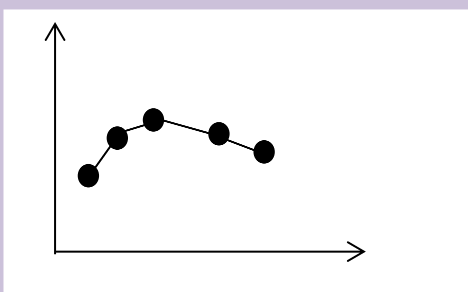
Kenanga Futures Sdn Bhd

Understanding Technical Analysis : Candlestick Charts

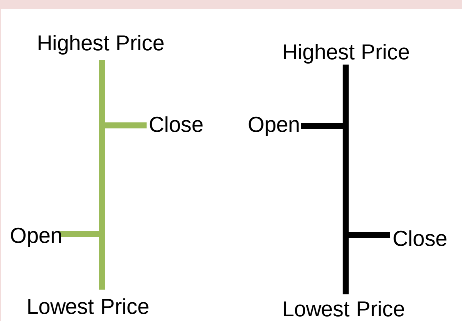
Understanding the Candlestick Chart Pattern

Charts are the most essential working tools of technical analysis. Traders or analysts often use chart formations to detect any pattern or trend formation for future prices' prediction and forecast. The three simplest and most commonly used charts are the line chart, bar chart and candlestick chart.



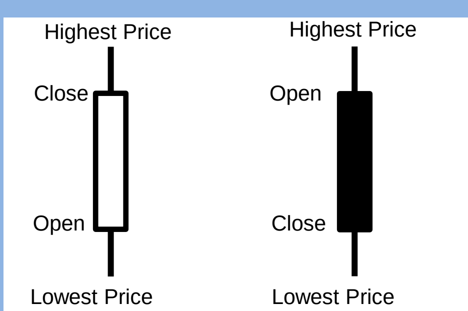
Line Chart

- The simplest form of technical chart in financial instrument analysis trading.
- The chart is constructed by connecting the daily closing price of the financial instrument, resulting in a continuous line being formed across the chart.



Bar Chart

- Unlike the line chart, the bar chart provide more information of the price action to the traders.
- Each day's price action is represented by a vertical bar.
- The upper end of the vertical bar is the highest price for the day, the lower end is the lowest price and the tic to the right of the bar is the closing price.



Candlestick Chart

- The most commonly used chart in technical analysis.
- Like the bar chart, the candlestick chart provides the price action information to traders through the real body and two shadows of upper and lower part.
- The existence of the real body provide useful information to traders on which type of traders dominate the session

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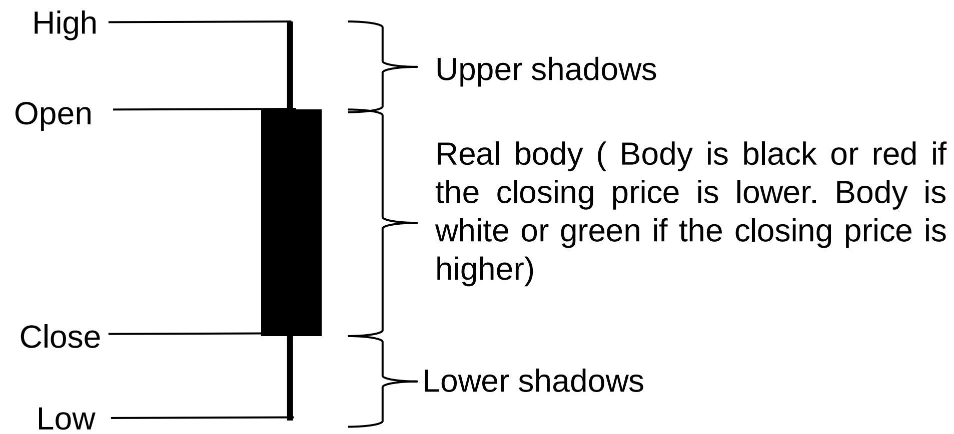
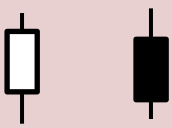
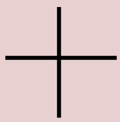
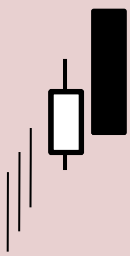
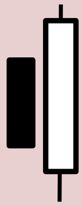
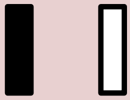
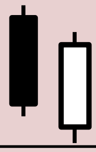
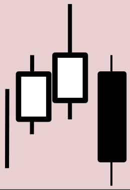
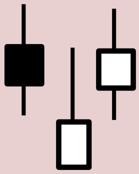
What is Candlestick Chart

Candlestick chart is the most popular components in technical analysis as it provides traders and analysts a better view of the financial instrument's price movement. The composition of this type of chart follows exactly the structure of a candle that consists a body and two lines, which is better known as shadows. Each candlestick represents the passage of a certain amount of time or the completion of a certain number of trades.



Candlestick Chart Patterns

	Spinning Top		Doji
	Dark Cloud		Engulfing
	Marubozu		Piercing Pattern
	Shooting Star		Inverted Hammer

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Identifying the Candlestick Chart Pattern

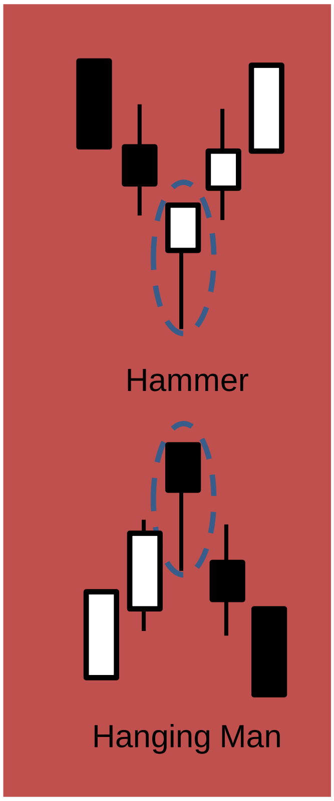
In technical analysis, traders or analysts will try to identify the potential direction of the financial instrument's price by identifying any candlestick chart pattern. Basically, a candlestick chart pattern is the trend in the movement of prices over a series of candlesticks, such as closing prices or highs or lows, during a specific period of time.

Generally, there are two types of candlestick chart pattern that are formed - **reversal or continuation chart patterns.**

Reversal Pattern

Reversal pattern is a type of candlestick chart pattern that signals a potential change of course of direction.

1 <u>Hammer and Hanging Man</u>



- Both hammer and hanging man candlestick can be identified through a formation of a candlestick with long lower shadows and no upper shadows.
- While both indicates a trend reversal, the nature of their appearance would tell the difference.
- A hammer candlestick can be identified in a downward trend which signifies the potential upward reversal.
- In contrast, the hanging man usually appears in an upward trend to signal the potential downward reversal.
- In identifying these type of candlesticks, one should be aware that the colour of the real body is not important.

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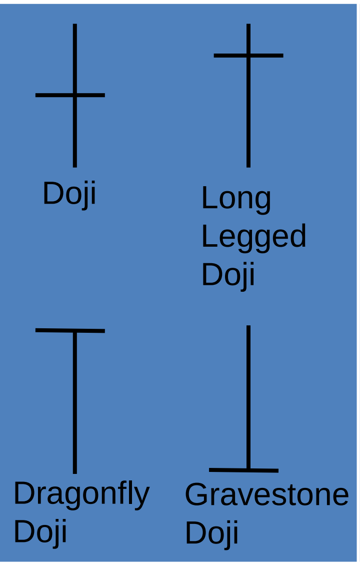
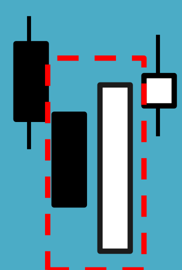
2 Doji

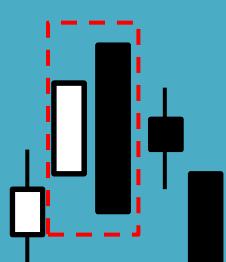


- A doji candlestick is a unique candlestick where it looks like a cross, inverted cross or a plus sign.
- Doji candlestick is often formed when there is an indecision in a market direction as the opening and closing price are near.
- Although doji candlestick is regarded as a neutral candlestick, its existence in the uptrend or downtrend can also be considered as a possible sign of trend reversal.
- There are many types of doji candlestick which are doji, long legged doji, dragonfly doji and gravestone doji.

3 Engulfing Pattern



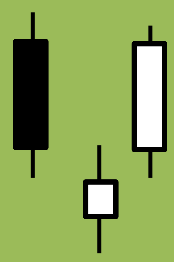
Bullish Engulfing Pattern



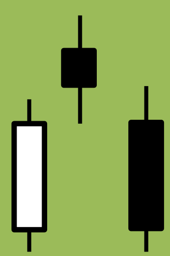
Bearish Engulfing Pattern

- Unlike the previous candlesticks which can be identified through a single candlestick, an engulfing pattern candlestick is formed though a combination of two candlesticks.
- This pattern can be characterised by a small body candlestick, followed by another colour candlestick where its body engulfs the previous day's body.
- A bullish engulfing pattern is formed when a small black body candlestick is followed by a large white body candlestick. A bullish engulfing pattern usually occurs at top of the trend and might signal a potential reversal to downward trend.
- In opposite, the bearish engulfing pattern is formed when a small white body candlestick is followed by a large black body candlestick. A bearish engulfing pattern usually occurs at the bottom of the trend and might signal a potential reversal to the upward trend.

4 Stars



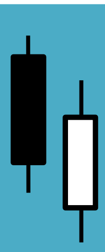
Morning Star



Evening Star

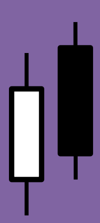
- A star candlestick is characterised when a small body candlestick is gapped away from the previous day candlestick.
- Like a doji candlestick, a star candlestick is an indication of an indecision in market direction.
- There are two major types of star candlesticks which are morning star and evening star.
- A morning star is characterised by three candlesticks where the first candlestick is a large black body, followed by a small body candlestick and large white body on a second and third days respectively.
- A morning star is viewed as a bullish reversal pattern.
- Meanwhile, an evening star consists of a large white body candlestick on the first day, followed by a small body and large black body candlestick on a second and third days respectively.
- An evening star is viewed as a bearish reversal pattern

5 Piercing Pattern



- A piercing pattern is a bullish reversal pattern that can be identified through the combination of two candlesticks.
- The pattern can be characterised when the first candlestick, which is a strong black body candlestick, is followed by a white body candlestick that is gap down open but close above the mid point of the first candle.

6 Dark Cloud Cover

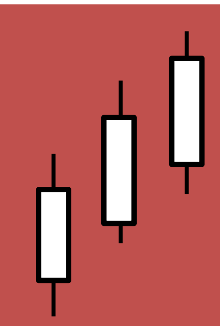


- Dark cloud cover candlestick is an opposite form of piercing pattern that showed a bearish reversal pattern.
- Like piercing pattern, this type of candlestick can be identified through the combination of two candlesticks.
- The first candlestick is a strong white body candlestick and the second candlestick is a black body candlestick that gaps up on open but close below the mid point of the first candle.

Continuation Pattern

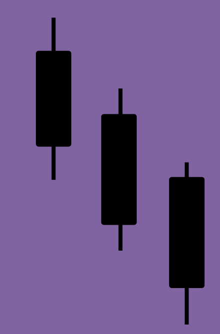
A continuation pattern occurs when a series of candlesticks is formed to show the ongoing trend continues or resumes.

1 Three White Soldiers



- Three white soldiers is formed when three long white body candlesticks occur with each successive open being within the body of the previous day and each successive close being higher than the previous day's and near the day's high.
- This type of candlestick is usually formed in the downtrend to signal the trend is over and the upward trend is continued to charter.

2 Three Black Crows



- Three black crows is exactly an opposite form of the three white soldiers.
- The pattern can be seen when three consecutive long black body candlesticks are formed with each successive open being within the body of the previous day and each successive close being below the previous day's and near the day's low.
- In contrast to three white soldiers, the three black crows is usually identified in the upward trend to signal the trend is over.

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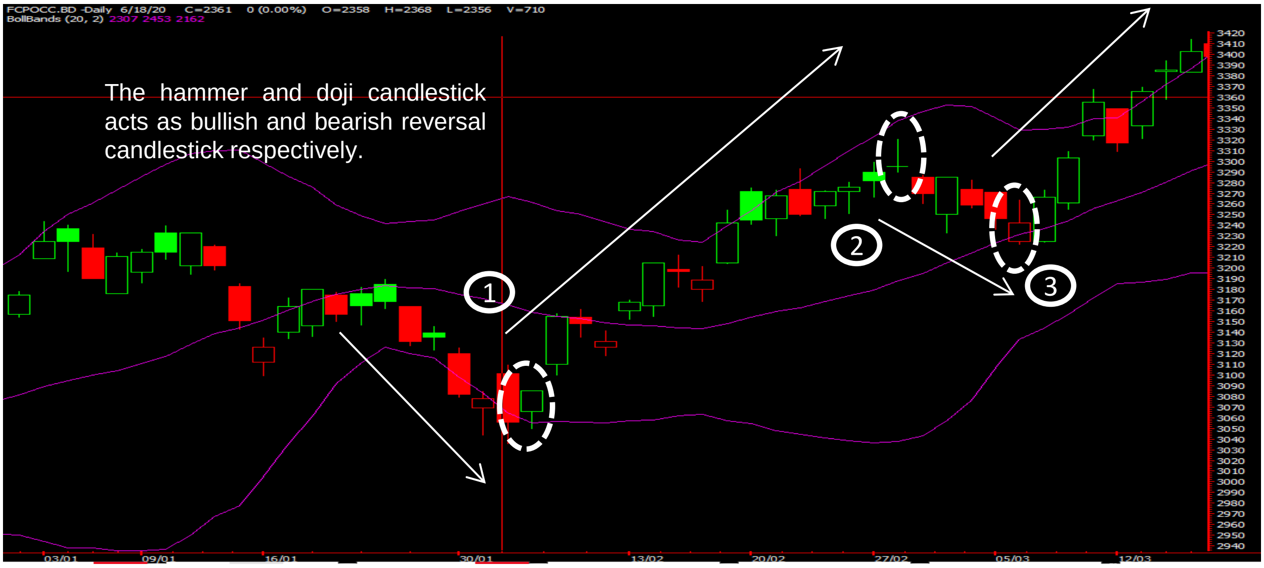
Candlestick Chart Example

Reversal Pattern

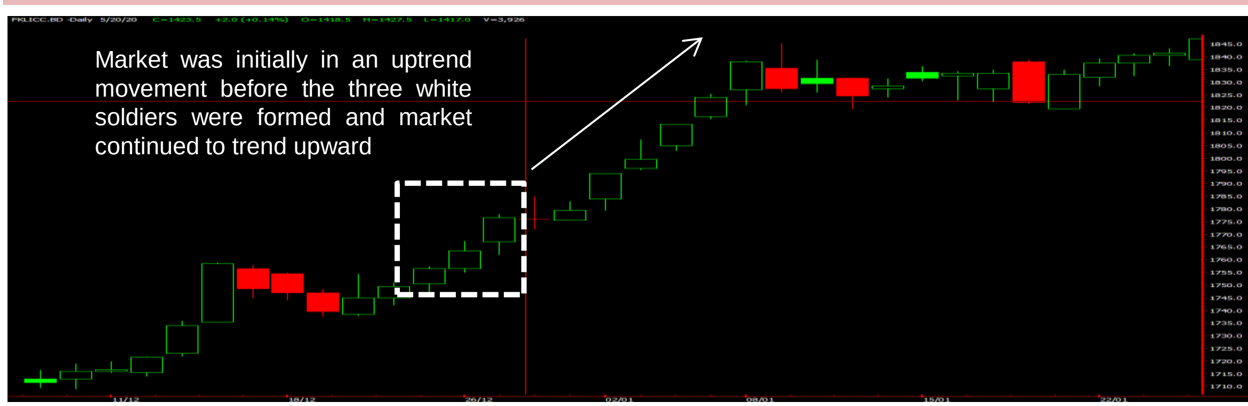


Explanation

In the trading chart example above :

1. Market initially in a downward trend before it reversed upward when a hammer candlestick formed
2. Market was in an uptrend movement but reversed downward when a doji candlestick formed
3. Again, market bounced back higher when an inverted hammer candlestick is formed

Continuation Pattern



Explanation

In the trading chart example above, three white soldiers were formed that served as the continuation chart pattern. Earlier, market was initially heading downwards. Three white soldiers was subsequently formed, indicating a change and continuation of an upward momentum.

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