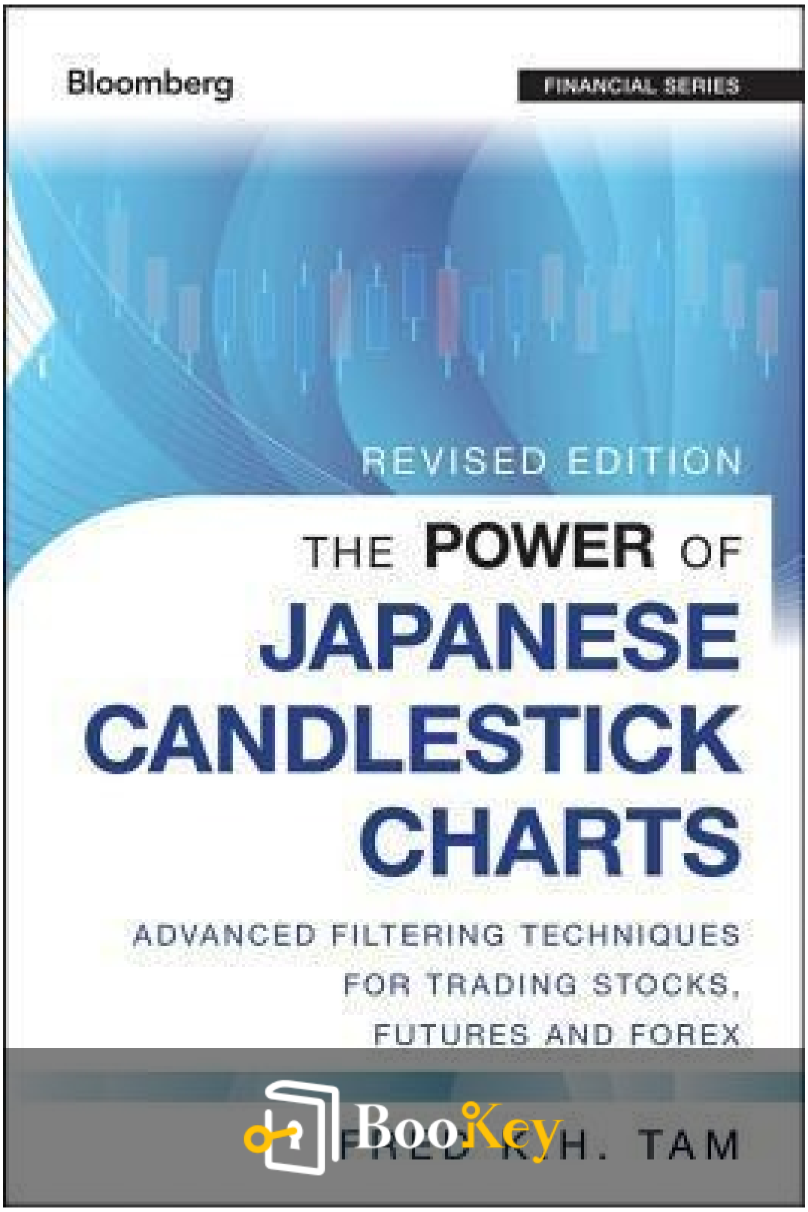
The Power of Japanese Candlestick Charts PDF

Fred k.h. Tam



The Power of Japanese Candlestick Charts

Unlock Market Timing with Candlestick Charting Techniques

Written by Bookey

About the book

Discover the transformative world of candlestick charting with "The Power of Japanese Candlestick Charts" by Fred K.H. Tam. This essential guide delves into a powerful approach to market timing designed for short-term profits, setting itself apart from traditional Western techniques like moving averages and MACD. With a focus on meticulous price analysis, Tam reveals how candlestick signals can generate accurate buy and sell indications well ahead of conventional methods. Ideal for both futures and stock market investors, this comprehensive resource is filled with hundreds of illustrated charts that make the sophisticated techniques accessible to analysts, stock traders, and day traders alike. Experience the power and precision of Japanese candlestick methodology and elevate your trading strategy.

About the author

Fred K.H. Tam is a seasoned financial analyst and educator renowned for his expertise in technical analysis and market strategies, particularly through the lens of Japanese candlestick charting techniques. With a strong academic background and extensive experience in the financial markets, Tam has dedicated his career to demystifying complex trading concepts and empowering investors with practical tools for success. His insightful writing not only reflects a profound understanding of market dynamics but also showcases his passion for teaching, making him a respected voice in the arena of trading literature. Through his work, including "The Power of Japanese Candlestick Charts," Tam continues to inspire traders and investors to harness the art of candlestick analysis in their decision-making processes.

Summary Content List

Chapter 1 Summary : Introduction

Chapter 1 Summary

Introduction

The Japanese candlestick charting technique, developed in the 1700s, has a long history of use in rice trading in Japan. It gained recognition in the U.S. during the 1980s, thanks to its high trading accuracy, prompting American traders to seek insights into the methodologies employed by Japanese traders. The technique became more accessible to Western traders through the works of American analyst Steve Nison, whose books helped unveil its forecasting capabilities. With the growing availability of candlestick charts in trading platforms, their popularity has surged in both Japan and the West.

Historical Background

The Tokugawa Shogunate (1615-1867) unified Japan and fostered economic growth, particularly in Osaka, which became the rice trading hub. Munehisa Homma emerged as a legendary trader, using candlestick techniques and market psychology to achieve significant trading successes. He documented weather conditions and analyzed historical prices, ultimately becoming a financial consultant to the government. Homma's works led to the development of modern candlestick charting.

Reasons Candlestick Charts Are So Popular Today

1.
Leading Indicator
: Provides earlier reversal signals compared to Western techniques.
2.
Pictorial
: Visual representation of market psychology through vivid

terminology and patterns.
3.
Versatile
: Can be used independently or in conjunction with Western technical tools.
4.
Applicable Across Time Frames
: Suited for both short-term and long-term trading.
5.
Flexible and Adaptable
: Usable in various markets, including stocks, futures, and commodities.
6.
Time-Tested
: Proven effective over centuries, maintaining its relevance.

Construction of the Candlestick Chart

- In Japan, candlesticks are referred to as "Ashi," meaning "leg" or "foot."
- To construct a candlestick chart, four price elements are required: open, close, high, and low.
- The process includes marking the open and close, creating a "real body," and adding upper and lower shadows to

represent price extremes.

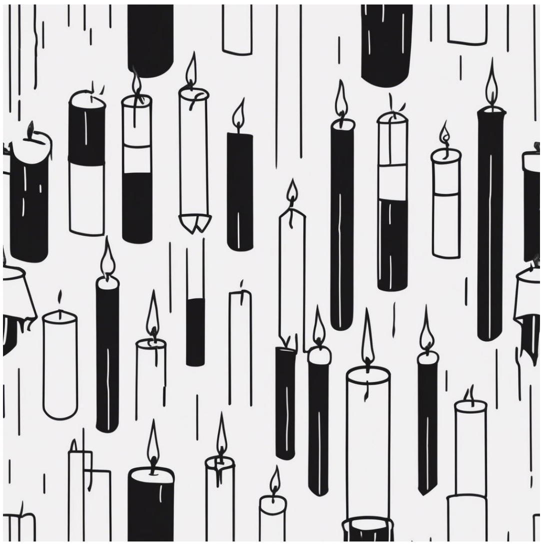
Comparison with Bar Charts

Drawing a bar chart typically requires three price elements, with the option to include an open price. Candlestick charts provide a more dynamic representation of market psychology compared to traditional bar charts, which are less visually informative.

Conclusion

Candlestick charts have grown in popularity due to their effectiveness in illustrating market trends and psychological states, making them a preferred choice for traders across various markets.

Chapter 2 Summary : Single Candle Types



Section	Key Points
Single Candles	Foundational elements; represent one trading day; help understand psychology, analyze relationships, and aid trading decisions.
Basic Candlestick Formation	1. White Candle: Bullish 2. Black Candle: Bearish 3. Doji: Indecision
Interpreting Candlestick Elements	Size: Larger indicates strong movements. Location: Indicates continuation or reversal potential. Colour: White for bulls, black for bears.
Long and Short Candles	Long Candle: Indicates significant movement; sentiment depends on color. Short Candle: Minimal movement; suggests consolidation or possible reversals.
Types of White Candles	1. Long Marubozu: Extremely bullish 2. Long White Candle: Strong bullish day 3. Long Closing Bozu, Long Opening Bozu: Bullish 4. Inverted White Umbrella: Reversal indication 5. White Umbrella: Reversal indication 6. Short White Candle: Weaker bullish sentiment 7. White Spinning Top: Indecision 8. White Lower Shadow, White Upper Shadow: Continuation signals
Actionable Insights on White Candles	Context matters, especially aligning with breakouts or top formations.

Section	Key Points
Types of Black Candles	1. Long Marubozu: Extremely bearish 2. Long Black Candle: Bearish sentiment with support 3. Long Opening Bozu, Long Closing Bozu: Bearish 4. Inverted Black Umbrella, Black Umbrella: Reversal indications 5. Short Black Candle: Weak bearish sentiment 6. Black Spinning Top: Indecision 7. Black Lower Shadow, Black Upper Shadow: Control signals
Actionable Insights on Black Candles	Long black candles breaking support indicate strong sell signals; caution near market bottoms.
The Doji	Represents indecision; analyzed for reversal potential. Variants include: 1. Four Price Doji 2. Gravestone Doji: Bearish reversal 3. Long-Legged Doji: High volatility 4. Dragonfly Doji: Bullish reversal 5. Small Doji Variations: Major reversal indicators
Conclusion	Understanding single candles and their psychological implications aids trading decisions; always analyze in context.

CHAPTER 2: Single Candle Types

Single Candles

- Single candles are the foundational elements of Japanese candlestick analysis, typically representing one trading day.
- Key purposes of reading single candles include:
  1. Understanding the psychological factors influencing candle formation.
  2. Analyzing the relationship of a single candle with preceding candles to discern psychological shifts.

3. Making decisions to buy, hold, or sell based on the emerging patterns.

Basic Candlestick Formation

- There are three basic candle types:
  1. **White Candle**: Closing price higher than opening price (bullish).
  2. **Black Candle**: Closing price lower than opening price (bearish).
  3. **Doji**: Opening and closing prices are nearly equal, indicating indecision.

Interpreting Candlestick Elements

- **Size**: Larger candles suggest strong market movements.
- **Location**

: The positioning of the candle relative to price levels indicates potential continuation or reversal.

-

Colour

: Indicates market control; white for bulls and black for bears, except in umbrella candles.

Long and Short Candles

-

Long Candle

: Signifies significant price movement and potential bullish/bearish sentiments depending on colour.

-

Short Candle

: Represents minimal price movement; usually seen during consolidation or indecision periods but can indicate possible reversals in certain contexts.

Types of White Candles and Their Interpretations

1.

Long Marubozu

: Extremely bullish, with no shadows.

2.
Long White Candle
: Strong bullish day, near high with small shadows.
3.
Long Closing Bozu
: Bullish, closes at the high.
4.
Long Opening Bozu
: Bullish, opens at the low.
5.
Inverted White Umbrella
: Indicates reversals based on location.
- Variations include
Shooting Star
(top) and
Inverted Hammer
(bottom).
6.
White Umbrella
: Signals reversals based on its position.
- Variations include
Hanging Man
(top) and
Hammer

(bottom).

7.

Short White Candle

: Indicates weaker bullish sentiment.

8.

White Spinning Top

: Reflects indecision; context is crucial for interpretation.

9.

White Lower Shadow

: Bullish continuation signal.

10.

White Upper Shadow

: Indicates slight bullishness with profit-taking.

Actionable Insights on White Candles

- Recognizing the context of long white candles is crucial, especially when they align with breakout scenarios or signal potential top formations.

Types of Black Candles and Their Interpretations

1.

Long Marubozu

: Extremely bearish, representing total market control by bears.

2.

Long Black Candle

: Indicates bearish sentiment but some buying support.

3.

Long Opening Bozu

: Bearish, closes near the low.

4.

Long Closing Bozu

: Highly bearish, closes at the low.

5.

Inverted Black Umbrella

: Significant for reversal indications.

6.

Black Umbrella

: Indicates potential reversals based on location.

7.

Short Black Candle

: Weak bearish sentiment, may indicate consolidation.

8.

Black Spinning Top

: Reflects market indecision; context matters.

9.

Black Lower Shadow
: Bears are in control but hints at buying support.
10.
Black Upper Shadow
: A stronger bearish signal due to price pressure.

Actionable Insights on Black Candles

- Long black candles breaking support suggest strong sell signals, while those seen near market bottoms may indicate potential support, warranting caution.

The Doji

- Represents market indecision with opening and closing prices equal.
-
Significance
: Analyzed for its potential reversal capabilities, especially when located at extreme market prices.
-
Doji Variants
 include:
  1.

Four Price Doji
: Rare occurrence.
2.
Gravestone Doji
: Characterized by its long upper shadow; potential bearish reversal.
3.
Long-Legged Doji
: Indicates extreme market volatility and indecision.
4.
Dragonfly Doji
: May suggest bullish reversal if located at low prices.
5.
Small Doji Variations
: Indicate possible major market reversals when found at extremes.

Conclusion

Understanding the various types of single candles, their formations, and the psychological implications behind them helps traders make informed decisions in the market. The positioning and behavior of these candles should always be analyzed in relation to preceding candles and market context for feasible trading actions.

Example

Key Point:Understanding single candles is fundamental for making informed trading decisions.

Example:Imagine you just bought your first stocks. As you look at the price chart, you see a long white candle that has formed. This candle indicates a strong bullish movement, suggesting that buyers have firmly taken control of the market. You can feel the excitement rising—traders around you are optimistic, fueling your decision to hold onto your stocks longer, anticipating even greater gains. This single candle not only reveals the market sentiment, but also reminds you to analyze its context against previous candles to ensure you're set to make wise trading moves.

Chapter 3 Summary : The Umbrella Group

CHAPTER 3 The Umbrella Group

This chapter discusses the "Umbrella Group" of candlestick patterns, known as karakasa in Japanese, which resembles the shape of an umbrella. Key aspects of these patterns include their location and shape, while color holds little significance due to their small real bodies, indicating that neither bulls nor bears dominate the market. The long shadows associated with these candles give them reversal implications.

Umbrella Group Candlestick Patterns

-

White Hammer or Hanging Man (White Umbrella Candle)

-

Definition:

Small real body with a lower shadow at least twice the length of the body. The close is equal to or just below the high with minimal upper shadow.

-

Location:

After a downtrend (Hammer) or after an uptrend (Hanging Man).

-

Interpretation:

Hammer suggests bullish potential; Hanging Man suggests bearish potential. Confirmation is advised before trading.

-

Black Hammer or Hanging Man (Black Umbrella Candle)

-

Definition:

Similar to the White Hammer, but the close is below the open. The long shadow is significant while color is not.

Chapter 4 Summary : Reversal Patterns

Section	Content
Chapter	4: Reversal Patterns
Introduction	- Chart patterns are categorized into reversal and continuation patterns. - Reversal patterns indicate a trend reversal; continuation patterns suggest a temporary pause before the previous trend resumes. - Japanese theory recognizes over 50 reversal patterns, 8 of which are common across financial markets.
Best Time to Rely on Reversal Patterns	- Show accuracy after significant rallies or declines (5-15 cycles). - Most effective for identifying V or Spike Tops/Bottoms.
Index of Reversal Patterns	- Reversal patterns can be single, double, triple, or multiple candles. - Guide traders on market entry or exit decisions.
Single Candlestick Patterns	1. Spinning Top 2. Hammer 3. Hanging Man 4. Inverted Hammer 5. Shooting Star 6. Doji at the Bottom 7. Doji at the Top 8. Bullish & Bearish Meeting Lines 9. Bullish & Bearish Belt-Hold Lines
Double Candlestick Patterns	1. Bullish & Bearish Engulfing 2. Fred Tam’s Inside Out Patterns 3. Piercing Line & Dark Cloud Cover 4. Thrusting Line & Incomplete Dark Cloud Cover 5. Bullish & Bearish Harami Patterns
Triple Candlestick Patterns	1. Three-River Morning & Evening Doji-Stars 2. Abandoned Baby Bottom & Top 3. Three-River Morning & Evening Stars 4. Tri-Star Bottom & Top 5. Breakaway Three-New-Price Patterns
Multiple Candlestick Patterns	1. Concealing Baby Swallow 2. Ladder Bottom 3. Tower Bottom & Tower Top 4. Eight-to-Ten New Record Lows & Highs

Section	Content
Conclusion	- Traders should look for reversal patterns and understand their implications. - Each pattern serves as an indicator for entering or exiting trades based on market sentiments and potential reversals.

Chapter 4: Reversal Patterns

Introduction

- Chart patterns are categorized into reversal and continuation patterns.
- Reversal patterns indicate a trend reversal, while continuation patterns suggest a temporary pause before the previous trend resumes.
- Western and Japanese charting theories differ in the names and number of recognized patterns, with Japanese theory identifying over 50 reversal patterns, at least 8 of which are common across financial markets.

Best Time to Rely on Reversal Patterns

- Reversal patterns show accuracy after significant rallies or declines (5-15 cycles).

- They are most effective in identifying V or Spike Tops/Bottoms.

Index of Reversal Patterns

- Candlestick reversal patterns can be single, double, triple, or multiple candles.
- They guide traders on market entry or exit decisions.

Single Candlestick Patterns

1.
Spinning Top

2.
Hammer

3.
Hanging Man

4.
Inverted Hammer

5.

Shooting Star

6.
Doji at the Bottom

7.
Doji at the Top

8.
Bullish & Bearish Meeting Lines

9.
Bullish & Bearish Belt-Hold Lines

Double Candlestick Patterns

1.
Bullish & Bearish Engulfing

2.
Fred Tam’s Inside Out Patterns

3.

Piercing Line & Dark Cloud Cover

4.
Thrusting Line & Incomplete Dark Cloud Cover

5.
Bullish & Bearish Harami Patterns

Triple Candlestick Patterns

1.
Three-River Morning & Evening Doji-Stars

2.
Abandoned Baby Bottom & Top

3.
Three-River Morning & Evening Stars

4.
Tri-Star Bottom & Top

5.

Breakaway Three-New-Price Patterns

Multiple Candlestick Patterns

1.
Concealing Baby Swallow

2.
Ladder Bottom

3.
Tower Bottom & Tower Top

4.
Eight-to-Ten New Record Lows & Highs

Conclusion

- Traders should look for reversal patterns and understand their implications in the market context.
- Each pattern serves as a potential indicator for entering or exiting trades based on market sentiments and potential reversals.

Example

Key Point:Recognizing Reversal Patterns

Example:Imagine you’re observing a stock that has been climbing steadily. Suddenly, you notice a Spinning Top candlestick forming after a significant rally. This single candlestick pattern symbolizes indecision among traders, suggesting that the strong buying momentum may be waning. Recognizing this pattern in real-time prompts you to consider selling your position before a potential downturn, highlighting the importance of identifying reversal patterns as critical signals for effective trading decisions.

Critical Thinking

Key Point:Reversal Patterns' Reliability at Trend Extremes

Critical Interpretation:Tam emphasizes that reversal patterns are most effective following substantial market rallies or declines, asserting their accuracy tends to increase when these patterns manifest after 5-15 cycles. However, this claim may not hold universally across all market conditions, as seen in various studies analyzing technical analysis effectiveness (see: "Technical Analysis: A Comprehensive Guide to the Principles and Applications of Technical Analysis" by T. J. M. Brynjolfsson). Thus, while Tam's viewpoint provides useful guidelines for traders, market behavior's inherent complexity suggests that reliance on these patterns must be coupled with broader market analysis and risk management strategies.

Chapter 5 Summary : Continuation Patterns

Continuation Patterns

Introduction

Japanese candlestick patterns provide more reversal patterns compared to Western classical charting theory, offering 53 documented patterns versus fewer in the West. While reversal patterns indicate trend changes, continuation patterns suggest market consolidation before resuming a prior trend, characterized by pullbacks and brief corrections.

Types of Continuation Patterns

Continuation patterns can be categorized broadly into:
1.
Double Candlestick Patterns

- Separating Lines

- Kicking Pattern
- On-Neck Pattern
- In-Neck Pattern
- Thrusting Line

2.

Multiple Candlestick Patterns

- Rising Three Methods
- Falling Three Methods
- Mat Hold Pattern

3.

Windows (Gaps)

- Various window patterns such as Tasuki Upside and Downside Gaps, Side-by-Side White Lines.

Double Candlestick Patterns

Bullish and Bearish Separating Lines

-

Bullish Separating Lines

: Formed by a black candle followed by a white Belt-Hold candle; indicates a continuation of an uptrend.

-

Bearish Separating Lines

: Consists of a white candle followed by a black Belt-Hold candle; indicates continuation of a downtrend.

Kicking Pattern

-

Bullish Kicking Pattern

: A Marubozu Black Candle followed by a Marubozu White Candle with a gap between them implies continued upside.

-

Bearish Kicking Pattern

: A reverse structure suggests continued downside.

On-Neck and In-Neck Patterns

-

On-Neck Pattern

: A black candle followed by a small white candle indicates bearish continuation.

-

In-Neck Pattern

: A black candle followed by a white candle closing inside suggests ongoing bearish momentum.

Thrusting Line

- A black candle followed by a white candle closing just below the midpoint represents bearish continuation unless confirmed otherwise.

Multiple Candlestick Patterns

Rising Three Methods

- Comprising a long white candle plus three smaller black candles, followed by another long white candle; indicates bullish continuation.

Falling Three Methods

- Consists of a long black candle followed by three smaller white candles, and then another long black candle; signals bearish continuation.

Mat Hold Pattern

- Similar to Rising Three Methods, but features gaps between candles with less severe corrections; suggests bullish continuation.

Windows (Gaps)

General Concept

- Windows represent gaps on the chart and act as support or resistance. Patterns involving gaps include:

1.
Tasuki Upside Gap
: A bullish pattern signaling continuation after profit-taking.
2.
Tasuki Downside Gap
: A bearish pattern indicating ongoing downtrend even after small retracements.
3.

Side-by-Side White Lines

: Two white candles gapping above a long white indicates persistent buying pressure.

4.

High and Low Price Gapping Plays

: Patterns that emerge after rallies or declines signifying traditional bullish or bearish breakouts.

Conclusion

Japanese candlestick continuation patterns serve as crucial signals for traders, indicating potential price movements following consolidation phases. Identifying these patterns can provide valuable insights for traders aiming to optimize their investment decisions.

Chapter 6 Summary : Summarizing Part I

CHAPTER 6: Summary of Part I

Overview of Candlestick Patterns

Part I of this book covers common candlestick patterns, including:
- Ten single black and white candles
- Seven doji patterns
- Four umbrella group patterns
- Fifty-three reversal patterns
- Fourteen continuation patterns
It is noted that this is not an exhaustive list, as there are many other patterns, some of which may be abstract and less useful to traders.

Trading with Candlestick Analysis

Candlestick analysis can be a standalone trading strategy, especially in fast-moving markets. Understanding reversal and continuation patterns gives traders an edge. However, reliance solely on candlestick patterns can lead to false signals. Proper trading involves knowing when to act on or ignore signals.

Combining Candlestick Analysis with Technical Indicators

Research indicates that candlestick techniques are more effective when used in conjunction with other technical indicators. Factors that can cause pattern failures include:
- Sell signals during an uptrend or weak buy signals in a downtrend
- Ineffectiveness in sideways trends
Jack Schwager's tests suggest that filtering with additional indicators, such as momentum, can yield better results by aligning trades with short-term trend directions.

Chapter 7 Summary : Filtering with Western Indicators

CHAPTER 7 Filtering with Western Indicators

Candlestick chart analysis is effective on its own; however, combining it with Western indicators enhances profitability. This approach, called filtering or the Rule of Multiple Techniques, involves using multiple technical indicators to confirm trading signals, increasing the likelihood of accurate market forecasts.

Using Filtering Techniques

-
Defining the Trend:
Use trend lines, moving averages, or oscillators to establish the market trend, categorized as up (bullish), down (bearish), or sideways.

Scenarios

1.
Bull Market:
 Look for bullish patterns to enter long positions while ignoring sell signals. Use sell patterns only to exit long positions.
2.
Bear Market:
 Seek bearish patterns to enter short positions and avoid buy signals until the trend changes to bullish.
3.
Overbought/Oversold Situations:
 Exit trades during overbought conditions and consider entering during oversold conditions, utilizing daily and weekly charts for trend direction and shorter charts for timing.

Technical Indicators

-
Moving Averages:
 A trend-following tool that smooths price fluctuations. Employs simple, weighted, and exponential moving averages. Identify bullish trends with price above the average

and bearish trends with price below.

-
MACD (Moving Average Convergence Divergence):
Uses the difference between two EMAs and a signal line to determine trends and potential reversals. Utilize bullish and bearish reversal patterns to buy or sell, respectively.
-
RSI (Relative Strength Index):
Ranges from 0 to 100, indicating overbought (>70) or oversold (<30) conditions. Look for divergences and cross above/below the 50 threshold to make trading decisions.
-
Stochastic Oscillator:
Compares closing price to a price range, helping identify overbought (>80) and oversold (<20) conditions. Similarly, utilize crossing signals for buy/sell decisions.
-
Momentum:
Assesses the rate of price movement, with positive values indicating bullish trends and negative values indicating bearish trends.
-
Williams' %R:

Indicates overbought and oversold states similar to the stochastic method, assisting in identifying potential reversals.

-

Directional Movement Index (DMI):

Identifies market trends using the +DMI and -DMI lines to give buy/sell signals, supplemented by the ADX to confirm signal strength.

-

Commodity Channel Index (CCI):

Identifies overbought/oversold conditions based on price deviations from the mean.

-

Volume Analysis:

High volume confirms trends; sudden spikes can indicate exhaustion or reversal points.

-

Bollinger Bands:

Measure volatility and predict price targets by observing movements outside the bands.

-

Elliott Wave Theory:

Identifies market trends through wave patterns that predict bull and bear markets.

Conclusion

The systematic application of these techniques, along with candlestick patterns, significantly enhances trading accuracy and profitability. Observing multiple indicators can help traders make informed decisions based on the alignment of data.

Chapter 8 Summary : P.I. System Trader

CHAPTER 8 P.I. System Trader

Identifying Candlestick Patterns

Candlestick patterns can sometimes be easily identified, such as the Bearish Engulfing pattern signaling a sell on candle 4. However, there are instances where patterns are not obvious, particularly for beginners. The P.I. System Trader is introduced as a tool to help traders identify buy or sell signals even when candlestick patterns are unclear.

The P.I. System Trader

Developed in 1998, the P.I. System Trader mimics candlestick reversal patterns. Its buy and sell signals generally align with candlestick patterns, ensuring that traders do not miss reversal signals. This system specifically identifies reversal signals rather than continuation signals, which is crucial for successful trading.

Using Multiple Techniques to Filter Signals

While the P.I. System Trader can be effective, relying solely on it may lead to false signals. It is advisable to incorporate additional indicators such as the 50-day moving average or oscillators to filter out inaccuracies. This chapter suggests using a combination of techniques, referred to as the Rule of Multiple Techniques, to enhance trading decisions.

Trading Rules for P.I. System Trader

1. **Step 1:** Check the 50-day moving average for the overall trend.
   - **If bullish:** Take all buy signals from the P.I. System Trader; ignore sell signals or close long positions.
   - **If bearish:** Take all sell signals; ignore buy signals or cover short positions.

Advantages of P.I. System Trader

The P.I. System Trader may identify signals that candlestick patterns do not clearly present, allowing traders to execute trades based on well-timed reversible signals. It can be programmed into various trading software, providing flexibility in application. Instead of relying solely on the 50-day moving average, traders can use other trend indicators to refine their strategies while implementing the daily signals in alignment with the defined market trend. This integrated approach enhances trading strategies by combining Japanese candlesticks with Western technical analysis.

Chapter 9 Summary : Sakata’s Five Methods

CHAPTER 9: Sakata’s Five Methods

Overview of Sakata’s Five Methods

Sakata’s Five Methods, developed by Munehisa Homma in the 18th century, are foundational trading rules that focus on rice futures trading. Homma is recognized as a legendary trader in Japan, often referred to as the “god of the markets.” His methods, rooted in Sakata's Constitution, have evolved through the integration of candlestick charting techniques.

Sakata’s Constitution

The original rules of Sakata’s Constitution consist of five crucial trading principles:
1. Maintain a balance between time and price without succumbing to greed.
2. Aim to sell at market peaks and buy at troughs.

3. Increase positions after significant price movements (100 bags).
4. Quickly rectify errors in market forecasts by liquidating positions and taking a break.
5. Liquidate a majority of profitable positions as prices reach anticipated highs or lows.

The Japanese Method of Three

Central to this trading philosophy is the Japanese saying, “To consult the market about the market,” which emphasizes observing market movements over external influences. This analysis leads to a predictive understanding of future market directions, rooted in the concept of Three Level Fluctuations, which aligns with Elliott Wave Theory.

Sakata’s Five Methods Explained

Chapter 10 Summary : Computerized Candlestick Forecasting

Chapter 10: Computerized Candlestick Forecasting

Introduction to Candlestick Techniques

For over a century, Japanese candlestick techniques were not known in the West until Steve Nison introduced them in his book, "Japanese Candlestick Charting Techniques" in 1991. His work greatly influenced Western technical analysis and established him as the leading authority on the subject. Nison's methodologies have been used by institutional traders and are now available to individual traders worldwide.

The Need for Automated Analysis

A major challenge in learning candlestick patterns is the sheer number of reversal and continuation patterns available, making it difficult to identify them manually. Nison saw this issue and developed the Nison Candle Scanner in 2013 to automate candlestick pattern recognition, allowing traders to quickly find profitable setups across multiple markets.

Features of the Nison Candle Scanner

- **Candlestick Pattern Filtering**: Users can filter various markets for specific candlestick signals. The scanner presents a list of markets that currently show the selected pattern.
- **Highlighting Patterns**: The tool displays candlestick patterns on charts, either by full name or abbreviation, making it easy to identify and understand signals.
- **Custom Chart Alerts**: Traders can set real-time alerts for chosen markets and candle patterns, streamlining the monitoring process.

Nison Candle Highlighter on MetaTrader 4

Nison also created the Nison Candle Highlighter for

MetaTrader 4, which provides powerful tools for identifying candlestick patterns in various trading markets, making it accessible for both beginners and experienced traders.

Conclusion

The introduction of computerized candlestick analysis revolutionizes how traders identify and utilize candlestick patterns, making it easier to navigate the complexities of trading across multiple markets and time frames.

Chapter 11 Summary : Conclusion: Facts about Candlesticks

Chapter 11 Conclusion: Facts about Candlesticks

Introduction to Candlestick Technique

The Japanese candlestick technique, relatively unknown outside Japan until Steve Nison popularized it in 1991, utilizes the same price data as bar charts but excels in recognizing complex patterns and interpreting market psychology.

Key Advantages of Candlestick Charting

-
Market Insights:
 Candlesticks provide intuitive messages about the market's inner psychology.
-
Spotting Turning Points:

They are particularly effective in identifying market turning points and trading spikes or inverted V formations, outperforming Western charting theories.

-

Contextual Use:

Reversal patterns are most effective following significant price movements (rally or decline) and are less useful in sideways markets.

Continuation Patterns and Indicators

-

Trend Continuation:

Candlestick continuation patterns assist in gauging ongoing trends and are true leading indicators of potential market reversals, often ahead of Western technical indicators.

-

Short-Term Focus:

Candlestick analysis is best suited for short-term trends (5 to 15 days) and can be adapted for longer-term analysis using weekly or monthly charts.

Combining Techniques for Enhanced Profitability

The candlestick technique can be a standalone trading method, but combining it with Western technical indicators (such as Moving Averages, RSI, MACD, and others) enhances profitability. This is referred to as the Rule of Multiple Techniques or candlestick filtering.

Trend Analysis

-

Alignment with Primary Trends:
Traders should focus on candlestick signals that align with the primary trend and disregard counter-trend signals to minimize failure rates.

-

Adapting to Market Conditions:
Recognizing the overall technical evidence may be more crucial than individual candlestick patterns, especially in contrasting market conditions.

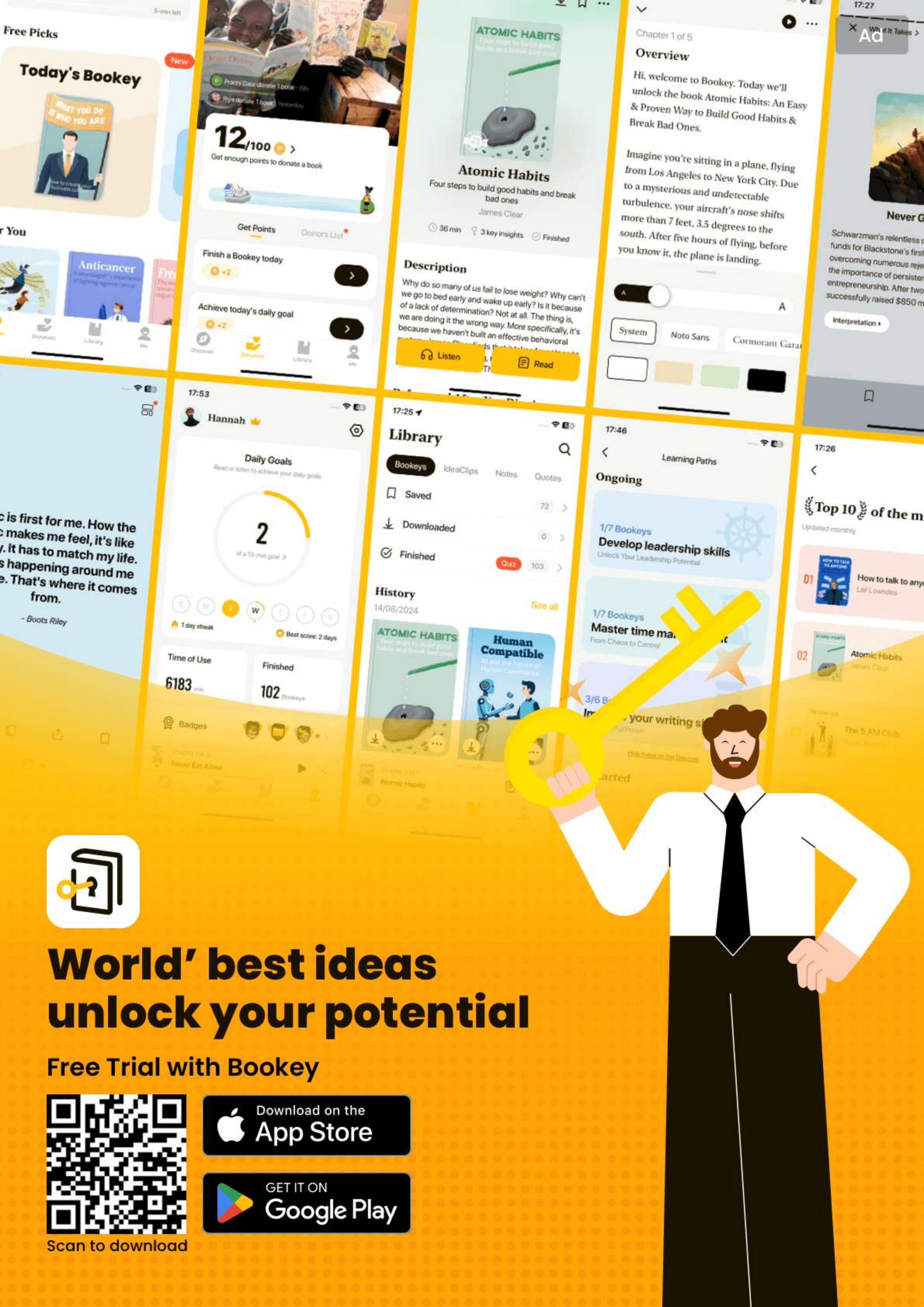
Supporting Tools

For traders struggling to identify complex reversal patterns, the P.I. System Trader can simulate candlestick reversal patterns and be integrated into charting software. The Nison

Candle Scanner further aids in efficiently finding profitable patterns across various markets.

Final Thoughts

Emphasizing flexibility in chart reading and the importance of overall market context, traders are encouraged to take signals in the direction of prevailing trends for better success.


World' best ideas
unlock your potential
Free Trial with Bookey
Scan to download
Download on the
App Store
GET IT ON
Google Play

Best Quotes from The Power of Japanese Candlestick Charts by Fred k.h. Tam with Page Numbers

View on Bookey Website and Generate Beautiful Quote Images

Chapter 1 | Quotes From Pages 54-83

1. Munehisa Homma was perhaps the first person in recorded Japanese history to have used past prices to predict futures price movements—and he did it successfully.
2. The fact that it is still very much in use today after more than 300 years since its discovery is testimony to its usefulness.
3. Candlestick charts can be applied to follow as many markets as desired—be they stocks, futures, currency, or commodities.
4. Understanding how Japanese traders use their charts would help the American traders answer the question 'What are the Japanese going to do next?'
5. Many Japanese candlestick patterns are not found in

Western chart techniques.

Chapter 2 | Quotes From Pages 84-125

1. Reading the single candle marks the beginning of Japanese candlestick analysis.
2. To understand the players' psychology behind the formation of the candle.
3. A large size candle suggests tremendous strength and power behind the move.
4. Its large size makes it a very powerful candle, but the location of this long candle is important.
5. A doji is classified as a neutral candle if it is found within a sideways market.
6. A long white candle reflects extreme power and strength behind the move.
7. If the doji is found after a rally or at a high price area, it is generally viewed as a potential bearish reversal pattern.
8. The location of the doji is of significance.
9. Long candles may signal a reversal pattern.
10. To act by making a decision on whether to buy, hold, or

sell through the patterns that emerge.

Chapter 3 | Quotes From Pages 126-149

1. The long shadow makes it a larger than average candle.
2. A Hammer (regardless of colour) is a potentially bullish signal.
3. A Hanging Man is a potentially bearish signal.
4. For conservative traders, confirmation is required before acting on this candle.
5. An Inverted Hammer (regardless of colour) is a potentially bullish signal.
6. A Shooting Star (regardless of colour) is a potentially bearish signal.

Chapter 4 | Quotes From Pages 150-246

1. The job of an analyst or trader is therefore to distinguish between the two types of patterns as early as possible during their formation and to trade in the direction of the breakout.
2. Reversal patterns show extreme accuracy when they are spotted after a sharp rally or decline (of between 5 and 15 cycles).
3. A low price area can be defined as an area where the Western oscillators like Relative Strength Index, stochastic, momentum, or Williams' Percent R are oversold or where a previous support existed.
4. These candlestick reversal patterns will be the trader's guide as to whether one should enter or exit the market.
5. For every bullish reversal pattern, there is almost always a bearish equivalent.

Chapter 5 | Quotes From Pages 247-313

1. Japanese candlestick patterns clearly give us more clues for spotting market reversals.

2.No stock or market moves up in a straight line without pulling back.

3.Continuation patterns tell us that the market is consolidating and taking a rest, after which it is expected to move or to resume its prior trend.

4.Gaps are formed because of a void in buy/sell orders or due to an overwhelming influx of buy/sell orders.

5.Windows also act as support and resistance areas.

Chapter 6 | Quotes From Pages 314-338

1. Yes, because the candlestick technique is a standalone technique. A trader can make money just by using pure candlestick chart analysis...

2.But using pure candlestick chart analysis can result in a high number of false signals.

3.The Bruce Babcock tests revealed that a simplistic interpretation of candlestick patterns is not profitable.

4.To summarize, the trader starts by: Identifying the primary trend... Trade in the direction of this trend.

Chapter 7 | Quotes From Pages 341-511

1. Candlestick methods, by themselves, are a valuable trading tool," says Steve Nison, in his book, Japanese Candlestick Charting Techniques. "But candlestick techniques become even more powerfully significant if they confirm a Western technical signal.
2. The more technical indicators that assemble at the same price area, the greater the chance of an accurate forecast.
3. If the slope of the moving average is pointing upward, it shows that market players are bullish about the market. If the slope of the moving average is down, it shows players are bearish.
4. When price moves outside the upper band, this is a sign of great strength, and a continuation of the uptrend is implied. When price moves outside the lower band, this is a sign of great weakness, and a continuation of the downtrend is implied.
5. An interesting phenomenon of the %R indicator is its

uncanny ability to anticipate a reversal in the underlying security’s price.

6. If +DMI > –DMI, trend bullish; if +DMI < –DMI, trend bearish.

7. If prices fail to rise above the extreme point, you should continue to hold your existing position.

Chapter 8 | Quotes From Pages 512-523

1. The P.I. System Trader essentially mimics the candlestick reversal patterns such that the timing of its buy or sell signals tends to coincide with that of candlestick patterns.

2. Having a system that can pick up reversal patterns as soon as the market turns is important because winning in the markets is all about buying low and selling high.

3. The idea here is not to rely on candlesticks alone or the P.I. System Trader daily signals to execute trades.

4. This concept of applying Western indicators in conjunction with Japanese candlesticks to spot reversals is known as filtering or the Rule of Multiple Techniques.

Chapter 9 | Quotes From Pages 524-569

1. Without being greedy, think about the time and price ratio by looking at last price movements.
2. Attempt to sell at the top and buy at the bottom.
3. If one forecasts the market incorrectly, one should attempt to identify the error as soon as possible.
4. The chart is a record of market price movements in a picture form.
5. Correct interpretation of the market's psychology through reading the charts, therefore, holds the key to success in making money in the markets.
6. Very early in Japan's cultural history, the number three was considered a mysterious number, and it is thought that a divine power lives within it.
7. Sakata's Five Methods are intended to group frequently recurring price patterns to help the trader discern the next market direction.

Chapter 10 | Quotes From Pages 570-586

1. Nison's work has been highlighted in several finance publications including the Wall Street Journal, Barron's, Institutional Investor, and Euroweek.
2. Nison recognized it was a challenge for traders to browse through multiple markets on several time frames just to find profitable trade setups.
3. He designed the innovative Nison Candle Scanner in 2013, using the NinjaTrader Platform.
4. With such a large number of patterns it would be a challenging task, especially for the newbie, to identify them.
5. Candlestick charts are the best tool to see what's going to happen in the market—faster than old-fashioned bar charts.

Chapter 11 | Quotes From Pages 587-590

1. The Japanese candlestick technique had been relatively unknown for the last three centuries, except in Japan, until Steve Nison popularised it in

1991.

2. Candlestick charting is the only technique that generates intuitive text messages (results) about the inner psychology of any market.
3. Candlestick reversal patterns work best if they are found after a rally or decline. They are not useful in forecasting market direction in a sideways market.
4. Be flexible about chart reading. Where you stand in relation to the overall technical evidence may be more important than an individual candlestick pattern.
5. The trader should take a candlestick signal in the direction of the primary trend and to ignore a candlestick signal that is counter to the primary trend; otherwise there can be a high degree of failure.

The Power of Japanese Candlestick Charts Questions

View on Bookey Website

Chapter 1 | Introduction| Q&A

1.Question

How did the Japanese candlestick charting technique influence modern trading practices?

Answer:The Japanese candlestick charting technique, originating in the 1700s, has shifted the landscape of trading by providing a more visually descriptive method of charting price action than traditional bar charts. Once adopted by U.S. traders in the late 1980s, it became crucial for developing strategies that anticipate market movements, making it a powerful tool for decision-making in stocks, commodities, and currencies. This method captures the psychology of market participants more effectively, allowing traders to identify potential reversals and market sentiments before they materialize.

2.Question

Who was Munehisa Homma and what was his contribution to candlestick charting?

Answer:Munehisa Homma, often regarded as the 'god of the markets,' was a pioneering trader in Japan's rice markets during the 18th century. His meticulous records and understanding of market psychology led him to develop techniques that formulated the basis of candlestick charting. Homma's approach to analyzing price patterns and past prices paved the way for predictive trading strategies, revolutionizing market analysis and establishing him as a legendary figure in trading.

3.Question

What makes candlestick charts a leading indicator compared to Western charting methods?

Answer:Candlestick charts are considered leading indicators because they provide earlier reversal signals than most Western charting techniques. This unique capability allows traders to identify potential market movements before they become visible through traditional methods, enabling more strategic entry and exit points.

4.Question

What are the four essential components required to draw a candlestick chart?

Answer:The four components necessary to construct a candlestick chart are: 1) Open price, 2) High price, 3) Low price, and 4) Close price. These elements create the 'real body' and 'shadows' of the candlestick, which represent the market's opening, closing, highest, and lowest prices over a specified time period.

5.Question

Why are candlestick charts easy to remember and interpret for traders?

Answer:Candlestick charts employ vivid terminology such as 'shooting star,' 'hanging man,' and 'doji,' which create memorable visual and mental images. This pictorial nature makes it easier for traders to recall and apply these patterns in making trading decisions, as each name evokes specific market conditions.

6.Question

What are some of the advantages of using candlestick charts in trading?

Answer:Candlestick charts offer multiple advantages including: 1) They serve as leading indicators, showing reversal signals earlier; 2) Their pictorial nature allows for easier interpretation of market psychology; 3) They can be used in conjunction with Western technical tools; 4) They are adaptable for both short and long-term trading; 5) They allow traders to analyze a variety of markets, including stocks, futures, and currencies; 6) Their long history and refinement make them a reliable trading method.

7.Question

In what ways can candlestick charts be applied to different trading strategies?

Answer:Candlestick charts are versatile tools that can be applied to various trading strategies. They can be utilized for short-term trading by using intra-day charts, or for longer-term forecasting through daily, weekly, or monthly charts. This adaptability allows traders to implement candlestick principles across diverse markets such as equities, commodities, and foreign exchanges, thus supporting portfolio diversification.

8.Question

How does the historical context of Japan influence the use of candlestick charts today?

Answer:The historical context of Japan, particularly during the Tokugawa Shogunate's agrarian economy and its focus on rice trading, laid a foundational understanding of market behaviors and psychology that still resonates today. The techniques developed by early traders, especially Munehisa Homma, have been refined over centuries, contributing to the robustness and relevance of candlestick charting in contemporary financial markets.

9.Question

What visual elements differentiate candlestick charts from bar charts?

Answer:Candlestick charts include both the 'real body' and 'shadows' which provide a more nuanced view of market dynamics compared to bar charts. The real body (representing the open and close) combined with the upper and lower shadows (showing the high and low prices) allows for a clearer representation of market sentiment and momentum, revealing shifts in buyer and seller psychology better than the often flatter appearance of bar charts.

Chapter 2 | Single Candle Types| Q&A

1.Question

What is the primary purpose of identifying a single candlestick in Japanese candlestick analysis?

Answer:The primary purposes are to understand the players' psychology behind the candle formation, investigate the relationship of the current candle with those that preceded it to interpret psychological changes, and to make decisions about trading actions—whether to buy, hold, or sell based on the emerging patterns.

2.Question

Describe the significance of candle size in candlestick analysis.

Answer:A large candle suggests significant strength and power behind a market movement and indicates volatile market conditions. Its interpretation revolves around the context—whether it appears at a low or high price, which helps indicate whether it suggests a continuation or reversal of the trend.

3.Question

What does a white candlestick signify compared to a black candlestick?

Answer:A white candlestick indicates that the closing price is higher than the opening price, reflecting bullish control and market optimism, while a black candlestick shows that the closing price is lower than the opening price, indicating bearish control and market pessimism.

4.Question

Explain the concept of a doji and its implications in candlestick analysis.

Answer:A doji represents a situation where the opening and closing prices are virtually the same, indicating market indecision. It takes on greater significance in high or low price areas, where it may hint at a potential market reversal, especially when positioned after a strong bullish or bearish candle.

5.Question

What is the meaning of an Inverted Hammer and its significance when located at the bottom of a market trend?

Answer:An Inverted Hammer signifies a potential reversal at the bottom of a downtrend. It suggests that despite the bears' dominance during the day, bulls showed strength by pushing prices up, thus hinting at a possible end to the decline, albeit requiring confirmation from subsequent trading.

6.Question

In the context of a long white candle at a high-price area, what trading actions should a trader consider?

Answer:A long white candle at a high price area should be approached with caution; it may indicate resistance or a potential market top. Traders should be prepared to take profits on long positions and watch for bearish confirmation in subsequent candles to make sell decisions.

7.Question

How do short candles differ from long candles, and what do they indicate about market sentiment?

Answer:Short candles, defined by small real bodies and shorter price movements, reflect a lack of decisiveness in the market, often indicating consolidation. In contrast, long candles indicate strong movements in the market and are viewed as more significant, suggesting clear bullish or bearish sentiment based on their color and position.

8.Question

What action should a trader take when encountering a Long Marubozu Black Candle breaking support?

Answer:When a Long Marubozu Black Candle breaks support, it is a strong signal for a trader to take a short position, as it reflects bearish control with high selling activity, often indicating continued downward movement.

9.Question

Can an umbrella candle always be interpreted the same? What influences its interpretation?

Answer:No, the interpretation of an umbrella candle can vary based on its location. The significance of whether it's at the top or bottom of a trend is crucial; for instance, a Hanging Man at the top suggests a potential reversal while a Hammer at the bottom signals a possible reversal to the upside. The market context guides its interpretation.

10.Question

What does a Spinning Top indicate in the context of trading patterns?

Answer:A Spinning Top candle indicates market indecision, often representing a balance of power between buyers and sellers. Depending on its position after a strong rally or decline, it may signal potential reversals or continuation of trends and should be analyzed in conjunction with preceding candles to determine its implications.

Chapter 3 | The Umbrella Group| Q&A

1.Question

What are umbrella group candles called in Japanese, and what does their name signify?

Answer:Umbrella group candles are called "karakasa" in Japanese, which means "paper umbrellas". This naming is due to their visual similarity to the shape of an umbrella, symbolizing protection and the potential for reversal in price movements.

2.Question

What is the importance of the color of umbrella group candles?

Answer:Color is insignificant in the interpretation of umbrella group candles; the key factors are their shape, location, and the presence of long shadows. The small real body indicates a neutral day, suggesting that neither bulls nor bears dominate.

3.Question

What distinguishes a White Hammer from a White Hanging Man?

Answer:A White Hammer appears after a downtrend or at a low price area, signaling a potential bullish reversal. Conversely, a White Hanging Man occurs after an uptrend or at a high price area, indicating a potential bearish reversal.

4.Question

In what situation should traders seek confirmation before acting on umbrella group candles?

Answer:Conservative traders are advised to seek confirmation through subsequent price action before acting on any umbrella group candles, as these patterns signal potential reversals rather than guaranteed outcomes.

5.Question

What indicates that a black umbrella candle (Black Hammer or Hanging Man) has significant implications?

Answer:The significance of a black umbrella candle is indicated by its long lower shadow, which must be at least twice the length of the small real body, regardless of its black color. This reflects market rejection of lower prices.

6.Question

What are the characteristics of an Inverted Hammer and

what can it signal?

Answer:An Inverted Hammer has a small real body, is located at the low after a downtrend, and features a long upper shadow at least twice the body length. It can signal a potential bullish reversal when confirmed.

7.Question

How do the White and Black Inverted Hammer differ in terms of interpretation?

Answer:Both the White and Black Inverted Hammers have similar structures but differ in interpretation based on market context. A White Inverted Hammer can indicate a bullish reversal, while a Black Inverted Hammer suggests a potential bearish reversal.

8.Question

What do the long shadows in umbrella group candles indicate about market behavior?

Answer:The long shadows in umbrella group candles indicate a rejection of price levels, suggesting that the market may be ready to reverse direction after testing those extremes, either above or below.

9.Question

Why is the positioning of an umbrella group candle critical in its analysis?

Answer:The positioning of an umbrella candle is critical because it provides context—whether it follows a trend or appears within a range can radically change its implication as a potential bullish or bearish signal.

10.Question

Can you provide an example of how the umbrella group candles work in real market scenarios?

Answer:In the Kuala Lumpur Composite Index Futures from 2013, a Hammer was observed after a decline, indicating a potential reversal. Similarly, a Hanging Man appeared after an advance in Sersol Industries, suggesting a possible price drop. These examples illustrate how market trends can shift based on these candle patterns.

Chapter 4 | Reversal Patterns| Q&A

1.Question

What distinguishes reversal patterns from continuation patterns in candlestick charting?

Answer:Reversal patterns indicate a change in trend direction, signaling either a switch from bullish to bearish trends or vice versa, while continuation patterns suggest that the current trend will continue following a brief pause or pullback.

2.Question

Why is it important for traders to identify reversal patterns as early as possible?

Answer:Identifying reversal patterns early allows traders to position themselves advantageously before the market makes a substantial move in a new direction, thereby maximizing potential profit.

3.Question

What are some examples of common reversal patterns identified by Western and Japanese charting theories?

Answer:Western charting theory commonly identifies patterns like Head-and-Shoulders and Double Tops, while Japanese charting includes patterns such as the Bullish Engulfing and Dark Cloud Cover, illustrating different approaches to market psychology.

4.Question

How does volume play a role in validating reversal patterns like the V or Spike Tops or Bottoms?

Answer:Heavy volume accompanying a reversal pattern, such as a Bullish or Bearish Engulfing, indicates strong conviction in the new trend direction, enhancing the pattern's reliability as a signal to trade.

5.Question

What types of confirmation signals should traders look for following a hammer or hanging man candlestick pattern?

Answer:Traders should look for a bullish confirmation candle that closes above the hammer or a bearish confirmation candle that closes below the hanging man, which reinforces the expectation of a trend reversal.

6.Question

What criteria define a Bullish Engulfing pattern, and why is it considered a strong bullish signal?

Answer:A Bullish Engulfing pattern consists of a black candle followed by a white candle that completely engulfs the black candle's body; it indicates a decisive shift in momentum from sellers to buyers, often leading to significant upward price movement.

7.Question

How might market oscillators like the Relative Strength Index complement the identification of reversal patterns?

Answer:Market oscillators help confirm oversold or overbought conditions, providing additional context for reversal patterns, as their signals in conjunction with candlestick formations can indicate probable trend changes.

8.Question

In what context is a Doji considered a bullish or bearish signal?

Answer:A Doji appearing after a prolonged trend, particularly at the top or bottom, signals indecision among traders; if it appears after a price decline, it can signal a potential reversal upwards, while at the top, it suggests a possible reversal downwards.

9.Question

What does the phrase 'the stomach is 80 percent full' refer to in terms of trading patterns?

Answer:This phrase indicates that when a market reaches eight or more record highs or lows without a meaningful reversal, it is likely exhausted, leading traders to anticipate a reversal due to overbought or oversold conditions.

10.Question

What are the implications of patterns such as the Advance Block and Deliberation for traders?

Answer:These patterns signal potential bearish reversals following prolonged uptrends. The Advance Block features rising candles with weakening upward momentum, while the Deliberation shows indecision at highs, warning traders to be cautious and possibly take profits.

Chapter 5 | Continuation Patterns| Q&A

1.Question

What is the key difference between reversal and continuation patterns in Japanese candlestick charts?

Answer:Reversal patterns indicate a potential trend change in the market, while continuation patterns suggest that the market is taking a pause or consolidating before resuming its existing trend.

2.Question

How do continuation patterns help traders in understanding market behavior?

Answer:Continuation patterns signal that although there may be short-term fluctuations (such as pullbacks due to profit taking), the existing trend (either up or down) is likely to continue, allowing traders to maintain their positions.

3.Question

What characteristics define a Bullish Separating Line pattern?

Answer:A Bullish Separating Line consists of a black candle followed by a white Belt-Hold candle, where both candles open at the same price, and it occurs during an uptrend. The second candle indicates a regain of control by the bulls.

4.Question

Why is the Bullish Kicking pattern significant in candlestick analysis?

Answer:The Bullish Kicking pattern features a gap between a Marubozu Black Candle and a Marubozu White Candle, which signifies a strong bullish sentiment, suggesting that the market will continue moving upward after a brief pullback.

5.Question

How does the In-Neck pattern indicate a potential continuation of a bearish trend?

Answer:The In-Neck pattern consists of a long black candle followed by a white candle that closes just inside the previous black candle's body. This pattern reflects that the downtrend is still in control, and if the low of the white candle is broken, it suggests that the bearish trend will continue.

6.Question

What actions should a trader take when identifying a Rising Three Methods pattern?

Answer:Upon identifying a Rising Three Methods pattern, which indicates market rest after a rally, traders should maintain a long position and consider further buying if the closing price of the breakout candle exceeds the highest price of the previous candles.

7.Question

What role do gaps (or windows) play in continuation patterns?

Answer:Gaps act as indicators of strength in the market; when a price gap occurs during a trend, it suggests a strong continuation of that trend. If the gap is 'filled' or violated, it could indicate potential weakness or reversal.

8.Question

Explain the significance of volume in identifying continuation patterns.

Answer:Volume plays a crucial role; increasing volume on breakout days signals strong conviction from buyers or sellers, reinforcing the likelihood of the continuation of the trend. Conversely, decreasing volume during consolidations highlights weak buying or selling.

9.Question

How can traders effectively use the Tasuki Gap patterns in their trading strategies?

Answer:In a Tasuki Upside Gap, traders should buy on the third candle if it does not break the gap, while in a Tasuki Downside Gap, they should sell if the gap is not violated upwards. Each pattern indicates a continuation of the existing trend.

10.Question

What does the Falling Three Methods pattern reveal about market dynamics?

Answer:The Falling Three Methods pattern, which consists of a long black candle followed by smaller white candles and another black candle, indicates that after a brief correction due to bargain hunting, the bearish trend is likely to resume.

Chapter 6 | Summarizing Part I| Q&A

1.Question

What is the main takeaway from Chapter 6 regarding candlestick patterns?

Answer:The chapter emphasizes that while there are many candlestick patterns to learn, not all of them are necessary for effective trading. The key is to understand a core set of practical patterns that can improve trading decisions.

2.Question

Is it possible to succeed in the market using only candlestick chart analysis?

Answer:Yes, but the chapter warns that relying solely on candlestick analysis can lead to false signals. Traders are encouraged to combine candlestick analysis with other techniques to improve accuracy.

3.Question

How should traders use candlestick patterns according to the chapter?

Answer:Traders should utilize candlestick patterns in conjunction with trend analysis, ensuring they trade in the direction of the primary trend to increase their likelihood of success.

4.Question

What common mistakes do traders make with candlestick patterns?

Answer:Traders often take signals counter to the primary trend or fail to apply additional filters to prevent false signals, which can lead to poor trading outcomes.

5.Question

What does the chapter say about combining candlestick patterns with technical indicators?

Answer:The chapter stresses that integrating technical indicators with candlestick patterns can enhance the effectiveness of trade decisions, as it helps confirm the context and trend direction.

6.Question

What is the Rule of Multiple Techniques mentioned in Chapter 6?

Answer:The Rule of Multiple Techniques advises traders to confirm candlestick signals with additional technical indicators to strengthen their trading strategy and decision-making process.

7.Question

Why is understanding market trends critical for candlestick trading?

Answer:Understanding market trends helps traders identify when to enter or exit trades based on candlestick signals, thereby improving the success rate of their trading strategies.

8.Question

What practical steps does the chapter suggest for amending trading strategies?

Answer:Traders are advised to first identify the primary market trend (bullish or bearish) and then to execute trades in the direction of that trend using relevant candlestick patterns.

9.Question

How does the chapter suggest dealing with the inherent risks of using candlestick analysis?

Answer:To manage risks, traders should incorporate money management strategies and ensure they are not acting on candlestick signals that are against the prevailing market trend.

10.Question

What overall conclusion does the author draw about candlestick trading and its effectiveness?

Answer:The author concludes that candlestick analysis, when used alongside trend analysis and technical indicators, can lead to more informed and profitable trading decisions.

Chapter 7 | Filtering with Western Indicators| Q&A

1.Question

What is the concept of filtering in technical analysis, and why is it important?

Answer:Filtering is the practice of using multiple indicators to confirm a trading signal, increasing the probability of making accurate forecasts. By applying various technical indicators simultaneously, traders can avoid false signals and enhance their decision-making. For example, if a candlestick pattern suggests a bullish trend, but a moving average and an oscillator also confirm this trend, the trader can have greater confidence in the buy signal.

2.Question

Can you summarize the three scenarios mentioned in the chapter regarding decision-making in bullish and bearish trends?

Answer:In a bullish trend, traders should seek bullish candlestick patterns to enter long positions and ignore bearish signals. In a bearish trend, they should look for bearish patterns to enter short positions and ignore bullish signals. In cases of overbought or oversold conditions, traders should use corresponding reversal candlestick patterns to exit trades or enter new positions.

3.Question

How does the use of time frames in trading impact the effectiveness of signals?

Answer:Combining multiple time frames allows traders to determine the overall market trend and refine their entry/exit signals. For example, a trader might use a weekly chart to establish a long-term trend, then utilize daily charts to time their trades, and even employ shorter time frames for precise entries. This multi-timeframe analysis enhances the likelihood of executing successful trades.

4.Question

What are Moving Averages used for in the context of technical trading?

Answer:Moving Averages (MAs) are trend-following indicators used to smooth out price fluctuations, helping traders identify the market's direction. An upward sloping MA signals bullish sentiment, while a downward sloping MA indicates bearish sentiment. MAs can also generate buy or sell signals when prices cross above or below them.

5.Question

Describe the interpretation of the MACD indicator and how it can be used in conjunction with candlestick patterns.

Answer:The MACD (Moving Average Convergence Divergence) generates buy and sell signals based on the crossing of two exponential moving averages. A bullish signal occurs when the MACD line crosses above the signal line, while a bearish signal happens when it crosses below. Traders can look for candlestick patterns, like Bullish Engulfing or Shooting Star, to confirm these MACD signals.

6.Question

What is the Relative Strength Index (RSI), and how can it be utilized in trading?

Answer:The RSI is an oscillator that measures the speed and change of price movements, gauging whether a market is overbought (above 70) or oversold (below 30). Traders can use RSI levels to inform their entry and exit strategies, combined with reversal candlestick patterns to predict potential price reversals.

7.Question

Explain how Bollinger Bands function and the significance of price movements relative to these bands.

Answer:Bollinger Bands consist of a middle band (simple moving average) and two outer bands that represent standard deviations. Price moving outside the upper band indicates strength and potential continuation upward, while price below the lower band suggests weakness and potential continuation downward. Movements outside these bands followed by price returning inside are often viewed as reversal signals.

8.Question

What role does volume analysis play in the context of candlestick patterns and market signals?

Answer:Volume analysis helps confirm the strength behind price movements. Increasing volume supports the current trend, while decreasing volume can indicate a potential reversal. For example, a price increase accompanied by a volume spike suggests strong buying interest, while a similar spike on a price decline can signal selling pressure. Therefore, analyzing volume alongside candlestick patterns enhances signal reliability.

9.Question

Summarize the main advantage of using the Rule of Multiple Techniques in trading.

Answer:The Rule of Multiple Techniques enhances signal validation and reduces trading risks by requiring confirmation from multiple sources before executing trades. By ensuring that various indicators align towards the same market direction, traders can improve their accuracy and profitability in trading decisions.

Chapter 8 | P.I. System Trader| Q&A

1.Question

What challenges do traders face when identifying candlestick patterns?

Answer:Traders can find it easy to identify some candle patterns, like the Bearish Engulfing, which is a clear sell signal. However, at times, patterns can be ambiguous or not evident at all, leading to difficulty in spotting reversals. This can be especially challenging for newcomers to candlestick techniques.

2.Question

How does the P.I. System Trader assist traders?

Answer:The P.I. System Trader helps traders by automatically identifying buy and sell signals that may not be obvious through traditional candlestick analysis. It mimics the reversal patterns of candlesticks, ensuring that traders do not miss crucial signals even when the patterns are not clearly visible.

3.Question

Why is it important to filter false signals when using the

P.I. System Trader?

Answer:Filtering false signals is crucial because relying solely on the P.I. System Trader might lead to incorrect trading decisions. By using additional indicators like the 50-day moving average or oscillators, traders can better confirm signals, thus ensuring more reliable trade entries and exits.

4.Question

What is the Rule of Multiple Techniques?

Answer:The Rule of Multiple Techniques involves using various indicators in conjunction with candlestick patterns to enhance trading accuracy. This method helps traders validate signals from the P.I. System Trader or candlesticks, minimizing the risk of false actions and improving overall strategy effectiveness.

5.Question

How can a trader determine whether to buy or sell using the P.I. System Trader?

Answer:A trader first checks the trend indicated by the

50-day moving average. If the trend is bullish, they will take all buy signals from the P.I. System Trader, while ignoring sell signals. Conversely, if the trend is bearish, they will take all sell signals and ignore buy signals.

6.Question

Can the P.I. System Trader be integrated into trading software, and if so, how?

Answer:Yes, the P.I. System Trader can be programmed into trading software by applying established trading rules. These rules include using the 50-day moving average or other trending indicators to filter signals and guide trading decisions.

7.Question

What advantages does the P.I. System Trader provide over solely relying on candlestick patterns?

Answer:The P.I. System Trader triggers signals that are not always obvious from candlestick patterns alone. It ensures traders do not miss potential reversal signals due to unclear patterns and helps to simplify decision-making during trading.

8.Question

What types of signals does the P.I. System Trader identify?

Answer:The P.I. System Trader exclusively picks up candlestick reversal signals, not continuation signals. This focus helps traders time their trades with market reversals, which is critical for successful trading.

Chapter 9 | Sakata’s Five Methods| Q&A

1.Question

What are Sakata's Five Methods and who developed them?

Answer:Sakata's Five Methods, developed by Munehisa Homma in the mid-eighteenth century, are a set of trading rules that combine the trading principles of Sakata's Constitution with advanced candlestick charting techniques. Homma, known as the 'god of the markets,' was famous for his success in trading Japanese rice markets.

2.Question

How do Sakata's Five Methods help traders make better decisions?

Answer:Sakata's Five Methods help traders by providing a structured approach to interpreting market movements through specific rules, such as identifying key price levels to buy or sell and recognizing patterns that indicate potential market reversals or continuations.

3.Question

What does the Japanese saying 'To consult the market about the market' imply for traders?

Answer:It implies that traders should focus on analyzing the actual market movements and price charts rather than being influenced by external factors like news or economic policies, as the market itself provides the most reliable indicators of future trends.

4.Question

Can you explain the significance of the number three in Sakata's methods?

Answer:The number three holds cultural significance in

Japan, considered a mystical number that suggests divine power. In trading, it also reflects market behavior through patterns like Sanzan (Three Mountains), Sansen (Three Rivers), Sanku (Three Gaps), and others, emphasizing that market price movements often occur in three stages.

5.Question

What should traders do if they incorrectly forecast market movements, according to Sakata's Constitution?

Answer:If traders forecast the market incorrectly, they should quickly identify their error, liquidate their position, and wait on the sidelines for 40 to 50 days to reassess the market.

6.Question

How does the Three Level Fluctuations theory relate to market predictions?

Answer:The Three Level Fluctuations theory posits that market prices move in a zigzag pattern—up three levels and then down three levels. This theory is linked to Elliott Wave Theory and assists traders in identifying probable price movements based on historical patterns.

7.Question

What are the implications of the Three Gaps pattern in trading?

Answer:The Three Gaps pattern indicates that prices have moved too rapidly and are likely forming a trend reversal. Recognizing these gaps allows traders to anticipate potential changes in market direction, informing their buying or selling strategies.

8.Question

How do Sakata's methods integrate traditional and modern trading techniques?

Answer:Sakata's methods blend the historical trading wisdom from Sakata’s Constitution with contemporary techniques like candlestick charting, creating a robust framework that enhances trading decisions over time.

9.Question

What are the key benefits of using patterns like the Three Parallel Lines in trading?

Answer:The Three Parallel Lines pattern indicates a possible continuation of the market trend, giving traders clear signals about when to enter or exit trades based on the persistence of price movements.

10.Question

Why is understanding market psychology critical for trading success according to the Sakata methods?

Answer:Understanding market psychology is vital because it enables traders to interpret price patterns accurately, allowing them to make informed decisions that align with market trends and trader behavior.

11.Question

What relationship exists between Sakata's theories and Western charting techniques?

Answer:Both Sakata's theories and Western charting techniques identify and document recurring price patterns that reveal market psychology, indicating similarities in their predictive power despite cultural differences.

Chapter 10 | Computerized Candlestick Forecasting| Q&A

1.Question

What was the catalyst for the introduction of Japanese candlestick charting to the Western world?

Answer:The catalyst was Steve Nison's book 'Japanese Candlestick Charting Techniques', published in 1991, which revealed candlestick techniques to Western analysts, revolutionizing technical analysis.

2.Question

How has Steve Nison contributed to the popularity of candlestick charting?

Answer:Steve Nison is known as the father of modern candlestick charting, having authored bestselling books, trained thousands of traders worldwide, and integrated candlestick techniques with Western indicators to enhance trading.

3.Question

What challenges do traders face when learning

candlestick patterns, and what solution was introduced?

Answer:Traders face the challenge of identifying a large number of candlestick patterns, which can be overwhelming. The solution introduced was the Nison Candle Scanner, a software that automates the identification of these patterns.

4.Question

What features does the Nison Candle Scanner offer to traders?

Answer:The Nison Candle Scanner features market filtering for specific candlestick signals, real-time alerts for market changes, and the ability to highlight patterns on charts, significantly reducing analysis time.

5.Question

How does the Nison Candle Highlighter enhance trading for MetaTrader 4 users?

Answer:The Nison Candle Highlighter enables MetaTrader 4 users to effortlessly locate candlestick patterns and integrates powerful analytical tools, optimizing both the trading experience for beginners and professionals.

6.Question

Why is it beneficial for traders to utilize computerized candlestick scanning?

Answer:Computerized candlestick scanning allows traders to save hours of analysis time, enabling them to quickly identify potential trading opportunities across various markets and time frames.

7.Question

In what way does combining candlestick analysis with Western indicators improve trading strategies?

Answer:Combining candlestick analysis with Western indicators provides traders with a multi-faceted view of market movements, enhancing prediction accuracy and allowing for more confident trading decisions.

8.Question

What impact did the introduction of the Nison Candle Scanner have on trading practices?

Answer:The introduction of the Nison Candle Scanner transformed trading practices by automating pattern recognition, thus allowing traders to focus on executing trades rather than spending extensive time on analysis.

9.Question

Can you describe the steps involved in using the Nison Candle Scanner effectively?

Answer:To use the Nison Candle Scanner, select your desired candlestick pattern, choose the specific market or market group, view the list of markets currently in that pattern, and click to see the highlighted pattern on the chart.

10.Question

How does the Nison Candle Scanner ensure traders stay updated with market signals?

Answer:It allows traders to customize alerts for specific candlestick signals across markets and provides real-time notifications, ensuring they remain informed of significant market movements.

Chapter 11 | Conclusion: Facts about Candlesticks| Q&A

1.Question

What is the primary advantage of using Japanese candlestick charts over Western bar charts?

Answer:Japanese candlestick charts allow for better recognition of complex patterns and provide intuitive insights into market psychology, which can help traders understand market behavior more effectively.

2.Question

How has the popularity of candlestick techniques changed over time?

Answer:Candlestick techniques were relatively unknown outside Japan for over three centuries until Steve Nison popularized them in 1991, bringing them to a wider audience.

3.Question

In what market conditions are candlestick reversal patterns most effective?

Answer:Candlestick reversal patterns are most effective when identified after a market rally or decline, whereas they offer less utility in sideways market conditions.

4.Question

What role do Western technical indicators play when using candlestick patterns?

Answer:Western technical indicators should be used in combination with candlestick patterns to enhance trading profitability by confirming the primary trend and identifying overbought or oversold conditions.

5.Question

What is meant by the concept of 'candlestick filtering'?

Answer:Candlestick filtering, also referred to as the Rule of Multiple Techniques, emphasizes the need to align candlestick signals with the overall market trend as identified by other technical analysis tools.

6.Question

How important is the overall technical evidence compared to individual candlestick patterns?

Answer:Overall technical evidence is crucial; the broader market context can supersede individual candlestick signals, meaning a bullish signal in a bear market should be approached with caution.

7.Question

What tools does the author suggest to assist traders in identifying candlestick patterns?

Answer:The author suggests the P.I. System Trader for mimicking candlestick reversal patterns and the Nison Candle Scanner for efficiently locating profitable candlestick patterns across multiple markets.

8.Question

What is the typical timeframe for which candlestick analysis is most attuned?

Answer:Candlestick analysis is typically attuned to shorter-term trends, generally ranging from 5 to 15 days.

9.Question

Can candlestick techniques be effective in long-term trading? If so, how?

Answer:Yes, for long-term trading, candlestick techniques can be effective when applied to weekly or monthly charts to capture the broader market trends.

10.Question

Why should traders avoid acting on candlestick signals that are counter to the primary trend?

Answer:Acting on candlestick signals against the primary trend can lead to a high degree of failure, as they are less likely to be successful in a prevailing market direction.

The Power of Japanese Candlestick Charts Quiz and Test

Check the Correct Answer on Bookey Website

Chapter 1 | Introduction| Quiz and Test

1. The Japanese candlestick charting technique was developed in the 1700s for use in rice trading in Japan.
2. Candlestick charts require five price elements to be constructed, including open, close, high, low, and volume.
3. Candlestick charts are less visually informative compared to traditional bar charts.

Chapter 2 | Single Candle Types| Quiz and Test

1. Single candles represent multiple trading days in Japanese candlestick analysis.
2. A Doji candle indicates a strong bullish sentiment due to its equal opening and closing prices.
3. A Long White Candle near a high price indicates strong bullish sentiment and potential breakout.

Chapter 3 | The Umbrella Group| Quiz and Test

1. The Umbrella Group candlestick patterns have significant implications due to their color.
2. The White Hammer candlestick pattern suggests bullish potential after a downtrend.
3. Black Inverted Hammer indicates a potential bullish signal after a rally.

Chapter 4 | Reversal Patterns| Quiz and Test

1. Reversal patterns indicate a trend continuation in financial markets.
2. Japanese charting theory recognizes over 50 different reversal patterns, many of which are common across financial markets.
3. Reversal patterns are not effective after significant market rallies or declines.

Chapter 5 | Continuation Patterns| Quiz and Test

1. Japanese candlestick patterns provide more reversal patterns compared to Western classical charting theory, with 53 documented patterns.
2. Continuation patterns indicate trend changes in the market.
3. The Rising Three Methods pattern is a bullish continuation pattern characterized by a long white candle followed by three smaller black candles and another long white candle.

Chapter 6 | Summarizing Part I| Quiz and Test

1. Part I of the book discusses an exhaustive list of candlestick patterns essential for traders.

2. Candlestick analysis can be used as a standalone trading strategy in fast-moving markets.
3. Traders should rely solely on candlestick patterns for making trading decisions.

Chapter 7 | Filtering with Western Indicators| Quiz and Test

1. Candlestick chart analysis is effective on its own without needing to combine it with Western indicators.
2. The Relative Strength Index (RSI) indicates overbought conditions when it is above 70.
3. The Directional Movement Index (DMI) uses only a single line to provide buy/sell signals.

Chapter 8 | P.I. System Trader| Quiz and Test

1. The P.I. System Trader was developed to help identify buy or sell signals even when candlestick patterns are clear.
2. The P.I. System Trader only identifies reversal signals and not continuation signals, which is necessary for effective trading.
3. To improve accuracy, traders are advised to use the P.I. System Trader as the sole tool for trading decisions without any additional indicators.

Chapter 9 | Sakata’s Five Methods| Quiz and Test

1. Sakata’s Five Methods were developed by Munehisa Homma in the 18th century, who is known as the 'god of the markets.'
2. The 'Sansen' method in Sakata’s Five Methods uses two candles to signal reversals in pricing.
3. According to Sakata’s Constitution, traders should liquidate profitable positions as prices reach expected highs or lows.

Chapter 10 | Computerized Candlestick Forecasting| Quiz and Test

1. Steve Nison introduced Japanese candlestick techniques in the West through his book published in 1991.
2. The Nison Candle Scanner was developed in 2010 to help traders identify candlestick patterns automatically.
3. The Nison Candle Highlighter is only accessible to experienced traders and cannot be used by beginners.

Chapter 11 | Conclusion: Facts about Candlesticks| Quiz and Test

1. The Japanese candlestick technique was popularized by Steve Nison in 1991 and is well-known outside Japan.
2. Candlestick patterns are particularly effective in identifying market turning points and outperform Western charting theories.
3. It is best to rely solely on candlestick patterns without considering Western technical indicators for enhanced profitability.