Rick Saddler's
Introduction to Trading with
Japanese Candlesticks him

Learning to Read Stock Charts
With
Japanese Candlesticks

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Table of Contents

Introduction to Trading with Japanese Candlesticks

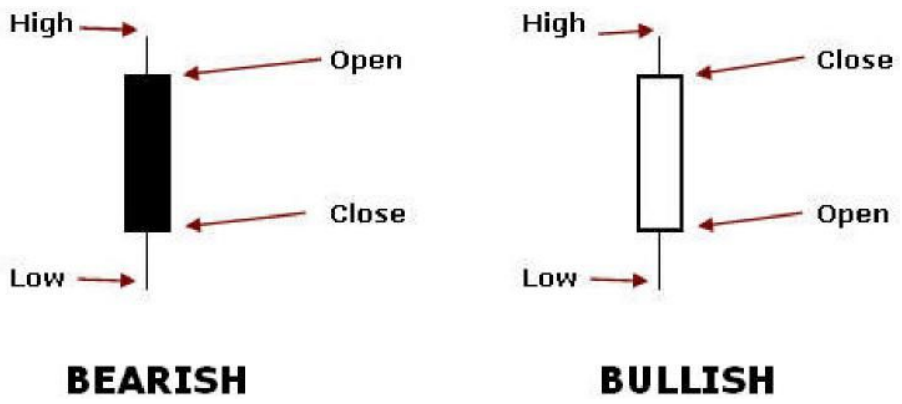
Japanese Candlesticks are gaining popularity among individual traders, mainly because they are easier to learn and interpret versus bar charts. Of equal importance is the fact that they fall into the category of leading indicators. Unlike lagging indicators (for example; a moving average) which appear after the fact, the Japanese Candlesticks signals are leading indicators because they provide early warning alerts to possible price movements. **When you see one of these alerts confirmed by moving averages, they can provide profitable trade opportunities**.

Rather than bore you with the history of Japanese Candlesticks, suffice it to say they have been in use for over 400 years. They are reliable and provide traders with extremely valuable insight to potential price movements.

Many traders use Japanese Candlestick charts simply because they are more visually appealing than bar charts and as a result they are easier to read and interpret. The candlestick chart appears to be three-dimensional making it easier to see the relationship between the open and close and the high and low. Each candlestick allows you to more easily detect the price action that is indicative of either selling pressure or of buying pressure. The body of the candle itself is thicker than the shadow also making it far easier to see how the close price relates to the open price than when reading bar charts.

Japanese Candlesticks also provide more of a real time depiction of market sentiment whereas bar charts often only signify market noise. Candlesticks utilize one to three time periods and are able to visually block out market noise unlike bar charts. Bar charts will actually allow spikes to highs and lows to be prominent in their data unlike candlesticks which are able to focus on what the market actually did to force price action during a period of trading.

The image below illustrates the construction of Japanese Candlesticks.



The hollow Bullish candle forms when the stock price closes higher than its opening price.

The solid Bearish candle forms when the stock price closes lower than its opening price.

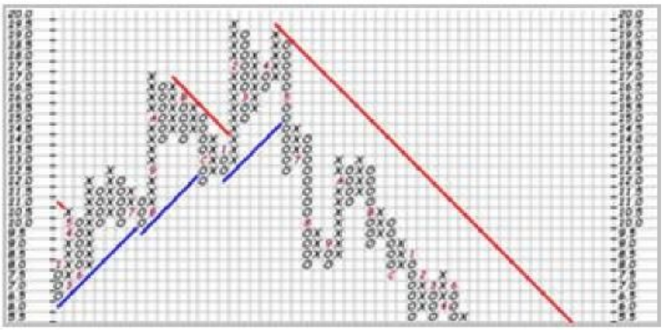
Candlestick charting methods have quickly gained popularity over the last several years. Whether you are a novice trader, or experienced professional, I believe once you understand the power behind the signals you will never go back to other charting methods again!

The art is not in making money, but in keeping it!" – Unknown

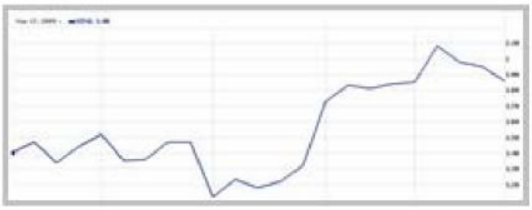
Compare Japanese Candlesticks to other charting formats.

> **Bar Charts**: Better than line charts for displaying opening and closing prices, yet still visually limited.

> **Point and Figure Charts**: Good for visualizing support and resistance but so are candlesticks and not as easily learned.



> **Line Charts**: straightforward illustrations best used for short trading frames but limited data compared to candlesticks.



> **Japanese Candlesticks Chart:** obviously my chart preference, as the balance of this document will attest to the many attributes of the effectiveness of utilizing the signals and patterns.

Now that you can visibly compare the other charting formats, let's look at some of the advantages of trading with Japanese Candlesticks.

1. Quickly see opening and closing prices, which are important indicators for support and resistance levels.
2. One quick glance is all you need to see whether the buyers or sellers are in control.
3. Each individual candlestick tells a story of investor sentiment, giving you an insight not only *how* to trade but *when*.
4. The majority of popular charting systems utilize candlestick signals and patterns in their scanning systems. What a great way to narrow down thousands of trades into a manageable list.

"Never spend your money before you have it"- Thomas Jefferson

Why I have a passion for Candlestick Signals and Patterns

Once upon a time, maybe just like you, I began my education to learn how to make profits from trading the markets. I chose to focus mainly on technical analysis versus fundamental analysis. My first obstacle was to wade through copious declarations of the latest 'Holy Grail' of trading techniques. ***My decisions became much easier once I was introduced to Japanese Candlesticks.***

There are a number of complex, and often over-whelming, amounts of information for new investors. Even if you are able to refrain from falling victim to the latest gimmicks, the tried and true methods can sometimes be mathematically challenging. Interesting observation; many of these indicators suggest using a wave, arc, fan, or some type of visual cue to use in conjunction with the resulting data.

The visual picture provided by candlesticks gives us a quick assessment of anticipated price movement. By learning a few basic signals, even a new chartist can easily see the 'story' behind the candlesticks.

Most every trading platform available includes scanning ability for utilizing candlestick signals and patterns. This is especially important if you don't want to spend your time reviewing thousands of charts. Considering there are over 10,000 entities from which to choose, time management is a must.

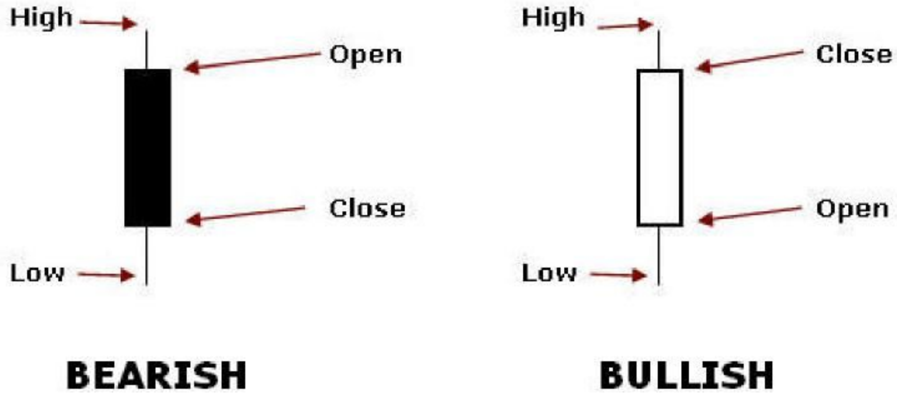
And, my most popular reason for using candlesticks? They work exactly the same in varying time periods. So whether I want to find a swing trade, run a quick scalp, or place a day-trade – **Candlestick signals work equally well in all time frames**.

Recognizing the story behind the signals

To effectively trade with candlesticks one must first understand the information contained in the construction of the signal and the meaning behind the variations in the different candlestick signals and patterns. But, don't worry, there are only a dozen main signals. Once you're familiar with these major signals, the rest falls into place quite nicely.

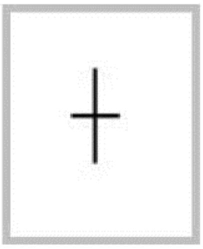
There are 4 main components that build a candlestick:

1. **Opening price**; is the first piece of data needed and will start the candlestick either at the top or bottom part of the candle, depending on whether price action is *Bullish* or *Bearish*. As illustrated earlier, the Bullish candlesticks are usually represented by a white, or green body on the chart. The Bearish candlesticks are usually black or red, depending upon your charting program.
2. **Highest price**; is illustrated by a wick (or tail) above the body of the candle unless the price never goes above the opening price. In this case there is no wick above the body of the candle.
3. **Lowest price**; is also represented by a wick (or tail) below the body of the candle. Again, if the underlying stock is experiencing considerable Bullish action, there may be no wick below the bottom body of the candle. (illustrating the price never traded below the close of the day.)
4. **Closing price**; the final piece of data needed to complete the candlestick signal. The closing price finishes the body of the candle near the top (if Bullish) or the bottom (if Bearish).



Doji and **Doji Variations**

Doji



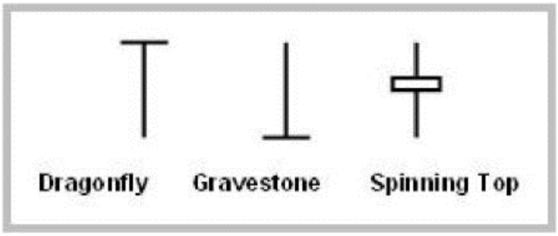
The Doji is one of the most informative signals in Candlestick trading and is comprised of one candle. It forms when the opening price and closing price occur at the same level (or very close) in a specific timeframe.

In order for a doji signal to be valid it must meet two conditions. **First,** the opening price and the closing price of the stock must be almost at the same price level (as stated above). **Second,** there must be an upper shadow or a lower shadow, or both.

When a doji candlestick is formed, a cross formation appears (as seen above) with the horizontal line representing the opening price and closing price occurring at the same level. The vertical line on the doji candlestick chart represents the total trading range during that timeframe. This clearly indicates that the bulls and the bears are at an equilibrium signifying a state of indecision. When this occurs the trader should keep an eye out for a trend reversal.

Doji lines are patterns in the doji candlestick chart with the same open and close price. There are three special types of Doji lines explained on the next page.

Doji Variations



1) **Dragonfly Doji** – This doji line has a long lower shadow and no upper shadow and it indicates a bearish trend reversal. This type of doji opens at the high of a session, has a significant inter period decline, then it climbs back up closing at the same level as the open.

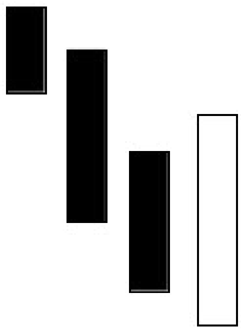
2) **Gravestone Doji** – This doji line has a long upper shadow and no lower shadow and indicates a bullish trend reversal. It is derived by the formation of the signal looking like a grave stone and is formed when the opening price and closing price occur at the low of the day. Its specialty is for calling market tops and it could indicate imminent disaster for a stock.

3) **Spinning Top (Long-Legged) Doji** – This doji line has a long upper and lower shadow with the price in the middle of the range. It is a very important reversal signal and it signifies a great amount of indecision in the market. It is formed when prices trade well over and below the day's opening price, but then close almost at the same level as the opening price.

Engulfing Patterns

Engulfing patterns form when the body of the second candlestick completely *engulfs* the first. They often complete other reversal patterns, showing even stronger evidence that an eminent change will occur. Therefore; *Engulfing Patterns* are frequently spotted at the top or bottom of a move.

Bullish Engulfing Pattern



This is a major reversal pattern comprised of two opposite colored bodies. It is formed after an established downtrend, and it opens lower than the previous day's close; and closes higher than the previous day's open. The first candlestick represents a falling share price (black or red image) and the second candlestick represents the share price starting low and ending up at or near its highs (white or green image).

To qualify as a Bullish Engulfing pattern these conditions must be met.

1. There must be a definable downtrend.

2. The white or green candle must completely engulf the body of the previous black or red candle.

3. The body of the engulfing candle must be the opposite color of the first candle. (the exception would be if the first candlestick is a Doji, or small bodied candle)

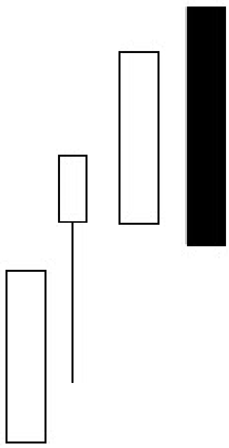
The size of the black or red candlestick is of no consequence, however the shadows (or tails) of the small candlestick (black or red) are short, which enables the body of the large candlestick (white or green) to cover the entire candlestick from the previous day. The size of the white or green candle is of more consequence because the larger it is, the more bullish the anticipated reversal.

What does this reversal pattern indicate is happening in the markets?
The bullish engulfing pattern is used when a stock has been declining and it typically represents a change in investor sentiment. The assumption that this pattern carries is that after a period of selling pressure, the white or green candle forms because the stock has opened below the previous close; the buyers moved in and pushed the price higher. (The exception to this rule, however, is if the first real body of the engulfing pattern is a doji or an extremely small body. A doji candlestick chart engulfed by a very large white or green real body could be a bottom reversal).

To confirm this pattern, the share price must strengthen further in the following time period, or in other words, **a bullish confirmation should come within 1 to 3 time frames after the pattern** .

The name of this pattern implies that the bulls have taken control of price movement from the bears. The bullish engulfing pattern is associated with a declining trend in price, which implies that a low or end to the price decline has occurred.

Bearish Engulfing Pattern



The bearish engulfing pattern consists of a small white/green candlestick with short shadows or tails followed immediately by a large black/red candlestick that *engulfs* the previous candle.

To simplify, engulfing patterns are when the body of the second candlestick engulfs the first and are considered reversal patterns.

To qualify as an engulfing candlestick, certain conditions must be met.

1. There must be a definite uptrend.
2. The second real body (do not include the tails) should have the opposite color of the first real body.
3. The second day's body should completely engulf the previous day's body. (I use the example of 'day' but it is the same in all time periods)

The first day's color is the same as the trading trend. In order to be considered a bearish engulfing pattern, the second day of the signal should be a black (or red) candle opening above the close of the previous day and closing below the open on the previous day's white (or green) candle.

It is found at the top of an uptrend, meaning the stock must be in a definite uptrend before this signal occurs. It is important to note that this signal often follows or completes the doji, the hammer, or the gravestone patterns.

What does the bearish engulfing pattern indicate is happening in the markets?
This pattern typically is accompanied by an uptrend in a security and can indicate a peak or a slowdown in its advancement. It may signal a future bearish trend which means that the bears are overwhelming the bulls and prices will move down.

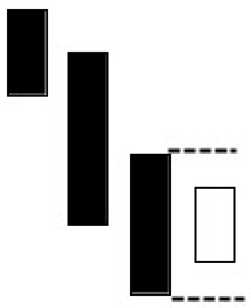
The second black (or red) candlestick begins to form, after an advance, and when residual buying pressure causes the security to open above the previous close.

Sellers then begin to drive the prices down and by the end of the session, the prices will move below the previous open. As a result, the second candlestick (black or red) engulfs the previous day's body and creates an apparent short-term reversal. The bearish engulfing pattern creates a very strong probability that the buying is over and selling will dominate price action so there is opportunity for creating a good short position.

This pattern is the exact opposite of the bullish engulfing pattern. Both indicate reversals at the tops and the bottoms and are easily recognized indicators at the end of a trend. The signals are extremely accurate when a bullish engulfing pattern occurs during oversold conditions, and the bearish engulfing signal is equally valid when it occurs in the overbought area.

Harami Candle - Bullish

"White body within black candle"



The bullish harami candle is found at the bottom of a downtrend, and is the reverse of the engulfing pattern. The Japanese definition of this candle means *pregnant woman* or *body within*. When identifying a bullish harami candle the body of the first candle must be the same color as the current trend and should be a long black (or red) candle. The body of the second candle is a white (or green) candle and it opens and closes **within the body** of the previous day's candle.

Additionally, as mentioned above, the downtrend must have been evident for a good period of time with a long black or red candle occurring at the end of the down trend. The presence of this candle indicates that the trend is over. Also, the location and the size of the second candle can determine the magnitude of the reversal.

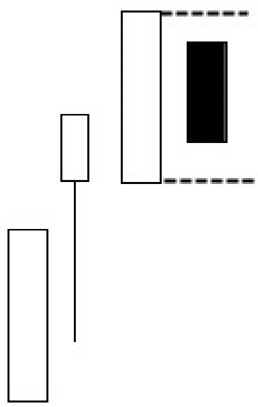
What does this bullish candlestick pattern indicate is happening in the markets?
This bullish signal occurs during a downtrend when the bulls step in and open the price higher than the previous day's close. Price goes up as the bulls continue to preside. This is a result of investors holding their positions, in hopes of a reversal only to eventually give up and sell, indicating that the trend is over. In other words, the bears are concerned and the shorts begin to cover their positions. The bulls are then able to close the candle higher into the previous day's body.

Confirmation is required the following day . The bulls must stay in control, convincing the bears that the trend is over. This is a great opportunity to enter into a long position.

When identifying the bullish candle it is important to note two things. **First**, the higher the white or green candle closes up on the red candle, the more convincing it is that a reversal has occurred. **Second**, the longer the black or red candle and the white or green candle the stronger the reversal.

Candlestick Harami – Bearish

"Black body within white candle"



The bearish candlestick harami is found at the top of an uptrend, and is the exact opposite of the bullish harami candle. It is also defined as *pregnant* or *body within* and it is a two candle formation.

To be valid it must contain the following criteria. **First**, the body of the first candle is white (or green) and the body of the second candle is black (or red). **Second**, price action must have been in a definite uptrend in order for this signal to occur. This can be visually identified on a chart when the long white or green candle occurs at the end of the trend. In other words, when identifying this pattern, the body of the first candle must be the same color as the current trend. The next day (or time period) should be a black or red candle opening below *or lower* than the close of the previous day, and closing above or higher than the open of the previous day's green candle. This also means that the first body of the pattern is a long body and the second body is smaller.
Confirmation is needed and the next day (or time period) must show continued weakness.

What does the bearish candlestick harami pattern indicate is happening in the markets?
This is an exciting candlestick pattern because it occurs at the top of a trend! The bears step in and open the price lower than the previous day's close. The bulls then begin to take their profits and get out before the price closes lower for the day. In other words, more

experienced investors know when they see this signal that they must take their profit and move on before the trend reverses. Otherwise, they will watch their profits quickly diminish.

Additional information of interest - The longer the white/green and black/red candles, the more forceful the reversal. Second, the lower the black/red candle closes down on the white/green candle, the more convinced investors are that a reversal has occurred, regardless of the size of the black/red candle.

Kicker Signals

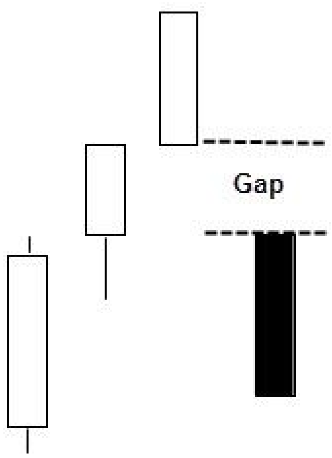
Kicker signals are one of the most powerful signals and they indicate a severe change in investor sentiment. This signal is most relevant when it occurs in the oversold or the overbought area, and it works equally well in either direction (bullish or bearish).

This two candle pattern formation occurs when **two candles of opposite colors** form next to each other **with a gap** between the candles.

The Kicker Signal is considered one of the most important candlestick signals, as it illustrates a strong change in investor opinion. The change in sentiment is so severe that it creates a dramatic visual change of not only an abrupt change in direction but with such strength it creates a gap (void) between the changes.

The first candle opens and moves upward in the direction of the current trend. The second (black or red) candle opens much lower than the first (white or green) candle’s close forming a gap. Price then continues lower which is the opposite direction of the previous day’s candle. There is typically little or no upper wick when seeing this signal.

Bearish Kicker Signal

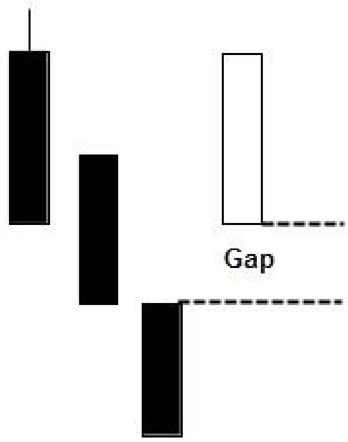


It is important to note that the trend is irrelevant for this signal. This signal typically occurs due to surprising news likely to affect investor sentiment. The price should never retrace into the previous day's trading range in order for this kicker signal to be valid.

A bearish signal of this nature indicates very strong selling pressure. There are also instances in which bearish kicker signals are strengthened. A longer candles makes the reversal more dramatic, as does a larger gap.

What do bearish kicker signals indicate is happening in the markets?
As previously discussed, this signal illustrates a dramatic change in investor outlook due to surprising news that changes the direction of the price. A true kicker signal demonstrates such a drastic change in direction that the new direction will continue with significant strength for a good period of time.

Bullish Kicker Signal

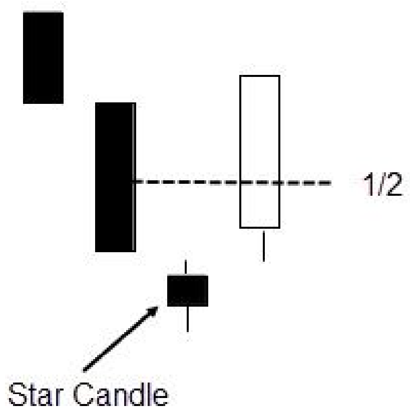


This signal is the exact opposite of it's Bearish counterpart. The first candle opens up and then continues to move down in the direction of the current trend. The second (white or green) candle opens much higher than the first (black or red) candle's close forming a gap. Price then continues higher which is the opposite direction of the previous day's candle.

It is important to note that the trend is irrelevant for this signal. This signal typically occurs due to surprising news likely to affect investor sentiment. The price should never retrace into the previous day's trading range in order for this kicker signal to be valid.

A bullish signal of this nature indicates very strong buying pressure. There are also instances in which bullish kicker signals are strengthened. A longer candles makes the reversal more dramatic, as does a larger gap.

Morning Star



The morning star is a bullish reversal signal found at the bottom of a downtrend. It is a is a **three candle pattern** and suggests that *good things are to come*. Or, in other words, that **prices are going to increase**.

To qualify as a morning star signal four criteria must be met.

1. The stock must be in a definite downtrend before this signal can occur.

2. The first day of the signal must confirm the current downtrend by displaying a long black (or red) real body. (**the bears are in complete control the first day**)

3. The second day displays a candle formation that indicates a state of indecision as the **star candle** gaps away from the first day. (The star may also be a Doji Candle) Supply and demand is equal on this day.

4. The third day should display a white (or green) candlestick that should close at least halfway up the black (or red) candlestick.

5. In other words, the long white/green body gaps up from the prior day. This third candle provides the confirmation needed to indicate a reversal. (**This confirmation is apparent in the morning before the sun rises, thus giving this signal its name**.)

Additional pattern notations for the morning star candlestick:

~The larger the candles, the greater force for a reversal.

~A gap (or window) between the first and second day, adds additional odds for the reversal.

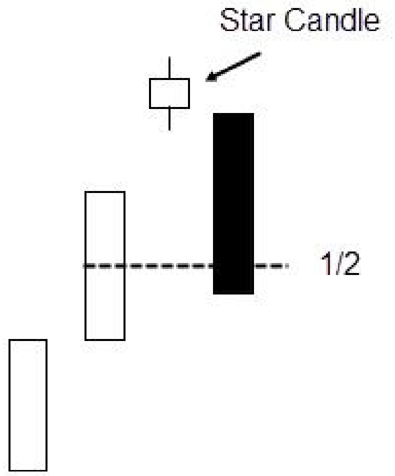
~Even more advantageous; a gap occurring before and after the star candle Note: A gap is not as common and is not required, but when you witness a gap 'pay heed' there is potential for even greater force.

~The higher the third day's candle comes up in relation to the first day's black/red candle, is even more compelling as it will cause the reversal to occur with greater strength.

What does this signal indicate is happening in the markets? Again, this trend means that a strong downtrend has been in effect and the bears are in full control. A tug-of-war ensues causing great concern for the bears, and eventually the bulls are able to take over.

> ***"If you can count your money, you don't have a billion dollars!"***
> ***`J. Paul Getty***

Evening Star Candlestick



The evening star candlestick indicates *bad things are on the horizon* for traders. Or, in other words, lower stock prices may be on the way. This pattern is a **top reversal signal** and is the opposite of the morning star signal. Investors must be careful when identifying the evening star candlestick pattern since it tends to be more difficult to identify than other Japanese candlesticks patterns.

The criteria required, in order for this signal to be valid includes the following conditions.

1. The stock must have been in a definite uptrend before this signal can occur. (**The bulls are in complete control on the first day**.)
2. The first day of the signal must be a long white/green body continuing the current uptrend.
3. The second day (indecision day causing the **star candle formation**) increases the probabilities of a reversal. (The star may also be a Doji Candle) Supply and demand is equal on this day.
4. The third day should be a long red/black body that closes down at least **halfway into the body of the first day's green candle**. This is proof the bears have stepped in with strength. (supply is far greater than the demand)

Additional pattern notations for the evening star candlestick:

~The larger the candles, the greater force for a reversal.

~A gap (or window) between the first and second day, adds additional odds for the reversal.

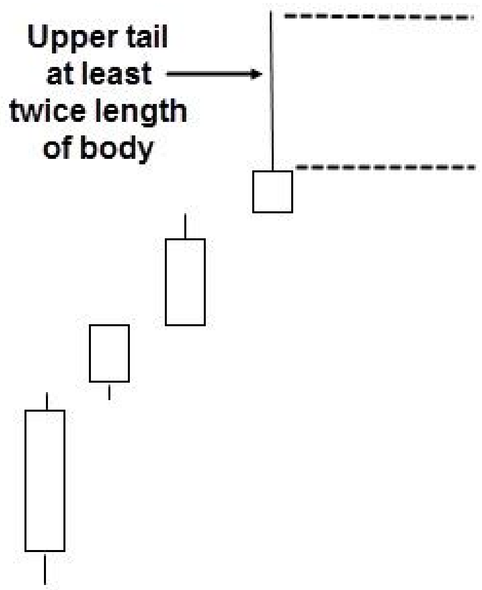
~Even more advantageous; a gap occurring **before and after** the star candle Note: A gap is not as common and is not required, but when you witness a gap 'pay heed' there is potential for even greater force.

~The lower the third day's candle comes down in relation to the first day's white/green candle, is even more compelling as it will cause the reversal to occur with greater strength.

What does the evening star candlestick indicate is happening in the markets?
Again, this trend means that a strong uptrend has been in effect and the bulls are in full control. A tug-of-war ensues while the sellers begin to take profits. This causes great concern for the bulls, and eventually the bears are able to take over.

"Of one thing, be certain: if a CEO is enthused about a particularly foolish acquisition, both his internal staff and his outside advisors will come up with whatever projections are needed to justify his stance. Only in fairy tales are emperors told that they are naked. " ~Warren Buffet

Shooting Star Candlestick Signal



The Shooting Star candlestick signal is a Bearish Reversal Signal indicating price has reached the top of its uptrend. It sends an important alert for those traders with open long positions that it is time to close their trade. For experienced traders watching for new short positions, it offers an early opportunity for greater profits.

The Shooting Star Candlestick reversal signal criteria are

First, there is an established uptrend.

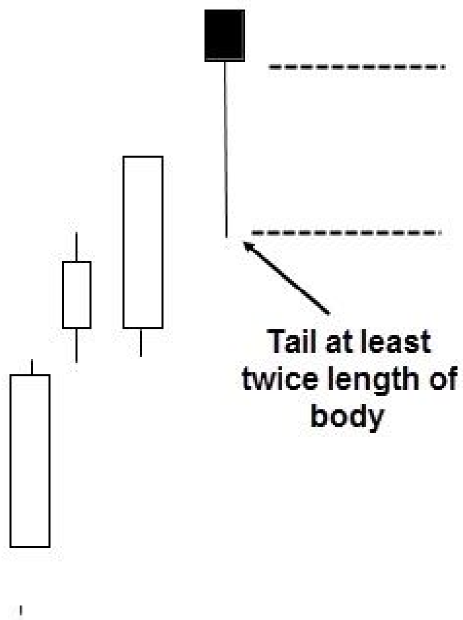
The candlestick has a small body and a long upper tail, or shadow equaling **at least twice the length of the real body**. (The upper tail shows the extent of the price movement during the trading period) There should be little, or no, lower shadow (or tail).

While not required, this pattern has even greater importance when there is a gap between the real body of the previous trading period.

What does this signal indicate is happening in the markets?
This candlestick formation depicts the battle between the Bulls and Bears. The Bulls are in charge with an established uptrend. The Bulls continue to push prices higher on the market open, but the Bears step in and bring the price back down to near the initial starting point.

This serves as an early warning that while the Bulls may have kept the price movement positive, they are loosing their ability to maintain control.

Hanging Man Candlestick Signal



The hanging man candle is a reversal pattern in which a small real body forms at the upper end of the trading range with a long lower shadow with no, or almost no upper shadow. The longer the shadow (or tail) the more bearish the reversal.

The hanging man occurs during an uptrend and it is named as it looks like a hanging man with dangling legs. When identifying a hanging man candle, there are four criteria that must be met.

1. A long lower shadow should be at least two times the length of the real body.

2. There should be no upper shadow or a very small upper shadow with the real body at the upper end of the trading range. (The color of the body is not important, but a black body has slightly more bearish implications).

3. The stock must have been in a definite uptrend before this signal can occur.

4. The day after the hanging man is formed confirmation must occur in the form of a black candle, or a gap down with a lower close.

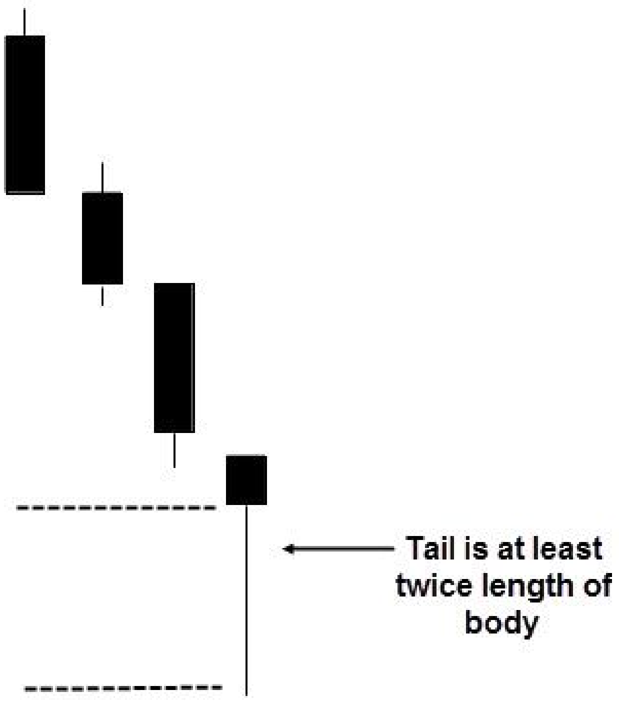
It is important to note that the longer the lower shadow, the more likely a reversal is to occur and the pattern is slightly more reliable if the real body is black.

What does the hanging man candle indicate is happening in the markets?

This signal indicates trend exhaustion and suggests a bearish reversal. The long lower shadow of this signal designates sellers are stepping into a trend. The price opens higher after a strong up-trend has been in effect but it then starts to move lower as the bears take control. The bulls however still have control and the price is increased at the high end of the trading range, thus creating a small real body. While the bulls were able to keep the price high, selling was still apparent with the bulls losing strength, signaling a reversal may occur. The lower open (or black candle) the following day confirms the selling. Basically, even though the sellers brought the market very low, in the end the buyers brought the closing price back up near the market open. This signal indicates that buyers are losing control and bearish traders are gaining strength.

"If investing is entertaining, if you are having fun, you're probably not making any money. Good investing is boring." ~ George Soros

Hammer Candlestick Signal



The Hammer candlestick signal is a bullish reversal pattern that forms after a decline, and signifies that the market is “hammering” out the bottom. In order to qualify as a hammer signal, there are three conditions that must be met.

1. The stock must be in a definite downtrend before this signal can occur.

2. The long lower shadow must be a minimum of two times the real body.There is little, or no, upper shadow on the real body.

3. The day after the hammer is formed, the markets should display continued buying because the real body is at the upper end of the trading range.

When detecting a hammer signal, the color of the real body is not important. However the longer the lower shadow, the more significant this candle becomes. It can also be said that a black body has slightly more bearish indications and a white body has slightly more bullish indications. (although the color is not really as important) Basically, the hammer signal is a reversal signal from down trend to up trend and it is only effective when it appears in an established down trend.

What does the candlestick hammer signal indicate is happening in the markets?

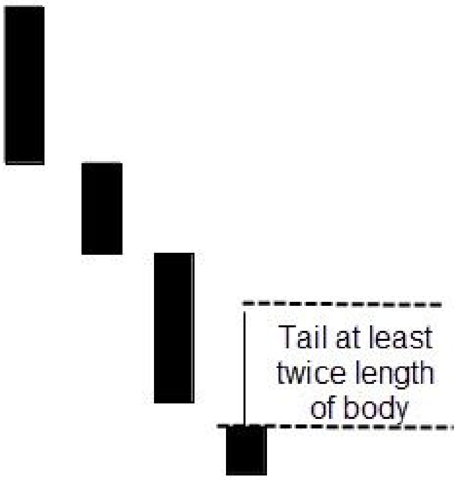
Basically it means that on the day of the hammer candle, there is strong selling taking place in the markets. As the day progresses the market recovers and closes near the unchanged mark, or higher in some instances. After a decline, the ***hammer*** signals a bullish revival.

The long lower shadow indicates that sellers drove the prices lower during the session, but that buyers regained momentum and ended the session on a strong note. Since the low of the candlestick hammer signal shows that more sellers remain, a bullish confirmation is required on the next day.

This seems like a good opportunity to review candlestick construction and shadows. It is important to discuss the shadow because it plays a significant part in the recognition of the candlestick hammer signal. The shadow is depicted by long thin lines above and below the body, which represents the high and low price range. The high is marked by the top of the upper shadow and the low is marked by the bottom of the lower shadow. If the stock closes higher than it's opening price, then a white/green candlestick forms and the bottom of the body represents the closing price. Conversely, if the stock closes lower than its opening price, then a filled candlestick is formed (black or red) and the top of the body represents the opening price and the bottom of the body represents the closing price.

"Education is the foundation of success. Just as scholastic skills are vitally important, so are financial skill." ~ Robet Kiyosaki

Inverted Hammer Signal



The inverted hammer candlestick signal is a bullish reversal signal that occurs after a downtrend, at a support level, or during a pullback within an uptrend. It is characterized by a long upper shadow and a small real body, preceded by a long black/red real body.

In order to be considered an inverted hammer, there are four criteria which must be met.

1. This signal must occur in a established downtrend.

2. The small real body must form near the bottom of the price range.

3. The upper shadow is usually two or more times the length of the body.

4. The lower shadow is small or nonexistent.

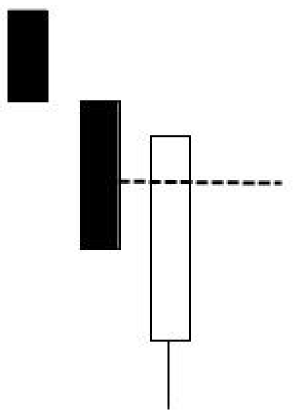
The inverted hammer candlestick signal requires bullish confirmation before any action should be taken, and it can be confirmed by a "gap-up" or by a long white candlestick with heavy volume.

The larger the gap, the stronger the confirmation. In order to detect a "gap," measure the distance between both real bodies, first measuring the higher of the open or the close for the inverted hammer and then by measuring the lower of the open or close for the previous session. A "gap" is present if the hammer's higher value is less than the previous session's lower value. Gaps should be used as strength indicators and they form in many places. The witnessing of a gap at the beginning of a new trend produces profitable opportunities.

What does the inverted hammer signal indicate is happening in the markets?
This candlestick signal is formed when the market opens at or near its low and it occurs in bearish conditions. Price then changes direction and the bulls are able to rally the prices up briefly but without the ability to sustain buying pressure. As a result prices close at or near the low of the day and the bears take the necessary actions to protect their gains. The longer the market can hold above the inverted hammer's real body, the more likely prices will rise.

NOTES:

Candlestick Piercing Pattern



The Candlestick Piercing Pattern is a reversal in a down trending market (similar to the bullish engulfing pattern) and is therefore considered bullish. This pattern is made up of a long black/red candlestick, showing a price decline. It is then followed by a long white/green candlestick, showing price increase. The white/green body must start below the bottom of the black/red body and close at least halfway up the previous day's candle, thus *piercing* the previous candle.

To classify as a candlestick piercing pattern four criteria must be met.

1. The two-day pattern illustrates a black/red candle (down day) followed by a white/green candle (up day).

2. The pattern appears in an established downtrend.

3. The second day opens lower than the trading of the previous day.

4. The white/green candle closes at least midway up, or more than halfway up, the black/red candle.

A stronger reversal is likely when there is a long black/red candlestick and a long white/green candlestick The longer the black/red candle and the white/green candle the stronger the reversal of the pattern. The higher the white/green candle closes into the black/red candle the more prominent the reversal is for this pattern. Lastly, the greater the gap down from the prior day's close the stronger the reversal. It is also important to note that the day before the piercing candle appears, the daily candle should have a fairly large dark black/red body to signify a strong down day.

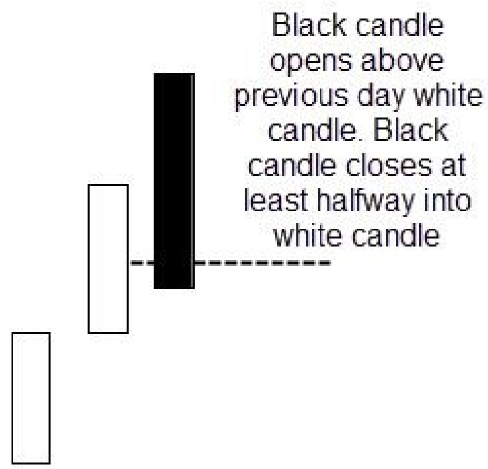
What does the candlestick piercing pattern indicate is happening in the markets?

This pattern indicates that the stock has shifted from a declining price trend to a rising price trend. The theory behind the appearance of this pattern indicates that the bears have been in control of the stock (in the downtrend) and then the stock opens below the close of the first candle and the bulls take over.

This pattern appears at the beginning of a trend so many traders use it as a buy signal.

NOTES:

Dark Cloud Cover Pattern



The Dark Cloud Cover pattern is a bearish reversal pattern composed of a white/green bodied candlestick followed by a black/red bodied candlestick. It is the opposite of the piercing candlestick pattern which is a bullish reversal pattern. The dark cloud cover pattern occurs at the end of an established uptrend. (whereas the piercing candlestick pattern occurs at the end of a downtrend)

To qualify as a Dark Cloud Cover, four conditions must be met.

1. The stock price must be in a definite uptrend.

2. There is a positive candle (either a white or green body) followed by a negative candle (either a black or red body).

3. The black/red body passes the midpoint of the prior day's white/green candle. To clarify, the black/red candle body should open above the high of the previous day's white/green candle and close more than halfway into the body of the previous day's white/green candle.

4. Fourth, the day following the first black/red candlestick must continue to drop and close lower than the first black/red candlestick to provide confirmation of this pattern.

What does this reversal pattern indicate is happening in the markets?

The bulls were in control during the uptrend. We see continued confidence as they gapped up the price on the open, but the bears stepped in to close prices near the low of the day. The bulls were unable to maintain the upward momentum and the bears took over. More selling is highly likely which will move prices lower.

If the bears can hold control the day after the dark cloud cover, then the probabilities of a trend reversal are very high. This can be either a gap down the next day, or a lower close on the next trading day.

When witnessing this bearish reversal pattern it is important to note a few things. The higher the gap up from the previous day's close, the more prominent the reversal because the market was unable to sustain the high price level. Also, the longer the white/green candle and the black/red candle the stronger the reversal. Also, the lower the black/red candle closes into the white/green candle, the stronger the reversal as well.

Additionally, if the volume is high during both days, then the pattern is considered to be more valid. Traders must be careful that they don't mistake a bearish engulfing pattern for this pattern. If the black/red candlestick were to close lower (below the open of the previous day), it becomes a bearish engulfing pattern, which has slightly stronger bearish connotations.

That's a Wrap!

I hope you have found this introduction to Japanese Candlesticks helpful. As I said in the beginning of this e-book, I was once in your shoes and struggled to find profitable trading strategies. I found that incorporating Japanese Candlesticks into my charting analysis provided a strong basis for building additional techniques. The major signals covered in this e-Book will provide you with more potential stock trades than you will ever need. However, as you grow in your trading career, you will want to be familiar with additional candlestick patterns, and technical analysis techniques.

Check out www.hitandruncandlesticks.com to learn more about our services, receive private online coaching, sign up for membership and enter the live trading room. Our live trading room provides daily group coaching all day long and gives you the opportunity to interact with Rick Saddler and other experienced traders.

Keep it Simple - Keep it Mechanical ~ Rick Saddler