – but in my defence, this is still not an indicator.

Chart 1 - An Indicator Laden chart

The third reason is that this naturally overcomes a key issue with indicators – namely that they lag – they tend to only make their prediction or forecast long after the price has made its move. Using Price Action, you get to make your decision as soon as the price makes its move.

What is Price Action

To put it succinctly, Price Action is the “footprint” of the market activity. Forex markets are where currencies are bought and sold between many traders, and it is this exchange of money that leaves a trail. This trail is the market’s price movement and can be observed - tracked - on a currency chart. As a Forex trader, you can learn to identify and trade off of the visual tracks left behind from the Price Action as it leaves its trail across the chart. This approach is a Price Action trading strategy.

Another analogy is that price is the heart of any financial market. It is like learning to read a book; if you don’t know how to read you will not be able to understand the words in the book or the story it conveys. If you don’t know how to read the price action of a market you will not know how to make sense of a price chart or the “story” it is telling you.

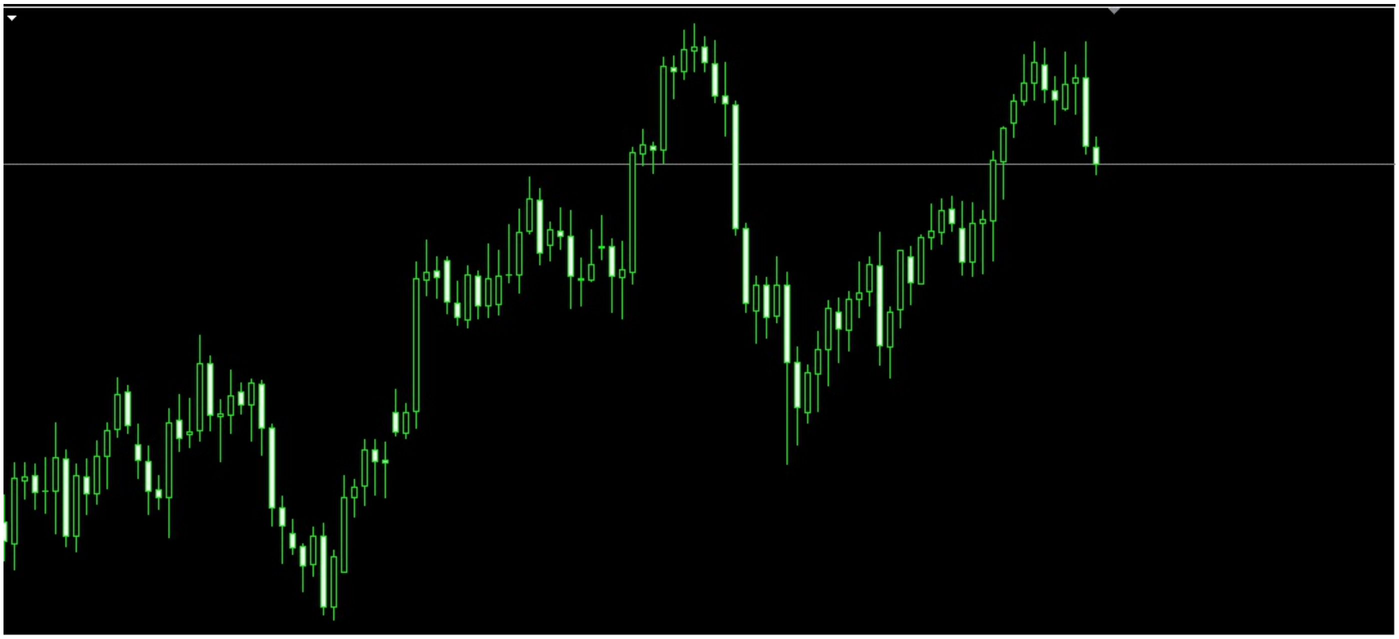
Chart 2 - A Typical Price Action chart

These Price Action trading strategies form as a result of price movement in markets tending to be repetitive due to the fact that humans are ultimately behind the price movement. Also, because human emotions are relatively predictable when it comes to matters of money; their actions in the market often result in Price Action formations that repeat periodically. These can be very accurate predictive tools of future price direction.

Price Action strategies can be traded in any financial market and on any timeframe. It is advisable though, to focus on trading higher timeframes.

Summary

Price Action is a simple but professional way to approach Forex trading; many traders believe that it is probably the most consistently profitable method that a trader can use in the markets today.

There is a strong belief that most Technical Analysis strategies in use are tailored to the market conditions at the time - whether intentionally or not. However, when the market conditions change these systems tend to lose their effectiveness. The markets are dynamic in nature meaning they are constantly changing and require dynamic strategies to be completely successful.

Conversely, Price Action will adapt with any changing market condition; the price will always reflect the status of the market.

There is an adage amongst traders who firmly believe in Price Action trading; “The Price is the one thing that never lies”.

Chapter 2 - Price Action

History

Martin Pring is credited with being the first trader to notice the PinBar pattern on charts. Interestingly, the term ‘pin bar’ is short for Martin’s original term for the bar formation – which he called the Pinocchio bar. This was based on the fact that Pinocchio, a wooden doll brought to life by his creator, would have his nose grow larger every time he told a lie. This analogy tied in perfectly with Martin’s observations because a pin bar is broken down into two moves. The first move is when price moves from the first position to the second. This often attracts eager breakout traders who enter the market based on this initial price momentum – thereby causing a strong price action, either up or down.

The second part of the move happens when this original movement does not replicate the market’s true intentions and is basically telling a lie. The price then springs back from the second position to its original position – leaving a long candle wick in its trail. This imitates the story of Pinocchio’s nose; the bar grows a big nose as the ‘lie’ is ultimately revealed by the price on the chart.

When Martin Pring identified the PinBar most traders were using bar charts – today the more popular graphical representation is the Candlestick chart. Traders find this more popular because it is easier to read and tends to reveal better market information. The use of candlestick charts makes the PinBar pattern much more noticeable.

Trading Price Action

The best way to trade the Price Action is to behave like a specialist surgeon and not a general butcher. You will need to wait for the best price action indication rather than trade anything that you think could be a possible opportunity. You need to consider it as a game of patience; a game where you wait for the perfect condition to reveal itself and then trade only that action. By doing this, you will definitely find a positive correlation between your account value and amount of patience exercised. Just as it requires effort to be successful in anything, you have to take time to learn how to recognise and use this strategy effectively.

Learning Price Action

There are three major points you should consider when tackling this trading approach, namely;

Learn to master one price action strategy at a time. If you really want to master this trading strategy start with an open mind devoid of any preconceived ideas resulting from failed trading strategies. Master one Price Action pattern at a time so that you can instantly recognise it and the message that it brings. You need to live and breathe this setup until you are confident that you know every angle and condition it can or should be traded in.

Start with the higher timeframes. Higher timeframes naturally smooth out the price action of the lower timeframes. This has the dual effect of limiting your trading exposure while increasing your success ratio.

Practice, practice, practice. You need to be able to instantly recognise a pattern and the action it has on the market. To do this successfully you need to practice. Avoid a lot of trial and error by having a skilled trader mentor you on this concept.

Understanding, and hopefully mastering Price Action trading will certainly make you a better and more successful Forex Trader. This holds true even if you only add this technique to improve or confirm the indications of an existing strategy. It doesn't matter what trading strategy or system you are currently using, nor end up using, the ability to recognize high-probability price action patterns and setups will make that strategy much more effective.
Remember that irrespective of your trading strategy you will always have to deal with price movement as you trade the market, either consciously or sub-consciously. It makes sense that if you really want to become a profitable trader you simply have to understand price dynamics and how it ebbs and flows and interacts with various levels in the market.

Volume

I don't think that many traders believe that Volume plays a part in Price Action trading but I assure you that it does.

Volume is simply the number of contracts traded over a period of time. As even the most reliable of patterns or formations will fail sometimes, you should consider volume as another tool in determining what is happening within the market and more specifically within the pattern.

The general belief is that volume should increase in the direction of the price. If the trend is moving up, the volume should be heavier on the up periods and lighter on the down periods. Conversely, if the trend is down, volume should be heavier on the down periods and lower on the up periods. This has to be true because in an uptrend there should be more buyers than sellers while in a downtrend there should be more sellers

than buyers.
When volume starts to diminish it could be a warning that the trend may be losing momentum and that a consolidation or a reversal could be coming up. If the trend was up and you start to see more volume on dips rather than on rallies; it is possibly a warning that the buyers are weakening and that the sellers are becoming more aggressive. The reverse would be true in a downtrend. Another point to consider is that when volume moves in the opposite direction of the price, it is divergence – an extremely powerful signal in Forex Trading.
One of the reasons why volume tends to reduce during periods of indecision is for that very reason. During periods of consolidation or sideways movement, traders will often tend to avoid the market, waiting to re-enter once a definite breakout appears.
While it is typical for volume to diminish during times of consolidation, it is a clue to possible future direction by measuring the level of conviction of the buyers and the sellers. During sideways movement, seeing if there is heavier volume on the up periods or on the down periods could be useful in getting positioned or confirming the formation of a pattern. The idea is that if there is more volume on the up periods than the down periods, the buyers are probably more aggressive and the market will more than likely breakout upwards. The reverse is true if the volume is heavier on the down periods; the market is much more likely to breakout to the downside.

Chapter 3 - Western Candlestick Patterns

These are candlestick patterns that have originated from the Western world – as opposed to the Far East, Japan, who are credited with original candlestick discovery. You will find that there is a degree of similarity between these and the Japanese patterns, probably due to the fact that the Japanese Candlestick patterns were discovered many years before these, and as such are extremely comprehensive in their coverage. From this it is reasonable to assume that there should be some degree of overlap.

Candlestick Makeup

Before discussing Candlestick patterns we should look at the make-up of Candlesticks themselves.

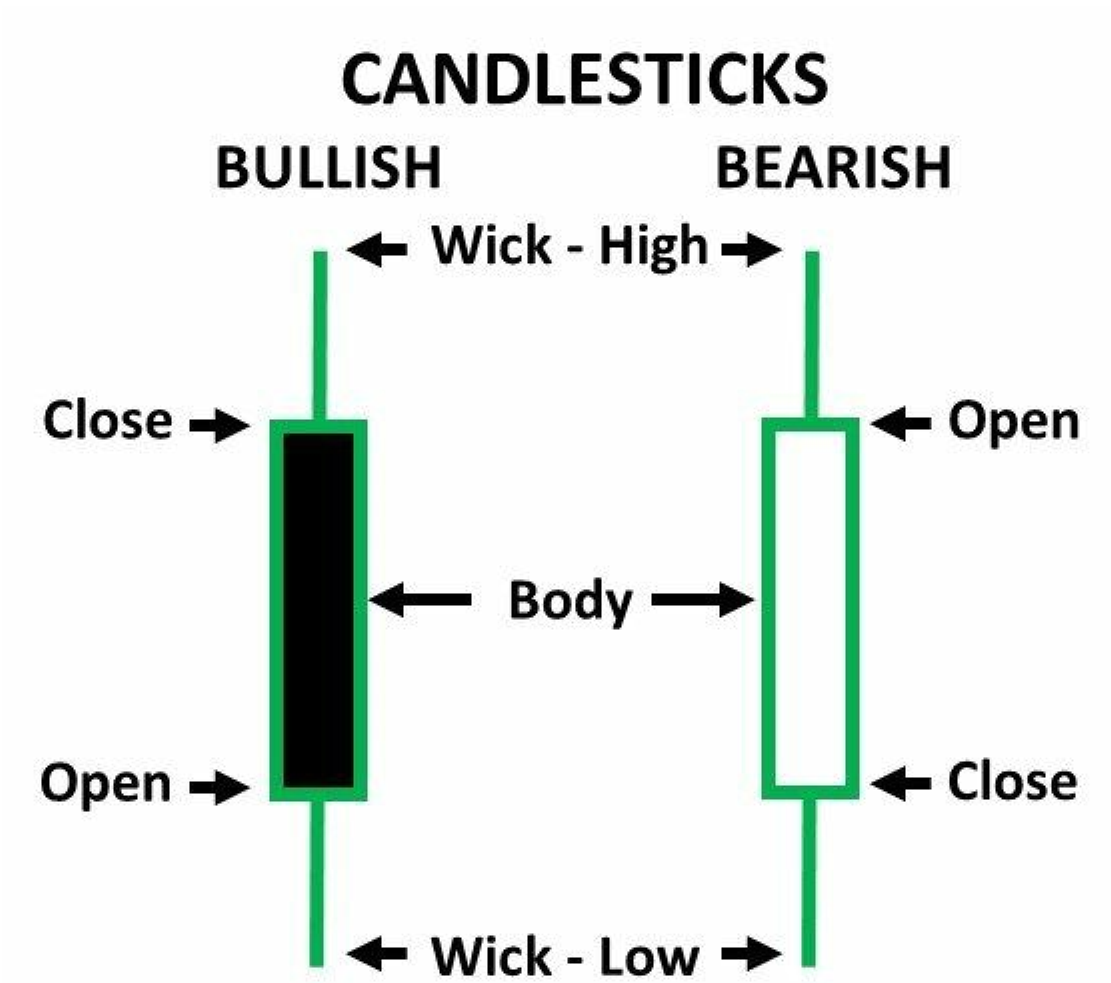

Figure 1 - Candlestick Makeup

Basic interpretation of a Bullish Candlestick is that a long non-filled Candlestick body indicating strong buying pressure. The longer the body is, the further the close is above

the open. This indicates that prices advanced significantly from open to close indicating that the buyers were aggressive.
Conversely, a long black – or as in all these examples, white, the default MT4 colour - or filled Candlestick, shows strong selling pressure. The longer the filled Candlestick the further the close is below the open. This indicates that prices declined significantly from the open and sellers were the more aggressive.

The wicks or shadows also give market related information. Candlesticks with a long upper wick and short lower wick indicate that the buyers were more dominant during that period and pushed the prices higher. However, the sellers later forced prices back down from these highs creating a long upper wick.
Conversely, Candlesticks with a long lower wick and a short upper wick indicate that the sellers initially dominated during the period and forced the prices lower. Later, towards the end of the session, the buyers rallied, bidding the prices back up creating a long lower wick.
It is this type of information that you are able to gather from Candlesticks making them the charting choice amongst traders.

PinBar Makeup

The diagram shows the basic makeup of a PinBar. They should always have a long wick on one side and either no wick or a very short wick on the opposite side. The bodies should also be rather short – the Open and Close points close together.

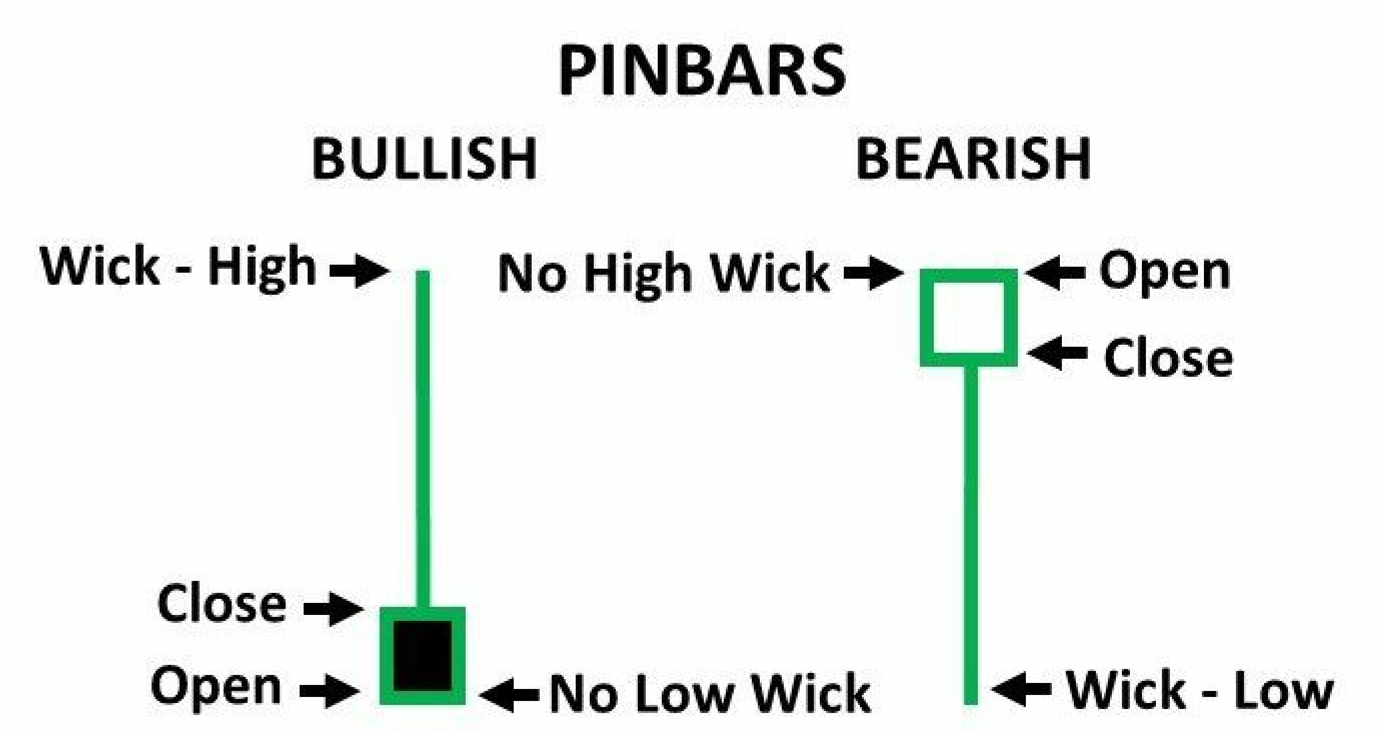

Figure 2 - Basic PinBar Makeup

They are labelled Bullish and Bearish respectively as usually an empty body refers to a Bullish candle while a filled body refers to a Bearish one. These patterns generally indicate price reversals and consequently the Bullish PinBar actually indicates a Bearish price reversal and vice versa. The first pattern in the diagram is a Bearish Reversal and the second a Bullish Reversal. From this you will realise that patterns are generally named for their action rather than their makeup.
The diagram below shows the full PinBar makeup. Here you can see what some traders refer to as the eyes of the pattern – the eyes of Pinocchio. The pattern shows a Bearish Reversal where the Left Eye is the Bullish trend that has been running; the Nose is the actual PinBar where the reversal takes place and the Right Eye is the start of the Bearish trend. This is then the start of a Bearish reversal – the running Bullish trend is now reversing to the start of a new Bearish trend.

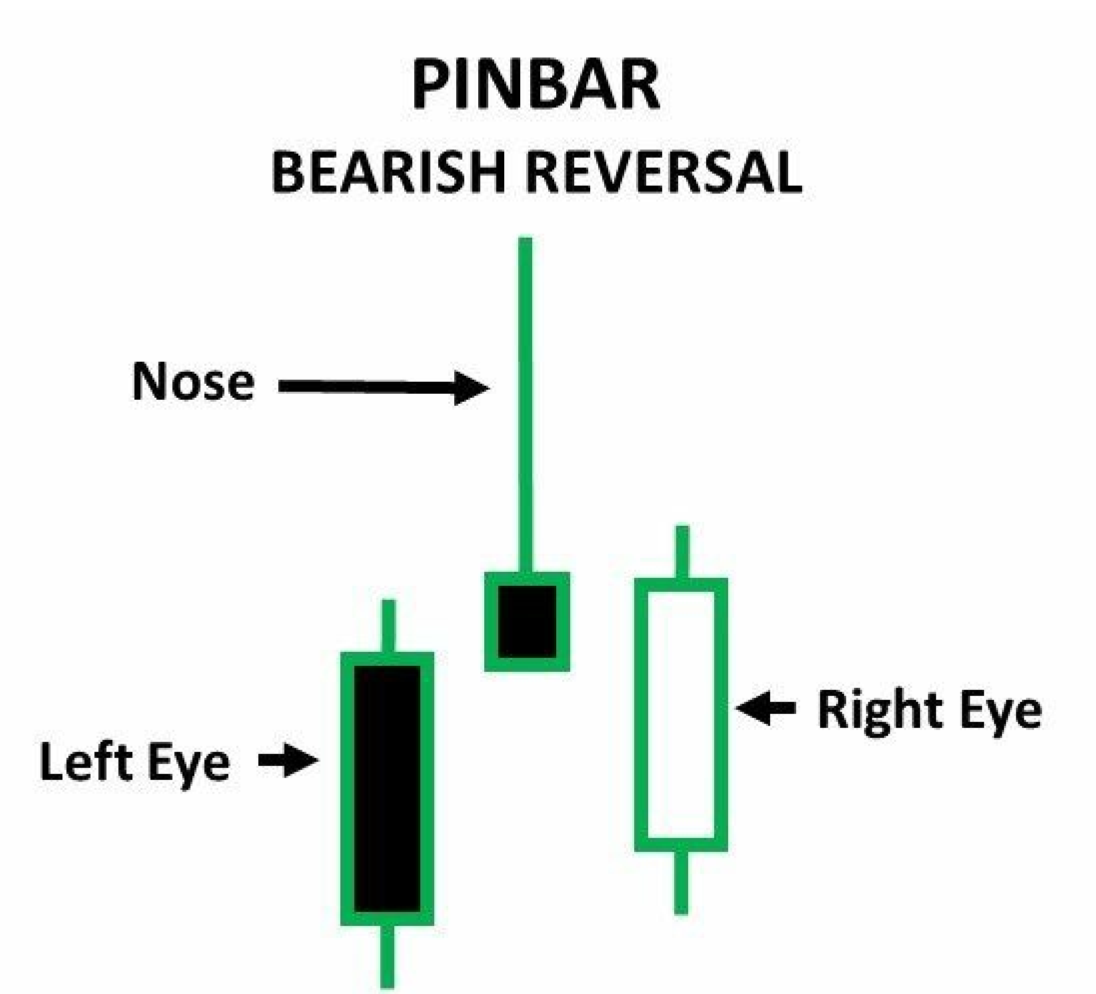

Figure 3 - Full PinBar Makeup

The lie that Pinocchio told is that some traders believed that the initial Bullish run on the nose candle would endure but it reversed leaving a long nose – Pinocchio's lying

nose. Hence, the price lied about its intended direction.
The ideal makeup of this pattern has the following characteristics;

 The wick must be at least three times the length of the candle body
 Ideally the wick should also be of similar size as the previous candle. The bigger the wick the better – in fact, the smaller the body and the longer the wick the better
 The closing price must be located within the length of the preceding candle – there should be no gaps between Closing Opening and prices
 Body must be on the very end of one side of the wick; there should not be a wick on the opposite end of the body. If there is it should be very short
From the chart above you can see the PinBar indicating the Bearish reversal. This PinBar example meets all the requirements for a classic reversal signal.

The best point of entry would be to wait for the open of the next candle before placing your order. As further confirmation try and see if there is a Support or Resistance line - in this example a Resistance line - close to the PinBar. This approach will further re-enforce the reversal pattern.

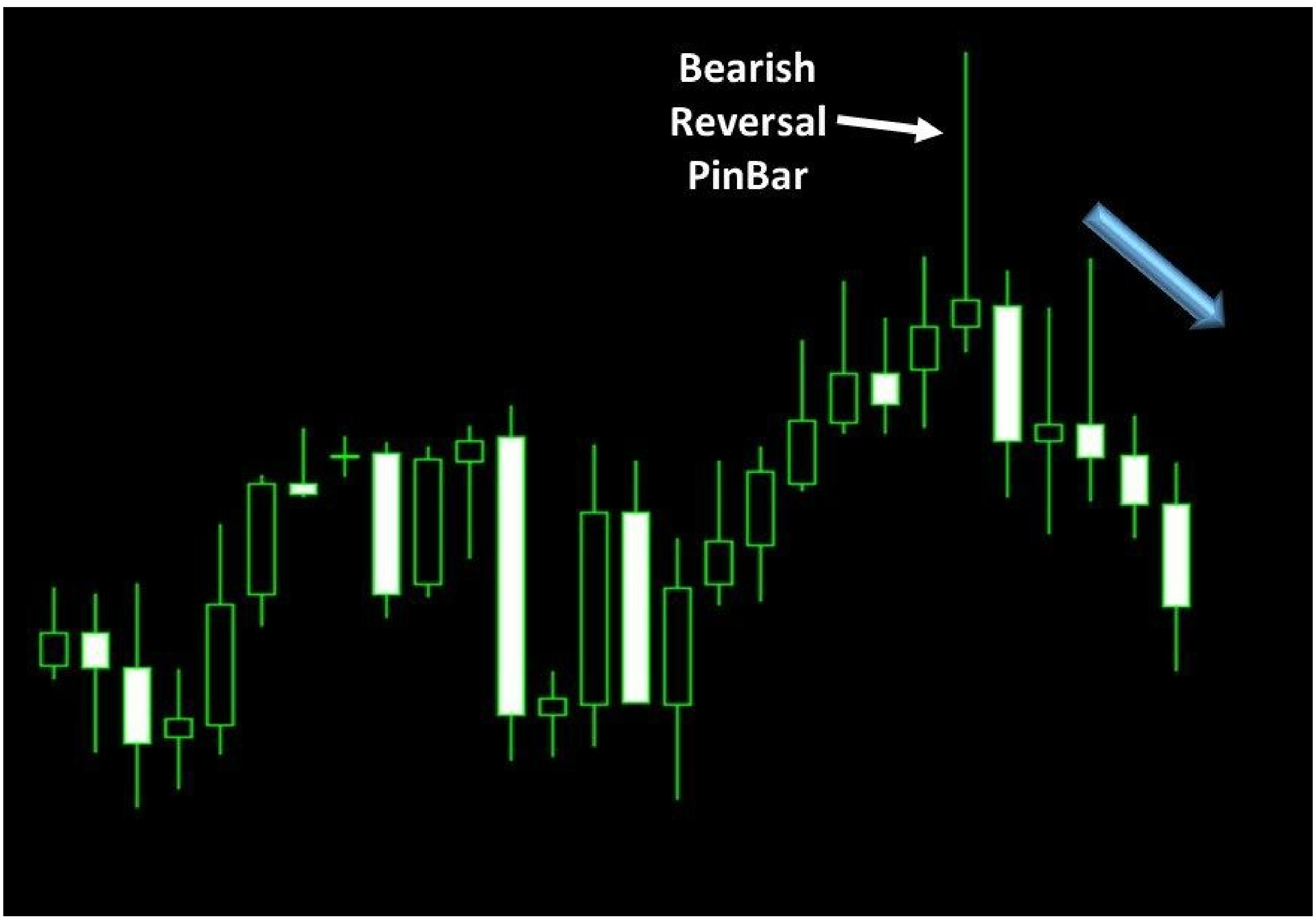

Chart 3 - Bearish Reversal PinBar

In this example, you would place your stop-loss above or below the wick of the candle depending on the timeframe you are working with. Another reason for having a Support or Resistance line close to the PinBar is that if a trade moves against you it will most likely be curbed at the Support or Resistance line before resuming in your chosen direction. You would therefore place your Stop Loss below the Support line for long orders and above the Resistance line for short trades.

Outside Bar Makeup

This is another pattern – also with a counter-part in the Japanese Candlestick patterns – that many traders frequently utilise.

An Outside bar is larger than the bar preceding it and totally overlaps it in Japanese Candlestick terms, it is known as an Engulfing bar. Its high is higher than the previous high and its low is lower than the previous low.

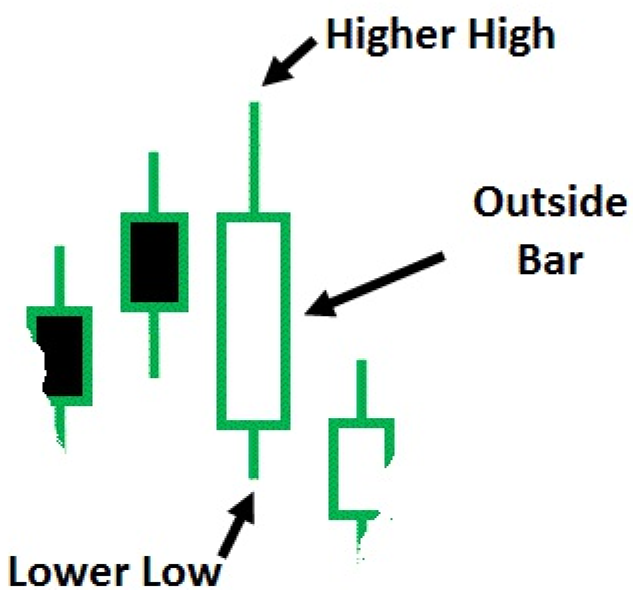

Figure 4 - Outside Bar Makeup

An outside bar's interpretation is based on the concept that market participants were undecided or inactive on the previous bar. Subsequently, during the development of the Outside bar they demonstrated new enthusiasm, and as shown in these two examples, created a new Bearish run.
Also importantly, you need to consider the full pattern in which the Outside bar occurs; in both cases the Outside bar was a strong Bearish bar indicating strong continued downtrends.

Chart 4 - Outside Bar

An Outside bar is therefore a continuation pattern – where trading will continue in the direction of the Outside candle. In the above chart, traders would be looking to go short upon the close of the Outside Vertical Bar; this is in anticipation of reaping the renewed momentum.

Naturally, the Bullish Outside bar is the reverse of the Bearish Outside bar described above.

Inside Bar Makeup

This pattern is the reciprocal of the Outside Bar pattern discussed above. The Inside Bar is a pattern which has the Outside Bar smaller and within

the high to low range of the previous bar. In this pattern the high is lower than the previous bar's high, and the low is higher than the previous bar's low. Where it actually sits inside the previous bar is irrelevant. It can be towards the top or bottom of the previous bar; its actual position makes no difference to its interpretation.

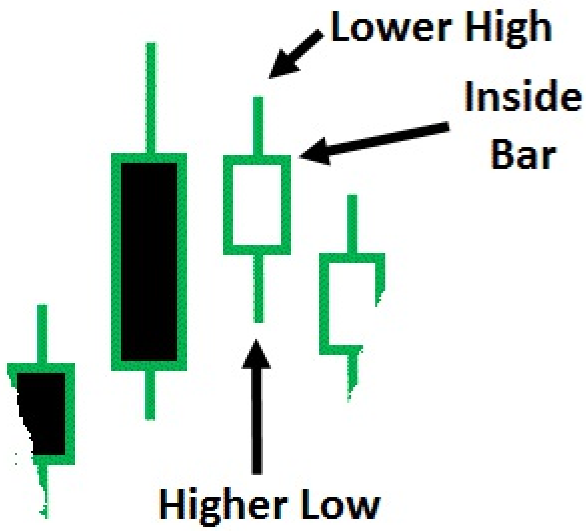

Figure 5 - Inside Bar Makeup

It is also acceptable to have the two lows at the same level; the Inside bar

must just not exceed the boundaries of the previous candle. However, if both the highs and the lows are the same, it becomes more difficult to recognise it as an Inside Bar. The Japanese also have a similar pattern called a Harami – which means pregnant in Japanese. This because it looks like a pregnant mother when viewed from the side; the first bar being the mother with the Inside Bar giving the appearance of being the baby. A slight negative about this pattern is that it generally reflects a period of indecision or consolidation as Inside Bars generally appear when the market consolidates after making a large directional move. Perhaps more importantly, they can also appear at turning points in the market – often at a key decision level such as at major Support or Resistance level.

Inside Bars are considered to act as both continuation and reversal signals. When using this pattern as a signal to enter the market, and because of this indecision, rather wait for the price which would be the third bar of the pattern to move past level of the first bar - the one prior to the Inside Bar
- the mother.

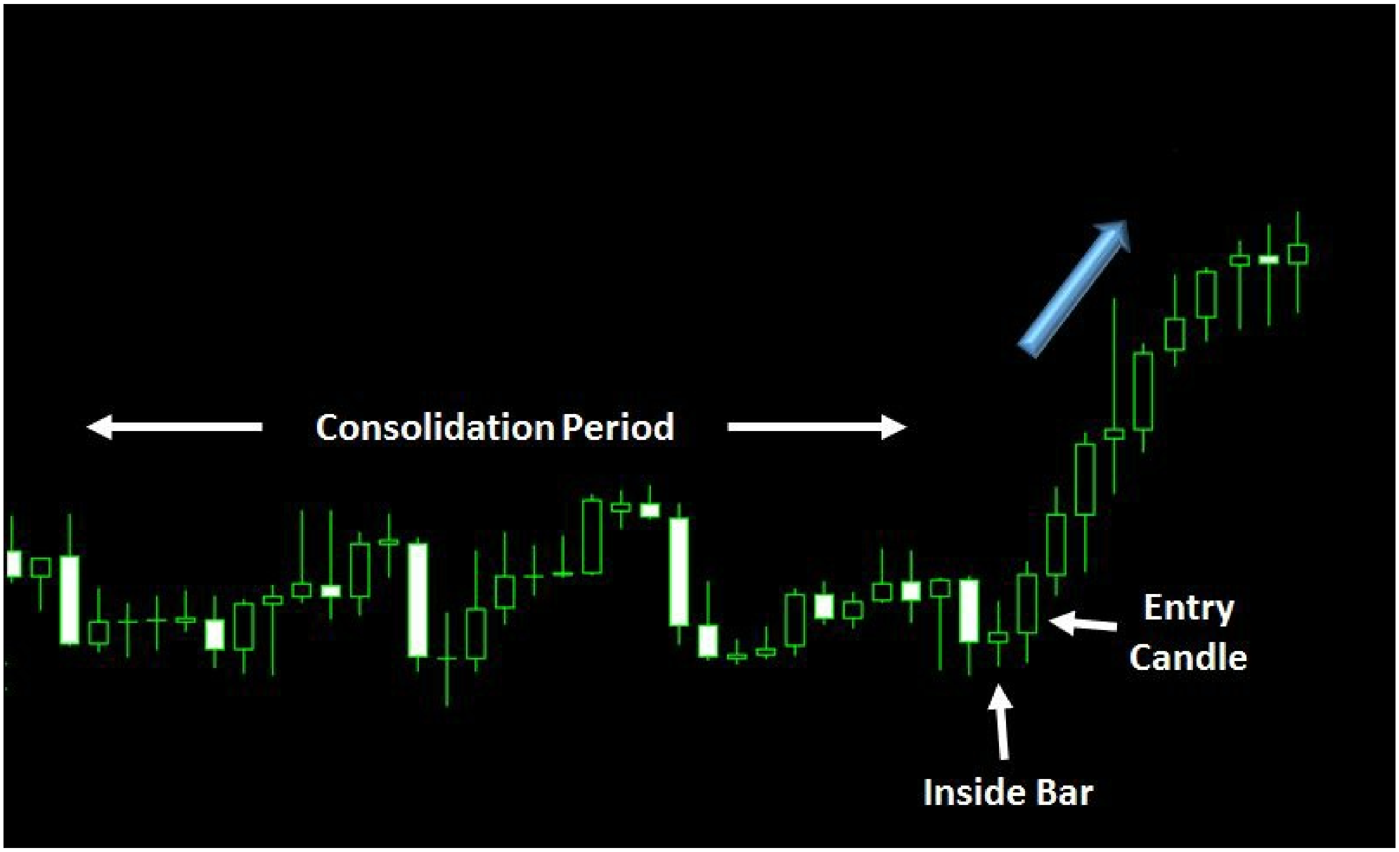

Chart 5 - Inside Bar

From the example chart above, you can see the Inside Bar appearing after

a period of consolidation. Place your order through a Pending order or manually, after the candle after the Inside Bar breaks the level of the mother candle. This is indicated by the Entry label on the example chart. By waiting for the candle after the Inside Bar (the baby) to break the level of the mother, you remove all the indecision of whether the pattern is signaling a continuation or a reversal.

Generally, you would place your Stop Losses just above or below the mother bar; the bar before the Inside Bar. You would have to adjust your Stop Losses if the mother bar is exceptionally long - you would need to do this so as to bring your risk/reward ratio back to an acceptable value.

Chapter 4 - Candlestick Patterns

History

Candlestick charts originated in seventeenth-century Japan following the country's unification under the Tokugawa Shogunate, between 1603 and 1868. This period was also the precursor to the central Japanese commodities markets, with the most prominent being the Dojima rice exchange in Osaka. This futures trading developed from a scenario where, to generate additional income, rice farmers began to sell receipts for future delivery, becoming some of the world's first commodity futures traders. A noticeable figure in this market was Munehisa Homma, a wealthy rice farmer and commodity trader. He believed that markets were influenced by human emotions which often created a rift between current prices and their intrinsic value. He went on to invent Candlestick Charts in an attempt to capture some of these emotions; and also in an attempt to predict future price movements. It is from these beginnings that Candlestick Charts have become the principal form of technical analysis around the world.
Until around 1989, Candlestick analysis was a secret to Westerners and known only to the Japanese stock traders. Steve Nison, a writer and former technical analyst at Merrill Lynch, stumbled upon Candlesticks while talking to a Japanese stockbroker. He researched the ideas and later brought Japanese Candlesticks back to America where it took root in mainstream technical analysis. Nison wrote a book, Japanese Candlestick Charting Techniques in 1992, which is still considered as the formative work on Candlestick Charting.
The Candlestick patterns originally had flamboyant Japanese names, such as Nagare Boshi for example, but thankfully a lot of them have since been given English names more suitable to their function, such as Shooting Star, thus making them a little easier to remember.

Candlesticks in Trading

Japanese Candlestick patterns are used in technical analysis by traders either independently or as confirmation to other indicators in a trading strategy. All Candlestick patterns can be classified as either Bullish or Bearish depending on the pattern and where it occurs in relation to the recent price movement.
Candlestick patterns are probably one of the most researched topics in Forex Trading. There are analytical reports covering topics such as Statistical Frequency of Appearance, Statistical Success Probabilities and even one which is an in-depth research based solely on the Doji pattern and its behaviour.

The primary aim of Candlestick patterns is to focus on the following;

That the price action is more important than the why, the news, earnings, etc.
That all known information is reflected in the price
That buyers and sellers move markets based on expectations and emotions - fear and greed
That markets fluctuate
That the actual price may not reflect the underlying value As a general rule of thumb, the longer the real body, the more intense the buying or selling pressure. Conversely, shorter bodies indicate less price movement and represent consolidation.

Candlestick Patterns

Please note that all the Candlesticks represented here use the default MT4 colour set; this is where a white candle indicates a downward moving or Bearish candle. A black candle is the opposite; this shows a Bullish or upward moving candle. It is however possible to change these colours to anything that you like so it is important to realise that whenever you look at Candlestick Patterns it is most important that you understand what represents Bullish candles and what indicates Bearish ones. I have also used as many of the more Western names as I could; hopefully making them easier to memorise. Remember that when reading other Candlestick literature, both the name and the colours of the pattern could be different; there is unfortunately no fixed standard addressing either of these issues.

White or Black Marubozu

These are patterns with long Black or White candle bodies without any wicks; they are also known as Long White or Black Days.
White Marubozu indicates strong buying pressure – at the open the buyers were aggressive and drove the price up; while Black Marubozu shows strong selling pressure. A Marubozu can also **Figure 6 - Marubozu** indicate a reversal; for example after a long down
trend a White Marubozu can indicate the potential turning point. Another point is that the longer the candle body, the more important the indication.

Spinning Tops

These are Candlesticks with long upper and lower wicks and relatively small real bodies. They generally represent indecision but with the next trend probably moving in the direction of the next opening candle. Even though the session opened and closed with little change, prices moved significantly higher and lower during the session where neither the

Figure 7 - Spinning Top

buyers nor sellers could gain the upper hand and the result is this standoff.

Doji

The word Doji refers to both the singular and plural forms of this pattern.
The body of a Doji must be as small as possible; ideally, but not necessarily, the open and close should be equal.
Doji reflects an indecision between buyers and sellers. Prices move above and below the opening level during the session but close at or near the opening level. Neither the bulls nor the bears were able to gain control during

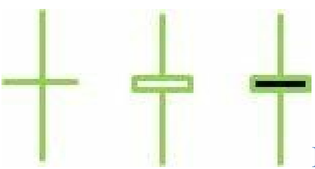

Figure 8 - Doji

the session and a turning point could be developing.

Steven Nison states that Doji formed among other Candlesticks with small real bodies should not be considered too important. However, Doji that form among Candlesticks with long real bodies are deemed significant.

Doji Combinations

Doji alone are not enough to mark a reversal and therefore further confirmation may be warranted. The relevance of a Doji depends on the preceding trend or preceding Candlesticks. After an advance, or long white Candlestick, a Doji signals that the buying pressure is starting to weaken. After a decline, or long

Figure 9 - Doji Combinations

black Candlestick, a Doji signals that selling pressure is starting to diminish. Doji indicate that the forces of supply and demand are becoming more evenly matched and a change in trend may be near. This pattern generally indicates a reversal in the opposite direction to the preceding long bodied candle.

Hammer

A Hammer is Bullish Reversal Candlestick pattern made up of just one candle. With a little imagination the candle looks like a hammer as it has a long lower wick and a short body at the top of the Candlestick and with little or no upper wick. Do not get this confused with the Doji.
In order for a candle to be a valid hammer, the lower wick must be at least twice as long as the length of the body.
When you see the Hammer form in a downtrend

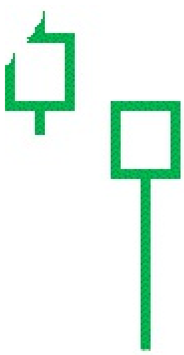

Figure 10 - Hammer

it is a sign of a potential reversal. The long lower wick represents a period where the sellers were initially in control but the buyers were able to reverse that control and drive prices back up to close near the high for the period, thus the short body at the top of the candle.

Hanging Man

The Hanging Man candlestick pattern is a Bearish sign. This pattern occurs mainly at the top of uptrends and is a warning of a potential downward reversal. It is important to emphasize that the Hanging Man pattern is a warning of potential price change and is not in itself a signal to go short.
The Hanging Man formation, just like the Hammer, is created when the open, high, and close are roughly around the same price. Also,

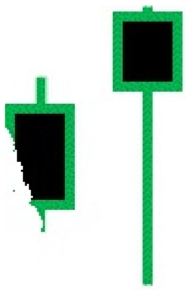

Figure 11 - Hanging Man

there is a long lower shadow which should be at least twice the length of its body. After a long uptrend the formation of a Hanging Man is Bearish because prices hesitated by dropping significantly during the period of the candle.

Star Patterns

These are patterns where there is a Doji above or below a longer bodied candle; these are three candle patterns. The Evening Star is a pattern where a Bullish long bodied candle is followed by a Doji and then another long bodied Bearish candle. The third candle must close at least halfway down the first candle body. This indicates a Bearish reversal.
The Morning Star is the opposite – it comprises a Bearish long bodied candle followed by a Doji, and then a Bullish candle that closes at least half

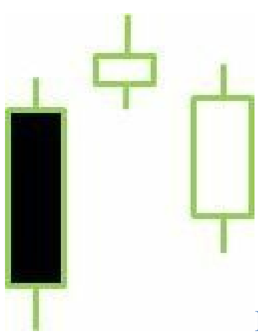

Figure 12 - Evening Star

way up the first candle body. The Morning Star indicates a Bullish Reversal.

There is another commonly recognised Star pattern – the Shooting Star. This is a two candle pattern which generally appears in an uptrend. It opens higher, trades even higher and then closes near its open. One of its traits is that the second candle should have a long wick and short body and is Bearish. Lower trading in the next candle reinforces a pullback.

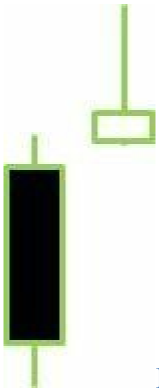

Figure 13 - Shooting Star

Harami

This is a two Candlestick pattern. Harami means pregnant in Japanese and, to a degree, this pattern reflects a woman's pregnant body as the second candle is embedded in the body of the first; a pregnant mother viewed from the side.
The first Candlestick usually has a large real body, either bullish or bearish, and the second candle's body is smaller than the first. The shadows - both high and low - of the second Candlestick do not have to be contained within the first, though it is preferable. The second candle may also be a Doji.

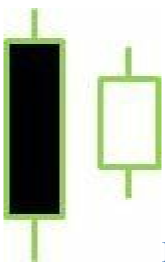

Figure 14 - Harami

A pattern criterion is that the second candle must be completely engulfed by the body of the first candle. The second candle direction can be opposite to the first but is not mandatory. Haramis indicate a possible reversal to the opposite direction of the first candle.

Engulfing

This is a reversal pattern that can be either bullish or bearish depending upon whether it is after an uptrend or downtrend. The pattern comprises the second last candle having a small body, followed by the last candle whose body completely engulfs the previous candle's body. If the pattern follows a downtrend it indicates a potential bullish reversal – after an uptrend it indicates a bearish reversal.

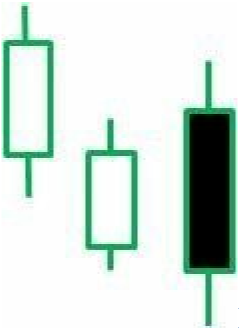
Figure 15 - Bullish Engulfing

Tweezers

This pattern comprises of two candles; a Bullish candle in the first period and a Bearish candle in the second. In the Bearish pattern, the longish Bullish candles closes on the high and has a relatively short Low wick.
The next candle is a Bearish candle must open at the same high/close of the first candle. There must be no upper wick and the close must be reasonably close to the low.

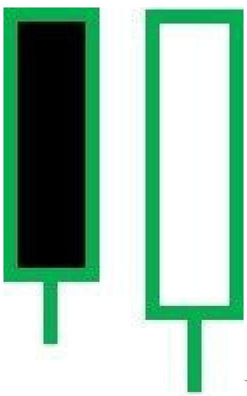
Figure 16 - Tweezers Top

This is considered a reversal pattern with the original upward movement reversing to start a new downtrend.
There is the exact opposite pattern, the Tweezers Bottom which would indicate a reversal from a downtrend to a new uptrend.

Bearish 3-Method

This pattern comprises of five candles – a long Bearish body followed by three small bodies – in this example, Bullish
- and a long Bearish body on the outside. The three small Bullish candles

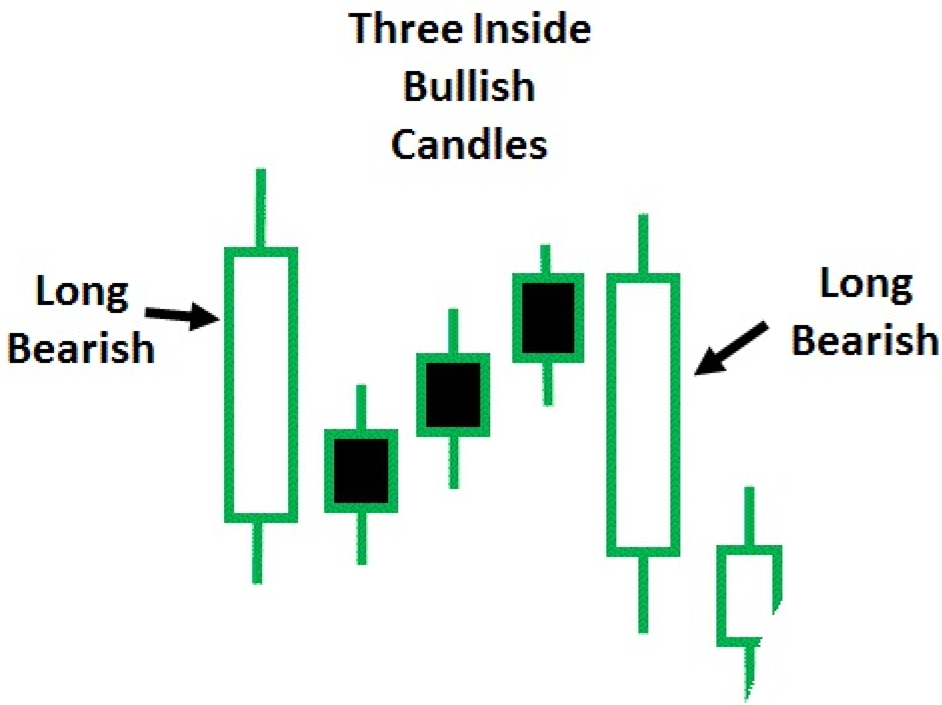

Figure 17 - Bearish 3-Method

must be contained within the range of first Bearish long body. This is considered as a Bearish continuation pattern with the price continuing in a Bearish direction.
There is a similar pattern, Bullish 3-Methods which is the exact opposite of this pattern – this pattern would suggest that the price would continue in a Bullish direction.

3 White Soldiers

Consists of three long Bearish Candlesticks with consecutively lower closes. In this pattern the closing prices need to be near to or very close to their lows. The closing wicks need to be short, if they exist at all.
When it appears at the top of a trend it is considered as a Bearish reversal signal.
There is the opposite pattern to this; 3 Black Crows which would comprise of 3 Bullish candles, which when at the bottom of a Bearish trend signals a potential reversal.

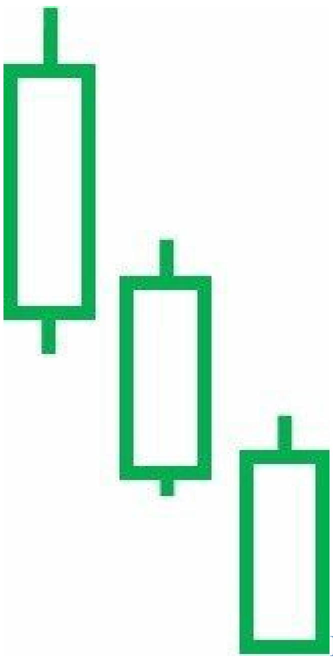

Figure 18 - 3 White Soldiers

Upside Gap Two Crows

This is a three candle Bearish pattern that happens only in an uptrend. The first candle has a long Bullish body followed by a gap to the next open; this candle has a small Bearish body and remains gapped above the first candle. The third candle is also a Bearish candle whose body is larger than the candle before it and must engulf it.
The close of the last candle must be above the close of the first long Bullish candle.

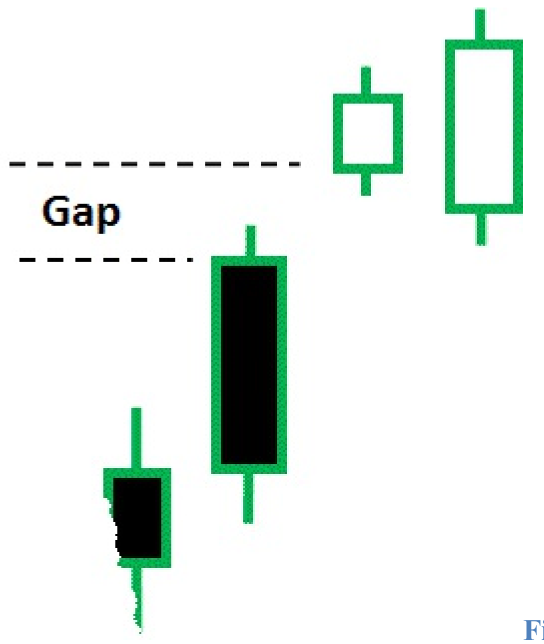

Figure 19 - Upside Gap Two Crows

Piercing Line

This pattern indicates a Bullish reversal opportunity. It comprises of two candles. The first candle which is a downtrend, is a Long Black Day – that is a Bullish candle that has a long body and a short wick at the top and bottom, also known as a Marubozu. The next candle must open with a new low, then close above the midpoint of the body of the first candle.

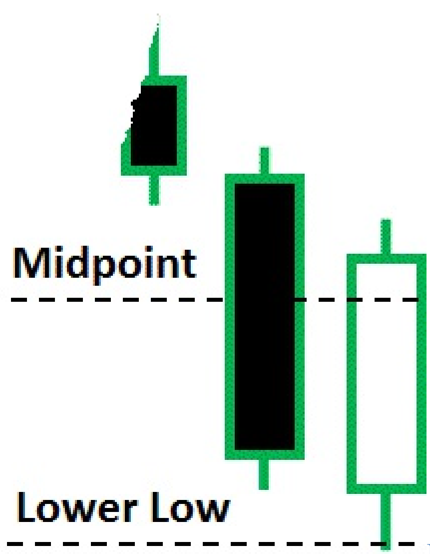

Figure 20 - Piercing Line

Upside Tasuki Gap This pattern can get you confused with the Upside Gap Two Crows as there are some similarities.

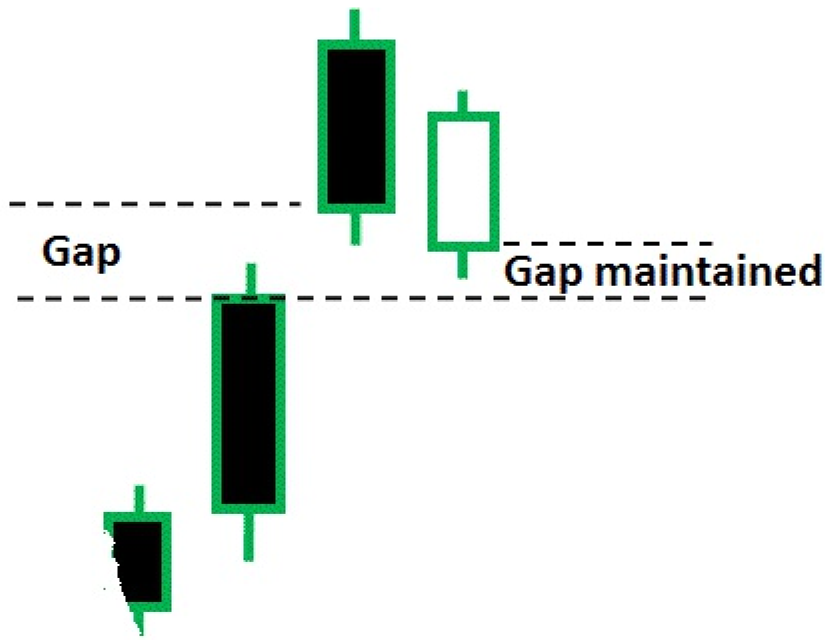

Figure 21 - Upside Tasuki Gap

This pattern starts with a long Bullish candle followed by another Bullish candle and most importantly, one that has opened with a gap above the first one.
The third candle is a Bearish candle which must open within the body of the second candle. It must partially close the gap between the first two candles but most importantly, must not completely close the gap.

This is a Bullish continuation pattern indicating that the Bullish trend will continue.

Stick Sandwich

This is a Bullish reversal pattern.
It consists of two Bearish bodies which surround a Bullish body.
The closing prices of the two Bearish candles must be equal; close to their own

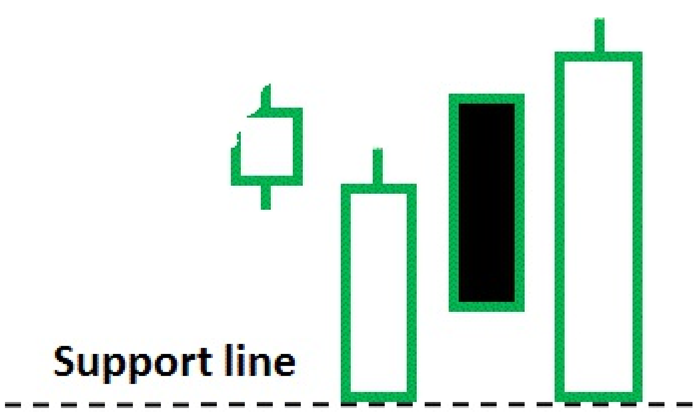

Figure 22 - Stick Sandwich

Support line. A support price is apparent and the opportunity for prices to reverse is possible.

What a Candlestick won't tell you

Although Candlestick deliver the most information of any of the charting methods they have a shortfall; they do not reflect the sequence of events that took place between the open and close. They only show the final results of the open and the close. The high and the low points are obvious and indisputable but Candlesticks unfortunately cannot tell you which of the high or low came first.

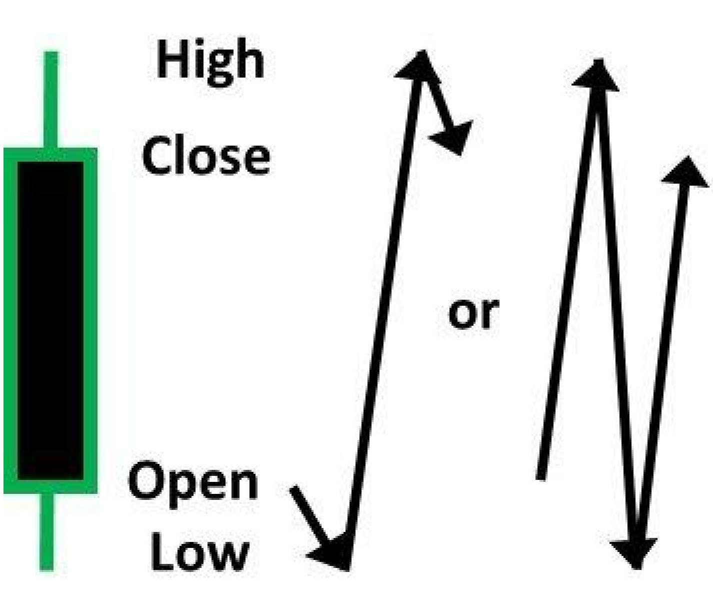

Figure 23 – How a Candlestick could get created

For example, with a long Bullish candlestick the assumption is that prices advanced for most of the session. Based on the high and low sequence, the session could have been a lot more volatile. The example above depicts two possible high and low sequences that could form the same resultant Candlestick.
The first sequence shows two small moves and one larger move: a small reversal off the open to form the low followed by a sharp retracement to form the high and finally, a small decline to form the close. The second sequence shows three rather sharp moves: a sharp advance off the open to form the high, a sharp decline to form the low and finally, another sharp advance to form the close.
The first sequence portrays strong, sustained buying pressure and would be considered more Bullish. The second sequence reflects more volatility with some increased selling pressure. These are only two examples and there is a multitude of potential combinations that could result in the creation of the same basic Candlestick.
Candlesticks still offer valuable information on the relative positions of the open, high, low and close. Just remember that the trading activity that finally formed a particular Candlestick can vary dramatically.

Merging Candlesticks

There is an interesting phenomenon with Candlestick patterns; those patterns that are made up of one or more Candlesticks can usually be merged together to form a single Candlestick. This resultant Candlestick should always capture the principals of the original pattern.

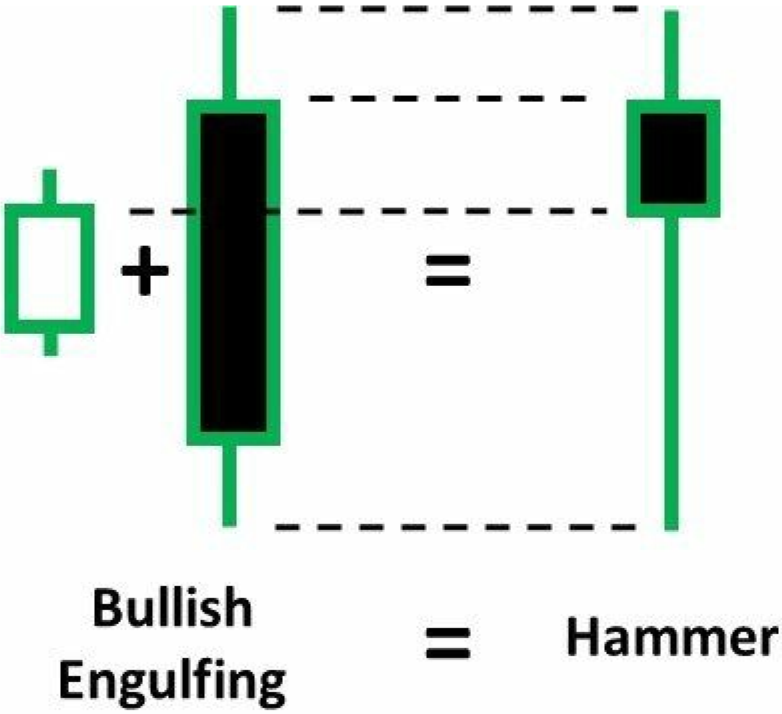

Figure 24 - Merging a two Candlestick pattern

Generally, you can achieve this by using the following components – those in a two Candlestick pattern:
 The open of first Candlestick
 The close of the second Candlestick
 The high and low of the pattern

In this example, use the close of the first Candlestick to create the open of the resulting candle. Use the open of second Candlestick to create the new open.

Finally, use the high and low of the pattern to create the new high and low of the single candle. From the two candles, which represent a Bullish Engulfing Pattern you can merge them into a single Hammer pattern. The long lower shadow of the Hammer signals a potential Bullish reversal and just as with the Hammer, the Bullish Engulfing Pattern requires Bullish confirmation.

Chapter 5 - Trading Price Action

The following strategies utilise Price Action. Although they do not use any indicators they often use some form of Support and Resistance lines.

Pure Price Action

Without considering Candlestick patterns, the principle behind using Price Action to gauge future market direction is relatively simple. One strategy will do this is;

Wait for at least three candles all in the same direction – more than 3 is even better

A candle in the opposite direction negates the count – you would need to start the count again

In an Uptrend, wait for a candle to close below the Low of the previous candle, then enter with a Sell

In a Downtrend, wait for a candle to close above the high of the previous candle, then enter with a Buy

In the example, you can see the first Sell opportunity which is highlighted by the first circle. There were four distinct Bullish candles and then the momentum stopped – coincidentally on a Doji pattern, which helps to confirm the reversal. The next candle closed below the low of the Doji, which is the trigger to place the Sell order. The result was a sustained and profitable Bearish run.

The next circle shows a profitable Buy opportunity. Notice the swing high between the first and second circles – this did not meet the criteria for a sell opportunity as there were not three consecutive Bullish candles. There were two Long candles, a Short and another two Long candles. The next swing high also did not meet all the criteria.

The next two circles show where the candles met the requirements for placing an order – and as shown in this example, both were successful. The trigger highlighted by the third circle was also confirmed by a Doji pattern.

Chart 6 - Price Action strategy

Take Profit Points

Using this strategy your take Profit position – your exit strategy – is also rather simple.

Conservatively, you can wait for three consecutive candles in your direction and then close the order

A mandatory close would be a trigger in the opposite direction – where there is a reversal and the next candle closes either above the previous high or below the previous low

Head and Shoulders

This is a chart formation rather than a Candlestick pattern. The formation can range over many candles with the total number varying from formation to formation.

The Head and Shoulders formation consists of a Left Shoulder, a Head and a Right Shoulder. You would then add a line below the two Shoulders as the Neckline.

The Left Shoulder is formed at the end of an extensive move, either up or down depending on the formation, and is usually accompanied by high volume. Once the

top of the Left Shoulder
is formed there is a
reversal and prices slide

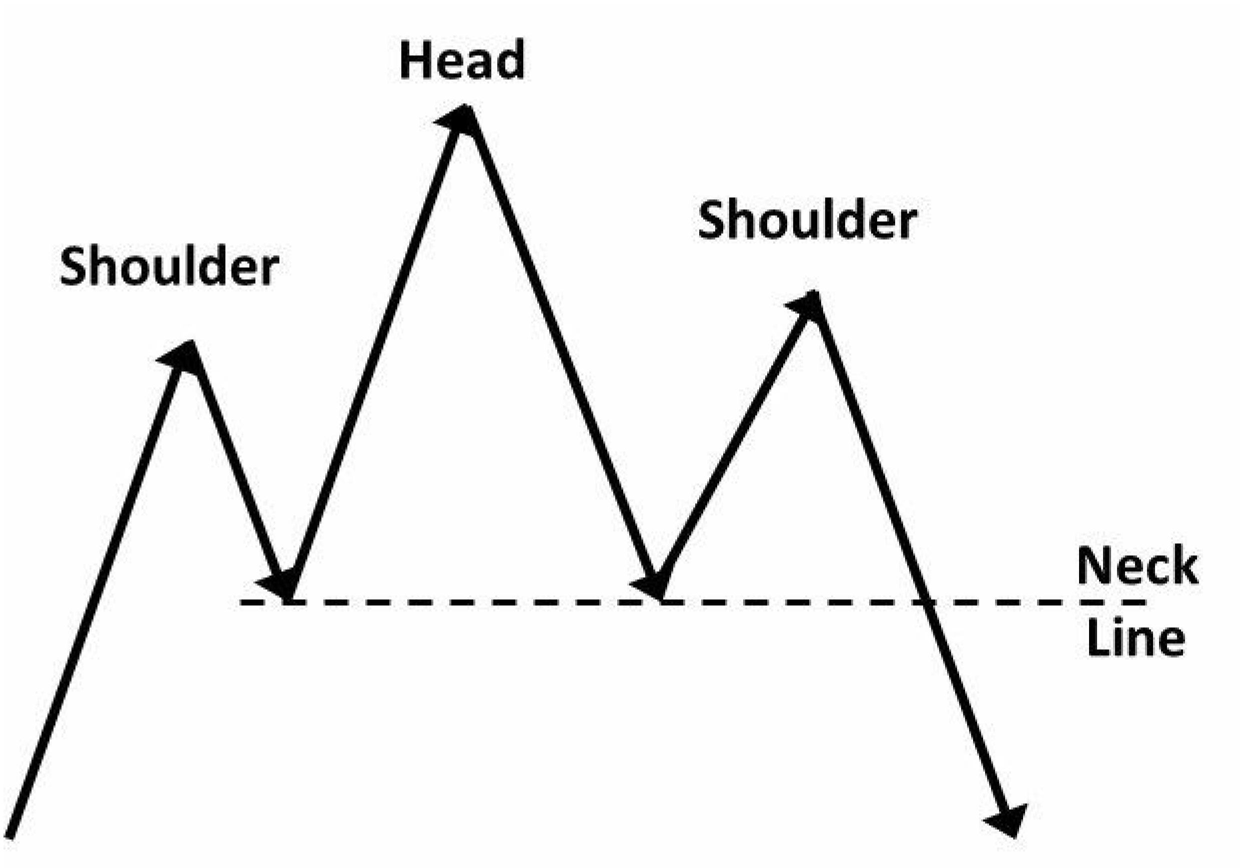

Figure 25 - Head and Shoulders Top

down generally with lower volume. The prices then rally upward to form the Head, but now with greater volume. There is then a second retracement back down with less volume.

The Right Shoulder is formed when prices rally but remain below the Head. They should then retrace and fall down to at least below the peak of the Left Shoulder.

A neckline is drawn across the bottoms of

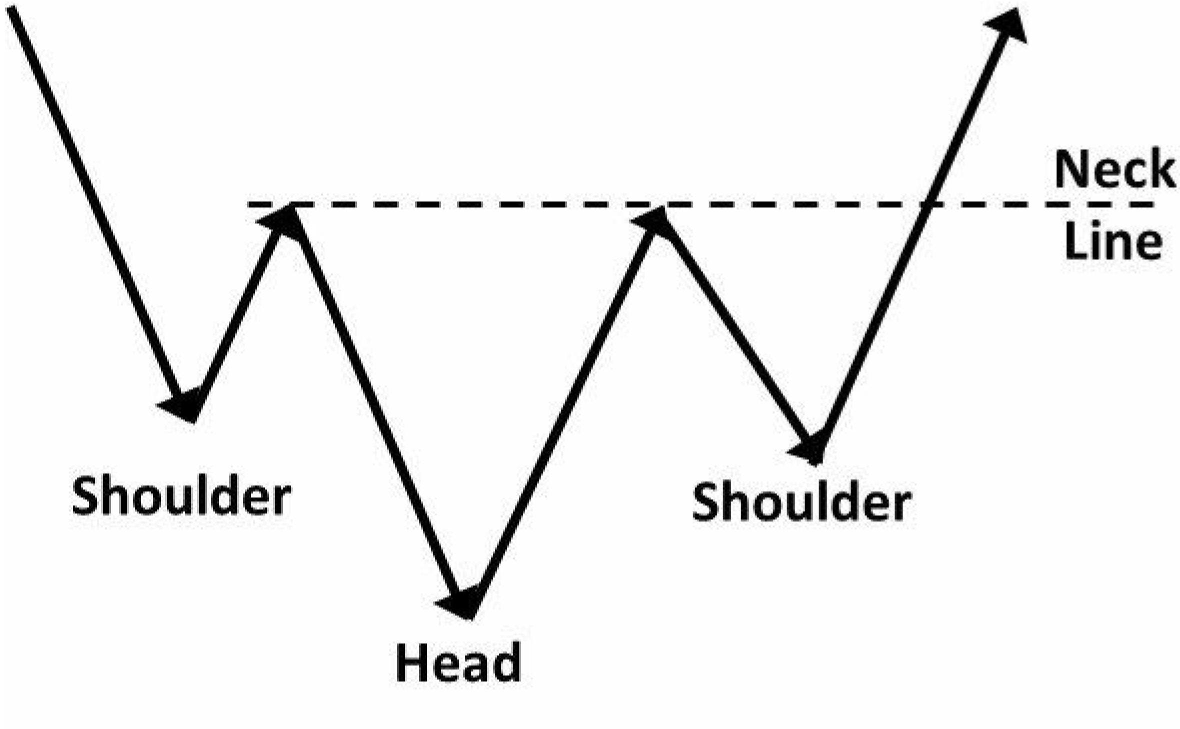

Figure 26 - Head and Shoulders Bottom

the left shoulder, the head and the right shoulder. When the price breaks through this neckline and keeps on falling after forming the right shoulder, it is confirmation of the completion of the Head and Shoulders Top formation.
The Neckline is important as it forms a Support or Resistance line for the two Shoulders. The formation is incomplete until the neckline has formed.
You get both a Top Head and Shoulders and a Bottom Head and Shoulders pattern – the Bottom is the reverse of the Top formation – as shown in the two diagrams above.

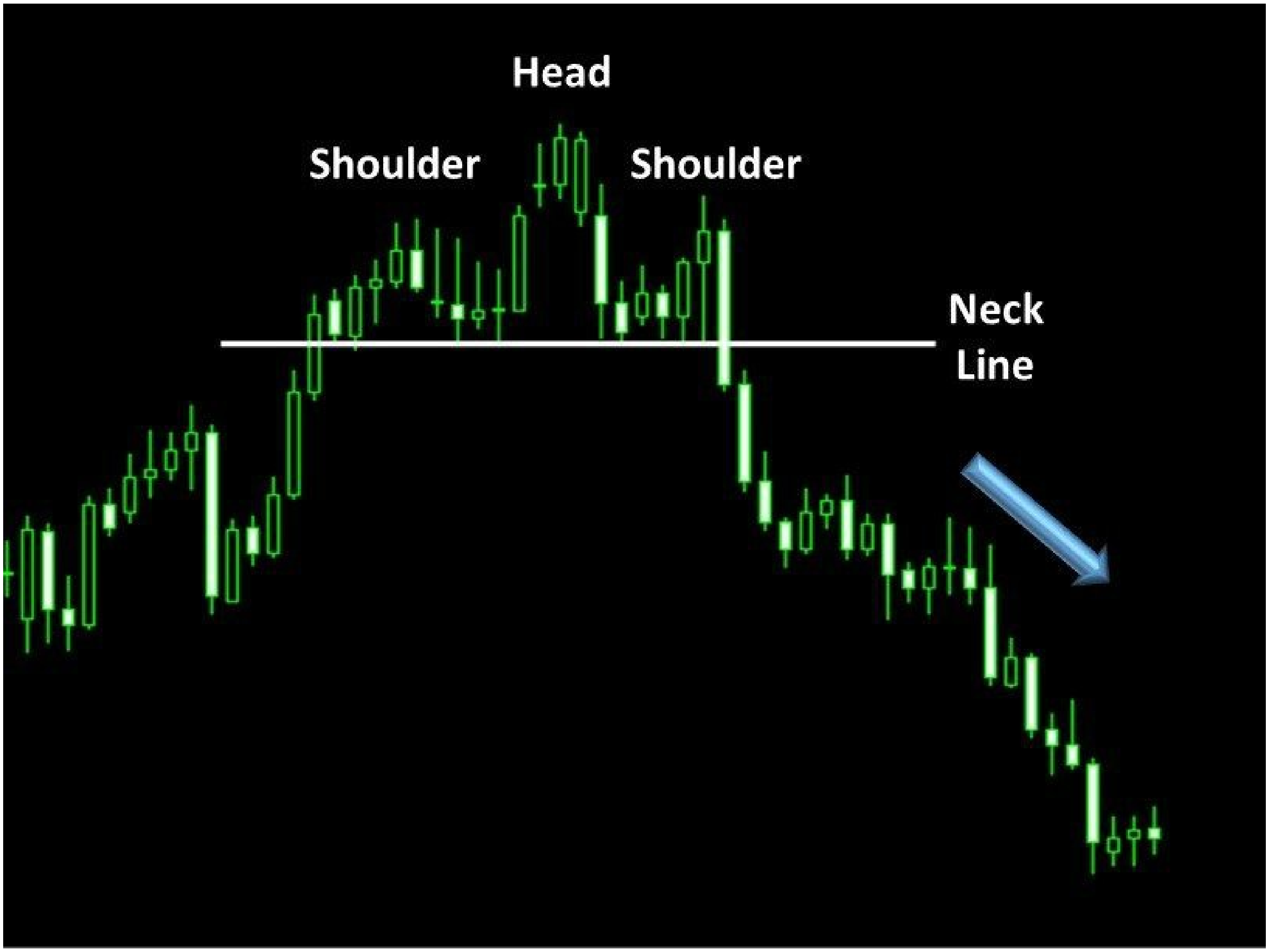

Chart 7 - Head and Shoulders

Trading the Head and Shoulders Formation

It is relatively straight forward to take advantage of this formation. Wait for confirmation of a breakout down through the neckline after the Right Shoulder forms. This is your signal for a Sell entry, if the formation is a Top Head and Shoulders. Alternatively, enter a Buy if it is a Bottom Head and Shoulders.
Your exit points, - your Take Profits – are a little less well defined. Basically you would have to wait for a reversal Candlestick pattern to appear, or exit just above a Support or Resistance line if you have them. You would place your Stop Loss just above the high of the right shoulder for a Top formation. They would be just below the Right Shoulder for a Bottom formation.

Double Top

This is another formation rather than a pattern. You can even think of it as a Head and Shoulders but without the Head – only the two Shoulders.

It appears as two consecutive peaks of approximately the same price – they can form a

Resistance line but this is not mandatory. The two peaks are separated by a trough between them. The price level of this trough is

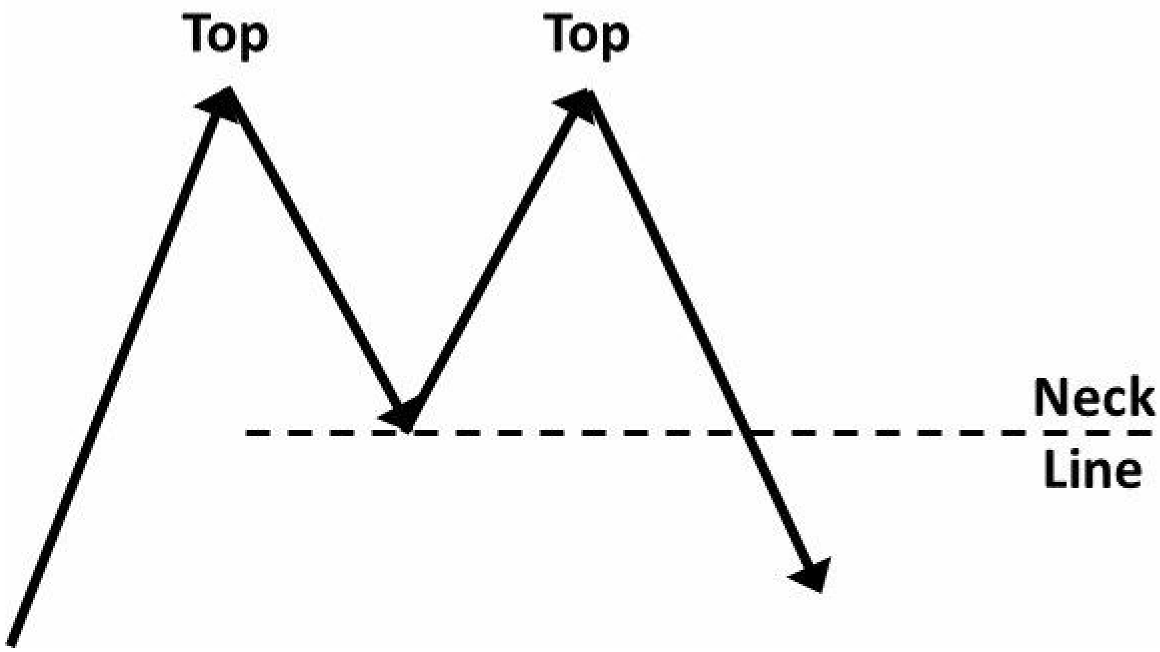

Figure 27 - Double Top

the Neck Line of the formation. The formation is completed and confirmed when the price falls below the neck line indicating that further price decline is highly probable. The double top pattern shows that demand is outpacing supply – the buyers are dominating - up to the first top. This will cause the price to rise. The supply-demand balance then reverses; supply outpaces demand
– the sellers now dominate - causing the price to fall. After a price valley, the buyers again begin to dominate again and the prices rise.
This formation is generally regarded as a Bearish signal if prices drop below the neck line after the second Top. The formation is often found at the end of a Bullish trend.

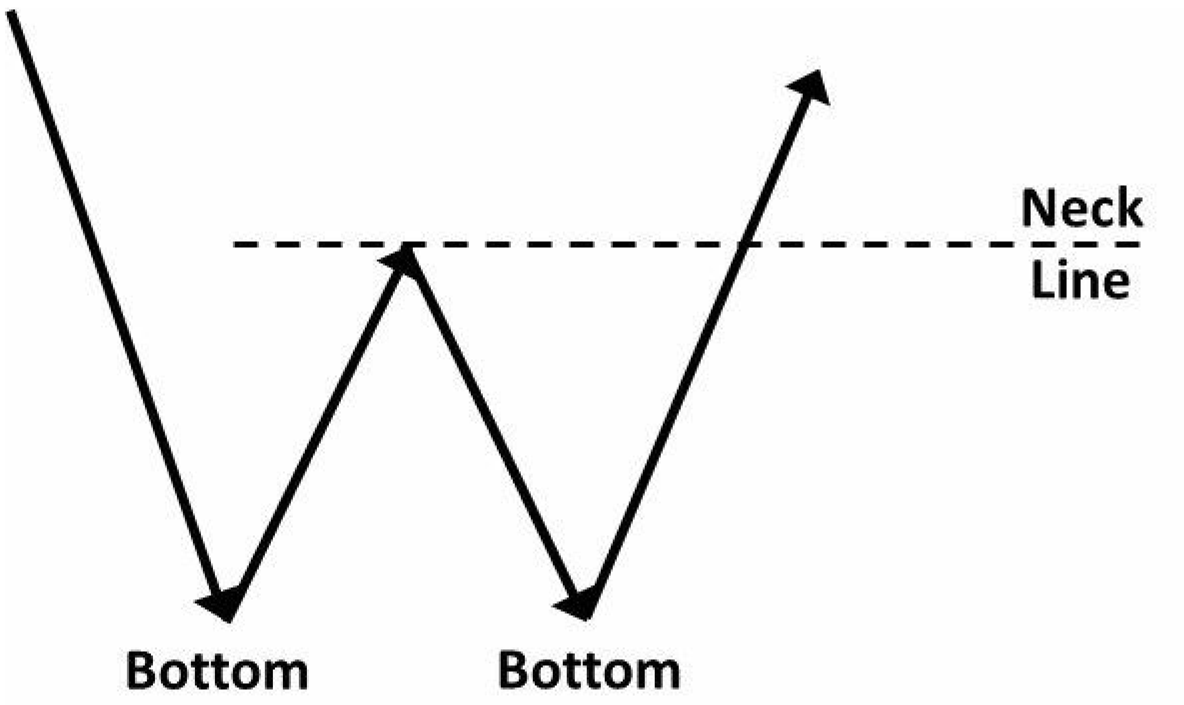

Figure 28 - Double Bottom

As a word of caution, the valley between the two Tops should be reasonably well formed. If they are too close – if the valley is too small it could be that it is simply a minor reversal in the basic upward trend and not the actual valley. In this case, the Double Tops formation would not be created.

As expected, there is the opposite formation; Double Bottoms, which is the reverse of the Double Tops.

Chart 8 - Double Top

Trading the Double Top Formation

Trading this formation is similar to trading the Head and Shoulders formation.
You would wait for confirmation of a break down through the neckline after the second Top was formed. This would be your signal for a Sell entry - when the formation is a Double Top. Alternatively, you would enter a Buy for a Double Bottom.
Just as with the Head and Shoulder formation, your exit points, - your Take Profits – are vaguely defined. You would have to wait for a reversal Candlestick pattern to appear or exit just above a Support or Resistance line.
You would place your Stop Loss just above the high of the second Top for a Double Top formation. They would be just below the second Bottom for a Double Bottom formation.

Triple Top

As expected, this formation is almost identical to the Double Top formation with the exception that it has an additional high and low in its makeup, making three high Tops.

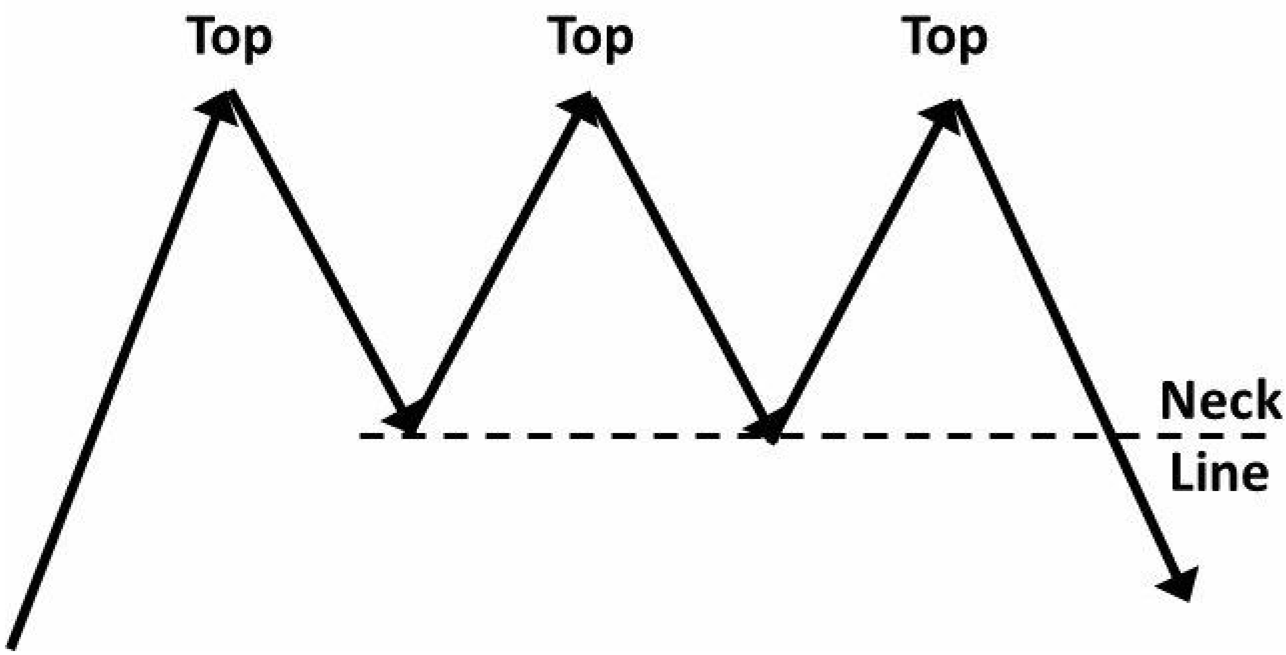

Figure 29 - Triple Top

The fundamentals that drive the Triple Top formation are the same as those for the Double Top except that there is one more renewed attempt by the Buyers to enter the market. If this action did not take place and the Sellers rallied, you would have had a perfect Double Top with the price continuing down. It is this last attempt by the Buyers that creates the third Top.

The formation is only complete when the price drops below the Neck Line – which is also the entry for a Sell opportunity.

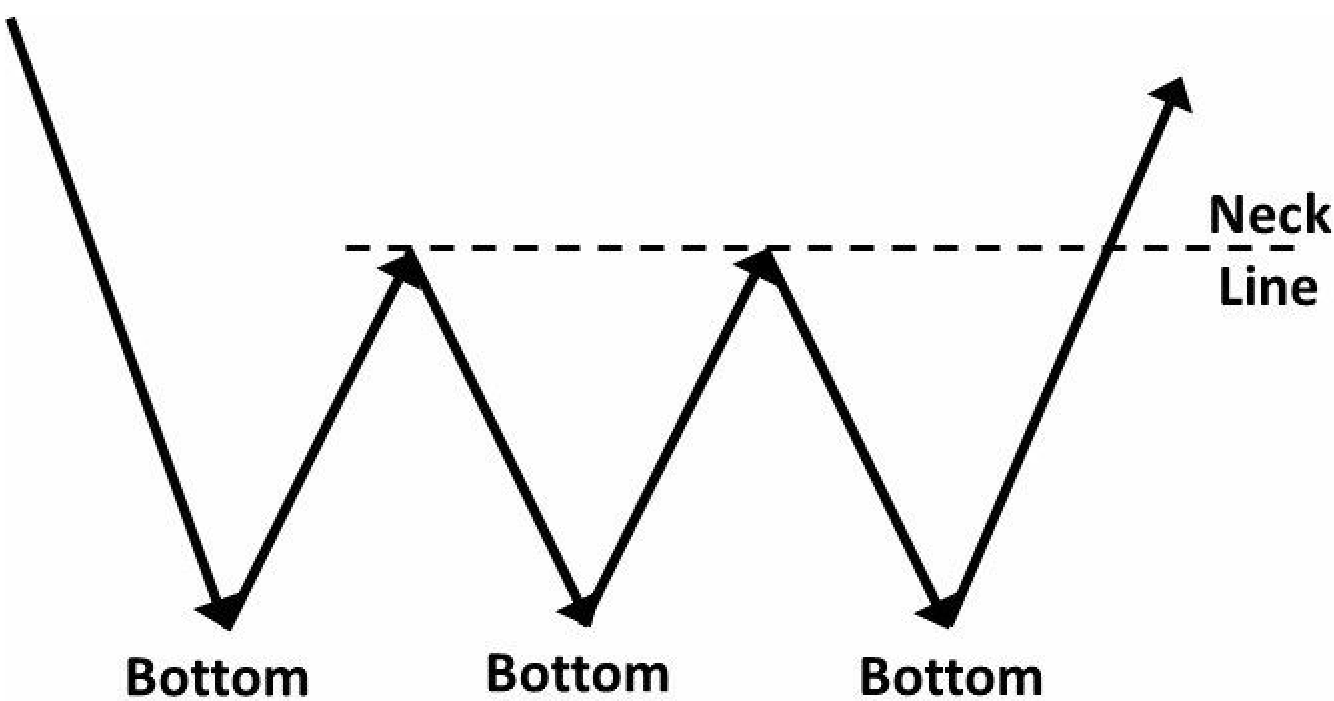

Figure 30 - Triple Bottom

Just as with its counterpart there is also a Triple Bottom which is the reverse of the Triple Top.

Chart 9 - Triple Top

Trading the Double Top Formation

Trading this formation is identical to trading the Double Top or Bottom formation. You would wait for confirmation of a breakdown through the neckline after the third Top was formed. This would be your signal for a Sell entry
- if the formation was a Triple Top. Alternatively, you would enter a Buy for a Triple Bottom.
Just as with the majority of these formations, your exit points, - your Take Profits – are less well defined. You would have to wait for a reversal Candlestick pattern to appear, or exit just above a Support or Resistance line.
You would place your Stop Loss just above the high of the third Top for the Triple Top formation. They would be just below the third Bottom for a Triple Bottom formation.

Gartley Pattern

This is an interesting pattern that was first introduced in 1935 by trader H.M. Gartley in his book, Profits in the Stock Market. There are some very definitive rules regarding this formation but it will suffice to say that you would look for a lopsided “M” or a lopsided Double Top.

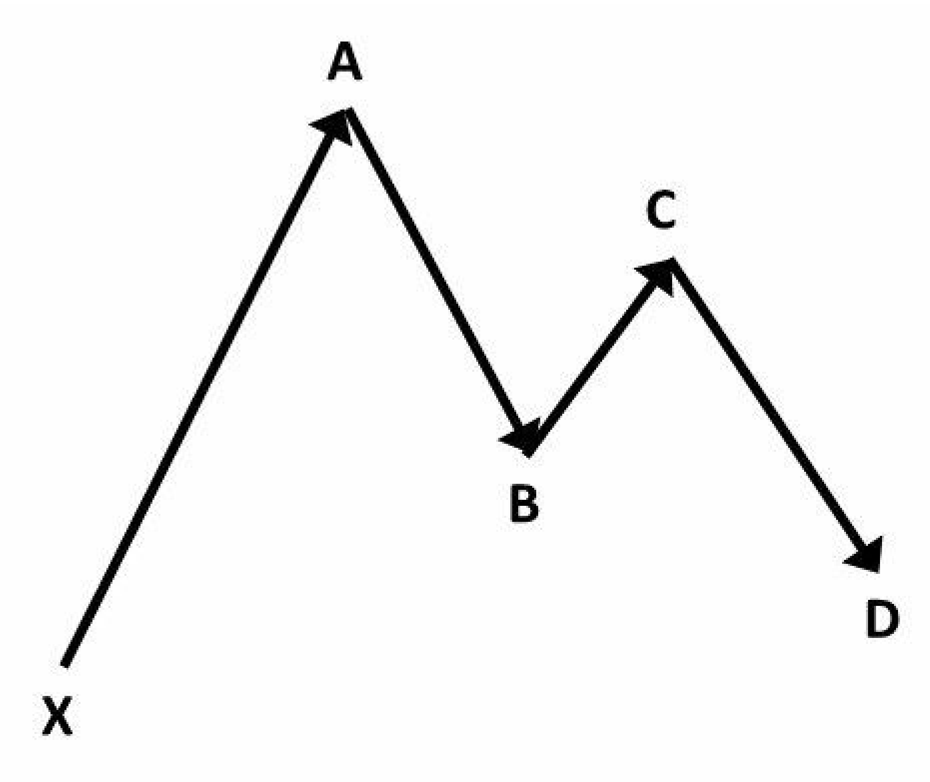

Figure 31 - Bullish Gartley

I find this to be a rather accurate formation - it doesn’t appear too often, but when it does, I follow its prediction. Also, to be completely truthful, I have an indicator which easily identifies this pattern and draws the pattern on the chart and I use this indicator on all my charts. If you are interested, it is freely downloadable off the internet.
A few points to consider;

It contains a bullish ABCD pattern preceded by a significant low
- point X
Ideally, X to A line should move in the direction of the overall trend
The move from A to D typically reflects a short-term correction of the established trend
Point D should reflect the convergence of Fibonacci retracement and Extension levels, suggesting a potentially stronger level of support giving a higher probability for market continuation of the original trend

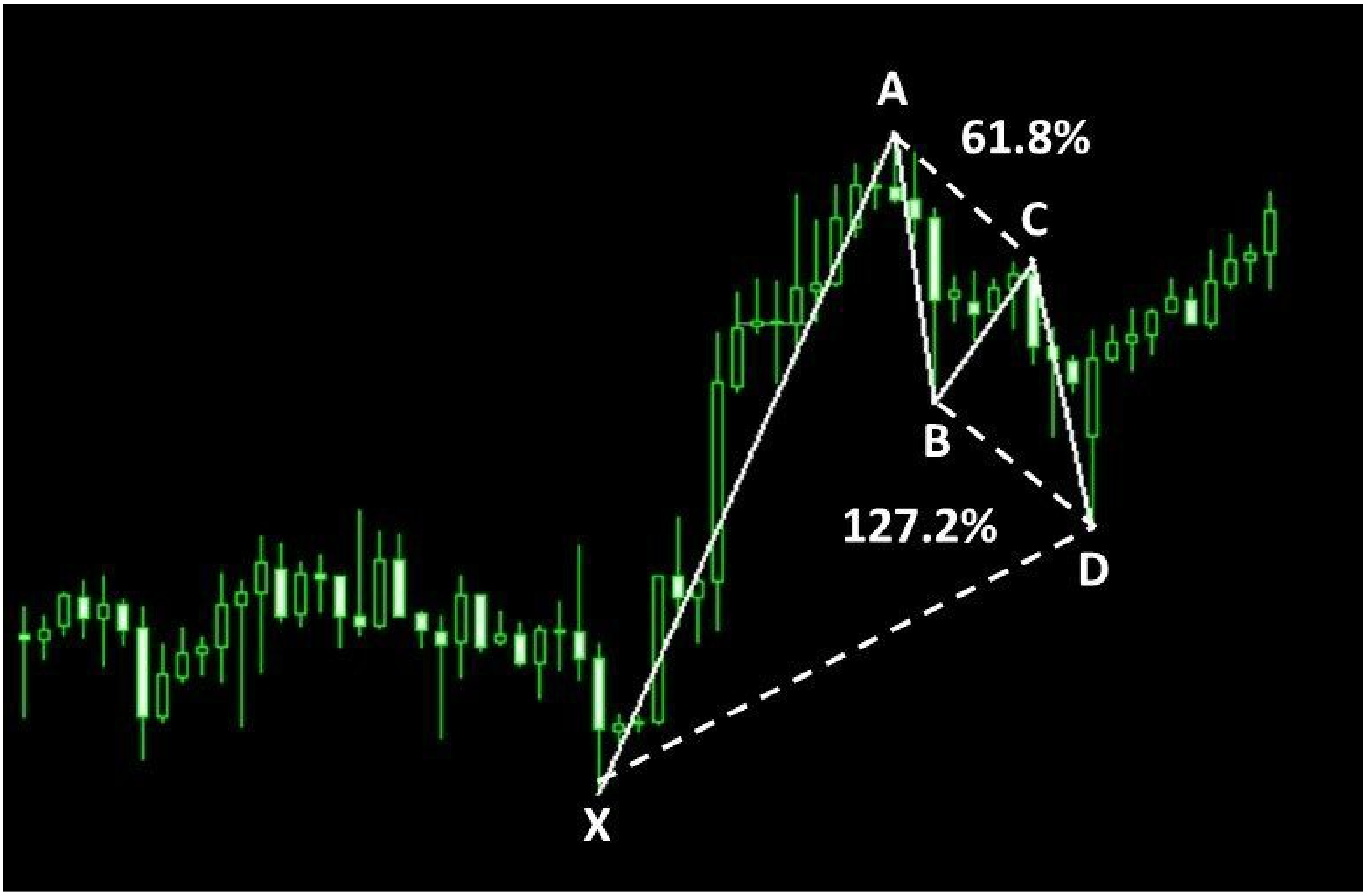

Chart 10 - Bullish Gartley

For this pattern to be valid, each of the points - X, A, B, C and D - should represent a significant high or significant low on a price chart. These points define four consecutive price swings or trends which make up each of the four pattern lines.
Some rules to try and consider;

Swing down from point A to D ideally will be a 61.8% or 78.6% retracement of XA
The time from XA and AD ideally should be in ratio and proportion to the Time of AD and is typically between 61.8% – 161.8% of XA
In case the ABCD move may complete at 100% of XA – this would be a Double Bottom. In this case, the time of XA and AD should be equal for an accurate Double Bottom

The following points comprise the make-up of all of H.M. Gartley's patterns.
Point X is the start of the trend – either up or down Point A is the end of the initial trend
Point B is the first pullback of the trend
Point C is the reversal after the pullback; generally, not breaking

point A

Point D is the last of the markets reversal momentum

Trading the Gartley pattern Trading this formation is similar to trading the other formations.

You would wait for confirmation of a breakout through the CD Resistance line once the full pattern was formed. This would be your signal for a Buy entry if the pattern was a Bullish Gartley. The reverse of this holds for a Bearish Gartley.

Just as with the other formations, your exit points, - your Take Profit and Stop Losses – are less well defined. You would have to wait for a reversal Candlestick pattern to appear or exit just above a Support or Resistance line.

You would place your Stop Loss below the low of the CD leg of the formation.

Butterfly

There is quite an assortment of harmonic patterns, although there are four that seem most popular. These are the Gartley, Butterfly, Bat and Crab patterns.
This is another pattern from H. M. Gartley and was originally published by him in his book Profits in the Stock Market. What is interesting though, is that the Fibonacci levels were only later added by Scott Carney in his book The Harmonic Trader.

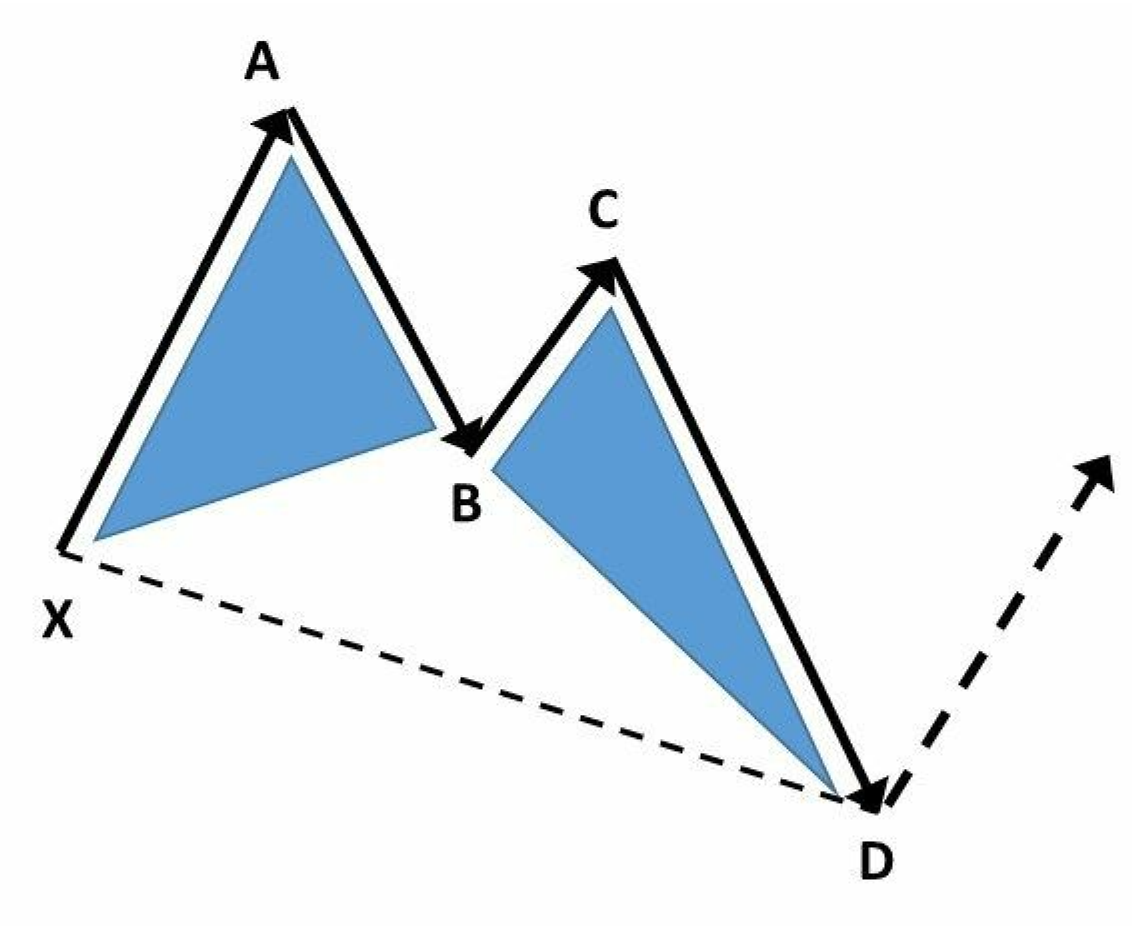

Figure 32 - Bullish Butterfly

This formation is very similar to the Gartley except for one major difference. In the Gartley, point D is above point X; in this pattern it is important that point D is well below point X.

There is another technical difference; a Butterfly pattern completes at the convergence of two separate Fibonacci extension levels, whereas the Gartley completes at the convergence of a Fibonacci retracement and extension.

Lastly, the pattern is basically formed by connecting two triangles at point B.

Aside from those three points there is a lot of similarity between the two formations.

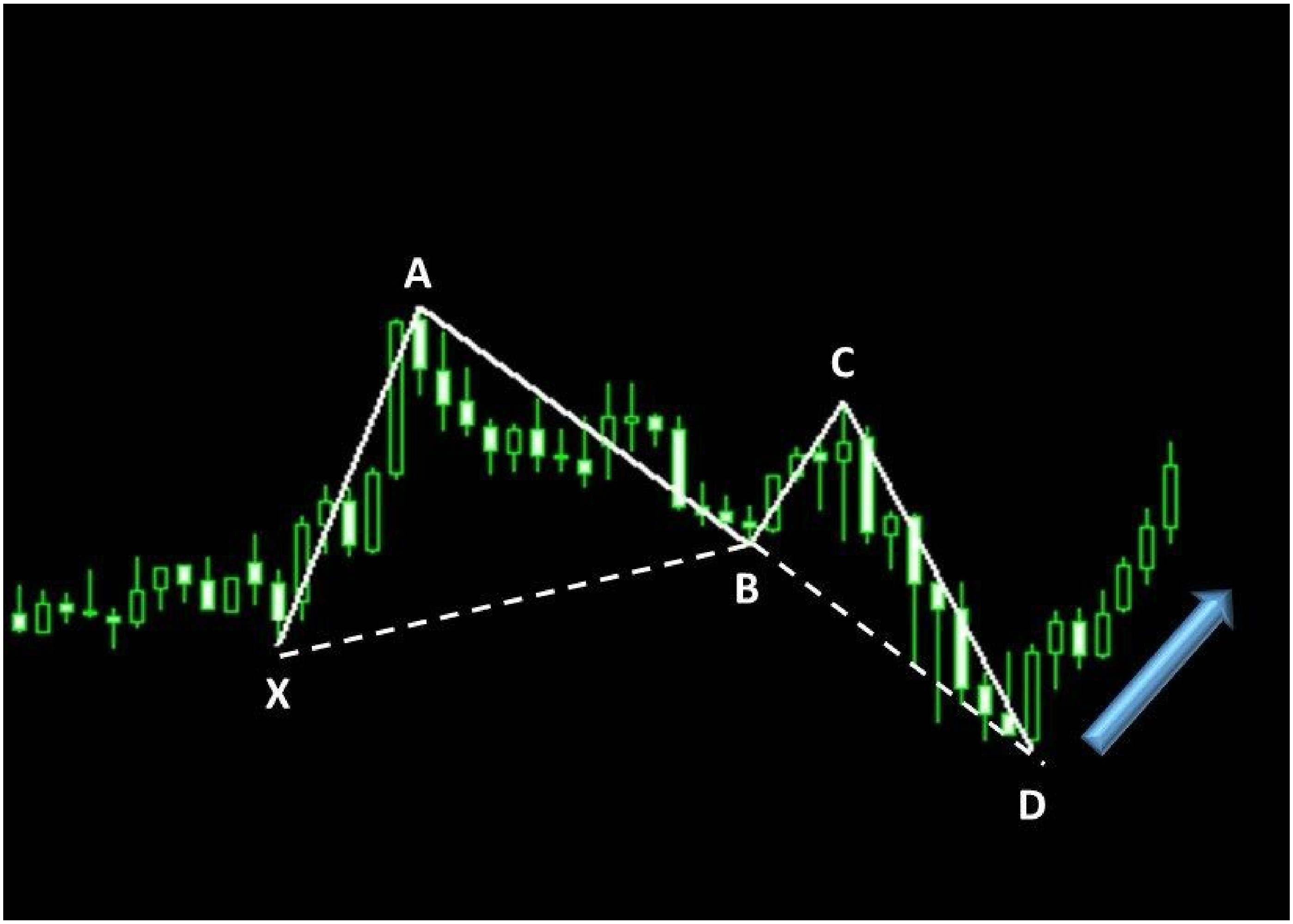

Chart 11 - Bullish Butterfly

Some points to consider about the Butterfly;

- Contains an ABCD pattern preceded by a significant low, or high, at point X
- Convergence of Fibonacci extension ratios - Point D is the extension of BC and XA
- It is formed by two connecting triangles at B
- The formation is only found at significant highs and lows

Just as with other formations, you have the reciprocal Butterfly as well; the Bearish Butterfly which is simply the opposite of the above. The triangles – the wings – would be pointing down.

Trading the Butterfly pattern

Trading this formation is almost identical to how you would trade the Gartley formation. Wait for confirmation of a breakout through the CD Resistance line once the full pattern was formed. This would signal a Buy entry if the pattern was a Bullish Butterfly. The reverse of this hold for a Bearish Butterfly Just as with the other formations your exit points - your Take Profit and Stop Losses – are not well defined. To exit, you would

have to wait for a reversal Candlestick pattern to appear or alternatively, exit just inside a Support or Resistance line.
You would place your Stop Loss below the low of the CD leg of the formation.

Bat formation

This is another formation identified by H.M. Gartley which is similar to the others but with some technical variations.

The Bat pattern is close to the Butterfly in appearance but not in its technical makeup. Point B has a smaller retracement of XA of 0.382 or 0.50 – but less than 0.618. The extension of the BC wave into D is at minimum 1.618 and potentially 2.618. Therefore, D will be a 0.886 retracement of the original XA wave.
Also, you will find that point D is higher than point X; whereas with the Butterfly it is lower.

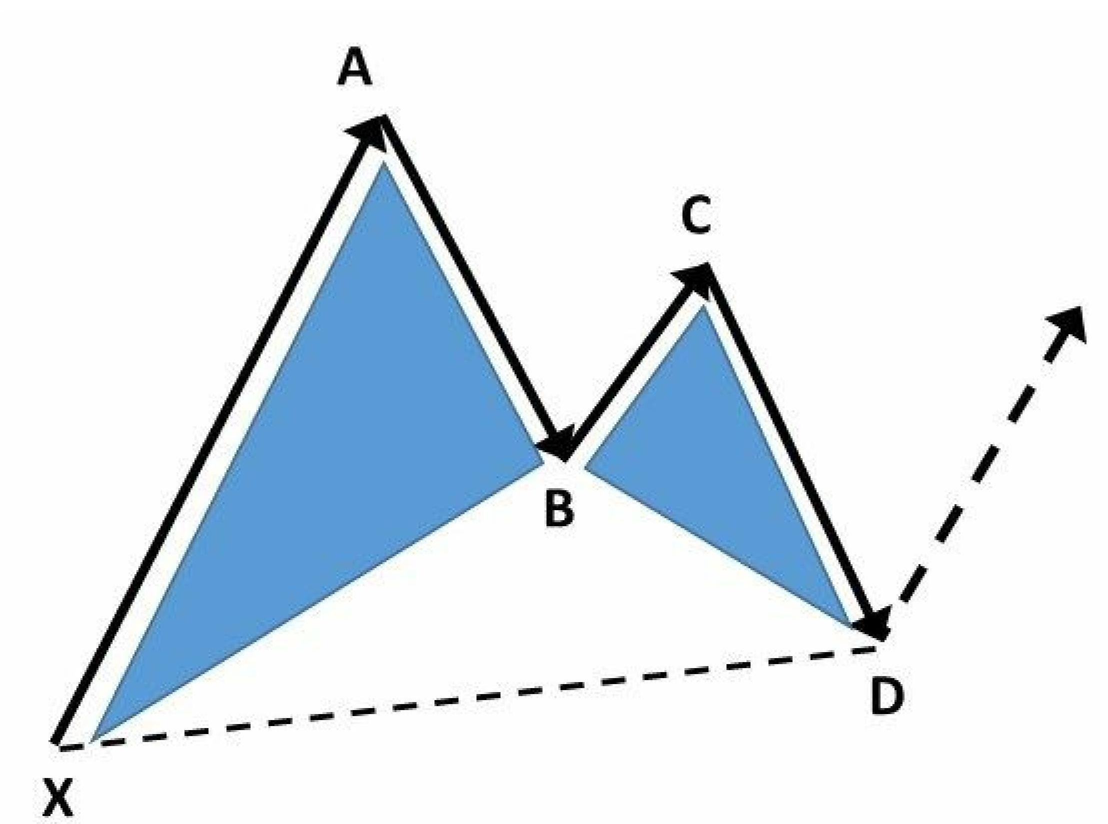

Figure 33 - Bullish Bat

When the selling has stopped and the buyers enter the market, you would place a long position and take advantage of the Bullish reversal on the breakout of the CD Resistance line – this for a Bullish Bat. The opposite is true for a Bearish Bat.
The makeup is similar to the Butterfly in that the formation comprises of two triangles – pointing up for a Bullish formation and pointing down for a Bearish one.

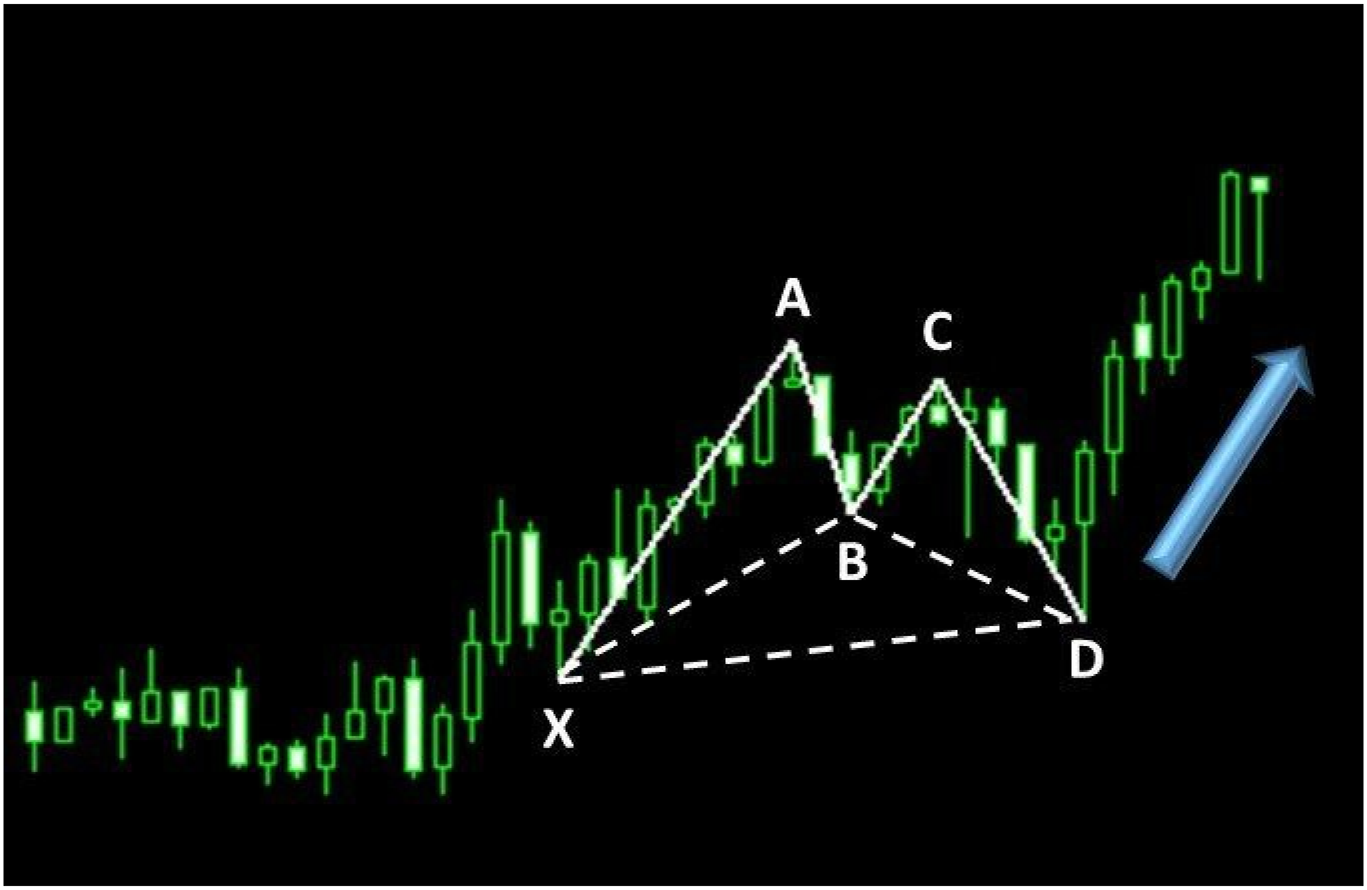

Chart 12 - Bullish Bat

Trading the Bat formation

Trading the Bat is identical to trading the Butterfly in every respect.

You would wait for confirmation of a breakout through the CD Resistance line once the full pattern was formed. This would be your signal for a Buy entry if the pattern was a Bullish Bat - the opposite is true for a Bearish Bat.

Just as with most of these formations, your exit points - your Take Profit and Stop Losses – are less well defined. You would have to wait for a reversal Candlestick pattern to appear or exit just inside a Support or Resistance line.

You would place your Stop Loss below the low of the CD leg of the formation.

Cup and Handle

This is another formation pattern and not a Candlestick pattern. As you would expect, it is made up of many candles over a long period. In reality, it is often much more erratic than the diagram below. Although the

formation can range of many candles, its basic form should remain

the same.

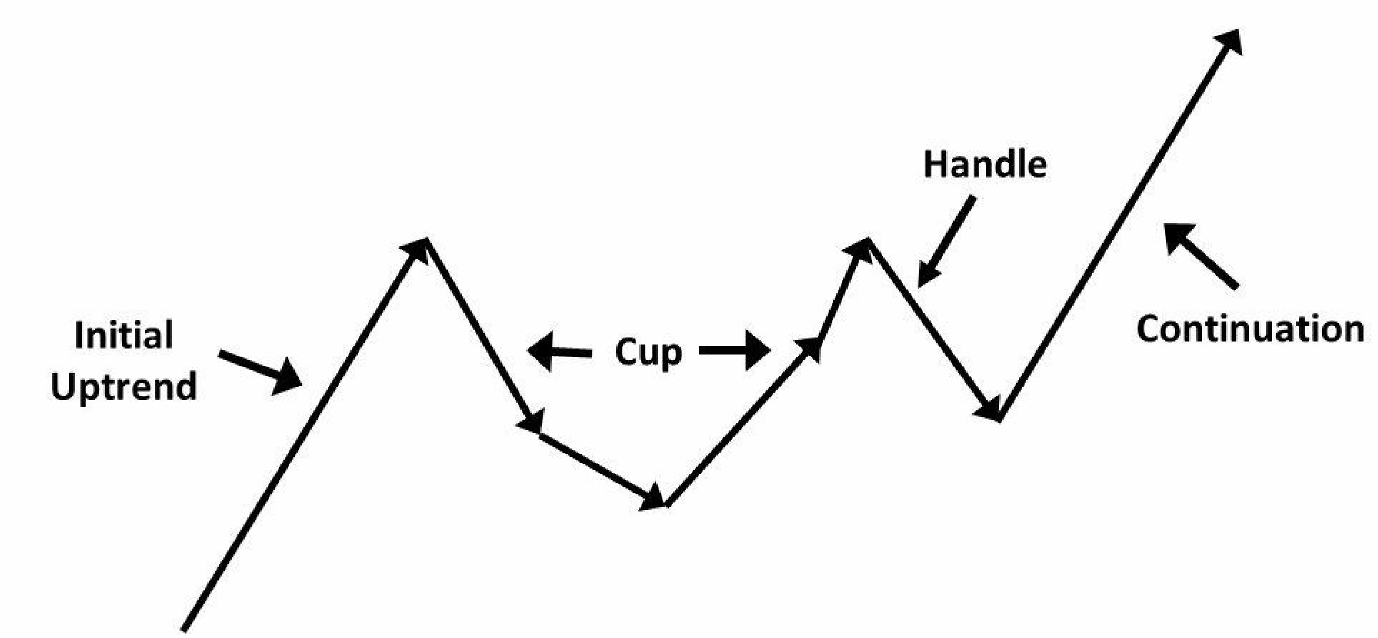

Figure 34 - Cup and Handle

There are a few important requirements that the pattern has to meet. These are;

It must be preceded by a reasonably strong upward move This then stalls and retraces to start the Cup The price will then consolidate – have no clear trend – for a few candles This would be the bottom of the Cup The price will then regains momentum and moves back upwards to near the peak of the initial upward move This action creates the complete cup The last part of the formation - the handle - is a relatively small downward move, which is over a few candles The final component is when the price moves higher to continue its original trend

In general the higher or stronger the initial trend, the weaker the final breakout. This is due to the energy expended in the initial upward trend weakening the final breakout – the opposite is also true.

Also, the Cup should be realistically well rounded; the reason is that the Cup and Handle pattern is a signal of consolidation within a trend. It is this consolidation that forms the rounded bottom of the Cup. Finally, the Handle; you should draw at least a Resistance line if not a complete Channel along the Handle. It is the breakout of the Resistance line that triggers the Buying opportunity.

Chart 13 - Cup and Handle

The example chart above highlights many of the Cup and Handle requirements. Most notable is the consolidation phase at the bottom of the cup. Also, in this example, the handle is neatly bounded by a channel.

Trading the Cup and Handle

Trading this formation is similar to most of the other formations discussed here.

You would wait for confirmation of a breakout through the Resistance line at the top of the Handle. This would be your signal for a Buy entry. Just as with the other formations, your exit points - the Take Profits – are not well defined. You would have to wait for a reversal Candlestick pattern to appear or exit just inside another Support or Resistance line.

You would place your Stop Loss just below the Support line of the Handle at the point of the breakout

Bearish Diamond

This is probably one of the more difficult patterns to recognise – or at least I think so.

To try and help you to identify it I would suggest that you look for a lopsided or offcentre Head and Shoulders pattern. One of the shoulders should be a lot lower, or higher, than the other. The Head must still be the prominent swing high.

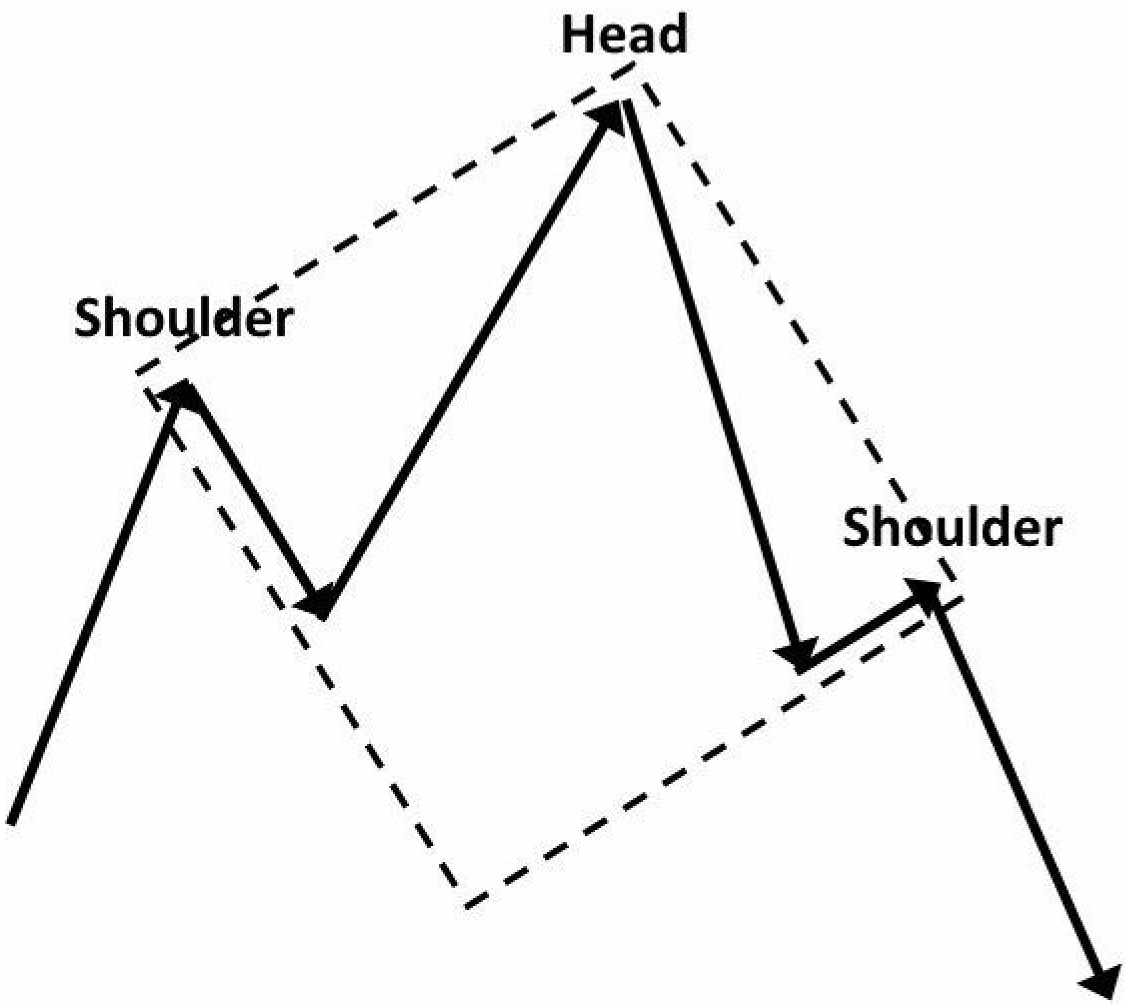

Figure 35 - Bearish Diamond

Once you have identified these points you need to draw a diamond - a square on its side – covering these three points. Also, you will notice there is no neckline in this pattern – the diamond takes its place.

To draw the Diamond, which acts as the Support and Resistance lines, you should start from the left Shoulder to the Head and then from the Head to the right shoulder. These two Resistance lines will form the top of the formation and importantly, the price should not break above the upper Resistance line formed by the right Shoulder. If the price was to break the Resistance line the pattern would fail and you would need to redraw it – the price would effectively have created a new right Shoulder. You would finally draw the two Support lines creating a Diamond which Support the lower troughs of the Shoulder. These two lines should now connect the bottom half to the top and complete the pattern.

Chart 14 - Bearish Diamond

The example chart shows most of the Bearish Diamond features. The offcenter Head and Shoulders is easily visible with the left Shoulder being lower than the right.
In this example, the Head is only just the highest swing high, but it is higher than both the Shoulders.
Perhaps the only component that may add some confusion is that there is almost a second right Shoulder. When the Support and Resistance lines of the Diamond are added all the components fall into place and it is more recognisable.
The breakout below the right Shoulder Support line is clearly visible and resulted in an extremely profitable Bearish price action.

Trading the Bearish Diamond

Trading this formation is similar to trading any of the previous formations; you would be looking for a break of the lower Right Shoulder Support line. You will then want to place your entry shortly below this level to capture the subsequent decline in the price. As with most formations your exit points, both Stop Losses and Take Profits, are less well-defined.

Candlestick Patterns

This strategy shows you how you can utilise Candlestick patterns in conjunction with Support and Resistance lines.

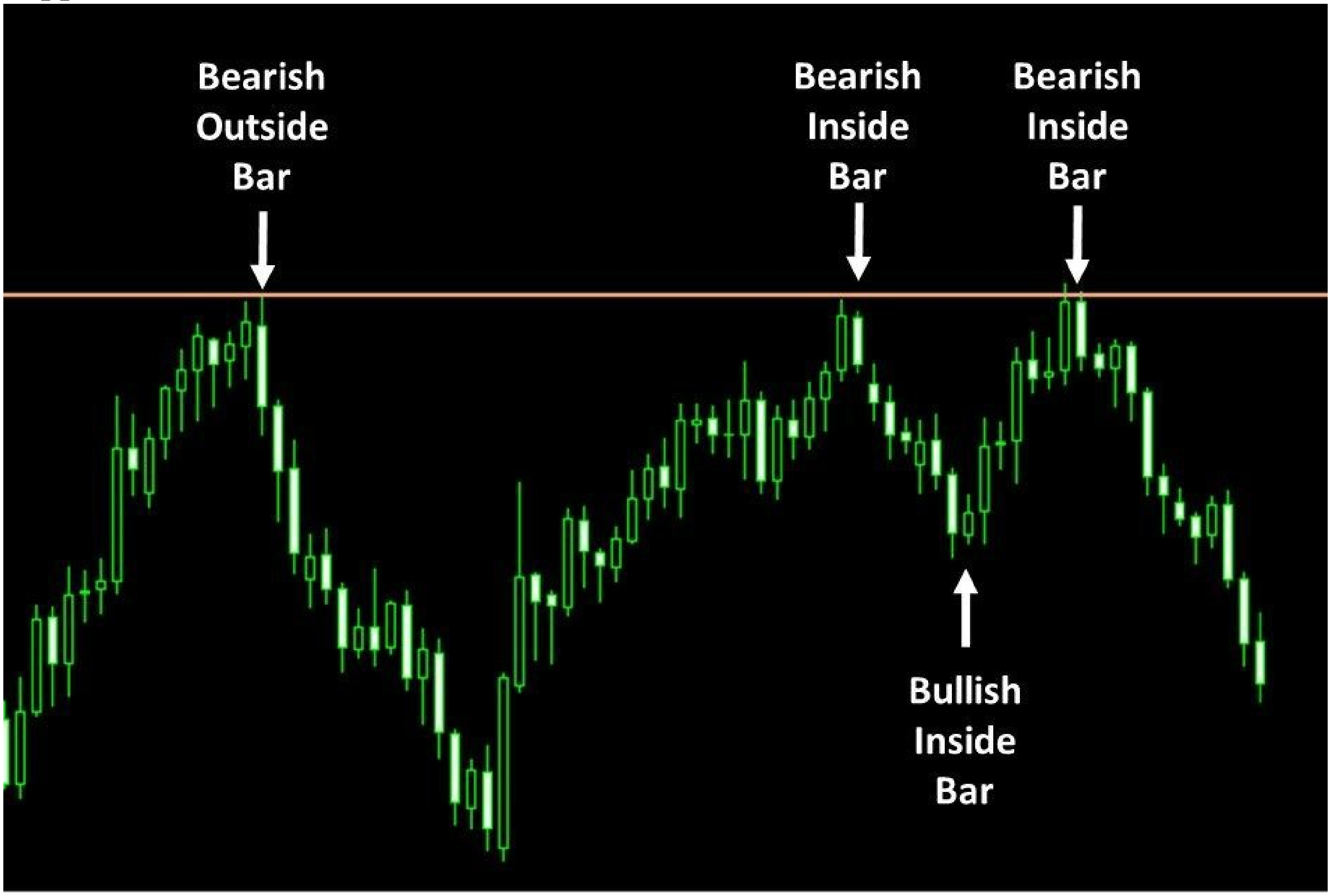

Chart 15 - Candlestick Patterns

From the example chart, you can see the first Bearish Outside bar which indicates a reversal of the trend. At this point you would not know that this swing high was to become a line of Resistance.
On confirmation of the new downtrend, you would then draw the Resistance line along the swing high. This would then become a future Resistance line for all other high points.

At the swing low after this, you can see an outside bar indicating a new Bullish reversal. This reversal is not highlighted on the example chart.

This Bullish trend continued back to the Resistance line and at that level there is a Bearish Inside bar pattern indicating a reversal and the start of another new Bearish trend.
This downward trend then reversed at a Bullish Inside bar pattern where it reversed all the way back to the Resistance line.
At the third hit on the Resistance line another Bearish Inside bar appeared indicating a

third Short opportunity.
Your exit points would either be just inside a Support or Resistance line or at an opposite signal from another Candlestick pattern.

Automated Pattern Identification

The indicator I discussed earlier – the one freely downloadable off the internet which will identify and highlight all of H.M Gartley's patterns.

I am aware that it goes against the principle of not using indicators when trading on price action however I think that this is justifiable as we are not using an indicator to predict market direction but rather only to highlight a pattern or formation.

You can find indicators to identify Gartley's formations and others to highlight Candlestick patterns.

Chart 16 - A highlighted Gartley formation

Of course the negative of using this type of indicator is that they tend to clutter your screen – you would need to make the decision whether to manually identify the patterns or to use some assistance.
On the positive side – the identification of the patterns is extremely accurate and

produces excellent trading results. Also, when using an indicator, you are less likely to miss any formations irrespective of how hidden they are in the chart.

However, ultimately the choice is yours whether to use this type of indicator or not.

Chapter 6 - Table of Captions

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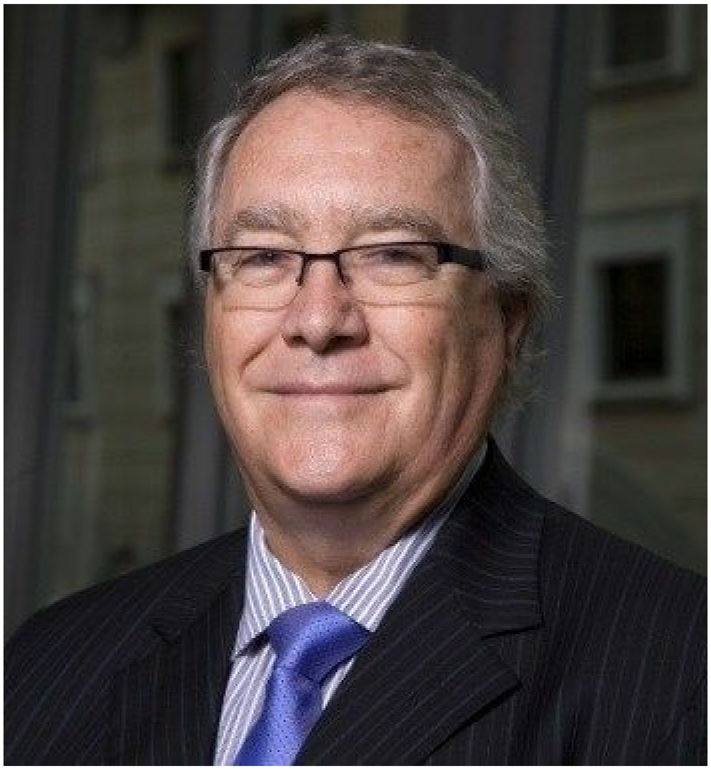
Charts

About the Author



Raoul Hunter has been an IT professional for over 40 years. He started trading Forex over 10 years ago initially with moderate success. Having persevered with his trading he has achieved a high degree of success in the last few years.
His technical IT background has been extremely valuable in his Forex endeavours

as he has developed a number of Indicators, Scripts and Expert Advisors for the MT4 platform.
Although this book explains some of the basics around Support and Resistance lines its primary focus is using these levels in day-today trading strategies. The strategies discussed here are tried and tested and produce some good results.
He has also published;

Forex Trading with MT4
Forex Trading with Moving Averages
Forex Trading with Support and Resistance