PROFITABLE CANDLESTICK TRADING

Pinpointing Market Opportunities to Maximize Profits

Second Edition

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Japanese Candlestick charting and analysis is one of the most effective technical methodologies in the universe of technical analysis. This has proven to be truer with more research and investigation since the first publication of this book 10 years ago. The same problems that appeared to keep the Candlestick method out of the limelight back then have persisted to make Candlesticks still a fairly underused method today. Through the years, the number of people who have become proficient users of Candlestick analysis had been minimal, but now there is a small core of Candlestick investors that consistently improve techniques that make Candlestick signals work better. Nearly three decades of using the signals have produced two basic revelations: the signals are extremely accurate, and it is unusual that more people have not become advocates of the technique.

The Candlestick Trading Forum web site has been instrumental in educating investors and showing them how to use the candlestick signals correctly. A decade ago it was evident that one of the most powerful investment techniques has been sitting in front of the U.S. investment community, yet it has not exploded in popularity as one would expect. There is a definite perception about Candlestick trading. It is seen as requiring a long time to learn and become proficient. That is the major reason the majority of investors have stayed away from Candlesticks. That misconception is what spurred the original writing of this book. The Candlestick Trading Forum has become one of the leading web sites in teaching investors how to quickly learn the common-sense aspects of Candlestick analysis. The past decade has shown great improvements in the accuracy of Candlestick signals. The original publication of this book developed a community of investors who have worked well and continue to work well in researching and identifying confirming indicators that improve the results from Candlestick analysis. Other books on the topic were written nearly two decades ago. Those books were informational and well written, but they were published in a vacuum. Once the books were read, each investor was out there on her own. The number of people to confer with after first becoming exposed to the Candlestick method was
minimal. The ideas were new in the United States, and there were few places to turn to for guidance.

For the past three decades, most investors have been aware of Candlesticks. The most common statement is “They know about Candlesticks; they just don’t know how they work.” An extremely high percentage of chart followers have the Candlestick formations on their charts versus the standard bar charts. This is due to the favorable visual impact. The illustrative properties of the Candlestick chart make viewing much easier.

Four hundred years of research by successful Japanese rice traders constituted the inception of statistical analysis. What may take computers one afternoon to perform, the Japanese rice traders assembled over centuries of time. However, there is a definite benefit involved with human interpretation of these signals. The Japanese traders were able to describe the investor sentiment behind the formation of the signals. This becomes an extremely powerful asset for exploiting profits from markets that involve human emotions.

Being thoroughly convinced that Candlestick analysis surpasses all other technical analysis induced me to eliminate the misperceptions. Japanese Candlestick analysis is definitely not a passing fad. It is here to stay and effectively extracts profits from the trading markets—profits for those who take the little time required to become acquainted with the Candlestick thinking process.

Not only does the knowledge of what a signal looks like benefit the Candlestick-educated investor, but learning the common-sense psychology that formed the signal provides the investor with a whole new perspective into successful investing. Somebody is making huge profits in the markets. It is not what the conventional wisdom advocates: Buy and hold. The big winners are those who have developed successful methods for interpreting when to buy and sell. Candlestick analysis is that method. Read this book, and your investment abilities will be forever improved, improved to the point of not just constantly exceeding market averages, but being able to exploit the indications of the signals to amass extraordinary profits.

Once you learn the Japanese Candlestick technique, your understanding of how investment markets work will dramatically alter your investment psychology. The probabilities of producing magnificent profits will always be in your favor. Learn Candlesticks and reap the knowledge that has led to centuries of successful trading.

Learning how to use any trading technique does not stop when you finish reading a book. The information in this book should be convincing enough for readers to want to improve their investment capabilities. The common-sense aspects built into Candlestick analysis makes learning this technique very easy. The Candlestick Trading Forum web site was established when this book was originally published. The online continuing training allows investors to
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gain complete clarity about the profitable aspects the signals produce. Each Thursday night, a free training session reinforces the information learned in this book.

The past 10 years have seen some very relevant improvements in candlestick trading techniques. Whether trading stocks, options, currencies, or commodities, the simple visual depiction of investor sentiment will improve your investment capabilities dramatically.

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Although Steve Nison is credited with introducing Candlesticks to the U.S. markets, Greg Morris wrote a couple of books that were instrumental in making Candlestick analysis interesting. His writings and research made for a compelling reason to investigate Candlestick analysis further. He has since become a gracious and generous friend.

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To keep from possibly blemishing any reputations associated with those acknowledged as contributing to the completion of this book, it should be noted that any factual errors or omissions found within this book are solely my responsibility.
Chapter 1

INTRODUCTION

The learning of books, that you do not make your own wisdom, is money in the hands of another in time of need.  Japanese Proverb

Japanese Candlestick analysis is a highly effective but underused investment decision-making technique. Most people in the U.S. investment community are aware of Candlestick analysis, but few understand how or why it actually works. Candlestick charts reveal many insights using well-recognized Japanese Candlestick formations, yet few people understand the ramifications or significance of the signals that are clearly and reliably displayed.

This book was written to educate investors on how to use the Japanese Candlestick technique profitably. The easy-to-follow procedures detailed in this book provide the reader with profit-making techniques that can be learned quickly. More importantly, learning the principles of market psychology underlying the Candlestick methodology will revolutionize the reader's overall investment psyche forever. While this may sound bold and far-fetched, fortunes have been made using the Japanese Candlestick techniques. Knowing how to use the Candlesticks and why they work will immediately improve the reader's investment profitability and permanently alter overall investment perceptions. This newly acquired perception will produce consistent profits along with an associated mental reprogramming designed to maximize investment returns. Once investors become convinced of the reliability of the Candlestick methodology, they also acquire a preprogrammed investment discipline. As a result, Candlesticks add a whole new dimension to enhancing the investor's profit-making abilities.

Most readers will be surprised at how the knowledge gained from a close reading of this book dramatically enhances investment abilities across all investment vehicles and overall trading time frames. More than 400 years of refined reversal-identification and trend continuity projection is now at the reader's disposal. Mastering the Candlestick methodology will be the next major step for maximizing investment returns. Ten years of additional trading research has added valuable revisions to this book. Candlestick signals
have one consistent aspect. They visually identify what is occurring in investor sentiment. Investor sentiment has not changed and will not change over the next 500 years. The addition of computer-generated technical indicators greatly enhances the information provided by Candlestick signals.

Why aren’t the Candlestick signals used more? Why, if the signals demonstrate such a high degree of accuracy, are there not many more investors, whether institutional or individual, using these signals? The answer is that the Candlestick technique in the past has been too labor-intensive and required a long and steep learning curve before the investor gained proficiency. This book was written to provide the reader with an easy and fast training program to circumvent those obstacles.

The Benefits of the Candlestick System

Japanese Candlestick signals possess one major attribute that is not present in other technical systems: The signals are created by the change in investor sentiment. This point is the crux of the success of Candlestick analysis. Again, to emphasize the importance of what you have just read: The signals are created by the change in investor sentiment. Understanding this truism will make it easier to adapt your investment psychology to this successful trading discipline.

This information can be utilized for successfully trading the S&P 500 e-minis as well as long-term holds. The improved computer programs have greatly enhanced the correct rate ratio associated with Candlestick analysis. Just from the year 2000 to 2010, computer scanning capabilities and execution programs have dramatically improved an investor’s capabilities for producing profits. Applying computer-generated trend analysis techniques to the Candlestick signals has greatly improved the signals’ effectiveness.

The secrets of the effectiveness of the signals can be learned in a fast and easy process. An investor does not need to be knowledgeable about technical charting to take immediate advantage of the signals. The graphical formation of a signal makes reversals immediately visible. A Candlestick formation provides a visual graphic of investor psychology during a specific time period. For the purpose of illustration in this book, the standard time frame is one day, and the trading entity is stock—equity as opposed to commodity. Investment strategies can be structured, of course, for whatever time period is suited to your trading style: minute-to-minute or monthly. Applicable trading instruments include any vehicle that has the key elements of investor fear and greed.

The graphics of a Candlestick chart have greater appeal than Western charts (commonly known as bar charts). The amount of data displayed is exactly the same, but the ease of visual interpretation is dramatically different. The immediate representative depiction of price movement as the result
of investor sentiment is visually in front of you. Recognizing the change in investor sentiment is made easier when the graphics are clear and easy to understand.

Once you become accustomed to the Candlestick charts, all other charting will seem diminished in terms of effectiveness. That is not to say that other charting techniques cannot be used as “alert” functions. Candlestick signals, incorporated with other types of charts, fine-tune the reversal identification process. Watch your profits soar by simply combining Candlesticks with basic technical charting methods.

Candlestick analysis is the process for putting all the probabilities in alignment. The signals and patterns can make analyzing the market indexes very easy. If you know which direction the market should be moving, then you can establish your portfolio positions in that direction. Obviously, all boats are going to rise in a rising tide. The Candlestick signals and patterns help identify which stocks have the better upside potential. If it has been determined that the market indexes are moving positive, the next step for improving the probabilities is starting to see which of these sectors have the strongest reversal signals. From that point, each sector can be broken down into the individual stocks. Simple scanning techniques will identify which stocks have the best and most forceful reversal signals.

When you are able to identify the direction of the market, identify which sectors are moving best with the direction of the market, and finally scan for the strongest stocks in that sector, the probabilities are now greatly in your favor. These capabilities allowed the Candlestick investors to make an immense amount of money in the market decline from 2007 to March of 2009. Upon witnessing the market bottom in March of 2009, strong returns were made during the uptrend going into 2010. Fortunately, utilizing Candlestick analysis is not rocket science. It is merely utilizing the graphic depiction of investor sentiment.

A Successful History

Knowing the history of the formations inevitably imparts confidence in the Japanese Candlestick technique. Since Japanese rice traders developed the system long ago, it must have credible features. The history of the rice traders who developed the signals reinforces that assumption. With its 400 years of development, the Candlestick methodology got its major refinement in the mid-1700s.

Kosaku Kato (1716–1803) was born in the city of Sakata (now Tamagata Prefecture) during the Tokugawa Period (Eighth Shogunate). Adopted by the Honma family, he became known as Sokuta Honma. His successful interpretation of the Candlestick formations made him the most feared and respected rice trader in Japan, and the wealth he produced for his family became legendary.