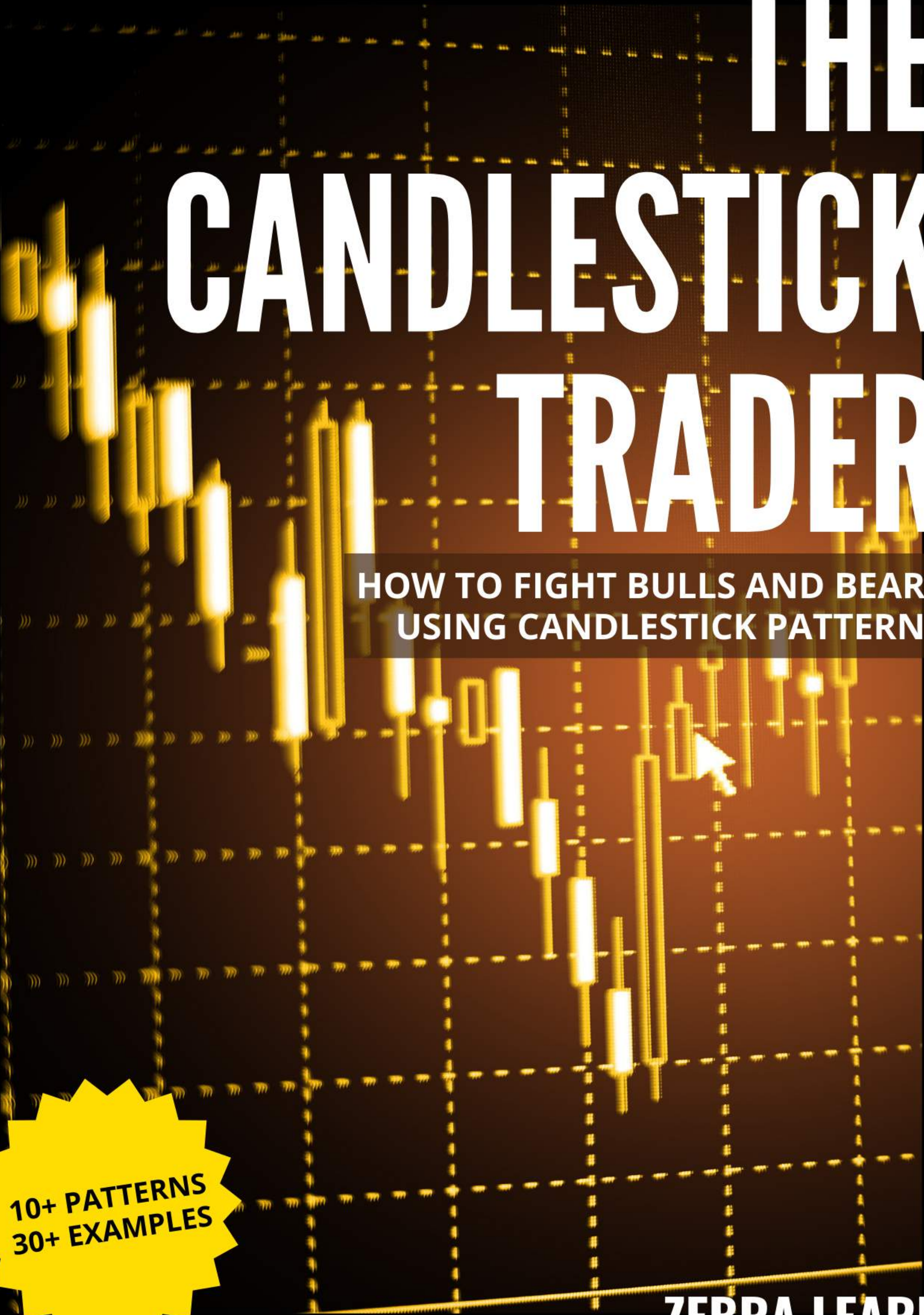
THE CANDLESTICK TRADER

HOW TO FIGHT BULLS AND BEARS USING CANDLESTICK PATTERNS



10+ PATTERNS
30+ EXAMPLES

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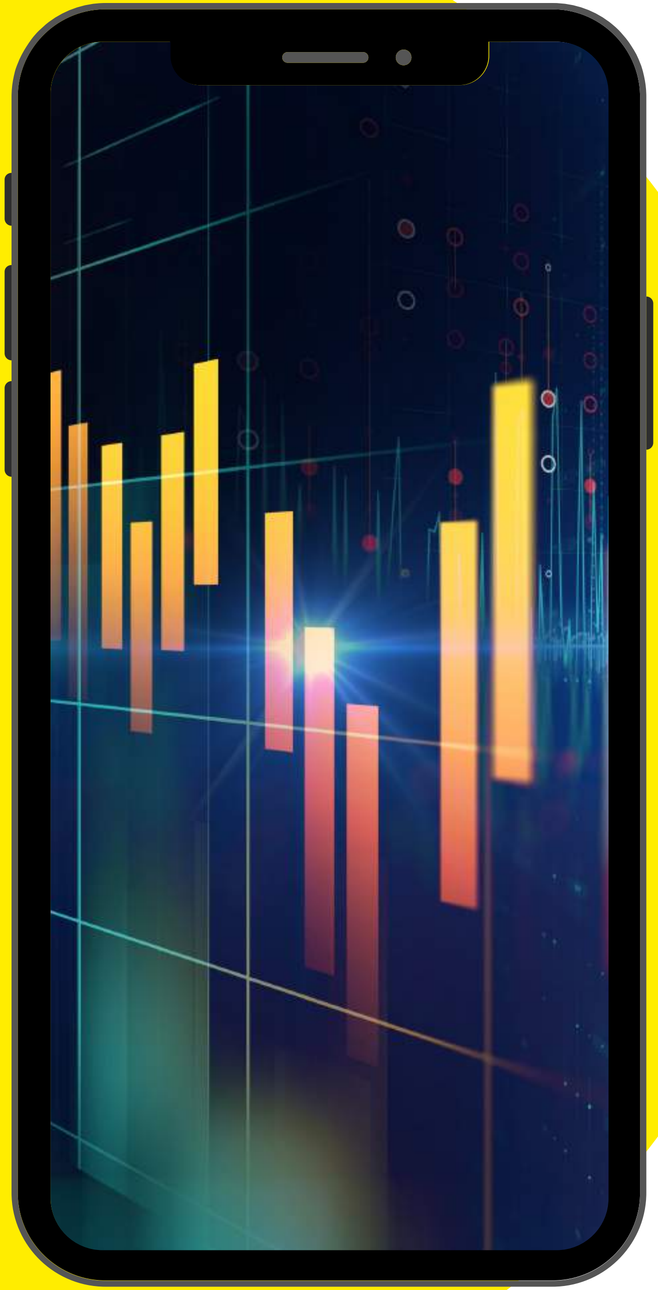
CANDLESTICKS



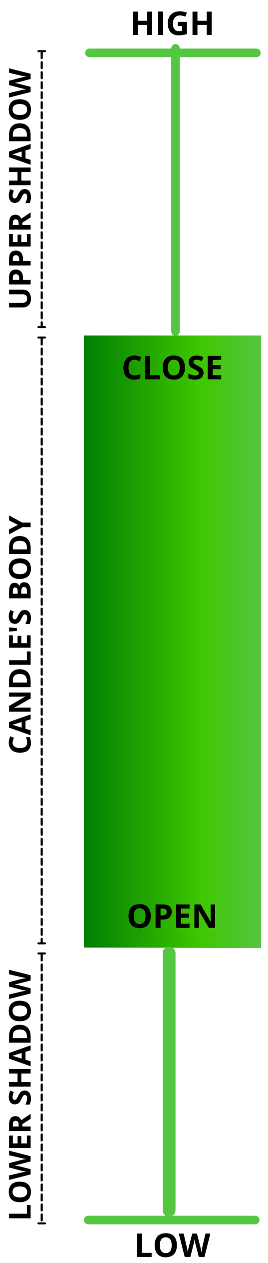
INTRODUCTION

The candlestick method refers to a style of financial chart reading that is used to understand the price movement of assets, and derivatives or currency. Each candlestick is built using a fixed time-frame which can be a minute, 5 minutes, an hour, a day or any custom period of time. Each candlestick is built using the high price, low price, opening price and closing price during that defined time period. We will have a very detailed take on candlesticks and create candlesticks ourselves too in this section.

Candlesticks were developed in Japan in the 18th century for rice trading and were introduced to the Western world later. Since then, they have become a fundamental tool of technical analysis and is one of the simplest ones.

This is typically how candlesticks look and they come in two colours – red (Bear Candle) and green (Bull Candle). When we see a chart, we will see a series of such individual candles and we will try to understand the pattern created by them. Each candle represents a fixed period. If we are using a 1-hour candle, 8 such candles will be created for an 8-hour trading session.

A series of such candles are studied to understand the behaviour of the price of the underlying asset.

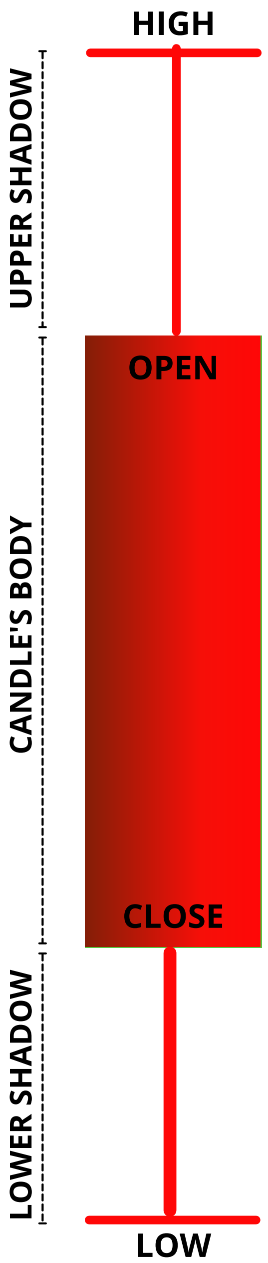


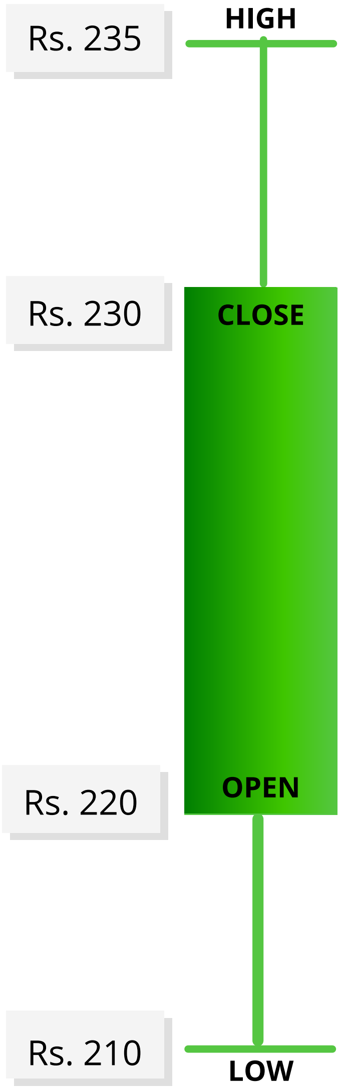
BULL CANDLE

When the closing price is higher than the opening price i.e. the price has increased in the session, we can say that it will form a bull candle. Such candles are coloured green. So, going ahead whenever we see that the candle is green, we will know that the price has appreciated and the lower end of the candle's body is the opening price and upper end is the closing price.

BEAR CANDLE

The second candle is a bear candle. Here, the price decreases in the time period and are coloured in red. Going ahead whenever we see a candle in red, we will know that the upper end of the candle body is the opening price whereas the lower end is the closing price.





EXAMPLE

Let us say we create 1-day candles. This means each candle represents one day period. Let us say the stock opened at Rs. 220 at the start of trading, during the day it reached a low of Rs. 210 and a high of Rs. 235 and at the ending of the day, the price was Rs 230.

We will use this data to create a candlestick. The stock was closed at a price higher than open. This means it is a bull candle (price has increased). We start with the opening price, then mark the low, high and the closing price. We create a candle body between the opening and closing price. Then, we join the high and low using a line. A candle to denote this has been shown.

HOW TO CONSTRUCT CANDLES

1

We will start by finalizing a time frame i.e. the time duration reflected in each candlestick. After that, we will identify the open price, high price, low price and close price. If it is a live chart i.e., the market is still on, then, the current price is considered as the close price for the latest candlestick.

2

Next, we will mark the open price on the chart with time being on the X-axis and price being on the Y-axis. Match the time frame and the price chart when building candlesticks.

3

Next, we will mark the high and low price on the graph and draw a line through them as the candle body will lie somewhere between this range.

4

Next, we will mark the close price or the live price and build the candle's body between the open and close price.

5

Identify whether it is a bear candle or bull candle and colour accordingly. This way we will have created one candle. We have to create a series of candles to understand trends and patterns so that we can make a decision based on them.

It is advised to create a few candlesticks manually using the data available on the BSE website regarding the day's prices for various stocks. We will together create candlesticks for around 20 companies to get a good hang of it. In real life, we will hardly be creating candlesticks ever. These can be accessed on the tools that we discussed earlier. Most of our attention will go towards reading and interpreting candlesticks and taking decisions based on our interpretations.

In practice, we will never be creating Candlesticks. In fact, we will access data for candlesticks using the charts and use them to conduct analysis. This is typically how candlesticks look in a chart. An individual candlestick means nothing in itself, but it is the pattern that we study and derive conclusions. The art of reading candlesticks is in understanding the patterns hidden in them. For practice, we will stop here and estimate the High, Low, Open and Close price for each of the candlesticks shown in the chart.

This is another example how charts look. This is exactly the same as previous, only difference is that the time period for which data is used is longer in this case. We select the length of time period based on our strategy and preferences. So, we have understood how Candlesticks are created and how they work. Next, let us understand different patterns that exist in candlesticks and how we use them to make technical analysis decisions.

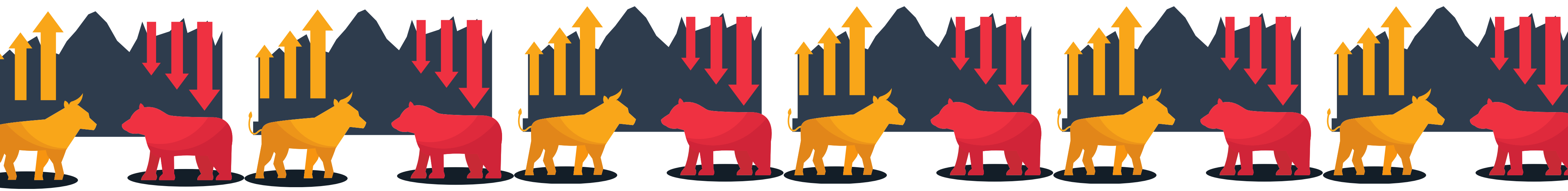
BULLS V/S BEARS

Let us take a quick detour and understand the composition of the market and the creation process of candlesticks. The market for any asset contains two kinds of participants – Short (Bear) and Long (Bull).

Bears refer to those people who benefit when the price of the asset goes down. They bet against the asset i.e. the price of the asset will fall. Bulls are those people that benefit when the price of the asset goes up. They bet for the asset i.e. its price will increase. Bears profit at the expense of bulls and vice versa.

Short term price movement of any asset can be compared metaphorically to the brawl between bears and bulls. At some points, the bulls are in charge and more powerful than the bears (price increases during this phase) and during other times the bears are in charge over the bulls (the price of the asset falls in this period). So, this constant fight between bears and bulls is what determines the short term movements and fluctuations in the price of assets.

Next, we will look into the impact of the fight on candlesticks and our analysis of the same. So, we can say that candlesticks are a pictorial representation of the constant tussle between bears and bulls. It represents the behaviour of the two and portrays who is gaining power and losing power. As we saw earlier, when similar circumstances arise, we expect the future to rhyme with the past if not be an exact copy of the past. Thus, we will take positions based on the behaviour of bears and bulls in the market.
We will now understand the candlestick patterns and their benefits, comprehend the behaviour of bulls and bears and the market psychology that influences the candlestick patterns.




BULL
BEAR