

Introduction to Japanese Candlesticks

What are Candlesticks?

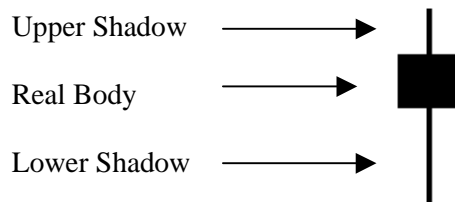
Candlesticks are a method of charting prices for financial markets. They were the precursor to the modern-day bar chart and are used today as an analytical tool by technical traders.

They are very similar to bar charts in that they are built using only four pieces of data: opening, high, low and closing prices.

It is important to realize that *candlesticks do not tell you anything different than a bar chart* because they are based on exactly the same data. However, candlesticks make certain patterns much easier to recognize.

Just like bar charts, candlesticks can be used in any time frame and are best used in conjunction with other technical indicators.

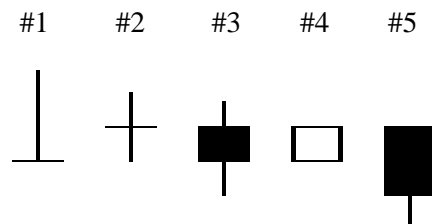
The Parts of a Candlestick



The top of the upper shadow is the high for the period, and the bottom of the lower shadow is period's low.

The height of the real body is the difference between the period's open and close. If the real body is **white** ("hollow"), the *close was higher than the open*; it was an "up" period. If the real body is **black** ("solid"), the *close was lower than the open*; it was a "down" period.

When the opening and closing prices are the same, there is no real body. These types of candles are called *doji* and usually signify a "market in balance." The first two candles below are examples of doji.



Here's how you'd read the candles above:

#1 - open, close and low were all the same

#2 - open and close were the same

#3 - close was lower than the open

#4 - opened at the period's low, closed at the period's high

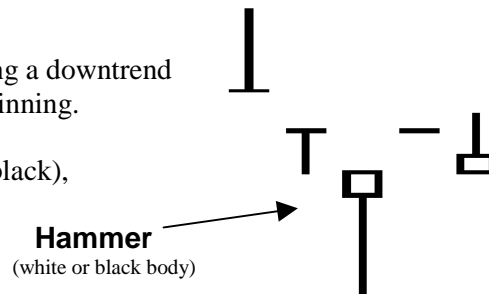
#5 - opened at the period's high

Bullish Candlestick Patterns

The Hammer

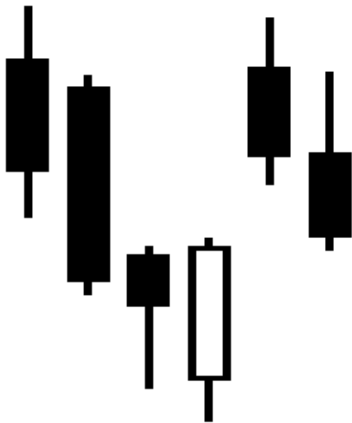
A candle like the one shown at the right that appears during a downtrend can signal that the downtrend is over and a reversal is beginning.

Characteristics: small real body (either white or black), no upper shadow.



Bullish Engulfing Pattern

This is a two candle pattern that can signal a reversal when it is formed during a downtrend.



Characteristics: a larger white body candle follows and “engulfs” the previous black candle.

(i.e. the black candle’s open is lower than the white candle’s close, and the black candle’s close is higher than the white candle’s open).

Since you’d need to wait until the second candle has finished being built in order to verify the pattern, you may miss a profitable trading opportunity if you use this pattern as an entry point. Another use of the Bearish Engulfing Pattern is as a support level for future prices. When prices retry the low of this two candle pattern, they will usually find strong support at this level.

The Piercing Pattern

This pattern can also signal a reversal when it appears during a downtrend. There are some important differences between this pattern and the Bearish Engulfing Pattern.

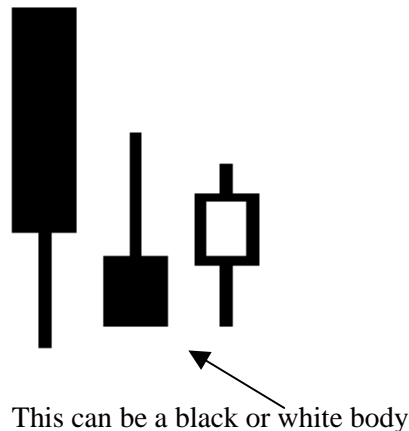
Characteristics: after a black candle, a white body candle gaps lower on the open, but closes within the body of the previous black candle.

The Morning Star

The Morning Star is a three candle pattern that signals a bottom reversal.

Characteristics:

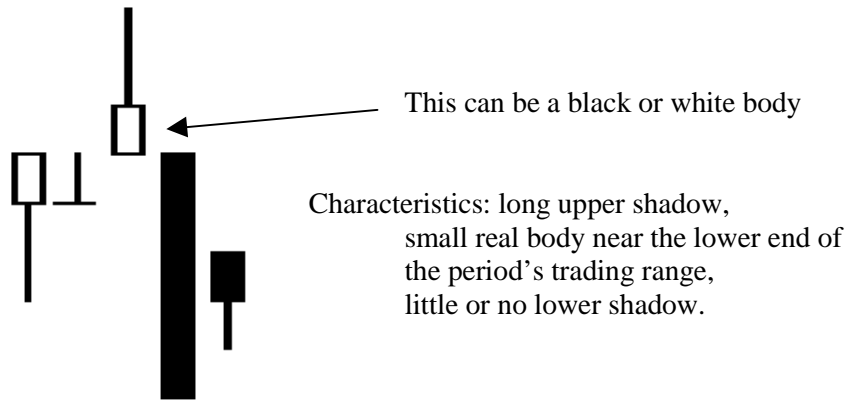
- 1st Candle: long black real body
- 2nd Candle: small real body (either white or black) that doesn’t touch the previous candle’s body
- 3rd Candle: white real body that trades into the range of the body of the first black candle.



Bearish Candlestick Patterns

The Shooting Star

When a Shooting Star appears during an uptrend, it can signal a bearish reversal.



Bearish Engulfing Pattern

This pattern is the bearish equivalent of the Bullish Engulfing Pattern. It signals a reversal in a rally.



Characteristics: a white candle occurring *during a rally* is followed by a black candle whose real body envelopes the white candle's real body (i.e. the black candle's open is higher than the white candle's close, and the black candle's close is lower than the white candle's open).

Dark Cloud Cover

Dark Cloud Cover is the bearish equivalent of the bullish Piercing Pattern. When it occurs during a rally, we expect a reversal is on the way.

Characteristics: long white real body, followed by a black candle. The black candle opens higher than the previous close, but closes well within the body of the white candle.



Evening Star

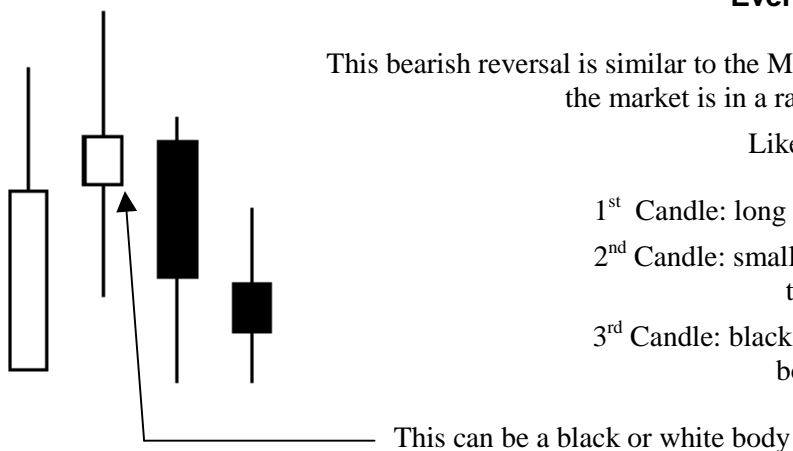
This bearish reversal is similar to the Morning Star pattern, except that it occurs when the market is in a rally and signals the beginning of a downtrend.

Like the Morning Star, it is a three candle pattern.

1st Candle: long white real body

2nd Candle: small real body (either white or black) that doesn't touch the previous candle's body

3rd Candle: black real body that trades into the range of the body of the first white candle.



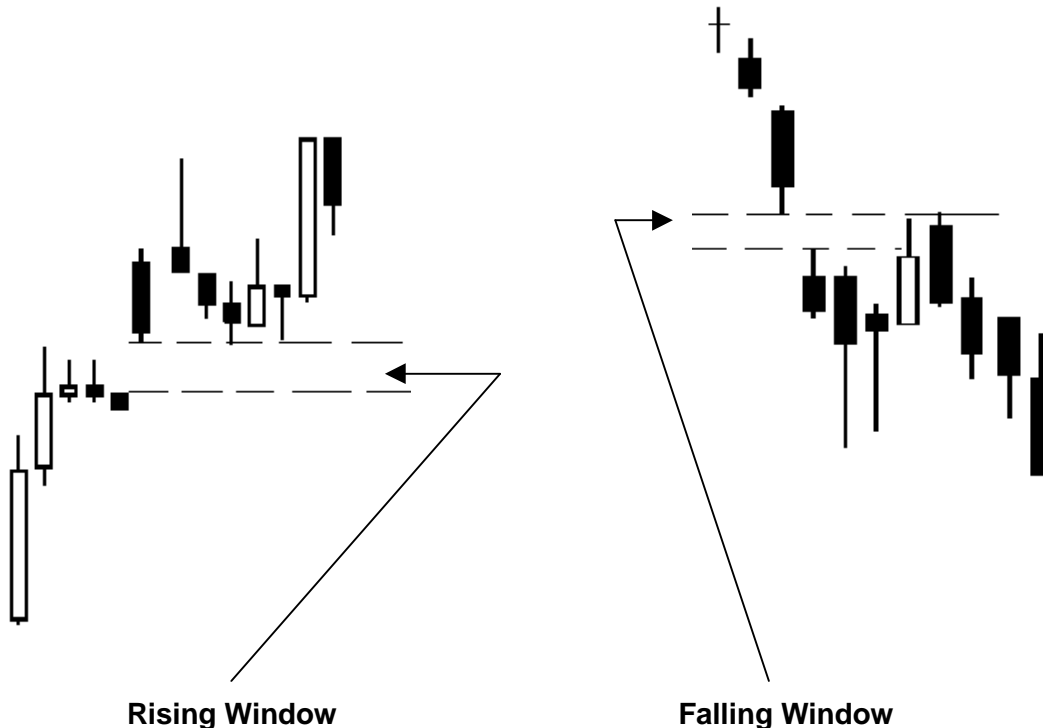
Windows

The bullish and bearish patterns above are *reversals*; they help you recognize when the market direction is changing.

There are also candlestick patterns which help you recognize that a trend is likely to continue. An example of such a pattern is a **window**. Windows are equivalent to gaps (up or down) on bar charts.

When the market gaps up or gaps down, it is a strong indication of market sentiment. Windows use this gap as a **support level** for small market corrections **if the market is trending up**, and as a **resistance level** if the market is **falling**.

Windows tell you that the current reversal is only a “blip,” and the longer term trend should continue.



The candle patterns above demonstrate how the gap (up or down) acts as a support or resistance area, respectively. Notice that the candle can move into the gap area intraday, but as long as it closes outside window, the window is still representing support or resistance.

Aspen Candlesticks

Candlesticks can be used in conjunction with any of the indicators in Aspen Graphics. Overlays, conventional Studies, DeMark and MESA indicators can all be charted on, and using, candlesticks.

Changing from Bars to Candlesticks

To convert a bar chart in Aspen to candlesticks, you can : 1) do a <Ctrl> **N** or
2) type: **.cand** <Enter> or
3) From a Graph Menu, select **Study**, and then choose **Candlesticks** in the upper left corner of the menu.

Changing the Colors of Candlesticks

A user can change the colors of candlesticks in Aspen. To do this, bring up a Parameter menu for your candlestick chart, and change the colors across from the “Bar,” “Down” and “Up” fields.

NOTE: As of version 3.02a, Color Rules can not be implemented on candlesticks.