INTERNATIONAL
DAY TRADING
ACADEMY

THE COMPLETE GUIDE TO CANDLESTICKS

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Since 2014
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I am the Co-Founder and Director of the International Day Trading Academy. I have a background and a degree in teaching and I'm a passionate trader.

I'm well-recognized and highly respected in the IDTA trading community as an expert in the psychology of trading, economic cycles of trading, and Investments.

I have an extensive history in share trading, real estate, property development, and other forms of investing.

Since 2014 I have been a regular contributor for Australia's largest trading publication, Your Trading Edge magazine. I've contributed articles about psychology, forecasting, and technical analysis.

I hope that in reading this book you are able to improve, or build a foundation of trading psychology that can help you be the best trader that you can be.

To your success,

Cameron Buchanan
Professional Trader and Educator

INTERNATIONAL DAY TRADING ACADEMY

THE BEGINNERS GUIDE TO CANDLESTICKS

If you have ever seen a trading chart, you've likely seen a candlestick, candlestick charts have become the most popular chart type amongst traders. In this guide we'll walk you through what candlesticks look like, what candlesticks tell us about market activity, and how traders use them to predict market movement.

One of the main reasons that candlestick charts are so popular is the remarkable amount of information that candlesticks can provide in such a simple visual representation. Candlesticks can provide several separate pieces of information in one visual, and laid side by side give traders a strong representation of what other traders around the world are thinking. Understanding candlesticks is a fundamental part of trading, and as Day Traders we spend our days looking at charts filled with candlesticks. It's the movements, and characteristics of these candles that help us understand what the market is doing and indicate what we feel we should and should not be trading.

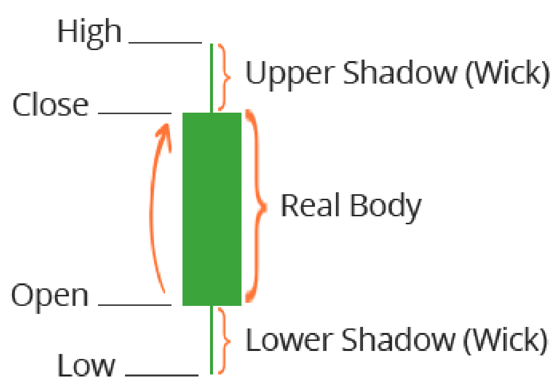
When we begin to view a number of candlesticks as they lay themselves out on a chart, traders are able to take the randomness of the market, using simple visuals, and piece together patterns that indicate probabilities.

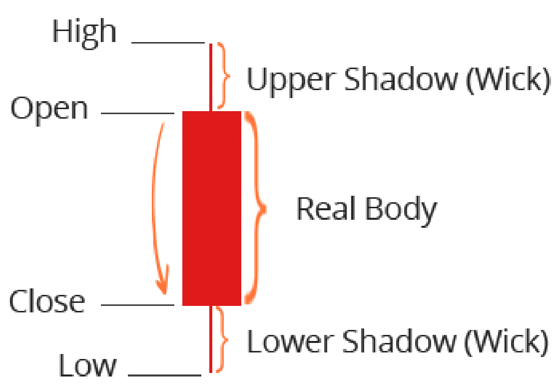
First, let's quickly establish what a candlestick describes in a general sense. A candlestick is a representation of price movement over a given period of time, a long term trader may look at candles that represent movement over a period of a day or month, whereas Day Traders most typically tend to look at 5 minute candles for example, which of course represents a period of 5 minutes.
There are 2 types of candlesticks, a "buyer's candle" (typically green) and a "sellers candle" (typically red). Both of these types of candle will provide 4 pieces of information which I'll get into shortly.

First, let's look at the parts that make up a candlestick. A candlestick consists of 3 parts, the "real body", or "body", a wick at the top of the body (upper wick), and a wick at the bottom of the body (lower wick). You can probably now see where they get their name "candlestick".

Those 4 pieces of information mentioned above are what dictate the composition of these parts (the body and upper/lower wicks). The first thing that a candle will tell us is the "open price" which is the price when the candle is first established. At the "close" of the candle (5 minutes after the open if looking at 5 minute candles) we will then also know the "close price", these two pieces of information are what make up the body of the candle, i.e.. the difference between the open price and close price. The upper wick will tell us the "high", or the highest price that was reached during that candle, the lower wick will tell us the "low" or the lowest price that was reached during that candle.

Let's take a look at some candlesticks.



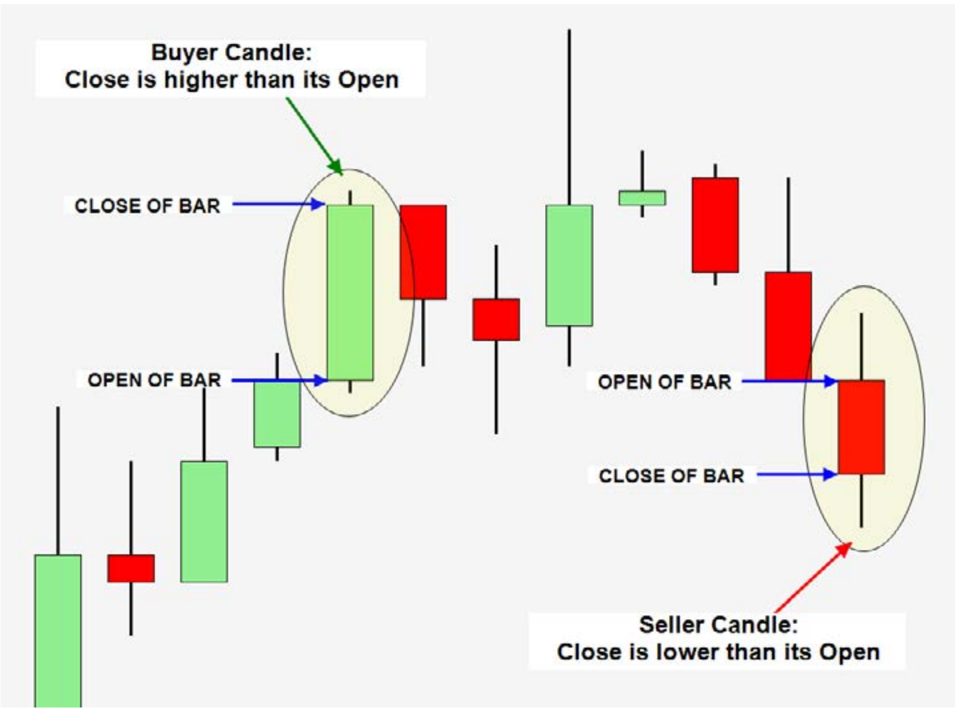


Candlestick example

It's 9:00am and a candle opens, for simplicity let's say at $1.00. After 5 minutes (9:05am) the candle has closed, the price is now $1.10, the difference between $1.00 and $1.10 on the chart makes up the body of the candle. Let's say within this period of 5 minutes the price went as high as $1.15, and was at one point as low as $0.90. These pieces of information creates the upper and lower wicks, respectively.

Buyer candles and Seller candles.

For a candle to be "green" (buyer's candle), the open price must be lower than the close price (in this case after the conclusion of the 5 minutes we are viewing). That being the case, it would mean that the buyers were able to push the price higher and we say that the sellers have owned the candle. As you can imagine, for a candle to be red in colour, the opposite is true. For a candle to be "red" (seller's candle), the open price must be higher than the close price. In this scenario the sellers were able to push the price down and we say that the sellers have owned the candle.



Putting the puzzle together

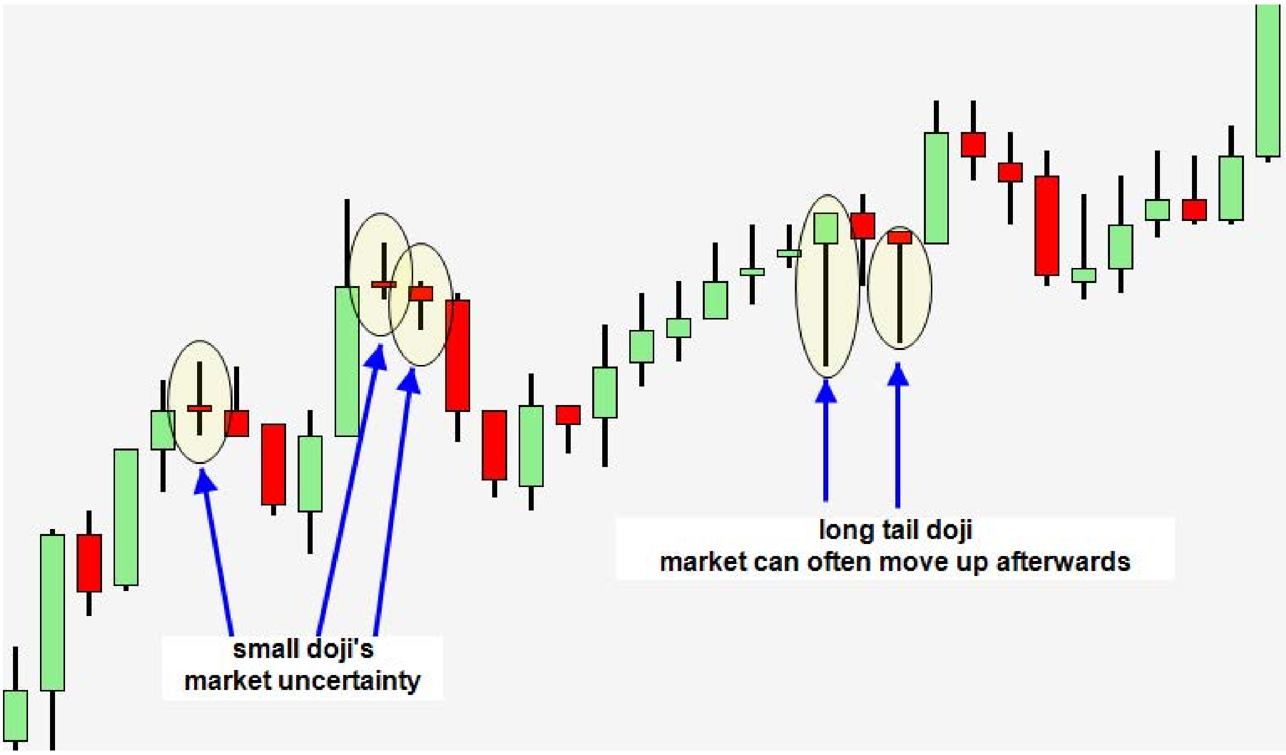
The markets and movement of price are completely random on a micro scale, but once we start to look at multiple candles next to each other, they begin to form common patterns that can suggest where the market is most likely to move (not that the market obliges every single time). But when a trader does this they are able to use probability to their advantage, based on what typically happens in such a scenario.

There are many different patterns that traders follow, each fitting into specific trading strategies. But no matter the pattern or strategy, the candlesticks will tell the trader whether they think they should buy, or sell.

"When you look at a string of candlesticks you begin to see patterns that you can base a strategy on"

Small bodied candles

A candle with a small body means that both the buyers and sellers pushed more or less as hard as each other and there was little movement after the end of 5 minutes. In this instance, the closing price is fairly close to the opening price, hence, there is no real dominance by either team. These are called Doji candlesticks, should the candlestick have a large wick, either top or bottom, that means that at some point in that 5 minute period there was dominance from either the buy (the top wick) or seller (the bottom wick). This indecision is called 'sideways movement', or a period of 'consolidation', this could imply a potential reversal in some cases (the International Day Trading Academy 101 Futures Trading Course discusses this in detail). A long wick can also indicate a potential reversal.



Large bodied candles

A candle with a large body means that either the buyer or seller has dominated during the period of time that the candle represents. If the candle has a long body and is green this means that the buyers owned the candle and if red, the sellers owned the candle. This can be a good indication of “momentum” where the market wants to push higher or lower and has little resistance.

What the candlesticks tell us

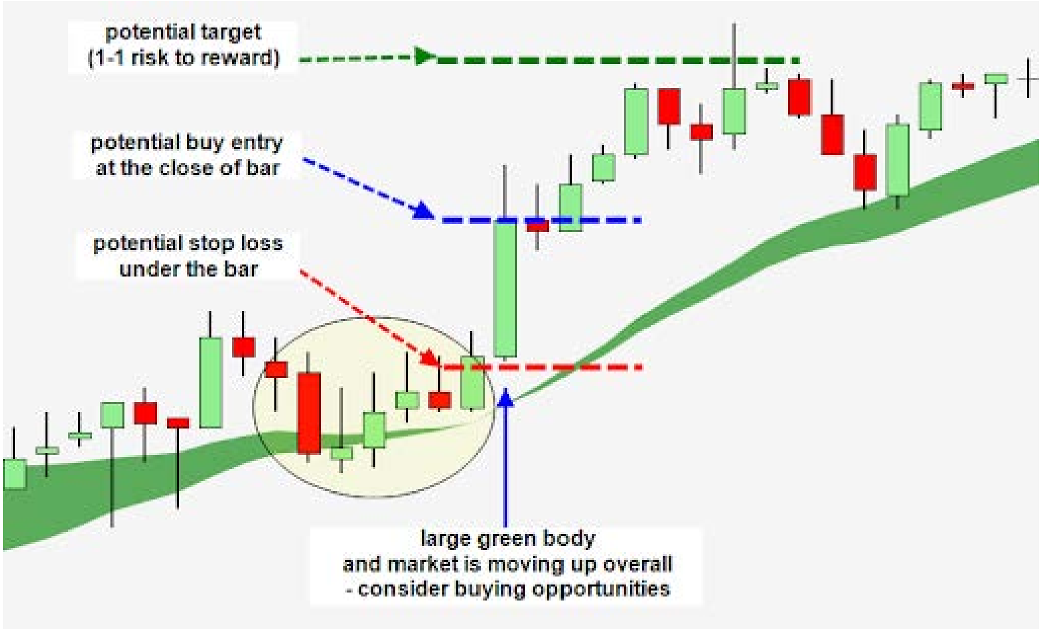
If a candle has a large body and is with the trend of the market, it is a very strong candle we would like to generally look for a buying trade opportunity after it. If a candle has a small body, or is against the trend of the market, we simply do not trade off it and wait for more confirmation.

As all traders globally see the same thing at the same time, the trends in a Futures Market tend to become a self-fulfilling prophecy and are very powerful. Traders tend to want to take the path of least resistance, which makes sense.

Big green bodies with the trend

In the case of the image shown below, we are in an uptrend (we will cover trends shortly). This uptrend is denoted by the big green band running through the image. Notice the big green bodied candle with the arrow underneath.

Can you see that the body of the big green candle is bigger than the candles before it in the yellow circle? A big green candle with the trend is a very strong candle and a great opportunity to take a very high probability buy trade.



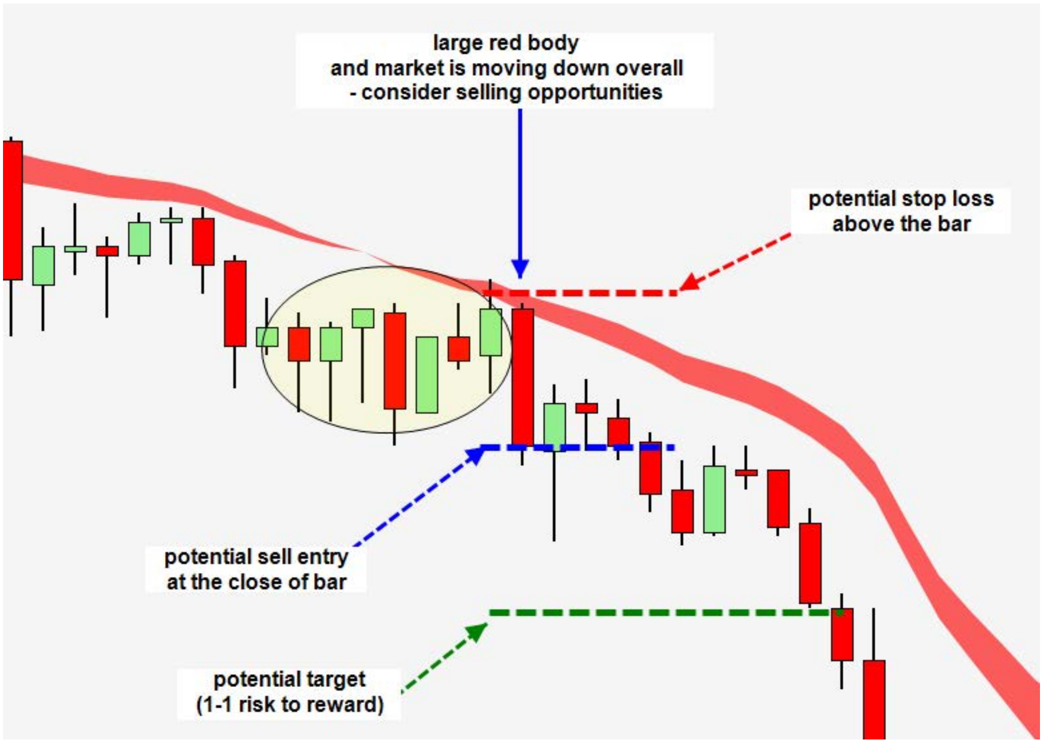
Note that if you did buy the market at the close of this big green candle, with stop loss under the candle and went for 1-1 risk reward, the market paid the $400 USD target (the green dashed-line) in under 35 Minutes (market shown here is the S&P500 futures). Not a bad trade! Please also note that all of the candles prior to the big green candle we have targeted are all small. Small candles are not strong in the Futures Markets and as such we do not trade off them.

Big red bodies with the trend

In the case of the image shown below, we are in a down trend. This down trend is denoted by the big red band running through the image.

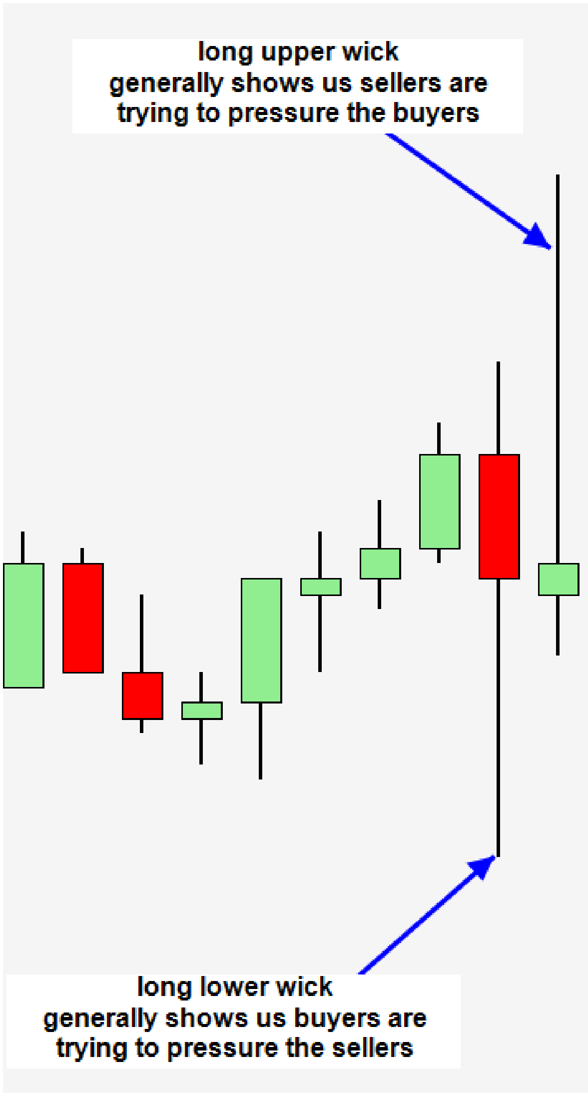
Notice the big red bodied candle with the arrow above. Can you see that the body of the big red candle is bigger than the candles before it in the yellow circle? A big red candle with the trend is a very strong candle and a great opportunity to take a very high probability sell trade.

Note that if you did sell the market at the close of this big red candle, with stop loss under the candle and went for 1-1 risk reward, the market paid a $360 USD target (the red dashed-line) in under 5 Minutes. Not a bad trade! Please also note that all of the candles prior to the big red candle we have targeted are all small compared to each other. Small candles are generally not strong in the Futures Markets and as such we do not trade off them.



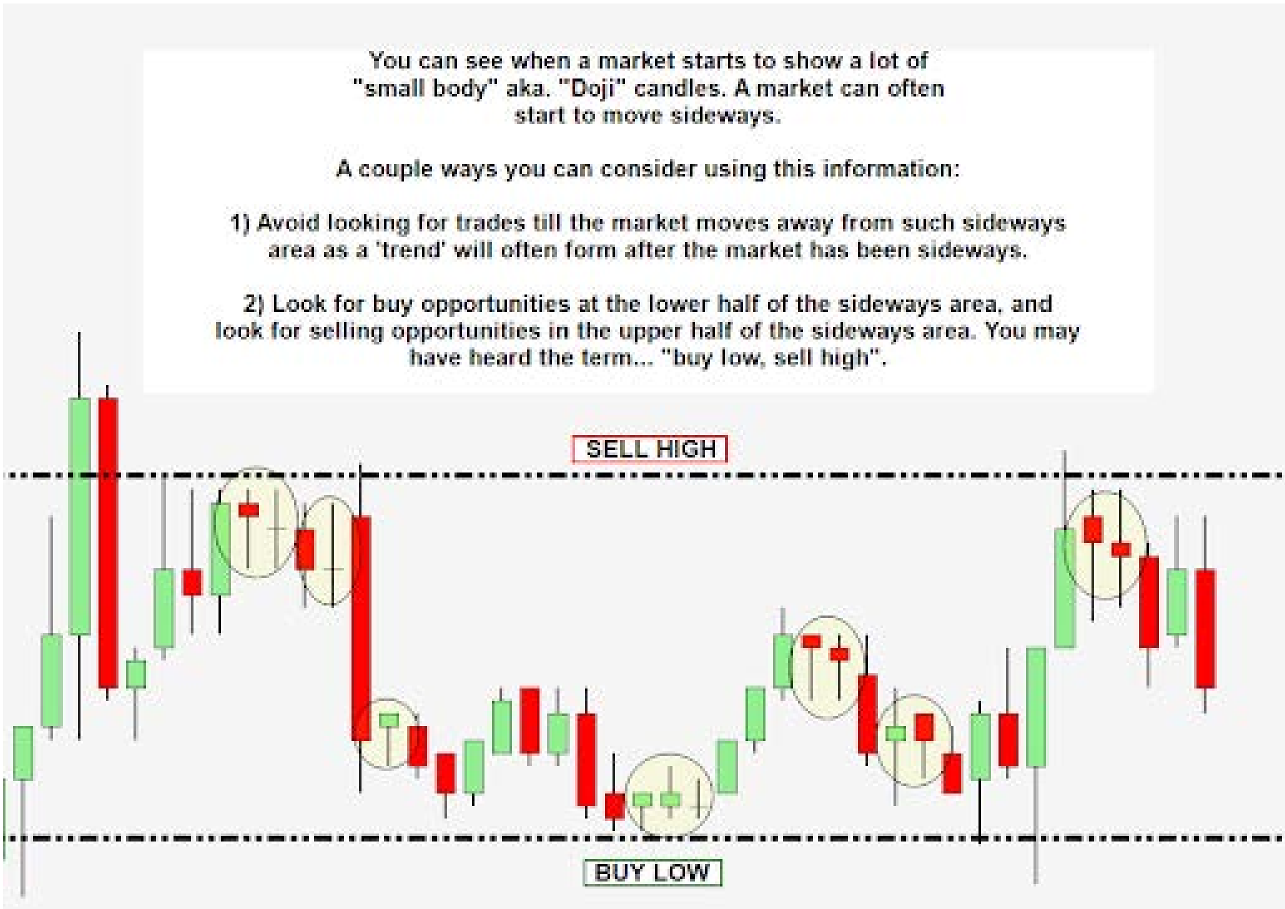
What do wicks indicate?

A long upper wick would represent selling pressure, pushing price back down to the close of the candle. A long lower wick would indicate buying pressure, pushing price back up toward the close of the candle. Something else to note is that a candle may not necessarily have an upper or lower wick, if the open/close price is the same as the high/low that would mean that there would be no wick to that candle.



What is a Doji candle and what does it look like?

As briefly mentioned above, a Doji candle has an open and close price that are very close together. This means that there is not a lot of support or resistance for price movement and neither team is dominating the candle. Doji candles will indicate indecision in the market and can be considered "sideways movement" (neither movement up nor down).



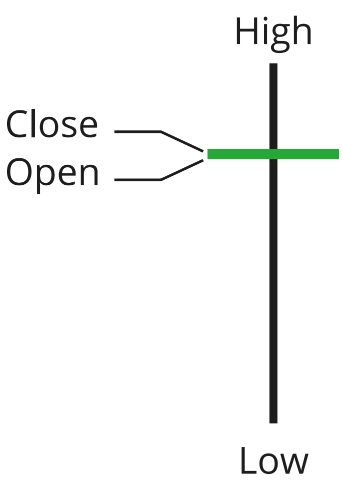
TYPES OF DOJI CANDLES

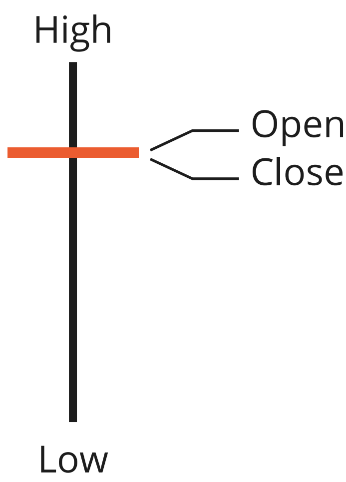
At the International Day Trading Academy, we focus more on "patterns" than types of Doji candles, however it's worth looking at some of the various forms of Doji candles. (When we refer to patterns, we are talking about looking at a combination of candles in a row to look for repetitive cycles, aka. patterns, then use patterns to assist us in making trade decisions)

Dragonfly Doji

A Dragonfly Doji is a candlestick that resembles a dragonfly, meaning it has a short body and a long lower wick. This type of candle can be an indicator of a potential reversal to either the downside or upside depending on prior price action.

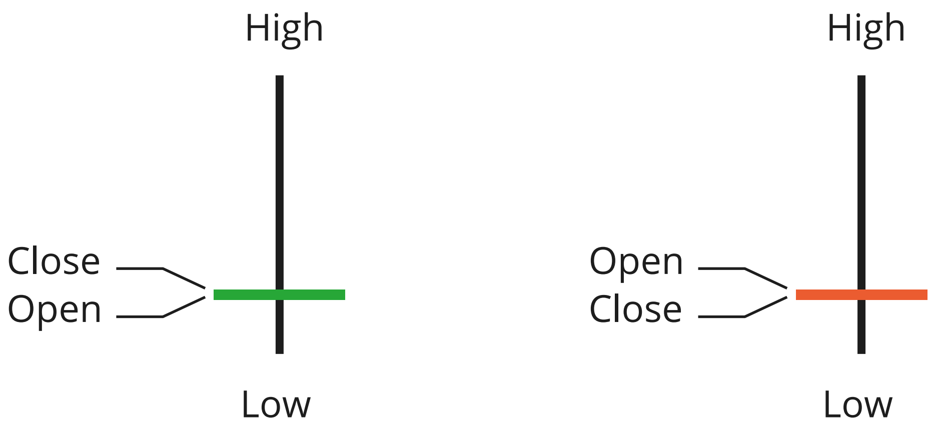
The long tail is created by a large volume of sell-offs pushing price down followed by a strong pushback from the buyers. Following a downtrend, the Dragonfly candlestick may signal a price rise is forthcoming. Following an uptrend, it shows more selling is entering the market and a price decline could follow. In both cases, the candle following the Dragonfly Doji needs to confirm the direction.





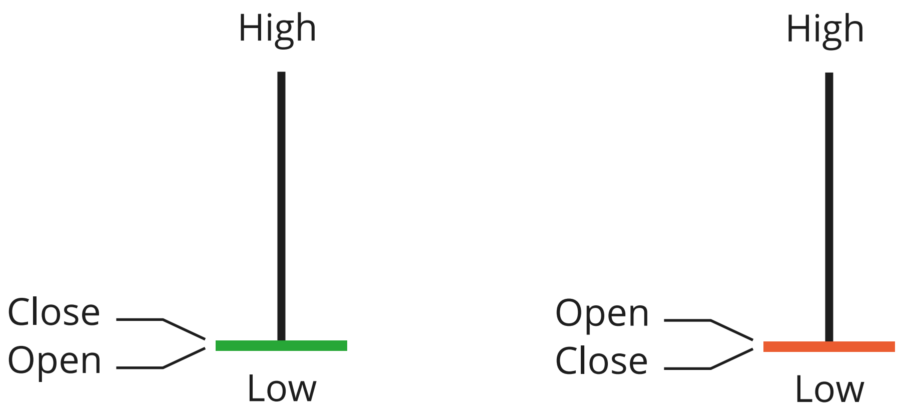
Gravestone Doji

A Gravestone Doji is the inverse of a Dragonfly Doji. The Gravestone Doji has a short body and a long upper wick. This indicates that buyers were able to push price up before the sellers were able to consolidate and close the candle out close to the opening price. A Gravestone Doji is a bearish reversal candlestick; it shows that the buyers were in control at the beginning of the candle but were pushed back down strongly. This type of candle can indicate a longer term bearish (downward) trend.



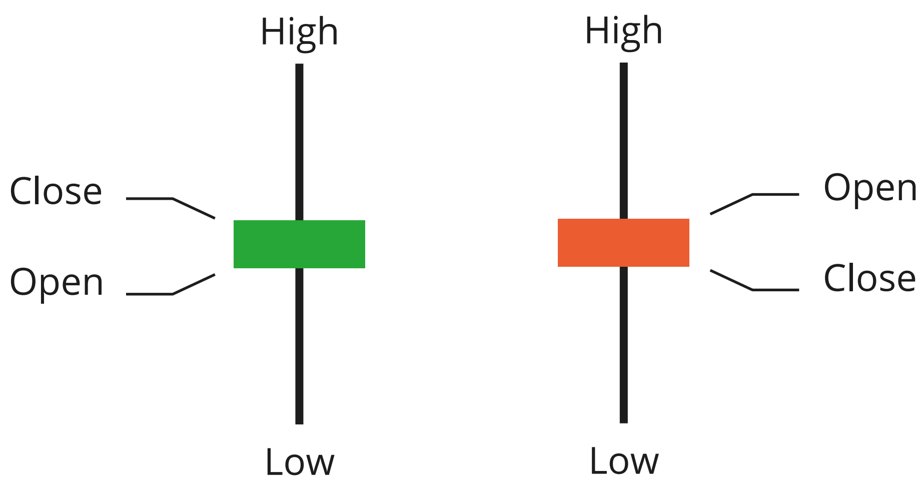
Shooting star

A shooting star candle has little or no lower shadow with a long upper shadow and small body. This is seen to be a bearish candle typically following an uptrend. A shooting star candle can indicate the potential of a potential reversal.



Spinning top

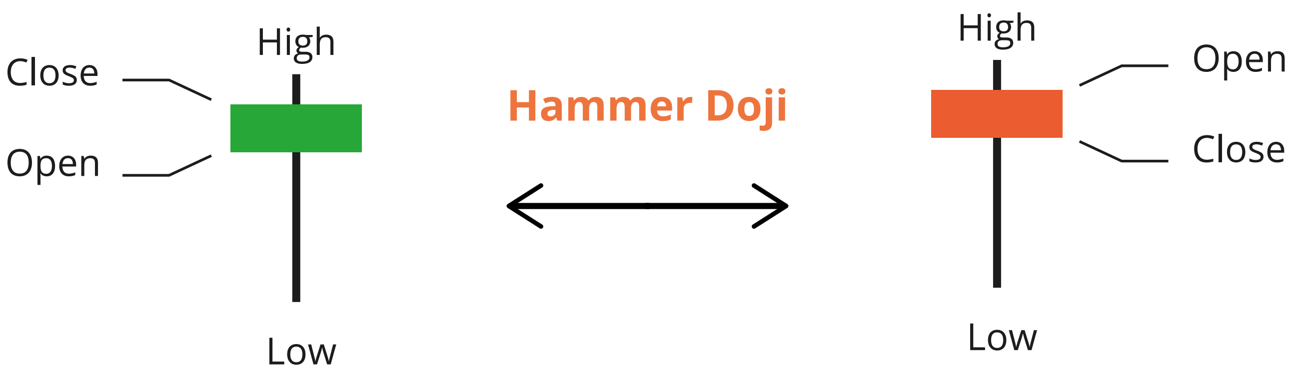
A spinning top candle is a little like the combination of both a Dragonfly and Gravestone Doji. This candle has a short body with a long upper wick and a long lower wick of roughly the same size. This type of candle indicates that there is indecision between traders. While both the buyers and sellers were able to achieve a high and low respectively, neither side was able to dominate the entirety of the candle. Indecision like this can indicate the potential for sideways movement to follow. A spinning top can also indicate a potential reversal from either an uptrend or downtrend. A green (buyers) spinning top can be viewed as a bearish candle, a red (sellers) spinning top can be viewed as a bearish candle.

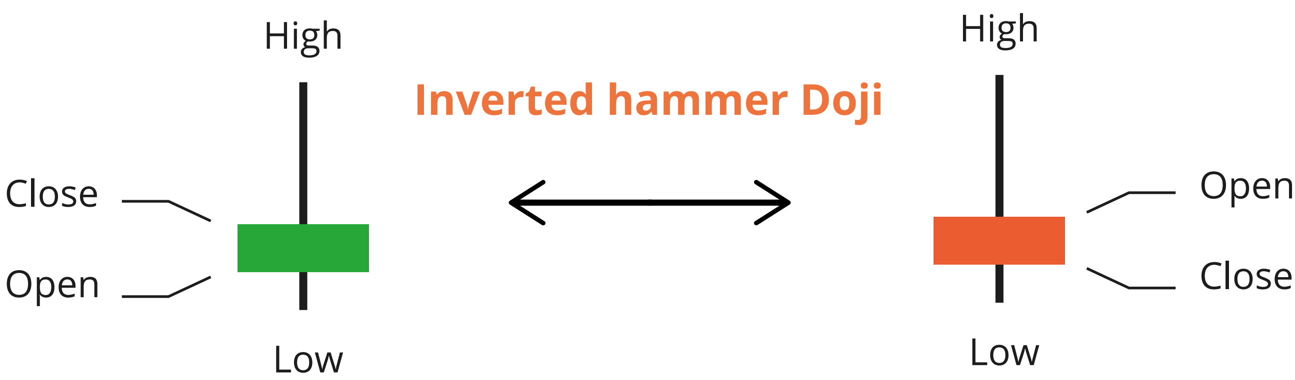


Hammers and inverted hammers

Hammer (and inverted hammer) candles look as you might imagine. A hammer candle is where there is typically a smallish body of the candle with a long lower wick (longer than the body) and no (or very little) upper wick. This type of candle looks like a hammer, hence the name. A hammer candle is what we would call a “bullish” candle, meaning that the buyers were able to dominate and push price up. The longer the lower wick, the more bullish the candle.

An inverted hammer is the opposite scenario, we would call this a “bearish” candle, in this scenario the sellers were able to dominate price, the longer the upper wick the more dominant the sellers were.





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