This implies that the Bullish Kicking pattern would be a top reversal pattern if the Marubozu White Candle is shorter than the Marubozu Black Candle.

Rules of Recognition

1. An uptrend must be in progress.
2. The first day is a Marubozu Black Candle.
3. The second day is a Marubozu White Candle.
4. An up-gap is formed between the black and the white candle.
5. Existence of shadows are also acceptable, not necessarily Marubozus.

- **Interpretation:** The Bullish Kicking pattern is viewed as bullish despite the appearance of the first black candle. The first black candle gives the impression that the uptrend is under siege. But the next day's candle gaps higher to open above the previous black candle's open. This up-gap on the second day together with a close higher than the previous high shows that the bulls have regained control and the uptrend continues.
- **Proper action:** Bullish continuation signal. Maintain long position. Place sell-stop below the low of the black candle.

Bearish Kicking Pattern (Bearish)

- **Pattern description:** The Bearish Kicking pattern is nearly identical to the Bearish Separating Lines except for a gap between the white and the black candle. The first day is a Marubozu White Candle that is followed by a Marubozu Black Candle. A Marubozu Candle is one where there are no upper or lower shadows.

One way of analysing the next direction is to compare the length of the real body of the two candles. The market should move in the direction of the longer of the two candles.

This implies that the Bearish Kicking pattern would be a bottom reversal pattern if the Marubozu Black Candle is shorter than the Marubozu White Candle.

Rules of Recognition

1. A downtrend must be in progress.
2. The first day is a Marubozu White Candle.
3. The second day is a Marubozu Black Candle.
4. A down-gap is formed between the white and the black candle.
5. Existence of shadows are also acceptable, not necessarily Marubozus.

- **Interpretation:** The Bearish Kicking pattern is viewed as bearish despite the appearance of the first white candle. The first white candle gives the impression of a counterattack by the bulls. However, the next day's candle gaps lower to open below the previous white candle's open. This down-gap on the second day, together with a close lower than the previous low, shows that the bears have regained control, and the downtrend continues.
- **Proper action:** Bearish continuation signal. Maintain short position. Place buy-stop above the high of the white candle.

Trading the Bullish Kicking and Bearish Kicking Pattern

Figure 5.3 and Figure 5.4 show some examples of Bullish Kicking and Bearish Kicking patterns.

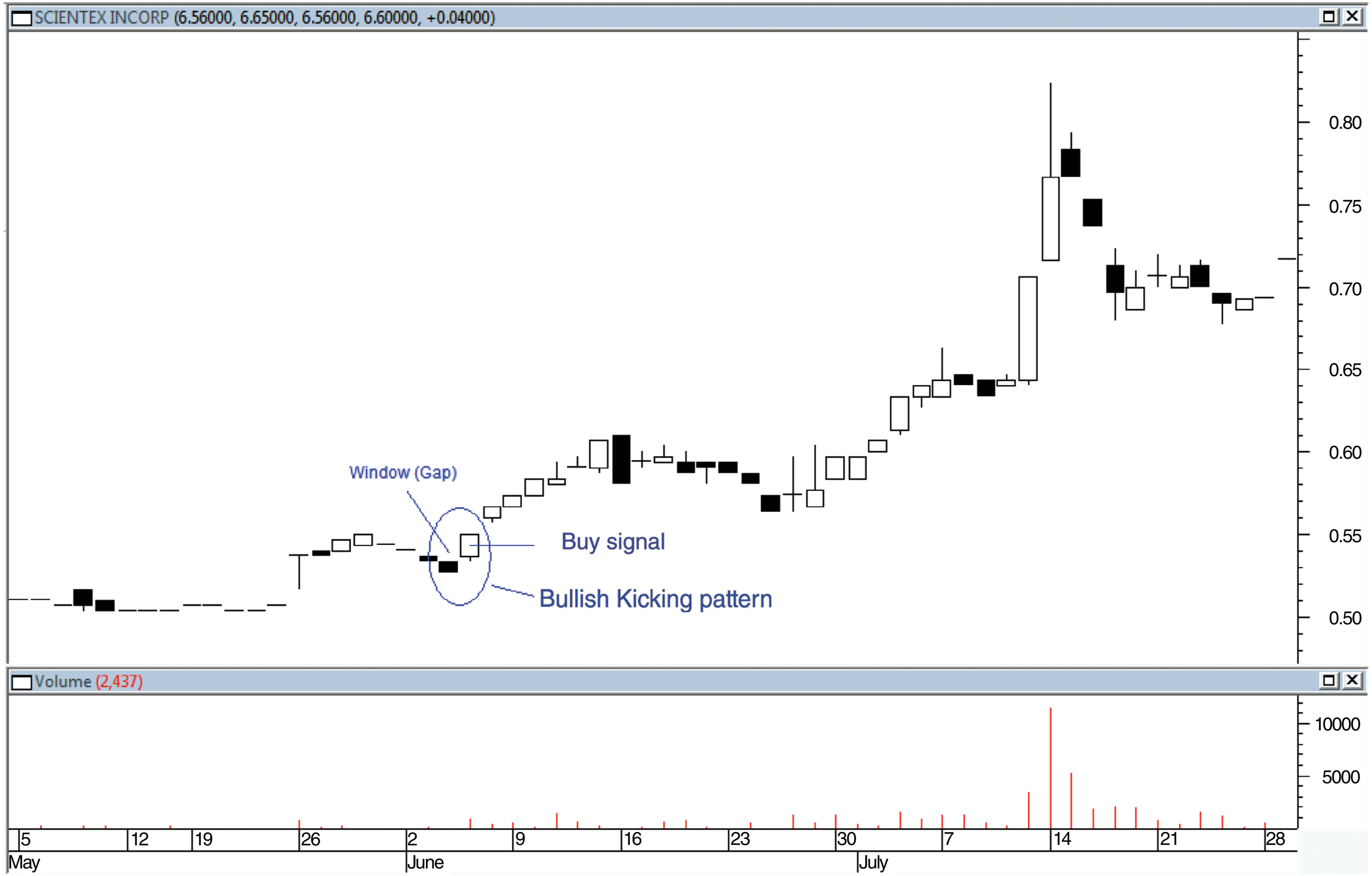


FIGURE 5.3 Scientex Malaysia Daily—Bullish Kicking pattern

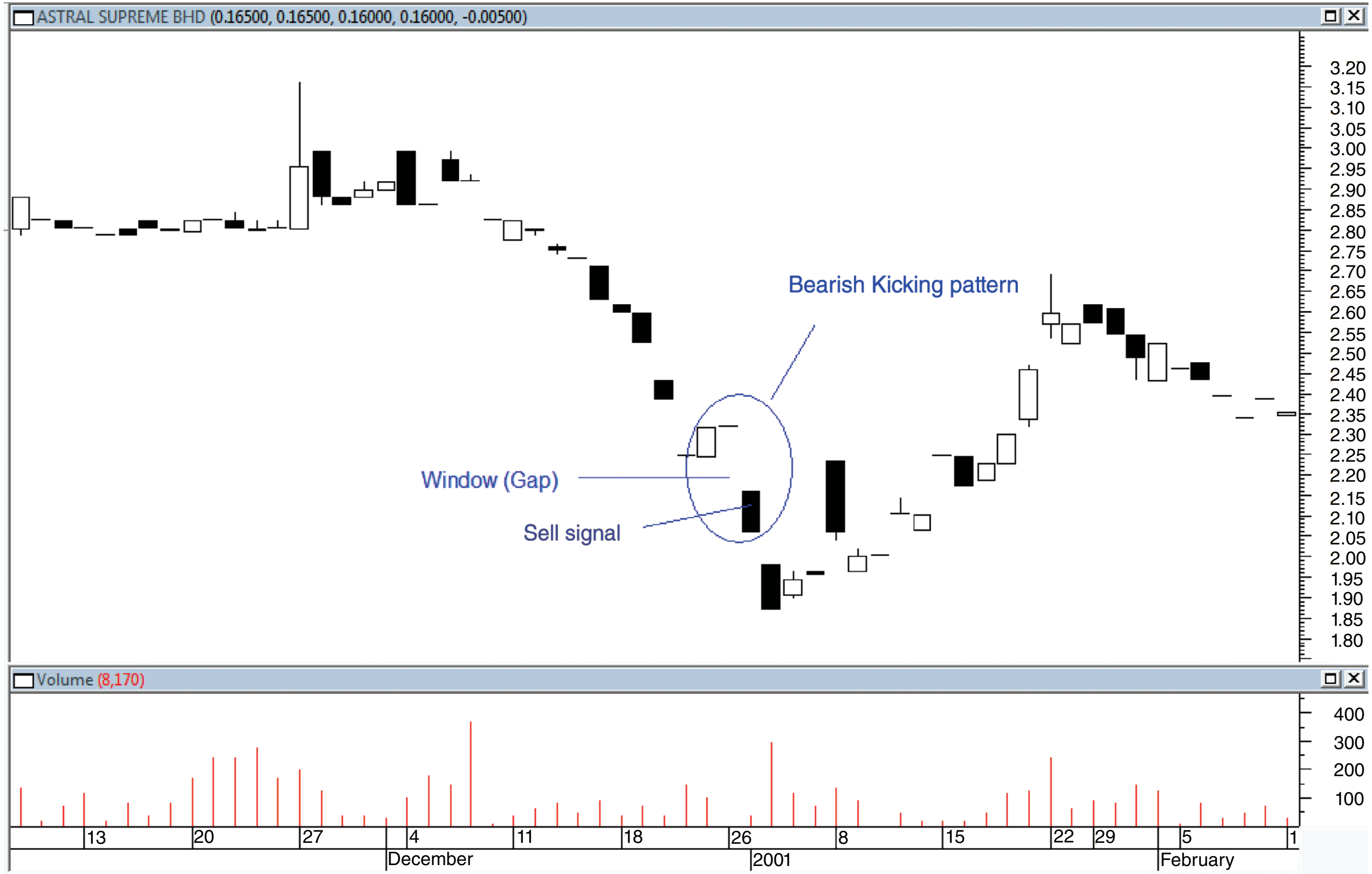
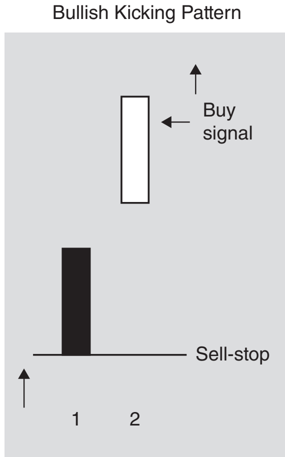
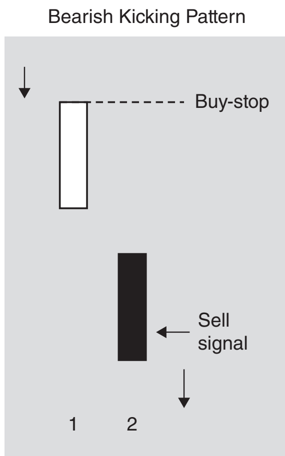


FIGURE 5.4 Astral Supreme Daily (2000)—Bearish Kicking pattern

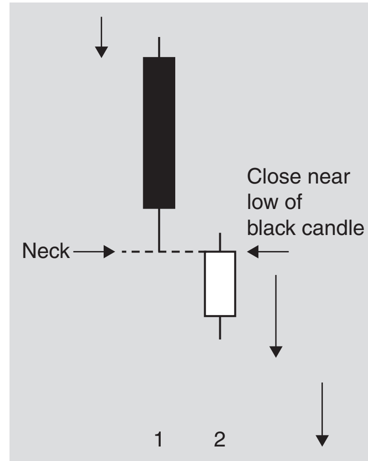


The close on candle 2 must exceed the high of candle 1 to trigger a further buy signal. Place sell-stop below the low of candle 1.



The close of candle 2 must exceed the low of candle 1 to trigger a further sell signal. Place buy-stop above the high of candle 1.

On-Neck Pattern



The On-Neck Pattern description, rules of recognition, interpretation, and proper action are explained here together with an example.

On-Neck Pattern (Bearish)

- **Pattern description:** The On-Neck pattern is a bearish pattern. It is comprised of a black candle in a downtrend that is followed by a small white candle whose close is near the low of the first black candle. This pattern is an underdeveloped version of the Piercing Line and Thrusting Line. It is similar to the In-Neck pattern and Meeting Lines. Note that they can become bottom reversal patterns if there is a confirmation candle that rises above the high of the black candle.

Rules of Recognition

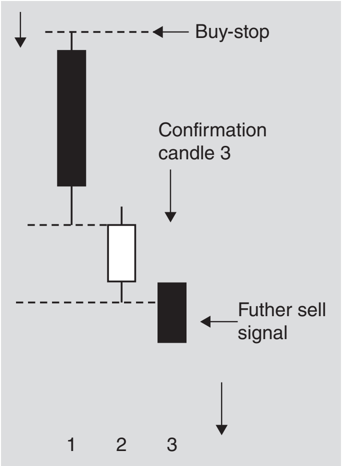
1. A downtrend must be in progress.

2. The first day is a long black candle.
3. The second day is a small white candle that closes at the low of the first day's black candle.

- **Interpretation:** The On-Neck pattern is viewed as a bearish continuation pattern because the second day's small white candle only manages to close at the low of the black candle. The bears are still in control, and the market should continue to move lower if the low of the white candle is broken.

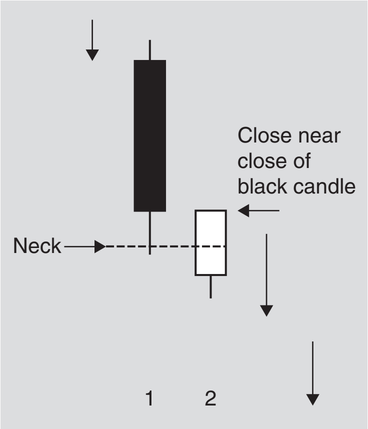
- **Proper action:** Bearish continuation signal. Maintain short position. Confirmation is required to further sell. Place buy-stop above the high of the black candle.

Trading the On-Neck Pattern Figure 5.5 shows an example of an On-Neck pattern.



The close of candle 3 must exceed the low of candle 2 to trigger a further sell signal. Place buy-stop above the high of candle 1.

In-Neck Pattern



In-Neck pattern description, rules of recognition, interpretation and proper action are explained here together with an example:

In-Neck Pattern (Bearish)

- **Pattern description:** The In-Neck pattern is a bearish pattern. It is comprised of a black candle in a downtrend that is followed by a Short Closing Bozu White Candle whose close is near or just inside the close of the first black candle. It is called In-Neck because of the white candle's close above the low (also known as the neck) of the first black candle. This pattern is an underdeveloped version of the Piercing Line and Thrusting Line. It is similar to the On-Neck pattern and Meeting Lines. Note that they can become bottom reversal patterns if there is a confirmation candle that rises above the high of the black candle.

Rules of Recognition

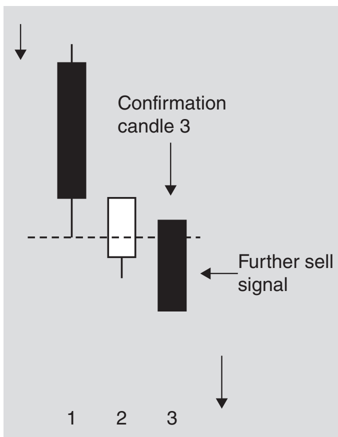
1. A downtrend must be in progress.

FIGURE 5.5 IJM Daily (2000)—On-Neck pattern

2. The first day is a long black candle.
3. The second day is a white candle that opens below the first day's low but closes into and above the low of the first day. They may even close into the real body of the black candle.

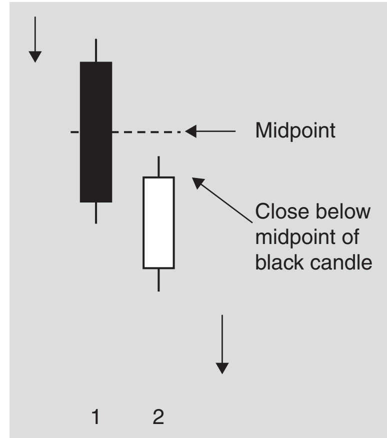
- **Interpretation:** The In-Neck pattern is viewed as a bearish continuation pattern because the second day's white candle only manages to close at the close of the black candle. The bears are still in control, and the market should continue to move lower if the low of the white candle is broken.
- **Proper action:** Bearish continuation signal. Maintain short position. Confirmation is required to further sell. Place buy-stop above the high of the black candle.

Trading the In-Neck Pattern Figure 5.6 shows an example of an In-Neck pattern.



The close of candle 3 must exceed the low of candle 2 to trigger a further sell signal. Place buy-stop above the high of candle 1.

Thrusting Line



The Thrusting Line pattern description, rules of recognition, interpretation, and proper action are explained next, together with an example.

Thrusting Line (Bearish)

- **Pattern description:** The Thrusting Line can be both a bullish or bearish pattern. It becomes a bearish pattern if there is no bullish confirmation. It is comprised of a black candle in a downtrend that is followed by a white candle that closes into but just below the midpoint of the black's real body. The Thrusting Line is an underdeveloped version of the Piercing Line.
  - If there is bullish confirmation via a close above the high of the last two candles, it becomes a bullish reversal pattern.
  - The Thrusting Line will also become a bullish reversal pattern if two of these patterns appear within a few days of each other, in which case it is called a Double Thrusting Line pattern.

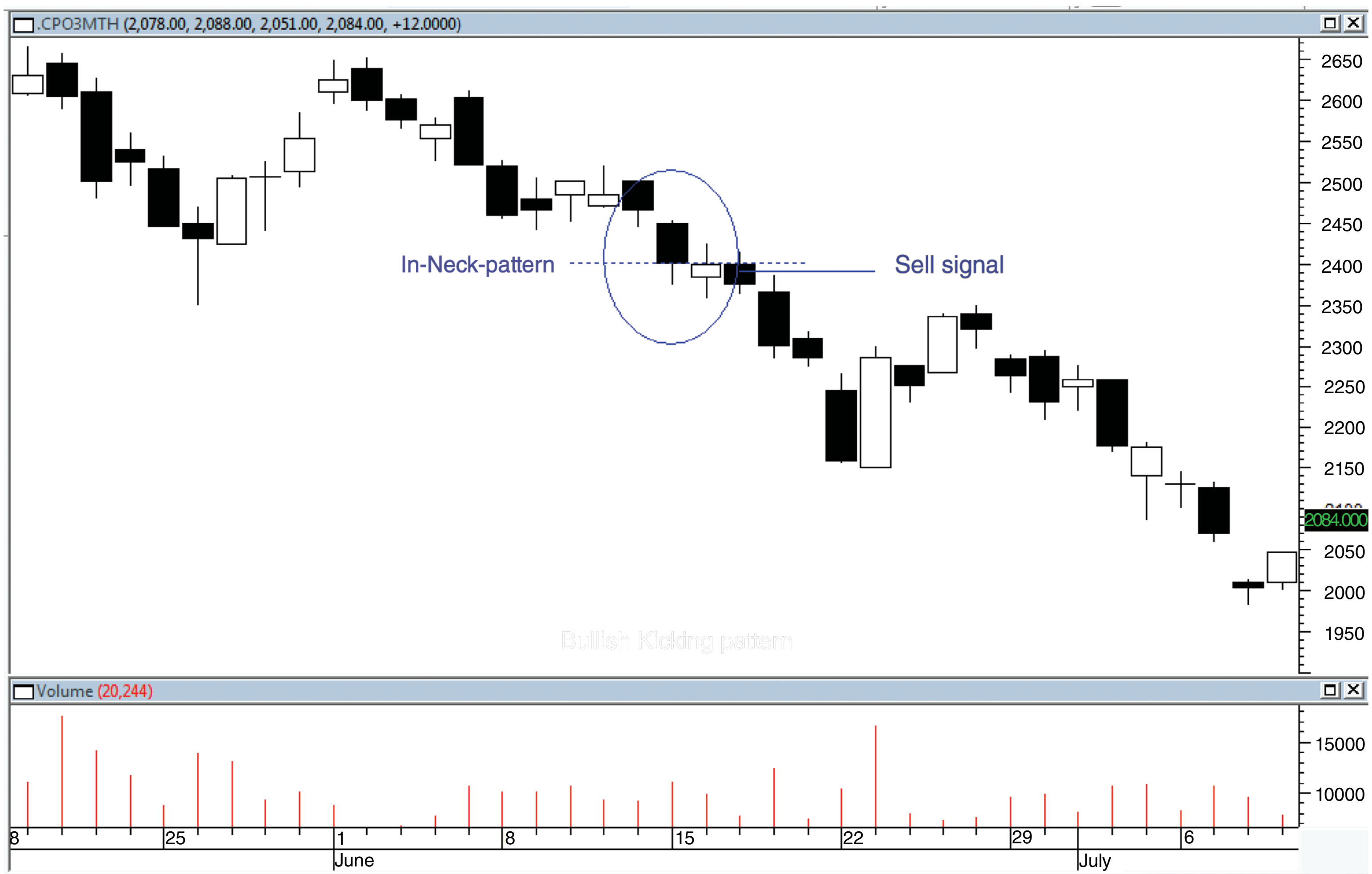


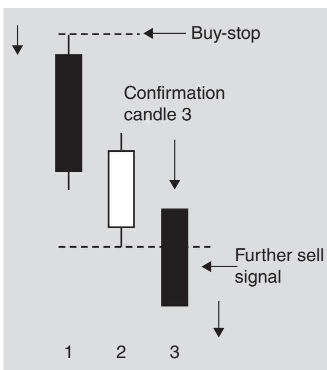
FIGURE 5.6 Crude Palm Oil Futures Daily (2014)—In-Neck pattern

Rules of Recognition

1. A downtrend must be in progress.
2. The first day is a long black candle.
3. The second day is a white candle that opens below the first day's low but closes into but not above the midpoint of the black candle's real body.

- **Interpretation:** The Thrusting Line is a bearish continuation pattern because, like the On-Neck and In-Neck patterns, the Thrusting Line represents the failure of the bulls to stage a successful counterattack. The bears are still in control, and the market should continue to move lower if the low of the white candle is broken.
- **Proper action:** Bearish continuation signal. Maintain short position. Confirmation is required to further sell. Place buy-stop above the high of the black candle.

Trading the Thrusting Line Figure 5.7 shows an example of a Thrusting Line Pattern.



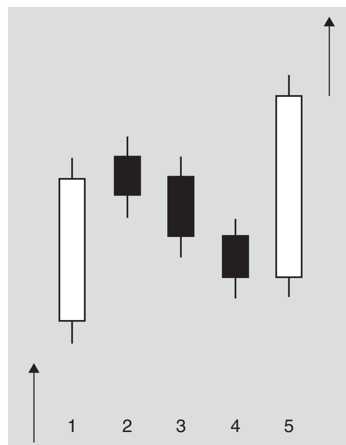
The close of candle 3 must exceed the low of candle 2 to trigger a further sell signal. Place buy-stop above the high of candle 1.

Multiple Candlestick Patterns

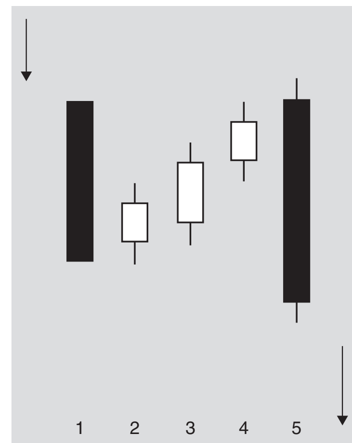
Multiple candlestick patterns such as the Rising Three and Falling Three Methods, Mat Hold, Windows, Tasuki Upside and Downside Gaps, Gapping Side-by-Side White Lines, and High-Price and Low-Price Gapping Plays are discussed here.

Rising Three Methods and Falling Three Methods

Rising Three Methods



Falling Three Methods



The Rising Three Methods and Falling Three Methods pattern descriptions, rules of recognition, interpretations, and proper actions are explained here together with some examples.

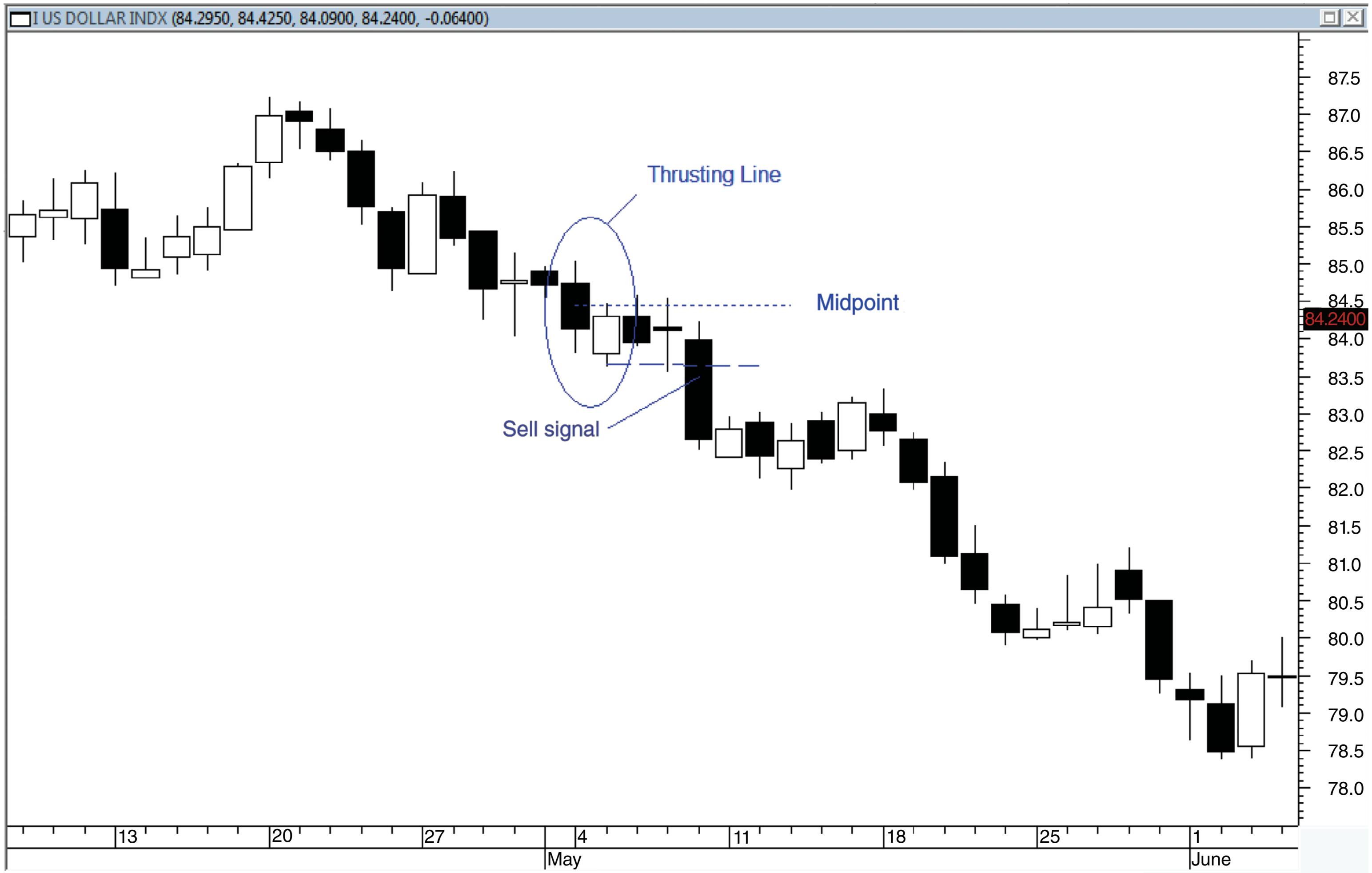


FIGURE 5.7 U.S. Dollar Index Daily (2009)—Thrusting Line

Rising Three Methods (Bullish)

Pattern description: The Rising Three Methods is a bullish continuation pattern that depicts a market at rest. It is comprised of five candles, one long white candle followed by three small black candles and another white candle. It represents a temporary pause in the current trend after a rally. The period of correction or rest is likely to be three days (hence the name *san-poh* or "three methods" in Sakata's Five Methods) after which the prior trend continues. Though the number three is a significant number in traditional Japanese candlestick theory, there is no hard and fast rule here that the correction has to take three days. It can be from one to five days, but three is the most common number. This pattern is equivalent to the Western Bullish Flag.

Rules of Recognition

1. An uptrend must be in progress.
2. The first day is a long white candle.
3. The second, third, and fourth days are composed of smaller candles that go against the main (up)trend. Their lower prices represent profit taking. These candles may be white or black candles but are likely to be black. The three candles must reside within the range of the first white candle.
4. The fifth day is a long white candle, reflecting a strong day, breaking out of the consolidation, and closing above the first white candle's close.
5. Volume falls during the correction on the second to the fourth day but rises significantly on the fifth day, on breakout.

- **Interpretation:** The Rising Three Methods is a bullish continuation pattern that is part of Sakata's Five Methods. After a rally, profit taking sets in, resulting in a minor correction—but not a trend change. It represents a market at rest. Volume drops significantly during this rest period, implying weak sellers. After the fourth day, buyers resurface to take the market higher for an uptrend continuation.
- **Proper action:** Bullish continuation signal. Maintain long position. Further buy if the close of the fifth white candle exceeds the highest high of the last four candles. Place sell-stop below the lowest low of the last two candles.

Falling Three Methods (Bearish)

- **Pattern description:** The Falling Three Methods is a bearish continuation pattern. It is comprised of five candles, one long black candle followed by three small white candles and another black candle. It represents a temporary pause in the current trend after a period of decline. The market makes a brief rebound, likely to be three days (hence the name *san-poh* or "three methods" in Sakata's Five Methods), after which the prior downtrend continues. Though the number three is a significant number in traditional Japanese candlestick theory, there is no hard and fast rule here that the rebound has to take three days. It can be from one to five days, but three is the most common number. This pattern is equivalent to the Western Bearish Flag.

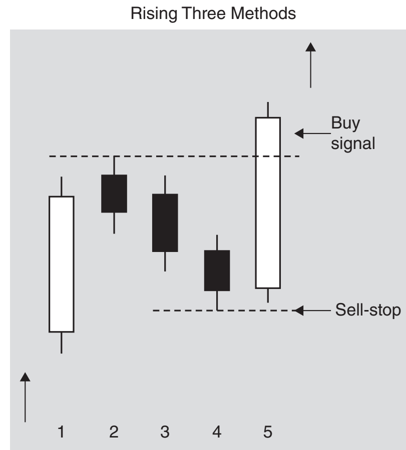
Rules of Recognition

1. A downtrend must be in progress.
2. The first day is a long black candle.

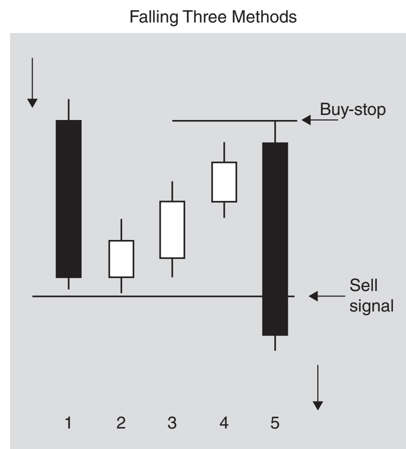
3. The second, third, and fourth days are composed of smaller candles that go against the main (down) trend. Their higher prices represent bargain hunting. These candles may be white or black candles but are likely to be white. The three candles must reside within the range of the first black candle.
4. The fifth day is a long black candle, reflecting a weak day, breaking out of the consolidation and closing below the first black candle's close.
5. Volume falls during the rebound on the second to the fourth days but rises significantly on the fifth day, on breakdown.

- **Interpretation:** The Falling Three Methods is a bearish continuation pattern that is part of Sakata's Five Methods. After a decline bargain hunting surfaces, resulting in a minor rally—but not a trend change. It represents a market at rest. Volume drops significantly during this rest period, implying weak buyers. After the fourth day, sellers resurface to sell-down the market lower for a downtrend continuation.
- **Proper action:** Bearish continuation signal. Maintain short position. Further sell if the close of the fifth black candle exceeds the lowest low of the last four candles. Place buy-stop above the highest high of the last two candles.

Trading the Rising Three Methods and the Falling Three Methods Figure 5.8 and Figure 5.9 show some examples of Rising Three Methods and Falling Three Methods patterns.



The close of candle 5 must exceed the highest high of the last four candles 1 to 4 to buy. Place sell-stop below the lowest low of candles 4 and 5.



The close of candle 5 must exceed the lowest low of the last four candles 1 to 4 to sell. Place buy-stop above the highest high of candles 4 and 5.

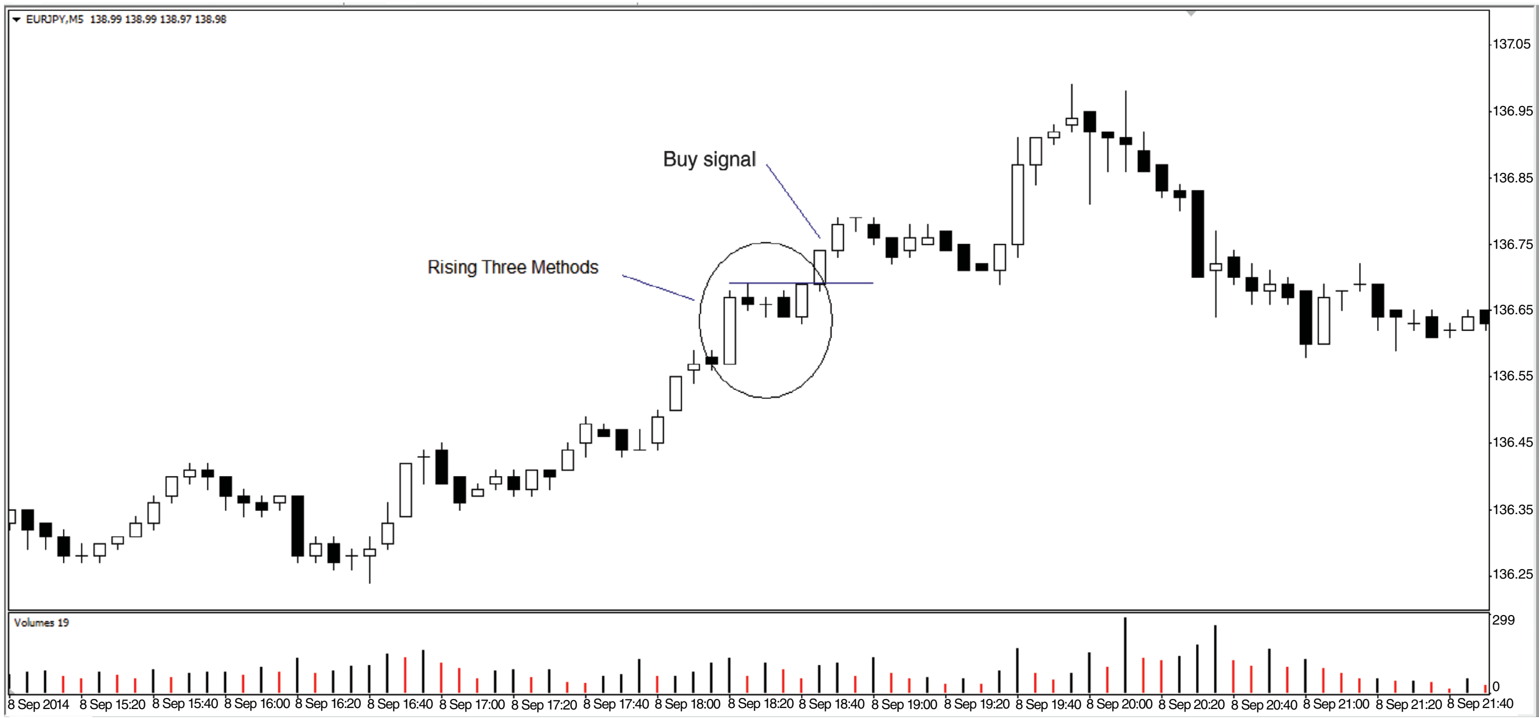


FIGURE 5.8 EurJpy 5-Minute (2014)—Rising Three Methods

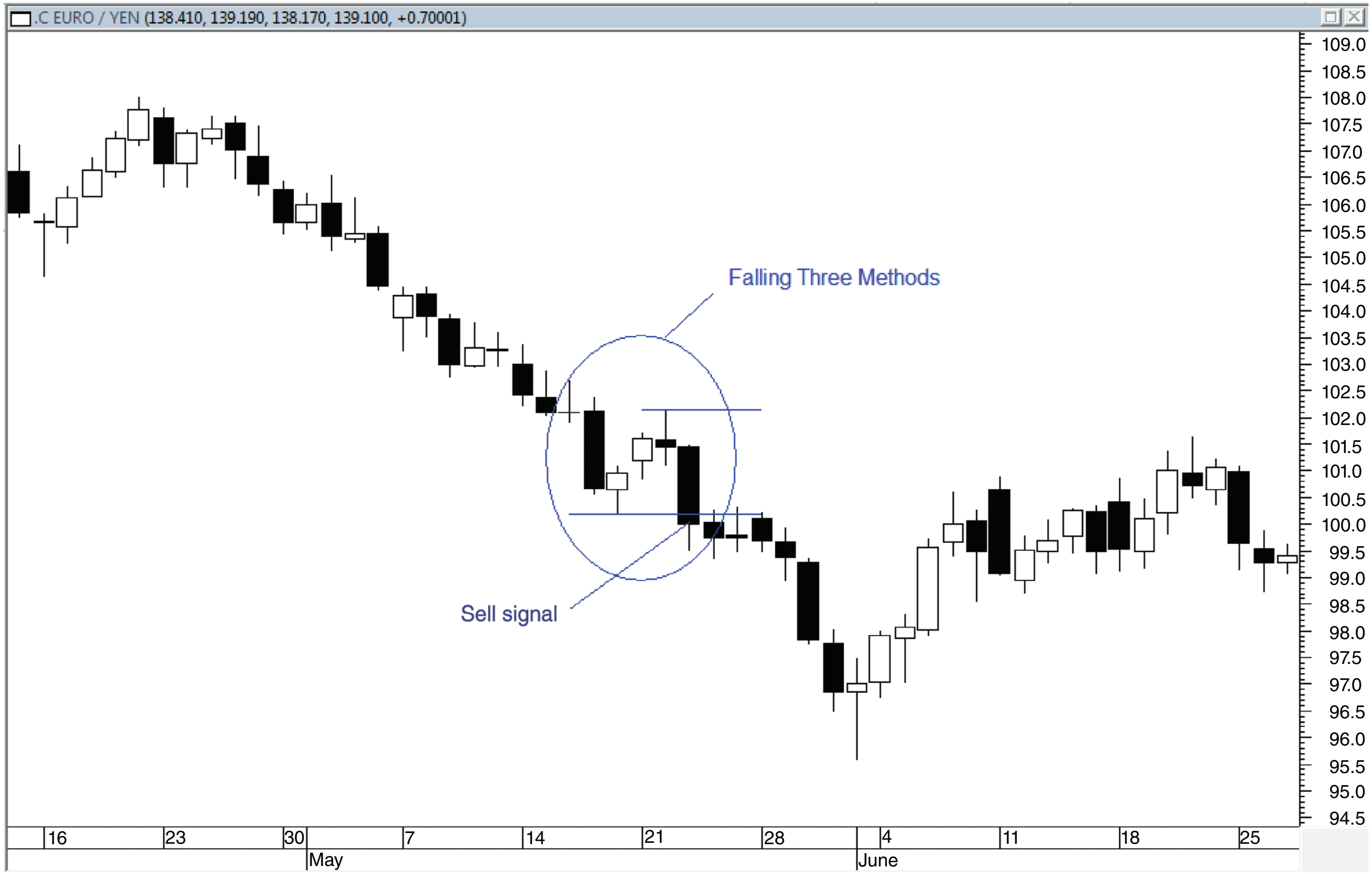
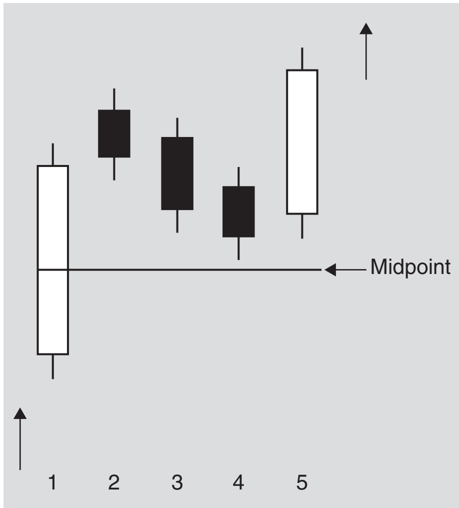


FIGURE 5.9 EurJpy Daily (2012)—Falling Three Methods

Mat Hold Pattern



The Mat Hold pattern description, rules of recognition, interpretation and proper action are explained next, together with an example.

Mat Hold Pattern (Bullish)

- **Pattern description:** The Mat Hold pattern is a bullish continuation pattern that is quite like the Rising Three Methods. The difference in the Mat Hold is where the second candle gaps above the first white candle and closes with the gap unfilled. The third candle comes down to fill the gap and closes into the first white candle. The first three days pattern will therefore look like an Upside Gap Two Crows but with the third candle penetrating back into the body of the first long white day. The fourth candle closes even lower but above the midpoint of the first day's white real body. The pullback here is not as severe as the Rising Three Methods. This pattern has similarities to the Western Bullish Flag.

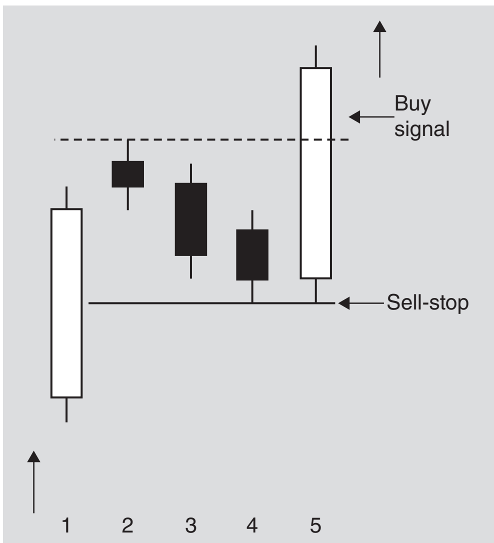
Rules of Recognition

1. An uptrend must be in progress.
2. The first day is a long white candle.
3. The second day gaps up but with a lower close (black candle). This gap is unfilled on the second day.
4. The third day comes down, covers the gap, and penetrates into the real body of the first white candle.
5. The fourth day closes even lower but above the midpoint of the first white candle.
6. The fifth day is a long white candle that closes above the second day's high. It still qualifies as a breakout even with a lower close as long as it closes above the highest high of the last two candles and volume rises significantly.
7. Volume falls during the correction on the second to the fourth days but rises significantly on the fifth day, on breakout.

- **Interpretation:** The Mat Hold pattern is a bullish continuation pattern that is similar to the Rising Three Methods and is part of Sakata's Five Methods. It is more bullish than the Rising Three Methods because the correction days are less severe. They do not fall below the midpoint of the first white candle. This dip is a result of profit taking and not a trend change. It represents a market at rest. Volume drops significantly during this rest period, but the uptrend resumes on the fifth day as buyers resurface.

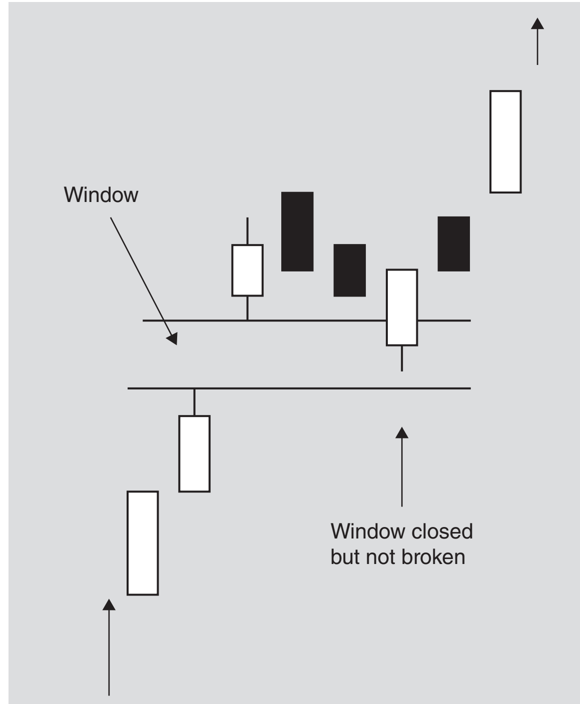
- **Proper action:** Bullish continuation signal. Maintain long position. Further buy if the close of the fifth white candle exceeds the highest high of the last four candles. Place sell-stop below the lowest low of the last two candles.

Trading the Mat Hold Pattern Figure 5.10 shows an example of a Mat Hold pattern.



Further buy if the close of candle 5 exceeds
the highest high of the last four candles 1 to 4.
Place sell-stop below the lowest low of candles 4 and 5.

Windows (Gaps)



Window in an Uptrend—Window not broken

There are several continuation patterns that come with gaps, which the Japanese refer to as windows.

In my first book, *Maximising Stock Market Profit*, I defined a gap as "an area in a chart where no transactions are done."

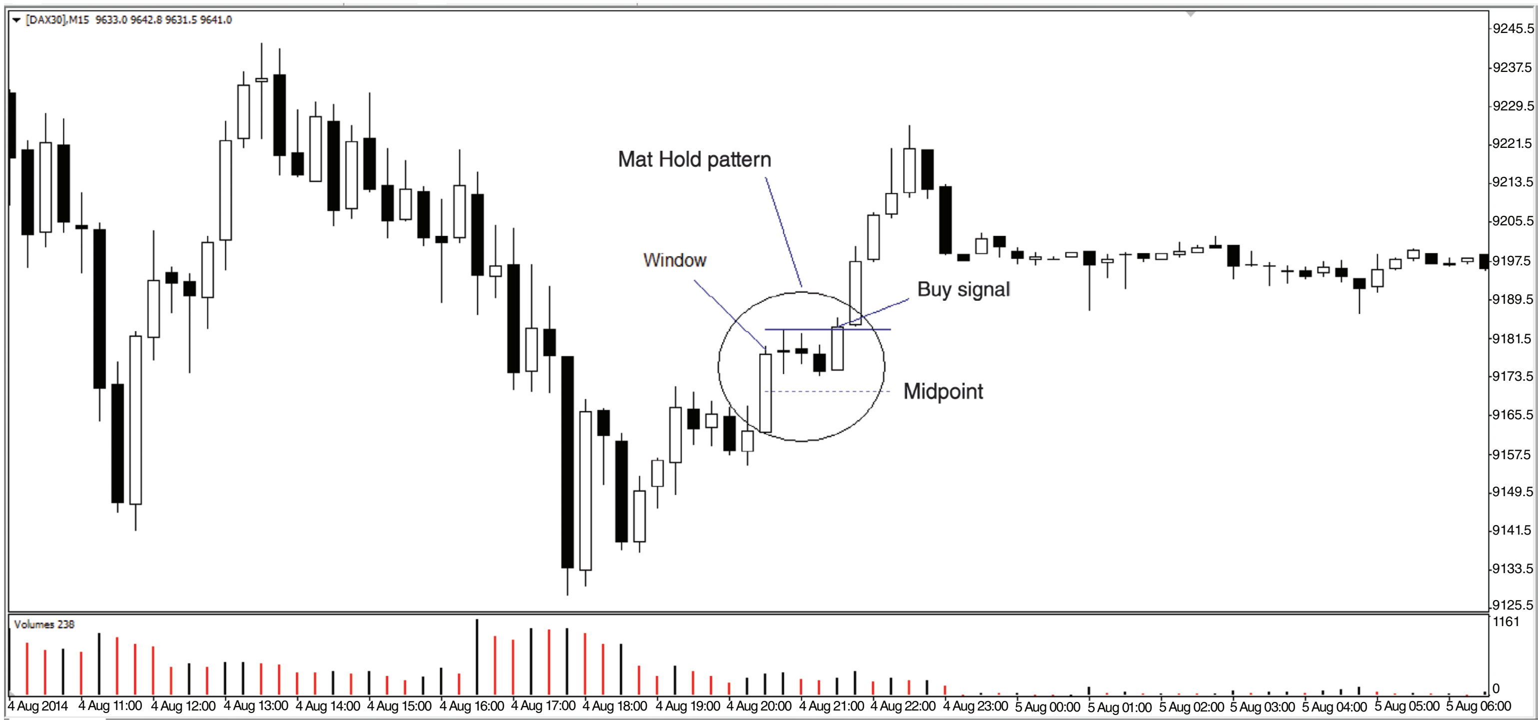
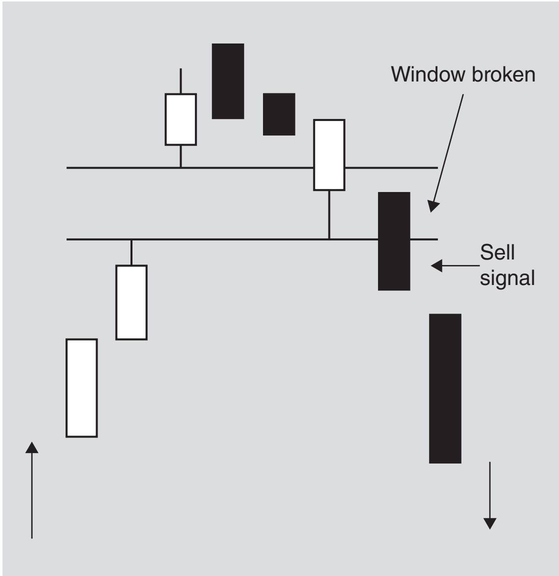


FIGURE 5.10 Dax 30 15-Minute (2014)—Mat Hold pattern



Trend Change—Window broken (violated)

I further explained:

A price gap is essentially a vacuum or a discontinuous point on the chart. Gaps are formed because of a void in buy/sell orders or due to an overwhelming influx of buy/sell orders. In an uptrend, for example, prices open above the highest price of the previous day, leaving an up-gap or an open space on the chart that is not filled during the day. In a downtrend, prices open below yesterday's low, leaving a down-gap that is not filled during the down day.

Upside gaps are signs of market strength while down gaps are signs of market weakness. Both represent potential power in the move that follows.

Gaps are sometimes filled before they continue with their prior trend. While the Western chartist would say, "The gap is being filled," the Japanese chartist would say, "The window is being closed."

Windows Acting as Support and Resistance Windows also act as support and resistance areas. A rallying market that has a window opened is likely to move in the direction of the window. Any corrections should find support in the window area. A good buying area is therefore the area just above the window. Likewise, in a downtrend, an opened window not closed and exceeded is an indication of lower prices.

A trend change occurs when a window is broken. For example, if the correction of an uptrend closes the window and violates the lower boundary of the window (breaking the window), then buy positions should be closed out and short positions instituted, as the trend is said to have changed. The opposite holds true in a downtrend.

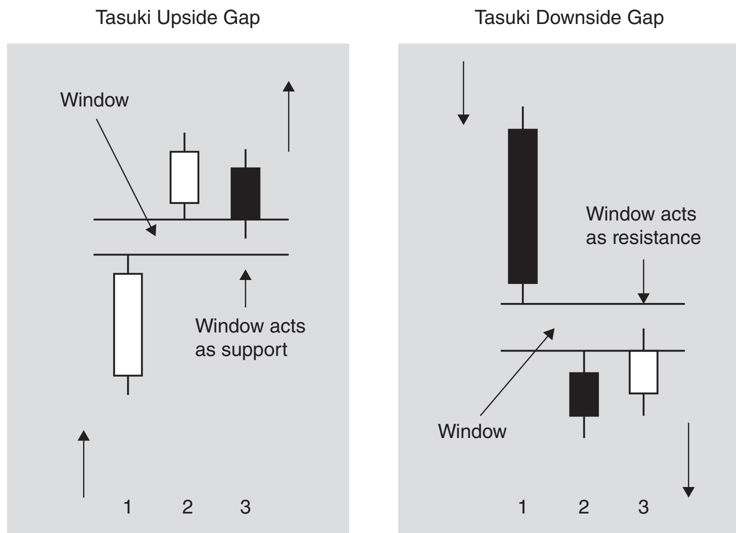
The various Japanese candlestick continuation patterns that involve gaps or windows are:

Pattern Names

- Tasuki Upside Gap
- Tasuki Downside Gap
- Up-Gap Side-by-Side White Lines

- Down-Gap Side-by-Side White Lines
- High Price Gapping Plays
- Low Price Gapping Plays

Tasuki Upside and Downside Gaps



Tasuki Upside and Downside Gaps pattern descriptions, rules of recognition, interpretations, and proper actions are explained here together with some examples.

Tasuki Upside Gap (Bullish)

- **Pattern description:** The Tasuki Upside Gap consists of a white candle that gaps up and closes higher than a previous long white candle. This is followed by a black candle opening inside the white's body and closing below the white's body. The window may be closed but must not be violated (broken) on the downside. If so, selling pressure is deemed to be strong, and this bullish pattern will be negated.

Rules of Recognition

1. An uptrend must be in progress.
2. The first day is a long white candle.
3. The second day is a small white candle that gaps up on the open and closes higher.
4. The third day is a small black candle that opens within the body of the second candle and closes below it.
5. The window (or gap) may be closed (filled) by the black candle on the third day but must not be violated on the downside.

- **Interpretation:** The Tasuki Upside Gap is a bullish continuation pattern. The correction on the third day did not close the window, implying sellers are weak. Japanese candlestick theory calls for a buy on the third day's black candle.

- **Proper action:** Bullish continuation signal. Maintain long position. Although Japanese candlestick theory calls for a buy on the third day, we suggest bullish confirmation via a close on the fourth day that is higher than the highest high of the previous two candles. Place sell-stop below the window.

Tasuki Downside Gap (Bearish)

- **Pattern description:** The Tasuki Downside Gap consists of a small black candle that gaps below and closes lower than a previous Long Black Candle. This is followed by a small white candle opening inside the black's body and closes above the black's body. The window may be closed but must not be violated (broken) on the upside. If so, buying momentum is deemed to be strong, and this bearish pattern will be negated.

Rules of Recognition

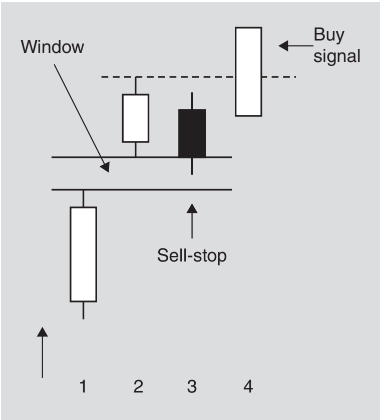
1. A downtrend must be in progress.
2. The first day is a long black candle.
3. The second day is a small black candle that gaps below on the open and closes lower.
4. The third day is a small white candle that opens within the body of the second candle and closes above it.
5. The window (or gap) may be closed (filled) by the white candle on the third day but must not be violated on the upside.

- **Interpretation:** The Tasuki Downside Gap is a bearish continuation pattern. The rally on the third day did not close the window, implying buyers are weak. Japanese candlestick theory calls for a sell on the third day's white candle.

- **Proper action:** Bearish continuation signal. Maintain short position. Although Japanese candlestick theory calls for a sell on the third day, we suggest bearish confirmation via a close on the fourth day that is lower than the lowest low of the previous two candles. Place buy-stop above the window.

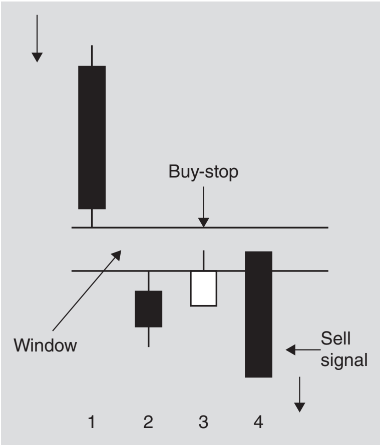
Trading the Tasuki Upside and Downside Gaps Figure 5.11 and Figure 5.12 show some examples of Tasuki Upside and Downside Gaps patterns.

Tasuki Upside Gap



Further buy if the close of candle 4 exceeds the highest high of candles 2 and 3. Place sell-stop below the window.

Tasuki Downside Gap



Further sell if the close of candle 4 exceeds the lowest low of candles 2 and 3. Place buy-stop above the window.

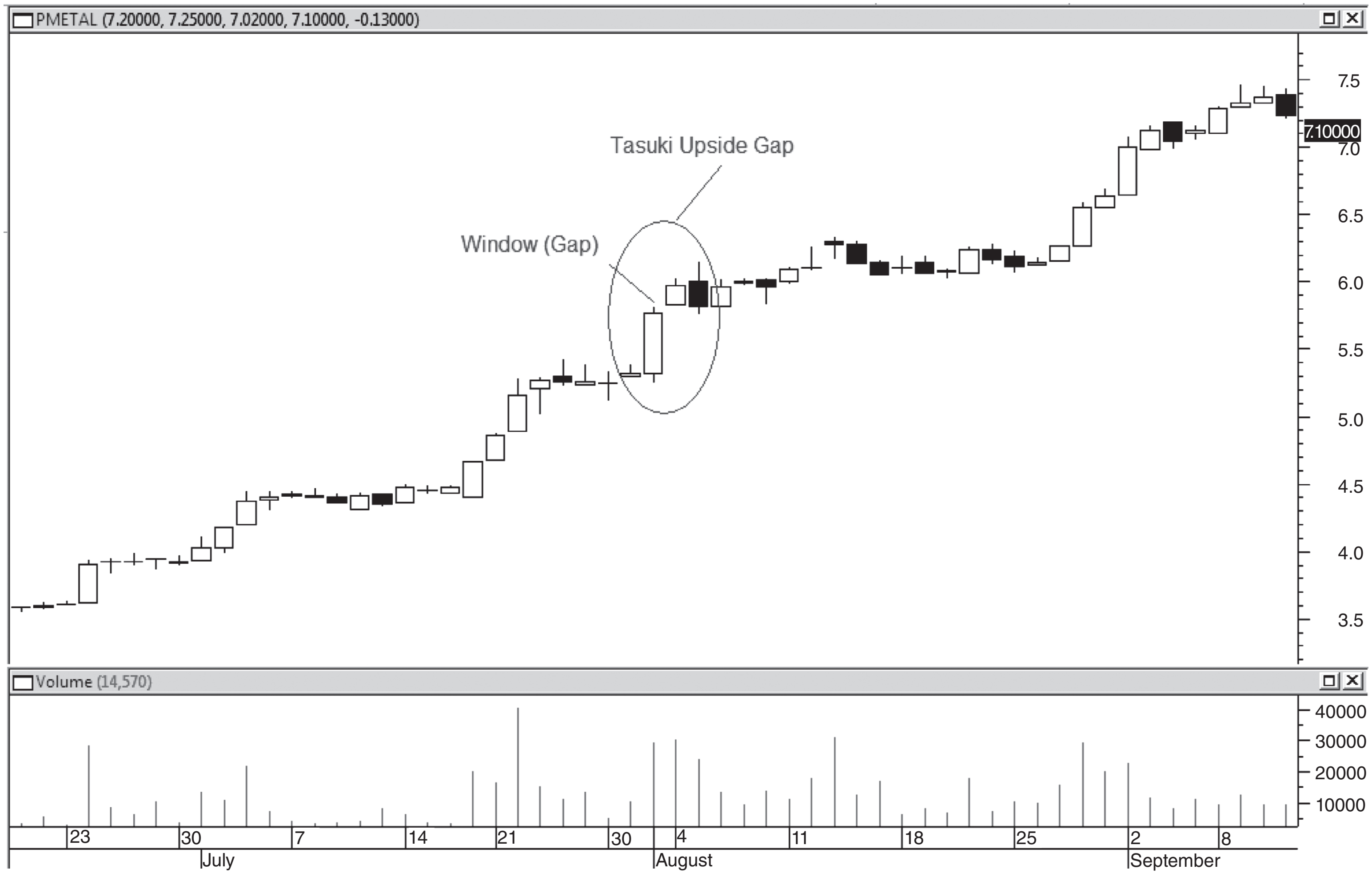


FIGURE 5.11 Press Metal Malaysia Daily (2014)—Tasuki Upside Gap

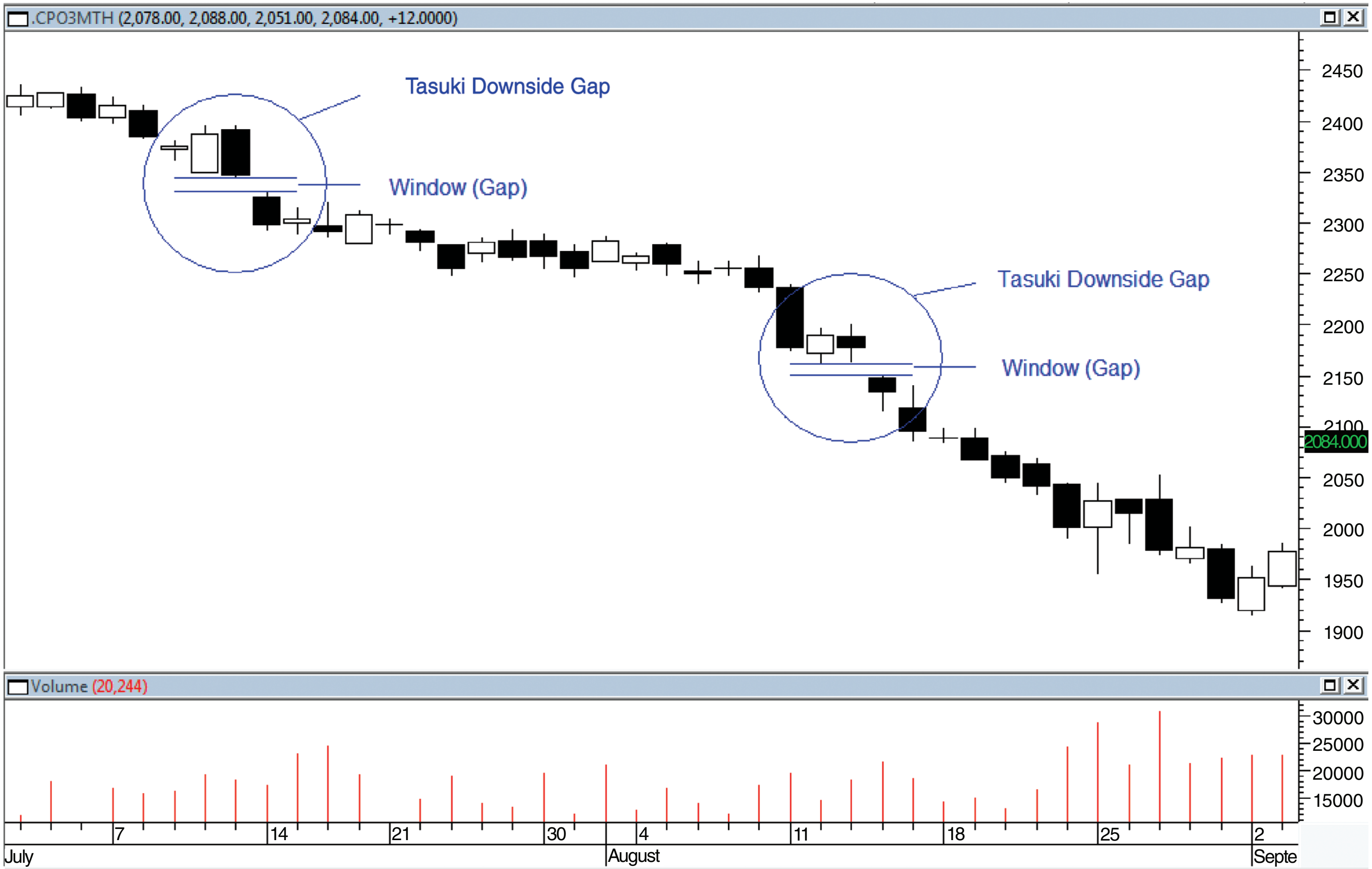
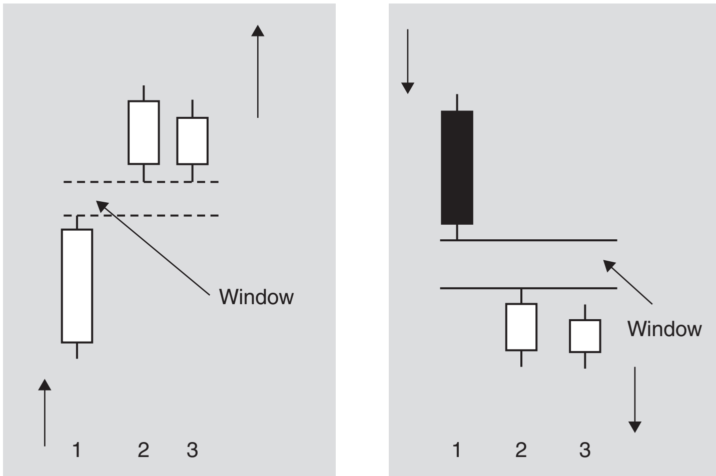


FIGURE 5.12 Crude Palm Oil Futures Daily (2014)—Tasuki Downside Gap

Gapping Side-by-Side White Lines

Up-Gap Side-by-Side White Lines　　Down-Gap Side-by-Side White Lines



Up-Gap and Down-Gap Side-by-Side White Lines pattern descriptions, rules of recognition, interpretations, and proper actions are explained next, together with some examples.

Up-Gap Side-by-Side White Lines (Bullish)

- **Pattern description:** The Up-Gap Side-by-Side White Lines is a bullish continuation pattern. This pattern consists of two white candles of similar sizes with about the same open gapping above a long white candle. Gapping side-by-side white lines are rare.

Rules of Recognition

1. An uptrend must be in progress.
2. The first day is a long white candle.
3. Two consecutive small white candles of about the same size gap above the long white candle.
4. The window (or gap) is not closed.
5. An upside breakout should occur within the next few candles on stronger volume.

- **Interpretation:** The two white candles that lie side-by-side with one another imply some profit taking but are yet well supported by the bulls. The inability of the bears to close the window and violate it implies bullish support. Japanese candlestick theory calls for a buy if the window is not violated on the downside. But I prefer an establishment of a higher close before further buying.

- **Proper action:** Bullish continuation signal. Maintain long position. Further buy above the highest high of the second and third candles but place sell-stop below the window.

Down-Gap Side-by-Side White Lines (Bearish)

- **Pattern description:** The Down-Gap Side-by-Side White Lines is a bearish continuation pattern. This pattern consists of two white candles of similar sizes with about the same open gapping below a long black candle. Breaking a new low is recommended before further selling in this bearish scenario. Gapping side-by-side white lines are rare.

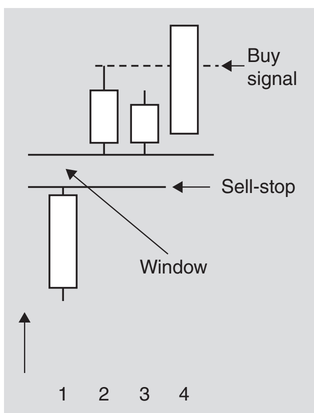
Rules of Recognition

1. A downtrend must be in progress.
2. The first day is a long black candle.
3. Two consecutive small white candles of about the same size gap below the black candle.
4. The window (or gap) is not closed.
5. A downside breakout should occur within the next few candles on stronger volume.

- **Interpretation:** The two white candles that lie side-by-side with one another are viewed as short covering or bargain hunting. Once they are over, the bearish trend continues. Japanese candlestick theory calls for a sell if the window is not violated on the upside. But I prefer an establishment of a lower close before further selling.
- **Proper action:** Bearish continuation signal. Maintain short position. Bearish confirmation is suggested by further selling only upon the break of the lowest low of the two white candles. Place buy-stop above the window.

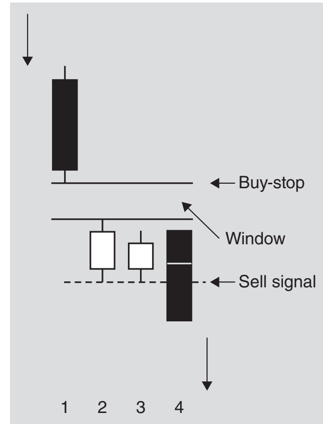
Trading the Up-Gap and Down-Gap Side-by-Side White Lines Figure 5.13 and Figure 5.14 show some examples of Up-Gap and Down-Gap Side-by-Side White Lines patterns.

Up-Gap Side-by-Side White Lines



Further buy if the close of candle 4 exceeds the highest high of candles 2 and 3. Place sell-stop below the window.

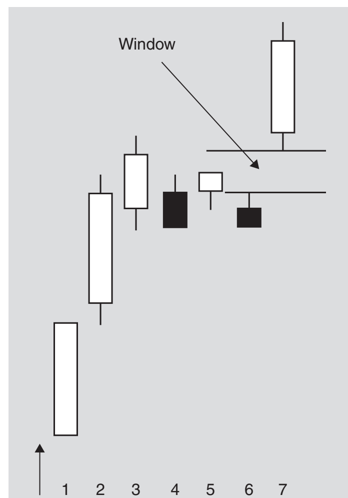
Down-Gap Side-by-Side White Lines



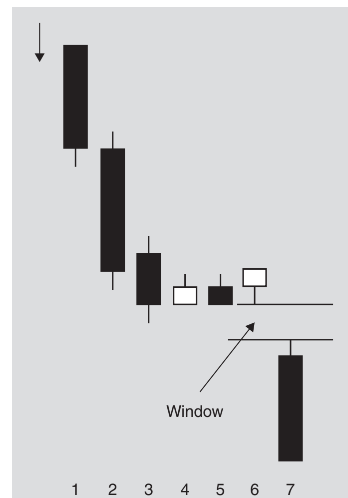
Further sell if the close of candle 4 exceeds the lowest low of candles 2 and 3. Place buy-stop above the window.

High-Price and Low-Price Gapping Plays

High-Price Gapping Play



Low-Price Gapping Play



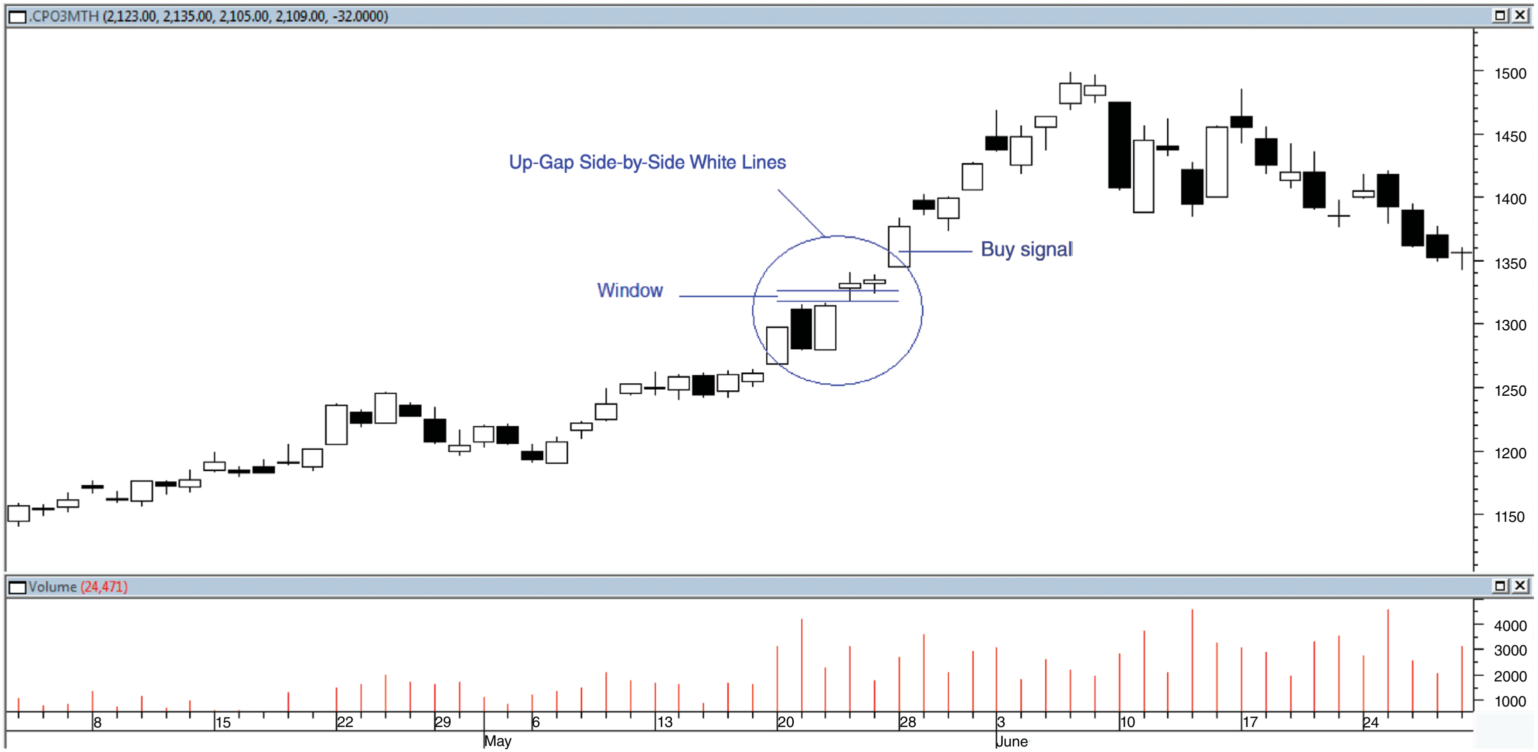


FIGURE 5.13 Crude Palm Lio Futures Daily (2002)—Up-Gap Side-by-Side White Lines

FIGURE 5.14 Kuala Lumpur Composite Index Futures Daily (2012)—Down-Gap Side-by-Side White Lines

The High-Price and Low-Price pattern descriptions, rules of recognition, interpretations, and proper actions are explained next, together with some examples.

High-Price Gapping Play (Bullish)

- **Pattern description:** The High-Price Gapping Play is a bullish continuation pattern. After a rally, the market consolidates its gains with a few small body candles. The market then makes an up-gap (or opens a window), and breaks out of the consolidation for an uptrend continuation. The High-Price Gapping Play is equivalent to the Western Bullish Pennant Breakout.

Rules of Recognition

1. An uptrend must be in progress.
2. The first day is a long white candle.
3. This is followed by a series of candles with small real bodies, indicating a market consolidation.
4. The long white candle gaps up and breaks out of the consolidation to continue its prior trend.
5. The window (or gap) is not closed. Volume is significantly higher on the breakout candle.

- **Interpretation:** After a rally, profit taking usually sets in, which is represented by a group of small candles. This consolidation should not last more than a week and represents the market taking a breather. Soon the bulls resurface to take prices higher, as they still see value in the market. Japanese candlestick theory calls for a buy on the breakout day.
- **Proper action:** Bullish continuation signal. Maintain long position. The gapping day is a buy day. Confirmation is in the form of higher volume on the breakout day, and the close is usually above the highest high of the consolidation candles. Place sell-stop below the window.

Low-Price Gapping Play (Bearish)

- **Pattern description:** The Low-Price Gapping Play is a bearish continuation pattern. After a decline, the market consolidates for a few sessions. The market then makes a down-gap (or opens a window), and breaks out of the consolidation for a downtrend continuation. The Low-Price Gapping Play is equivalent to the Western Bearish Pennant Breakout.

Rules of Recognition

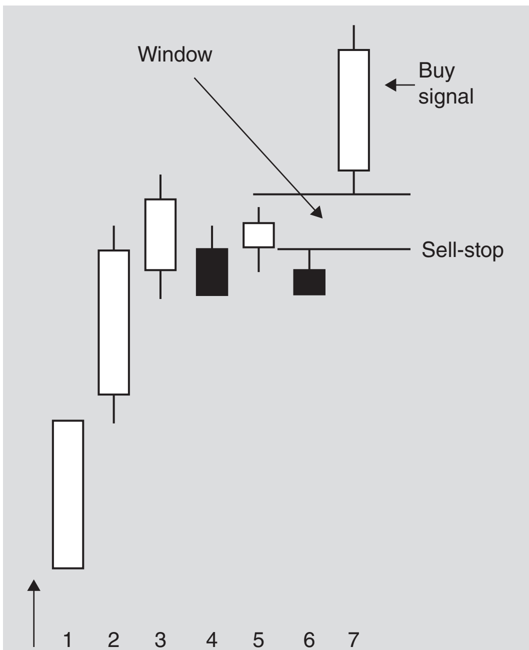
1. A downtrend must be in progress.
2. The first day is a long black candle.
3. This is followed by a series of candles with small real bodies, indicating a market consolidation.
4. A long black candle gaps down and breaks out of the consolidation to continue its downtrend.
5. The window (or gap) is not closed. Volume is significantly higher on the breakout candle.

- **Interpretation:** After a decline, bargain hunting usually surfaces; this is represented by a group of small candles moving in a sideways direction. This consolidation should not last more than a week and represents the market taking a rest after a sell-off. Soon the bears re-emerge to continue selling, as they believe the market is still overvalued. Japanese candlestick theory calls for a sell on the breakout day.
- **Proper action:** Bearish continuation signal. Maintain short position. The gapping day is a sell day. Confirmation is in the

form of higher volume on the breakout day, and the close is usually below the lowest low of the consolidation candles. Place buy-stop above the window.

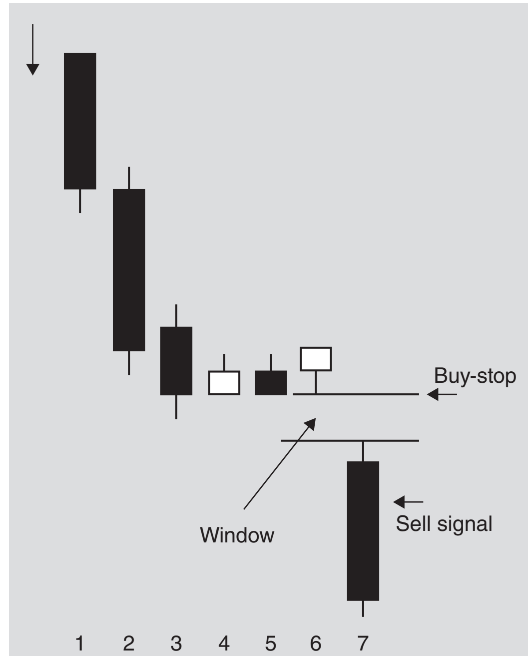
Trading the High-Price and Low-Price Gapping Plays Figure 5.15 to Figure 5.17 show some examples of High-Price and Low-Price Gapping Play patterns.

High-Price Gapping Play



Further buy if the close of candle 7 exceeds the highest high of candles 3 to 6. Place sell-stop below the window.

Low-Price Gapping Play



Further sell if the close of candle 7 exceeds the lowest low of candles 3 to 6. Place buy-stop above the window.

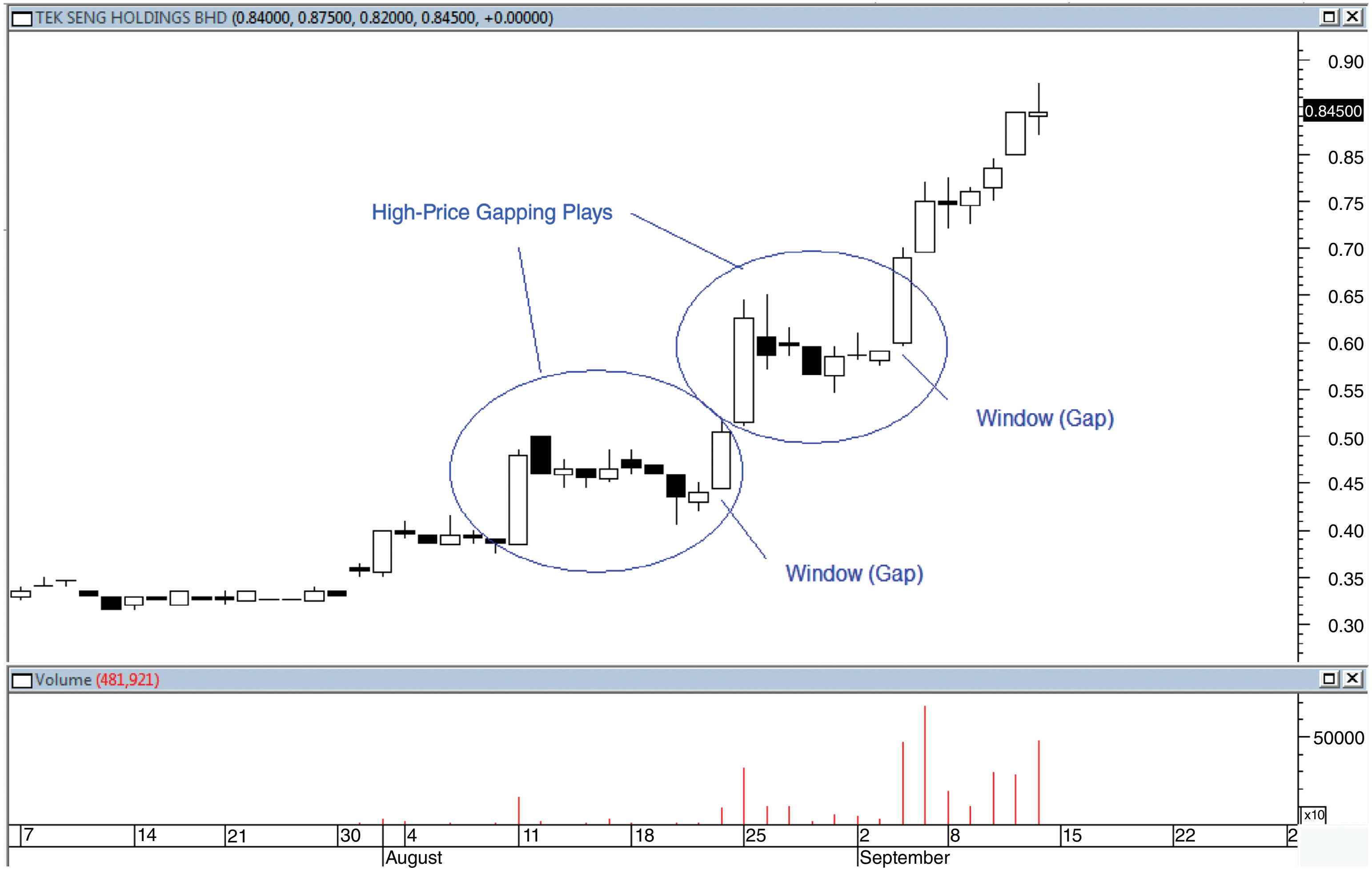


FIGURE 5.15 Tek Seng Malaysia Daily (2014)—High-Price Gapping Plays

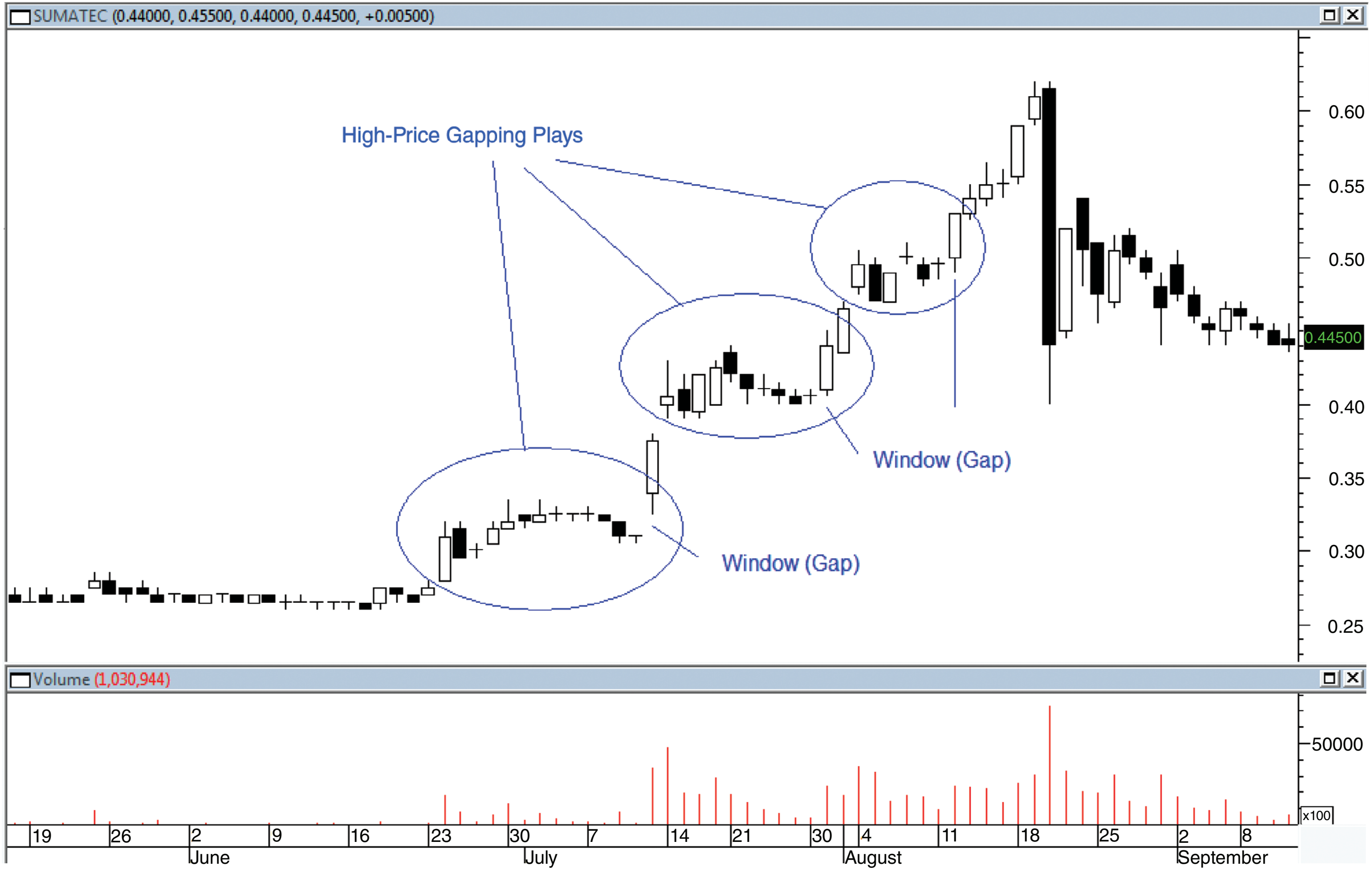


FIGURE 5.16 Sumatec Malaysia Daily (2014)—High-Price Gapping Plays

FIGURE 5.17 Felda Global Ventures Malaysia (2014)—Low-Price Gapping Play

Summarizing Part I

Part I of this book has been devoted to describing the most common candlestick patterns. So far I have described:

1. Ten single black and white candles, seven doji, four in the umbrella group
2. Fifty-three reversal patterns
3. Fourteen continuation patterns

But this is not an exhaustive list of patterns available in candlestick literature. There are many more patterns, some of them abstract ones that a normal trader will not find useful or encounter. Alternatively, they may be covered by another pattern. For example the Stick Sandwich is an abstract pattern. However, this pattern is sufficiently covered by a similar pattern called Tweezers Bottom. The Anaume is another example of an abstract pattern, but it bears some resemblance to an Inverted Hammer confirmation pattern.

The trader must understand that even with the large number of patterns in candlestick analysis, there is no necessity to know an all-encompassing list. I believe that the many patterns covered in this book are detailed enough to make you a better-equipped candlestick trader.

Can One Trade the Market and Profit Just by Applying Candlestick Chart Analysis?

Yes, because the candlestick technique is a standalone technique. A trader can make money just by using pure candlestick chart analysis because Japanese candlestick theory is best applied in trading fast-moving markets and is excellent in catching market turning points. Knowledge of the many types of reversal patterns gives you an edge over other traders. Similarly, knowledge of continuation patterns gives you that additional edge as to when to hold on to a position, add to new positions, and where to place your stops.

But using pure candlestick chart analysis can result in a high number of false signals. There are times when the candle signals fail. Therefore, to increase the chances of making a correct trade one should augment candlesticks with other techniques to filter out false signals. Knowing when to take a candlestick signal and when to ignore one will determine the extent of a trader's success.

Candlestick Chart Analysis Is Best Used in Conjunction with Technical Indicators

Test results and experience have shown that whilst the candlestick technique is a valuable trading tool, using it as a standalone may not give the desired result for many traders.

One must understand that candlestick patterns do not work all the time. Some patterns may fail some of the time for various reasons. One example of failure is when a bearish candle pattern signals a sell in an uptrend. This sell signal in a bullish scenario is a weak sell signal and should not be taken, as the market can soon revert back to an uptrend to reach a higher high.

Conversely, a bullish candle pattern may not give the desired result after buying because the primary trend is down. A buy signal in a downtrend is considered a weak buy signal, and the market may soon revert back into a downtrend.

Another reason for failure is when signals are triggered in a sideways trend. Candles do not work best in sideway trends. As such, if one applies indiscriminately, for example, a buy-and-hold strategy following the occurrence of a candlestick pattern, the trade may or may not show a profit over the next 5 to 10 days or in the following weeks.

Jack Schwager in his book *Schwager on Futures—Technical Analysis* revealed some tests by Bruce Babcock, the editor and publisher of *Commodity Traders Consumers Report*, which showed that the results were much better if one had applied some kind of filter to sieve out false signals. In his test, he used the momentum indicator to assure that the trade was consistent with the short-term trend direction.

Schwager's conclusions on candlestick analysis are as follows:

1. The Bruce Babcock tests revealed that a simplistic interpretation of candlestick patterns is not profitable. In other words, blindly following candlestick patterns is not an effective methodology.
2. If the trader takes into account the context in which specific candlesticks occur (i.e., by looking at other prevailing patterns, both candlestick and classical and at the overall trend)

before buying or selling, then candlestick chart analysis will produce better results.

3. Besides applying the candlestick technique, a trader should incorporate money management strategies to produce better results.

Conclusion

From the results of the Bruce Babcock tests as well as from my experience, my conclusion is that candlestick-charting analysis should be used in conjunction with trend analysis.

In other words, the trader should take a candlestick signal that is in the direction of the primary trend and ignore (or give less weight to) a candlestick signal that is counter to this trend.

To define a trend, use Western classical charting techniques like trend line analysis, support, and resistance. Once the primary trend is determined, you should use candlestick analysis to trade in the direction of this trend and to ignore (or give less weight to) candlestick signals counter to this defined trend.

Another way to define a trend is by applying the moving average over price. Yet another way is by using Western oscillators like momentum, relative strength index, moving average convergence divergence, commodity channel index, directional movement index, stochastic, Elliott wave theory, and so on. The use of Western technical indicators to help define a trend is discussed in Part II of this book.

Once the main trend of the market is determined, be it the short-term, intermediate, medium, or long-term, the trader should then execute trades by taking candlestick signals that are in the direction of the defined trend.

Summarising, the trader starts by:

1. Identifying the primary trend (by asking the question: Is the trend bullish or bearish?).
2. Trade in the direction of this trend.

This will improve your percentage of winning trades and reduce your percentage of losing trades. It is important not to go against the primary trend.

In Part II, I will be looking at how to apply Western technical indicators to help you define whether the primary trend is bullish or bearish and then apply candle patterns to execute trades in the direction of this trend. This concept of using Western technical indicators to confirm a candle signal is known as candlestick filtering or the Rule of Multiple Techniques.

PART II

ADVANCED CANDLESTICK TECHNIQUES

Filtering with Western Indicators

Candlestick chart analysis can be used as a standalone technique in trading the markets. But profitability improves when candlestick analysis is used in conjunction with Western classical charting and with oscillator analysis.

"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."[1]

This method of looking for confirmation from different technical indicators is called filtering or the Rule of Multiple Techniques. Arthur Sklarew in his book *Techniques of a Professional Commodity Chart Analyst* emphasises this principle, which says that "the more technical indicators that assemble at the same price area, the greater the chance of an accurate forecast."[2]

[1] Steve Nison, *Japanese Candlestick Charting Techniques: A Contemporary Guide to the Ancient Investment Techniques of the Far East* (Paramus, NJ: New York Institute of Finance, 1991).
[2] Arthur Sklarew, *Techniques of a Professional Commodity Chart Analyst* (Brightwaters, NY: Windsor Books, 1980).

Using Filtering or the Rule of Multiple Techniques

1. Define the trend. You can use trend lines, moving averages, or oscillators to help you define the trend. There are only three classifications of a trend: up, down, and sideways. An uptrend is also known as a bullish trend and a downtrend is known as a bearish trend.
2. Trade in the direction of this trend.

Scenario 1: In the Case of a Bull Market or Bullish Trend

1. If the trend is bullish, look for bullish candlestick patterns to enter the market on the *buy* or *long* side for both stocks and futures.
2. If the trend remains bullish, maintain *buy* or *long* positions on both stocks and futures. One should ignore candlestick sell signals. At most, use candlestick sell patterns to close longs *but do not enter short positions* until the trend line, oscillators, or moving average turn bearish.

Scenario 2: In the Case of a Bear Market or Bearish Trend

1. If the trend is bearish, look for bearish candlestick patterns to enter the market on the *sell* or *short* side for both stocks and futures.
2. If the trend remains bearish, maintain *short* positions in futures but *stay out (this is because in Malaysia short selling is prohibited)* of stocks. One should ignore candlestick buy signals. At most, use candlestick buy patterns to cover short positions *but do not enter* long *positions* on stocks and futures until the trend line, oscillators, or moving average turn bullish.

Scenario 3: In the Case of Overbought or Oversold Situations

1. If the market is overbought, look for bearish reversal candle patterns to exit your trades.
2. If the market is oversold, look for bullish candle reversal patterns to enter your trades.

On the questions of using daily, weekly, or monthly candle charts, future traders should use daily and weekly charts to determine the direction of the trend. Next, use the shorter-term charts like the 30-minute and 15-minute charts to trigger buy or sell signals, but only if they are in line with the direction of the longer-term charts.

For Malaysian stock market traders, you should use weekly and monthly candle charts to determine the direction of the trend. Next, use daily charts to trigger buy or sell signals. Hourly charts may even be used to provide earlier signals, but these signals must be in the direction of the longer-term trend.

This technique of using three time-frame charts (daily, weekly, and monthly) to screen your signals is called Triple Screening. More details are available in the author's second book, *Understanding KLCI Stock Index Futures*, or in *High Probability Trading* by Marcel Link.

Filtering with Moving Averages

The moving average is one of the oldest and most popular tools used by technicians. Its strength is as a trend-following device that offers the technician the ability to catch major moves.

The objective of a moving average is to smooth out daily fluctuations of prices to make it easier to view the underlying trend. 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.

If market players continue to be bullish, then the moving average will continue to rise. But because this line is an average of a body of data, this line naturally lags behind price. Therefore, in a bullish market, prices will soon rise above the moving average. Putting it another way, if prices are trending above the moving average, the market is bullish.

On the other hand, if players are bearish, the moving average will fall. And when this bearishness continues, prices will soon fall below the moving average. Another way of saying this is, "If price is trending below the moving average, the market is bearish." It is the interplay between price and the moving average that generates buy or sell signals.

The Simple Moving Average

This is the average of all the current closing prices against past price movements. Every period carries equal weight.

Formula for 3-day moving average = (Closing price of Day 1) + (Closing price of Day 2) + (Closing price of Day 3) divided by 3.

The result would be plotted as the first average. To create a moving average, the calculation is repeated and a new value plotted. This step is repeated to establish another moving average of longer term, for example, eight days.

The Weighted Moving Average

A different weight is given to each price used to compute the average. Usually the most recent prices are weighted more heavily than earlier prices. How the data is weighted is a matter of preference.

The Exponential Moving Average

The exponential moving average includes all prior prices used in the database. The last period carries the most weight, and smaller weights are assigned to each of the past prices.

Interpretation

The moving average can be used to define a trend. Once the market trend is defined, candlestick patterns can be used to time market entry and exit.

The Single Moving Average Crossover Method When the closing price rises above the moving average, the market is in a bullish trend (*buy*). When the closing price falls below the moving average, the market is in a bearish trend (*sell*).

Rule

Closing Price > M.A. = Trend Bullish = Buy
Closing Price > M.A. = Trend Bearish = Sell

When close is above the moving average, it is known as the Golden Cross.

When close is below the moving average, it is known as the Dead Cross.

The parameter that I used to define a trend is 50-SMA.

The Dual Moving Average Crossover Method When the short-term moving average rises above the long-term moving average, a bullish reversal is signalled (*buy*). When the long-term moving average falls below the short-term moving average, a bearish reversal is signalled (*sell*).

Rule

Shorter M.A. > Longer M.A. = Trend Bullish = Buy
Shorter M.A. < Longer M.A. = Trend Bearish = Sell

When the shorter moving average is above the longer moving average, it is also known as the Golden Cross. When the shorter moving average is below the longer moving average, it is also known as the Dead Cross.

Proper Action

Applying Candlesticks with Moving Averages

- **At Golden Cross.** Look for bullish candlestick patterns like the Hammer, Inverted Hammer, Bullish Engulfing, Piercing Line, Morning Star, Doji-Star confirmations, and so on to establish buy or long positions.
- **At Dead Cross.** Look for bearish candlestick patterns like the Shooting Star, Hanging Man, Bearish Engulfing, Dark Cloud Cover, Evening Star, Doji-Star confirmations, and so on to establish sell or short positions.

Using the Rule of Multiple Techniques

- **In case of bullish trend (Close > M.A.).** Look for bullish candlestick patterns to buy or go long. If trend remains bullish, maintain longs. Ignore candlestick sell signals or at most close longs but do not short.
- **In case of bearish trend (Close < M.A.).** Look for bearish candlestick patterns to sell or go short. If trend remains bearish, maintain shorts. Ignore candlestick buy signals or at most cover shorts but do not go long.

Figure 7.1 and Figure 7.2 show some examples of filtering with moving average and candle patterns at Golden and Dead Cross.

Filtering with MACD (Moving Average Convergence Divergence)

MACD or Moving Average Convergence Divergence is a popular indicator developed by Gerald Appel as a trend indicator. It is best used to determine the direction of a trend, and the idea here is to trade only in the direction of the MACD.

The MACD has two lines. The first MACD line makes use of the difference between two exponential moving averages (usually the 12-day and 26-day), and it employs a second exponential moving average (usually a 9-day) of the actual MACD line as a signal line.

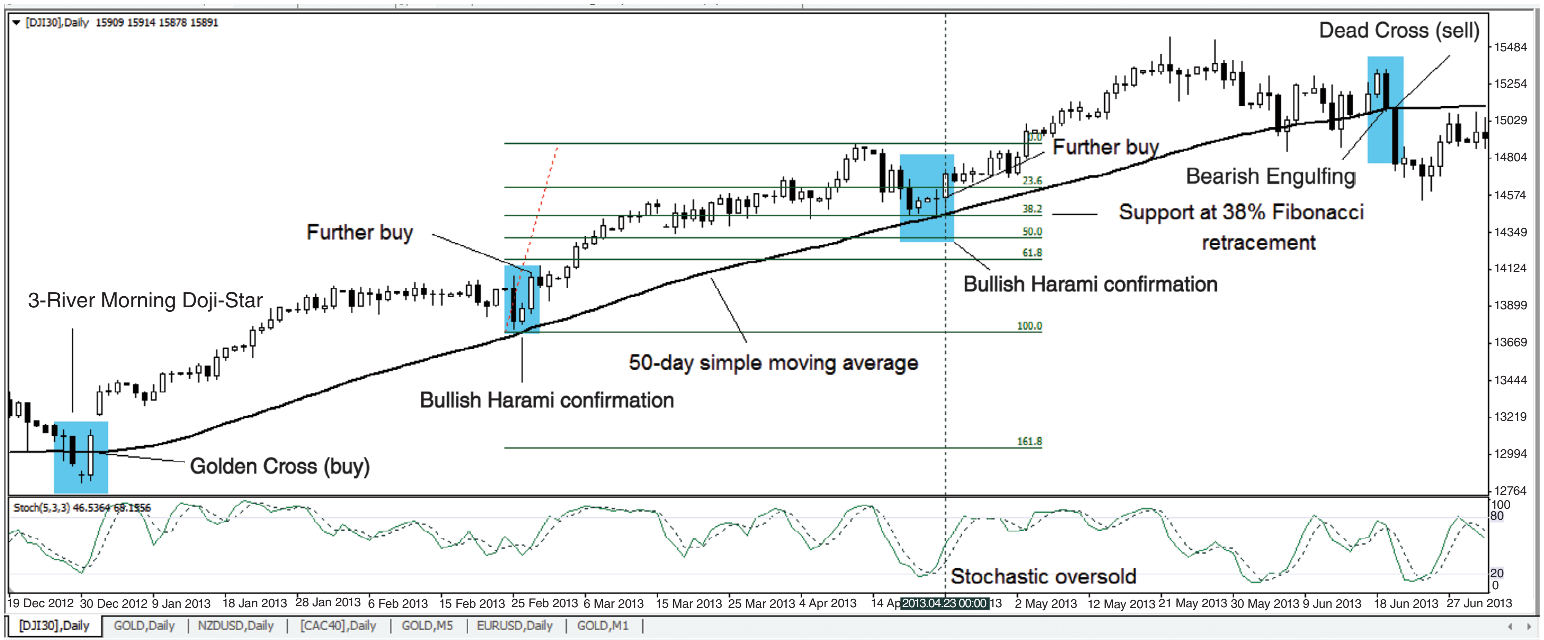


FIGURE 7.1 Dow Jones Industrial Average Daily (2013)—Filtering with moving average

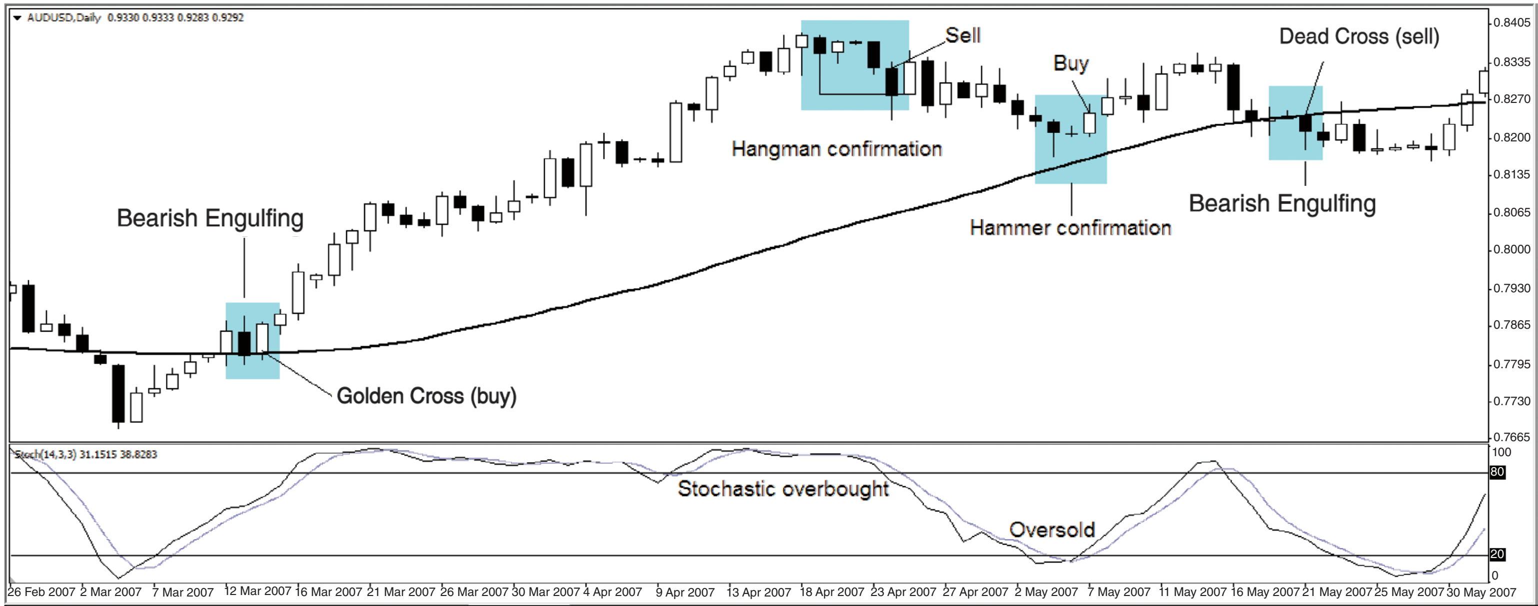


FIGURE 7.2 AudUsd Daily (2007)—Look for candle patterns at "golden" and at "dead" cross

The formula for MACD: The MACD line is the difference between two exponential averages (EMA), as shown here.

$$MACD = EMA1 - EMA2$$

The signal line will be an exponential moving average of the actual MACD line.

The number of days used is usually 12 and 26 days for the MACD line and a 9-day EMA for the signal line.

The MACD can also be plotted as a histogram that can be applied to determine the psychology of the players. An extreme reading on the histogram can signal an overbought or an oversold market. Drawn as an oscillator, the crossing of the zero line is used to trigger buy/sell signals. The other use of the MACD is to spot trend reversal through the concept of bull or bear divergence.

Interpretation

1. A buy signal is generated when the (fast) MACD line crossed above the (slower) signal line.
2. A sell signal is generated when the MACD line crosses below the signal line.
3. I use the parameters 5, 34, 5 for more timely crossings. These parameters have been popularized by Dr. Bill Williams. He also makes use of the MACD histogram to distinguish between Elliott's Wave 3 and Wave 5. Wave 3s tend to have the most extreme oscillator histogram reading while Wave 5's histogram is less extreme, producing a divergence.

Proper Action

Applying Candlesticks with MACD

- **MACD buy signal:** Look for bullish reversal patterns like the Hammer, Piercing Line, Bullish Engulfing, Morning Star, and so on to *buy*.
- **MACD sell signal:** Look for bullish reversal patterns like the Shooting Star, Doji-Star, Evening Star, Bearish Engulfing, Dark Cloud Cover, and so on to *sell*.

Using the Rule of Multiple Techniques

- **In case of bullish trend (MACD > signal).** Look for bullish candlestick patterns to buy or go long. If trend remains bullish, maintain longs. Ignore candlestick sell signals or at most close longs but do not short.
- **In case of bearish trend (MACD < signal).** Look for bearish candlestick patterns to sell or go short. If trend remains bearish, maintain shorts. Ignore candlestick buy signals or at most cover shorts but do not go long.

Figure 7.3 and Figure 7.4 show some examples of filtering with MACD and different MACD parameters that give differing timing signals.

Filtering with Relative Strength Index

The relative strength index (RSI) was developed in 1978 by J. Welles Wilder Jr. as an oscillator that graphically shows the internal strength of price advances to price declines over a specified

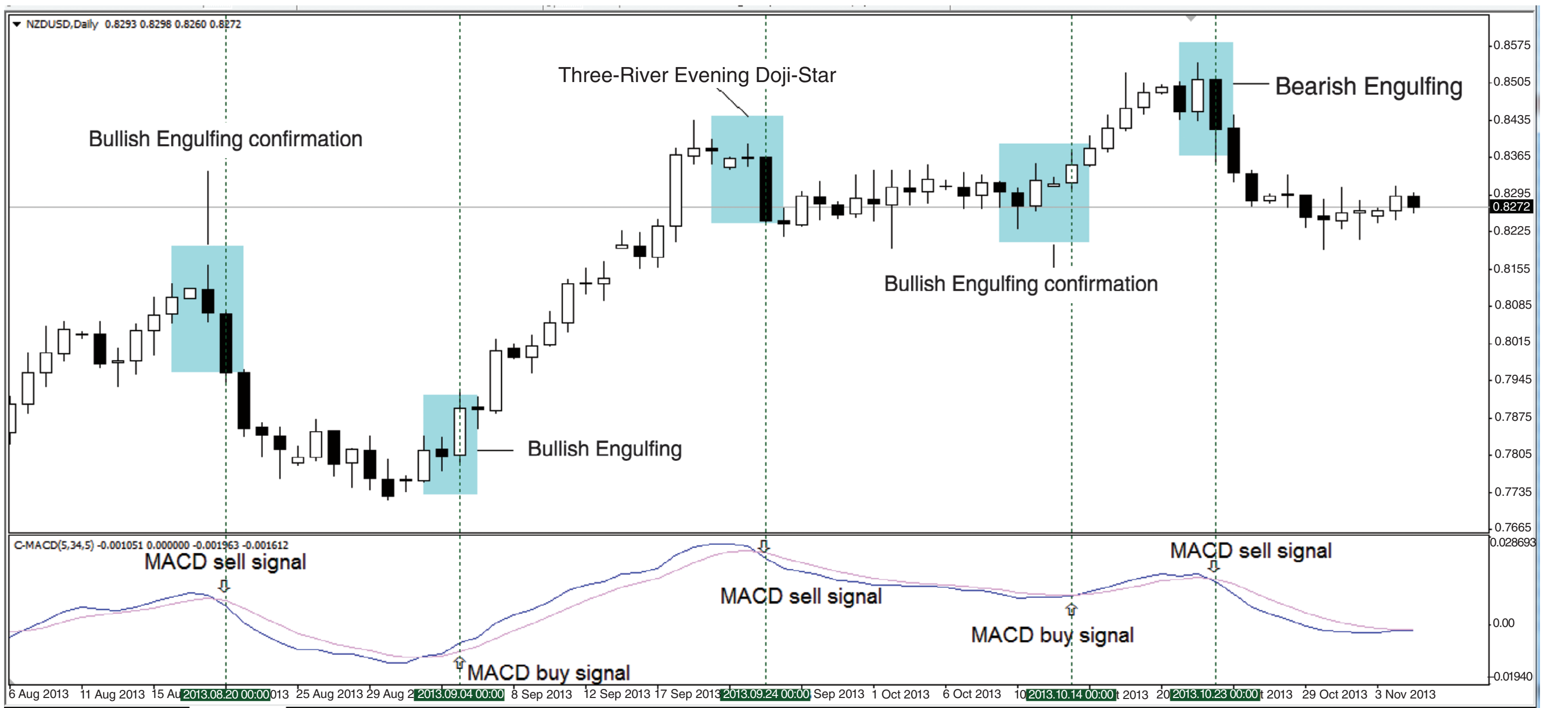


FIGURE 7.3 NzdUsd Daily (2007)—Filtering with MACD

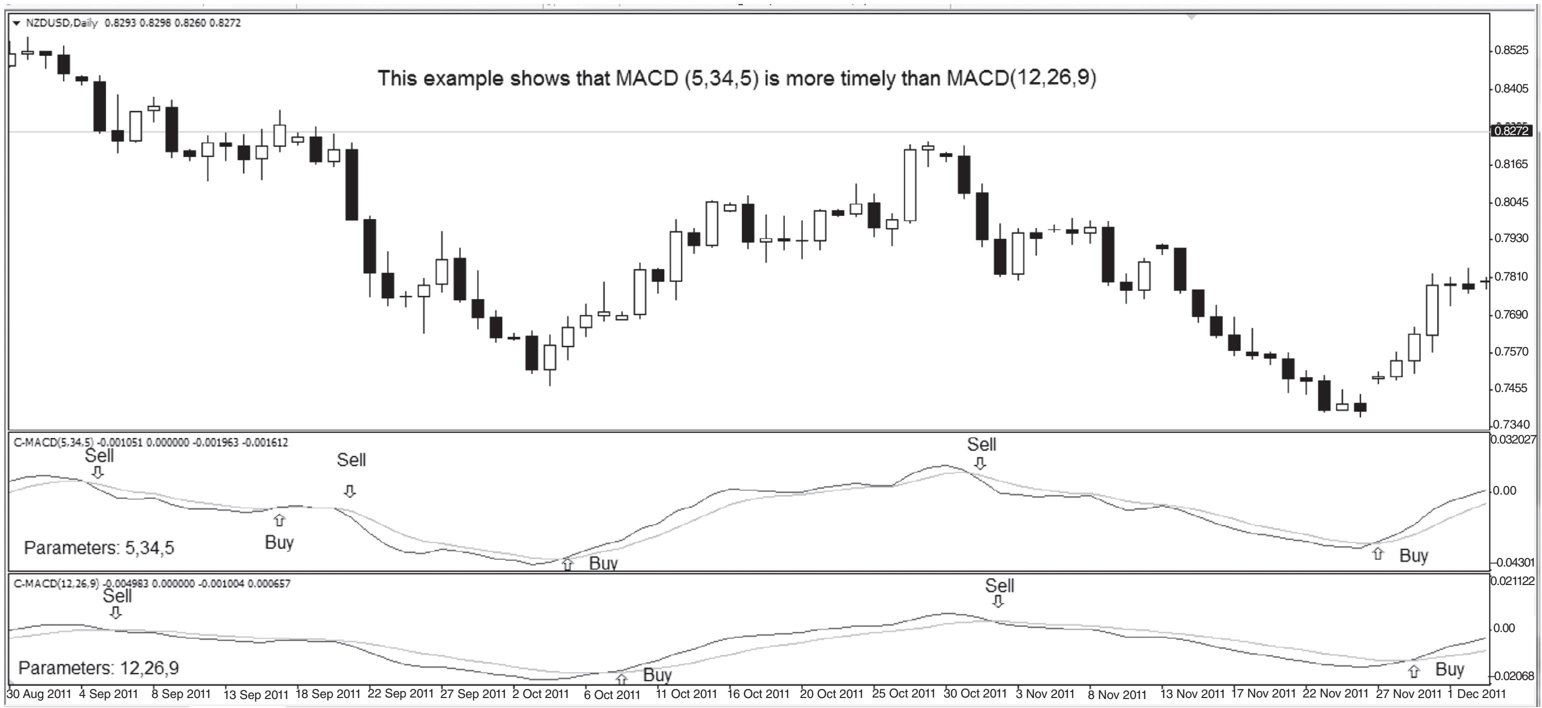


FIGURE 7.4 NzdUsd Daily (2011)—Different MACD parameters give differing timing signals

period. It creates a value that oscillates between 0 and 100 percent. Fourteen days is the most popular period.

The formula used is dependent only on closing price and is computed as follows:

$$RSI = 100 - (100/(1 + (\text{AV. up price change} - \text{AV. down price change})))$$

*AV. = Average

Interpretation

1. It is an overbought indicator when it approaches over 70 percent; the market is regarded as oversold when the RSI reads less than 30 percent.
2. Look for divergence. When prices make a new high and the RSI fails to make a similar move, there is bearish divergence, and this is potentially bearish. A bullish divergence occurs when prices make a new low, but the RSI does not. Divergences are more meaningful when the RSI oscillator readings are in overbought or oversold regions.
3. Crossing of the 50 level.

   If RSI > 50 = Trend Bullish = Buy
   If RSI < 50 = Trend Bearish = Sell

Proper Action

Applying Candlesticks with RSI

- **Above 70%.** Look for the Tweezers Top, Bearish Meeting Line, Bearish Harami, Doji-Star, Three-River Evening Star, Shooting Stars, and so on to sell. Market overbought.
- **Below 30%.** Look for the Tweezers Bottom, Bullish Harami, Doji-Star, Three-River Morning Star, Hammers, Inverted Hammers, and so on to buy. Market oversold.
- **RSI > 50.** Look for bullish candlestick patterns like the Hammer, Piercing Line, Bullish Engulfing, Morning Star, and so on to *buy*.
- **RSI < 50.** Look for bearish candlestick patterns like the Shooting Star, Doji-Star, Evening Star, Engulfing Bearish, Dark Cloud Cover, and so on to *sell*.

Using the Rule of Multiple Techniques

- **In case of bullish trend (RSI > 50).** Look for bullish candlestick patterns to buy or go long. If trend remains bullish, maintain longs. Ignore candlestick sell signals or at most close longs but do not short.
- **In case of bearish trend (RSI < 50).** Look for bearish candlestick patterns to sell or go short. If trend remains bearish, maintain shorts. Ignore candlestick buy signals or at most cover shorts but do not go long.

Figure 7.5 and Figure 7.6 show some examples of filtering with RSI and reversal patterns at overbought and oversold areas.

Filtering with Stochastic

The Stochastic Oscillator, developed by George Lane, compares the latest closing price with the total range of price action for a specific period. Lane uses five days. The values are between 0 and 100 percent. This indicator will prevent you from buying at

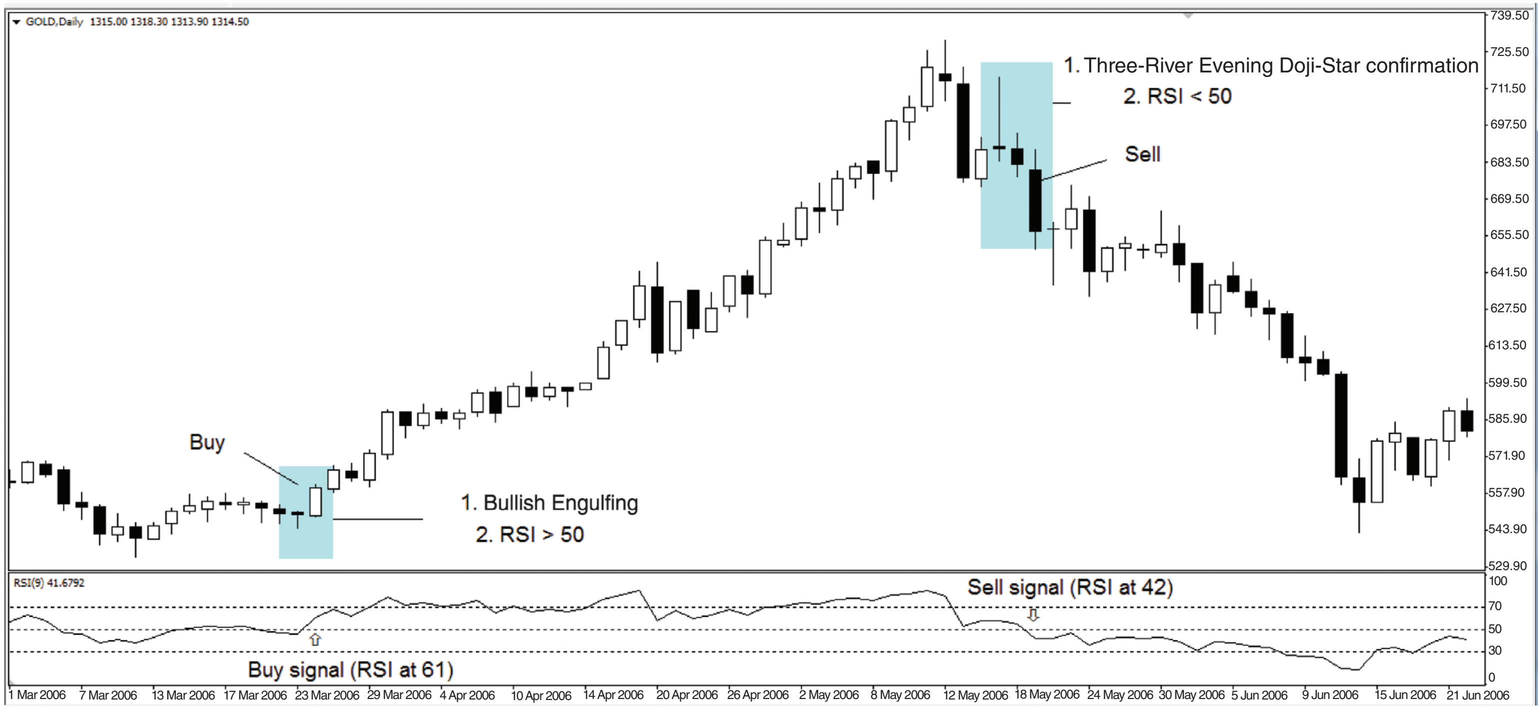


FIGURE 7.5 Gold Daily (2006)—Filtering with RSI (buy > 50; sell < 50)

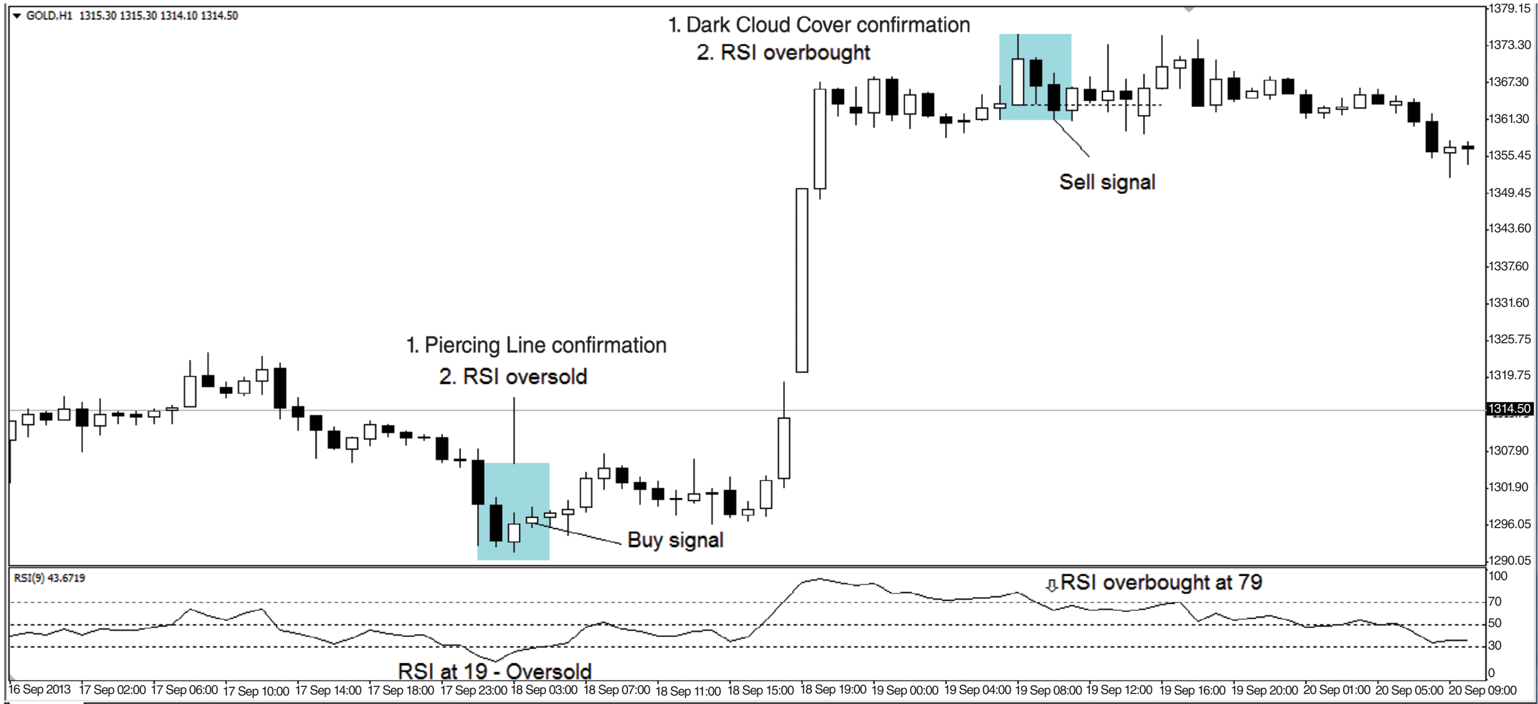


FIGURE 7.6 Gold Hourly (2013)—Look for reversal patterns at overbought and oversold areas