Doji

By JAMES CHEN Updated January 09, 2022
Reviewed by CHARLES POTTERS

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What Is a Doji?

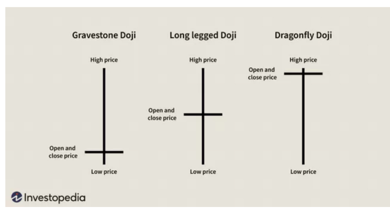
A doji—or more accurately, "dōji"—is a name for a session in which the candlestick for a security has an open and close that are virtually equal and are often components in patterns. Doji candlesticks look like a cross, inverted cross, or plus sign. Alone, doji are neutral patterns that are also featured in a number of important patterns.

A doji candlestick forms when a security's open and close are virtually equal for the given time period and generally signals a reversal pattern for technical analysts. In Japanese, "doji" means blunder or mistake, referring to the rarity of having the open and close price be exactly the same.

KEY TAKEAWAYS

- A doji is a name for a session in which the candlestick for a security has an open and close that are virtually equal and are often components in patterns.
- Alone, doji are neutral patterns that are also featured in a number of important patterns.
- Doji formations come in three major types: gravestone, long-legged, and dragonfly.

Depending on where the open/close line falls, a doji can be described as a gravestone, long-legged, or dragonfly.



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What Does a Doji Tell You?

Technical analysts believe that all known information about the stock is reflected in the price, which is to say the price is efficient. Still, past price performance has nothing to do with future price performance, and the actual price of a stock may have nothing to do with its real or intrinsic value. Therefore, technical analysts use tools to help sift through the noise to find the highest probability trades.

One tool was developed by a Japanese rice trader named Honma from the town of Sakata in the 18th century, and it was introduced to the West in the 1990s by Steve Nison: the candlestick chart. [1]

Every candlestick pattern has four sets of data that help to define its shape. Based on this shape, analysts are able to make assumptions about price behavior. Each candlestick is based on an open, high, low, and close. The time period or tick interval used does not matter. The filled or hollow bar created by the candlestick pattern is called the body. The lines that extend out of the body are called shadows. A stock that closes higher than its opening will have a hollow candlestick. If the stock closes lower, the body will have a filled candlestick. One of the most important candlestick formations is called the doji.

A doji, referring to both singular and plural forms, is created when the open and close for a stock are virtually the same. Doji tend to look like a cross or plus sign and have small or nonexistent bodies. From an auction theory perspective, doji represent indecision on the side of both buyers and sellers. Everyone is equally matched, so the price goes nowhere; buyers and sellers are in a standoff.

Some analysts interpret this as a sign of reversal. However, it may also be a time when buyers or sellers are gaining momentum for a continuation trend. Doji are commonly seen in periods of consolidation and can help analysts identify potential price breakouts.

Example of How to Use a Doji

The following chart shows a gravestone doji in Cyanotech Corp.'s stock from February 2018 following a significant high-volume uptrend, which could indicate a bearish reversal over the near term following the breakout.

Gravestone Doji Example.

In this example, the gravestone doji could predict a further breakdown from the current levels to close the gap near the 50- or 200-day moving averages at $4.16 and $4.08, respectively. Traders would also take a look at other technical indicators to confirm a potential breakdown, such as the relative strength index (RSI) or the moving average convergence divergence (MACD). Day traders may also put a stop-loss just above the upper shadow at around $5.10, although intermediate-term traders may place a higher stop-loss to avoid being stopped out.

What Is the Difference Between a Doji and a Spinning Top?

Candlestick charts can reveal quite a bit of information about market trends, sentiment, momentum, and volatility. The patterns that form in the candlestick charts are signals of such actions and reactions in the market. Doji and spinning top candles are quite commonly seen as part of larger patterns, such as the star formations. Alone, doji and spinning tops indicate neutrality in price, or that buying and selling pressures are, essentially, equal, but there are differences between the two and how technical analysts read them.

Spinning tops are quite similar to doji, but their bodies are larger, where the open and close are relatively close. A candle's real body can generally represent up to 5% of the size of the entire candle's range in order to be classified as a doji. Any more than that, it becomes a spinning top.

A spinning top also signals weakness in the current trend, but not necessarily a reversal. If either a doji or spinning top is spotted, look to other indicators such as Bollinger Bands to determine the context to decide if they are indicative of trend neutrality or reversal.

Limitations of a Doji

In isolation, a doji candlestick is a neutral indicator that provides little information. Moreover, a doji is not a common occurrence; therefore, it is not a reliable tool for spotting things like price reversals. When it does occur, it isn't always reliable either. There is no assurance the price will continue in the expected direction following the confirmation candle.

The size of the doji's tail or wick coupled with the size of the confirmation candle can sometimes mean the entry point for a trade is a long way from the stop loss location. This means traders will need to find another location for the stop loss, or they may need to forgo the trade since too large of a stop loss may not justify the potential reward of the trade.

Estimating the potential reward of a doji-informed trade can also be difficult since candlestick patterns don't typically provide price targets. Other techniques, such as other candlestick patterns, indicators, or strategies are required in order to exit the trade when and if profitable.

What Is a Dragonfly Doji Candle?

The dragonfly doji is a candlestick pattern stock traders analyze as a signal that a potential reversal in price is about to occur. Depending on past price action, this price reversal could be to the downside or the upside. The dragonfly doji forms when the stock's open, close, and high prices are equal.

This particular candlestick pattern is not a common occurrence, nor is it a reliable signal that a price reversal will soon happen. The dragonfly doji pattern can also be a sign of indecision in the marketplace. For this reason, traders will often use it as just one indicator of potential future price movement, combining it with other technical indicators before making trade decisions.

What Is a Gravestone Doji Candle?

A gravestone doji candle is a type of pattern that technical stock traders use as a signal that a stock price may soon undergo a bearish reversal. This pattern forms when the open, low, and closing prices of an asset are close to each other and have a long upper shadow. The shadow in a candlestick chart is the thin part showing the price action for the day as it differs from high to low prices.

While traders will frequently use the gravestone doji as a signal to enter a short position or exit a long position, most traders will review other indicators before taking action on a trade. The reason for this is that the gravestone doji pattern is not always a reliable indicator of a reversal. Many traders will look at the next day's candle to confirm the reversal (along with other technical indicators) before initiating a trade.

What Is a Long-Legged Doji Candle?

The long-legged doji is a type of candlestick pattern that signals to traders a point of indecision about the future direction of a security's price. This doji has long upper and lower shadows and roughly the same opening and closing prices.

In addition to signaling indecision, the long-legged doji can also indicate the beginning of a consolidation period where price action may soon break out to form a new trend. Long-legged doji can be a sign that sentiment is changing and that a trend reversal is on the horizon as the forces of supply and demand near equilibrium.

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A hammer is a candlestick pattern that indicates a price decline is potentially over and an upward price move is forthcoming. more

What Is a Bearish Abandoned Baby?
A bearish abandoned baby is a type of candlestick pattern identified by traders to signal a reversal in the current uptrend. more

Rickshaw Man Definition
The rickshaw man is a long candlestick with a doji body, centered between the high and low, that indicates indecision in the market. more

Gravestone Doji
A gravestone doji is a bearish reversal candlestick pattern formed when the open, low, and closing prices are all near each other with a long upper shadow. more

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