Candlestick Charts

Bullish Signals

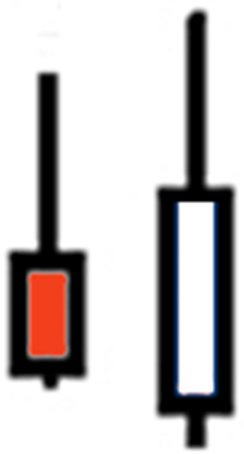
Morning Star

This pattern is not a common one but probably the most dynamic. This is due to the fact that it is made up of 3 candles which shows, naturally, longer and clearly market sentiment. As you can see from the image shown, the classic setup for a Bullish Morning Star is, for the first candle, a strong move lower that maintains the underlying negative tone of the market.

Prices then consolidate and the resulting candle shows little net movement – this can be minor gains, losses or, preferably, virtually no net movement.

Often this hesitation is followed by a renewal of selling pressure and the overall tone of the market is intact, but when the 3rd candle shows powerful buying interest –and gains must reverse more than half of the net losses – then the Morning Star pattern is confirmed. This is likely, when taken in context, to prove the catalyst for a complete change in the market's attitude to value.

Bullish Engulfing Pattern



Engulfing patterns (Bullish & Bearish) consist of 2 candles and also signals a complete change of direction. Here you can see a Bullish Engulfing pattern with the 1st candle showing upside rejection and modest net losses but the 2nd candle shows a renewal of demand that, open to close, totally engulfs the previous period's 'real body'. Obviously the larger the price action shown by the first candle, the more significant the reversal can be – there should however be an awareness that exceptionally large candles, first and second, probably denotes a non-technical event and therefore some awareness of the context may be needed to assess the impact.

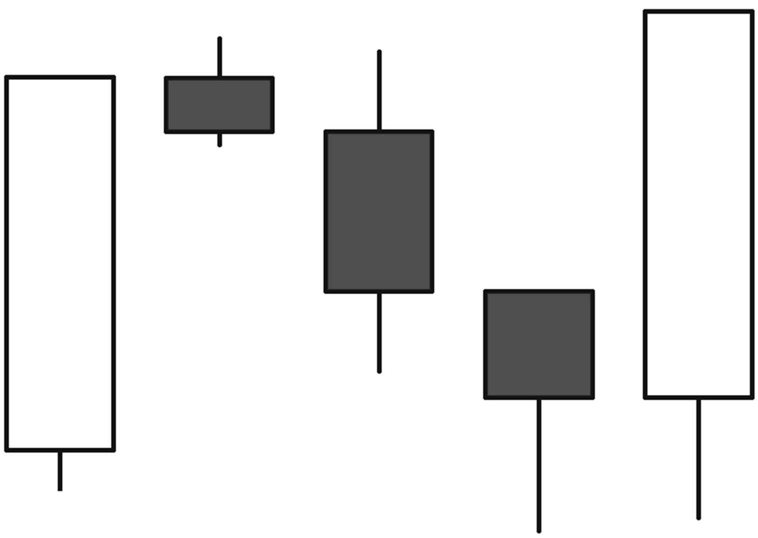
Bullish Piercing Patterns

This is another 2 candle pattern with a sizeable decline (dark candle) followed by an aggressive turn in sentiment. This renewed buying is not strong enough to recover the preceding period's entire net fall (real body) but to qualify as a Piercing pattern, it must regain more than half of the net losses.

Spring Hammer

This is one of my favourite patterns and although it is only a one candle formation I find that if used with Stochastics oversold, or prices basing near a trend or Fibonacci level, then it can be a great indicator of demand. The key element, see the image to the right, is the rejection of lower levels and it often doesn't matter if the net result is a minor decline or improvement. From the textbook the 'tail', difference between the real body and the low, should be at least twice that of the body (open-close) but in practice I like to see a tail longer than that.

Rising Three



This pattern could also be regarded as continuation. The bullish trend is continuing with a strong rise for the 1st candle. This is followed by a profit taking setback that lasts between 2-3 periods but this counter-move should ideally not break out of the real body parameters of the 1st candle. The pattern, and a renewal of the underlying trend, is completed by a 5th candle that completely regains the preceding 3 periods of decline.

Bearish Patterns

Bearish Evening Star

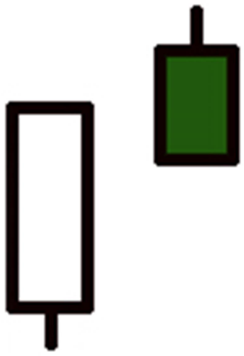
This is the mirror image of the Bullish Morning Star pattern.. As you can see the classic setup for a Bearish Evening Star is, for the first candle, a strong move lower that maintains the underlying bullish tone of the market. Prices then consolidate and the resulting candle shows little net movement.

Often this hesitation is followed by a renewal of buying interest pressure and the overall tone of the market is intact, but when the 3rd candle shows powerful selling–and losses must reverse more than half of the net gains– then the Evening Star pattern is confirmed.

Bearish Engulfing

Engulfing patterns (Bullish & Bearish) consist of 2 candles and also signals a complete change of direction. The image shown here is of the formation of a Bearish Engulfing pattern with the 1st candle showing fairly sizeable gains but the 2nd entirely overturning that upside. Obviously the larger the price action shown by the first candle, the more significant the reversal can be – there should however be an awareness that exceptionally large candles, first and second, probably denotes a non-technical event and therefore some awareness of the context may be needed to assess the impact.

<u>Bearish Piercing/Dark Cloud</u>



This pattern is the negative equivalent of the Bullish Piercing pattern. To achieve that the net decline has to reverse more than half of the preceding period. If the fall is not deep enough to confirm the creation of the Piercing pattern it could form the marginally less significant Dark Cloud.

Hanging Man

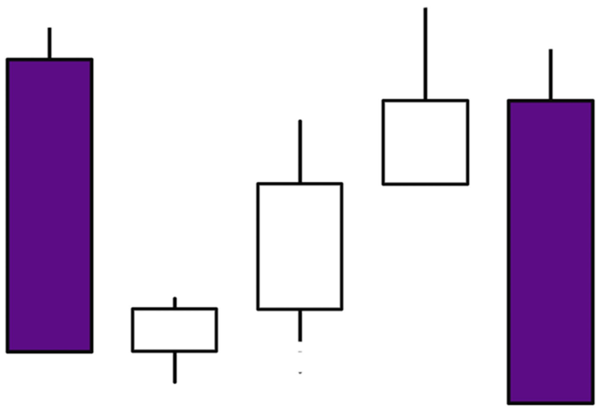
This is an unusual pattern as it is totally dependent on a net loss being posted. Following a clear up trend the open of this 1 candle pattern should lead to selling pressure but while the lows are sharply rejected, the rally from the bottom is not enough to take prices back to the open. It is the weakness of the bounce that is crucial and completes the 'Hanging Man' formation.

Inverted Hammer/Shooting Star

The Inverted Hammer pattern shows an aggressive rejection of the period's high and it this **upside failure, rather than whether the candle body shows small net gains or losses, that is** important. As such it is a mirror image of the Bullish Hammer.

A more extreme, and less common, variation of the Inverted Hammer is a Shooting Star. This is rarer as to form a perfect example the period that forms the upside failure has to open with a bullish gap higher and then the period following this candle opens with a gap lower. Due to the 24 hour FX markets the Shooting Star is almost never seen, but futures markets do produce such patterns.

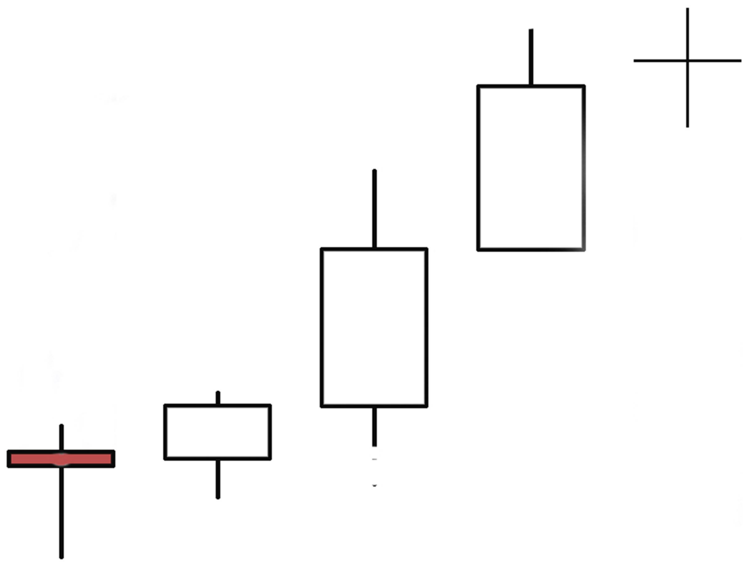
Falling Three



This pattern is the mirror image of the bullish Rising Three. In one sense it is bearish and the other continuation as for it to be valid it needs to be created within a negative trend. This trend is interrupted, after a sizeable down candle, by a profit taking rally that, ideally should be 3 up periods but weak enough to only reverse the preceding down candle or perhaps not even that. The formation is completed by a renewal of selling pressure that results in a strong fall – very often the 5th candle is a similar size to the 1st.

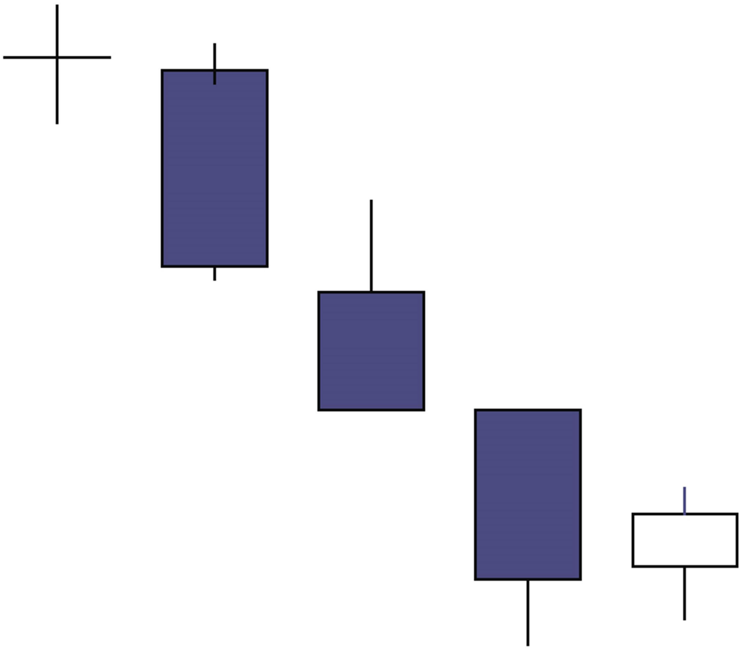
Continuation Patterns

3 White Soldiers



The key element here is the context which this pattern is presented. An up trend must be present ahead of some consolidation, then renewal of demand signalled by the 3 white soldiers.

3 Black Crows



The title is 3 Black Crows, and as you can see from the above it is graphically describing 3 periods of strong selling. But some leeway has to be given as the sequence may be 2 large declines or even 4.

The key element is that within an established move lower some hesitation, minor profit taking, is followed by a renewal of the downside signalled by this candle pattern.

Doji Patterns

Doji patterns are love/hate candles. Many swear by them, others find them tougher to read. I've mentioned perspective before and where Dojis are formed it is vitally important to only place emphasis when it fits into the underlying scenario.

Overall Doji patterns can be formed by minor net movement, positive or negative, but the nearer to an unchanged open to close the more they fit the theory.

What they immediately signify is market indecision – both the upside and the downside has been tested but rejected. This is quite straightforward but this is where the perspective comes in.

Doji patterns are often formed in quiet periods and it is then that their relevance has to be viewed as reduced. But when formed in normal market conditions then the key to their impact is what price action has preceded the formation. They are certainly a point where some thinking has to be done.

Long Legged

It only takes one look to see the difference in this Doji pattern.

Both the high and low have been rejected for an unchanged, or almost unchanged, open to close but this time the low was a deep one and unsurprisingly, although the lack of net movement highlights uncertainty, it is the bounce that is most likely to have the impact. Of course this greatly depends on the price action that preceding this period.

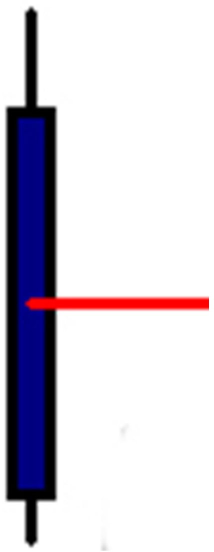
Gravestone

Here we have the complete opposite of the Long Legged Doji with the gains being much greater than the losses and so it is the upside rejection that is likely to have the greater impact on prices going forward.

Once again it is context that is the key thing before assessing the possible movement.

Marabuzo Lines

What is a Marabuzo Line?



Before we can see the relevance of the Line we have to look at what a Marabuzo actually is. The term is applied to the real body of a candlestick that is larger than the norm. That is a fairly nebulous concept and there is no hard and fast rule that can be applied here.

An evaluation of the chart being studied and the time period being used will determine the relevant numbers. Even that result will have to be reappraised to reflect different market conditions. Sideways, trendless trading will create less sizeable movements, therefore a relevant Marabuzo will, naturally, be of a smaller size than in volatile markets where all candlesticks are larger. Let us be clear; this style of analysis, like all Technical Analysis, is not a science but a **reasoned** application of principle.

Once a Marabuzo has been determined then the Marabuzo line can be drawn from the mid-point of the body; in other words halfway between the open and the close. In other words, a 50% retracement. As a candlestick chart is only a bar chart with the open and close filled in, the Marabuzo line could be drawn using a bar chart just as well, but for graphic purposes it is clearer when applied to candlestick charts. One of the first things learnt when beginning technical analysis is the importance of retracements points and whether the preference if for Fibonacci or Gann percentages, 50% is the most important of these levels. The major difference here is that the 50% retracement is applied not to the high and low of a movement but to the open and close of a time period - to a practitioner of candle charts, the key features. A horizontal line is drawn between the two and is extended to the right (into the future) where it will act as a support or resistance point.