Now…

Another variation of the Pinbar is the Engulfing pattern. They are very similar price patterns which I'll explain more in this section.

You'll learn:

- What does the Engulfing pattern really mean
- Why the Engulfing pattern and Pinbar is essentially the same thing
- Three biggest mistakes you must avoid when trading the Engulfing pattern
- How to improve your odds when trading the Engulfing pattern

Are you ready?

Then let's begin.

What does the Engulfing pattern really mean

An Engulfing pattern is a reversal candlestick pattern that "covers" the range of the previous candle.

Here's a simple textbook definition of it…

For a bearish Engulfing pattern, it <u>gaps higher</u> and closes below the low of the previous day.

For a bullish Engulfing pattern, it <u>gaps lower</u> and closes above the high of the previous day.

However:

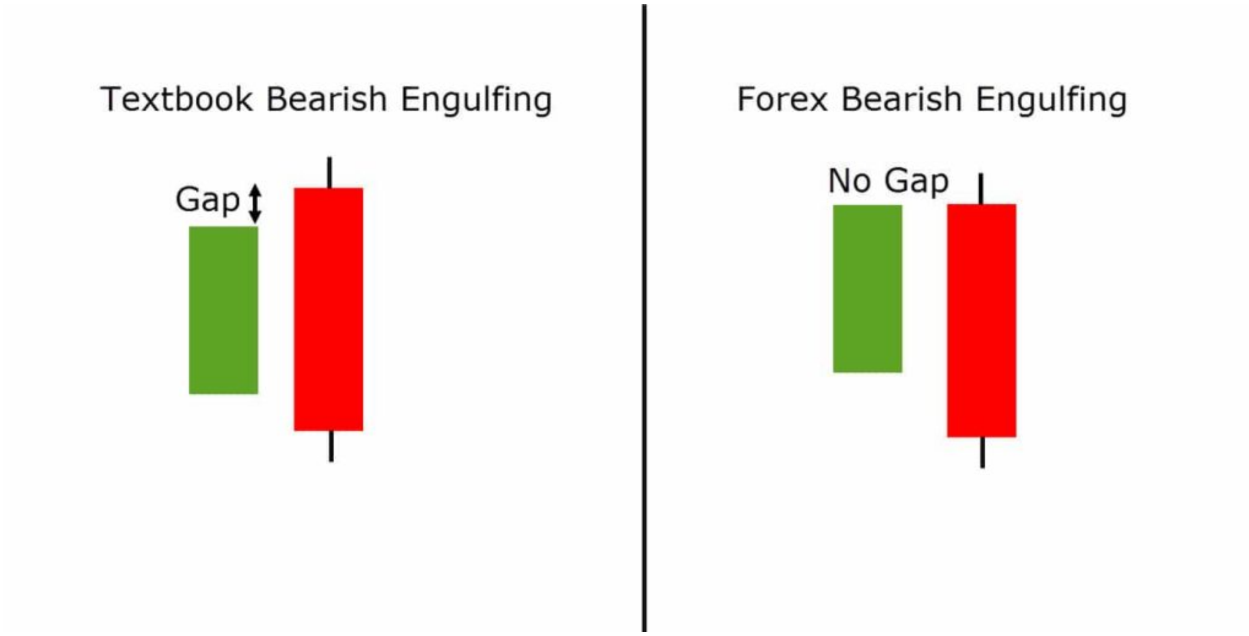
When you're trading the forex markets, you rarely get gaps. Thus, you need to tweak the textbook definition of Engulfing pattern to suit the forex markets.

So, here's my definition of it…

For a bullish Engulfing pattern, it <u>"covers" the body</u> of the previous candle and closes above the high of the previous day.

For a bearish Engulfing pattern, it <u>"covers" the body</u> of the previous candle and closes below the low of the previous day.

Here's what I mean:



Do you understand?

Great, let's move on…

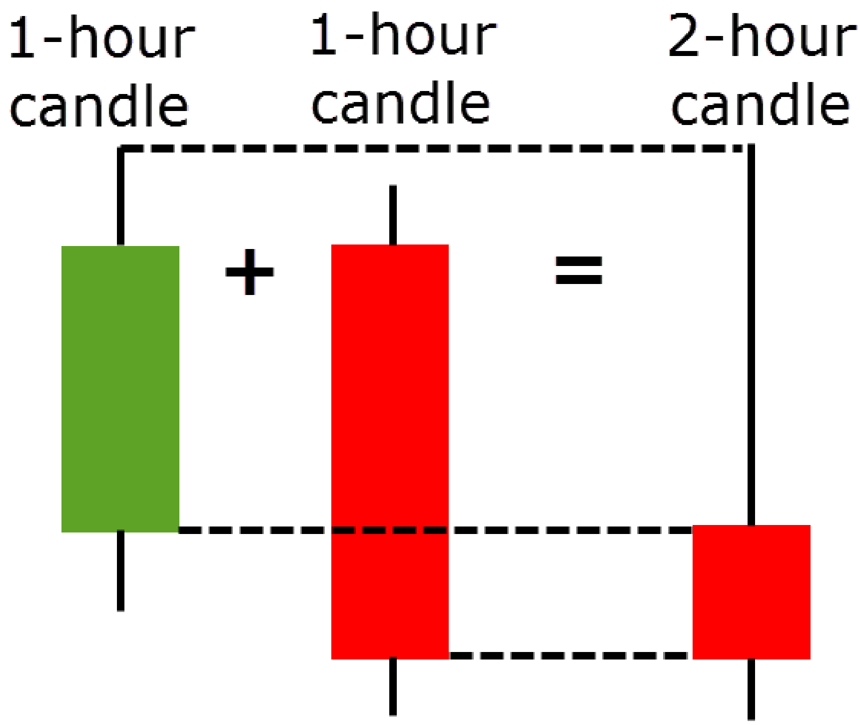
Why the Engulfing pattern and the Pinbar is essentially the same thing

If you recall, the Pinbar is a reversal candlestick pattern as the wick of the candle shows price rejection.

Now, if you look through the lens of multiple timeframes, the Pinbar and Engulfing pattern is essentially the same thing.

The only difference is the timeframe you're looking at.

Here's what I mean:



Does it make sense?

Good.

In the next section, I'll cover the mistakes to avoid when trading the Engulfing pattern.

The three biggest mistakes to avoid when trading the Engulfing pattern

Mistake #1 – Assuming the market will reverse because of an Engulfing pattern

A downtrend will not reverse just because there's a bullish Engulfing pattern on the chart. It takes much more than a single candlestick to reverse a trend.

Heck, even a major news release has difficulty reversing a trend, what more of an Engulfing pattern?

So…

If you spot an Engulfing pattern against the trend, watch what happens next. The odds are the trend will continue.

An example:

Mistake #2 – Giving too much attention to the Engulfing pattern

You know an Engulfing pattern represents price rejection.

But remember…

Price rejection can come in different forms (and patterns). If you focus only on the Engulfing pattern, then you'll miss lots of trading opportunities like this…

So, what's my point?

My point is… stop memorize chart patterns.

Instead, learn to read the price action of the markets. An invaluable skill that lets you better time your entries and exits.

Once you've learned it, you'll never need to memorize another pattern again.

Mistake #3 – Treating all Engulfing patterns the same

Here's one thing I believe in…

Structure triumphs candlesticks.

This means that the context where the candlestick pattern occurs is far more important than the candlestick pattern itself.

For example: If you get a Bearish Engulfing pattern that occurred in the middle of the range, then it's a 50-50 chance it can go higher or lower.

But…

What if you get a Bearish Engulfing pattern that occurred in a downtrend and at an area of Resistance?

The odds of it heading lower are much higher, right?

So remember:

Don’t trade candlestick patterns in isolation because it doesn’t give you an edge in the markets.

Instead, use it with your understanding of market structure and you will get better results.

How to improve your odds when trading the Engulfing pattern?

By doing these 4 things:

1. Trading with the trend
2. Trading from an area of value
3. Wait for break of structure (on the lower timeframe)
4. Trade Engulfing pattern at least 1.5 times the average true range (ATR)

Let me explain…

1. Trading with the trend

This is the easiest way to turn a losing strategy into a winning one.

By trading with the trend:

- You do not require precise entry to make a profit
- You have better odds for the trade to work out
- You have a greater profit potential as the impulse move is stronger

2. Trading from an area of value

If you’re buying groceries, you know how much you’re willing to pay based on your past experiences. Anything above value, you’ll not buy it.

But in trading… how do you identify value?

This is when Support and Resistance (SR) can help you.

Support – An area with potential buying pressure to push price higher (area of value in an uptrend)

Resistance – An area with potential selling pressure to push price lower (area of value in a downtrend)

Alternatively, you can use other techniques to define your area of value like Fibonacci levels, Pivot points, Weekly high/lows, and etc.

3. Wait for a break of structure (on the lower timeframe)

Here’s the thing:

A bullish Engulfing pattern is usually a retracement against the trend (on the lower time frame) — and this results in a low probability trade.

So, here’s what you can do:

If you spot a Bullish Engulfing pattern, then wait for a higher high to form (on the lower timeframe).

If you spot a Bearish Engulfing pattern, wait for a lower low to form (on the lower timeframe).

An example:

By waiting for a break of structure on the lower timeframe (in this case higher highs and higher lows), you're waiting for the price to confirm that buyers are in control before taking a long position. And this increases the odds of the Engulfing pattern working out.

4. Trade Engulfing pattern at least 1.5 times the average true range (ATR)

Earlier, you've learned that the larger the Pinbar relative to prior candles, the stronger the price rejection — and this concept applies to the Engulfing pattern.

So, if you get an Engulfing pattern at least 1.5 times the ATR, then it's telling you there's conviction behind the move.

Here's how to do it:

1. Check the current ATR value
2. Multiple the ATR value by 1.5
3. Compare it with the current range of the Engulfing pattern

And lastly…

Don't wait for all 4 factors to line up before taking a trade because if you do, you'll end up with little to no trades.

In my opinion, as long as you're trading with the trend (from an area of value), and you have a valid entry trigger, then you have enough to take the trade.

Summary

- The Engulfing pattern and Pinbar is essentially the same thing
- Don't assume the markets will reverse because of an Engulfing pattern

- Focus on the price action, not price pattern
- Not all Engulfing patterns are created equal
- You can increase your odds by trading with the trend, trading from an area of value, a break of structure break (on the lower timeframe), and trading Engulfing patterns with size at least 1.5 times ATR