Three Stars in the South

By CORY MITCHELL Updated August 24, 2021
Fact checked by KATRINA MUNICHIELLO

What Is Three Stars in the South?

The three stars in the south is an extremely rare three-candle bullish reversal pattern that appears on candlestick charts. It may appear after a decline, and it signals that the bearishness is fading.

KEY TAKEAWAYS

- The three stars in the south candlestick pattern is a very rare pattern that doesn't typically precede large price moves.
- This pattern is formed by three black or red (down) candles of decreasing size following a price decline.
- It indicates a bullish reversal, although the price should ultimately move in the expected direction before taking a trade.

Understanding Three Stars in the South

The three stars in the south is a bullish reversal pattern with four characteristics:

1. The market is in a downtrend.
2. The first candle is black with a long real body, long lower shadow, and no upper shadow.
3. The second candle is black with a shorter real body and a higher low than the first candle's low.
4. The third candle is black with a short real body, no shadows, and a close that's within the high-low range of the second candle.

These strict requirements make the pattern rare. The theory behind the pattern is that bears are gradually losing momentum as each of the three candles progresses, which eventually leads the bulls to attempt a rally to reverse the trend.

Most traders look for confirmation after the pattern. The confirmation, in this case, would be the price moving higher following the pattern, since that is what the pattern is supposed to indicate. If the price drops following the pattern, it is not a bullish reversal, but rather a bearish continuation pattern.

In practice, it is difficult to find this pattern on charts. The reversals can also be relatively muted, which translates to little upside for traders betting on a rally. The three stars in the south, as well as other candlestick patterns, don't have a profit objective. Therefore, even if they work, and the price rises following the pattern, in this case, there is no indication of how far it will rise.

Traders could use the pattern as a signal to exit a short position or to initiate a long position, although ideally entering on the confirmation bar—as the price starts to rise—is preferred. In addition, traders should look for confirmations in other chart patterns or technical indicators to support a reversal thesis.

If, for example, a stock is trending higher but has recently experienced a pullback, a trader could watch for a three stars in the south pattern coupled with a bullish stochastic crossover in oversold territory. When combined, these pieces of evidence create a more compelling trade idea, especially if the three stars in the south is followed by any bullish confirmation candles.

The difference between three stars in the south and three black crows is that the latter is a bearish reversal pattern coming after a price advance. The pattern is formed by three long black (down) candles, with the second and third candles opening within the real body of the prior candle and closing lower than they opened and below the prior close.

Three Stars in the South Trading Psychology

Suppose a security is engaged in an active downtrend, with confident bears looking for lower prices. The first candle in the patterns confirms this view with a sizable price drop. The bulls can only draw slight optimism from this candle, which is that it closed above the low of the day.

On the second candle, the security opens higher than the low of the first candle and fails to post a new low. The close lower than the open also decreases bull confidence.

The security opens higher on the third candle in a show of renewed bull commitment, but they fail to capitalize the price drops again. Bears fail to drop the security to a new low once again, indicating a reduction in selling power. The three bars form a small pennant pattern, indicating bearish exhaustion while giving bulls an opportunity to start a rally. The rally can only commence if the price moves higher following the pattern.

Three Stars in the South Example

The pattern is rare, so examples and trades are hard to come by with this pattern. The following pattern on a Toronto Dominion Bank (TD) daily chart is a slight variation of the three stars in the south in that the third candle has a small upper shadow. Ideally, it has no shadows. Also, the third candle makes a slightly higher high than the second candle. Ideally, the third candle should be contained within the range of the second candle.

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A trade could be entered when the price moves above the high of the three-bar pattern (or above the high of the second or third candle). A stop loss could be placed below the low of the candle (or below the low of the second or third candle).

Three Stars in the South Limitations

- The pattern is very rare, and it also doesn't tend to produce big moves following it, which means it isn't particularly useful for trading purposes.
- The pattern does not have a profit objective; therefore, it is up to the trader to determine how they will exit a profitable trade.

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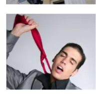
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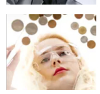
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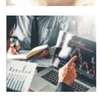
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