Three Inside Up/Down

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What Is Three Inside Up/Down?

The terms "three inside up" and "three inside down" refer to a pair of candle reversal patterns (each containing three individual candles) that appear on candlestick charts. The pattern requires three candles to form in a specific sequence, showing that the current trend has lost momentum and a move in the other direction might be starting.

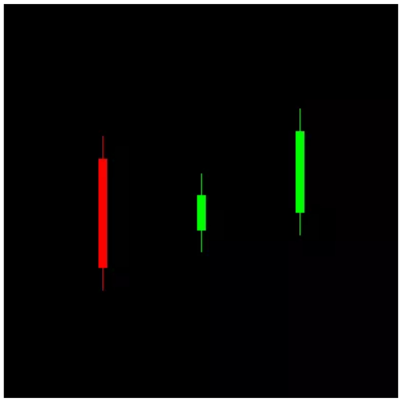
KEY TAKEAWAYS

- The three inside up pattern is a bullish reversal pattern composed of a large down candle, a smaller up candle contained within the prior candle, and then another up candle that closes above the close of the second candle.
- The three inside down pattern is a bearish reversal pattern composed of a large up candle, a smaller down candle contained within the prior candle, and then another down candle that closes below the close of the second candle.
- These patterns are short-term in nature, and may not always result in a significant or even minor trend change.
- Consider using these patterns within the context of an overall trend. For example, use the three inside up during a pullback in an overall uptrend.

Understanding the Three Inside Up/Down Candlestick Patterns

The up version of the pattern is bullish, indicating the price move lower may be ending and a move higher is starting. Here are the characteristics of the pattern.

1. The market is in a downtrend or a move lower.
2. The first candle is a black (down) candle with a large real body.
3. The second candle is a white (up) candle with a small real body that opens and closes within the real body of the first candle.
4. The third candle is a white (up) candle that closes above the close of the second candle.

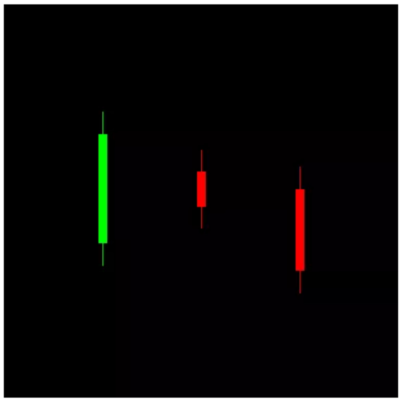


Three Inside Up.

The down version of the pattern is bearish. It shows the price move higher is ending and the price is starting to move lower. Here are the characteristics of the pattern.

1. The market is in an uptrend or a move higher.
2. The first candle is a white candle with a large real body.
3. The second candle is a black candle with a small real body that opens and closes within the real body of the first candle.
4. The third candle is a black candle that closes below the close of the second candle.

The three inside patterns are essentially harami patterns that are followed by a final confirmation candle, which many traders wait for with the harami anyway.



Three Inside Down.

Three Inside & Trader Psychology

Three Inside Up

The downtrend continues on the first candle with a large sell-off posting new lows. This discourages buyers, while sellers grow confident.

The second candle opens within the prior candle's trading range. Rather than following through to the downside, it closes higher than the prior close and the current open. This price action raises a red flag, which some short-term short sellers may use as an opportunity to exit.

The third candle completes a bullish reversal, trapping remaining short-sellers and attracting those who are interested in establishing a long position.

Three Inside Down

The uptrend continues on the first candle, with a large rally posting new highs. The second candle opens within the prior candle's trading range and closes below the prior close and current open. This causes concern for the buyers, who may start selling their long positions.

The third candle completes a bearish reversal, where more long positions are forced to consider selling and short-sellers may jump in to take advantage of the falling price.

Trading the Three Inside Up/Down Candlestick Pattern

The three inside up/down pattern doesn't need to be traded. It can simply be used as an alert that the short-term price direction may be changing.

For those that do wish to trade it, a long position can be entered near the end of the day on the third candle, or on the following open for a bullish three inside up. A stop loss can be placed below the low of the third, second, or first candle. This depends on how much risk the trader is willing to take on.

For a bearish three inside down, a trader could enter short near the end of the day on the third candle, or at the open the following day. A stop loss can be placed above the third, second, or first candle high.

These patterns do not have profit targets. Therefore, it's best to utilize another method for deciding when to take profits, should they develop. This could include using a trailing stop loss, exiting at a predetermined risk/reward ratio, or using technical indicators or other candlestick patterns to signal an exit.

> **!** Warning: These patterns can appear quite often and will not always signify that the price is set to trend in a new direction.

The pattern is fairly common, and therefore not always reliable. The pattern is also short-term in nature, so while it may occasionally result in significant trend changes, it may bring about only a small to medium-sized move in the new direction. Following the pattern, the price may not follow through in the direction expected at all, and may instead reverse course once again, in the direction of the original trend.

Trading in the same direction as the long-term trend may help improve the performance of the pattern. Therefore, during an overall uptrend, consider looking for the three inside up during a pullback. This could signal that the pullback is over and the uptrend is resuming.

During a downtrend, look for the three inside down following a small move higher. This could signal the move higher is over and the downtrend is resuming.

Example of Three Inside Up/Down Candlestick Patterns

The following Meta (formerly Facebook Inc.) chart shows an example of a three inside down pattern that fails. It appears during a strong price rise, but the third candle is relatively small and doesn't show a lot of selling conviction. The next day the price quickly resumes trading to the upside in alignment with the broader trend.

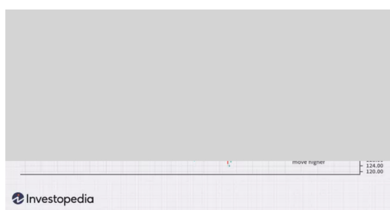


Image by Sabrina Jiang © Investopedia 2021

The next two examples occur during an overall price rise and occur during pullbacks against that rise. Once the pattern occurs, the price begins to move higher again, although not necessarily right away. In both cases, the price pauses after the pattern before moving up. Therefore, it would have been prudent to have a stop loss placed below the entire pattern in order not to be prematurely stopped out on a long position.

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