Trading Rules to Successful Profits

Effective Tips, Tactics, & Rules of Successful Traders

A Candlestick Forum publication – **Candlestick Precision™**
Trading Tools & Techniques – developed by Stephen W. Bigalow

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If you must play, decide on three things at the start: the rules of the game, the stakes, and the quitting time. **Chinese proverb**

The following has been derived over many years of investing experience from numerous sources. It incorporates rules specifically applied to the use of candlestick signals. Since investing has become a more active part of people's lives, general investing rules are also included in this chapter. The mental state of an investor, as well as mechanically imposed disciplines, is important to successful investing.

Investing requires discipline. Every investor should utilize an investment program. The obvious reasons include not investing willy-nilly without any guidance or course. The biggest downfall for most investors is their own emotions. The candlestick signals provide a very simple and easy-to-use investment platform. The investment rationale incorporated into the candlestick signals provide insights into investment sentiment not found in any other trading method.

Having the ability to identify reversal signals creates an extremely beneficial dynamic. Once an investor becomes comfortable that the signals represent a high-probability situation, investment-trading rules can be better followed. The elimination of emotions, especially fear and greed, should be the prime goal for investors.

Emotions are the most difficult hurdle to overcome. When our own money is on the line, rational thought processes seem to disappear. It becomes very important to create guidelines and rules that keep emotional decision making out of our investment program. The biggest failure factor for most investors is the emotional element. Investment trades become skewed with investors "hopes" versus 'candlestick signals' of what the indicators mean. A mental decision process occurs every time an investor puts on, or takes off, a position. Our mental decision processes! Our egos come into play. Of course, we are all smarter than the rest of the world. That is what we all like to believe.

As confirmation, our mental prowess is quantified every time an investment decision is made.

Many investors think paper trading is a solution to learn how to trade correctly. Unfortunately, the mechanics of a trade is very simple when emotions are not involved. Many investors point out that they could make good money with good logical decisions when paper trading, but that all disappeared once they started putting real money on the line.

To buy a stock and watch as it goes down, not only hurts the pocketbook but also hurts the ego. We cannot be 'smart' in somebody else's eyes if our investment decision was wrong. When we are right, and get into a position of big profits, our sell parameters become fluid. The euphoric rhetoric that may be surrounding the circumstances causes us to modify our original selling strategy. The "sell" decision now becomes based upon other people's opinion. Or, we change our strategy because a few more points higher will allow us to buy a better car, new set of golf clubs, pay for next quarter's tuition, or anything else that has absolutely nothing to do with our original sell strategy.

Trading rules are easy to apply when using candlestick signals. The candlestick signals produce a high-probability format for when it is time to buy and when it is time to sell. Utilizing that format creates a self-imposed discipline. Why trade against the probabilities? As the professionals often tell us, you cannot time the markets. However, as can be clearly seen, the Japanese Rice traders have successfully timed the markets for centuries. The ability to see high-probability potential reversals in market trends allows an investor to apply simple trading rules. The following trading rules/insights are the accumulation of decades of actual investment practices. Some will be related directly to candlestick investing. Some will be general investment practicing rules. The conveyance of the following rules is purely for educational purposes. What each investor wants to put into practice will be a function of their personal characteristics. Some rules may be worthwhile for one investor while other rules may be worthwhile to another investor. Everyone usually knows his or her own weaknesses. Establishing a set of trading rules, to negate each individual's investing flaws, greatly improves the decision-making process.

Incorporate Good Investment procedures

A successful investment program requires a mechanical process for creating success. Just like any profitable endeavor, investing requires a structured business plan. Successful money managers establish a set of business disciplines. Money allocation, trading environment, consistent evaluation processes, and clear and concise planning are all required to maintain a good mental analytical process.

Logic dictates that if you do not know where you want to go, then you cannot possibly implement a structured plan to get there. The analysis of candlestick signals and patterns, although a primary element of a successful investment program, still requires a business structure for successful implementation. Too many investors try a trading technique that has been promoted as successful, put into action, and when it does not work perfectly, they move on to the next promoted technique. Unfortunately, there are drawbacks to this approach. The main one being that most investors do not investigate an investment technique any more than what the promotional material is telling them. One simple rule for the investment community is that if something is working, everybody will know about it. Be careful of the promotions of 'new secret technique finally revealed'. The normal question should be, "Where did this investment technique come from?" "Who developed it?' "And why is this fantastic secret trading technique being made available to me?'

Successful investors are more interested in finding proven techniques. Then they can learn how to use it successfully. The term "proven" implies that numerous investors have utilized the technique and reported its success. This eliminates one very important variable. No longer spending time and effort trying to learn a trading technique that has yet to be proven.

A major benefit from candlestick signals is that they have been proven to work for hundreds of years. This fact alone eliminates an important variable. If they are known to work successfully, then trading strategies/rules can be applied that help increase the probabilities of each individual investor recognizing what to do and what not to do in specific situations.

When you find a good investment technique, learn it well. If it does not seem to be working, do not desert it and try to find something new. If your analysis is that trading technique works, and it is not working for you, the trading technique is not at fault. You need to research to see what you are doing wrong. Discovering what was not working during that time or certain circumstances will educate you on what to do or not do the next time those circumstances appear.

When in Doubt - Get Out!

The most important aspect about investing is the ability to put the probabilities in your favor. The primary function of candlestick signals is to identify high-probability investments. The purpose of the step-by-step analysis of the markets, sectors, related stocks, and other trading entities, that would support the reasons for acting on a candlestick signal, is to develop a high-probability correct trading scenario.

The primary reason for establishing a trade is the identification of favorable indicators. Taking advantage of centuries of observations of investor reactions has created signals that make a profitable trade very plausible. That was the reason for putting on the trade. The investor has made an evaluation of a trade set up that has worked correctly in the past.

The candlestick signals are indicators of what price movements should occur in the future, with a reasonably high predictability. If the trend/price movement, after the candlestick signal, does not produce the expected results , or the price action starts creating some concern, close out the position. The reason for establishing the trade was to benefit from the probabilities established from historic previous results.

Why remain in a position where the favorable probabilities appear to have diminished? Remaining in the position puts your investment funds exposed to market moves that do not enhance your profit potential. A high probability trade signal still has the potential for creating losses. But, hopefully these will be diminished losses. Keeping funds exposed to a position, where the favorable odds have disappeared, makes the potential of losses that much greater.

If the premise of your investment strategy is to keep placing funds in high-probability trade situations and a trade does not appear to be working, close it!!! Preserve your capital when ever in doubt. The capabilities of the candlestick signals and patterns are always going to be available. The purpose of investing is to maximize your profits. The benefit of candlestick signals is to identify high profit situations. When a candlestick investor does not have a strong feel for what the trend is indicating, close the position. There are more strong trade signals occurring every single day/week/month, one minute/five minutes/ fifteen minutes on a candlestick chart somewhere. Preserve your capital to take advantage of the next trade.

Analyze what would negate a good potential trade

Neomagic Corp.

If all the parameters for establishing a trade are witnessed, as seen in the NeoMagic Corp. chart, the trade should then produce a high probability result. In this case, after a series of Doji, followed by a bullish candle when the stochastics were in the oversold condition, starting to curl up, all the aspects of a high probability trade are in place.

Neomagic Corp

If after a few days, the buying does not appear to be confirming the signal, be prepared to close out the trade. If the signals and the confirming indicators start creating some doubt, close the trade out immediately.

One of two scenarios will occur. First, the trade failed. This is part of the probabilities. Although a majority of the trades should work based upon a candlestick buy signal in an oversold condition, they will not "all" perform as expected. When the indicators start showing a doubtful result, it is time to get out.

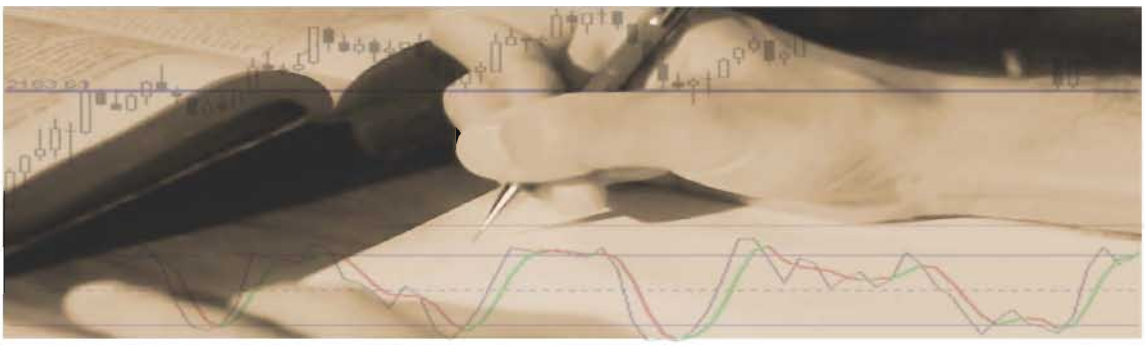
Second, due to the fact that 'buy' signals occurred in the right conditions gave evidence that it was the right time for buyers to start stepping in. That does not eliminate the possibility of buying back into the position when the next buy signal occurs.

The sole purpose for utilizing candlestick signals is to give a graphic indication when buying or selling has come into a price. The signals provide information that helps investors make a high probability decision. When the trading does not confirm as expected, close out the trade. As illustrated in the Inphonics chart, after the uptrend started from a belthold type signal, followed a couple days later by a morning star type signal, the uptrend fizzled out. Although the stochastics did not reach an oversold condition, the selling started. This could have led to a Jay-hook pattern in the process of forming but after a couple of days after the Spinning Top and Inverted Hammer, the buying did not look convincing. This produced a doubtful scenario. Instead of "hoping" something major will occur to save the position, close out the trade.

Learning to use candlestick signals correctly provides an expectation of what should occur after viewing candlestick signals or patterns. If those results do not appear as expected, move on to another trade situation where the results should perform as expected.

Laws without punishment are like bells with no clackers

Document Winning and Losing Trades



A major benefit to the learning process of any investment strategy is to write down the thinking process involved in both good trades and bad trades. Until an investor feels that, they can remember everything that should be indoctrinated into a trading process, writing down the initial analysis used when putting on the trade should be done on a daily basis. A well-maintained accounting of transactions and writing the results of good and bad trades in a journal is a good investment habit. Having a journal, of what the thought processes were during a good or bad trade situation, frees an investor's mental energy for analysis versus trying to remember previous trade occurrences.

The mind is a very nebulous entity. Important factors that should be remembered can often slip away through time or be lost when trying to analyze massive amounts of information. Having a documented journal of past trades allows an investor to refresh their memory on what worked or did not work in the past. Keep a journal at your workstation. It becomes a very strong aid for remembering what worked well and why a trade did not work.

A perfect candlestick signal might be occurring. All the parameters for establishing a high probability trade are in place. However, once the position is established, the price does not move in the manner expected. The question should be WHY? The simplest answer could be probabilities. As expected, not all trades are going to work. That is a process of probabilities. However, writing down other observations of why that trade did not work will dramatically increase an investor's ability to participate in profitable trades.

A perfect candlestick buy signal, yet the trade did not work. What other occurrences might be observed that may have caused the trade to fail? Was the market, in general, moving in the opposite direction than expected? Was the sector not showing any confirmation? Did an announcement about a related company affect the stock price? Were stochastics not quite in the oversold condition? Any number of observations might be made when a trade does not work. Writing down your observations will help commit the reasons behind failed trades to memory.

It is not difficult to assume that an observation as to why a trade did, or did not work, can be reviewed and incorporated into an investors analytical process. Emotions can be a tricky hurdle when learning a new investment process.

Writing down observations and your 'thoughts' can greatly alleviate future mistakes which can be easily passed over once emotions come into investment decisions.

A journal of past decisions can also help rectify what seems to be a bad trading period. There will be many times during ones investment career where a string of bad investments comes into play. Reviewing a journal of past trading observations as to what was, or was not, working in the past may quickly point a common analysis that is being used incorrectly.

Do Not Trade When Not Feeling Well

Investing requires clear mental thinking. Most people experience different mental outlooks when feeling under the weather. Having a bad cold, the flu, a toothache, headache or a multitude of other ailments can dramatically affect an individual's outlook.

Investing is just like any other activity. There will be times an investor may not "feel like" investing. Take a break. Being mentally refreshed is often a crucial aspect for thinking clearly. Investing does not require participating in the markets every single day. Investing should be taking advantage of market conditions when the investor wants to participate in the markets.

There are times when the market is not moving well enough to produce profits that would warrant spending mental time and energy. Often, during the summer, market activity/volume decreases dramatically when everybody is vacationing. Do not try to squeeze blood from a turnip. Go relax, rest up.

There will be times when trades do not seem to work. Positions put on, despite how strong a signal indicates a high probability trade, do not seem to work. Take a break. Go clear out the cobwebs. When you come back after a few days of rest, the analysis process should be clearer.

Simple maladies such as a head cold, a toothache, or a headache can alter an investor's perceptions. Some investors feel they need to be in the market every single day. However, not feeling well can definitely change an investor's attitude. The decision making process can be drastically slowed.

Scientific studies prove that the flu or a fever can greatly change a person's mental attitude. What should be strong decisive decision-making can become a lackadaisical, indecisive mental process when the brain functions are skewed by illness. Just as a professional baseball player should not be out on a field with a sprained ankle, an investor should not be in the game when the mind is not working at full capacity.

If you are not feeling well, stay out of the market. There will still be plenty of opportunities to make money in the markets later. It is better to 'sit-out' when not thinking at full capacity than to participate and lose money.

Preserve Capital

What do most money managers tell you is their first priority? To preserve capital. However, very few of them describe how they do that. Candlestick signals have simple stop-loss procedures that make the preservation of capital a given. (See our "Stop Loss Strategies & Techniques" Training CD)

The concept of preserving capital is as important as the function of maximizing profits. That is the mainstay of most investment advice. How does maximizing profits and preserving capital intermix? Utilizing the candlestick signals and high-profit patterns establishes expected price movements. Historic results demonstrate predictable price movements. If the projected trend does not confirm those expected results, then immediately make a new analysis.

Keep the analysis simple. Are my funds allocated into a position that will benefit the portfolio? Are those funds utilizing the benefits provided by the signals and the patterns? If an evaluation does not confirm both of those questions, then of investors needs to ask themselves, "Why am I in this trade?"

Investors today have a huge advantage over what investors had made available to them just a mere decade ago. Investment research, up until the past 10 years, came mainly from the brokerage firms. Research capabilities became much more plentiful for the individual investor through the computer network. Investment practices were much more limited without the accessibility of both fundamental research and technical research that has now made available very inexpensively on our computer screens. Today's investor has the ability to do their own research. They have access to the same investment tools of any professional investing firm. This allows for many techniques previously unavailable just over a decade ago for the investor to implement procedures that can preserve capital.

There will always be a supply of excellent buy signals or sell signals provided by candlestick signals. Each day, or whatever time period you are trading, there will be more trade opportunities than most investors will ever be able to take advantage. Why stay in a trade where you do not have analytical control? There is always somewhere to invest your funds where the signals indicate a high probability trade direction.

Candlestick signals incorporate stop loss procedures that are much easier to implement than most trading methods. Visual analysis illustrates when the Bulls start taking control and makes establishing stop loss procedures very simple. Using very simple scanning techniques, candlestick analysis provides a constant supply of potential buy situations every day. Closing out a position to protect capital is not a heralding experience. Candlestick analysis provides quick visual information for determining capital exposure. The mere fact that the signals get investors into high probability trades is a beneficial factor of candlestick signals. Conversely, the signals also illustrate when the probabilities dictate coming out of a trade.

Does that mean losses will be completely eliminated in a portfolio? Definitely not! However, it does mean that utilizing candlestick analysis greatly reduces the probabilities of being in the wrong trades. The signals also perform a function of demonstrating when a price trend is not performing as expected.

Preserving capital should be the secondary function of a successful investment program. The primary function should be to maximize returns while minimizing risk. Functions inherently incorporated into 400 years of analysis by Japanese Rice traders.

Rigel Pharmaceuticals Inc.

The decision process is easier when viewing a doubtful chart, as seen in the Rigel Pharmaceutical Inc. chart. When there does not appear to be a strong probability of upside potential, moving funds to another trade such as the Daystar Technologies Inc. chart, makes sense. The probabilities for upside potential are much greater when all the indicators line up. Moving funds from the low probability positions to high probability positions will produce consistent profits over the long run.

Daystar Technologies Inc.

A well-managed account involves shifting funds from a high risk situation consciously back to lower risk, high probability situations. The constant massaging of portfolio positions to where the probabilities of being in correct trade, ones with less downside risk and more upside potential, is a money management technique based upon common sense. Why stay in higher risk trades that 'might' have more upside potential? Move funds into trades with better chart signals that offer lower risk situations with greater upside potential.

Don't look back!

One of the big reasons investors' tend to lose profits – **"WHAT IF"** What if I sell after making good profits and the price goes up another 200%? The two emotional factors that affect investing the most are fear and greed. These emotions are found in many situations. Fear can be found when everything in the investment world looks terrible; there is no viable reason to be putting money into the markets. Greed is experienced when you jump into the markets/stocks after they are in an established uptrend. Everything looks rosy, you want in on the profit. Everybody wants to jump on board because nothing can go wrong.

Those are the normal circumstances for identifying fear and greed. However, fear can be experienced when it's time to sell a profitable position. For example, a stock is bought for $10 a share. Over the next two weeks, it moves up to $14 a share. Candlestick sell signals start appearing. However, what happens when a stock price gets strong? Everybody finds great things to say about the company. Although the candlestick signals indicate that is time to take profits, the verbal rhetoric keeps providing reasons why it is time to buy.

What is the fear factor for selling the stock? What if!!! What If you sell the stock at $14 and after a few days, it goes straight to $18? Boy, would we look stupid! So what do most investors do? Hang on to the stock even though the candlestick "sell" signals indicate it is time to get out. Finally closing out the position, but at a much lower price. All for the sake of not looking stupid had the stock gone to $18.

The candlestick signals produce an important message. They visually demonstrate when the "probabilities" indicate it is time to sell. The effectiveness of candlestick signals is the ability to show high probability buy and sell situations. **When the signals say it's time to sell, close out the position**.

There is nothing wrong with buying when it is time to buy and selling when it is time to sell. If, for some unforeseen reason, the price immediately spikes up after you sell it, do not look back. The trade was correctly closed. To 'hope' for additional price increases is exactly that, "hope." If a trade was closed based upon the signals indicating that it was time to sell, that was the trade.

The purpose of using candlestick signals is to get investors into a position when the probabilities say it is time to buy and get them out when it is time to sell. Under that investment philosophy, those funds coming out of a sold position should have been put into another trade where the probabilities were in the investor's favor.

Worrying about a stock price moving up after the position is sold becomes detrimental to rational investment thinking. Stocks prices **will** move up after the signals show "sell". However, not nearly as often as prices will continue down when a candlestick sell signal appears. Even if the price of the stock moved up after the sale, it was now in a higher risk area. Those funds should have been moved to another chart signal where the upside probabilities were great and the risk factor was much lower.

Take profits when it is time to take profits. There is nothing wrong with coming out of a position when the probabilities say it is time to come out. There is nothing wrong with buying that position back if the sell signals are negated. The J-hook pattern is a prime example of getting out when the signals said to sell and getting back in when the J-hook pattern shows buying. The purpose of investing is not to maximize your profits on every trade. The purpose of investing is to maximize your profits in your account.

What does candlestick analysis reveal? That exuberant buying occurs at the top of a trend. If the probabilities indicate that is time to take profits, what are the possible scenarios? That it is time to take profits. If there are no sell signals, stay in the trade. Candlestick analysis also illustrates the possibility of patterns forming. What could possibly occur based upon a pullback occurring? A Jay-hook pattern. Having the knowledge of what the signals do to form a Jay-hook pattern makes taking profits when it is time to take profits an easy decision. The trade can always be reestablished when the new pattern is confirming. This greatly alleviates the fear of selling too soon.

Old truths, old laws, old friends, old books, and old wine are best.
Polish Proverb

Do not chase trades

A major problem most investors have is 'missing' a trade. That problem becomes amplified with the ability to discuss trades in chat rooms. What is everybody usually talking about in the chat rooms? The stocks that are moving big right now. When viewing a stock that seems to be skyrocketing, most investors want to be participating. It is very hard to sit there watching everybody else make money in a position that you are not in. What is the first thing that goes through the investors mind? Is it too late to get into this position?

The purpose of candlestick signals is to get an investor into a position at the appropriate time. What does candlestick analysis teach us? That prices start to move exuberantly at the top. If a stock price is being discussed in a chat room, because it is starting to move big and fast, what should be anticipated? The price is now getting near a top. Is that where you want to be buying a stock price?

The purpose of candlestick analysis is to reveal when a price is reversing at a bottom. If you are sitting there watching a stock moving up strong, do not chase it. You are supposed to be looking for the charts that tell you that it is time to buy. You want to be the one selling a position that you already own when it is starting to move exuberantly at the top. Buy low and sell high, that is the framework that candlestick signals create. Buying high, hoping to sell higher, is a high-risk investment strategy. If you consistently look for the buy signals at the bottom, the probabilities dictate that you will be participating in the fast-moving stocks when they reached their selling areas. Stay with the high probability program.

Cut Your Losses Short, Let Your Profits Run.

The beginning of wisdom is to call things by their right names.
Chinese Proverb

Cut your losses short and let your profits run is the advice provided by practically every investment adviser in the world. The only problem with their advice is they do not tell you how to do it. Candlestick analysis provides a framework for keeping losses small. The visual analysis that identifies a buy signal or a sell signal incorporates the change of investor sentiment. The result of the investor sentiment change should lead to confirmation of a new direction.

If a candlestick buy signal, indicated a new upward trend, but is immediately negated by more selling, the message provided by the buy signal loses its relevance. Simply stated, if the sellers are still present, after a candlestick buy signal is formed, to the magnitude that prices move back down to a point where they override the buy signal, close the position immediately. The buy signal did not work.

Trades are established based upon a signal providing a high-probability situation. If that signal is negated, the high-probability situation does not remain. Close the position. Move on to an identified high-probability situation. Does that mean this trade will not work? No, it just means that it is not working right now. If that trade was implemented because of a candlestick buy signal in an oversold condition, and it does not work, the oversold condition has not disappeared. Continue to watch for the next buy signal. However, the next buy signal may occur two days later or two months later. If a trade is not working,

get back out immediately and use those funds to take advantage of another high-prospect trade.

If an External Event/Announcement Changes the Reason for being in a Trade - Close it!!!

Buying a position should be based upon the information built into the 'buy' signal. If the signal is the reason for buying, then the parameters become clear for staying in the trade. The trend should move in an expected manner. But, if something happens that completely alters the reason for being in a position, get out and get out immediately.

There will always be situations that do not make a trade work as expected; an unexpected announcement, a world event, something that may change the investor sentiment instantly and for the extended future. When that occurs in a position that you are holding, close it immediately. It has completely changed the reason for buying the position.

Set Your Stops

There is no luck except where there is discipline.
Irish Proverb

A major human flaw is setting a stop, and then changing our mind when prices get near the stop price. That process defeats the purpose of setting the stops in the first place. Why do investors change their minds? When making rational evaluations, investors will make rational decisions. However, in the heat of trading, emotions come into play. As demonstrated in our *Stop Loss Strategies & Techniques* Training CD, candlestick analysis places stop losses based upon logical selling indications. If you find yourself in a situation where you are questioning your own stop-loss decision, remind yourself that you made that stop-loss point based upon clear, non-pressured analysis.

Setting a stop at a pre-derived percentage movement means nothing. The markets do not care where you bought. The price is going to move up and down in a trend. Trends can have short-term pullbacks. ***The basic reason for establishing a stop loss is to be out of a position if it is not confirming the reason for being in the position.*** Candlestick signals make stop-loss procedures relatively easy. If you are buying based on what a candlestick signal implies the buyers should now be in the trend. Price moving back down through the level that suggested the buyers were taking control, reveals that the sellers were still in control.

Entering a position is based upon a signal. Visually, a trading level should be recognized as an area that would indicate that the buyers did not follow through; and the sellers were still in control. Use that as your stop. Prices' breaching that area negates the reason for being long. Close out the position. That is how you cut your losses short.

When you visually analyze where the stop loss point should be, it would not change the scenario once you have put your position on. If you anticipate that a percentage of the established trades may not work, then utilize the candlestick stop-loss process.

There will be more high-probability trades to place your investment funds. Get out of the bad ones immediately and move to the good ones.

The Fear of Selling Too Soon

The firm tree does not fear the storm.
Indonesian Proverb

Fear works against most investors when it is time to take profits. Fear and greed! Fear that after taking profits on your trade it will continue to move higher. Moreover, the greed that you may miss the profit on any continued move. How stupid we would look after buying a stock at $10, took profits at $16 and two weeks later, it was trading at $24! The first question should be, "looking stupid to whom?" 99.9% of the time nobody other than yourself, knows what trade you have made. The other .01% doesn't give a hoot. They have their own problems. What it boils down to is not looking stupid to you.

Unfortunately, this ego problem induces the majority of investors to continue to hold a position well past the optimal "sell" time.

The inherent attributes candlestick signals provide is a format that indicates when the "probabilities" say it is time to sell. Most investors lose sight of the premise of their investment program. A good investment program indicates when it is time to buy and when it is time to sell. These are the outstanding features found in candlestick signals.

Profitable investing requires discipline. That discipline involves following the signals/indicators that are the basis for one's investment program. There is nothing wrong with buying a position when the indicators say to buy. There is nothing wrong with selling a position when the indicators say it is time to sell.

Will there be occasions when a price continues higher after you close out a position? Definitely! There are two ways to resolve the emotions of that issue. First, when an investor comes to the realization that if they execute their trades based upon a trading program that provides a high percentage of profitable results, they can always look back at a trade that continued higher with solid investor logic. They bought when it was time to buy and they sold when it was time to sell. That trading discipline will work in favor of the investor over the long run.

There is nothing wrong with taking profits when the probabilities indicate that it is time to take profits. Are there times when the signals are indicating a profit-taking pullback in an uptrend versus a full-scale reversal? Certainly, but being able to identify candlestick signals in the formation of high-profit patterns allows an investor to take advantage of anticipated price movements.

The perfect example is the J-hook pattern. After a strong positive move, candlestick signals usually indicate the probability of a sell off.
Will that sell off be 5% or 55%? That question cannot be answered when the reversal signals first appear. Why take the chance of holding a position that may give back most of the profits?

The worst-case scenario is a candlestick sell signal indicating it is time to take profits. Four days later the price starts moving back up. If it appears as if a trading pattern is forming, buy the position back. There is nothing wrong with buying it back at a higher price. The point of investing is to put funds in positions that show a high probability of producing profits. That will mean there will be trends that provide opportunities to make "most" of the profits available from that price move. **The point of investing is to maximize your profits for your account, not to try to maximize profits on every trade.**

Averaging Down

The concept of averaging down should not be in the realm of candlestick analysis. Averaging down is performed by investors that do not incorporate a trading strategy. Averaging down is the rationale for holding a position too long in the first place. The swing trader clearly has analytical benefits using candlesticks signals. Once a trade is executed, the negation of the candlestick buy signal should create cause to close the position quickly. Cut your losses short, let your profits run. Utilizing the simple stop loss analysis that candlestick signals offer eliminates the need to consider averaging down.

The long-term investor may have a different perspective. Averaging down is occasionally applied if the long-term chart has experienced a pullback but not a sell signal. Even then, the analysis needs to involve one important factor, "Is this the best place to be committing funds at this time?" Do not allocate more money into a position for the sake of averaging down just because an existing position is already in place.

Analyzing Profit Targets

Analyzing profit targets and setting profit targets are two dramatically different functions. To arrange taking profits at a specific percentage gain is like cutting off your nose to spite your face. Unless an extensive statistical study has been made upon a specific trading entity, discovering what the average/median price

move has been historically, then a lot of effort may be wasted. For most investors, it is difficult to find positions that will move in a profitable direction. If a trading program has been devised to identify high probabilities of a trend direction, then it should be utilized to its fullest potential.

When analyzing a reversal chart pattern, profit targets should be utilized for anticipating the potential gains. Consider where the next resistance level might be. This analysis would involve trend lines, moving averages, Fibonacci numbers, or any other technical indicator that might reveal the potential end of the next trend. Logic dictates that a bullish signal or pattern that has a potential of a 15% return is much better than a chart analysis that reveals only a 5% return. Use that analysis to decide which trade to enter.

Once entering the trade, do not let the target be the sole 'sell' factor. The candlestick signals remain the main factor for when to sell. A signal to sell the position may occur well before reaching the target.

The candlestick signals identify when a price reversal has occurred. Indicators can project the potential strength of the price move. Other technical factors can project potential targets. However, the majority of the time the signals simply indicate that a new trend is in the making. To interject a self-imposed profit target greatly reduces the benefits that candlestick signals provide. Once a price trend moves, which was bought based upon a candlestick buy signal, it becomes a relatively simple procedure to analyze when to sell. Identifying the candlestick sell signal should be the determining factor.

The time and effort of finding positions that are going to move in a profitable direction should not be compromised by a preset function that has absolutely nothing to do with how far the price will move.

Take Windfall Profits

Zeal without knowledge is a runaway horse.
English Proverb

The major benefit of interpreting candlestick signals is that it tells you when buying or selling is coming into a position. You may not necessarily know why buying or selling is coming into the position but apparently somebody does. The smart money, or the money that has knowledge of a company or a trading entity, will be making buy and sell decisions based upon their knowledge. The graphics of the candlestick signals is the representation of that knowledge.

The results of that knowledge will create candlestick signals. Information from candlestick signals becomes a source of recognizing where buying and selling is occurring. They visually portray what is occurring. This often leads to being able to participate in situations where the signals indicate something major is about to happen. Essentially the signals position an investor to be in the right situations at the right time.

When a big price move does occur, do not be hesitate to take some profits immediately. Most investors are happy when their portfolio or a position provides a 10% return annually. Getting a large price move within a one or two-day period, warrants taking some profits. If stock price moves up 10%, 20%, 40%, or 100% in one day, sell half the position. Moving profits into your account was the purpose of being in the position in the first place. Could the price move higher? Certainly, and you will still make profits with the remaining half of the position. Will there be profit-taking after the first big move? Certainly, if so, you can formulate your strategy for exiting now with half a position. If you get a big move fast, take profits. Remember, greed has killed more men than lightning.

Take Profits, do not immediately re-enter if the price keeps moving

When it is time to take profits, take the profits! A major "faux pas" many investors make is analyzing that it is time to take profits and they close out the trade. Then the price starts moving up further. What is the first reaction by most investors? Oh boy, I need to get right back in. This might be an astronomical price move and I just closed out my position. I need to get back in.

Do not do it!!! The reason for taking profits is to put money into your account. The reason for putting on a trade is to take advantage of a high probability profitable trade. Most investors have a hard time finding trades that even produce profits. Using the candlestick signals dramatically improves the probabilities of being in a profitable trade. What is the purpose of being in a profitable trade? To make profits for your account! Not to maximize the profits from the trade. If your analysis is that it is time to take profits, a signal has occurred, it is in an overbought condition, or any other parameter that has been utilized previously for indicating that is time to take profits, act on those indicators. That will produce the right decision a vast majority of the time. To sell a position and then see it move higher will cause that temporary ego dilemma. Have I sold out a position before it reached its peak? The investor that reacts emotionally and immediately buys back the position is now in a high-risk trade.

The risk comes from the fact that the analysis indicated it was time to take profits based upon the parameters. Those parameters, especially using candlestick signals, of high probability results attached to them. To reenter a position because it was going higher after you sold it is going against those high probability parameters. Additionally, emotionally buying back the position creates another risk dynamic. The ego is going to be less likely to close the position at the proper time if it starts going back down. How foolish we would look if we sold a position, bought it back higher and then had to sell again at a lower price. The initial purchase of the trade had a program for when to sell. An emotional buy in overbought conditions usually does not have a sell in mind. If you sell a position based upon the indicators revealing the right time to sell, take the money and move to another fully analyzed, low risk trade.

Sell half your position on big price moves

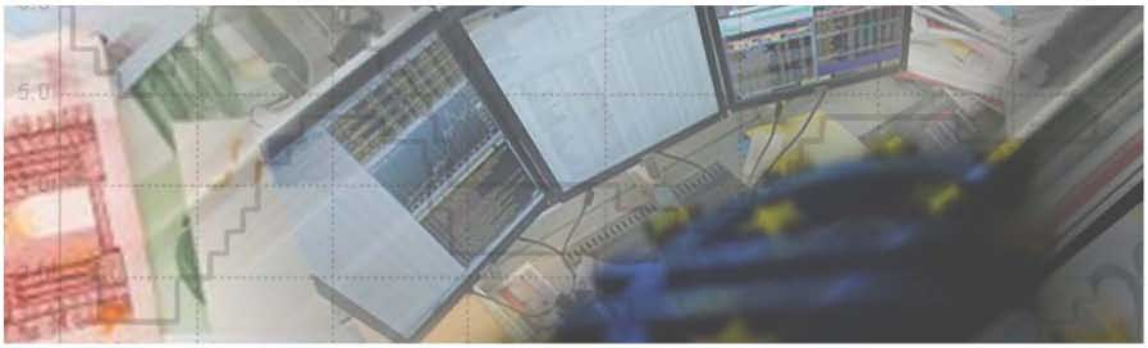
Because the ego is hard to fight, there are some simple solutions to get over that hurdle. Take off half the position. A position is bought based upon the signals illustrating a trend reversal. What is the expectation? The price should move up, obviously. What happens when a price starts to skyrocket? It brings everybody's attention to it. Rumors and speculation start running rampant. You become elated with potential profits. Now you wonder when to sell. What if you sell now and the rumors are true? Could this be a takeover? Are the shorts getting squeezed? What is the biggest fear? Taking quick profits and watching the price moved dramatically higher without you. Most investors cannot bear not participating in the potentially huge mega move. They hold the position until it comes back down as quickly as it went up.

How do you resolve the ego dilemma? Sell half the position when prices are skyrocketing. How does this affect your emotions? Selling half the position at least puts profits into your account immediately. The purpose for buying the position in the first place was to make profits. If those profits come bigger and faster than expected, put some of that back in the account. Now you are contending with half of a position. If you already made big profits, and the price goes higher, at least the ego can rationalize that you're still making bigger profits on part of the position. If prices come crashing back down, you can rationalize that you were smart enough to take out some of the profits as it was skyrocketing.

How often do huge moves pan out in a price move? A very miniscule percentage of the time. Nevertheless, that move is everyone's dreams. It's that dream that keeps most investors from taking windfall profits quickly. Selling half the position, on an initial big move, helps the mind rationalize holding onto the remaining half position with hopes of a huge price move. If it sells off, at least half the position was sold at a higher price.

This same procedure should be implemented upon seeing a gap up in the overbought conditions. A huge price gap, after a sustained uptrend, creates an immediate emotional high that something big could be happening. Taking off half a position at least locks in the high probability gains.

Do not Formulate New Opinions/Strategies as a Trade Progresses



If you are buying based upon a daily signal, sell based upon a daily signal. If a daily candlestick "buy" signal is the reason for entering a trade, then let a daily candlestick "sell" signal indicate when to come out of a trade. A common mistake technical investors make is exiting a trade because of price movement occurring contrary to expectation on a shorter timeframe.

An example would be buying a stock or commodity position based upon the criteria of a good bullish trade, a candlestick buy signal with stochastics in the oversold condition, starting to curl up. After two or three positive trading days, the price sells off hard early in the day. It would form a candlestick sell signal if it closed at that level. However, the stochastics or other trend parameters may still be in an upward trajectory. What should be the course of action? Nothing! Wait until the end of the time frame that your investment program involves. If you are buying based upon a daily buy signal, then sell based upon the completion of a daily candlestick sell signal. Whatever price movement occurs in between the open and the close is noise. The signal is created at the end of the timeframe.

Will there be selling during an uptrend? Of course. If the price goes into the close at the same levels it did during the early part of the day, it would create a candlestick sell signal. Although stochastics are heading up, a new investment strategy can be analyzed with that information. More than likely, prices may end up near the top of the trading range at the end of the day. Keep in mind, the candlestick buy signal provided a high probability indicator that a trend reversal had occurred. **Allow the signals to dictate what prices should do**. The signals are formed at the **END** of the timeframe.

Other Opinions

Some men are just as sure of the truth of their opinions as are others of what they know.
Aristotle

One major human flaw is listening to other people. Hearing somebody else's opinion can start causing doubt when maintaining a position. The exposure to financial news stations and a multitude of investment chat rooms creates the opportunity to hear many 'opinions'. If you buy based upon a set of parameters, do not change your investment decision parameters midstream. Everybody will have an opinion on what should be done with specific investments. Base your decisions upon your own analysis for entering and exiting trades.

There are two major reasons for not letting others influence your decisions. First, the establishment of a trade was based upon evaluations of the indicators that you know, or are learning, for making profitable trades. To circumvent the exiting of a trade, because of another source's influence, does not allow the investor correct analysis of the success or failure of that trade. If the trade does not work, an investor wants to be able to analyze the result based upon the failure of the indicators they are using. Exiting a trade based upon other criteria does not add information to your program knowledge.

Secondly, the opinions of others may be formulated by completely different or unknown factors. Their viewpoint could be influenced by a multitude of factors that have nothing to do with the reason you have put on a trade. Their timeframe, their risk tolerance, the information that they based their opinion on may not have anything in common with your investment technique. Does this necessarily mean that all other opinions need to be ignored? Not necessarily, that information may be assimilated into your total analysis, but <u>not</u> as a prime decision factor.

Watch the Charts - Not the News

The major benefit of candlestick signals is that it tells you exactly what investors are doing. The strongest element of the signals is that it provides a graphic account of what investor sentiment is doing ***right now***.

Consider the definition of smart money. Smart money usually knows what is going on in a stock/industry well before it becomes public knowledge. When the average investor gets the news, it is usually old news. That is plainly illustrated when a chart has been declining for two months, then gaps down at the bottom on bad news.

It has to be assumed that the smart money knew what was going on months ahead of time. They were selling anticipating the news coming out sometime in the future. A gap down or a big candle day to the downside on a news announcement should invoke one important question. When everybody else was selling, who was buying?

There are usually very few surprises in the investment world. Somebody usually knows things well in advance of a news announcement. By the time reports come out by major financial news stations, this news is already built into the stock. Watch the candlestick signals. When the news appears so bleak that there can't be any possible way that anybody would want to buy and the charts start showing candlestick buy signals, it provides some very important information. Somebody is buying. Conversely, how often do you hear investors complain when a company comes out with a great announcement and the price of the stock goes down? The announcement/news is already built into the price.

The candlestick signals produce a visual confirmation of what is actually happening. Buy when candlestick signals indicate a buy, even though the news is terrible surrounding that company/sector. You will have a high likelihood of making profits. Sell when the candlestick signals indicate a sell. Although the future appears tremendous, the question always remains, why is somebody selling if the news and the outlook are so wonderful?

Trade the Chart Pattern, Not the Name.

Often an investor will not put money into a trading entity when they have lost money in it before. "I lost money in that stock in the past; I don't want to touch it again." Remember, the markets and stocks do not give a hoot what you think, what you're going to do, or what you've done in the past. Prices are going to move in the manner that will be predictable based upon patterns.

If you run across a chart pattern that shows a very strong signal but then you see that, it is a position that lost you money before, do one simple procedure. Put your hand over the name and look at the chart. If the chart reveals a strong reason to buy, do not let the name influence your decision.

Stay With Your Indicators

The candlestick signals are statistically proven patterns. The candle formations are the illustration of investor sentiment, more specifically of ***actual*** investor sentiment. The financial news programs or financial newspapers are full of so-called professional opinions. Do not let others affect the analysis of a chart pattern. **If you buy based upon technical reasons, then you should sell based upon technical reasons**.

The advantage candlestick investors have is being able to see a graphic depiction of what the true investor sentiment of a price is doing despite all the verbal rhetoric. Quite often negative commentary will persist about an industry/sector/stock. At the same time, the candlestick signals indicate buying. The signals illustrate what is actually happening.

Once an investor learns to successfully interpret the signals and the confirming indicators, all other opinioned information will become incidental. If your indicators work successfully a high percentage of the time, follow what they express. This allows an investor to cut through all informational rhetoric.

Stay With Your Trading Program

It is best not to swap horses while crossing the river
Abraham Lincoln

Trading programs should be defined. If an investor does not understand what their trading program should be, they will not make money. A large percentage of investors do not have a trading program. They get money to invest, and then look for something to buy immediately.

Once you have developed your trading program, stay with it. First, it will help identify which trading techniques are working. Moving from one investment program to another, whenever something is not working, prohibits the investor from figuring out how to correct the flaws.

Using the candlestick signals as a basis for a trading program allows an investor to trade and analyze the results of a signal formation. It permits an investor to stay with a trade that may not currently be producing big profits, knowing through past experience that the signals have not been negated.

Set your parameters based upon the candlestick signals. Other indicators can be applied in specific market conditions. Whether using candlestick signals or not, moving from one trading strategy to another will never allow an investor to analyze changes that can be profitable as market conditions change.

Learn a trading strategy extremely well. Constantly tweak it as conditions change. If somebody recommends another trading strategy or system, research it before jumping into it. Once it's researched, experiment by taking its good points and applying it to your existing trading program.

Too often investors will buy stocks based upon the availability of information when they have funds to invest with no strategy for getting in. This means there is probably no strategy for when to get out. Learn your investment trading strategy well. Then start improving upon it, by integrating what you learn as you go, into YOUR own program.

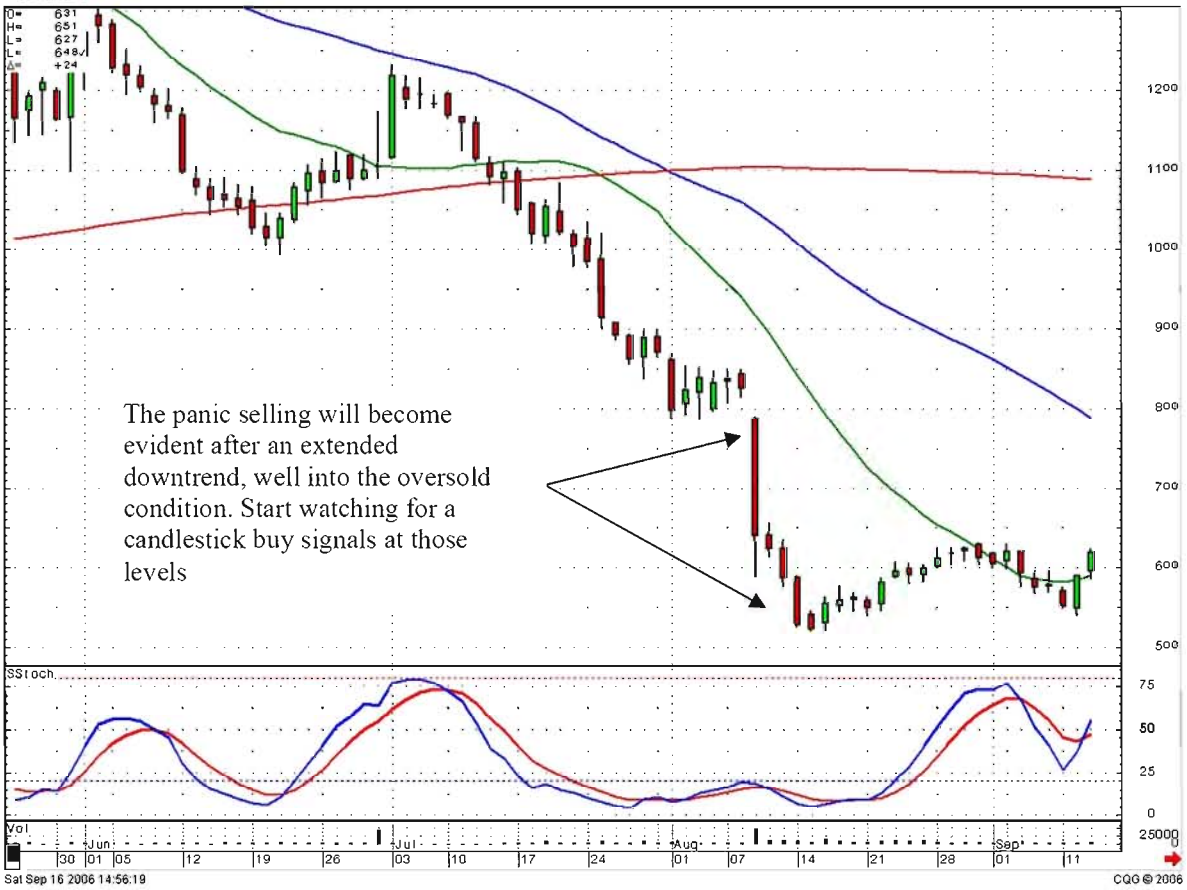
When panic is seen at the bottom, start watching for buy signals.

The benefit of candlestick charts is that they graphically depict investor sentiment. Long candles illustrate either strong bullish sentiment or strong bearish sentiment. After an extended downtrend, the fear factor starts entering into investor psychology. What happens after a price continues down for an extended period of time? Panic sets in! This panic is not limited to the average investor. All the so-called professionals will start giving their opinions as to why that price will continue lower. They come up with all sorts of analytical reasons why the company/industry/market warrants getting out of that stock position.

The average investor, you and I, are barraged with this negative input day after day. The information coming from the so-called professionals should have some fundamental background to it. Unfortunately, it usually doesn't. Professionals are influenced by their emotions just like everyone else. Acting on a rational basis in the investment area is counterintuitive to the human psyche. Where should investors buy? They should buy low of course. What happens when prices are low? There always seems to be the aura of gloom and doom.

Logic dictates when it is the best time to buy. When there is a lot of gloom and doom. Unfortunately, that invokes a dramatic grinding of emotional sentiment. Fortunately, the candlestick investor should be prepared to witness the candlestick buy signals when prices are at the bottom. The appearance of a candlestick buy signal after the evidence of panic selling creates the opportunity to be the buyer at the bottom.

RMIX



When exuberant buying appears at the top, start taking profits

The exact opposite of the panic selling at the bottom occurs at the top. The most gut wrenching time to buy it is when there is gloom and doom everywhere. The easiest time to buy is when everything looks rosy. However, as seen in the markets for hundreds of years, when everything appears to be rosy, that is the time to sell. When is the easiest for most investors to buy? When all the professional advice indicates that, everything is great. Everything is good, the company is going to grow forever, the sectors are going to get stronger, and the markets are heading much higher.

Emotions are what make sellers panic at the bottom. Emotions are what make investors exuberantly buy at the top. Candlestick chart patterns reveal when this exuberance starts coming into a price trend. Once identified, usually with large Bullish candles with prices in the overbought conditions, or gap up prices at the top, that is the time to start watching for candlestick sell signals and prepare to take profits.

ANTP

The Trend is your Friend

The trend is your friend is an often-used investment axiom. It should be utilized when evaluating candlestick reversal signals. **A simple rule is that the longer a trend maintains its existence, the more powerful and convincing a reversal signal needs to be**. If a trend can be observed, more than likely there will be candlestick reversal signals exhibited. If a trend could logically be observed, the reversal signals become the indications of the tops and bottoms of that trend channel. What is required is clear evidence that the trend has also been reversed.

DOW

Keep in mind, the longer a trend is in existence, the more convincing the candlestick reversal signal needs to be. A trend is obviously created by investor sentiment becoming comfortable with the current price movement. The longer this price movement, the more convinced investors become that the trend will last forever. Once a trend is easily identified, as being in a long sustained move, the more Investor perception is solidified.

Will there be sell signals in an uptrend? Definitely! But those sell signals need to be analyzed against the trend itself. There will always be pullbacks in an uptrend. There will always be bounces in a downtrend. However, if the price movement does not alter the analysis of the current trend, meaning not coming out of a trend channel, those reversal signals need to be observed for what they are, pullbacks or bounces in the current trend.

The PortaPlayer Inc. PLAY chart illustrates an easily recognizable trading channel. Note the tops and the bottoms of this channel experienced candlestick buy and sell signals. The uptrend clearly ended when a Bearish Harami indicated that the uptrend was stalled. The selling down through the trendline, after the Bearish Harami, revealed that the investor sentiment, as seen in the previous uptrend, had now become dramatically different.

More obvious was the trend reversal witnessed in TASR a few years back. The uptrend had continued for months. The verbal rhetoric on the TV financial-talk stations kept providing experts that would give reasons why TASR was destined to go up many fold from where it was. A Long-legged doji at the top followed by a gap down in price became the clear signal that the investor sentiment had finally changed. Although there had been previous candlestick sell signals, it wasn't until the big volume, Long-legged doji signal being confirmed that became the true reversal signal. The trend had finally changed.

However, before those points where it became obvious that the reversal had occurred, the appearance of candlestick sell signals did not change the course of the trend. The trend becomes the overriding factor for the analysis. A reversal of that trend requires a substantial candlestick sell signal to indicate that the investor sentiment had now changed from the prevailing sentiment.

Trading channels

Opportunity doesn't travel on any schedule -- you just have to watch for it
Japanese proverb

A trading channel is also a trend. The difference between the observation of a price trend and a trading channel can simply be described as the trading channel as a wider range between the tops and the bottom of the trend movement. A trend channel can usually be identified fairly early in its development by projecting parallel top and bottom trendlines. This projection becomes much easier when able to identify the candlestick reversal signals.

Having the ability to analyze the potential reversal of a current trend and then visually recognizing that it is or becoming a trend channel allows the candlestick investor to participate in high probability moves. Candlestick buy signals occurring, at what could be a support level of an existing trend channel, or candlestick sell signals occurring at the probable resistance level of a trend channel, permits an investor to move quickly for a high probability, low risk trade.

The high probability comes from identifying a support or resistance level of a trend channel. The low risk aspect comes from entering a trade right at a logical support or resistance level. A stop loss can then be placed just below that support or just above the resistance level.

TSAI long-term Chart

Upon seeing the first indications that a parallel trend channel could be forming, watching to see what signals occur at the extension of those trend channel's becomes a very easy visual process. If you can see it, so can anybody else that is viewing the charts.

TSAI short term chart

Moving averages act as targets

Candlestick signals work very effectively alone. However, the conviction of a reversal becomes that much stronger if it occurs at a major moving average. Most of candlestick analysis utilizes the 50-day and the 200-day moving average. The reason for the use of these moving averages is simple. Most of the money managers around the world use the 50-day and 200-day moving average in their analysis. The benefit of candlestick signals is that they reveal what investor sentiment is doing exactly at technical levels the other analysts are watching.

The 50-day moving average and the 200-day moving average work very effectively as support and resistance levels. Once candlestick signals and reversals can be identified as being influenced by the moving averages, then they can be used as likely targets in the next move. Does that mean prices will move to those levels? Definitely not! But they provide a *projected* target. The likelihood of those targets being an influence on the future price movement is relatively high. A key word in this statement is the word relatively. The advantage of the candlestick signals is to see what investor sentiment is doing at any time during a price trend. That could mean that a bounce off the 50-day moving average with the next projected target at the 200-day moving average is a good possibility. Nevertheless, witnessing what the signals <u>are</u> doing during that trend is the more important element.

Because the moving averages are such a highly watched trading level, being able to see what the trading activity is at those levels provides an excellent buy and sell format for the candlestick investor.

Clearly seen in the BEBE chart, the 50-day moving average has a definite influence on supporting the price of the stock. The 200-day moving average, the next likely target clearly revealed that the investor sentiment was changing once it reached that level. This resistance level showed confirmation that the Bulls were running out of steam at that level. The Spinning Tops and the Bearish Engulfing signal clearly reveal that the 200-day moving average was going to act as resistance.

When one moving average acts as resistance, what is the next likely target? The next lower moving average. In this case, the 50-day moving average. Note how the selling stopped right on the 50-day moving average with a Bullish Engulfing signal.

If short from the 200-day moving average, the probabilities of a bullish signal right on the 50-day moving average, with stochastics in the oversold condition, becomes an extremely high probability area to cover the short position.

BEBE

Watch for signals at levels that other investors are anticipating something to happen. The advantage that the candlestick signals provide is an immediate confirmation of what investor sentiment is doing at those levels.

Use support and resistance levels with candlestick signals to your advantage

A well known technical investment rule is when a support or resistance level is finally breached, it will usually tested one more time to see if the resistance level now acts as support. The opposite is true if a support level is finally breached; prices will come back up to test it to see if it will act as resistance.

A failure of a major moving average

A common rule is "if that moving average fails, prices will test the recent lows, where the prices bottomed and came back up to test the moving average. If that level fails, the next major moving average is likely to become the next target."

The same will be true once a price comes up and breaches a resistance level. Once the price moves above the resistance level, it is not unusual to see the price come back down and test that resistance level one more time. The advantage of the candlestick signals is that it will reveal immediately whether that once resistance level will now act as support. If it does, the price will now move up above the recent high an attempt to test the next moving average.

ITRI

This produces very simple trading strategies using candlestick signals. Once a price comes up through a moving average/resistance level, and sell signals form, a logical pullback target can be established. A pullback to that level should be expected.

The same is true with a price falling down through a support level. The price should come back up and see if that support level is now going to act as resistance. The candlestick signals will reveal that information very quickly at those levels.

The signal is the main factor

The optimal reversal signals occur when the confirming indicators are also occurring. For example, it is best to see a candlestick buy signal occur when the stochastics reveal the trend being in the oversold condition. However, keep in mind that is the optimal place to see a reversal. The information conveyed by the candlestick signals is the fact that there has been a change of investor sentiment. A candlestick 'buy' signal, occurring when the stochastics are yet to reach an oversold condition is still conveying some very important information. Heed that signal immediately.

Will that signal indicate a major reversal if the stochastics are not in the optimal conditions? Don't know! Nevertheless, the fact that the signal appeared needs to be addressed. A confirmation of that signal can be acted upon as if a reversal had occurred with the realization that it has not occurred in the optimal conditions. This would make following that position with more diligence. Maybe it is just a bounce in a trend. If so, an investor can be ready to close the position more quickly if weakness in that bounce starts to become evident.

The signal in itself is the most important factor for identifying what investor sentiment is doing. The confirming indicators are still secondary considerations. A signal forming when stochastics may not be in the optimal conditions may have other factors to consider.

The signal could be forming as part of a trading pattern. Trading patterns such as Jay-hook patterns, the Cradle pattern, the Scoop pattern, and Fry Pan Bottoms can have major reversal signals appearing when stochastics are in much higher levels.

RMIX

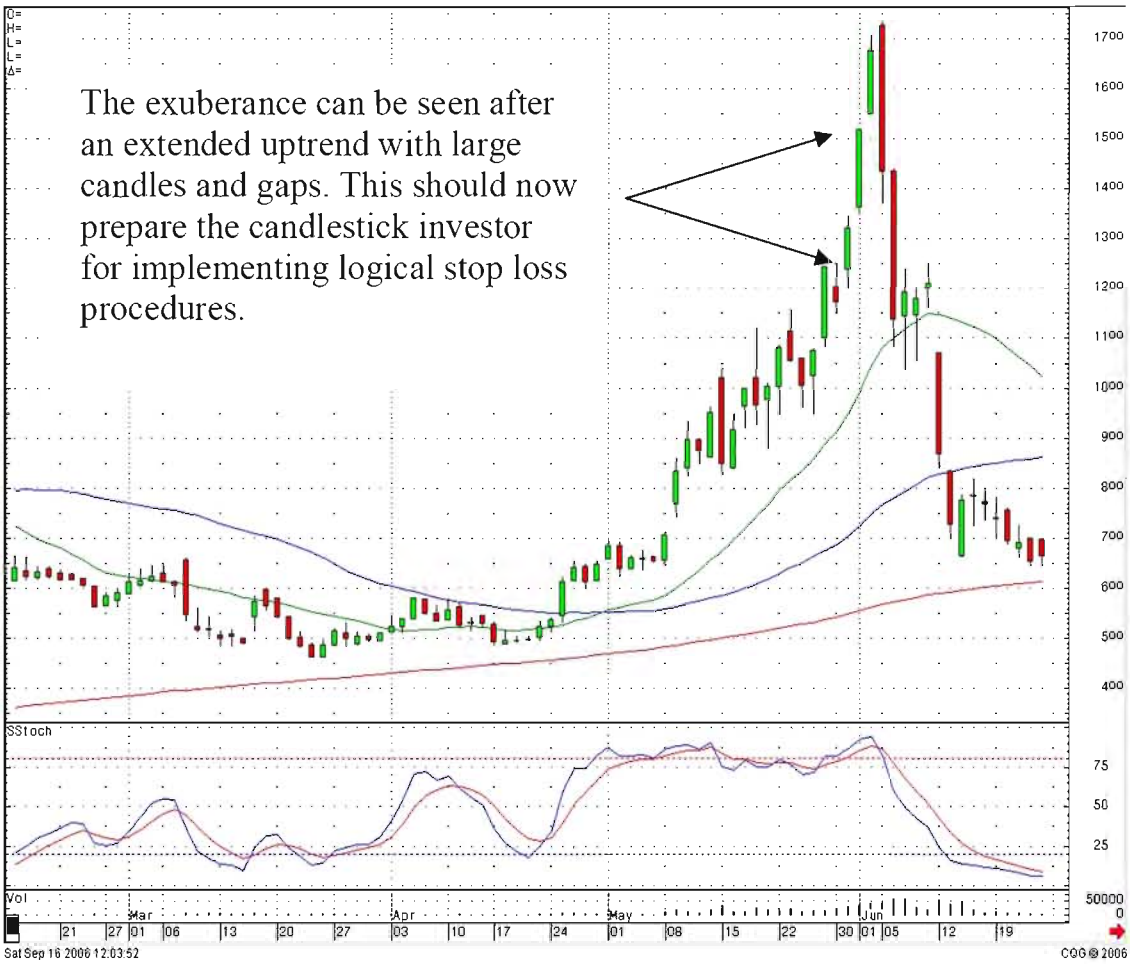
Simple Rules for Gaps with Candlestick Signals

Identifying candlestick reversal signals produces the information that has been statistically verified through centuries of actual use. They are here today because they have produced high probabilities of a potential reversal. What is needed to demonstrate a high probability that a reversal has occurred? Confirmation that a new trend is starting! Gaps are your strongest indicator that a trend is getting the buying or selling needed to confirm a reversal. A gap up in price after a candlestick buy signal clearly illustrates the urgency that the buyers now want to be participating in the new uptrend. A gap down in price after the appearance of a candlestick sell signal clearly illustrates the urgency of the sellers wanting to be out of that position. The appearance of gaps in conjunction with candlestick signals provides the information needed to identify powerful price moves.

A gap up at the top

Where do most investors buy? They buy exuberantly at the top. If a trend can be observed in the overbought condition, what should the prudent investor be looking for? The indications of a sell signal. What does a gap up in overbought condition illustrate? Exuberant buying at the top. **Witnessing a gap up in the overbought conditions should alert an investor to start watching for the opportunity to start taking profits.**

IFO



A gap down at the bottom

Where do most investors sell? They usually panic sell at the bottom. The fear factor usually becomes more pronounced at the end of an extended downtrend. That fear factor becomes graphically obvious when the candle bodies start becoming larger as the downtrend persists. OR the appearance of the price gapping down in the oversold conditions demonstrates the capitulation. **Upon seeing prices gap down in oversold condition, be prepared to start covering short positions or watching for your buy signal.**

HNT

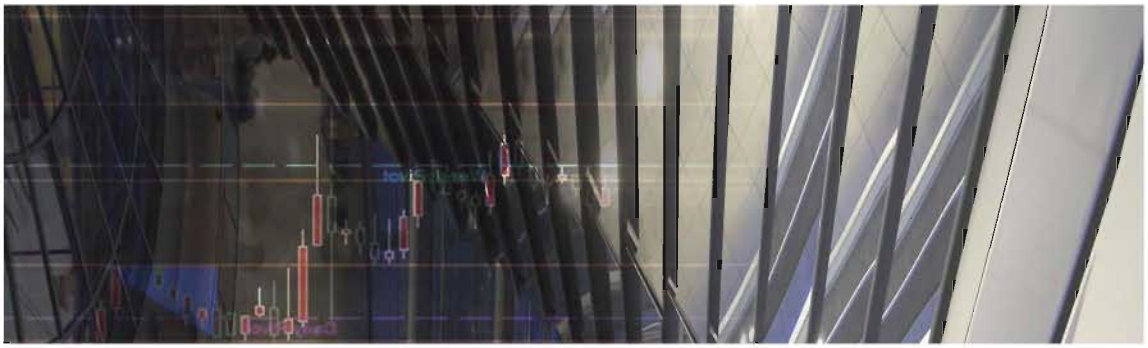
A gap down at the top

Witnessing a candlestick sell signal, in an overbought condition, produces a high probability situation the uptrend is over. Witnessing a gap down in price after that sell signal illustrates a simple fact. The sellers want out of this position with exuberance. The powerful price moves to the downside occur when the sellers are demonstrating that they want to be out of that position quickly. **A candlestick sell signal followed by a gap down in price becomes a very strong short position candidate.**

A gap up at the bottom

What is the Golden goose every investor is looking for? That stock position that is going to produce big gains. Is there any signals that produce the visual alert that a big price move is about to occur? Yes, the candlestick buy signal in oversold condition followed by a gap up in price. What does a candlestick buy signal illustrate? That there has been a change of investor sentiment at the bottom of a trend. What does a gap up in price illustrate? That after a candlestick buy signal has revealed that the downtrend has possibly stopped, the gap up in price illustrates that the buyers are trying to get into that position with great force. What is the best potential for a strong bullish price move? A price move that has the Bulls wanting to get into that position with great force. **A candlestick buy signal in oversold condition followed by a gap up in price produces your strongest of trends.**

The Significance of the Major Signals



This eBook has been written to describe the major signals. The purpose for this is to expedite the learning process. There are two definitions of major signals. Both are related to their importance for creating profits. As discussed earlier, a major drawback in the Candlestick signals being extensively utilized in the U.S. investment arena has persisted. It has been perceived that learning the signals is a lengthy and labor-intensive process.

Until recently, that was relatively true. True in the sense that there were very few people that understood the signals well enough to educate others on how to use them. That has now changed. Due to the dramatic decline in the stock market, beginning from March of 2000, the interest in Candlestick analysis has increased. Investors that had not lost money, over the next five years, came face to face with a reality check. Markets that do not go straight up require a more sophisticated investment program.

The two aspects of the major signals are simple. First, they are considered major because they produce a high probability for a reversal. Secondly, they occur frequently, providing numerous opportunities to profit from them. Keep in mind, Japanese rice traders observed the signals for centuries. They were able to categorize the signals. This categorization was the result of a basic parameter, PROFITS. Profits become a very good cultivation element. The Candlestick Forum categorizes these signals for the additional ease for learning.

All the signals have credibility. Yet some of the secondary signals only occur on rare occasion. The secondary signals are important to know, however they will be much less vital to successful investing. The secondary signals, although being extremely accurate may not appear enough to make putting a lot of time and effort into learning them initially. Learning them is important. There will be times when a secondary signal appears and it is beneficial to know what may occur in the near future. This is directed more toward the indexes. An inexpensive learning tool is the **Candlestick Flash Card Set 1**. The few dollars spent on this simple method for learning proper trading of the Candlestick Signals will save you hours of time and frustrations. It is well worth your while to learn the simple methods for ingraining the visual signal characteristics into your mind. Any one of these signals exploited properly could mean many thousands of dollars of profit in your pocket.

THE DOJI

The Doji is comprised of one candle. The Japanese say when a Doji occurs, one should always take notice. It is one of the most important Candlestick signals. The formation is created when the opening price and closing price are the same. This forms a horizontal line. The implication is that the bulls and the bears are in a state of indecision. It is an important alert at both the top and bottom of trends.

1. **At the top of a trend, the Doji signals a reversal without needing confirmation. The rule of thumb is that you should close a long or go short immediately.**

2. **The open and the close are the same or very near the same. The body should be extremely small. The Spinning Top signal also reveals the same formation, a small body. It represents the same information as the Doji.**

3. **The Doji occurring during the downtrend requires a bullish day to confirm the Doji day. The Japanese explanation is that the weight of the market can still force the trend downwards.**

4. **A gap away from the previous days close sets up for a stronger reversal move.**

5. **The length of the shadow does not need to be excessively long, especially when viewed at the end of a bullish trend, but a Long-legged doji demonstrates much greater indecision, producing more evidence that a change of investor sentiment is occurring.**

6. **A small Doji with large volume is also very indicative of a change of a price trend. Watch for immediate confirmation.**

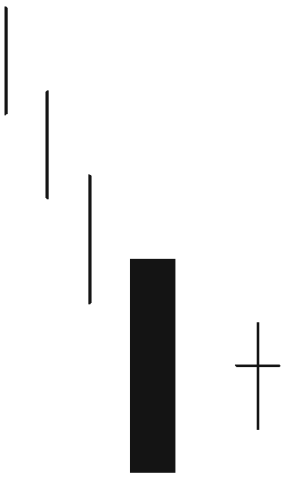
7. **If one Doji demonstrates indecision, a series of Doji illustrate much greater indecision. The trend will move in the direction of how the price immediately moves after the series of Doji.**

8. **Witnessing a Doji at the end of a relatively flat trading area, watch how the price moves dramatically after that Doji. That will indicate a strong price move in that direction.**

9. **A Doji as part of a multi-day signal, such as a Harami or Morning Star signal, will be a much stronger reversal signal potential for that signal.**

10. **Large volume on the Doji signal day increases the chances that a blow off day has occurred although it is not a necessity.**

Doji at end of flat trading

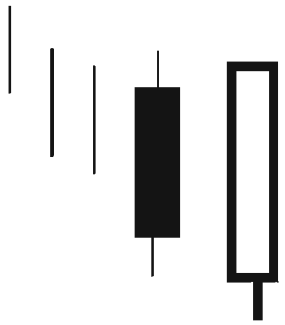


Harami – Doji

Morning Star – Abandoned Baby

ENGULFING PATTERNS

BULLISH ENGULFING



The Engulfing pattern is a major reversal pattern comprised of two opposite colored bodies. The Bullish Engulfing Pattern is formed after a downtrend. It opens lower that the previous day's close and closes higher than the previous day's open. Thus, the white candle completely engulfs the previous day's black candle. Engulfing can include either the open or the close being equal to the open or close of the previous day but not both.

1. The body of the second day completely engulfs the body of the first day. Shadows are not a consideration.

2. Prices have been in a definable down trend, even if it has been short term.

3. Large volume on the engulfing day increases the chances that a blow off day has occurred.

4. The body of the second candle is opposite color of the first candle, the first candle being the color of the previous trend. The exception to this rule is when the engulfed body is a doji or an extremely small body.

5. A large body engulfing a small body. The previous day was showing the trend was running out of steam.

   The large body shows that the new direction has started with good force.

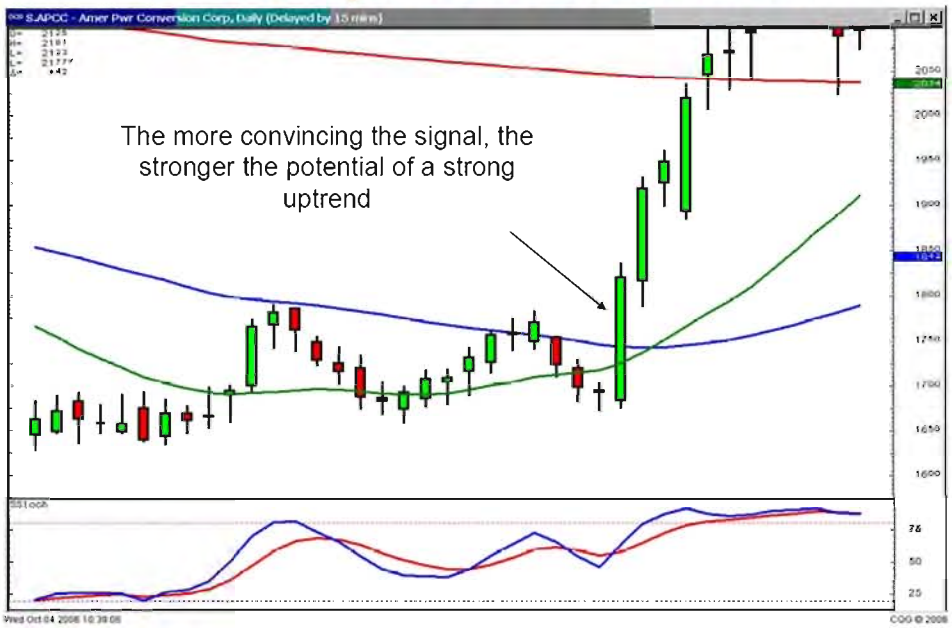
6. When the engulfing pattern occurs after a fast move down, there will less supply of stock to slow down the reversal move. A fast move makes a stock price over-extended and increases the potential for profit taking.

7. The engulfing body engulfing more than one previous body demonstrates power in the reversal.

8. If the engulfing body engulfs the body and the shadows of the previous day, the reversal has a greater probability of working.

9. The greater the open gaps down from the previous close, the greater the probability of a strong reversal.

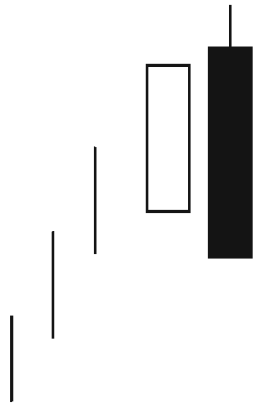
The Bigger the Bullish Engulfing Signal, the more powerful the reversal



ENGULFING PATTERNS

BEARISH

ENGULFING



The Bearish Engulfing pattern is a major reversal pattern comprised of two opposite colored bodies. The Bearish Engulfing Pattern is formed after an up trend. It opens higher that the previous day's close and closes lower than the previous day's open. Thus, the black candle completely engulfs the previous day's white candle. Engulfing can include either the open or the close be equal to the open or close of the previous day but not both.

1. **The body of the second day completely engulfs the body of the first day. Shadows are not a consideration.**

2. **Prices have been in a definable down trend, even if it has been short term.**

3. **The body of the second candle is opposite color of the first candle, the first candle being the color of the previous trend. The exception to this rule is when the engulfed body is a Doji or an extremely small body.**

4. **A large body engulfing a small body. The previous day was showing the trend was running out of steam. The large body shows that the new direction has started with good force.**

5. **When the engulfing pattern occurs after a fast spike up, there will less supply of stock to slow down the reversal move. A fast move makes a stock price over-extended and increases the potential for profit taking and a meaningful pullback.**

6. **Large volume on the engulfing day increases the chances that a blow off day has occurred.**

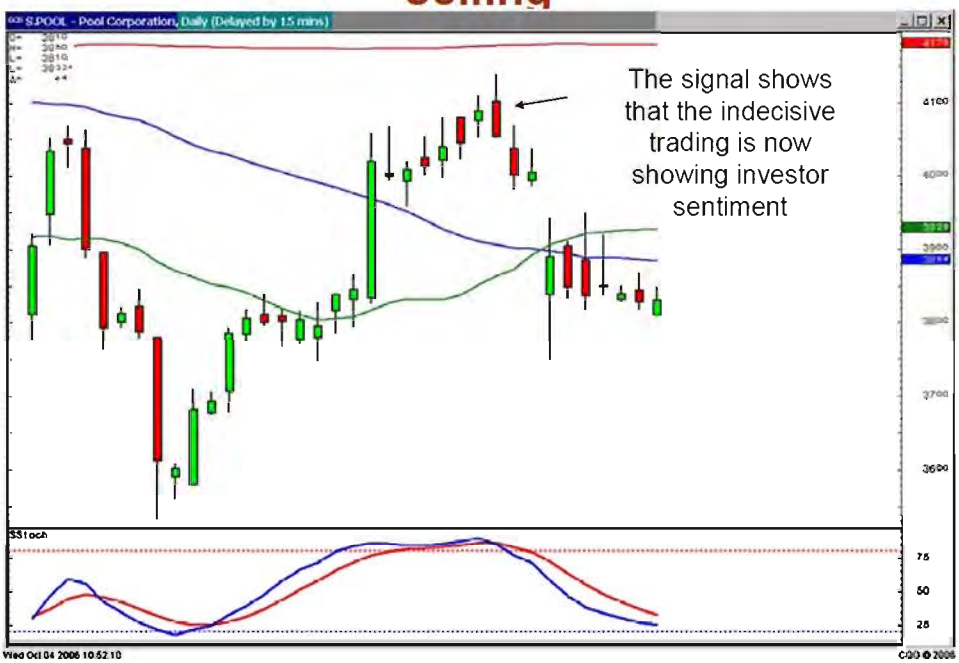
7. **A Bearish Engulfing signal following potential sell signals is a clear indication that the sellers have taken control. The previous sell signals need confirmation, the Bearish Engulfing signal is the final indicator.**

8. **The engulfing body engulfing more than one previous body demonstrates power in the reversal.**

9. **If the engulfing body engulfs the body and the shadows of the previous day, the reversal has a greater probability of working.**

10. **The greater the open gaps up from the previous close, the greater the probability of a strong reversal.**

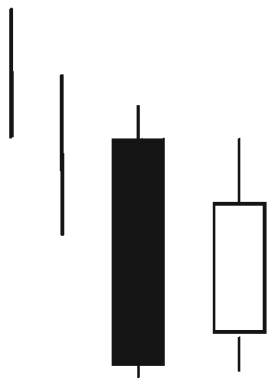
A Bearish Engulfing signal confirms the selling



HARAMI

BULLISH

HARAMI



The Harami is an often seen formation. The pattern is composed of a two candle formation in a down-trending market. The body of the first candle is the same color as the current trend. The first body of the pattern is a long body, the second body is smaller. The open and the close occur inside the open and the close of the previous day. It's presence indicates that the trend is over.
The Japanese definition for Harami is pregnant woman or body within. The first candle is black, a continuation of the existing trend. The second candle, the little belly sticking out, is usually white, but that is not always the case (See Homing Pigeon). The location and size of the second candle will influence the magnitude of the reversal.

1. **The body of the first candle is black, the body of the second candle is white.**

2. **The downtrend has been evident for a good period. A long black candle occurs at the end of the trend.**

3. **The second day opens higher than the close of the previous day and closes lower than the open of the prior day.**

4. **Unlike the Western "Inside Day", just the body needs to remain in the previous day's body, where as the "Inside Day" requires both the body and the shadows to remain inside the previous day's body.**

5. **For a reversal signal, further confirmation is required to indicate that the trend is now moving up. A gap up in price the next day is good strong confirmation.**

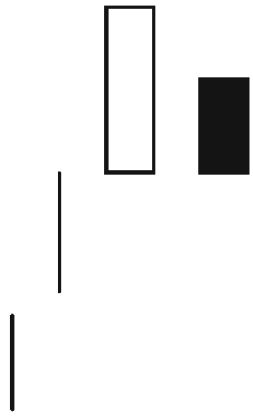
6. **The longer the black candle and the white candle, the more forceful the reversal.**

7. **The higher the white candle closes up on the black candle, the more convincing that a reversal has occurred despite the size of the white candle.**

A Harami needs confirmation

HARAMI

(Harami)



BEARISH

HARAMI

The Bearish Harami is the exact opposite of the Bullish Harami. Again, the pattern is composed of a two candle formation. The body of the first candle is the same color as the current trend. The first body of the pattern is a long body. The second body is smaller. The open and the close occur inside the open and the close of the previous day. Its presence indicates that the trend is over.

1. The body of the first candle is white, the body of the second candle is Black.

2. The up-trend has been apparent. A long white candle occurs at the end of the trend.

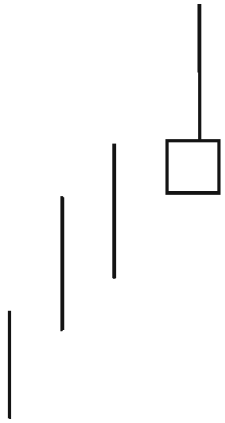
3. The second day opens lower than the close of the previous day and close higher than the open of the prior day.

4. For a reversal signal, confirmation is needed. The next day should show weakness.

5. The longer the white candle and the black candle, the more forceful the reversal. The lower the black candle closes down on the white candle, the more convincing that a reversal has occurred, despite the size of the black candle

SHOOTING STAR

SHOOTING STAR



The Shooting Star is also comprised of one candle. It is easily identified by the presence of a small body with a shadow at least two times greater than the body. It is found at the top of an up trend. The Japanese named this pattern because it looks like a shooting star falling from the sky with the tail trailing it.

1. The upper shadow should be at least two times the length of the body.

2. The real body is at the lower end of the trading range. The color of the body is not important although a black body should have slightly more bearish implications.

3. There should be no lower shadow or a very small lower shadow.

4. The following day needs to confirm the Shooting Star signal with a black candle or better yet, a gap down with a lower close.

5. The longer the upper shadow, the higher the potential of a reversal occurring.

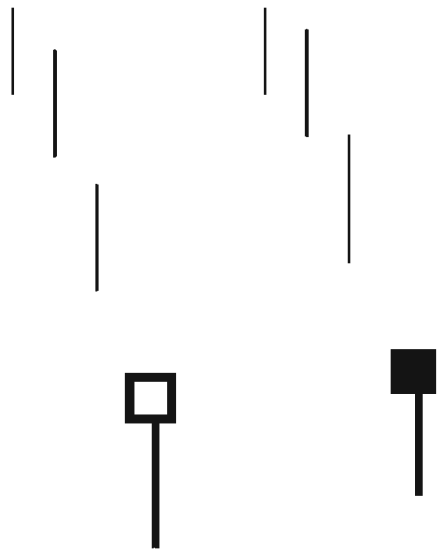
6. A gap up from the previous days close sets up for a stronger reversal move provided the day after the Shooting Star signal opens lower.

7. Large volume on the Shooting Star day increases the chances that a blow-off day has occurred although it is not a necessity.

The bigger the upper shadow, the more convincing the reversal

HAMMERS

HAMMERS
(TAKURI)



The Hammer is comprised of one candle. It is easily identified by the presence of a small body **with a shadow at least two times** greater than the body. Found at the bottom of a downtrend, this shows evidence that the bulls started to step in. The color of the small body is not important but a white candle has slightly more bullish implications than the black body. A positive day is required the following day to confirm this signal.

1. **The lower shadow should be at least two times the length of the body.**

2. **The real body is at the upper end of the trading range. The color of the body is not important although a white body should have slightly more bullish implications.**

3. **There should be no upper shadow or a very small upper shadow.**

4. **The following day needs to confirm the Hammer signal with a strong bullish day.**

5. **The longer the lower shadow, the higher the potential of a reversal occurring.**

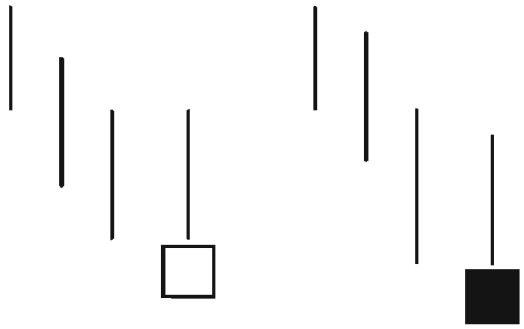
6. **A gap down from the previous day's close sets up for a stronger reversal move provided the day after the Hammer signal opens higher.**

7. **Large volume on the Hammer day increases the chances that a blow off day has occurred.**

The Hammer Tail provides important info

INVERTED HAMMERS

INVERTED HAMMERS



The Inverted Hammer is comprised of one candle. It is easily identified by the presence of a small body with a shadow at least two times greater than the body. Found at the bottom of a downtrend, this shows evidence that the bulls started to step in, but that the selling was still going on. The color of the small body is not important but a white candle has slightly more bullish implications than the black body. A positive day is required the following day to confirm this signal.

1. The upper shadow should be at least two times the length of the body.

2. The real body is at the lower end of the trading range. The color of the body is not important although a white body should have slightly more bullish implications

3. There should be no lower shadow or a very small lower shadow.

4. The following day needs to confirm the Inverted Hammer signal with a strong bullish day.

5, The longer the upper shadow, the higher the potential of a reversal occurring. The bullish movement of the trading has made the bears nervous.

6. A gap down from the previous day's close sets up for a stronger reversal move provided the day after the hammer signal opens higher.

7. Large volume on the Reverse Hammer day increases the chances that a reversal in day has occurred.

The upper shadow is what made the bears nervous

HANGING MAN

HANGING MAN

The Hanging Man is also comprised of one candle. It is easily identified by the presence of a small body with a shadow at least two times greater than the body. It is found at the top of an up trend. The Japanese named this pattern because it looks like a head with the feet dangling down.

1. **The upper shadow should be at least two times the length of the body.**

2. **The real body is at the upper end of the trading range. The color of the body is not important although a black body should have slightly more bearish implications.**

3. **There should be no upper shadow or a very small upper shadow.**

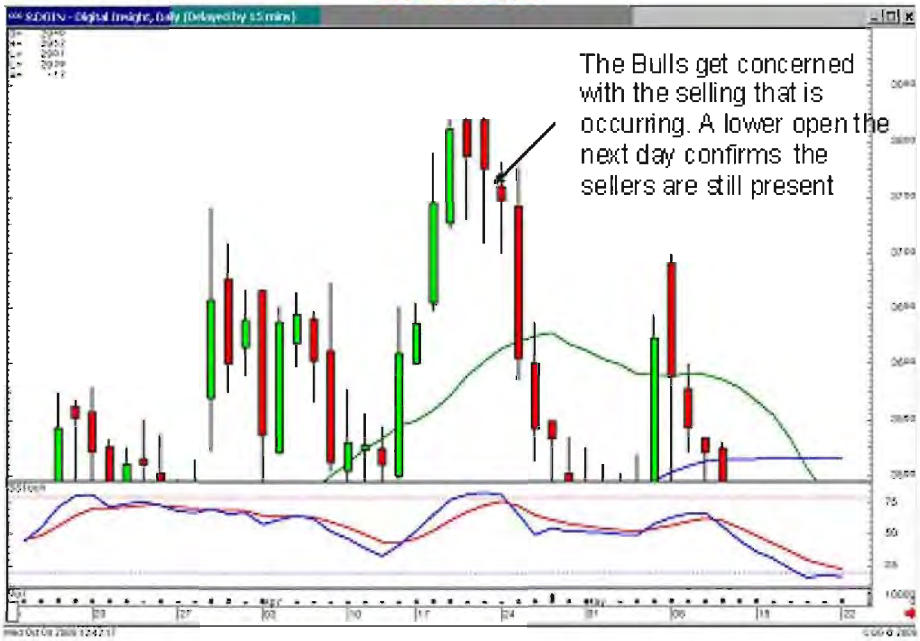
4. **The following day needs to confirm the Hanging Man signal with a black candle or better yet, a gap down with a lower close.**

5. **The longer the lower shadow, the higher the potential of a reversal occurring.**

6. **A gap up from the previous days close sets up for a stronger reversal move provided the day after the Hanging Man signal trades lower.**

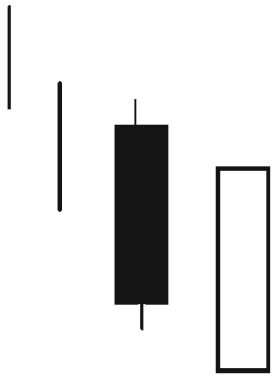
7. **Large volume on the signal day increases the chances that a blow off day has occurred although it is not a necessity.**

The lower shadow starts creating concern for the Bulls



PIERCING PATTERN

PIERCING PATTERN



The Piercing Pattern is composed of a two candle formation in a down-trending market. The first candle is black, a continuation of the existing trend. The second candle is formed by opening below the low of the previous day. It closes more than midway up the black candle, near or at the high for the day

1. **The body of the first candle is black, the body of the second candle is white.**

2. **The downtrend has been evident for a good period. A long black candle occurs at the end of the trend.**

3. **The second day opens lower than the trading of the prior day.**

4. **The white candle closes more than half-way up the black candle.**

5. **The longer the black candle and the white candle, the more forceful the reversal.**

6. **A greater the gap down from the previous days close, the more pronounced the reversal.**

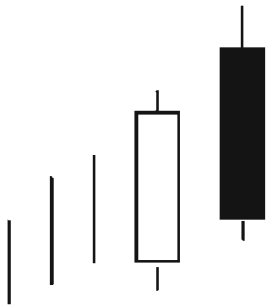
7. **The higher the white candle closes into the black candle, the stronger the reversal.**

8. **Large volume during these two trading days is a significant confirmation.**

The price gapping down at the bottom starts the Piercing signal

DARK CLOUD COVER

DARK CLOUD COVER



The Dark Cloud Cover is the bearish counterpart to the Piercing pattern. The first day of the pattern is a long white candle at the top end of a trend. The second day's open is higher that the high of the previous day. It closes at least one-half way down the previous day candle, the further down the white candle, the more convincing the reversal. Remember that a close at or below the previous day's open turns this pattern into a Bearish Engulfing pattern. Kabuse means to get covered or to hang over.

1. **The body of the first candle is white, the body of the second candle is black.**

2. **The up-trend has been evident for a good period. A long white candle occurs at the top of the trend.**

3 **The second day opens higher than the trading of the prior day.**

4 **The black candle closes more than half-way down the white candle.**

5. **The longer the white candle and the black candle, the more forceful the reversal.**

6. **A higher the gap up from the previous days close, the more pronounced the reversal.**

7. **The lower the black candle closes into the white candle, the stronger the reversal.**

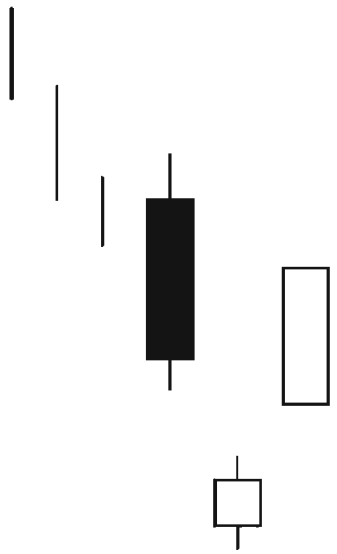
8. **Large volume during these two trading days is a significant confirmation .**

A greater the gap up, followed by a weak close, makes the Dark Cloud more significant

MORNING STAR

MORNING

STAR



The Morning Star pattern is a bottom reversal signal. Like the planet Mercury, the morning star, it foretells that brighter things, sunrise, is about to occur. Or that prices are going to go higher. It is formed after a obvious downtrend. It is made by a long black body, usually one of the fear induced days at the bottom of a long decline. The following day gaps down. However, the magnitude of the trading range remains small for the day. This is the star of the formation. The third day is a white candle day. And represents the fact that the bulls have now stepped in and seized control. The optimal Morning Star signal would have a gap before and after the star day.

The make up of the star, an indecision formation, can consist of a number of candle formations. The important factor is to witness the confirmation of the bulls taking over the next day. That candle should consist of a closing that is at least halfway up the black candle of two days prior. Identifying the Morning Star signal is relatively easy. It is visually apparent to the eye.

1. The down-trend has been apparent.

2. The body of the first candle is black, continuing the current trend. The second candle is an indecision formation.

3. The third day shows evidence that the bulls have stepped in. That candle should close at least halfway up the black candle.

4. The longer the black candle and the white candle, the more forceful the reversal.

5. The more indecision that the star day illustrates, the better probabilities that a reversal will occur.

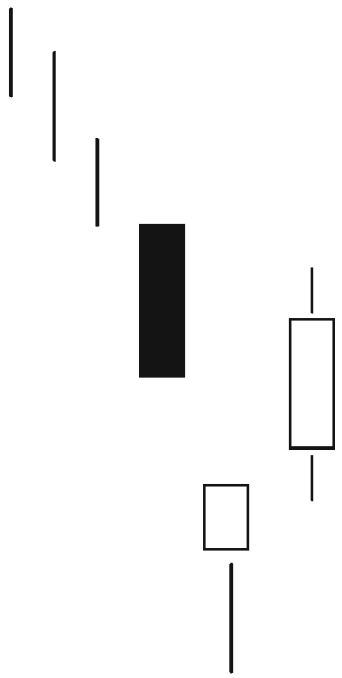
6. A gap between the first day and the second day adds to the probability that a reversal is occurring.

7. A gap before and after the star day is even more desirable.

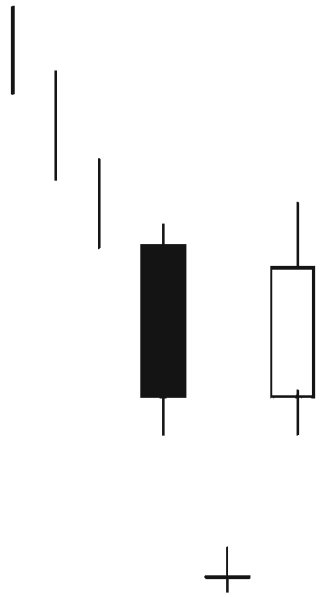
8. The magnitude, that the third day comes up into the black candle of the first day, indicates the strength of the reversal.

A gap down followed by a gap up in a morning star signal makes the reversal much more powerful

MORNING STAR DERIVATIVES

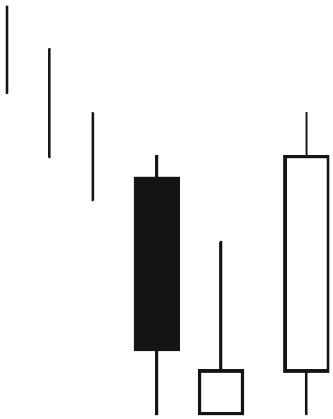


HAMMER

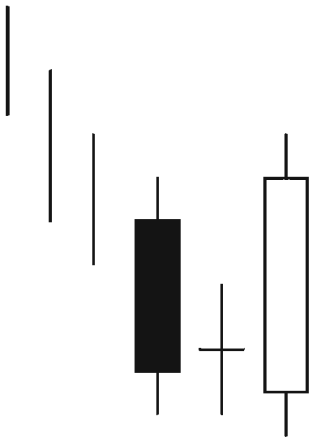


ABANDONED BABY

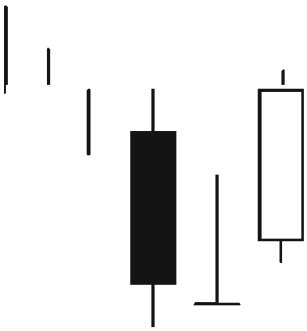
MORNING STAR DERIVATIVES



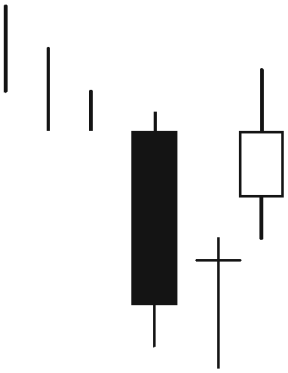
REVERSE HAMMER



DOJI STAR



GRAVESTONE DOJI

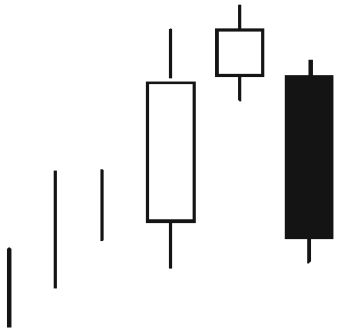


DOJI CROSS

EVENING STAR

EVENING

STAR



The Evening Star pattern is a top reversal signal. It is exactly opposite the Morning Star signal. Like the planet Venice, the evening star, it foretells that darkness is about to set or that prices are going to go lower. It is formed after an obvious uptrend. It is made by a long white body occurring at the end of an up-trend., usually when the confidence has finally built up. The following day gaps up, yet the trading range remains small for the day. Again, this is the star of the formation. The third day is a black candle day. And represents the fact that the bears have now seized control. That candle should consist of a closing that is at least halfway down the white candle of two days prior. The optimal Evening Star signal would have a gap before and after the star day.

1. The up trend has been apparent.
2. The body of the first candle is white, continuing the current trend. The second candle is an indecision formation.
3. The third day shows evidence that the bears have stepped in. That candle should close at least halfway down the white candle.
4. The longer the white candle and the black candle, the more forceful the reversal.

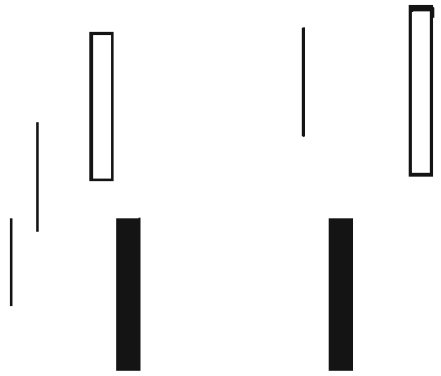
5. The more indecision that the star day illustrates, the better probabilities that a reversal will occur.

6. A gap between the first day and the second day adds to the probability that a reversal is occurring.

7. A gap before and after the star day is even more desirable. The magnitude that the third day comes down into the white candle of the first day, indicates the strength of the reversal.

The third candle of the pattern indicates the strength of the new direction

KICKER SIGNAL



The Kicker Signal is the most powerful signal of all. It works equally well in both directions. Its relevance is magnified when occurring in the overbought or oversold area. It is formed by two candles. The first candle opens and moves in the direction of the current trend. The second candle opens at the same open of the previous day, a gap open, and heads in the opposite direction of the previous day's candle. The bodies of the candles are opposite colors. This formation is indicative of a dramatic change in investor sentiment. The candlesticks visually depict the magnitude of the change.

1. The first day's open and the second day's open are the same. The price movement is in opposite directions from the opening price.
2. The trend has no relevance in a kicker situation.
3. The signal is usually formed by surprise news before or after market hours.
4. The price never retraces into the previous days trading range.
5. The longer the candles, the more dramatic the price reversal.
6. Opening from yesterday's close to yesterday's open already is a gap. However, gapping away from the previous day's open further enhances the reversal.

Why Use Rules

Not to have control over the senses is like sailing in a rudderless ship, bound to break to pieces on coming in contact with the very first rock.
Mahatma Gandhi

Trading rules are established to provide guidelines. Are there exceptions to the rules? Definitely! But rules for your investment program should be for the development of proper trading habits. Correct investment perceptions are developed through a minefield of emotional hurdles.

Utilizing a set of rules keeps the investor from backsliding into old habits. The statistical value of candlestick signals provides a format for an investor to have the probabilities constantly in their favor. Establishing a set of rules for your investment procedures is also putting favorable guidelines into an investment program. Utilize the experience conveyed by successful investors. The rules that were expressed in this chapter were provided by the investment knowledge of successful investors throughout the years.

Trying to formulate a successful investment program without guidelines is like running in quicksand. The basis for the successful consistent extraction of profits from the trading markets is not only learning a high-probability trading technique, but also establishing investment procedures to keep those profits.

There are a set of rules to apply to the candlestick patterns, not shown in this e-book. It is much better to learn what the rules are for each of those patterns specifically. Our training CDs on the high profit patterns go into greater detail about how to analyze those patterns. Each pattern has its own specific set of rules for getting in, for staying in, and for closing out the trade immediately. Please use our training CDs to gain a better understanding for identifying candlestick signals and patterns. Understanding the rules that make those patterns work provide an excellent format for staying in a trade or getting out of a trade.

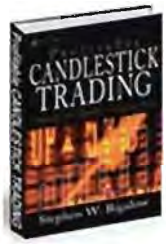
Stephen W. Bigalow

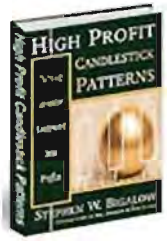
Over 30 years of of investment experience, including eight years as a stockbroker with major Wall Street firms.

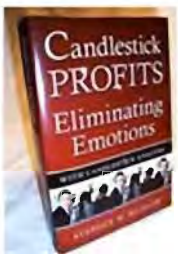
Business and Economics degree from Cornell University

Active member of AAPTA, the American Association of Professional Technical Analysts

Published Author of 3 Candlestick Analysis Trading Books







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