Trading

The "Lq" Candle

Abstract

This paper examines the effectiveness of technical analysis in financial market trading, specifically focusing on a strategy known as "The Lq Candle." Through a detailed exploration of this strategy, the paper outlines its underlying principles, trading methodologies, and practical implementation. Results from extensive backtesting are presented to assess its viability in real-time markets, and potential areas for further refinement and optimization are discussed.

Introduction

A basic understanding of financial markets, particularly forex trading, technical analysis, and the TradingView platform, is recommended for this paper. Key terms used include: **Lq**—referring to a specific candlestick pattern that will be explained in the methods section; **Sessions**—denoting the time when London/New York traders are active, with all time references in IST (Indian Standard Time); **SL (Stop Loss)**, **TP (Target Profit)**, and **RR (Risk-to-Reward Ratio)**.

Becoming a consistently profitable trader is challenging, as data from SEBI and other reputable sources suggest. I took it upon myself to explore what it takes to achieve profitability and sustain a trading career. Since March 2020, when I was first introduced to the Indian stock market, I've been fascinated by the complexity of the markets. Now, in October 2024, after years of research and practical experience, I can confidently say that trading is far from easy. Only perseverance and hard work lead to success, as the journey often begins without immediate results.

This paper presents one of my most significant works—the "Lq Candle" strategy. I will explain the methodology, provide results, and offer suggestions for improvement. This strategy has proven profitable for those to whom it applies.

Purpose of the Study

The objective of this research is to provide a comprehensive analysis of the "Lq Candle" trading strategy and to evaluate its effectiveness in the current forex market landscape.

Significance

This research contributes to the field of technical analysis by providing insights into a specific trading strategy that has shown promise in real-time market conditions, potentially benefiting both novice and experienced traders.

Outline of the Paper

The subsequent sections will detail the methods used in the research, present the results, discuss the implications of the findings, and suggest avenues for further improvement.

Methodology

This section provides an explanation of the concepts and ideas underlying the "Lq Candle" strategy. The process for analyzing the market and executing trades will be defined in the following steps.

Explanation

Consider a product, such as bread. If we observe the prices of bread over the last four hours, we notice a range between 90 and 100 rupees. After 30 minutes, the price drops to 85 rupees, leading us to believe it may continue to decline. However, after another three and a half hours, the price rises to 110 rupees.

What transpired during these eight hours? In the first four hours, the price was established between 90 and 100 rupees. In the subsequent four hours, someone sold bread below market value at 85 rupees, increasing demand and causing the price to rise to 110 rupees.

This example illustrates the concept of price dynamics but is not for understanding supply and demand. When visualized on a 4-hour candlestick chart, this scenario forms what is known as an Lq candle. An Lq candle occurs when the present candle breaks below the previous lows and closes bullish, or conversely, breaks above the previous highs and closes bearish. An image for reference is provided below:
Link to Image

Procedure

Before proceeding, it's essential to note that this strategy does not work universally. I have back tested it across various time frames for currency pairs such as EUR/USD, XAU/USD, USD/JPY and more but it has shown effectiveness predominantly with USD/JPY. The following steps will help you identify the Lq Candle strategy in real-time markets:

1. **Select the 4-Hour Candlestick Chart**: Focus on the USD/JPY pair.
2. **Understand the Candle Sessions**: The 4-hour chart divides the main trading sessions into three candles: the first for the London session, the second for the overlap of London and New York, and the third for the New York session.
3. **Utilize a Sessions Indicator**: Implement a sessions indicator to identify the London, New York, and London overlap sessions. I recommend using the "Sessions on Chart" indicator by Aurocks_AIF. Adjust the settings to display only the London and New York sessions.
4. **Identify the Lq Candle**: Look for the formation of an Lq candle within the specified time zones. Keep in mind that only three candles will be available for analysis, providing three opportunities to identify an Lq candle. Confirmation occurs only after the 4-hour candle has completed and a new candle has begun.
5. **Execute the Trade**: If an Lq candle forms, place a trade in the direction of the candle's close. Set the stop loss behind the lows of the Lq candle and establish a take profit target based on a 1:2 risk-to-reward ratio, meaning the take profit should be twice the size of the stop loss.
6. **First Lq Candle and Breakeven**: Only take the first Lq candle in the designated zone and adjust the trade to break even once the trade reaches a 1:1 risk-to-reward ratio .*Break Even* refers to the point at which the trade has moved sufficiently in your favor so that if you were to close the trade, you would neither make a profit nor incur a loss. This is typically achieved by adjusting the stop loss to the entry price, thereby eliminating risk while allowing the trade to continue to profit.

Results and Discussion

I conducted a backtest using four months of data for the USD/JPY currency pair, experimenting with various targets to determine which yielded the best results. Below are the results of my analysis, along with links to sample analyses for further reference.

Back test -1

Metric	Value
Target	1:2
Wins	13
Losses	8
Breakeven	5
Winrate(%)	69%

Return as per risk (risk *x)	x=18
Data's total time	46 days (1.5 month)

Back test-2

Metric	Value
Target	1:2
Wins	14
Losses	18
Breakeven	14
Winrate(%)	60%
Return as per risk (risk/trade *x)	x=14
Data's total time	77 days (2.5 month)

Discussion

The results indicate that the strategy has potential, particularly with a target risk-to-reward ratio of 1:2. In the first set of results, a win rate of 69% was achieved, suggesting that the strategy is effective within the tested conditions. However, the second set of results showed a win rate of 60%, indicating variability in performance.

Improvements

While the strategy has proven effective, there is room for improvement. Here are some ideas for enhancing performance:

1. **Explore Lower Time Frames**: Consider tuning into lower time frames to identify specific entry patterns that may yield better results.
2. **Identify Key Candle Patterns**: Analyze whether specific candles within the designated time zones exhibit higher win rates, and monitor these patterns for future trades.
3. **Broaden Asset Class Analysis**: Investigate whether the strategy is applicable to other asset classes and if it performs better under different market conditions.

Conclusion

In this paper, I presented the "Lq Candle" trading strategy, demonstrating its potential effectiveness in the financial markets, particularly in the USD/JPY pair. Through a thorough backtest over several months, I achieved a win rate of up to 69% with a risk-to-reward ratio of 1:2, highlighting the strategy's viability for traders looking to enhance their profitability.

While the results are promising, it is important to acknowledge the inherent challenges of consistent profitability in trading. The financial markets are dynamic and influenced by various factors that can impact trading outcomes. My analysis also indicates that further refinements could improve the strategy, such as exploring lower time frames for entry patterns and assessing its applicability to other asset classes.

This research contributes to the ongoing discourse on trading methodologies and offers insights for traders seeking to adopt a structured approach to technical analysis. I encourage further exploration and adaptation of the Lq Candle strategy, as well as continued experimentation with different market conditions and assets.

Ultimately, the journey to becoming a consistently profitable trader requires dedication, patience, and a willingness to learn from both successes and failures. I hope this paper serves as a valuable resource for traders at all levels, providing a framework to navigate the complexities of the financial markets.

References

1. **Raw Backtest Pictures**
   - [Backtest Picture 1](#)
   - [Backtest Picture 2](#)
     Note: Please be aware that the parameters in these images may have been adjusted to optimize results. Follow the procedure outlined in this paper for clarity.
2. **Basic Technical and Fundamental Knowledge (For Beginners)**
   - **Video 1**: 🎞 video-output-491AE702-D542-46A4-B634-C1313B213276.mov
   - **Video 2**: 🎞 video-output-DA3C8D08-F0B4-458C-85F1-54354937BC87.mov
     Disclaimer: These videos are created by me and feature content in a mix of Tamil and English.