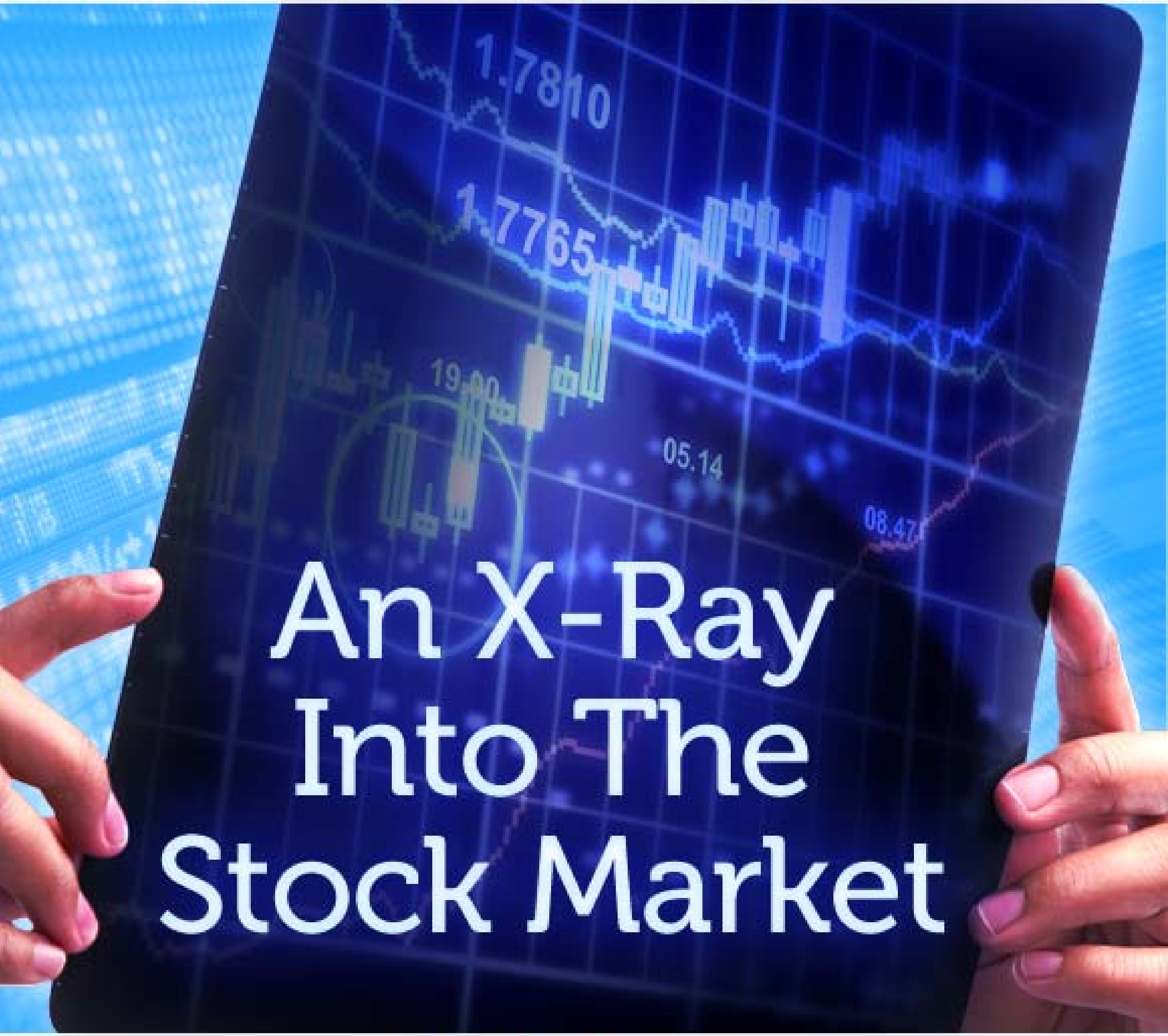
# Candlestick Charting Essentials:




## An X-Ray Into The Stock Market

By Mark Espy

# Acknowledgements

It is a pleasure to have an opportunity to share my understanding and application of Candlesticks, but real credit needs to be given to the trailblazers in this important and vital area of technical analysis. I would suggest further investigation into the fascinating world of Candlestick Charting by recommending further reading on the subject. The following books will add to your knowledge.

1. "The Candlestick Course" by Steve Nison / Wiley Publishing

2. "Profitable Candlestick Trading" by Steve Bigalow / Wiley Publishing

3. "Getting Started in Candlestick Charting" by Tina Logan / Wiley Publishing

4. "Candlesticks Explained" by Martin Pring / McGraw Hill Publishing

5. "Candlestick Charting Explained" by Gregory Morris / McGraw Publishing

## About the Author

**Mark Espy** is a trader just like you. He has run the gauntlet of trading tortures in his quest to reach the Holy Grail of Trading and, along the way, he has learned through painful experiences that there is no Holy Grail but you can through study and diligence learn how to succeed in uncertain markets. Mark commented “I reminisce on my first trading efforts and I realize that I was absolutely clueless early on. The smart money crowd regularly emptied my account and filled their purses. They readily accepted my generous contributions”.

Most people have learned that it doesn’t make sense to pay a financial professional a fee to lose your money. Although, that does not guarantee that you will do any better on your own. Candlestick analysis is one of the elements that can put you on the path to consistent profits in the markets and Mark’s book cuts to the chase with what you need to know to stay on the right side of the market.

Mark is a blogger at www.OptionsRevolution.com and www.RobinHoodTrader.com which was named one of the top 50 financial blogs on the internet and is Vice President of Education at www.markettamer.com. He has been a trader since 2000 and has trained people throughout the globe on Technical Analysis and trading strategies. He spent 25 years in the financial services industry and holds a Master’s Degree in Education.

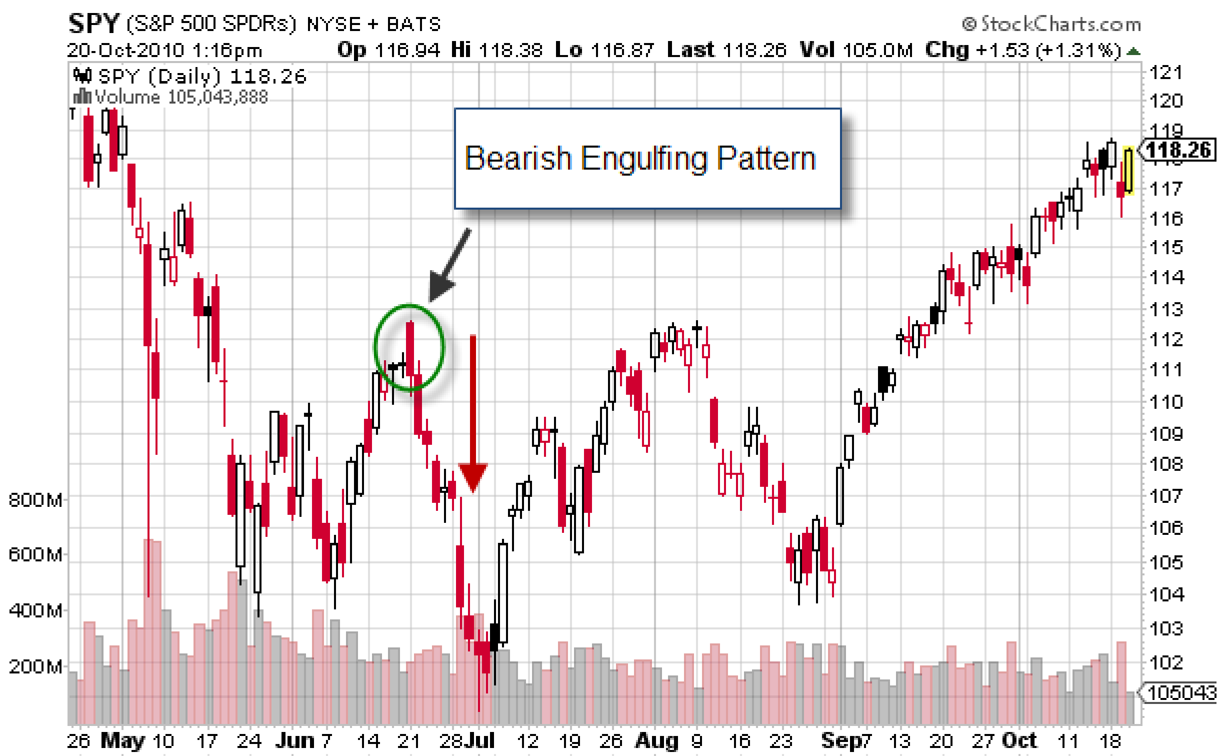
Mark has published numerous articles on trading and is in demand as a public speaker on the subject of Technical Analysis and trading the markets.

## Overview

It is the visual nature of the candle that makes it far superior to the bar chart. Candles have been around for about 400 years and were first used in Japan by a family of legendary rice traders. Through the years, patterns or configurations of candlesticks have emerged that can allow a trader to predict with a high degree of probability the reversal of a stock. Candlesticks can be especially effective when used with western technical analysis.

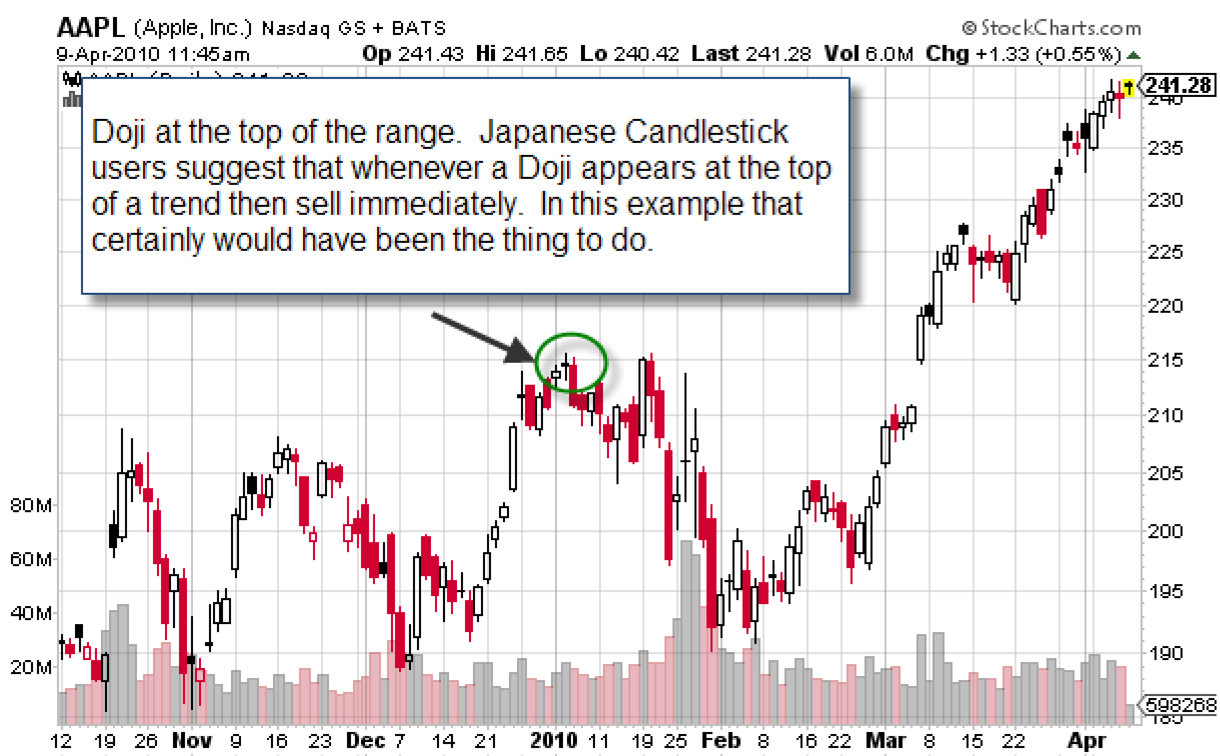
# The Bearish Engulfing Pattern

- As with any candlestick pattern, you must read and interpret it in the context of the chart. What I mean by that is that if a reversal pattern appears, you must have a trend to reverse. If a pattern that is normally interpreted as a reversal pattern is found in the context of a sideways non-trending market, that pattern means little to nothing.
- The Bearish Engulfing Pattern should be found at the top of an uptrend.
- The candle begins by gapping up above the prior day's close and then trading down so that the close is below the prior day's candle.
- It is only necessary to engulf the prior day's real body but is even more convincing if the engulfing pattern encloses the high and low of the prior session.
- There are times when the Bearish Engulfing Pattern will engulf several prior sessions which adds to the validity of the reversal.
- The engulfing is more convincing when it occurs on increased volume which reflects the investment communities' participation and sentiment on the move.
- We always look for follow through on the move as evidenced by continuing bearish trading.



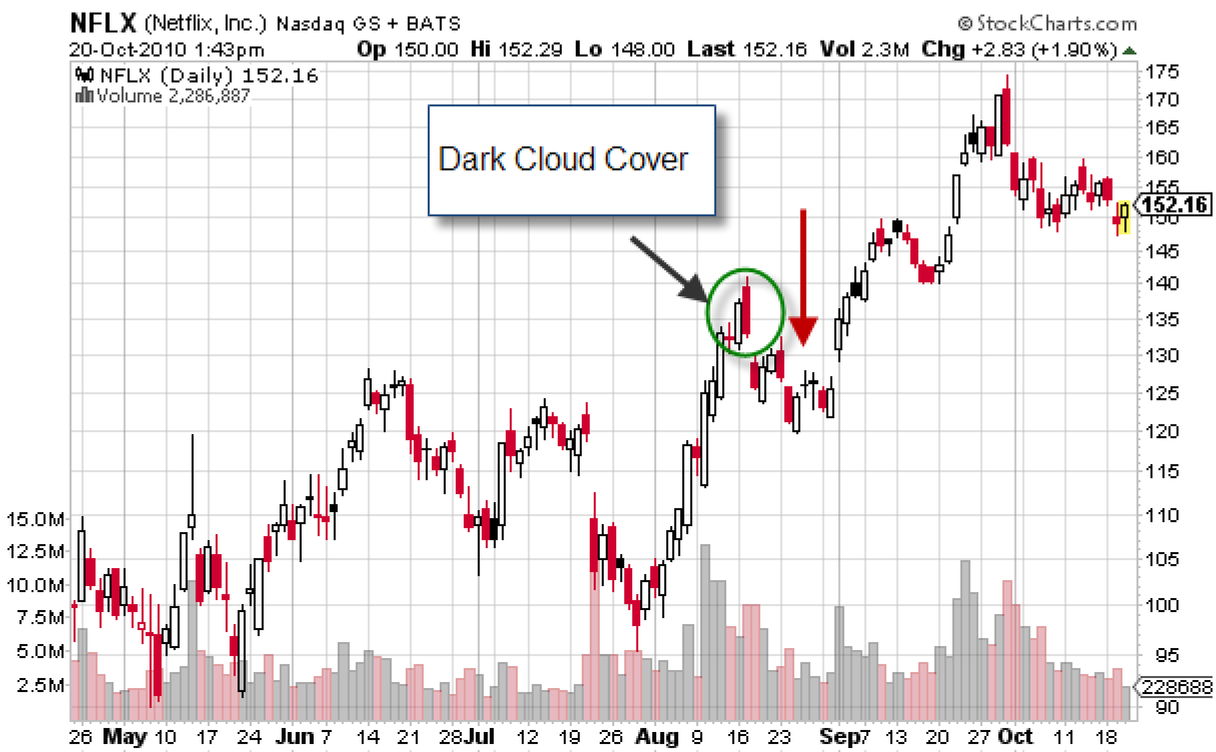
# The Doji Candlestick Pattern

- The Doji occurs when the stock opens and closes at the same level.
- It is an indication of major indecision in investment sentiment.
- It is important that we interpret the Doji in the context of the market.
- The Doji is a single candlestick pattern and is extremely powerful in foretelling a reversal.
- There are many variations of the Doji- The Doji Star, The Long Legged or High Wave Doji, The Gravestone Doji and The Dragonfly Doji. Each has a slightly different story to tell.
- The primary message that the Doji sends is that there is a “Tug Of War” going on between the bulls and the bears.
- When found at the top of a trend, it may be prudent to sell if you are long the market.
- Dojis at the bottom of the trend although very significant require more confirmation for a reversal.
- Dojis found in a sideways channel are not very significant
- The market will not always reverse immediately after a Doji, but many times the reversal will occur very shortly thereafter.
- Dojis specifically and Candlesticks in general are extremely powerful when used in conjunction with other technical indicators that confirm resistance and support.



# The Dark Cloud Cover Pattern

- The Dark Cloud is a two candlestick pattern that is found at the top of a trend, is bearish and warns us to "take out the umbrella" because a storm is brewing.
- The Dark Cloud forms with an initial gap up above the prior day's bullish close and proceeds to trade down and close at least half way into the previous day's bullish candle.
- The Dark Cloud is a bearish reversal pattern and is enhanced if the move is accomplished with higher volume.
- The Dark Cloud appears to be forming a Bullish Engulfing pattern but does not trade low enough to engulf the prior day's candle and is not considered quite as bearish as an engulfing pattern.
- The larger the bullish candle and the Dark Cloud candle, the more convincing the pattern becomes.
- The Dark Cloud Cover is the inverse of the Piercing Line pattern.



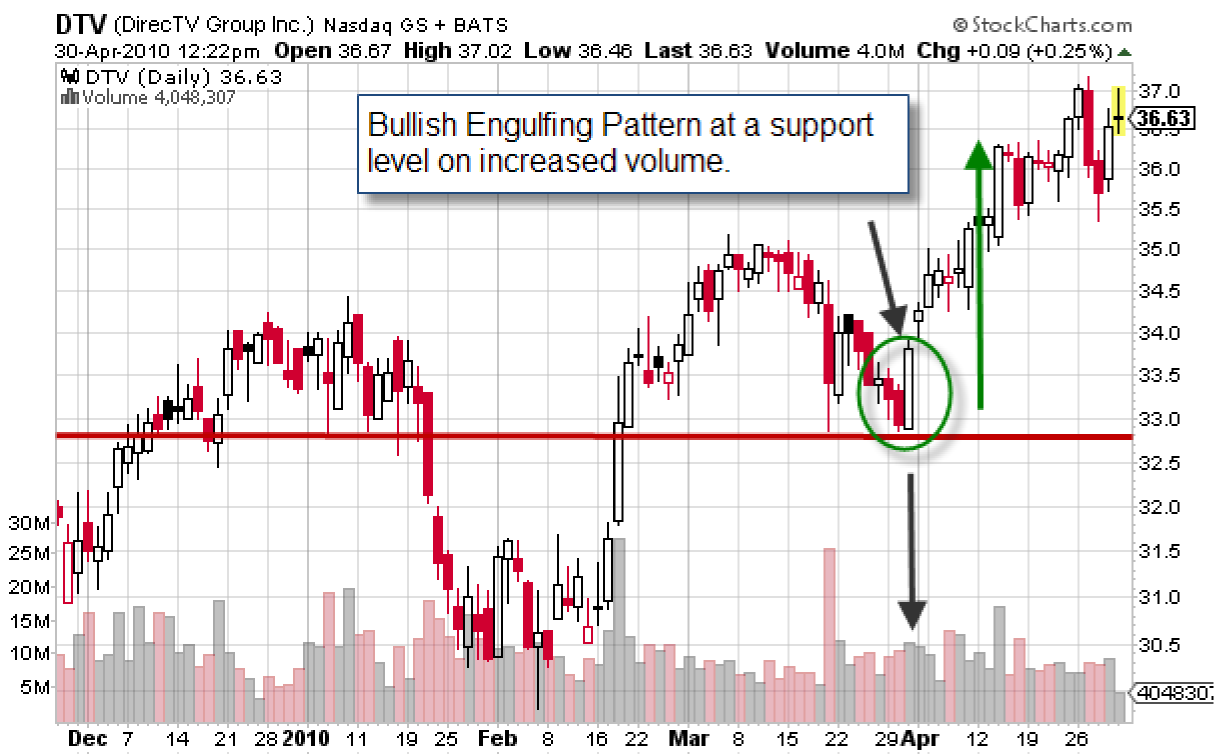
# The Piercing Line Candlestick Pattern

- The Piercing Line pattern is a two session pattern found in a bearish market.
- The pattern is most effective when found at a level of pre-defined support such as a double bottom or a major moving average.
- The candle will gap down and then proceed to trade up and close past the half way point of the previous bearish candle.
- The pattern is even more convincing as a reversal when the stock recovers from a significant gap to the downside and trades up with increased volume.
- The pattern is very similar to a Bullish Engulfing pattern but is not quite a bullish.


MYGN (Myriad Genetics, Inc.) Nasdaq GS
©StockCharts.com
23-Apr-2010 Open 22.40 High 23.00 Low 22.26 Close 22.98 Volume 1.4M Chg +0.50 (+2.22%)
MYGN (Daily) 22.98
Volume 1,354,359
Piercing Line at a Double Bottom on 2/15/10
27.0
26.5
26.0
25.5
25.0
24.5
24.0
23.5
22.98
22.5
22.0
21.5
21.0
8M
6M
4M
2M
26 Nov 9 16 23 Dec 7 14 21 2010 11 19 25 Feb 8 16 22 Mar 8 15 22 Apr 12 19

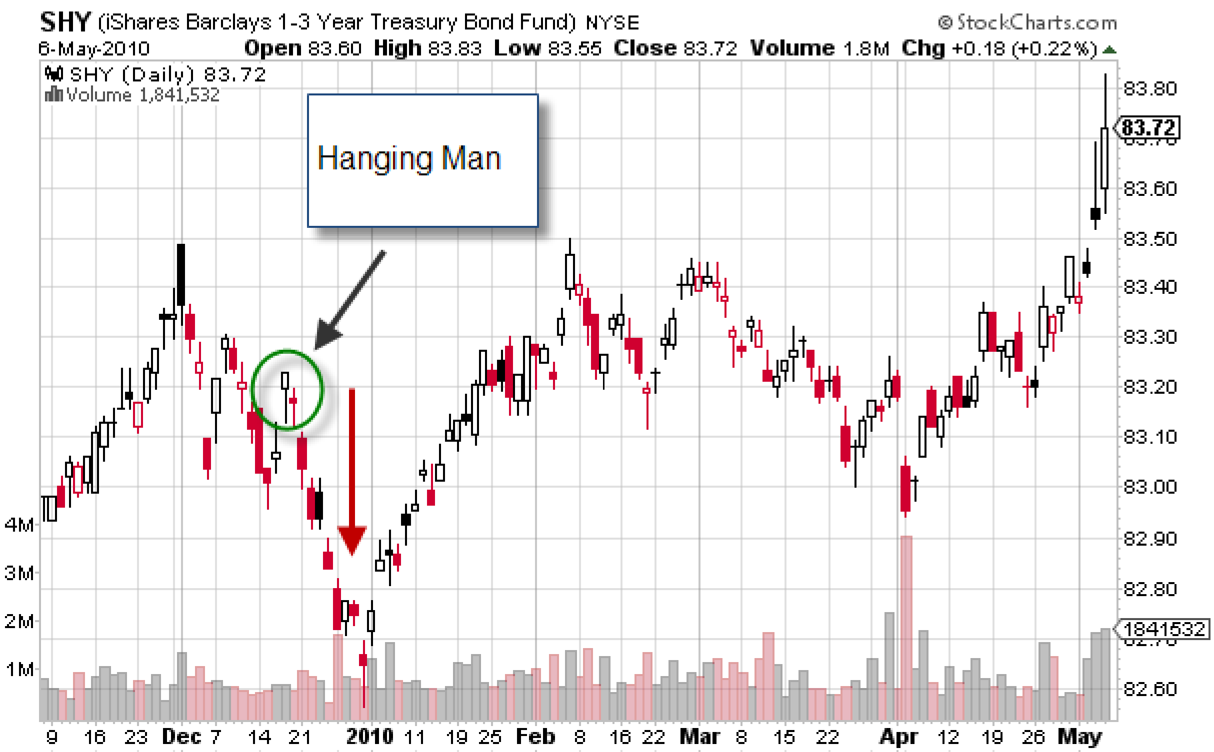
# The Bullish Engulfing Pattern

- The Bullish Engulfing Pattern is a bullish reversal pattern and is considered a major candlestick formation.
- The pattern is most effective when found at the bottom of a downtrend.
- The pattern represents a change in investor sentiment and is characterized by an initial gap down from the prior trading day.
- The stock will not follow through with the initial gap and will begin to trade up on increased volume.
- The mature pattern will end the session with a close above the prior session's open, thus engulfing the prior session's real body.
- The pattern is considered stronger when the stock trades up from a larger gap down and not only engulfs the real body but the entire trading range of the prior session.
- Sometimes you will see a situation when the Bullish Engulfing Pattern wraps around and engulfs several prior sessions and that is a very convincing reversal scenario.
- The Pattern is additionally effective when combined with a pre-defined level of support as represented by chart patterns, major moving averages, Fibonacci levels and trend lines.
- Oscillators such as Stochastics or RSI can also confirm a changing sentiment from being oversold to becoming more bullish.



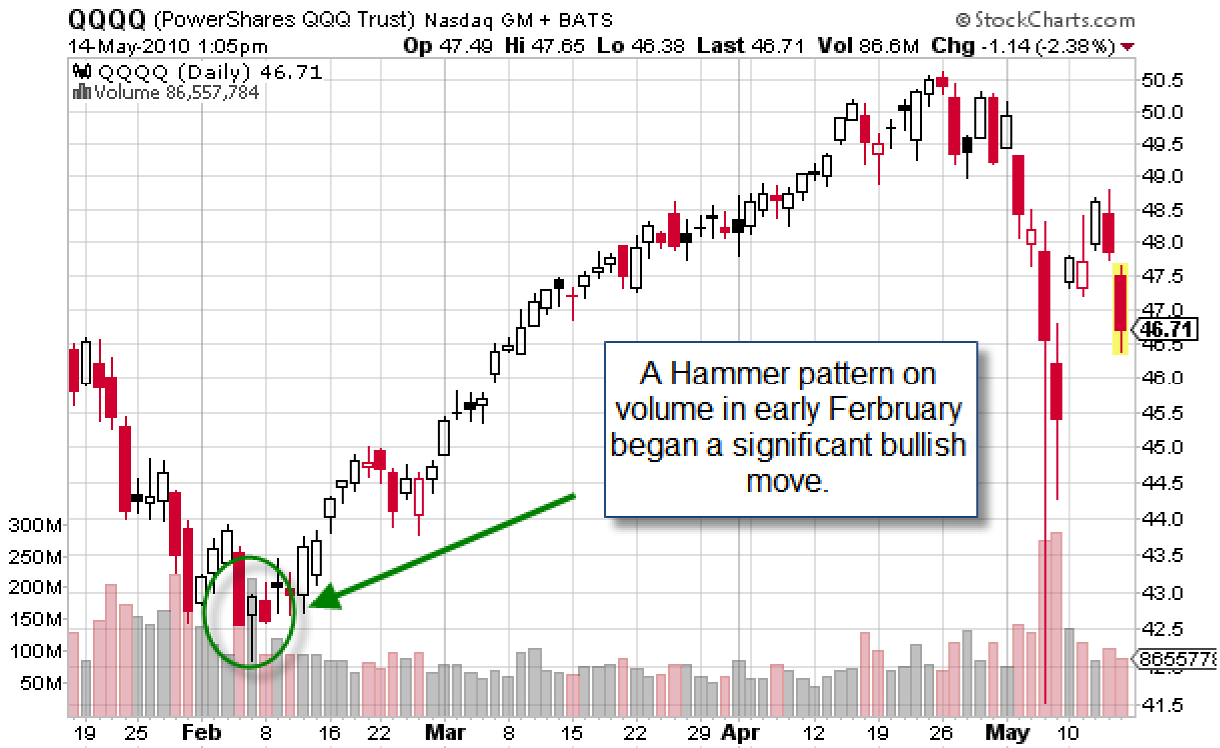
# The Hanging Man Candlestick Pattern

- The hanging man is a single candlestick pattern found at the top of a bullish trend and indicates a reversal is imminent.
- The name comes from the visualization of a man hanging depicted by a head and dangling legs.
- The real body of the candle should be small and finish in the upper 1/3 to 1/4 of the day's session.
- The wick or shadow should be a least twice the length of the real body.
- The candle should ideally have a "Shaven Head" with no shadow to the upside.
- The color of the real body is slightly more bearish if it is dark as opposed to white.
- The classic formation should occur with the Hanging Man gapping open to the upside on increased volume.
- A gap down and trade down candle the following day will confirm the reversal.
- At first glance, it may appear that the Hanging Man is a bullish candle because it closed higher than the previous day. However, the fact that it is apparent that sellers are present as represented by the long shadow will usually convince those that are long to close and take profit which is evidenced by a bearish follow though day in the next session.



# The Hammer Candlestick Pattern

- The Hammer candlestick is a bullish single session candle and is characterized by a small real body that closes in the upper 1/3 to 1/4 or the trading range of the session.
- The shadow of the pattern should be at least twice the size of the real body and there should ideally by no upper shadow.
- The candle is found at the bottom of a bearish trend and is more powerful if confirmed with other support.
- The color of the real body is not critical, although a white body is somewhat more bullish.
- A hammer on large volume at the bottom of a trend may be considered a capitulation day.
- The reversal is much more likely when the shadow is relatively long as compared to the real body of the candle.
- A gap down into the hammer and then a gap up, trade up on the follow through day is a very strong reversal signal.
- The classic hammer indicates a change in trader sentiment because at one point during the trading session the candle was long and dark representing massive bearishness. However, before the end of the day the bulls had pushed the stock back up to the top of the trading range on volume.
- Bears should begin to question the continued downtrend and when the stock follows through to the upside the next day it becomes confirmation that the trend has reversed.

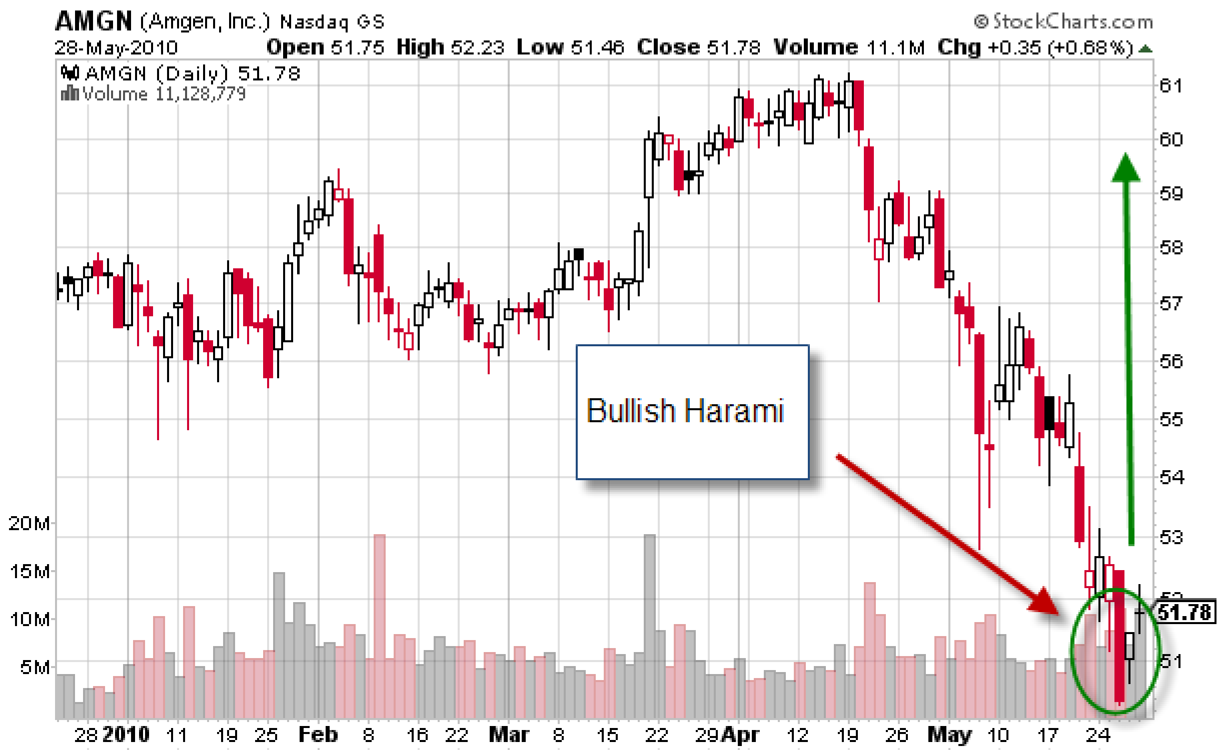


# The Bearish Harami Candlestick Pattern

- The Bearish Harami is a two session candlestick pattern.
- The first session is a long white candle at the top of an uptrend.
- The second candle gaps down from the prior session's close and trades down forming a dark candle with the close higher than the prior candle's open.
- Western technical analysts refer to this pattern as an "Inside Day" because the price action of the second session is totally inside of the prior candle.
- This pattern needs confirmation with a bearish follow through candle the next session.
- Large candles bode for a more convincing reversal signal.
- A close toward the bottom of the first candle is also a more compelling pattern.
- Increased volume confirms that profit taking is underway and the bears are in control.

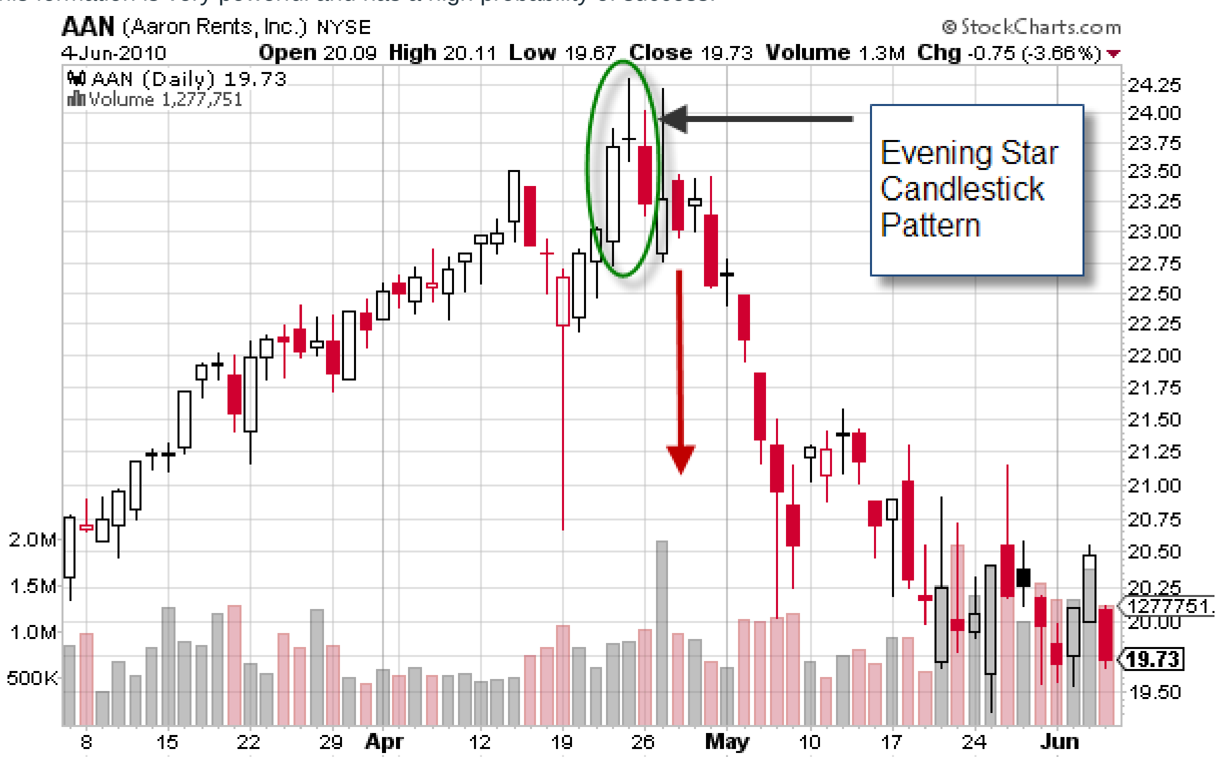
# The Bullish Harami Candlestick Pattern

- The Bullish Harami is a two candlestick reversal formation found at the bottom of a trend.
- The first candle of the formation is a long dark candle and the second is white.
- The open of the second candle is higher than the close of the first candle and the close is below the open of the first candle.
- Western technical analysis refers to the formation as an “Inside Day” when both the real body and the shadows of the second candle are “inside” the first candle.
- The formation generally requires a follow through confirmation candle.
- The formation is more powerful when both of the candles are longer as opposed to shorter.
- The second candle can dictate the strength of the reversal of the formation by closing higher up into the first candle’s trading range.
- The formation is more credible if associated with higher than normal volume.



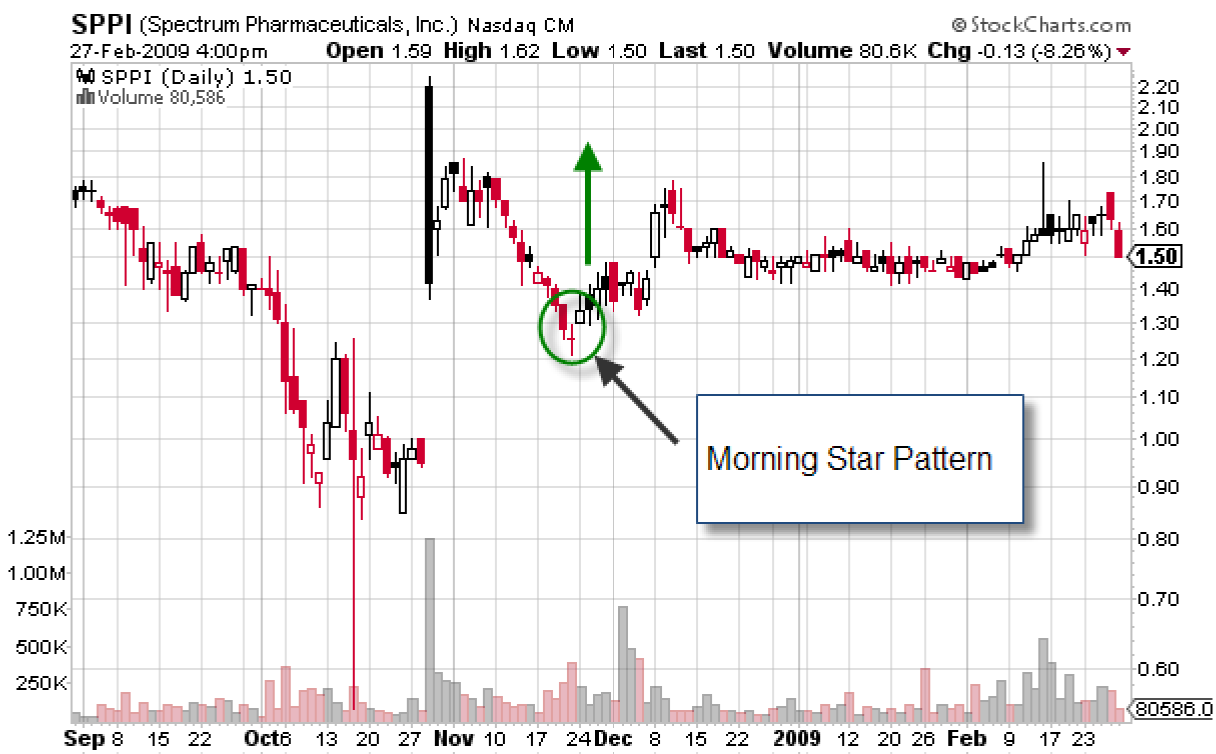
# The Evening Star Candlestick Pattern

- The Evening Star pattern is comprised of three candles.
- The pattern is found at the top of a trading range after a bullish trend.
- The first candle is a long white candle followed by a gap up to a doji or spinning top and then ideally another gap to the downside and trade down.
- The third candle should trade at least half way down into the candle of the first session.
- The longer the first and third candles, the stronger the formation.
- The second candle needs to show extreme indecision as evidenced by a doji or a very small real body.
- Volume should increase on the third candle as it trades down to confirm the reversal of market sentiment.
- This formation is very powerful and has a high probability of success.



# The Morning Star Candlestick Pattern

- The Morning Star candlestick pattern is the mirror image of the Evening Star except it is found at the bottom of a downtrend.
- The pattern consists of three candles with the first candle being long and dark followed by a gap down to a doji or Spinning Top and finishing with a gap up to a long white candle.
- The second candle indicates indecision and the third and final candle in the formation confirms the bullish reversal.
- The confirmation candle (The third candle) is much more convincing if it closes at least half way into the first long dark candle.
- Increased volume on the second and third candle will also confirm that the sentiment is changing as the bulls take the upper hand.
- The Evening and Morning Star candlestick formations are in my opinion two of the strongest reversal patterns in technical analysis.
- The validity of the formation is strengthened when confirmed by other indicators such as support and resistance zones, trend lines, major moving averages and chart patterns.

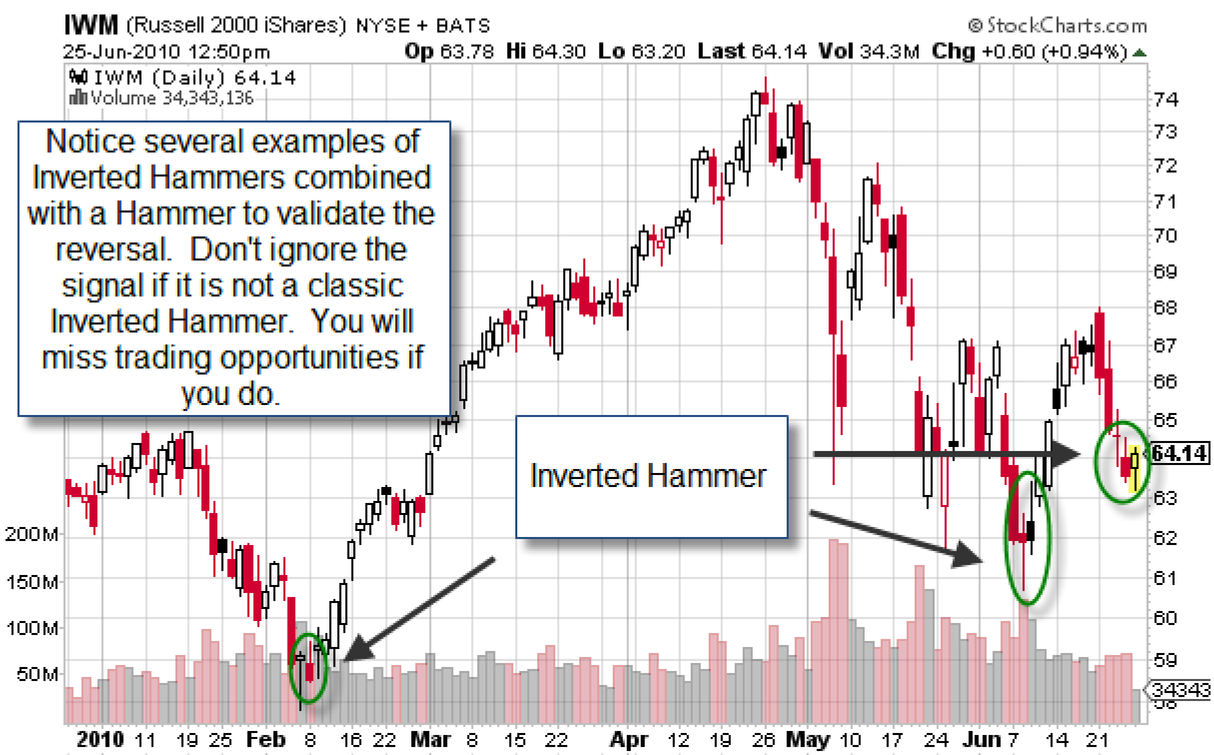


# The Shooting Star Candlestick Pattern

- The Shooting Star is essentially a single candle bearish reversal pattern but is enhanced in its' interpretation if read as a three candlestick pattern.
- The session prior to the Shooting Star should ideally be a long white bullish candle with a gap up to the shooting star candle.
- The Shooting Star candle has a wick that is at least twice the length of the real body with little or preferably no wick to the downside.
- If the Shooting Star candle is dark then it is a bit more bearish.
- The longer the upside wick the better the probability of a strong reversal.
- The reversal is confirmed when the stock gaps down after the Shooting Star session and trades down with a dark candle.
- If large volume is associated with the Shooting Star candle it indicates that the investment community attempted to take the stock higher and the consensus of opinion was that the stock couldn't justify the higher price level.

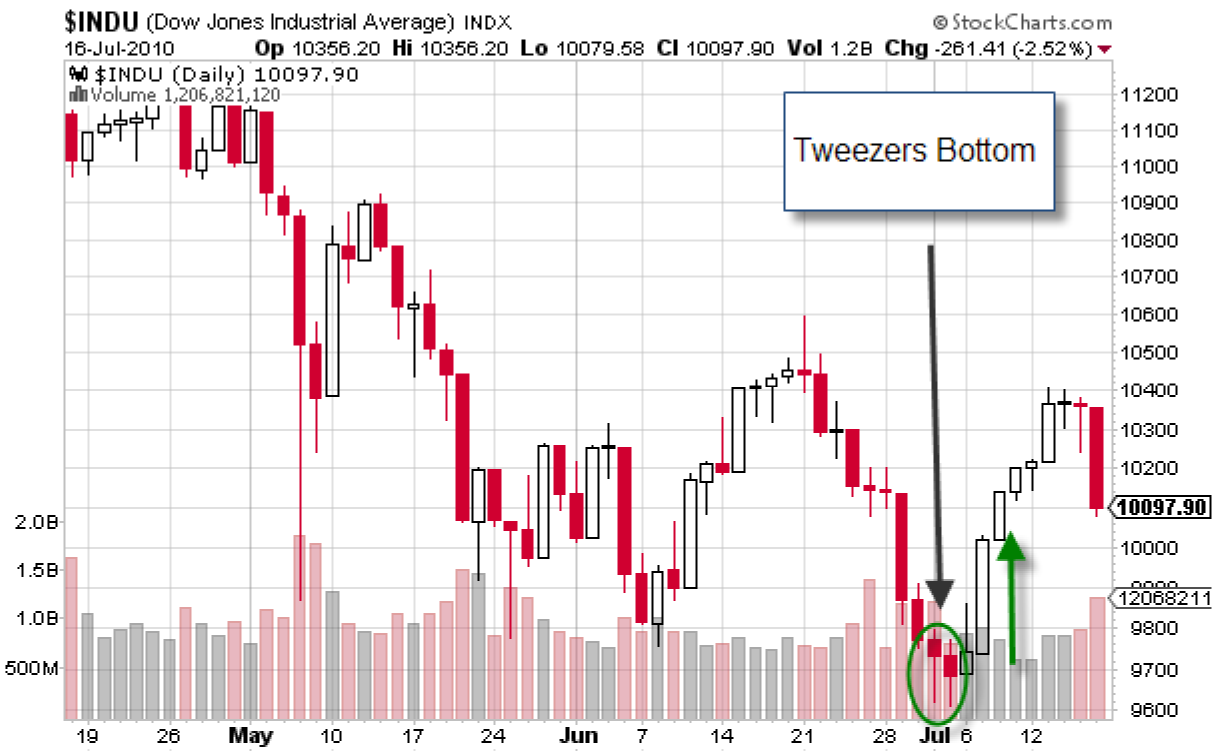
# The Inverted Hammer Candlestick Pattern

- The Inverted Hammer is a single session reversal pattern.
- The Inverted Hammer appears at the bottom of a downtrend and is the inverse of a Hanging Man pattern which is located at the top of a trend.
- The upper wick is ideally at least twice the length of the real body with little or no wick to the bottom.
- The pattern is slightly more bullish if the real body is white as opposed to dark.
- A gap down into the Inverted hammer increases the strength of the signal.
- Many times you will see the Inverted Hammer associated and combined with other candles such as a Hammer and/or a Doji that will confirm and strengthen the reversal.
- The relatively long wick to the upside begins to indicate to the bears that buying pressure is stepping in.
- The bears will heed the notice and begin to cover their short positions even though they won the battle temporarily by pushing the stock lower.
- The pattern is validated by a gap up to a bullish follow though session and is further fueled by more short covering.
- Increased volume on the reversal day is also an indication the stock will be changing direction.



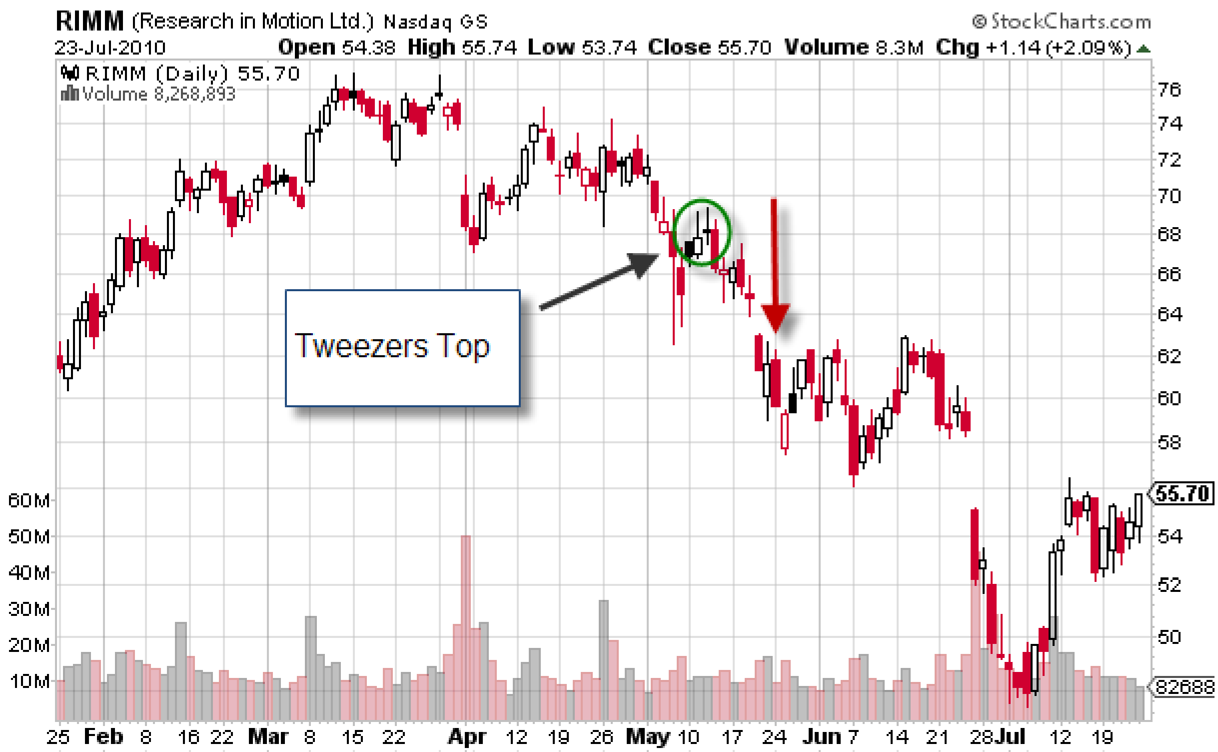
## The Tweezers Bottom Candlestick Pattern

- The Tweezers Bottom consists of at least two candles with close to identical lows and derives its' name from the resemblance to a pair of tweezers.
- I like to see wicks on both candles to the downside rejecting lower price levels.
- The classic Tweezers Bottom should have a longer bearish candle for the first candle followed by a smaller real body; although that configuration is not a hard fast rule.
- The Tweezers Bottom is more credible in longer timeframes such as weekly and monthly charts.
- The Tweezers Bottom should be followed by a bullish confirmation candle on increasing volume.



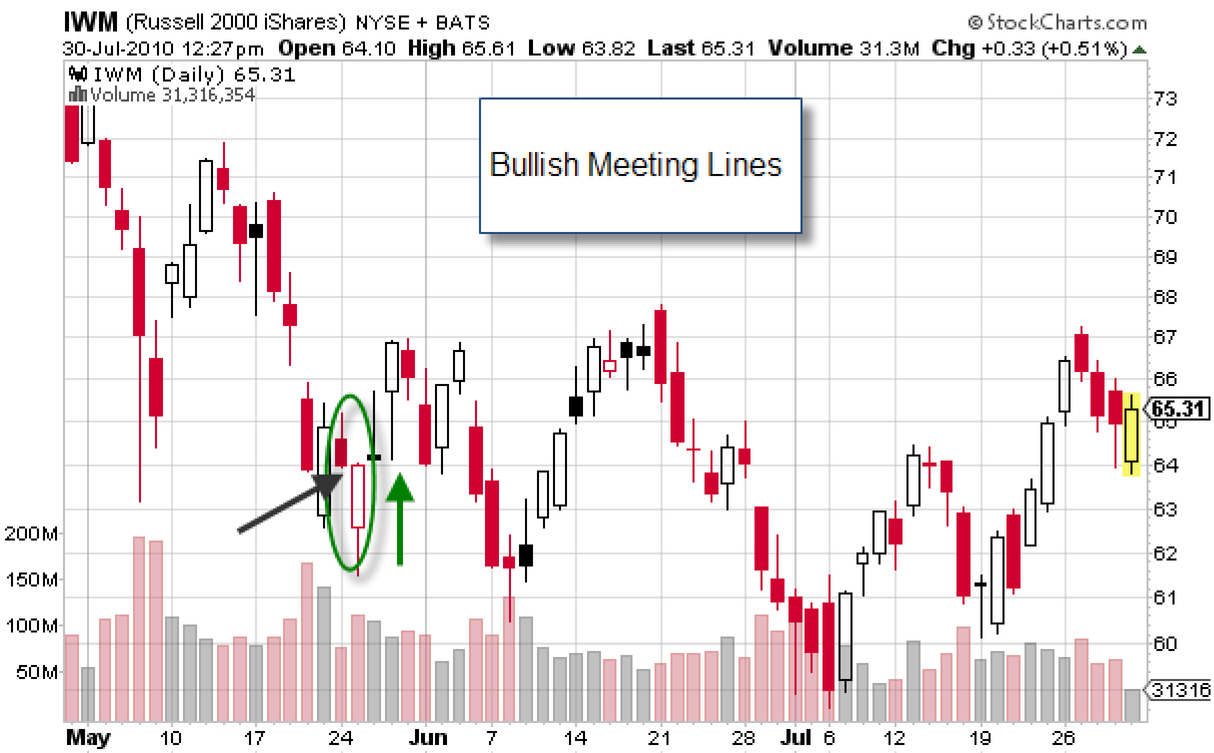
# The Tweezers Top Candlestick Pattern

- The Tweezers Top consists of at least two candles with close to identical highs and derives its' name from the resemblance to a pair of tweezers.
- I like to see wicks on both candles to the topside rejecting higher price levels.
- The classic Tweezers Top should have a longer bullish candle for the first candle followed by a smaller real body; although that configuration is not a hard fast rule.
- The Tweezers Top is more credible in longer timeframes such as weekly and monthly charts.
- The Tweezers Top should be followed by a bearish confirmation candle on increasing volume.



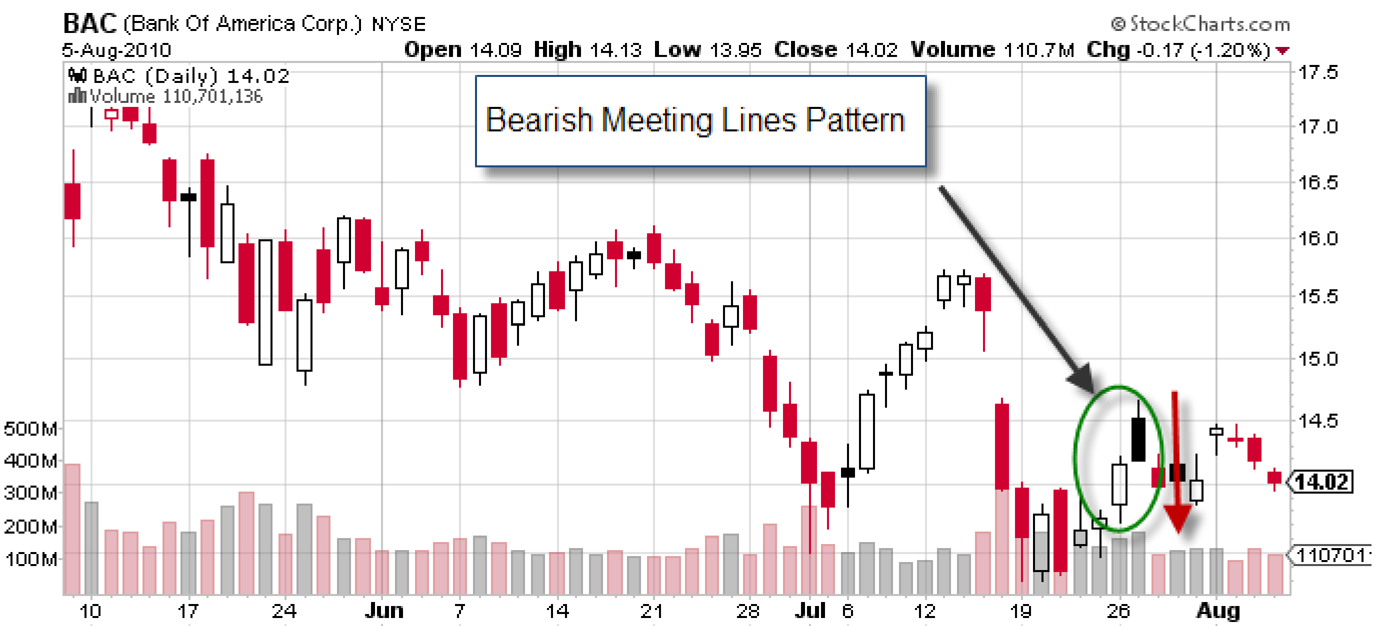
# The Bullish Meeting Lines Candlestick Pattern

- Bullish Meeting Lines is similar to a Piercing Line in that the stock gaps in the direction of the prevailing bearish trend and then reverses.
- The Piercing Line is more bullish because it closes at least half way into the prior session's bearish candle after gapping down; while the bullish Meeting Lines candle merely closes at or near to the close of the bearish candle.
- The Meeting Lines pattern is considered stronger if both the bearish and bullish candles are relatively long real bodies.
- There should be little or no wicks at the point where the two candles meet.
- This pattern needs confirmation with a bullish follow through candle the next session.
- As always, increased volume will confirm that the bulls have stepped in at this level and that lower price levels have been rejected.



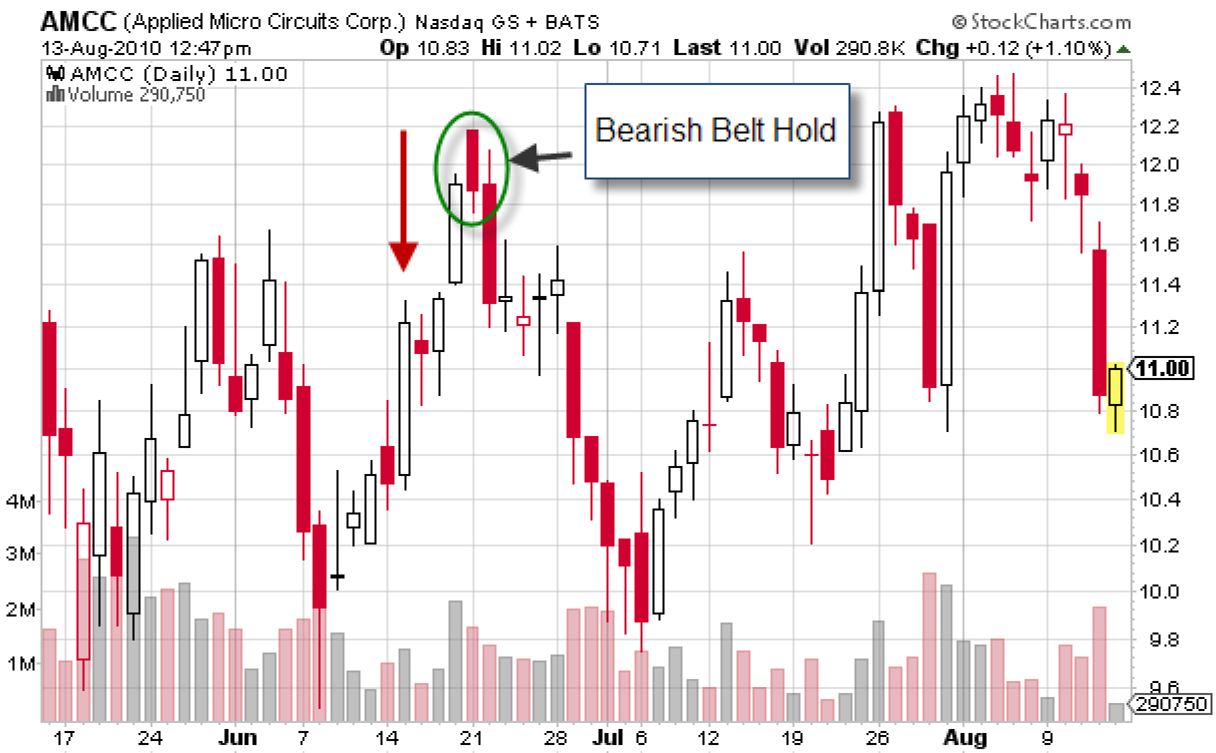
# The Bearish Meeting Lines Candlestick Pattern

- Bearish Meeting Lines is similar to a Dark Cloud Cover in that the stock gaps in the direction of the prevailing bullish trend and then reverses.
- The Dark Cloud is more bearish because it closes at least half way into the prior session's bullish candle after gapping up; while the bearish Meeting Lines candle merely closes at or near to the close of the bullish candle.
- The Meeting Lines pattern is considered stronger if both the bullish and bearish candles are relatively long real bodies.
- There should be little or no wicks at the point where the two candles meet.
- This pattern needs confirmation with a bearish follow through candle the next session.
- As always, increased volume will confirm that the bears have stepped in at this level and that higher price levels have been rejected.
- The Bearish Meeting Lines pattern is not seen that frequently.



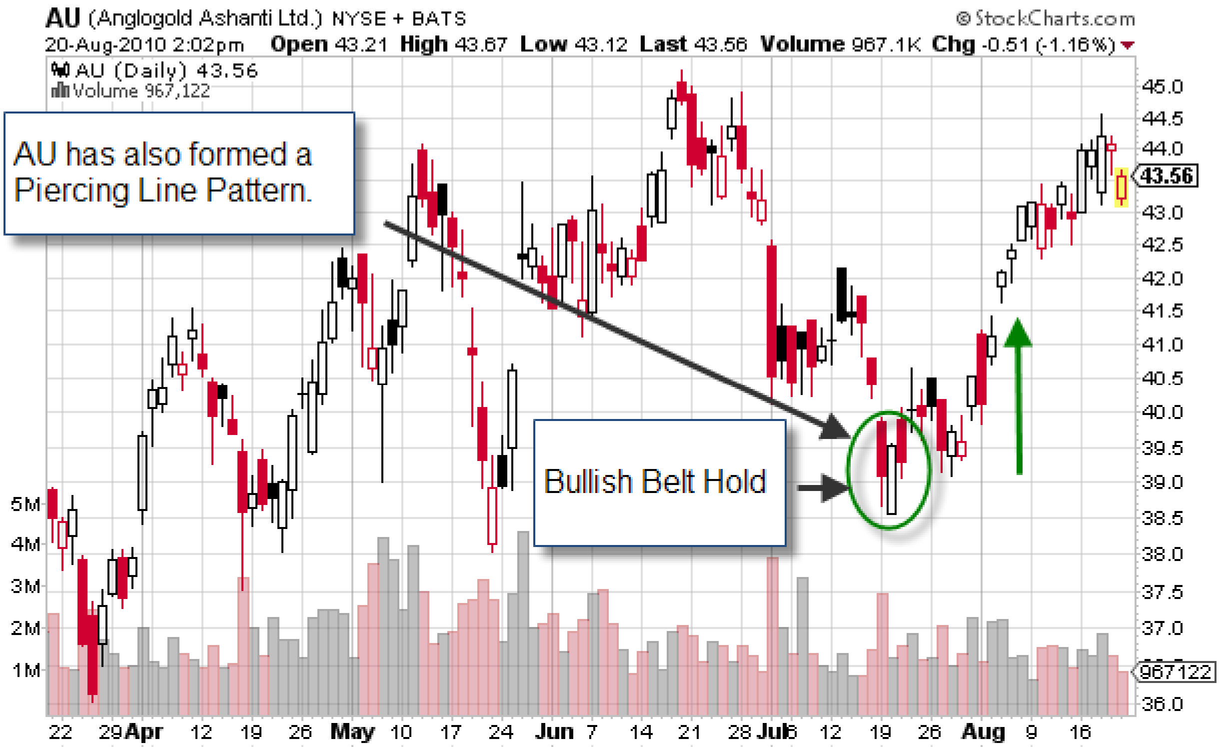
## The Bearish Belt Hold Candlestick Pattern

- The pattern begins with a gap to the upside in the direction on the existing trend.
- The stock immediately trades down and the high of the day is the opening gap.
- The candle is dark with no wick to the upside.
- The longer the real body the more likely a reversal is to occur



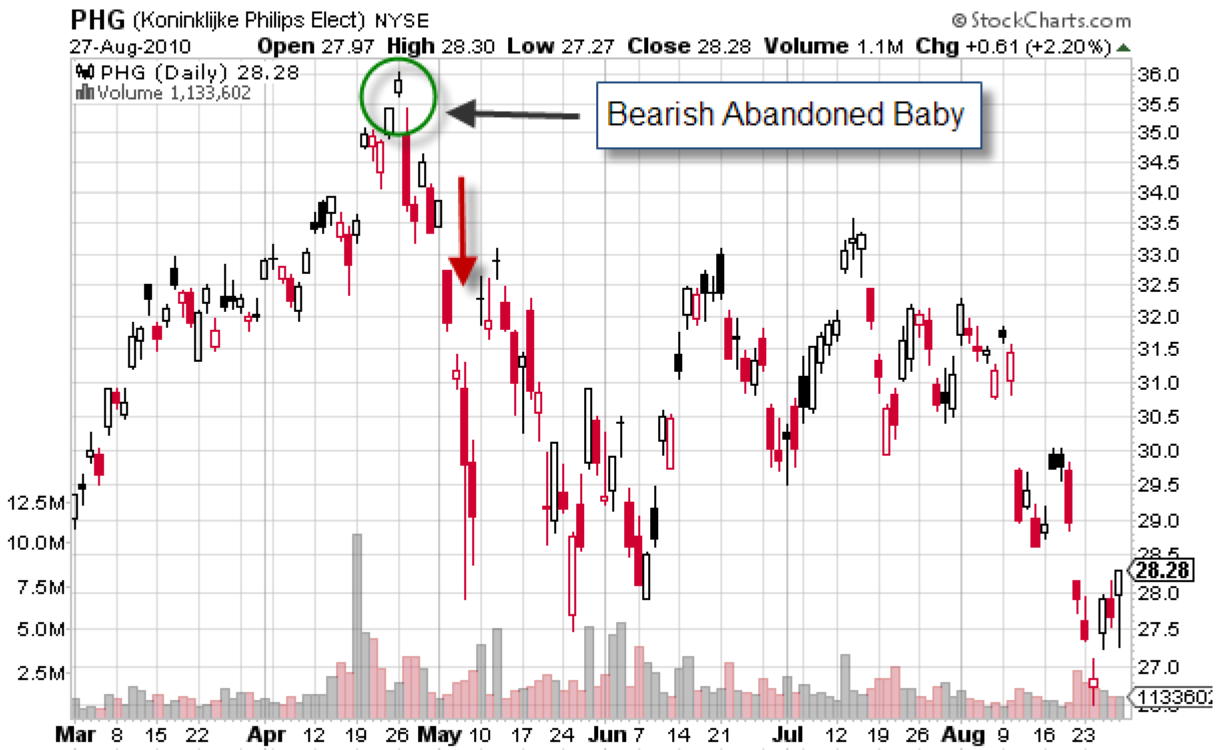
# The Bullish Belt Hold Candlestick Pattern

- The pattern begins with a gap to the downside in the direction of the existing trend.
- The stock immediately trades up and the low of the day is the opening gap.
- The candle is white with no wick to the downside.
- The longer the real body, the more likely a reversal is to occur



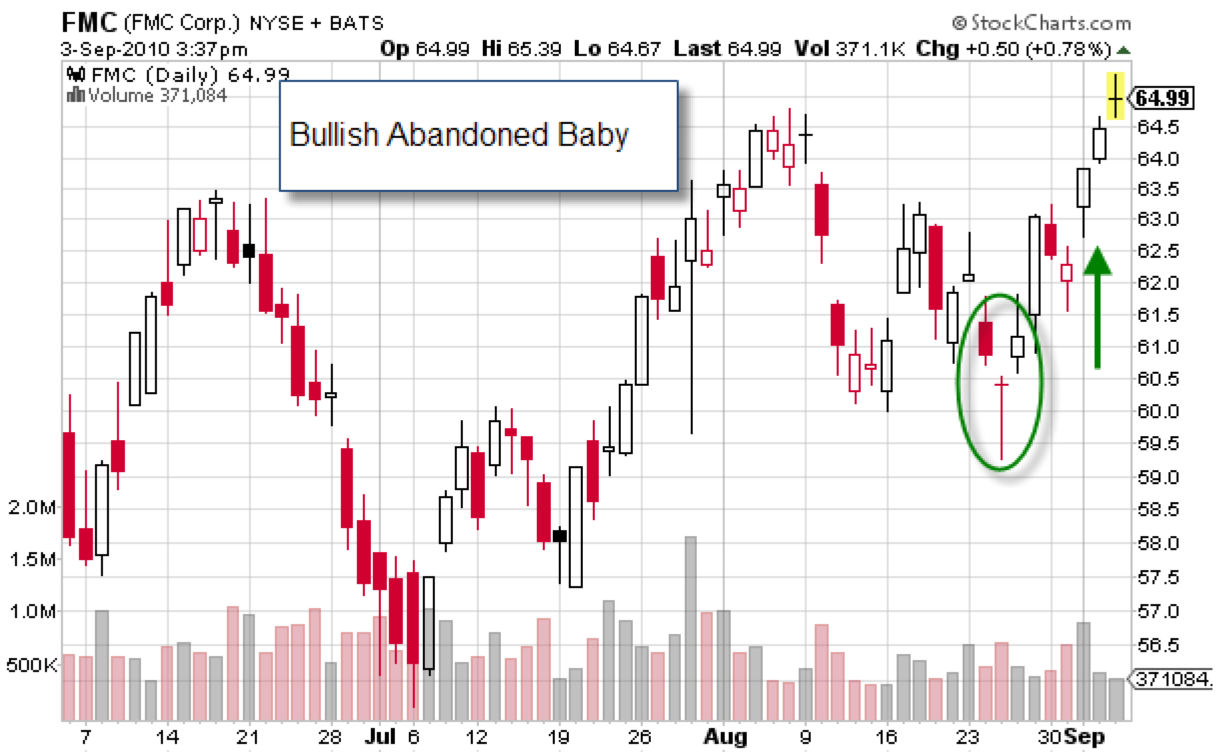
# The Bearish Abandoned Baby

- A three line pattern with the first candle moving bullishly in the direction of the predominant trend.
- The stock gaps up in the second session and trades in a very tight range at the top of the trend with no overlapping of wicks from the prior session.
- The final candle gaps down and trades well into the real body of the first candle, ideally on increase volume as the bears begin to push the stock down.
- This pattern is very similar to an evening star; however the difference is the magnitude of the gaps between the first and second session and the second and third session.  The “Abandoned Baby” depicts the separation of the second candle from the first and third candles and in fact appears to be “Abandoned”.
- This is an extremely powerful and infrequent formation that rarely fails to produce results.



# The Bullish Abandoned Baby

- A three line pattern with the first candle moving bearishly in the direction of the predominant trend.
- The stock gaps down in the second session and the real body trades in a very tight range at the bottom of the trend with no overlapping of wicks from the prior session.
- The final candle gaps up and trades well into the real body of the first candle, ideally on increased volume as the bulls begin to push the stock up.
- This pattern is very similar to a Morning Star; however the difference is the magnitude of the gaps between the first and second session and the second and third session. The "Abandoned Baby" depicts the separation of the second candle from the first and third candles and in fact appears to be "Abandoned".
- This is an extremely powerful and infrequent formation that rarely fails to produce results.



## Candlestick Essentials

Candlestick charting can make the difference in your trading. It can seem daunting when confronted with seemingly endless numbers of formations all sporting very odd names. Don't let that dissuade you from taking on the challenge of learning and applying what you have learned in this book.

There are literally scores of formations, however, most are merely iterations of the essential formations which are covered in this book. You can apply the knowledge within to improve your trading immensely. It's not rocket science, but it will take some effort to learn.

When you realize the power of this charting method, you will wonder why you ever used bar charts.

## What the Experts are Saying

*"For the first time, regular traders can find out simply, quickly and easily how to use Japanese Candlesticks to empower them to take control of their financial future"* – Jay Phillips / Principal at [www.markettamer.com](www.markettamer.com)

*"Incisive, clear and powerful. An outstanding guide to understanding market timing that every trader will benefit from"* – Ron Haydt / Publisher www.optionsrevolution.com