Candlesticks Signals and Patterns

by LuckScout.com Team

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1) Candlestick Signals and Patterns

A typical candlestick has one body and two shadows. The body shows the open and close prices. In bullish candles, the close price is higher than the open price. In bearish candles, the close price is lower than the open price.

To distinguish the bullish and bearish candles from each other, they are displayed with different colors. Usually, bullish candles are white or green, and bearish candles are black or red. In both of the bullish and bearish candles, the upper shadow shows the high price, and the lower shadow shows the low price.

That was the anatomy of the typical candlesticks in simple words. However, candlesticks can have several different shapes and patterns. Each shape and pattern has a different signal that tells the traders what to do. Candlesticks are great indicators. Many of the professional traders use nothing but candlesticks to trade.

Doji forms when the open and close prices are virtually equal. A Doji candlestick looks like a cross, inverted cross or plus sign. Doji means that bulls or buyers, and bears or sellers are well matched, and none of them is stronger than the other one. Therefore, Doji means indecision. It means after a Doji the trend can be continued, reversed or starts moving sideways. If you have a position, you'd better to close it and collect your profit when a Doji is formed. Look how many Doji candles we have on EUR/USD daily chart (watch the video). Many of them worked as a reversal signal. The price continued its way after many others. The price kept on going up after this Doji. The price reversed after a few Doji candles formed here (shown in the video).

The majority of Japanese candlestick signals are reversals.

Hammer and Hanging Man are reversal candlestick signals. They have long lower shadows and small bodies. Surprisingly, It doesn't matter whether these candles are bullish or bearish. When you find one on a downtrend, it is signaling that the trend is near to an end. We call it "Hammer" when formed on a downtrend. A similar candle on an uptrend signals that the uptrend is close to an end. We call it "Hanging Man" when formed on an uptrend.

Although these candles are known as reversal signals, it is better to wait for a confirmation when they are formed. It means, when a hanging man is formed on an uptrend, we have to wait for a bearish candle to form after that, to go short. It is the same with hammer. When formed on a downtrend, we have to wait for a bullish candle to form after that, to go long.

Inverted Hammer and Shooting Star are the inverted types of "Hammer" and "Hanging Man". However, they are weaker signals. They also need confirmation. High-Wave is a Doji candle with long upper and lower shadows. A group of High-Wave candles form a strong reversal signal.

The Engulfing Pattern forms by two candles. There are two kinds of Engulfing Pattern. In Bearish Engulfing Pattern a small candle with a bullish body is completely covered by the body of the next candle which has a big bearish body. "Bearish Engulfing Pattern" on an uptrend is a strong reversal signal that means the uptrend is ended and will reverse. It is a good chance to go short. In Bullish Engulfing Pattern a small candle with a bearish body is completely covered by the body of the next candle which has a big bullish body. Bullish Engulfing Pattern" on a downtrend is a strong reversal signal that means the downtrend is ended and will reverse. It is a good chance to go long.

Dark Cloud Cover is a bearish reversal pattern. Like "Bearish Engulfing" pattern, it forms with two candles. The second candle opens a little above the close price of the first candle, and goes down and closes a little above the open price of the first candle.

Dark Cloud Cover forms on uptrends and is a strong reversal pattern.

Piercing Line is the bullish form of "Dark Cloud Cover" pattern. It forms on downtrends, and is a reversal pattern. The second candle opens a little below the close price of the first candle, and goes up and closes a little below the open price of the first candle.

Harami is another reversal candlestick pattern that forms by two candles. There are two kinds of Harami. Bullish Harami forms on downtrends. And, Bearish Harami forms on uptrends. In Bullish Harami a large candlestick is followed by a smaller candlestick, while the body of the smaller candle is located within the vertical range of the larger body.

In terms of candlestick colors, the bullish harami is a downtrend of negative-colored or black candlesticks, engulfing a small positive or white candlestick, giving a sign of a reversal of the downward trend.

In Bearish Harami a large candlestick is followed by a smaller candlestick, while the body of the smaller candle is located within the vertical range of the larger body. In terms of candlestick colors, the Bearish harami is an uptrend of positive-colored or white candlesticks, engulfing a small negative or black candlestick, giving a sign of a reversal of the upward trend.

The Harami is not a reliable reversal pattern, but it is a useful warning. When a Harami forms while you are already in a position, you should move your stop loss

to a proper position, not to lose your profit if the trend reverses.

"Harami" means pregnant. The reason is that the first candle with the second one, which is smaller, look like a pregnant woman. The smaller the second candle, the stronger the "Harami" signal is. When the second candle is a Doji, the pattern is called "Harami Cross", which is stronger than the regular Harami.

Morning Star is a three candle pattern. This pattern forms on downtrends. The first candle should be a Bearish candle with a considerable body. The second candle is a small candle that is formed lower than the first one. This candle can be Bearish or Bullish. The third candle is a Bullish candle that is formed higher than the second one, and its body covers a significant portion of the first candle.

"Morning Star" is called Evening Star when formed on an uptrend.

The effectiveness and potency of the Morning Star and Evening Start patterns as reversal signals is dependent on some special factors that have to be considered. The distance (gap) between the morning or evening star with the first and third candlesticks. The bigger gap, the stronger signal. The degree of the coverage of the first candlestick by the third one is also important. The bigger the coverage, the stronger the signal. Sometimes, the Morning or Evening Star is a Doji candlestick. Again in this case, the most important thing is the gap between the first and third candlestick and the Doji.

Sometimes, the Morning or Evening Star is a very small candlestick with small or no shadows. The gap is so big and even none of the candlesticks shadows cover any

part of the Morning or Evening Star. This pattern is called Abandoned Baby which is a very strong reversal signal. Because of the high volatility, this pattern is very rare in the forex market and can only be seen in bigger time frames, but it can be seen in the stock market in smaller time frames like one hour. Abandoned baby can be seen both at the top of an uptrend or bottom of a downtrend.

Tweezers is made up of two candlesticks that are next or so close to each other. They have identical highs at the top of the market or identical lows at the bottom of the market. The Tweezers usually becomes formed by the candlesticks shadows but it can also be made by the bodies of the shaven candlesticks. The two candlesticks that form Tweezers can have small bodies like Doji and Hammer candlesticks.

Tweezers can not be considered as a strong reversal signals and it needs confirmation but you have to be careful when you see a Tweezers signal. The longer the shadows, the more weight we should give the Tweezers.

Tweezers that are formed right under resistance lines or above the support lines, are important, specially when they are made up of two Doji candlesticks. The longer the shadows, the more potent the Tweezers signal. It is also possible that you see a few or even several candlesticks between the two candlesticks that form the Tweezers pattern. Even in this case you should not ignore the Tweezers as a potential reversal signal.

When there are several candlesticks between the two that make the Tweezers pattern, they may form Double Tops or Double Bottoms patterns that show the levels of resistance or support.

How to Trade the Candlestick Signals and Patterns?

First, you have to wait for the candlestick signals and patterns to form completely. Then you take the proper position and set the stop loss. It is strongly recommended to wait for the confirmation candle to form.

With the candlestick signals that need confirmation, you take the position after the confirmation candle. In case of long positions, the stop loss has to be below the open price of the confirmation candle. In case of short positions, the stop loss has to be set above the open price of the confirmation candle.

Click Here to watch the video carefully.

2) High Wave Candlesticks and Their Reversing Power

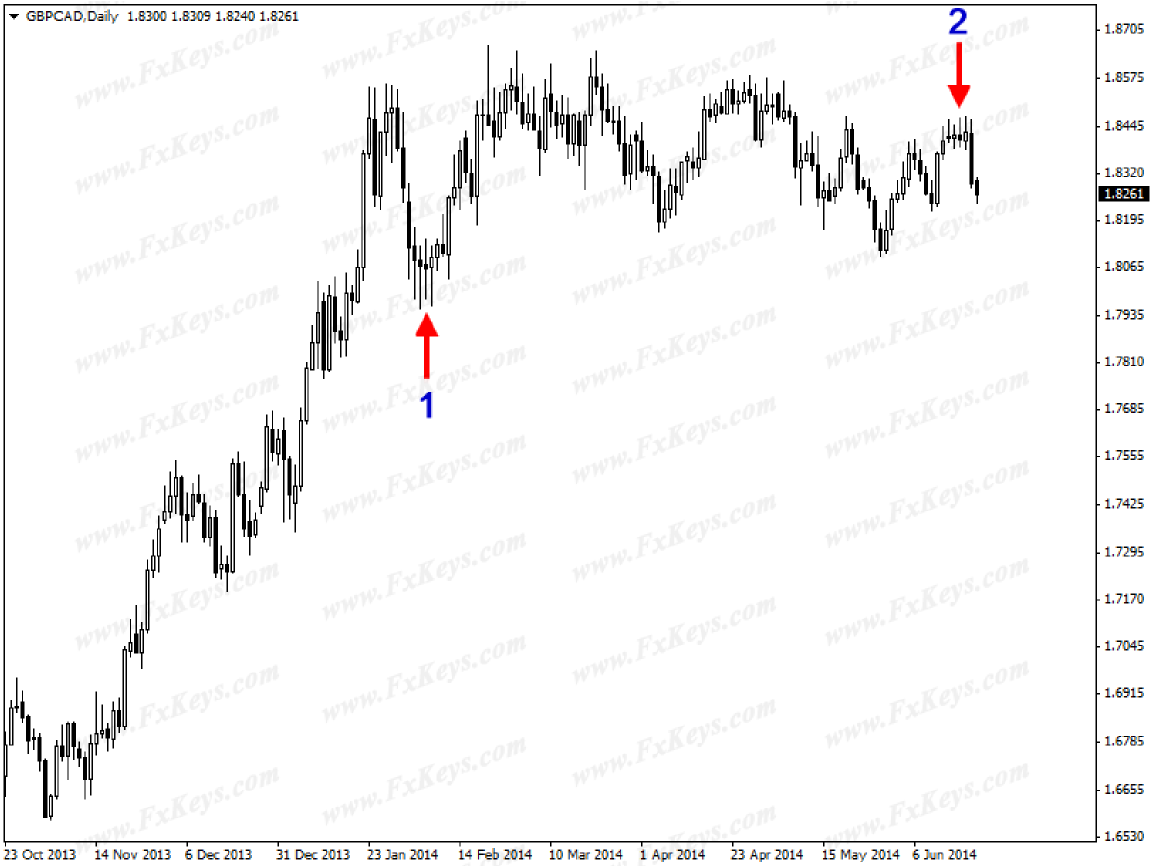
"High Wave" is a candlestick with a small body and long shadows. However, "High Wave" is known as a candlestick pattern by some traders. They say "High Wave" is a group of **consecutive** candlesticks with small bodies and long upper/lower shadows. I like to know "High Wave" as a candlestick pattern, because it is more applicable in practical trading. Therefore, in this post I consider high wave as a pattern, not as a single candlestick.

We traders like to have something that shows us the best entry point. It is not only that. We like to know where the best place is to set the stop loss, and also where the best place is to collect the profit and exit the market.

Candlestick patterns are great to show us the entry, SL and exit points. They are on time and reliable, if we wait for the strong ones to form. "High Wave" is a very strong reversal pattern. It tells us that sooner or later the market will reverse, and we can take the advantage of a strong movement. "High Wave" also helps us set a reasonable stop loss which is usually tight enough to let us have a x3 or even x5 target. Therefore, "High Wave" is a nice reversal pattern for trading. It is also good to know that they are so frequent in the forex market.

Let's analyze one of the markets and see how "High Wave" showed the market reversal in two occasions.

On the GBP/CAD daily chart there are two sets of "High Wave" candles. They formed when the market started ranging while it was strongly going up before. In both cases, they clearly indicated that the market would reverse, and it really did. When the first set formed, the market was going down, but suddenly it changed the direction and went up for over 550 pips. When the second set started forming, the market was going up for several candles, but suddenly changed the direction and a big and long bearish candle formed. In fact the second set is a newly formed signal.



Now the question is when is it the best time to enter when a high wave is formed?

There are a few ways to enter when a high wave is formed. One way which is a little riskier is that you enter when a few high wave candles form consecutively. You set your stop loss a little below the high wave candles low price if you go long and visa versa. This is a riskier way, because you enter when the confirmation candle still is not formed. For example, if you wanted to trade the above two high waves with this method, it would be like this:

For the first set, the entry would be at the close of the 2014.02.10 or 2014.02.11 candle on the daily chart. For the second set, the entry level would be at the close of the 2014.06.19 candle on the daily chart:

The other way which is a little harder, but less risky is that when a high wave forms on a time frame, you switch to a shorter time frame, locate a support (when you are waiting to go short) or resistance (when you are waiting to go long) and wait for its breakout. This gives more credit to the high wave pattern and when the support or resistance is broken you can take your position with more peace of mind. Besides, your stop loss can be more reasonable and tighter and your target can be wider. This method is much harder because you have to monitor the market for a longer time, and it is possible that you miss the chance to enter. I prefer the first method. It is riskier, but we can lower the risk by taking a smaller position.

There is another way too. When a high wave forms at the bottom of a bear market, you set a buy stop order few pips above the high price of the high wave candles. Therefore, when the market reverses and starts going up, you will have a long position if the price breaks above the high price of the high wave candles.

It is the same when a high wave forms at the top of a bull market. You should set a "sell stop" below the low price of the high wave candles.

There are a few more things that you have to know about the high wave pattern:

1. The longer the shadows and the smaller the bodies of the high wave candles, the stronger and more reliable the reversal power.

2. The number of high wave candles to form a high wave reversal pattern should be at least three. Usually after 3-6 candles the market will reverse.

Why High Wave Is a Reversal Pattern?

"High Wave" forms when the market has been going up or down for a while. This "while" can be a few to several candles. Usually after going up or down for a while, the market goes to an "indecision situation", because - for example - when the market is bullish, many of the bulls stop buying and many of them start closing their positions and collecting their profit. They ask themselves whether the market will keep on following the same direction or it will reverse. This means indecision, and it is while the Doji candles that have small or no body and long shadows will form. A few of these candles means creates fear of losing of the profit. And it is the time that most of the position holders close their positions to collect their profit. And so, the market will reverse. That is why they say the candlesticks reflect the psychological situation of the markets.

Now, try to locate some high wave candles/patterns on different markets and explain why they caused the markets to reverse. What would you do it you were to trade the high wave patterns you locate? When would you set your stop loss and target orders?

3) How to Trade the Continuation Chart Patterns with Candlesticks and Bollinger Bands

I am going to talk about the continuation chart patterns and the way they can be confirmed by two other strong tools, candlesticks and Bollinger Bands. I want to clarify this because some traders say that only the line chart is enough to locate and trade the chart patterns. I am not saying they are wrong, but we can trade the chart patterns much better using the candlesticks and Bollinger Bands.

Fortunately, some of the currency pairs are trending strongly, and some new trends are forming with some of the other currency pairs. "Trends" create good opportunities to trade the continuation chart patterns. We should always take the advantage of trends, because it is when we can make great profits easier and faster and with less risk.

Here I am showing you some of the positions I took recently. EURAUD is one of the pairs which is trending strongly now:

Recently I took two short positions through following the continuation patterns formed on the EURAUD chart. While EUR/AUD was going down strongly, it reversed after touching the Bollinger Lower Band on May 13, 14, 15. However, Bollinger Middle Band worked as a strong resistance and did not allow the price to go higher (follow the red arrows). Finally, the 2014.06.05 candle (#1 on the below chart), went down and touched the Bollinger Lower band, but closed above the small support line that was already formed on the chart. This movement, and then the next candle (#2) that also tested the support line, proved that the support was valid and the consolidation that was above the support line was also a valid consolidation.

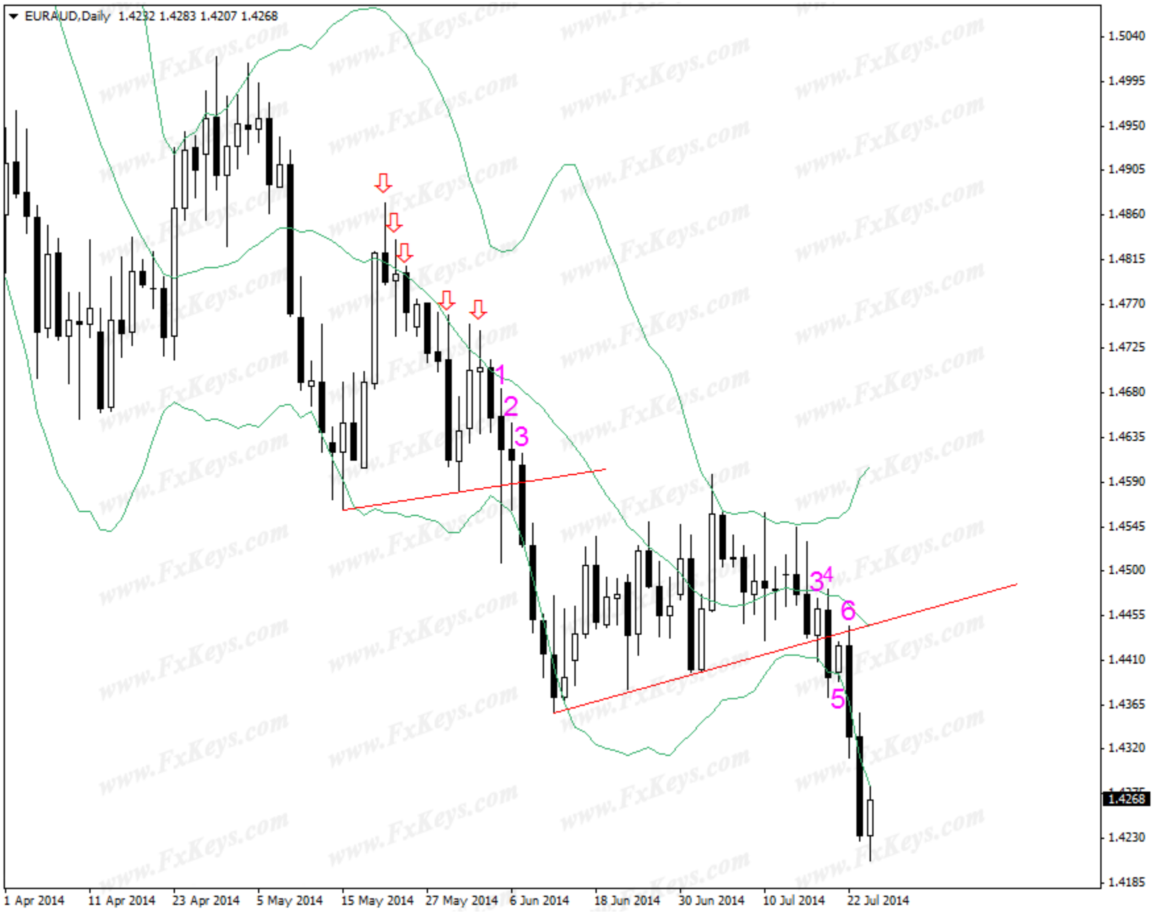
What we have above the first support is a continuation chart pattern which has formed on a bear market. Now all we need is a support breakout. If one of the candles closes below the continuation pattern support line, we can go short. That is not all. When we have a downtrend, then the Bollinger Lower Band is a great indicator. When a candle touches the lower band after a long time that the other candles had been closing above it, that is also a great signal that the downtrend wants to be continued again.

Candlestick #3 is such a candle. It not only closed below the support line, but was the first candle among the several last candles that touched the lower band. I went short at the close of this candle and while the next candle was forming, put the stop loss at the middle of its body (a 30 pips stop loss) and a 150 pips target.

The second trade setup:

After the 2014.06.12 candle close, EURAUD went against the trend to form another consolidation or continuation pattern. It went up and down several times and formed some small lows that enabled us to plot the second support line on the chart. Please note that during the time that EURAUD was going up and down to form the continuation pattern, it never touched the Bollinger Lower Band, which meant that it was not the time to go short yet. Finally, the candle 2014.07.17 which is #3 on the below chart, barely touched the lower band, but closed above the support line. This could awaken us to get ready to go short, because it was the first time after such a long time that the price touched the lower band. It meant that the downtrend wanted to be continued again.

The next candle (#4) formed the trade setup we were waiting for. Exactly like the first trade setup, it closed below the support line and touched the lower band. I went short while the candle #5 was forming, set the stop loss a little above the broken support line (a 30 pips stop loss), and a 150 pips target that was easily triggered:



So when we have a downtrend and then a continuation pattern forms, we have to...

1. Wait for the pattern to form a support line.
2. Wait for a candle to close below the support line.
3. If the candle that closes below the support line also touches the lower band, we will have a perfect trade setup.

It is the same with the uptrends. When there is an uptrend, we have to wait for a continuation pattern and its resistance. When one of the candles closes above the resistance and touches the Bollinger Upper Band, then we will have a perfect trade setup to go long.

For both of these setups, first we need a strong trend already formed, otherwise the support or resistance breakout and the candle that touches the lower or upper band means almost nothing.

4) Candlestick, Heikin Ashi and Renko Charts

Price chart is the best tool to follow the markets movements, and ups and downs. The price movement in long term, can not only teach us a lot of things, but also it can help us decide whether to enter the market or wait for a better chance.

Monitoring the markets' price movements during the past centuries, has made the traders alter the simple line charts, and create some other kinds of charts that are a lot more useful and effective in analysing the traders sentiments, and predicting the future movements.

It seems what Japanese traders have done, is way above the others. Japanese Candlesticks is the most famous invention of the Japanese traders. It is the most important tool we use here on LuckScout. Combination of Japanese Candlesticks with Bollinger Bands® has created a great trading system for us that has enabled us to locate the strongest reversal and continuation trade setups, in bull, bear and flat markets.

Regular candlesticks are not the only invention of Japanese traders. They have at least two more inventions similar to candlesticks.

Renko is one of the other inventions of Japanese traders. In regular candlesticks, time has a very important role, but in Renko chart only the price changes are recorded. It is a good tool for those who want to trade based on the price actions only. Renko can eliminate a lot of noise and shows only the strong movements and trends. It is a good tool for trend and swing traders.

Heikin Ashi is one of the other Japanese traders' inventions. It is pronounced Heikin AasAahee.

Heikin Ashi looks like the regular candlesticks at the first glance, but it is very different in reality. There are some very important differences between the regular candlesticks and Heikin Ashi. There are two moving averages built in the Heikin Ashi candlesticks. In regular candlesticks, each candlestick is completely independent, and has no relation with the previous and next candlestick, but in Heikin Ashi candles are related to each other, because the open price in each

Heikin Ashi candle is the average of the open and close prices of the previous candle. This is the most important difference.

The other difference is that the close price in each Heikin Ashi candle is the average of open, close, high and low prices during each unit of the time frame. For example if you use Heikin Ashi on the daily time frame, then the close price of each Heikin Ashi candle is the average of the open, close, high, and low prices in 24 hours.

The Heikin Ashi candle's high and low prices are also different. The high price is chosen from the highest price among the high, open and close prices during each unit of the time frame. Similarly, the low price is chosen from the lowest price among the high, open and close prices during each unit of the time frame.

As you see all of the four prices are completely different in Heikin Ashi. Why is that? Why did the Japanese traders made these changes in the regular candlesticks to have a candlestick named Heikin Ashi?

It was because of eliminating the noise again, like what Renko does. Japanese traders believe that in order to become able to trade properly, we should eliminate the price noises and only have the strong and real price moments. They believe that it is the noise that causes traders to make mistakes. If you look at a Heikin Ashi chart, you will see that bearish and bullish candlesticks are not too mixed with each other. When there is an uptrend, most of the candles are bullish and you can rarely see a bearish candle among them. It is the same when there is a downtrend. However, with the regular candlesticks you see several bearish candlesticks among the bullish ones, when there is an uptrend, and visa versa for downtrends.

The reason is that in Heikin Ashi most of the noise is eliminated because of the averaging system that is used to calculate the open and close prices.

Heikin Ashi is great for the swing traders who love to follow the trends. It works very well when the market trends. However, it becomes hard to trade the ranging and sideways markets with Heikin Ashi, compared to regular candlesticks, specially when the range becomes tighter.

There is an old article on LuckScout about Heikin Ashi. If you like to learn more about Heikin Ashi candles, and the way they can be used in trading, please read that article: What Is Heikin Ashi and How To Trade With It

Also there is an article about Heikin Ashi installation on MT4: [Download Heikin Ashi and Smoothed Heikin Ashi Indicator and Template for MetaTrader]

Which One Do I Recommend?

I am a regular candlestick fan, because each candlestick talks clearly about the market's condition. It can look noisy compared to Renko and Heikin Ashi charts, but those ups and downs are not noise for those who know the language of the candlesticks. They just clearly explain what is going on with the markets. Maybe it takes more time for a novice trader to learn to work with regular candlesticks, compared to Renko and Heikin Ashi, but it is worth the time you spend, because you will become able to (1) pick better trade setups, and (2) have better entry and exits prices. This makes a big difference.

5) The Importance of the Confirmation Candlestick

There are two kinds of candlestick signals from my point of view and according to my experiences:

1. The signals that have to be confirmed by the next candlestick
2. The signals that are strong enough the way that the don't to need to be confirmed by the next candlestick.

It is important to know the difference of these kinds of candlesticks, because with the first group, first you have to wait for the confirmation candlestick to form to complete the signal and trade setup. If you don't wait for the confirmation candlestick, it is highly possible that you lose.

With the second group you can take a position without having to wait for the next candlestick to form as the confirmation. If you wait for the next candlestick, you will miss a big movement and it will become too late to enter.

Sometimes the market starts moving strongly for several candlesticks. These candlesticks have strong bodies and small shadows that reflect the power of the movement. However, after a few to few candlesticks, the market slows down and you will see the candlesticks that have small bodies and long upper and lower shadows. Some of them even have no body at all. These candlesticks are called Doji.

Doji candlesticks reflect the market indecision. It means the market doesn't know whether it can keep on following the same direction, or it is time to stop and reverse.

When most traders buy, the market goes up strongly. And then, when many of them think that it is time to sell and collect their profit, the market stops going up as strong as it was used to. The body of candlesticks become smaller. In spite of this, some traders still think that the market will keep on going up, and so they buy. But the price goes up and down, and it is the time that Doji candlesticks start forming.

When some traders sell and some others buy, the market goes to indecision, and it doesn't know where to go. When most traders buy, the price goes up and we will have bullish candlesticks with strong bodies forming on the chart. When most traders sell, the price goes down and we will have bearish candlesticks with strong bodies. When some of them sell and some of them buy (indecision), Doji candlesticks will form on the price chart.

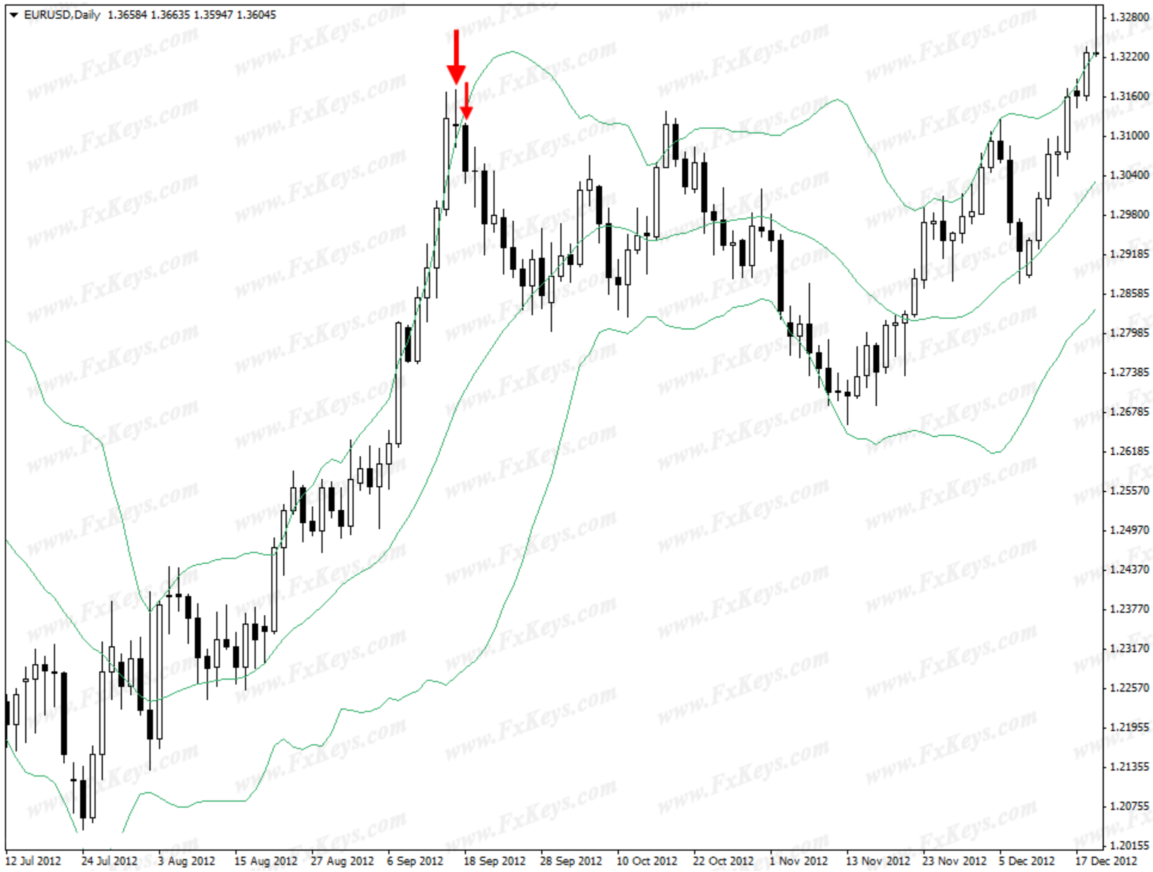
Now the question is what will happen when the Doji candlesticks appear on the chart? Will the price keep on following the same direction again, or it will reverse?

Forming just one single Doji that has no long shadows, doesn't mean that the market will reverse, unless a confirmation candlestick with strong body forms after the Doji, or even a few to few candlesticks after. For example, when the price is going up and a Doji forms, and then a strong bearish candlestick forms after the Doji, most probably the market will reverse and will go down at least for a few more candlesticks. In this case, we can take the advantage of Bollinger Bands. If the Doji and preferably the confirmation candlestick show a strong breakout on the Bollinger Upper Band, then the reversal is more probable.

To learn more about this, please read this article: [How to Trade Using Doji Candlestick and Bollinger Bands®]

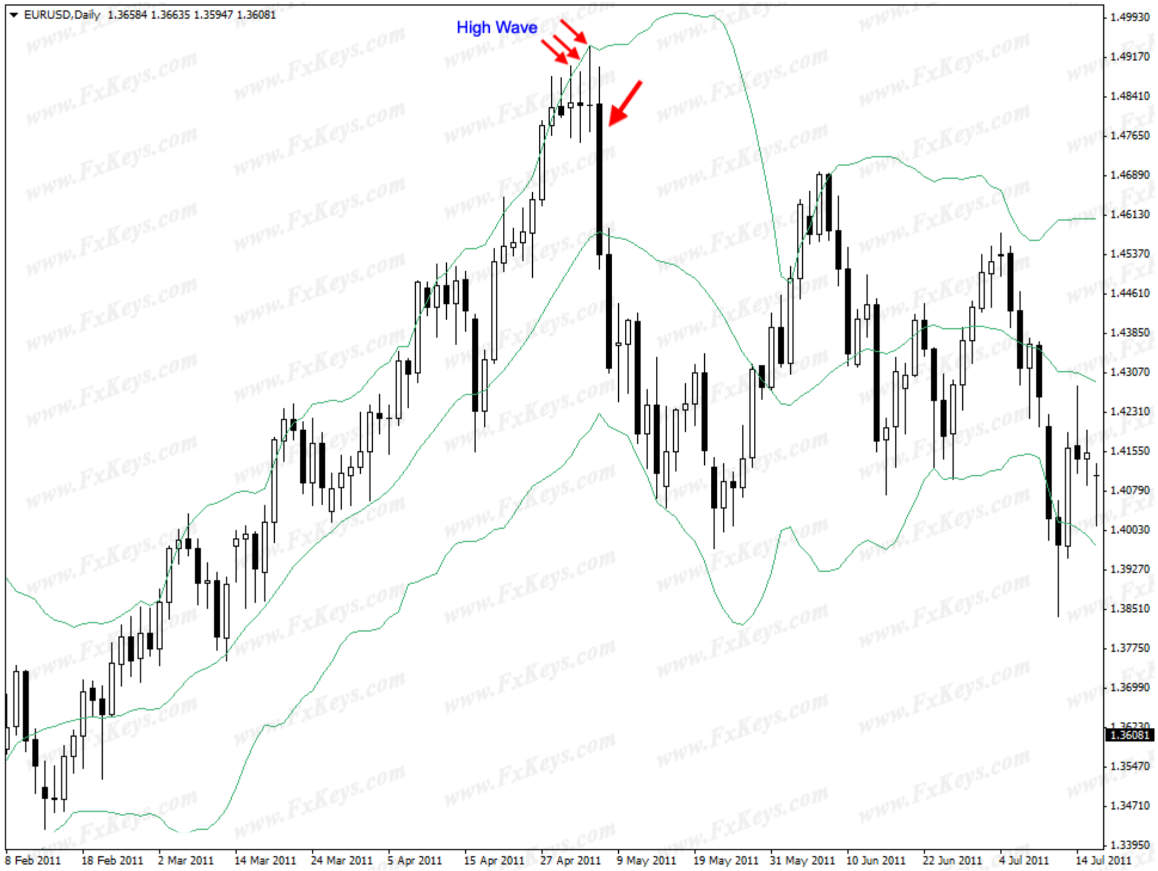
Here, I am showing you an example. As the below chart shows, EUR/USD has been going up for several candlesticks, but on 2012.09.17 a Doji candlestick forms. When the Doji is closed, still nobody knew whether EUR/USD would keep on going up, or it would reverse. However, the next candlestick (2012.09.18) which is bearish with a relatively strong body "confirmed" that the market had decided to reverse. There is a Bollinger Upper Band breakout too. Almost 90% of the Doji candlestick is formed out of the Bollinger Upper Band and this is also a strong reversal signal.

We could go short at the close of the confirmation candlestick and the stop loss had to be placed around the confirmation candlestick open price.



There are some cases that several Doji candlesticks form consecutively (High Wave). In this case, we do not have to wait for a confirmation candlestick like the one that you saw above. If the Doji candlestick have long upper and lower shadows, then most probably the price will reverse very strongly soon. We can still wait for a confirmation candlestick, but it can cause us to miss a big movement.

The below screenshot shows a good example of the High Wave Candlesticks and the strong reversal movement formed after. We could wait for the confirmation candlestick (the big bearish candlestick), but as you see most of the strong movement would be missed when this candlestick closed.



Another case that does not need any confirmation is when there is a big and strong bullish/bearish engulfing with a strong Bollinger Band breakout. When it forms on the chart, you can take the position at the close of the engulfing candlestick, and without having to wait for any confirmation. Please note that Piercing Line and Dark Cloud cover are both different kinds of engulfing patterns. So they have to be treated the same. I mean when they are strong with strong BB breakout, they don't need any confirmation:


EURUSD,Daily 1.36584 1.36635 1.35947 1.36084
1.44270
1.43295
1.42320
1.41345
1.40370
1.39395
1.38420
1.37445
1.36470
1.36084
1.35495
1.34520
1.33520
1.32545
1.31570
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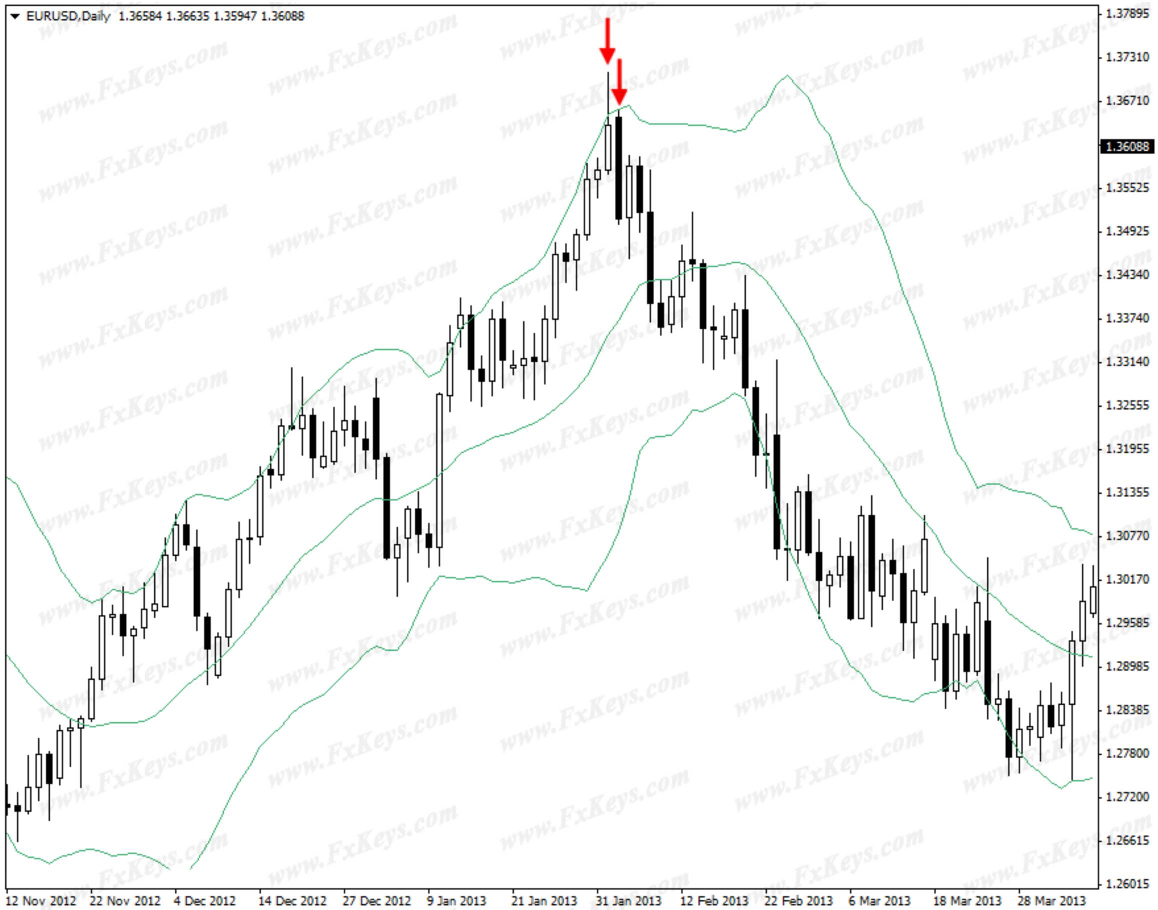
5 Jan 2011


EURUSD,Daily 1.36584 1.36635 1.35947 1.36088
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1.31355
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1.29585
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1.27200
1.26615
1.26015
12 Nov 2012
22 Nov 2012
4 Dec 2012
14 Dec 2012
27 Dec 2012
9 Jan 2013
21 Jan 2013
31 Jan 2013
12 Feb 2013
22 Feb 2013
6 Mar 2013
18 Mar 2013
28 Mar 2013
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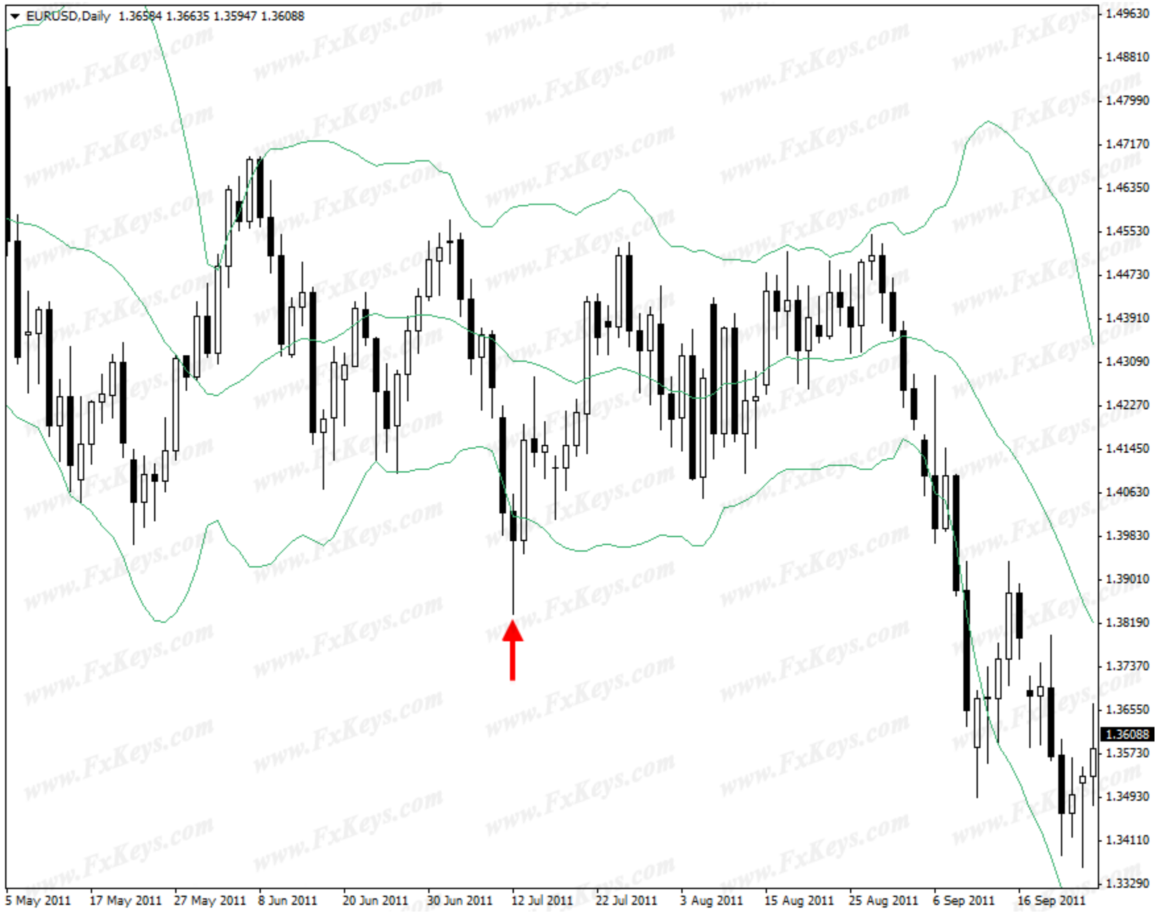
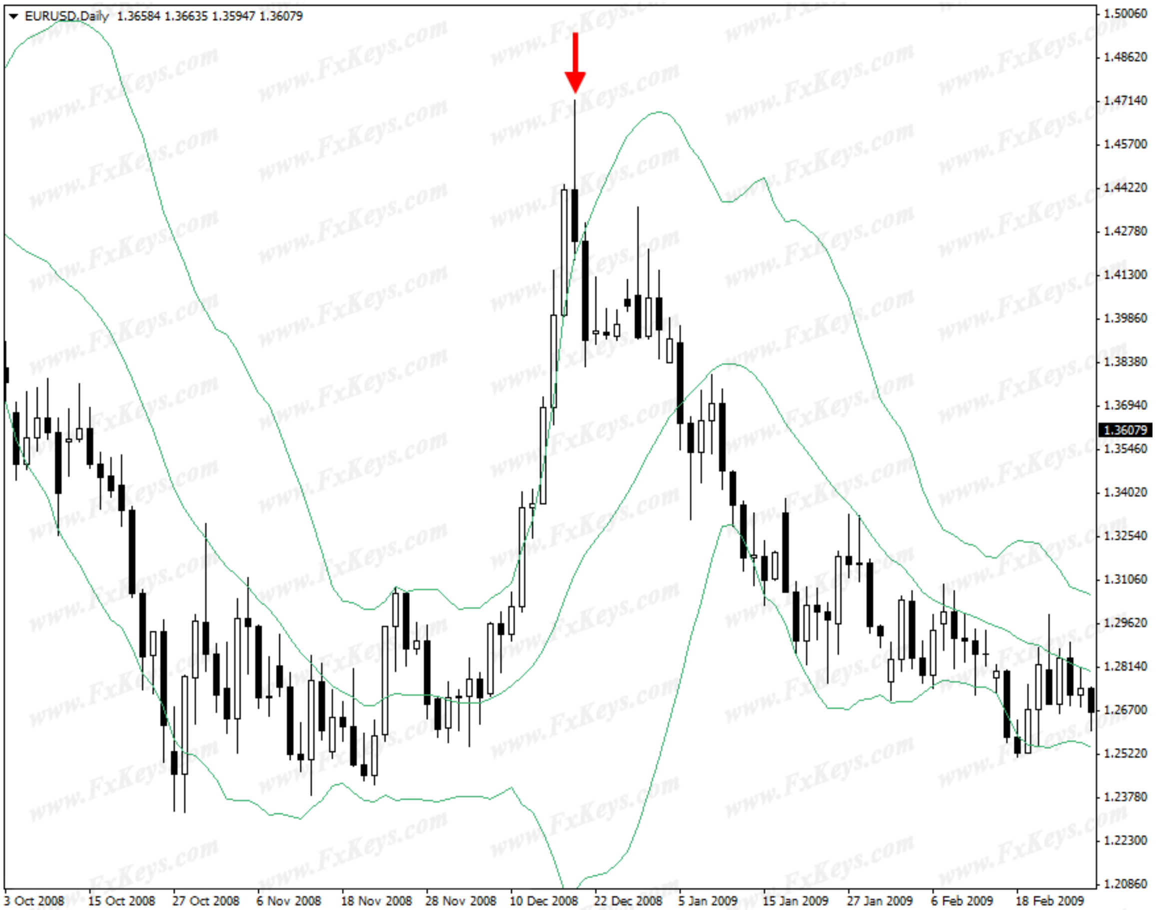
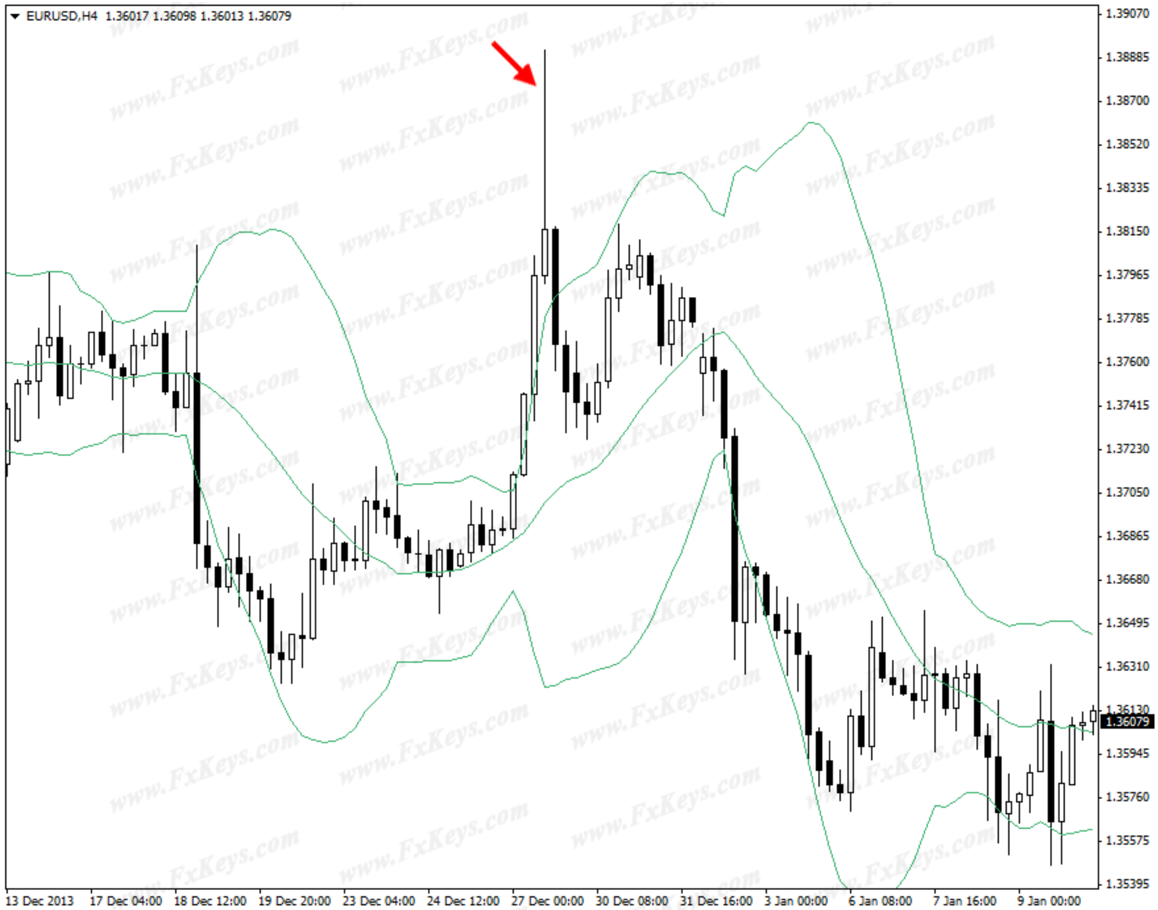
Another case that does not need any confirmation candlestick is when there is a very strong Bollinger Band breakout. Like the below example that almost 95% of the candlestick is formed out of Bollinger Lower Band. Additionally, the candlestick is a big and long candlestick. The bigger the candlestick and its shadows and the stronger the BB breakout, the stronger the reversal movement:



When 100% of a candlestick forms out of Bollinger Bands; Do you think that we had to wait for a confirmation candlestick? Definitely not:


EURUSD,Daily 1.36584 1.36635 1.35947 1.36079
1.50060
1.48620
1.47140
1.45700
1.44220
1.42780
1.41300
1.39860
1.38380
1.36940
1.36079
1.35460
1.34020
1.32540
1.31060
1.29620
1.28140
1.26700
1.25220
1.23780
1.22300
1.20860
3 Oct 2008
15 Oct 2008
27 Oct 2008
6 Nov 2008
18 Nov 2008
28 Nov 2008
10 Dec 2008
22 Dec 2008
5 Jan 2009
15 Jan 2009
27 Jan 2009
6 Feb 2009
18 Feb 2009



All the other cases of candlestick signals and patterns need confirmation.

Please note that even when there is a very strong signal like the above examples, having a reasonable stop loss is a must. Nothing is guaranteed in forex market. Therefore, even when the strongest signal/pattern forms, you have to enter with a reasonable and proper stop loss. That is not all. You have to move your stop loss to breakeven when it is the time ([read this](#)).

Candlesticks are great indicators for trading. Learn them properly: [The Language of Japanese Candlesticks](#)

6) Analysis of Strong Piercing Line and Bullish Engulfing Candlestick Patterns

In my last two articles, I have talked about the features of the strong Dark Cloud Cover and Bearish Engulfing candlestick patterns.

In our trading strategy, we only take the strong candlestick patterns that meet some special requirements. We ignore the other candlestick patterns. I had to talk about the Dark Cloud Cover and Bearish Engulfing Candlestick Patterns in two separate articles, because they are more frequent on the Forex market.

To have a better understanding of the strong Piercing Line and Bullish Engulfing patterns, I suggest you to read my Dark Cloud Cover and Bearish Engulfing articles first, because Piercing Line and Bullish Engulfing Patterns are the bullish forms of the Dark Cloud Cover and Bearish Engulfing Patterns.

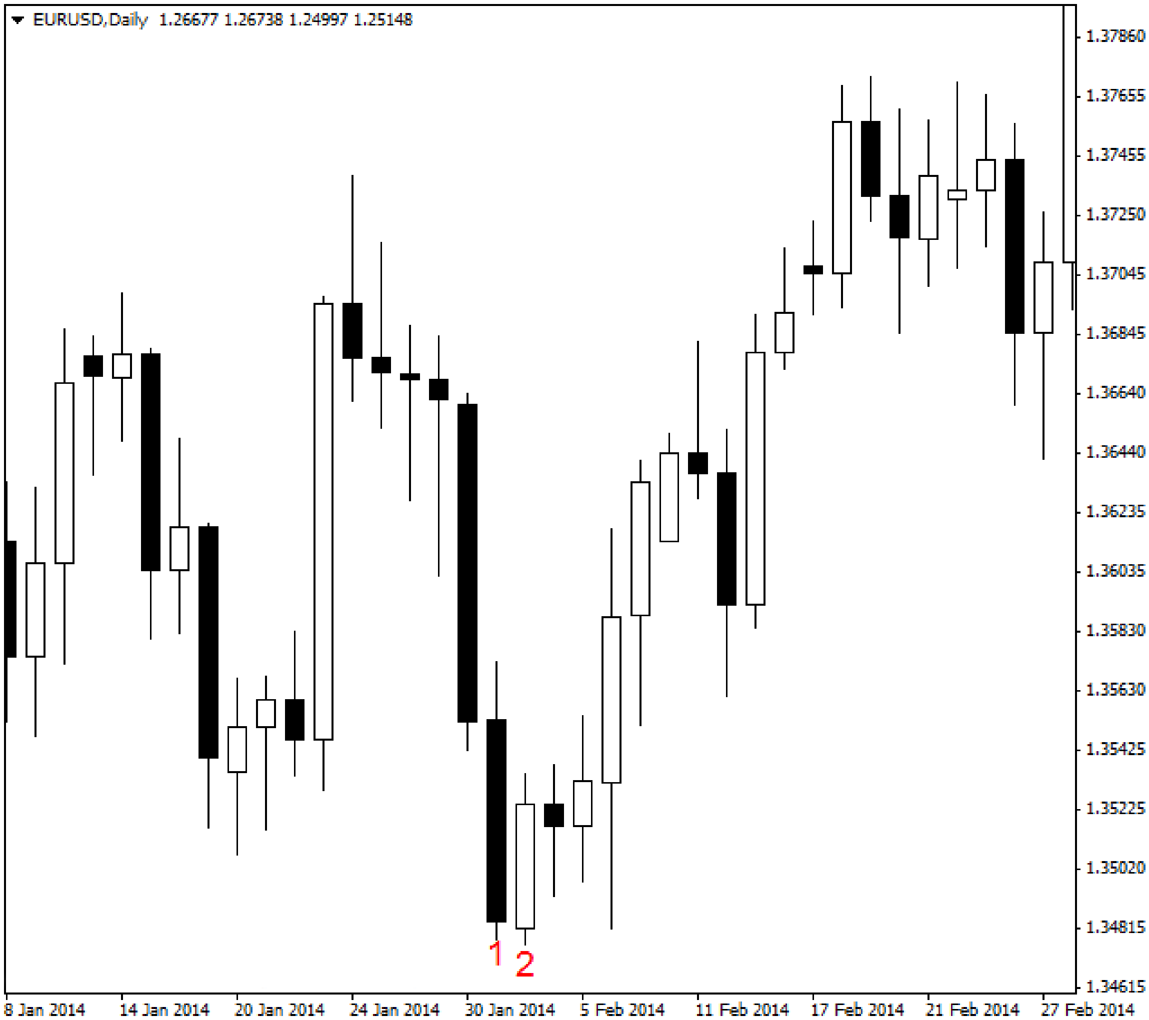
In this article, I am going to explain about the strong Piercing Line and Bullish Engulfing patterns. These patterns form less frequently compared to the bearish patterns, maybe because bulls are not used to attack as aggressively as bears, but usually bears' attack is sudden and strong, and this sudden and strong attack ends to the engulfing of the previous candlesticks by a big and strong bearish candlestick. The reason is the bears' attack is because of fear, but bulls' attack is because of greed. Fear comes suddenly and aggressively, whereas greed is a milder emotion.

Piercing Line Candlestick Pattern

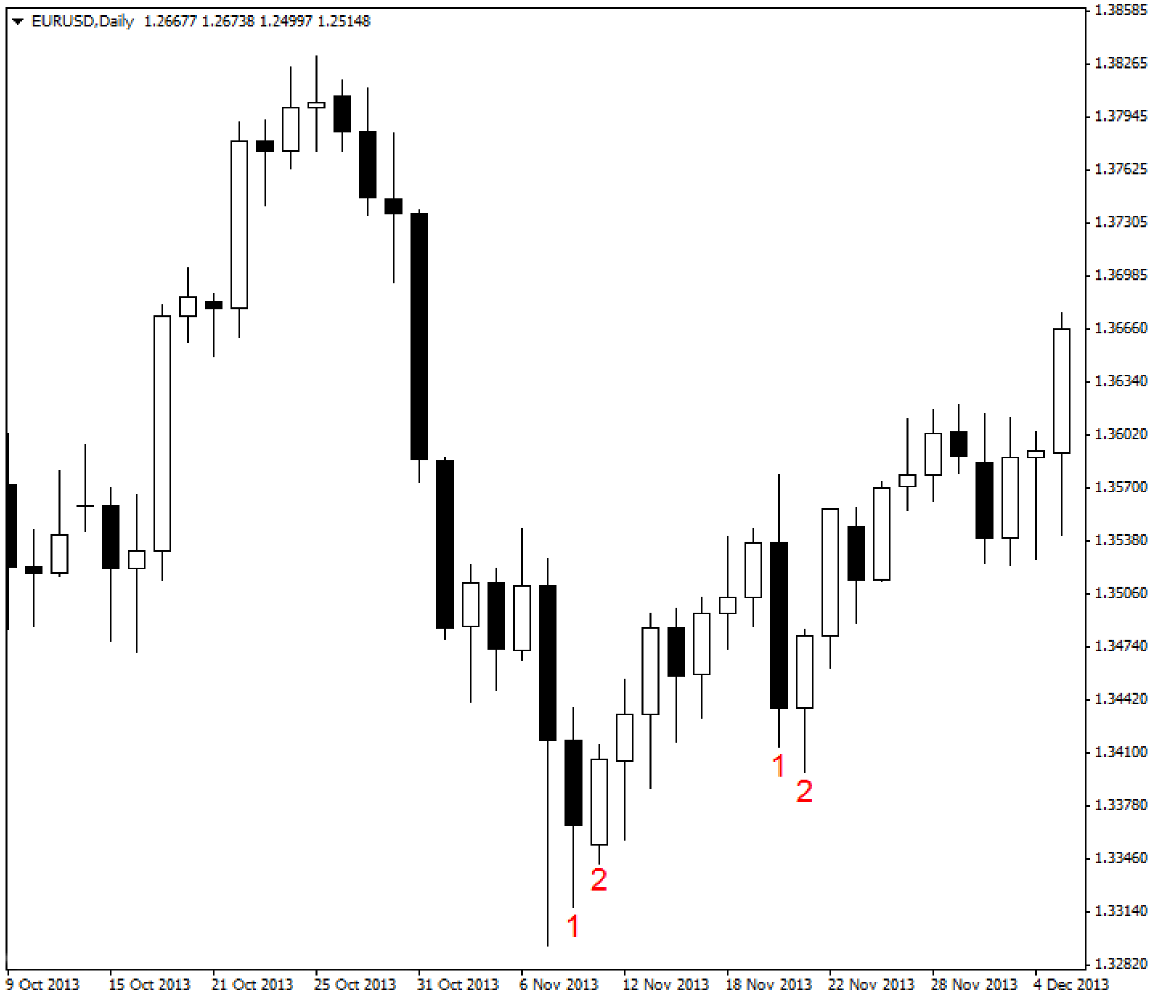
Piercing Line is the bullish form of Dark Cloud Cover. It is a bullish reversal pattern. It is "bullish", because it makes the price go up, when it forms. It is "reversal", because it forms at the bottom of the bear markets, and makes the price reverse.

This pattern forms by two candlesticks. The first candlestick has to be a bearish candlestick. The second candlestick has to be a bullish candlestick that opens a little below the close price, and closes below the open price of the first candlestick. If it goes up and closes above the open price of the first candlestick, then it will not be called Piercing Line, and it is Bullish Engulfing pattern, which is even stronger than Piercing Line.

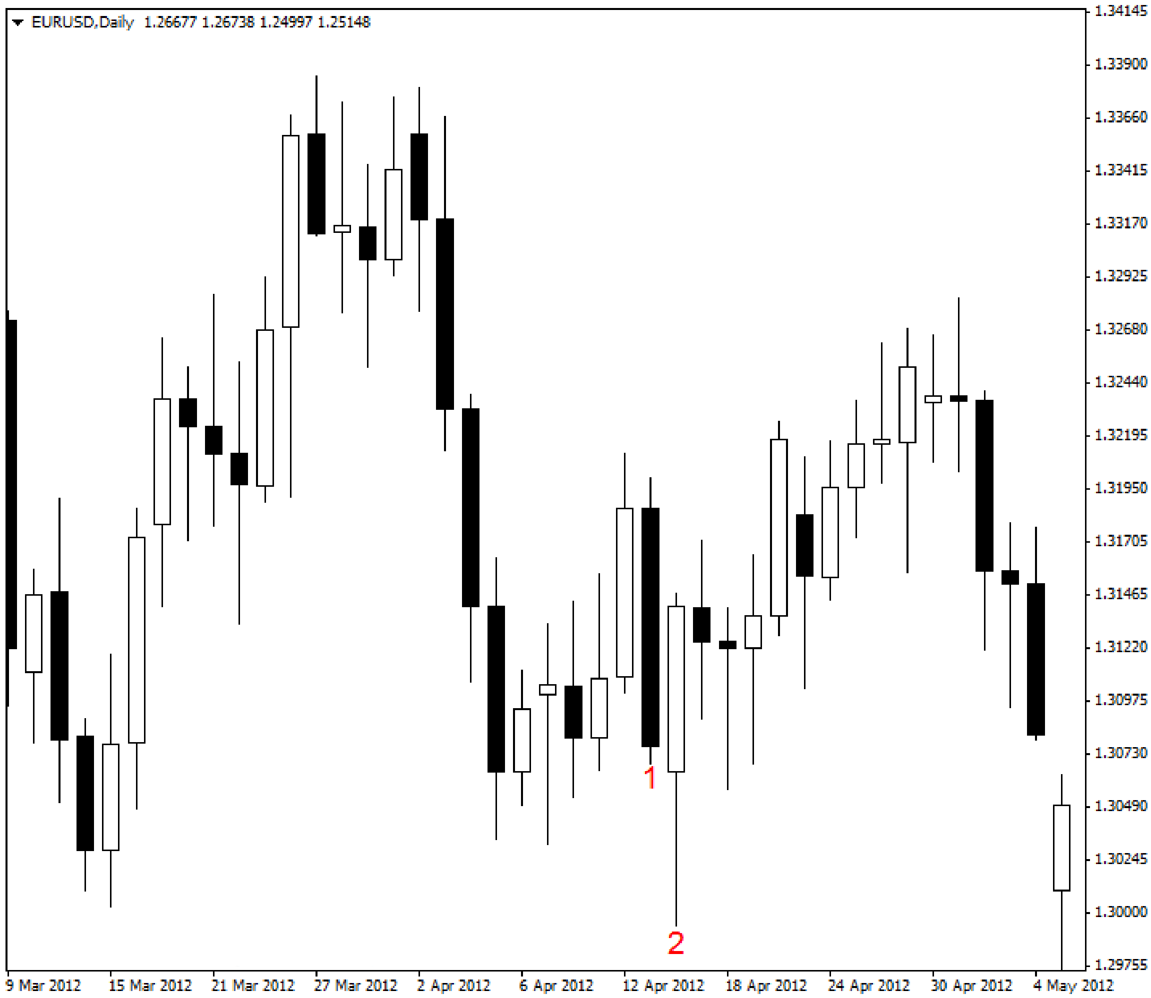
Please look at the below chart. Candlestick #1 which is the first candlestick in Piercing Line pattern, is formed by on EUR/USD daily chart. The second candlestick which is the main candlestick in Piercing Line pattern, and indeed is the candlestick that forms the pattern, is a bullish candlestick. As you see, the second candlestick is opened a little below the close price of the first candlestick. Additionally, it has engulfed some part of the first candlestick's body, but is closed below the open price of this candlestick. So this is a Piercing Line pattern.



Some more examples of Piercing Line pattern:



EURUSD,Daily 1.26677 1.26738 1.24997 1.25148
1.38585
1.38265
1.37945
1.37625
1.37305
1.36985
1.36660
1.36340
1.36020
1.35700
1.35380
1.35060
1.34740
1.34420
1.34100
1.33780
1.33460
1.33140
1.32820
1
2
1
2
9 Oct 2013
15 Oct 2013
21 Oct 2013
25 Oct 2013
31 Oct 2013
6 Nov 2013
12 Nov 2013
18 Nov 2013
22 Nov 2013
28 Nov 2013
4 Dec 2013



What Are the Features of a Strong Piercing Line Pattern?

Like Dark Cloud Cover Pattern, a Piercing Line Pattern has to meet some requirements to be known as a strong candlestick pattern.

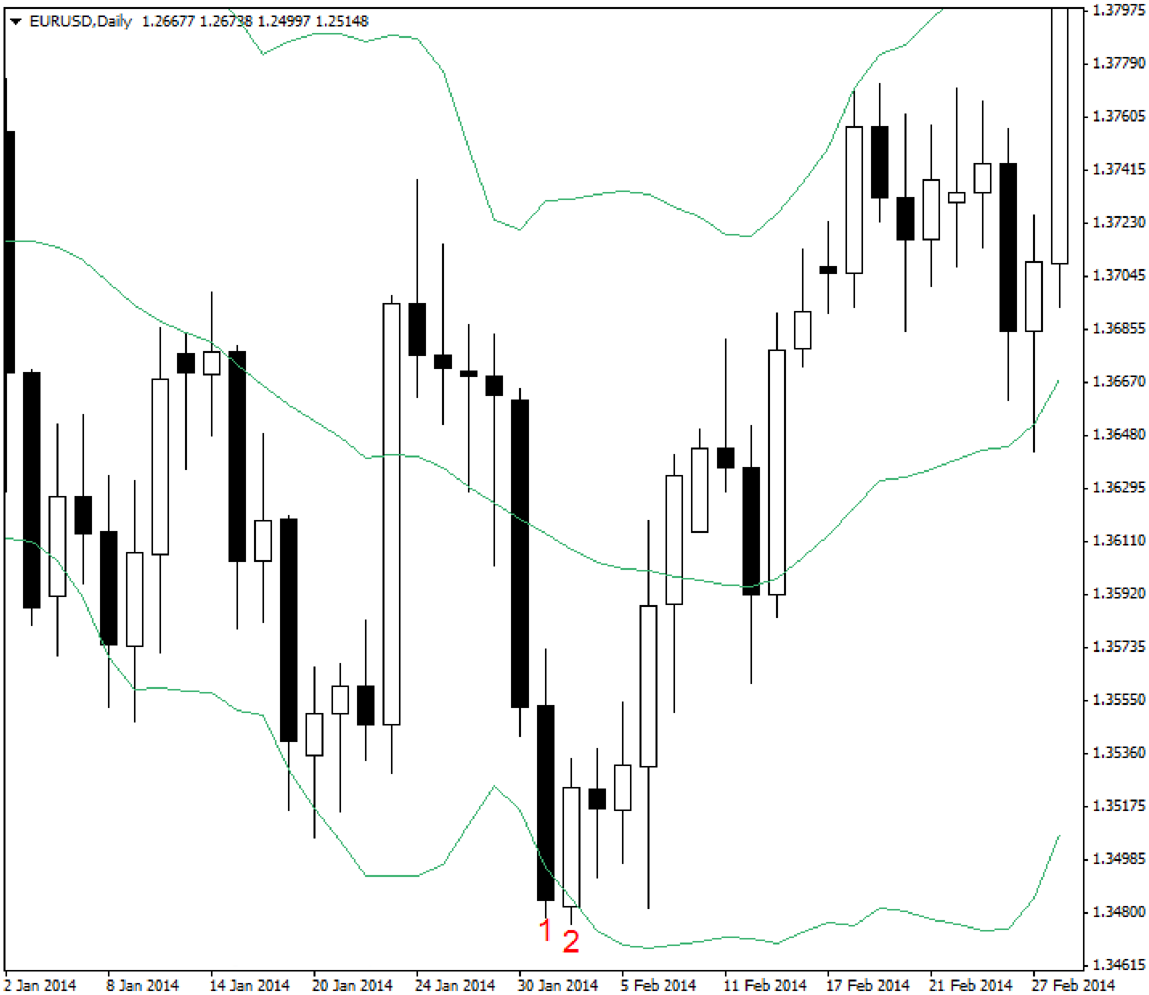
1. The first candlestick has to be a relatively big bearish candlestick. The longer the first candlestick, the stronger the pattern and the signal.

2. The second candlestick which has the main role in formation of the Piercing Line Pattern, has to be a relatively big bullish candlestick that engulfs most part of the first candlestick's body. The more it engulfs, the stronger the pattern.

3. Both of the first and second candlesticks should have broken out of the Bollinger Lower Band strongly. The stronger the Bollinger Lower Band breakout, the stronger the reversing power of the pattern.

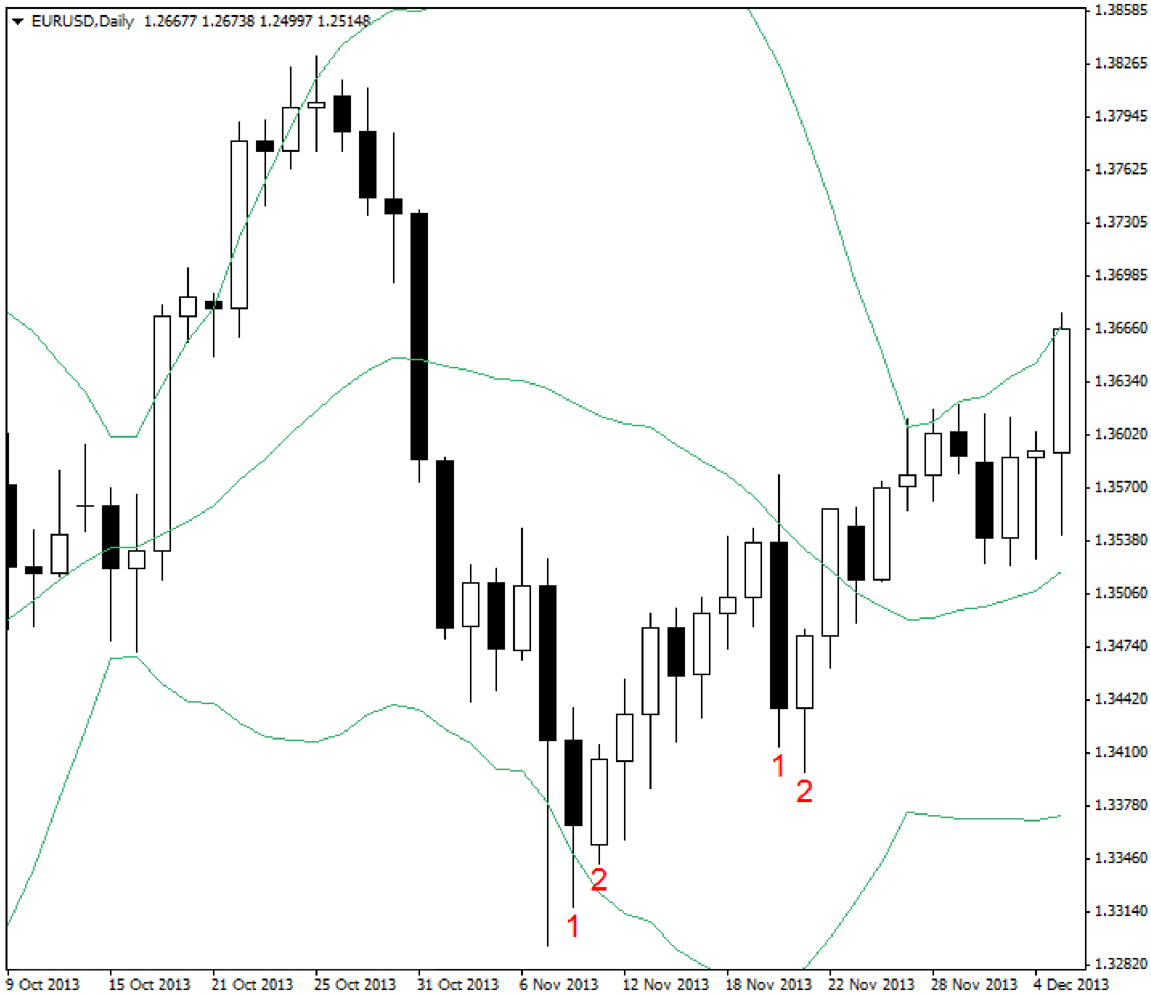
Let's add Bollinger Bands to the above charts and see how the above patterns have broken out of the Bollinger Lower Band.

In the first example, the first candlestick size is good. The second candlestick is not that big, and it has not been able to engulf the body of the first candlestick strongly. Their Bollinger Lower Band breakout is not that strong also:

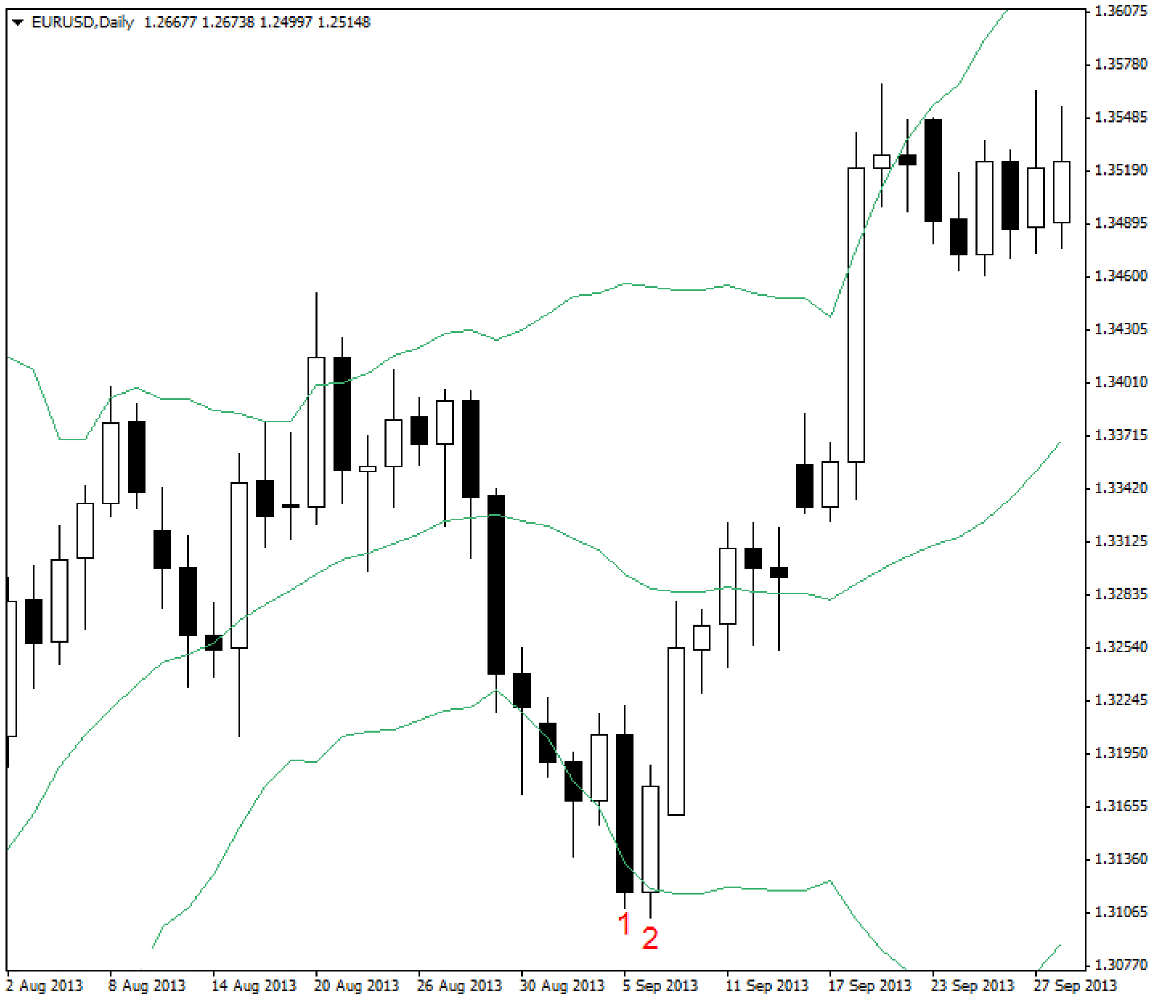


On the below chart which is related to the second chart we showed you above, in the first Piercing Line Pattern at the left, the second candlestick has not broken out of the Bollinger Lower Band, but the first candlestick and also the candlestick before, have broken out of the Bollinger Lower Band strongly.

In the second Piercing Line Pattern at the right side of the below chart, none of the first and second candlesticks have broken out of the Bollinger Lower Band, and the pattern is formed below the Bollinger Middle Band.



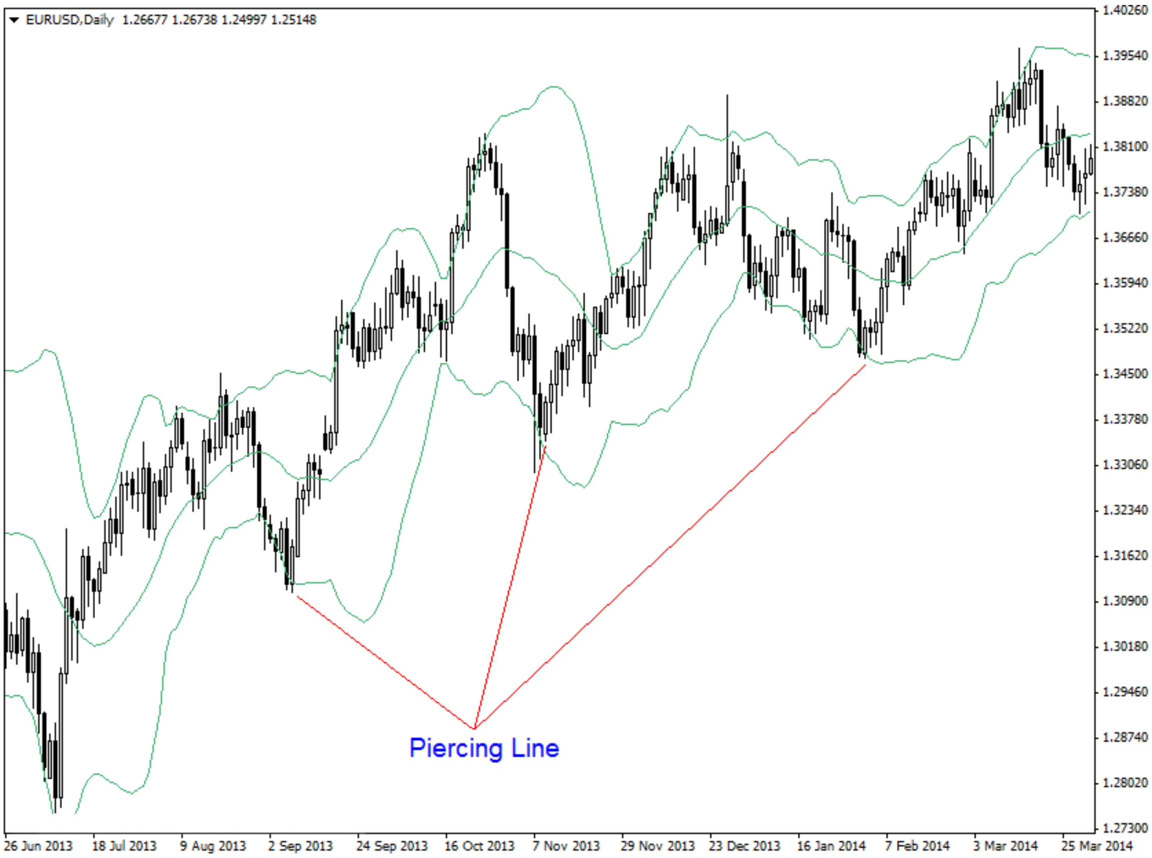
Another example can be seen on the below screenshot. The candlesticks sizes are not bad, and the Bollinger Lower Band breakout is also good (although it is not strong).



When all the above requirements are met, it means a strong Piercing Line Pattern is formed. However, a strong Piercing Line Pattern has to meet another requirement to be known as a strong long trade setup:

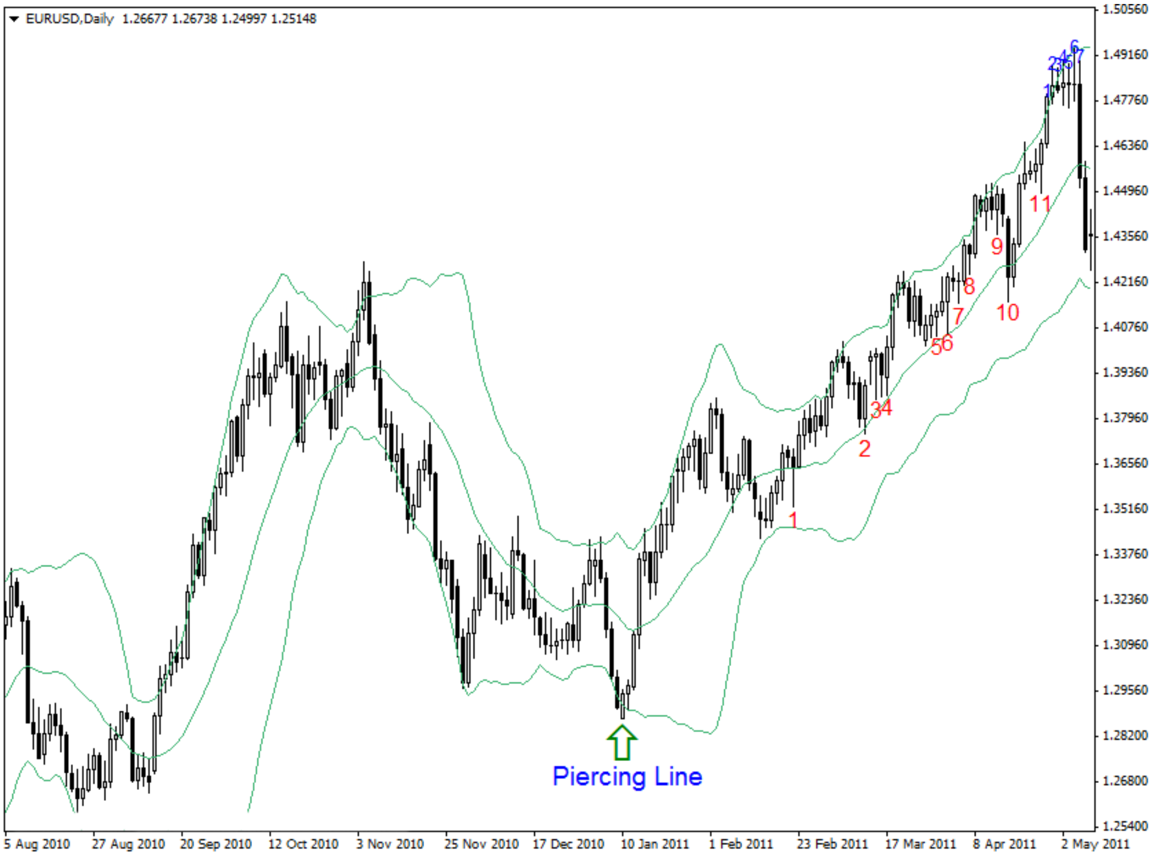
4. A Piercing Line Pattern which has met the above three requirements has to be formed where bears are not very strong. It has to form where bears look exhausted, and they don't have the the full control. If a Piercing Line Pattern with the above three conditions forms at the bottom of a too strong bear market, then it has to be ignored, because it is too risky to go long at the bottom of a too strong bear market.

All of the below three Piercing Line Patterns are formed when there was no strong downtrend, and bears did not have full control. The first one at the left and also the middle one, have a relatively good Bollinger Lower Band breakout. However, neither the candlesticks, nor the engulfing and Bollinger Lower Band breakout is that strong, therefore they are not strong trade setups:

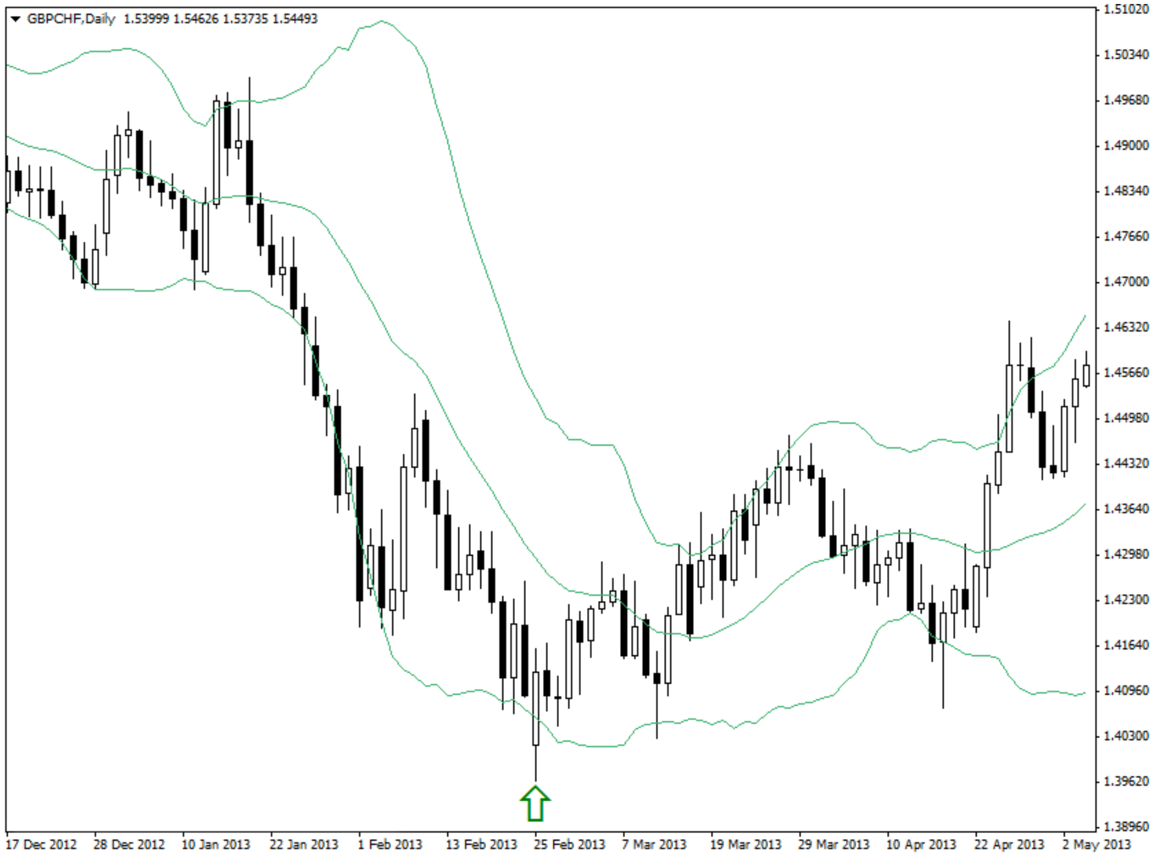


It is a little hard to locate a Piercing Line Pattern that meets all the three requirements strongly, and at the same time forms where bears are not too strong. On the below chart, the pattern is formed when bears had become exhausted and a Double Bottom or "M" pattern which is a reversal pattern was formed at the bottom of the downtrend. However, the first and second candlesticks are not too strong and the pattern is not strong enough by itself.

As I said, a too strong Piercing Line Pattern forms very rarely on the forex market. The reason is that usually the second candlestick doesn't open lower than the close price of the first candlestick, and it either opens at the same level or a little higher. Therefore, the pattern can not be called Piercing Line, and it is a Bullish Engulfing that can be seen very frequently on all charts and time frames.



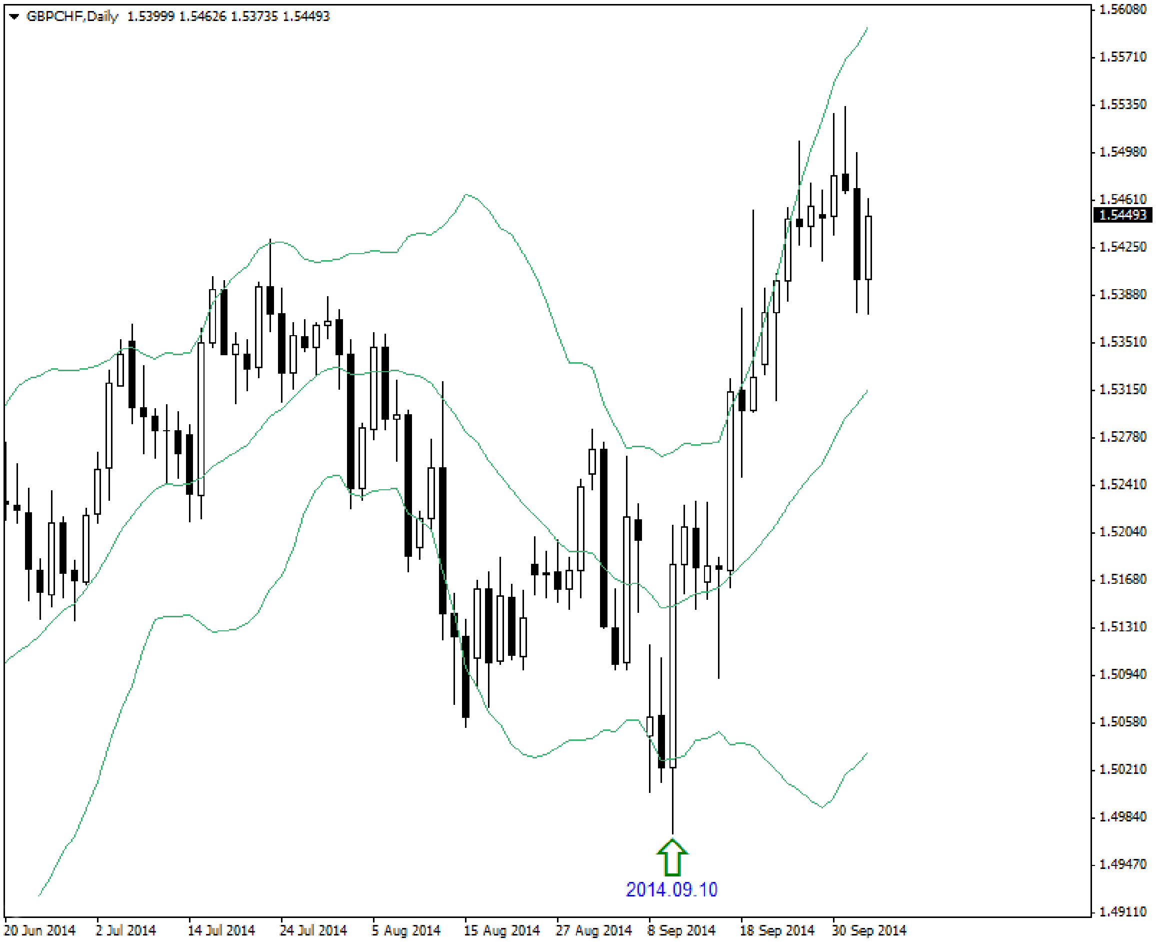
Exceptional cases can be seen sometimes. For example in the below chart, the second candlestick is opened about 73 pips below the close price of the first candlestick. The Bollinger Lower Band breakout formed by the second candlestick is good, but the pattern is formed where bears were still strong. That is why when the pattern formed, the price went up, but it stopped by the Bollinger Middle Band, went down again and then went up after forming a Hammer:



Bullish Engulfing Candlestick Pattern

Bullish Engulfing pattern forms on the forex market very frequently. Like Bearish Engulfing Pattern, Bullish Engulfing pattern is a too strong reversal pattern. This pattern has to form at least by two candlesticks. The first candlestick has to be a bearish candlestick, and the second candlestick has to be a bullish candlestick that goes all the way up and engulfs the body of the first candlestick. Sometimes when the first candlestick is not that long, the second candlestick goes up and engulfs the body of a few of the previously formed candlesticks including the first candlestick.

The below chart shows a strong Bullish Engulfing pattern formed on GBP/CHF daily chart. As you see, this candlestick is formed as a too strong bullish candlestick, and it has engulfed the body of several previously formed candlesticks.



A Bullish Engulfing pattern is strong when...

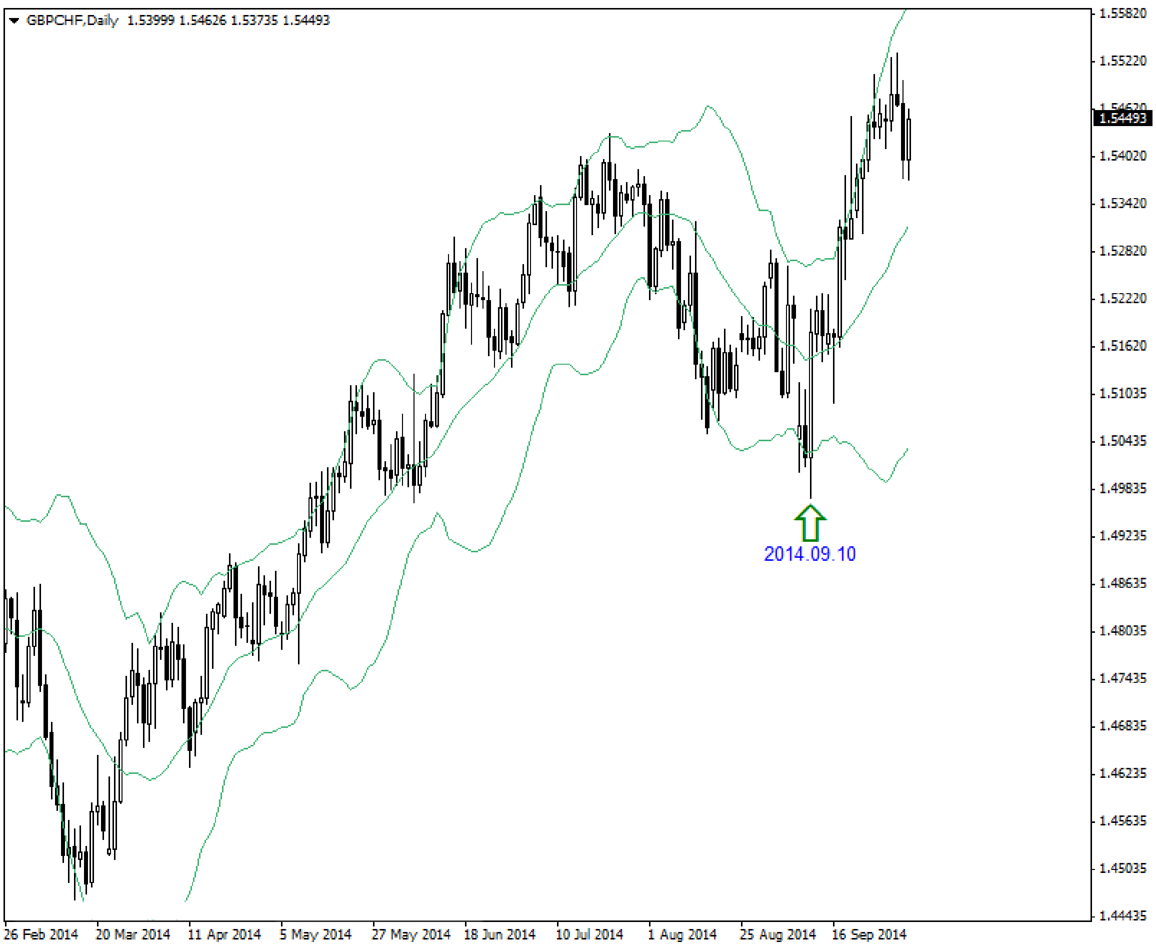
1. The bullish candlestick which is the main candlestick in the Bullish Engulfing Pattern closes with a long body, and it engulfs the body of the first candlestick and preferably a few of the previously formed candlesticks.
2. The second candlestick and preferably the previous candlesticks, or at least the first candlestick breaks out of the Bollinger Lower Band strongly.

As you see on the above chart, the bullish candlestick is not only long enough (it has engulfed several previous candlesticks), but it has broken out of Bollinger Lower Band strongly. Two of the previously formed candlesticks have broken out of Bollinger Lower Band also.

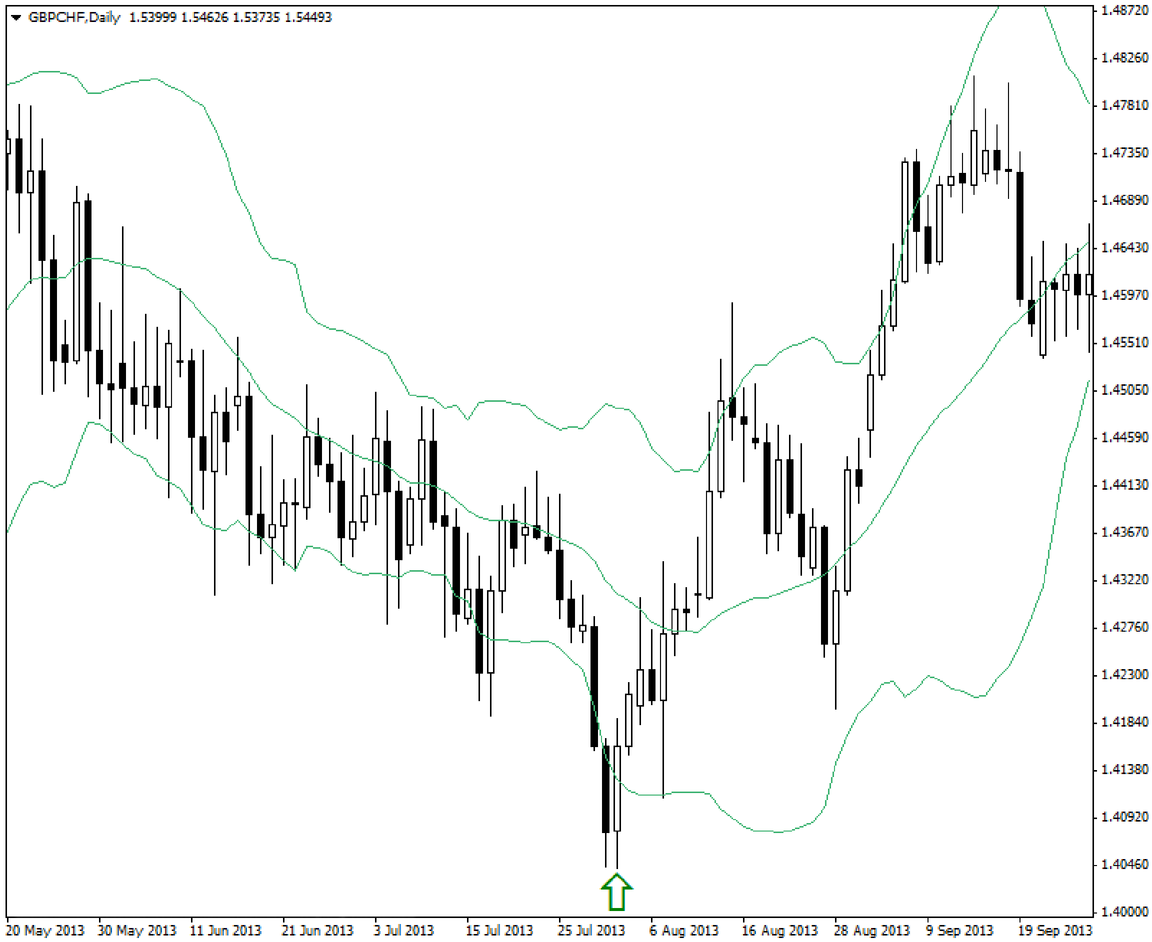
Therefore, the above pattern is a strong Bullish Engulfing Pattern. However, a strong Bullish Engulfing Pattern will be known as a strong long trade setup, if it forms when the bears are already exhausted, not when the bears are still too strong at the bottom of a too strong downtrend.

To know whether the above Bullish Engulfing Pattern is formed when bears were exhausted, we have to zoom out to see a wider picture of the GBP/CHF market.

As you see on the below chart, the Bullish Engulfing Pattern formed by 2014.09.10 candlestick, is not formed on a strong downtrend. It is formed almost at the end of a small bear movement that was formed after a strong uptrend. It means it is formed when bears never had the full control and the market was a bullish market indeed. This pattern and the long trade setup it has formed, can be known as the continuation of the uptrend.



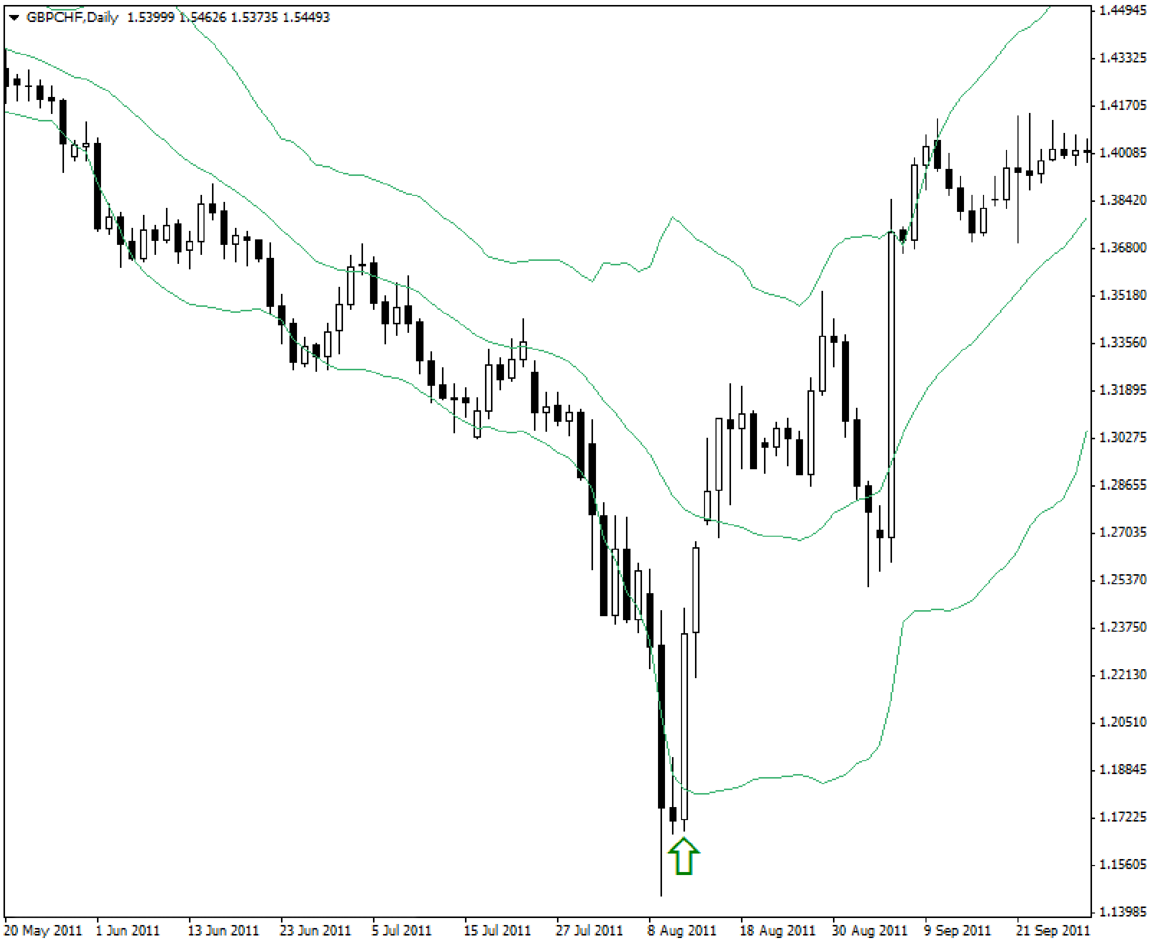
I can show you so many examples of strong Bullish Engulfing patterns that are strong long trade setups also (they meet all the requirements). Here is one of them formed by 2013.08.01 candlestick on GBP/CHF daily chart. Look how strongly both of the first and second candlesticks have broken out of the Bollinger Lower Band, and how strongly the second candlestick has engulfed the first one:



Here is another one formed by the 2011.08.11 candlestick on GBP/CHF daily chart (below). Indeed, the bullish candlestick that has formed the Bullish Engulfing pattern here is the confirmation candlestick for the Inverted Hammer that was formed before.

Of course, there is one problem with this pattern:

It has formed right at the bottom of a too strong bear market, and this is a strong negative point for this trade setup. However, the negative point is negated because the pattern is too strong by itself. Look at the bullish candlestick, the Inverted Hammer that was formed before, and also the long bearish candlestick (2011.08.09) formed before the Inverted Hammer, and see how they have broken out of Bollinger Lower Band strongly. The bullish candlestick itself is too strong and while it has also broken out of Bollinger Lower Band, it has engulfed the body of the 2011.08.09 candlestick very strongly. It means bulls already had the full control when the bullish candlestick formed:



I think now everything is clear about the Piercing Line and Bullish Engulfing candlestick Patterns, and the way they can be known as strong long trade setups. If you have any questions about these patterns, please submit a comment using the below form.

7) Features of a Strong Bearish Engulfing Candlestick Pattern

I have already talked about the features of a strong Dark Cloud Cover pattern in details. Bearish Engulfing Pattern is so similar to Dark Clod Cover. Indeed, Dark Cloud Cover is a kind of bearish engulfing with this difference that in Dark Cloud Cover, the second candlestick doesn't totally engulf the body of the first candlestick, and it closes somewhere above the open price of the first candlestick, but in Bearish Engulfing Pattern, the second candlestick engulfs the whole body of the first candlestick, and sometimes it even engulfs the body of a few previous candlesticks.

In this article, I am going to talk about the "Bearish Engulfing" candlestick pattern in details, and explain how to choose the strong Bearish Engulfing Patterns and ignore the weak ones.

What Is "Bearish Engulfing" Candlestick Pattern?

"Bearish Engulfing" is a bearish reversal candlestick pattern. It is "bearish", because it forms on bull markets, and is a signal that indicates the price reversal. It is the beginning of a down or bear movement. It is "reversal", because it reverses the uptrends.

Bearish Engulfing Pattern consists of at least two candlesticks, but sometimes there are more than a few candlesticks involved in this pattern.

In Bearish Engulfing pattern, at least one bullish candlestick has to form, that we call it the first candlestick. Then the next candlestick has to go all the way down to engulf the whole body of the first candlestick. It has to close either at the open price of the first candlestick, or below it.

It doesn't matter where the second candlestick opens. It can open above the close price of the first candlestick or below it. Something that matters is that the second candlestick completely engulfs the body of the first candlestick. If the second candlestick opens above the close price of the first candlestick, and then it doesn't cover the whole body of the first candlestick, it still is a Bearish Engulfing Pattern, but we specifically call it Dark Cloud Cover.

Bearish Engulfing and Dark Cloud Cover patterns are so similar to each other.

Sometimes either the first candlestick is not that big, or the second candlestick is too big, and so, the second candlestick not only engulfs the body of the first, but also one or a few of the candlesticks before. In this case, more than two candlesticks are involved in the Bearish Engulfing Pattern.

From the above explanations, it is clear that in Bearish Engulfing pattern, the second candlestick is the main candlestick, and indeed it is the candlestick that forms the pattern.

A typical example of a Bearish Engulfing Pattern can be found in the below screenshot. Of course there are some more Bearish Engulfing Patterns on the same screenshot too, but the one that is formed by the 2010.11.05 candlestick (#2) is stronger and looks like a typical sample of a strong Bearish Engulfing Pattern.

As you see, the second candlestick has completely engulfed the body and lower shadow of the first candlestick, and also the body of the candlestick before (candlestick #0).

When Is a Bearish Engulfing Pattern Strong Enough to Be Taken as a Short Trade Setup?

You can locate so many Bearish Engulfing Patterns on the price charts, but you have to know which one can be known as a short trade setup, otherwise you can lose money.

Like a strong Dark Cloud Cover pattern, a strong Bearish Engulfing pattern has to meet some requirements to be known as a "Strong Short Trade Setup" by us:

1) The Second Candlestick Size

The second candlestick is the most important part of a Bearish Engulfing Pattern. Indeed, it is the second candlestick that creates the pattern. The second candlestick in a Bearish Engulfing Pattern has to be a too long bearish candlestick. It has to engulf the body of the first candlestick completely. In case the first candlestick is not that big, then the second candlestick has to be long enough to engulf the body of a few of the previously formed candlesticks, like the candlestick #2 on the above chart that has engulfed two previous candlesticks.

The above requirement ensures that the Bearish Engulfing Pattern is strong by itself. When the second candlestick is long enough to engulf the body of the first or a few of the previous candlesticks, then we have a strong Bearish Engulfing Pattern formed on the chart. However, having a strong Bearish Engulfing pattern doesn't mean that we have a "Strong Short Trade Setup" also. A strong Bearish Engulfing pattern has to meet two more requirements, to be known as a Strong Short Trade Setup.

2) Bollinger Upper Band Breakout

At least the first and second candlesticks involved in the formed Bearish Engulfing Pattern should have broken out of Bollinger Upper Band strongly. Let's add Bollinger Bands to the above chart and see whether the candlesticks in our exampled Bearish Engulfing Pattern have broken out of the Bollinger Upper Band or not:

As you see on the below chart, candlestick #1 has broken out of the Bollinger Upper Band very strongly. The second candlestick has a strong Bollinger Upper Band breakout as well. Additionally, even the candlestick #0 has broken out of the Upper Band strongly too. So, our sample Bearish Engulfing Pattern meets the second requirements also.

3) The Uptrend Situation

The last requirement is that the Bearish Engulfing Pattern that we want to know it as a strong short trade setup, should not be formed RIGHT at the top of a too strong uptrend, otherwise it is too risky to be taken as a short trade setup.

The reason is clear. It is too risky to go short at the top of a too strong uptrend, even when the formed Bearish Engulfing pattern is so strong by itself.

A strong Bearish Engulfing Pattern which has strongly broken out of the Bollinger Upper Band also, will be known as a strong short trade setup, when it is not formed RIGHT at the top of a strong uptrend, and it is formed where bulls have already become exhausted. A strong Bearish Engulfing Pattern formed at the top of a strong uptrend can be the signal of the bulls' exhaustion, but it should not be known as a short trade setup, because of the extra risk that it has.

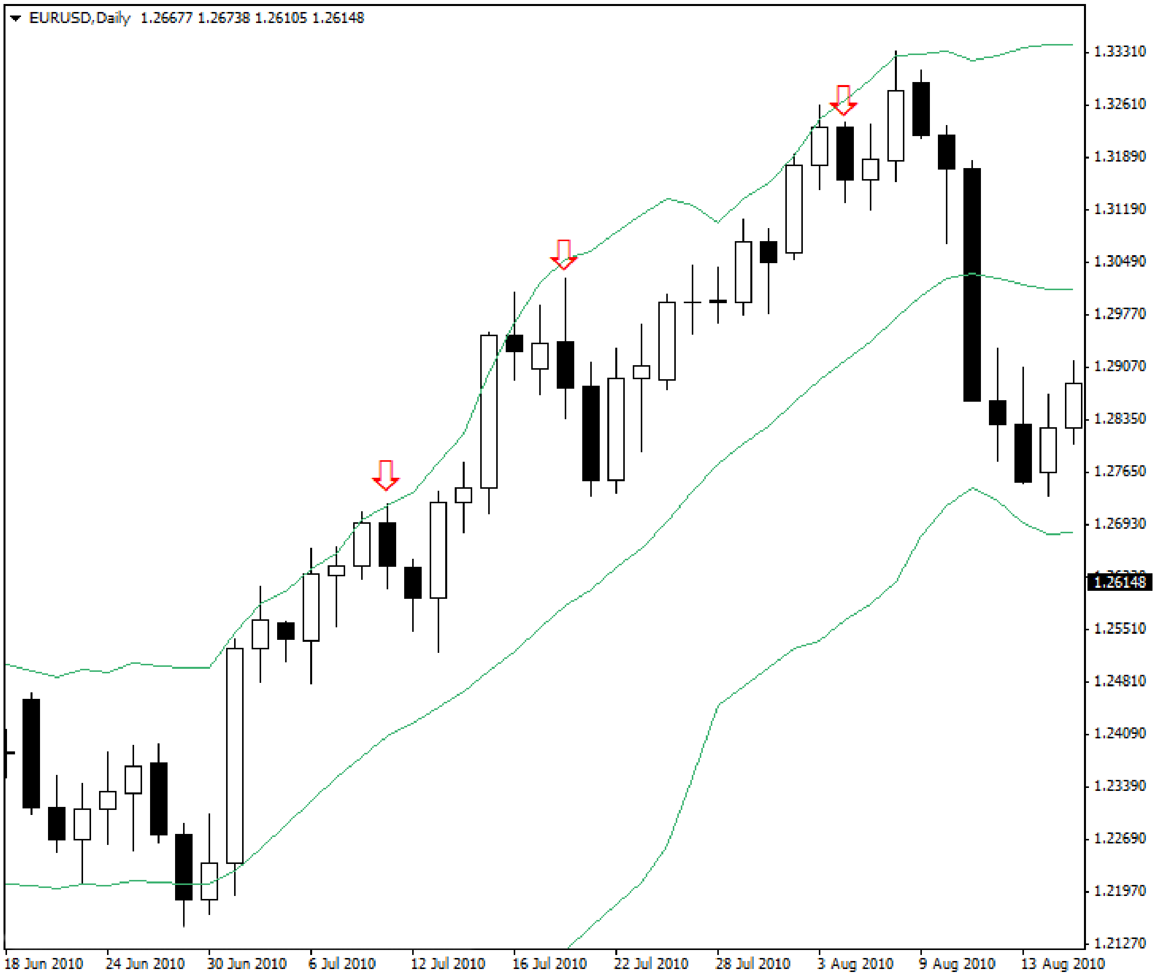
Let's zoom out and see whether our example Bearish Engulfing Pattern is formed right at top of a strong uptrend, or not (see the below chart).

As you see, our sample Bearish Engulfing Pattern is formed when the uptrend had stopped going up as strongly as it went up along the course that the big green arrow shows. If it was formed somewhere along the big green arrow, or where this arrow is ended, then it was right on a strong bull market, and it would be too risky to go short. But, it has formed when a W or Butterfly Pattern has already formed, and Bollinger Bands that were pointing to the upward direction strongly while the uptrend was so strong, has become almost horizontal.

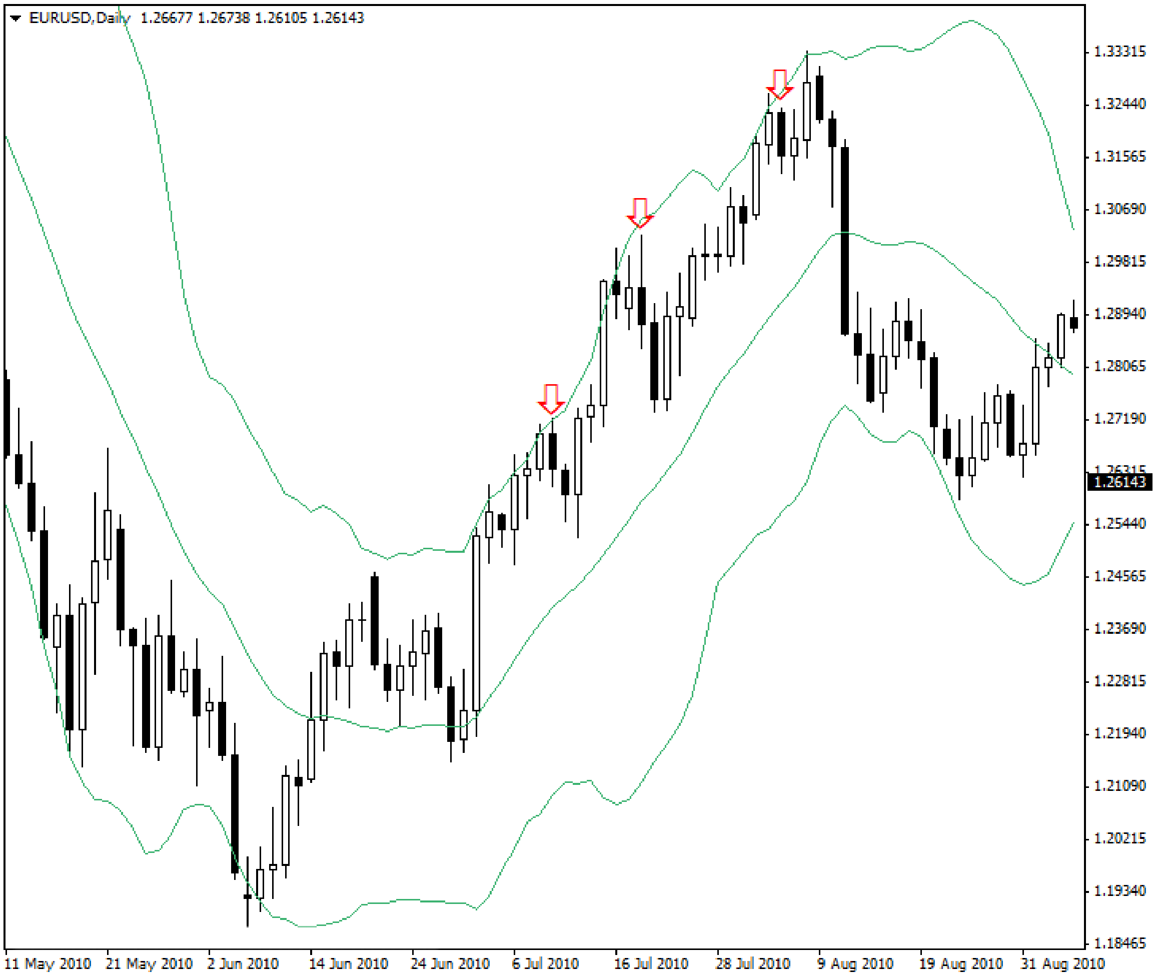
So, this Bearish Engulfing Pattern is not formed right at the top of a strong bull market. It is formed while bulls exhaustion signals were already appeared. Although I preferred it to form on a longer sideways market, but as the candlestick pattern is too strong by itself, this Bearish Engulfing Pattern can be known as a strong short trade setup with a 100 score, or 95-100 score based on a more conservative decision.

The Weak Bearish Engulfing Patterns

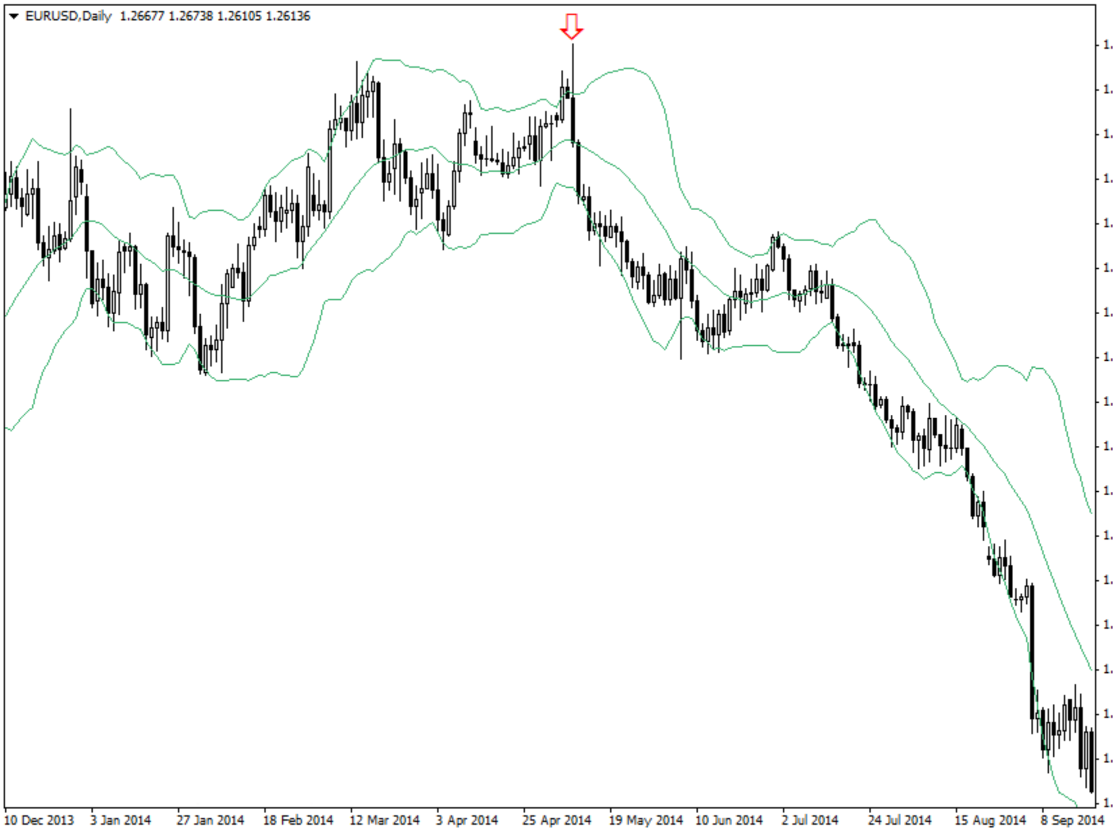
Now, let me show you a few weak Bearish Engulfing Patterns. Please look at the below chart. The red arrows are pointed to the weak Bearish Engulfing Patterns. The second candlestick is too short in all of the three patterns. Besides, they've formed while the uptrend was too strong and bulls still had the full control:



You can see the uptrend strength better, if you zoom out:



Below is the example of a very strong Bearish Engulfing patterns formed by on EUR/USD daily chart. As you see, it meets all the three requirements strongly:


EURUSD,Daily 1.26677 1.26738 1.26105 1.26136
1.39900
1.39220
1.38520
1.37820
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1.35740
1.35040
1.34340
1.33660
1.32960
1.32260
1.31560
1.30880
1.30180
1.29480
1.28780
1.28100
10 Dec 2013
3 Jan 2014
27 Jan 2014
18 Feb 2014
12 Mar 2014
3 Apr 2014
25 Apr 2014
19 May 2014
10 Jun 2014
2 Jul 2014
24 Jul 2014
15 Aug 2014
8 Sep 2014

8) Dark Cloud Cover and Piercing Line Candlestick Patterns in Forex Trading

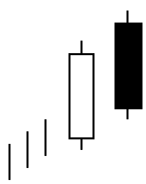
Dark Cloud Cover is a bearish candlestick pattern.

It means when it forms at the top of an uptrend, the uptrend can reverse and go down after that.

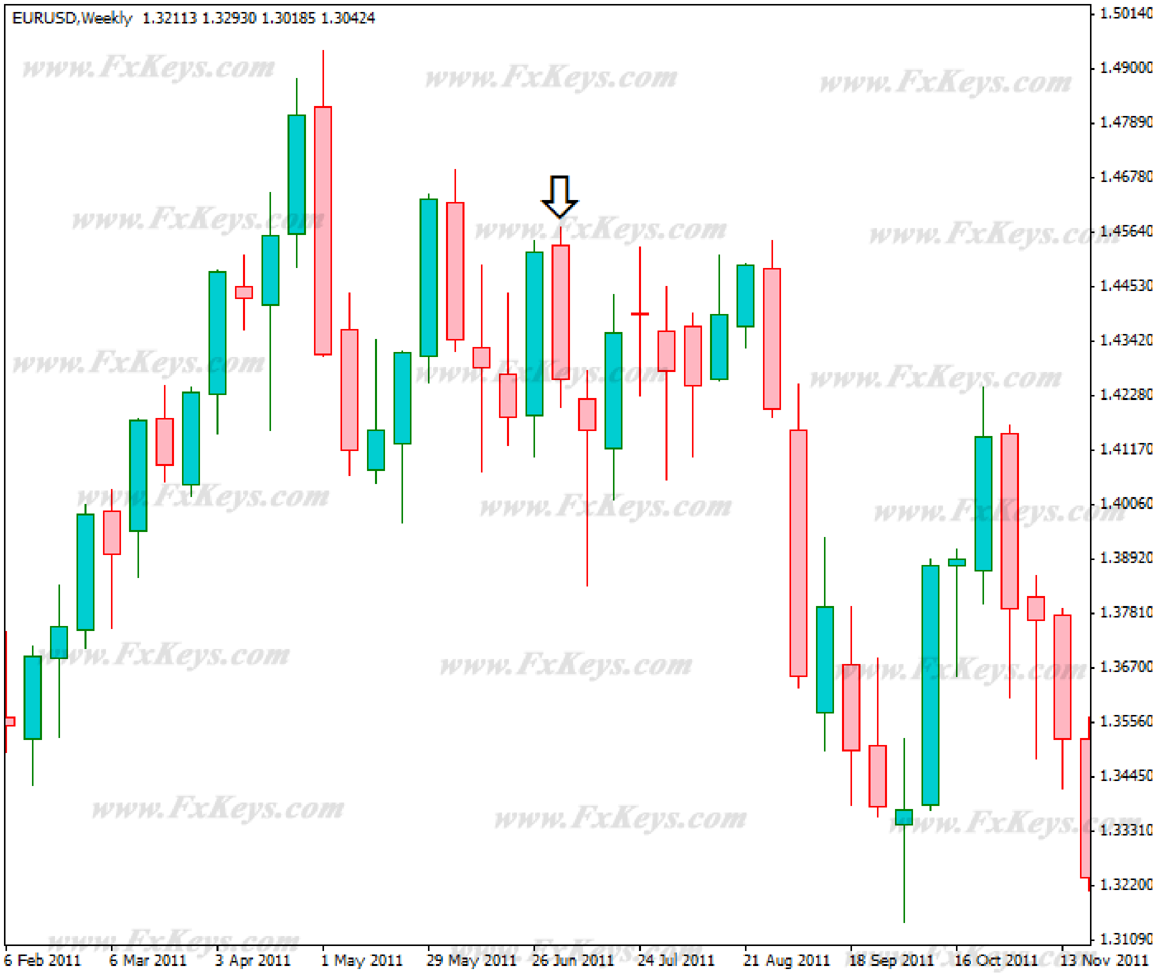
Dark Cloud Cover forms by a bearish candlestick that opens above the close price of the previous bullish candlestick.

The bearish candlestick goes down and covers most part of the body of the previous bullish candlestick.

It finally closes a little above the open price of the previous candlestick:



This is a Dark Cloud Cover pattern formed on GBP/USD weekly chart:



Piercing Line is the bullish form of Dark Cloud Cover pattern.

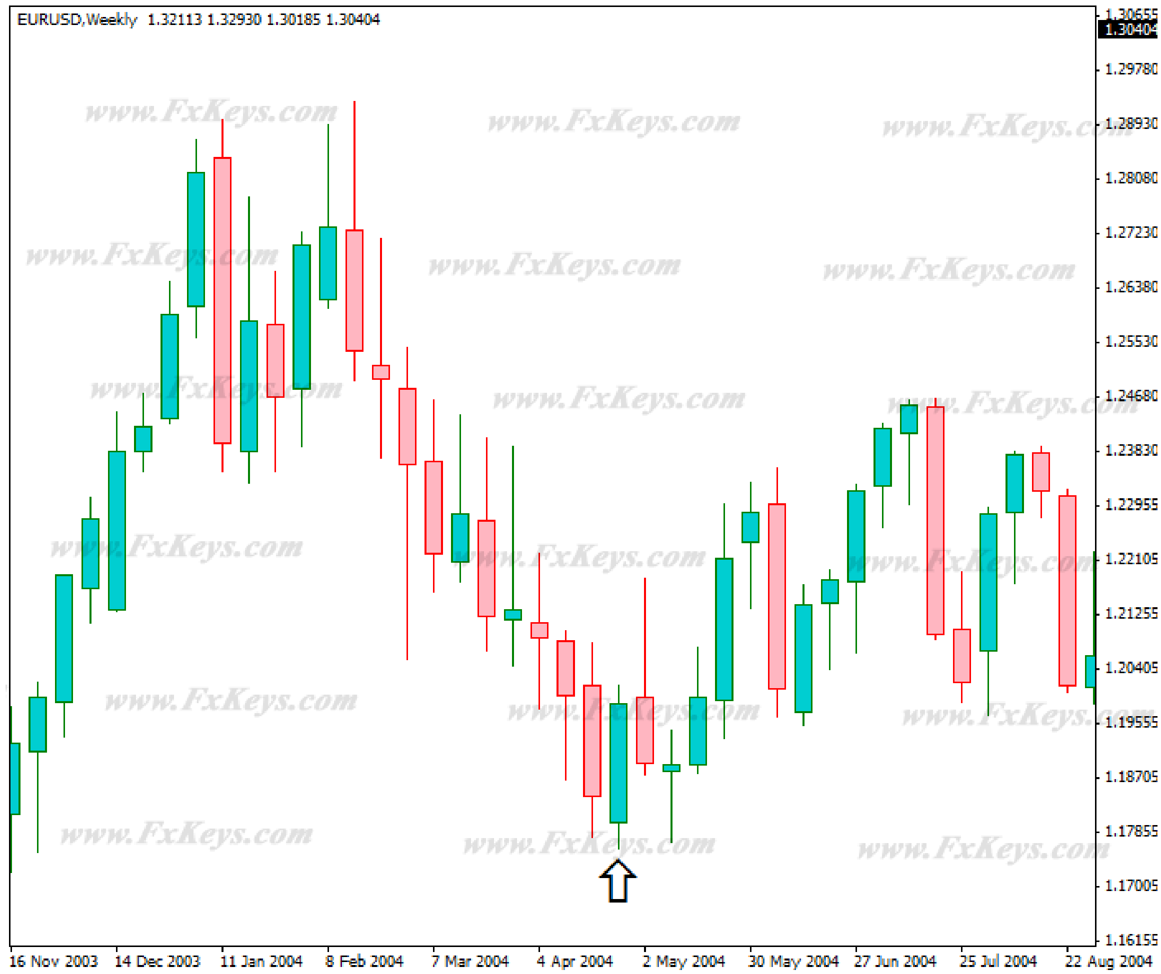
It forms at the bottom of a downtrend or a bear market.

It forms by a bullish candlestick that opens below the close price of a bearish candlestick.

The bullish candlestick goes up and covers most part of the body of the bearish candlestick.

It finally closes a little below the open price of the previous bearish candlestick.

A good and strong Piercing Line Pattern on GBP/USD weekly chart:



These two patterns, Piercing Line and Dark Cloud Cover, are reversal patterns, but not all of them can be taken as reliable trade setups.

Therefore, you have to learn how to choose the best and strongest patterns to trade.

I have written a couple of articles about this important topic.

9) Features of a Strong Dark Cloud Cover Candlestick Pattern

"Dark Cloud Cover" is among the candlestick patterns that I love, maybe because so far it has created a lot of profitable trade setups, and so many great opportunities for me.

So many candlestick patterns form on the price charts every day.

However, those that are good to take and make money with are not more than a few.

"Dark Cloud Cover" is one of them.

In this article, I am going to explain what "Dark Cloud Cover" is, how it forms, and above all, I am going to explain under what condition "Dark Cloud Cover" should be taken as a strong trade setup.

We have explained about this pattern in some of the other articles.

Therefore, we have to explain about the Dark Cloud Cover pattern in details, because it is a very important candlestick pattern for us.

What Is "Dark Cloud Cover" Candlestick Pattern?

"Dark Cloud Cover" is a bearish reversal candlestick pattern.

It is a "bearish" pattern, because it is a signal that indicates the beginning of a downward movement.

I mean when it forms on the chart, we know that most probably the price will go down.

It is a "reversal" pattern, because when it forms at the top of an uptrend, or after a few or few bullish candlesticks, the price usually changes its direction.

When it forms at the top of an uptrend, this pattern is the bulls exhaustion's signal indicating an incoming bearish attack.

"Dark Cloud Cover" consists of two candlesticks.

The first one has to be a bullish candlestick, and the second one which is the main candlestick in this pattern, has to be a bearish candlestick.

The second candlestick has to open a little above the close price of the first candlestick.

Then it has to go all the way down and close somewhere above the open price of the first candlestick.

Look at the below screenshot.

It is showing a typical examples of Dark Cloud Cover pattern formed by candlesticks on GBP/CAD daily chart.

Candlestick #1 which is the first candlestick in this Dark Cloud Cover pattern, has closed at 1.8506.

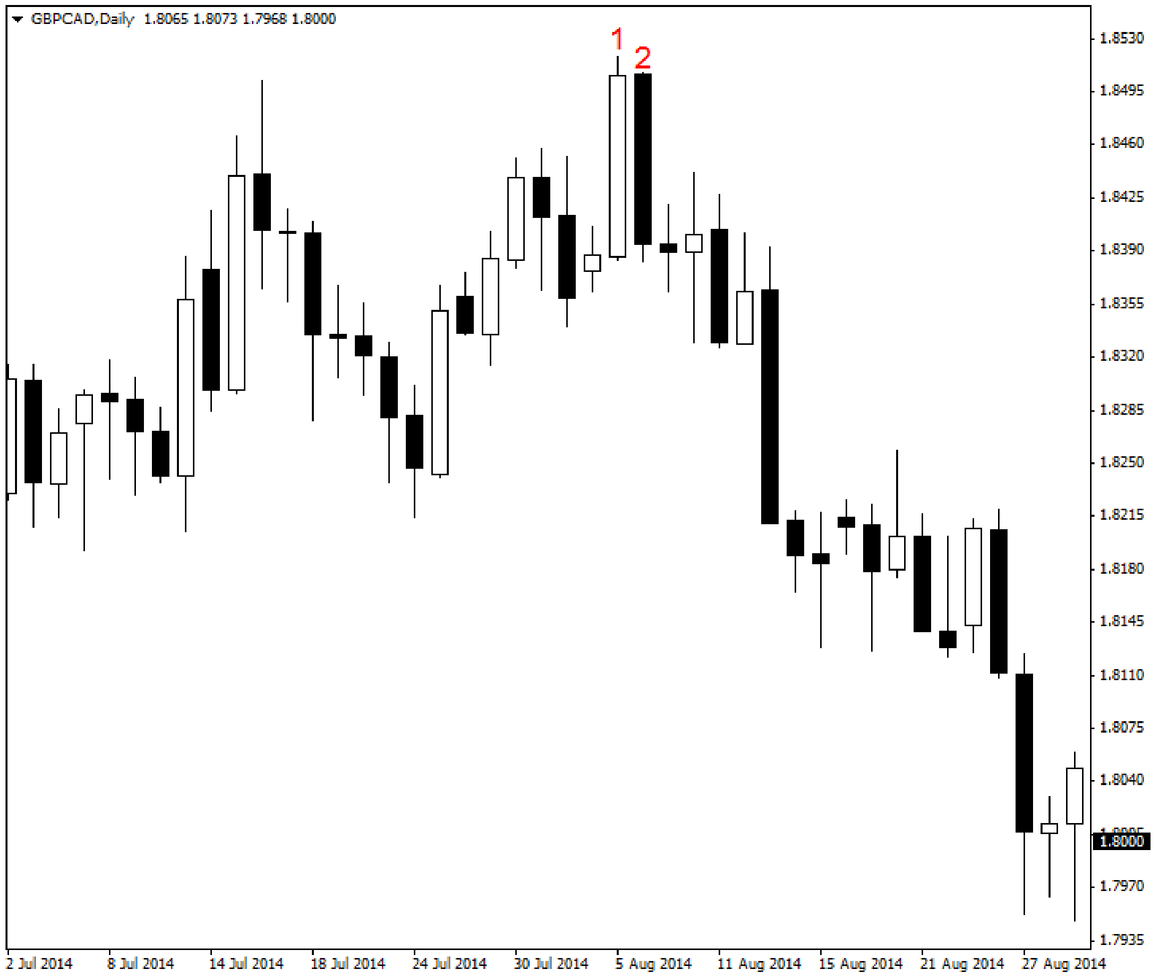
Candlestick #2 which is the second and the main candlestick in our Dark Cloud Cover pattern has opened at 1.8507, which is one pip above the close price of the first candlestick.

In Dark Cloud Cover patterns, usually the second candlestick opens several pips above the close price of the first candlestick, but this is not that important.

The most important thing to have a Dark Cloud Cover pattern is that the second candlestick closes above the open price of the first candlestick, otherwise the pattern cannot be called a Dark Cloud Cover anymore.

If it closes below the open price of the first candlestick, it is called Bearish Engulfing Pattern which is a strong bearish reversal pattern also.

In the below example, the first candlestick is opened at 1.8386, and the second is closed at 1.8394, which is 8 pip above the open price of the first candlesticks. So this is a Dark Cloud Cover pattern:



What Kind Of "Dark Cloud Cover" Pattern Can We Take as a Trade Setup?

It is very easy to locate so many Dark Cloud Cover patterns on the price charts and on different time frames.

However, not all of them are good enough to be known as a trade setup.

Many of them are weak and can not be trusted, and so we should not enter the market based on them.

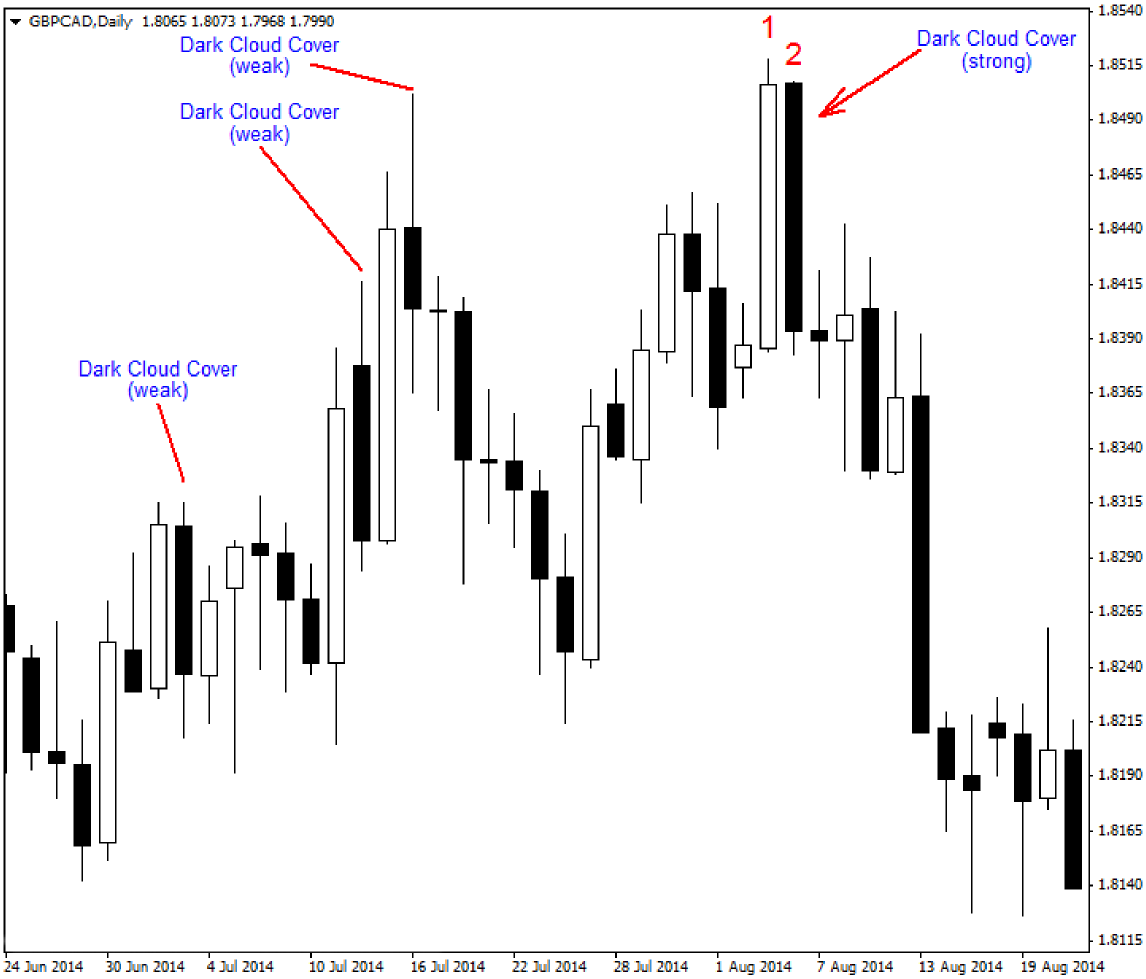
To go short, we need Strong Dark Cloud Cover patterns.

Look at the below chart, which is the same GBP/CAD daily chart I showed you above.

The difference is that in the below chart there was three more Dark Cloud Cover patterns marked at left side of the chart.

And at the right, we have the same typical Dark Cloud Cover pattern that I showed you above.

It is the strong Dark Cloud Cover pattern we need to go short:



What is the difference of the Dark Cloud Cover Patterns at the left, and the one at the right side of the above chart?

Why are the left patterns weak, but the pattern at the right, strong?

What Makes a Dark Cloud Cover Pattern Strong enough to be known as a trade setup?

There are some requirements that make a Dark Cloud Cover Pattern strong.

When a Dark Cloud Cover pattern meets all of these requirements, then it can be known as a strong pattern, otherwise it has to be skipped:

1. The first candlestick has to be a big bullish candlestick. The bigger the first candlestick, the better.
2. The second candlestick which is indeed the Dark Cloud Cover candlestick, has to be a big bearish candlestick that covers over 90-95% of the first candlestick's body.

When such a Dark Cloud Cover pattern forms, it should be known as a strong bearish candlestick pattern compared to the other Dark Cloud Cover patterns already formed on that chart.

However, there is one more requirement that I am going to add to the two above requirements.

It is true that when a Dark Cloud Cover pattern meets the above requirement, it is a strong Dark Cloud Cover pattern.

It is Bollinger Upper Band Breakout.

A strong Dark Cloud Cover pattern has to have a strong Bollinger Upper Band breakout formed by both of the first and second candlesticks.

If so, we take it as a strong short trade setup.

If not, we have to skip it.

Now let's add Bollinger Bands indicator to the above chart and compare the four Dark Cloud Cover patterns, and see why the three patterns at the left are weak, and the one at the right is strong. Please see the below chart.

Dark Cloud Cover pattern #1 doesn't meet any of the 2 requirements, because:

The first and the second candlesticks are not strong enough compared to the previously formed candlesticks.

The second candlestick (the bearish or black candlestick) has covered most of the first candlestick's body, but the problem is, it has closed with a relatively longer than usual lower shadow that reflects a little bit of extra bullish pressure, and this adds to the risk of going short based on this pattern.

Above all, Dark Cloud Cover pattern #1 is formed below the Bollinger Middle Band which is indeed at the middle of nowhere.

It has not broken out of the Bollinger Upper Band.

Therefore, pattern #1 has to be skipped.

Pattern #2 is formed by a strong bullish candlestick as the first candlestick of the Dark Cloud Cover pattern.

The second candlestick is a relatively strong bearish candlestick too.

However, (1) the first candlestick is not engulfed strongly by the second one.

(2) Additionally, none of the candlesticks have broken out of the Bollinger Upper Band.

Indeed, the first candlestick has broken above the Bollinger Middle Band, and then the second candlestick has tried to retest the broken Bollinger Middle Band, but the middle band has worked as a strong support.

This is not a good sign for a short trade setup, because it reflects a high bullish pressure.

Therefore, this pattern should not be known as a short trade setup.

In pattern #3, the first candlestick is big and strong, but the second candlestick has not been able to engulf even 25% of the body of the first candlestick.

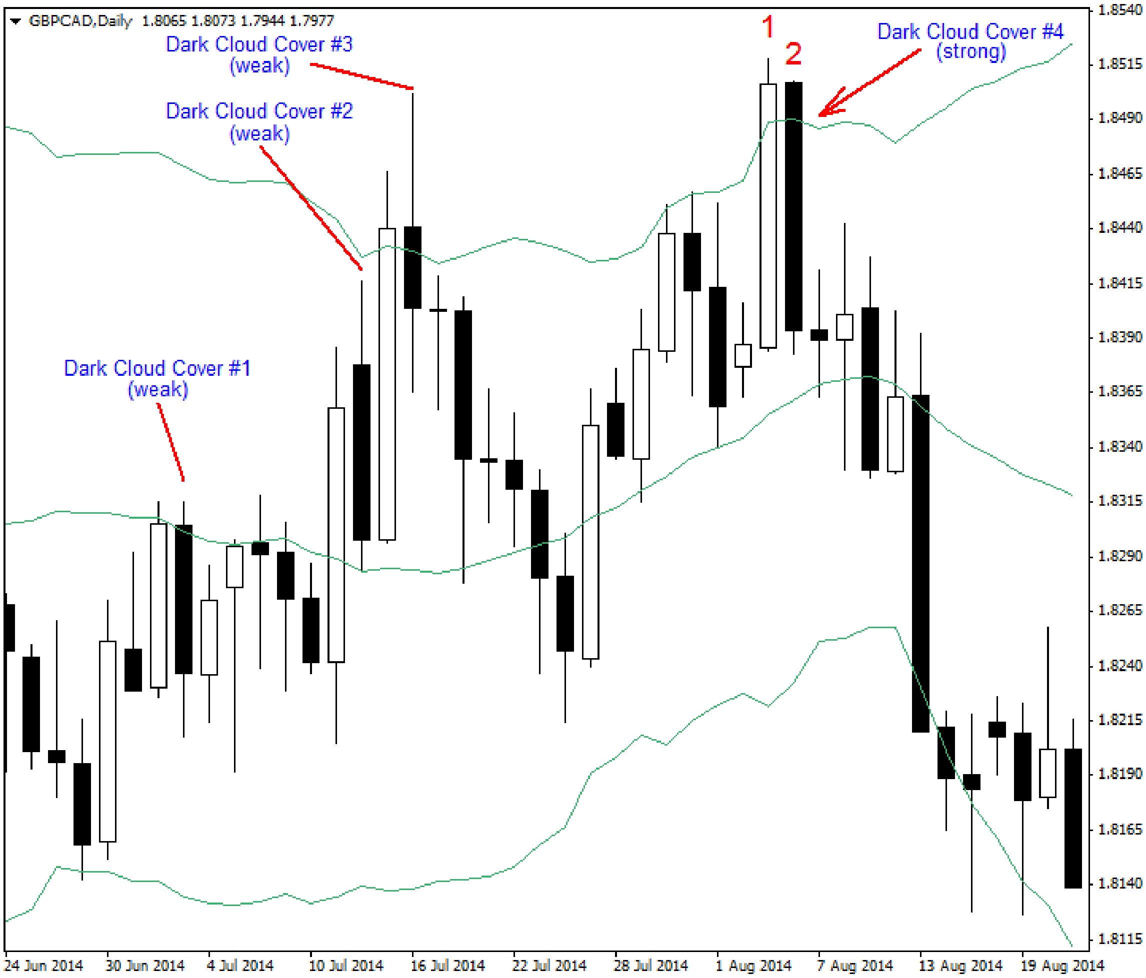
Although both candlesticks have broken out of the Bollinger Upper Band strongly, this pattern has to be skipped too, because of the second candlestick size.

Pattern #4 which is the king of Dark Cloud Cover patterns meets all of the requirements a Dark Cloud Cover pattern must meet to be considered as a strong short trade setup:

1. The first candlestick is a too big bullish candlestick.

2. The second candlestick is a too big bearish candlestick that has engulfed more than 95% of the body of the first candlestick.
3. Both of the first and second candlesticks have broken out of the Bollinger Upper Band strongly.

Therefore, Dark Cloud Cover pattern #4 is a strong pattern by itself, and so, it is eligible to be known as a short trade setup.



This article is focused on the features of a strong Dark Cloud Cover pattern, however, to go short based on a strong Dark Cloud Cover pattern, we need to check one more condition which has nothing to do with the formed Dark Cloud Cover candlestick pattern itself, and is related to the market condition:

Dark Cloud Cover is a bearish reversal pattern that indicates the beginning of a downward or bearish movement.

Naturally, it has to form at the top of a bull market to be known as reversal signal and short trade setup.

However, if it forms while bulls are still too strong, and uptrend is still too sharp, then a strong Dark Cloud Cover pattern like pattern #4 on the above chart, and the short trade setup it has formed, has to be ignored, because going short at the stop of a too strong bull market is stupid, and has too much risk.

Dark Cloud Cover pattern #4 is a too strong bearish candlestick pattern by itself, but it has to be skipped if formed at the top of a too strong bull market.

Now, let's zoom out and see where pattern #4 is formed.

Has it formed on a strong bull market, or it has formed while bulls were exhausted?

According to the below chart, pattern #4 is formed when GBP/CAD market has been ranging for a long time (the thick red arrow), after a too strong uptrend (the thick green arrow).

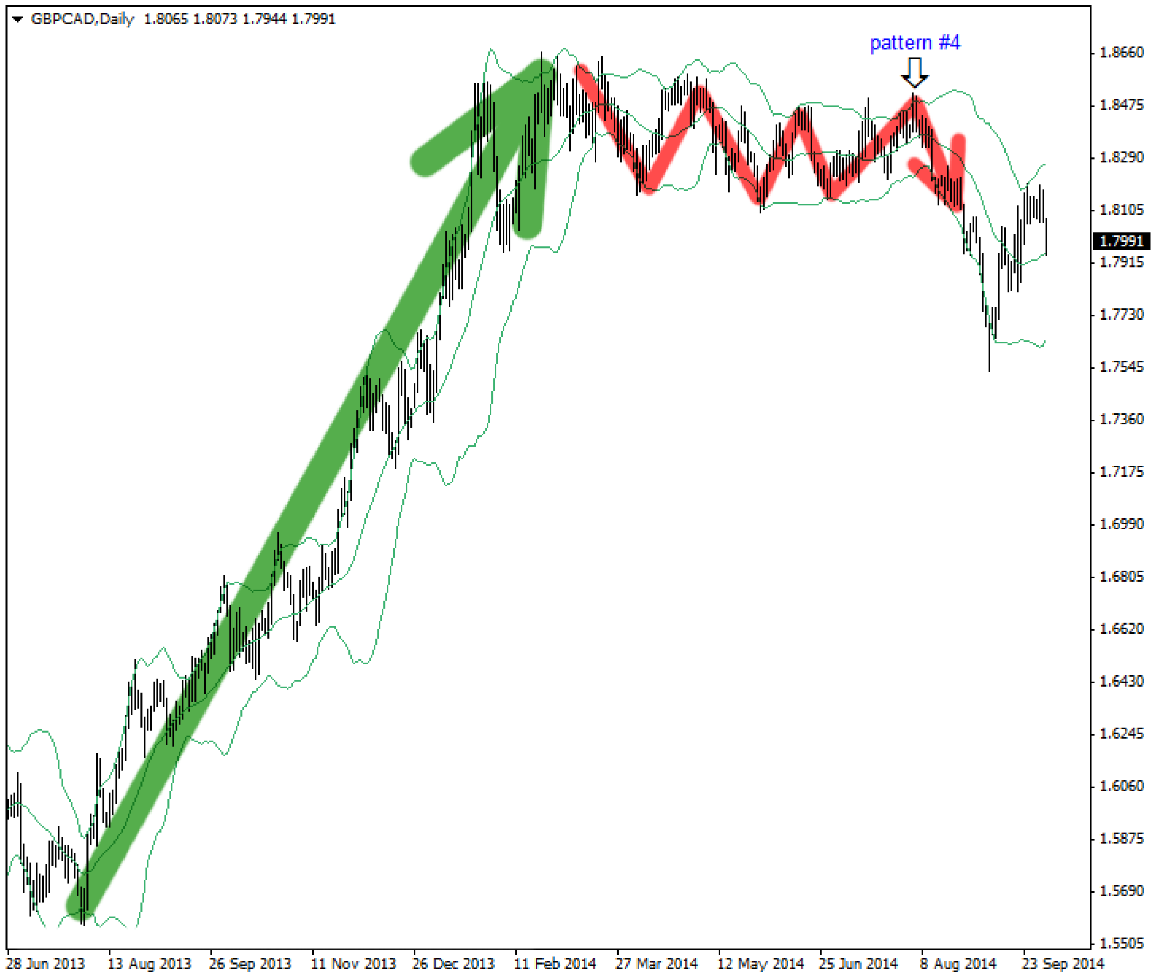
If pattern #4 was formed where the big green arrow ends, then it had to be ignored, because it is right at the top of a strong bull market there.

However, pattern #4 is formed after a long sideways (ranging) market, while the range had a tendency to go down (you can see the lower highs on the range), which means bulls were getting disappointed and were converting to bears, and the market was about to be controlled by bears.

That is a good condition to have a strong Dark Cloud Cover pattern formed.

Therefore, pattern #4 is a perfect short trade setup.

That is why we compare all of the short trade setups we locate, with this short trade setup formed on GBP/CAD daily chart by 2014.08.05 and 2014.08.06 candlesticks.



Am I saying that a strong Dark Cloud Cover that forms at the top of a too strong bull market, will not reverse the price?

Absolutely not.

Even a weak Dark Cloud Cover that forms at the top of a too strong bull market, "may" reverse the price very strongly.

But, do we know this before the price really goes down, or we can only see it when the price has already collapsed?

Nobody knows what will happen after formation of a trade setup, either strong or weak.

We have to decide based on what is already formed on the chart.

We have to analyze the conditions, and choose a good trade setup that has the minimum risk.

You can go short at the top of a strong bull market, and it is possible that you make a good profit.

However, those who take the risky trade setups, can not be profitable in long term.

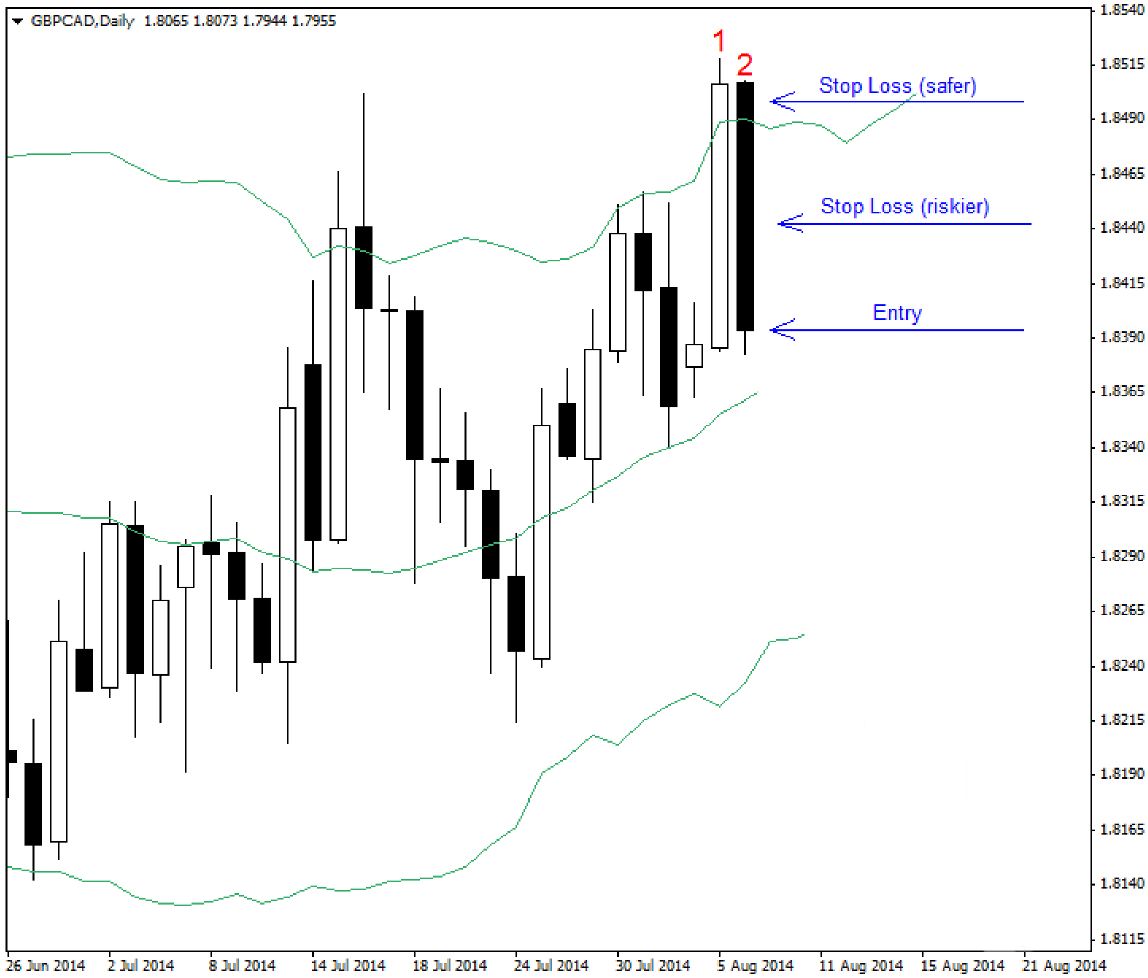
They make profit periodically, but can not be profitable consistently.

Am I saying that a strong Dark Cloud Cover that forms while bulls were already exhausted, can reverse the price definitely?

Absolutely not.

There is no guarantee that even a too strong Dark Cloud Cover formed while bulls were already exhausted, result in the price reversal and a strong bearish movement.

That is why we should always set a reasonable stop loss in all the positions we take.


GBPCAD,Daily 1.8065 1.8073 1.7944 1.7955
1
2
Stop Loss (safer)
Stop Loss (riskier)
Entry
1.8540
1.8515
1.8490
1.8465
1.8440
1.8415
1.8390
1.8365
1.8340
1.8315
1.8290
1.8265
1.8240
1.8215
1.8190
1.8165
1.8140
1.8115
26 Jun 2014
2 Jul 2014
8 Jul 2014
14 Jul 2014
18 Jul 2014
24 Jul 2014
30 Jul 2014
5 Aug 2014
11 Aug 2014
15 Aug 2014
21 Aug 2014

10) Hammer and Inverted Hammer Candlesticks

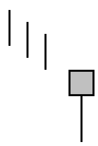
The Hammer candlestick looks like a hammer :)

The lower shadow forms the handle and the small body forms the head.

(If you are new to candlesticks and you don't know what body and shadow is, please read this article first.)

The Hammer candlestick forms at the bottom of a bear market.

Hammer is a reversal signal, but it is not that strong by itself and it needs confirmation:

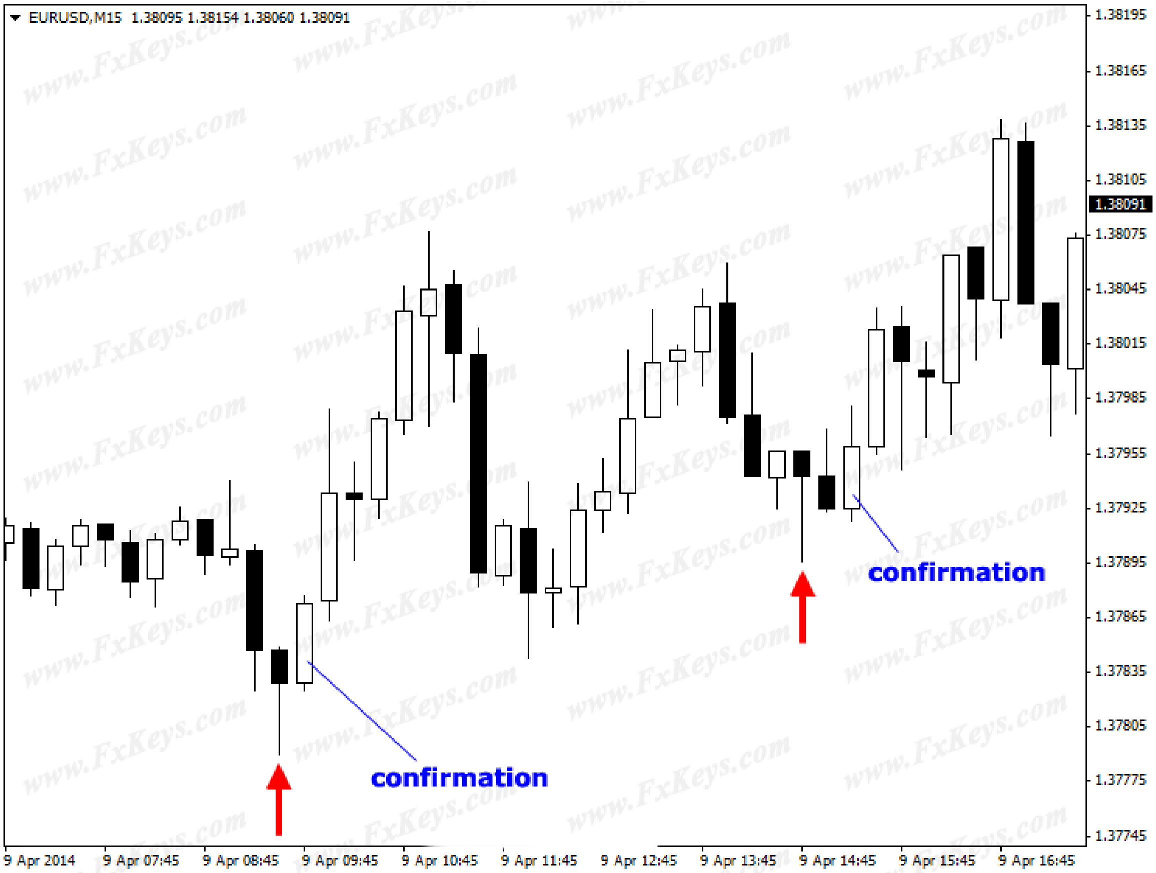


Hammer is so frequent on the forex market.

But, you should be careful not to go long as soon you see a Hammer at the top of a bear market, or after formation of a series of consecutive bearish candlesticks.

To go long, you always have to wait for the confirmation candlestick which has to be a bullish candlestick.

The bigger the body of the confirmation candlestick, the stronger the reversal long trade setup signal:



Why Does the Hammer Candlestick Form?

This is how a Hammer candlestick forms:

After the formation of several bearish candlesticks on a bear market, another bearish candlestick forms.

It forms a reasonable bearish body, but suddenly bulls (buyers) decide to take the control.

They start buying, and so, the price goes up and the bearish body of the candlestick turns into a long lower shadow.

However, still bulls are not strong enough to take the price too high, and so, the candlestick closes with a small bearish body.

If bulls succeed to take the price higher when the next candlestick opens, they form a bullish confirmation candlestick which is what we need to have a long trade setup.

You can go long and set your stop loss a little below the low price of the Hammer candlestick.

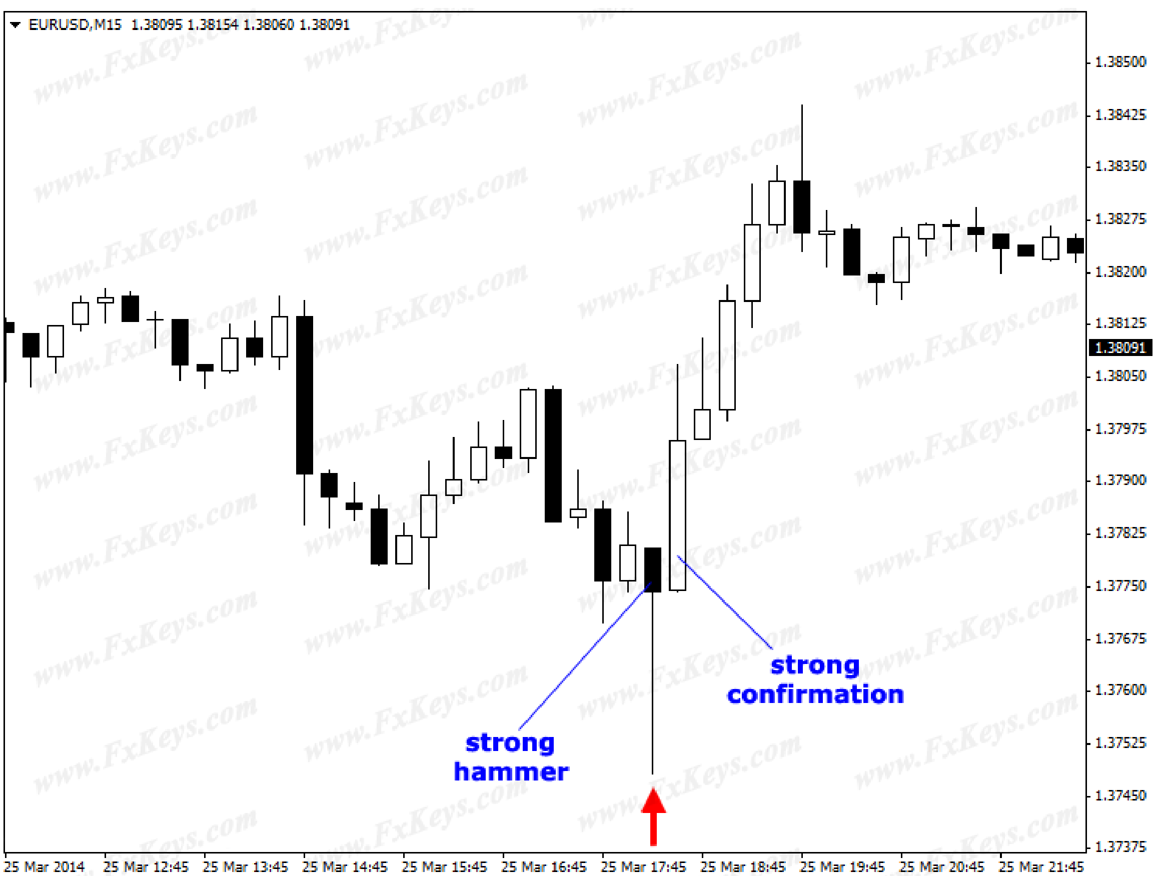
How the Trade Setup Will Be Stronger?

The longer the lower shadow of the Hammer and also the body of the confirmation candlestick, the stronger the reversal signal and long trade setup.

Look at the below strong reversal signal that formed on EUR/USD 15min chart.

The Hammer has a too long lower shadow and the confirmation candlestick has a too long body.

Therefore, this reversal candlestick pattern is very strong:



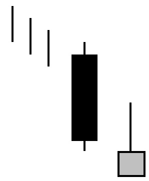
What Is Inverted Hammer?

It is the inverted form of the Hammer candlestick.

This candlestick closes below its open price which means bears are still strong.

Therefore, its reversal effect can be weaker than the regular Hammer.

However, if a strong bullish candlestick forms after an Inverted Hammer, you can go long and set your stop loss below the close price of the Inverted Hammer candlestick.



Hammer Candlestick and Bollinger Bands

If you add Bollinger Bands to your charts, you can have more confirmation to know whether the Hammer and the confirmation candlesticks are strong enough to be taken as long trade setup, or not.

If the Hammer lower shadow breaks out of Bollinger Lower Band strongly, then the long trade setup is stronger.

In the below chart, the first Hammer candlestick has broken out of Bollinger Lower Band very strongly.

Then the confirmation candlestick(s) form a few candlesticks after, and so, the long trade setup forms.

As you see, the price goes up very strongly.

The second Hammer candlestick also breaks out of Bollinger Lower Band, but not as strong as the first Hammer.

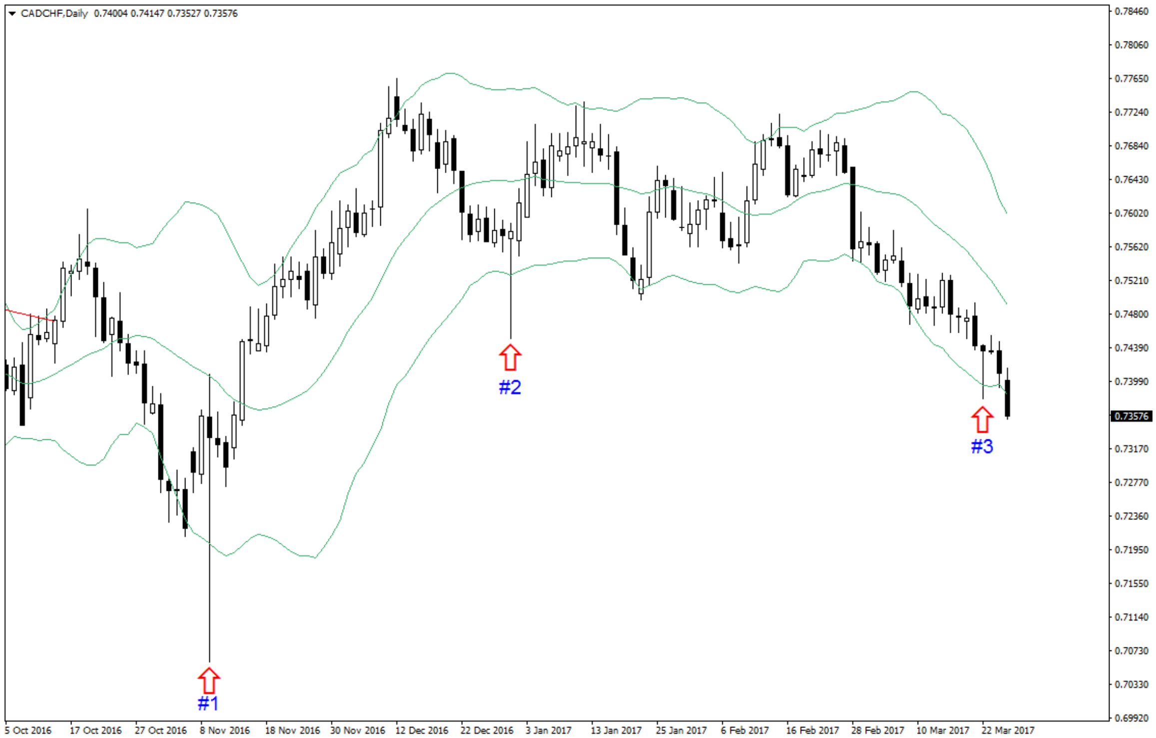
The confirmation candlestick forms right after the Hammer.

The price still goes up, but not strongly, because bulls were already exhausted.

The third Hammer hasn't broken out of Bollinger Lower Band strongly.

It is because the bulls' pressure was not strong enough, and so, no confirmation candlestick formed.

Therefore, the third Hammer candlestick hasn't formed a long trade setup.



Please note that the typical form of the Hammer candlestick doesn't have an upper shadow.

However, on the Forex market, most of the Hammer candlesticks have a small upper shadow too.

This is because the Forex market is very volatile and the price fluctuation is usually very strong.

11) Hanging Man Candlestick

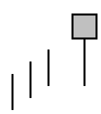
Hanging Man is a Hammer candlestick that forms on a bull market.

It means Hammer forms after some bearish candlesticks and it is considered as a reversal signal on a bear market.

But Hanging Man forms after some bullish candlestick and it is considered as a reversal signal on a bull market.

In spite of this, Hanging Man and Hammer candlesticks' shapes are the same.

Therefore, it is better to learn about the Hammer candlestick first and then read about the Hanging Man.



Hanging Man is a reversal candlestick, however like Hammer it has to be confirmed.

It means you shouldn't go short right when you see a Hanging Man formed at the top of a bull market.

A confirmation candlestick has to be formed first.

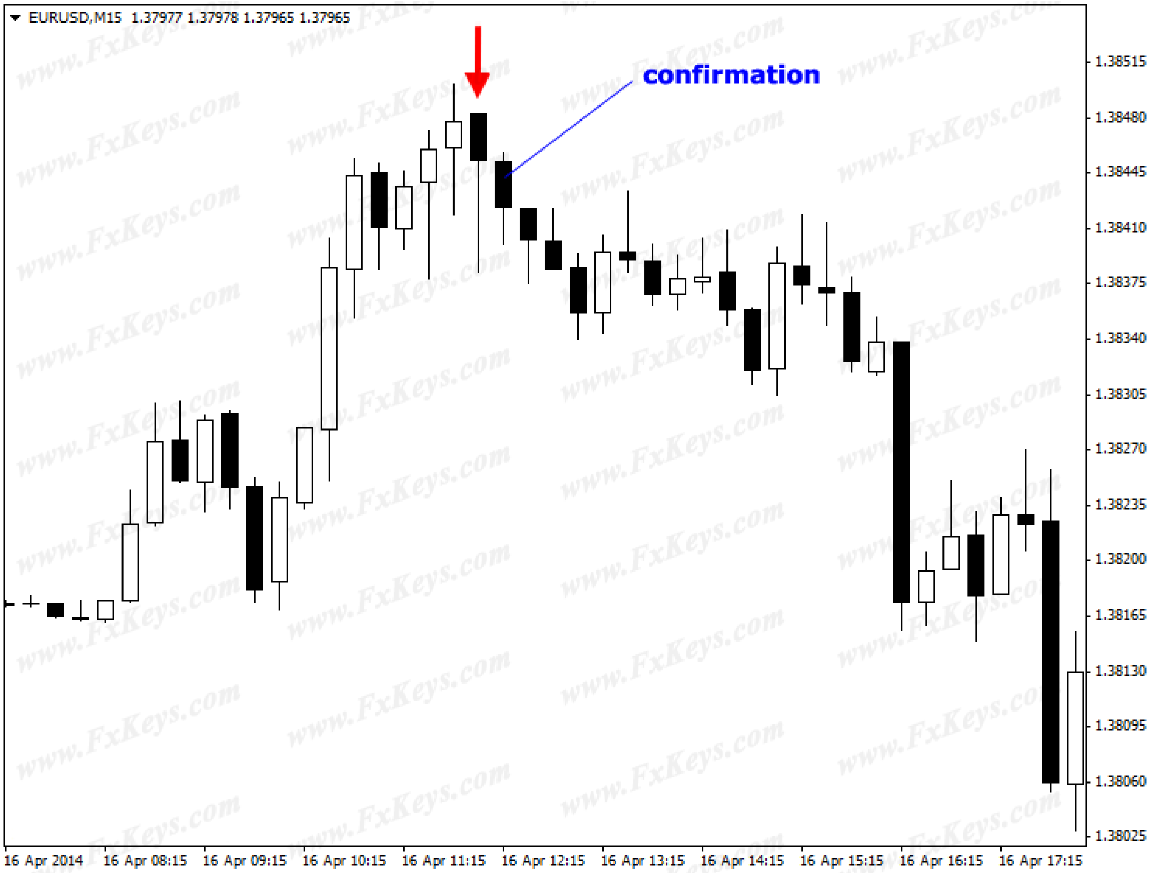
The confirmation candlestick has to be a bearish candlestick.

The bigger the bearish body of the confirmation candlestick, the stronger the reversal signal.

When the Hanging Man and its confirmation is formed, you can go short and place your stop loss above the open price of the Hanging Man.

When you see the confirmation candlestick is not strong enough, you can simply ignore the signal and wait for another trade setup.

Do not lose your money on weak signals.



On the below chart, you can see Hanging Man that has formed at the top of a bull market (the big green arrow) on EUR/USD weekly chart.

A typical Hanging Man candlestick doesn't have an upper shadow.

However, you can hardly find a typical Hanging Man on Forex market because it is so volatile and the price fluctuation is high, and so, a candlestick with no upper shadow can hardly form.

As you see, the price reverses after the Hanging Man and the confirmation candlestick:

If you are new to candlesticks, you can start with this article: [The Language of Japanese Candlesticks]()

12) Bullish Engulfing and Bearish Engulfing Candlestick Patterns in Forex Market

Engulfing Patterns are the strongest and most effective candlestick patterns.

They are the patterns that we follow religiously.

The reason is that when they are strong enough, the market usually follows them strongly.

They can be the beginning of the strong trends and reversals.

There are two kinds of Engulfing Patterns:

1. Bullish Engulfing Pattern
2. Bearish Engulfing Pattern

What Is Bullish Engulfing Pattern?

A Bullish Engulfing Pattern forms when a strong bullish candlestick opens below the close price of the previous candlestick.

The previous candlestick has to be a bearish candlestick.

Then the bullish candlestick goes up and covers the whole body of the bearish candlestick.

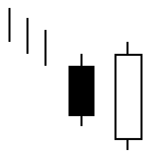
Finally, it closes above the open price of the bearish candlestick.

This pattern which forms on a downtrend, is a reversal pattern and causes the downtrend to reverse and goes up.

The formation of this pattern means that bulls have taken the control.

It means they have been able to take the price up and close it above the open price of the previous bearish candlestick.

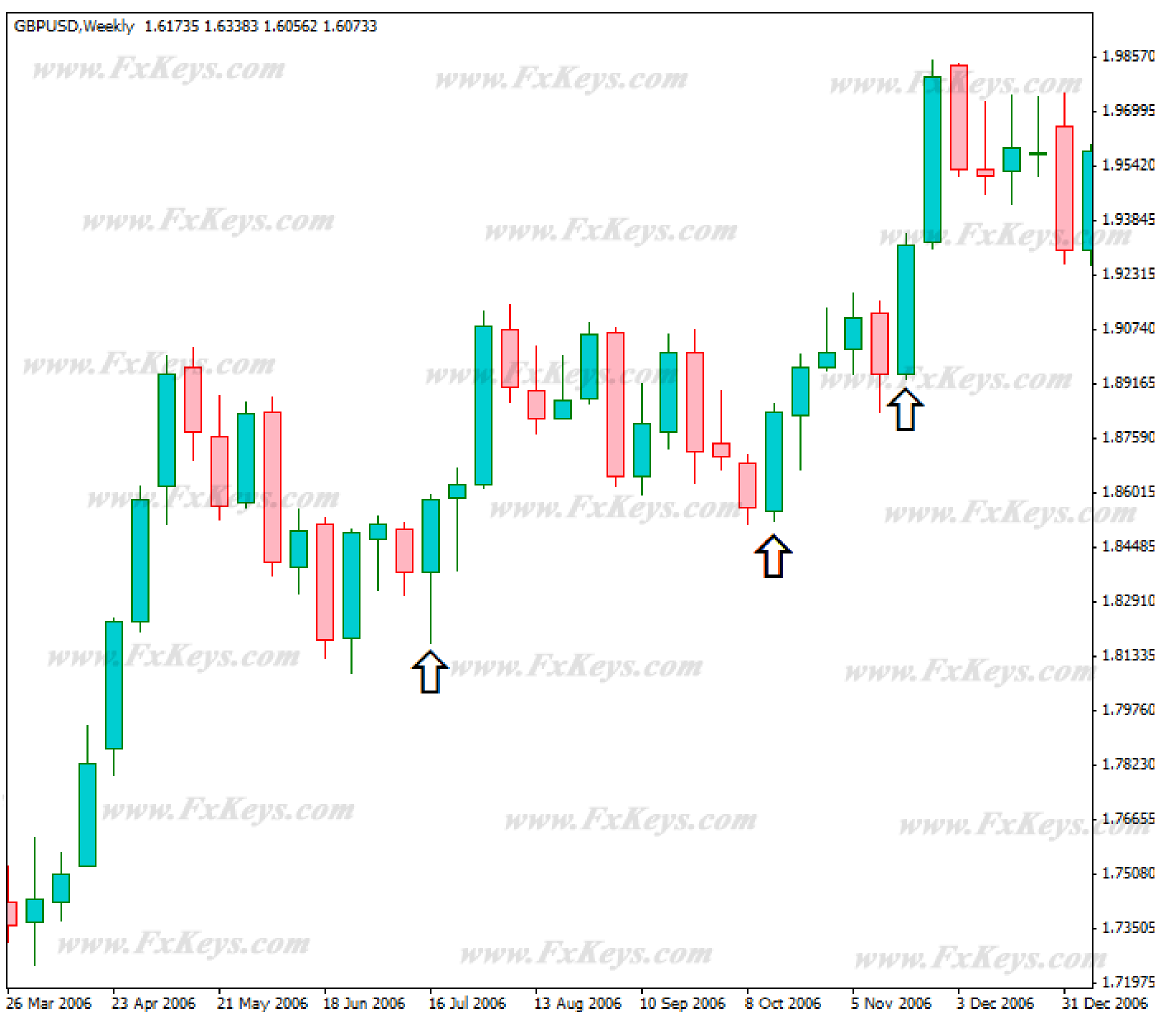
The more the bullish candlestick engulfs the previous bearish candlestick, the stronger the reversal signal is:



Sometimes, the bullish candlestick engulfs more than one previous bearish candlesticks.

This means the reversal signal is even stronger.

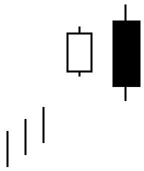
The below screenshot shows three Bullish Engulfing Patterns that are formed on GBP/USD weekly chart:



What Is Bearish Engulfing Pattern?

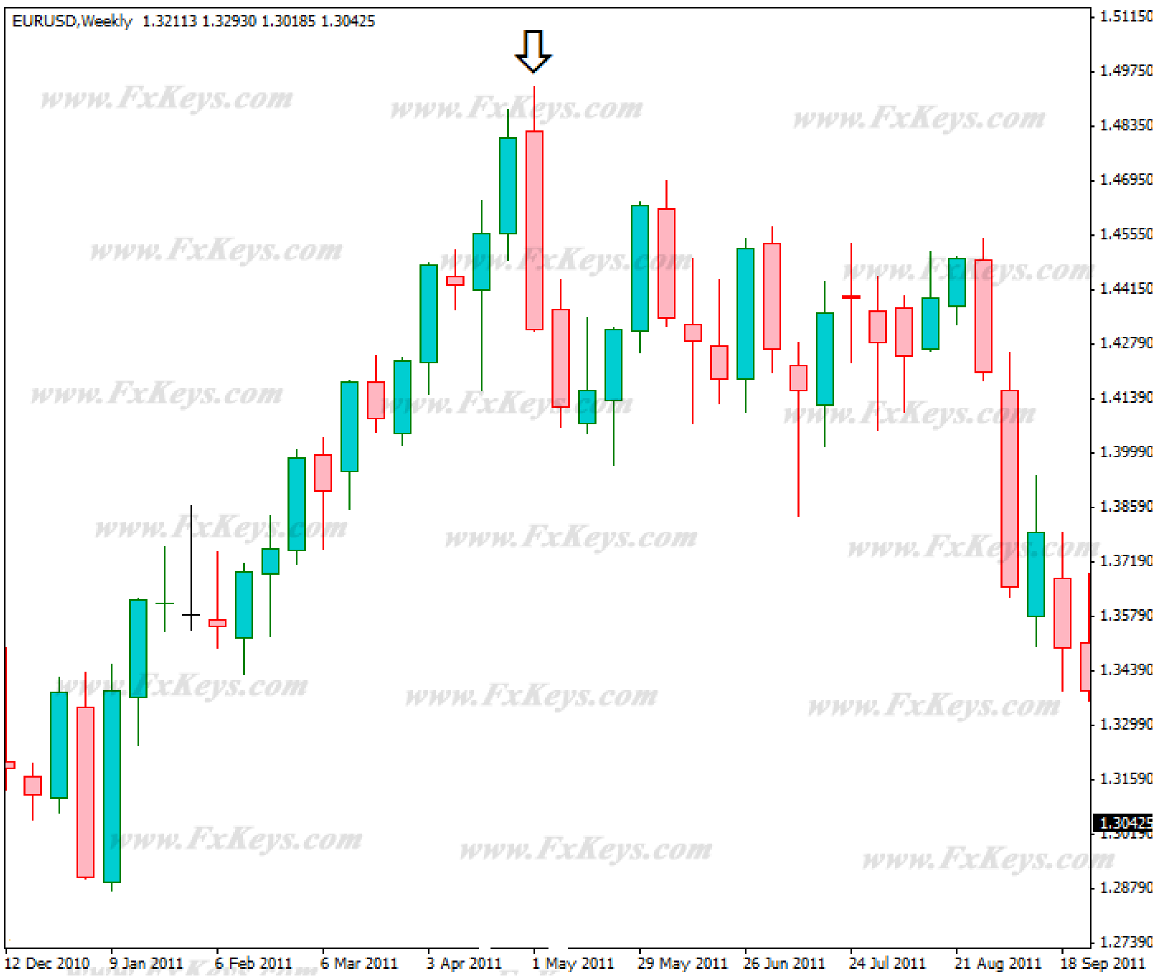
Bearish Engulfing Pattern forms by a bearish candlestick that engulfs the previous bullish candlestick.

This patterns forms at the end of an uptrend or a bull market:



Below is a very strong Bearish Engulfing Pattern formed on GBP/USD weekly chart.

As you see, the bearish candlestick has a very strong body that has engulfed the body of two previous candlesticks:



That was just the general information about the Bullish Engulfing and Bearish Engulfing candlestick patterns.

Indeed, you can locate many of these patterns on all charts and time frames.

However, it doesn't mean that each of them can be known as strong reversal patterns that you can take and enter the market.

Therefore, you should know how to evaluate and gauge these patterns and choose the strongest ones to enter.

13) Abandoned Baby Candlestick Pattern

There are some special candlesticks with special names.

However, the way that some candlesticks form against each other, forms some special candlestick pattern.

Abandoned Baby is one of these candlestick patterns.

What Is Abandoned Baby Candlestick Pattern?

Abandoned Baby is a small Doji candlestick (a candlestick without body.)

The difference is this small Doji forms at the top of an uptrend or bottom of a downtrend.

But there is a distinguishable gap between this candlestick, the previous candlestick and the next candlestick.

That is what they call the candlestick pattern Abandoned Baby.

It is because it looks like a small candlestick that is left alone.

The gap has to exist, otherwise the pattern can not be called Abandoned Baby anymore.

Abandoned Baby is a reversal pattern.

It means when it forms on a trend, the trend will change the direction most probably.

But it doesn't necessarily mean that the whole trend will change.

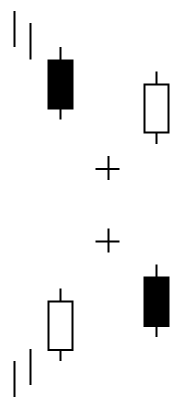
Sometimes this pattern forms at the top of a small up movement which is formed inside a downtrend.

And then after forming of the pattern, the up movement will be finished and the downtrend will be continued.

Bullish and Bearish Abandoned Baby

An Abandoned Baby that forms at the bottom of a downtrend is called Bullish Abandoned Baby.

And, the one that forms at the top of an uptrend is called Bearish Abandoned Baby:



As Forex market is volatile and liquid and is open 24 hours a day, I have rarely seen Abandoned Baby pattern forms on any of the time frames.

On Forex market, Doji candlesticks usually have long shadows, and so you can't see any gap between the previous and the next candlestick.

That is why it is really hard to see an Abandoned Baby pattern forms on the Forex market.

Therefore, here I show you a real example from the stock market.

Below, is a Bullish Abandoned Baby that has formed on Genzyme General daily chart.

As you see, the market has been going down before the candlestick pattern forms.

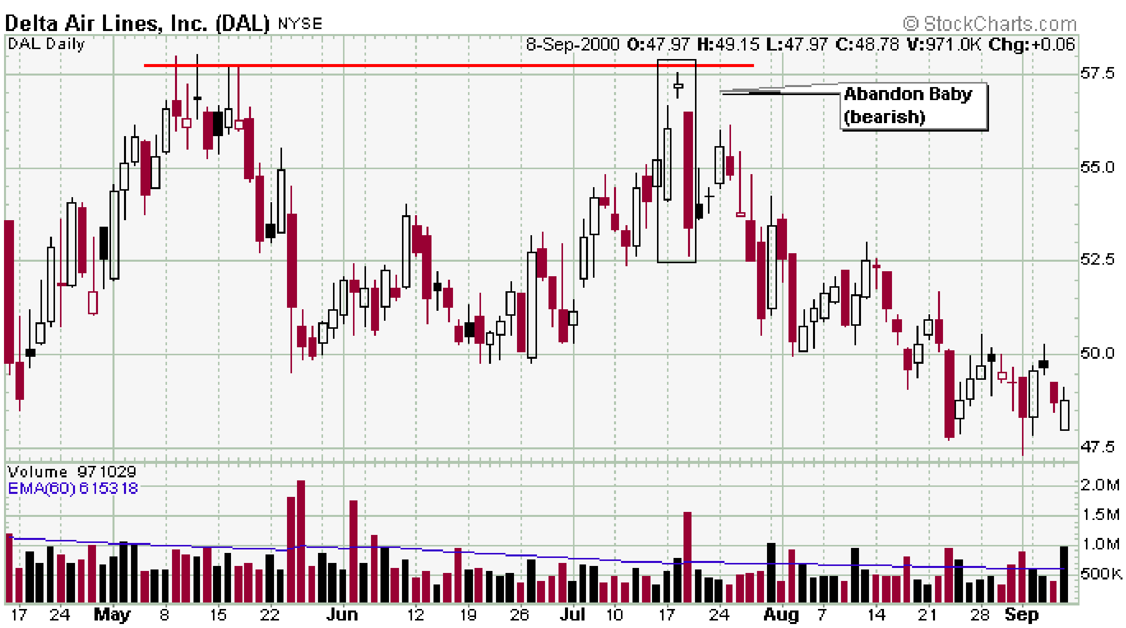
But it changed its direction and went up strongly after the pattern formed.

The market has been moving above a support level for few days before the formation of the candlestick pattern.

Below is a Bearish Abandoned Baby that has formed at the top of an uptrend on Delta Air Lines daily chart.

In this example, the gap between the previous and next candlesticks is more visible and distinguishable.

The bigger the gap, the stronger the pattern in its reversal impact on the market.



14) Inside Day Candlestick as a Strong Reversal Pattern

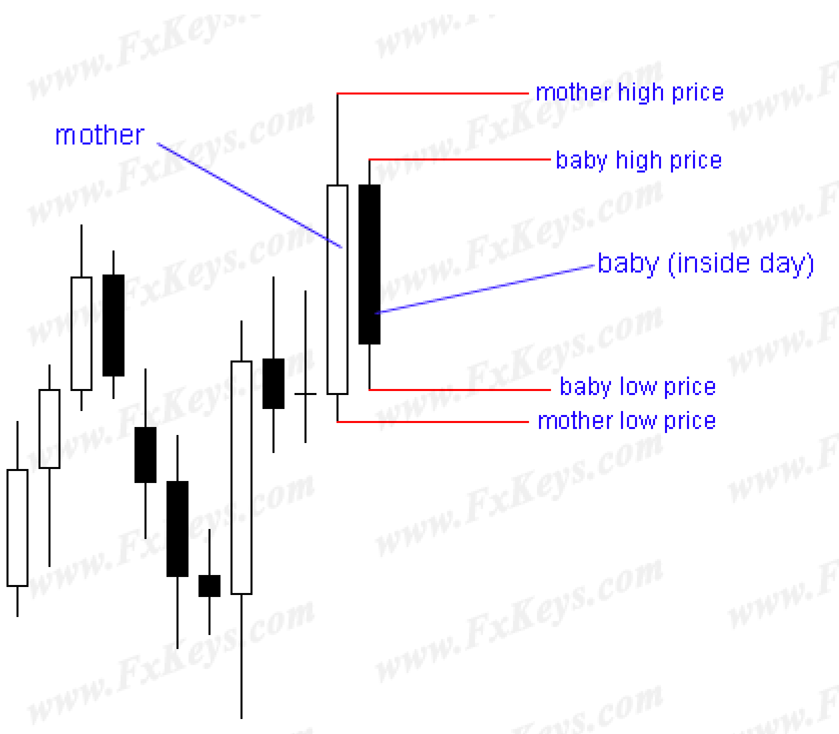
Those of you who have been trading stocks should be familiar with this name: "Inside Day Candlestick"

Inside Day is a candlestick pattern. Although it hardly forms on the price charts, it is usually very strong reversal signal.

Bollinger Bands® indicator can be used to empower this signal. We don't have to have Bollinger Bands on the charts to recognize this pattern. But Bollinger Bands helps a lot in locating and taking this pattern as a reversal signal. This is what even the most professional stock traders also admit. Many of them also use Bollinger Bands to locate and trade the "Inside Day Candlestick".

What Is the "Inside Day" Candlestick?

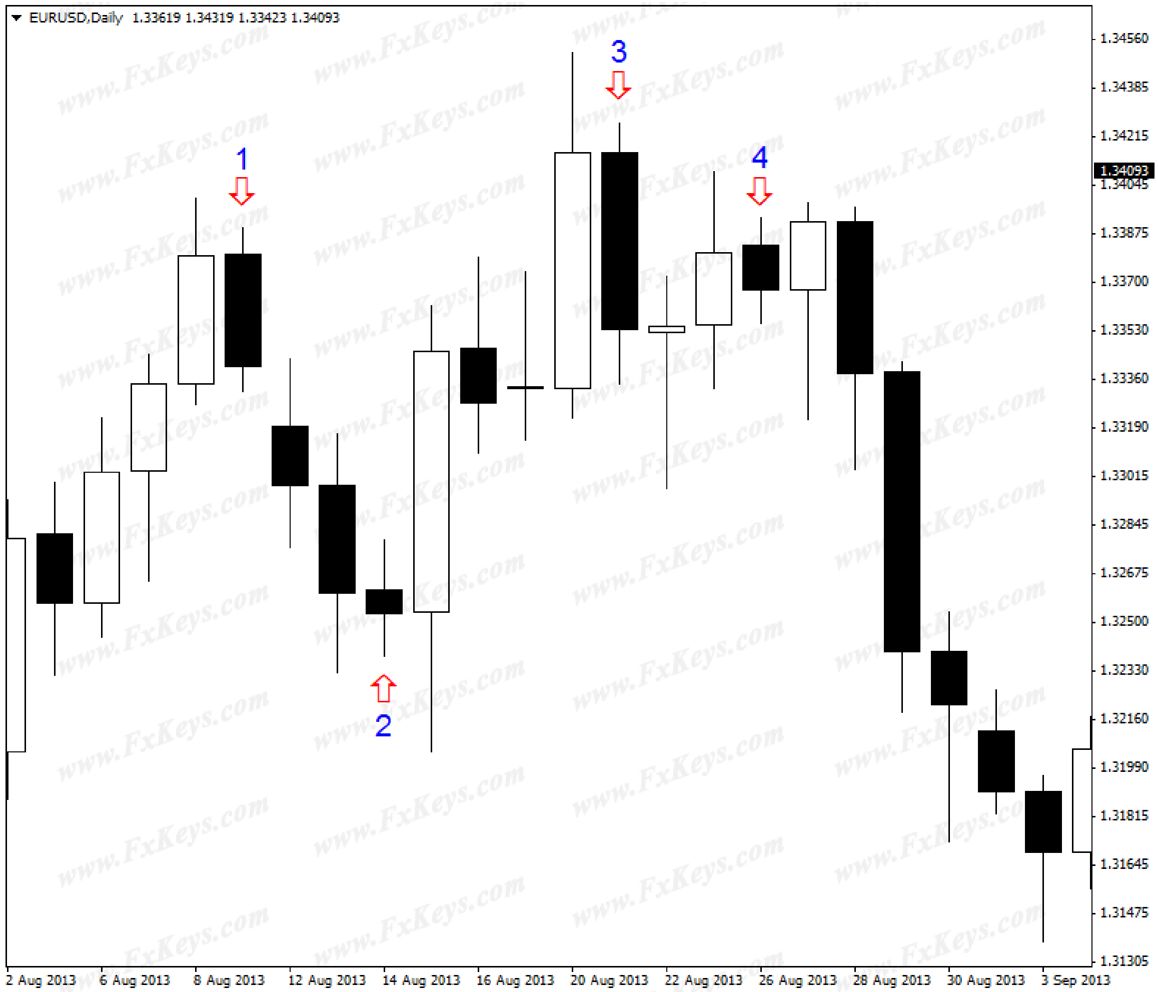
Do you remember Harami and Harami Cross patterns? "Inside Day" is exactly the same. In fact, "Inside Day" is the second candlestick (the baby) in the Harami pattern which is engulfed by the previous candlestick (the mother). Like all the other patterns like Dark Cloud Cover, here we need two candlesticks to have the pattern formed. However, with the "Inside Day" pattern, in fact the second candlestick is the "Inside Day" candlestick. American stock traders know the Harami pattern as "Inside Day Candlestick".



Why the Second Candlestick (the Baby) Is Called "Inside Day"?

Those traders who traded the daily chart, chose such a name for the second candlestick in the "Inside Day" or Harami pattern. Of course you can see the pattern in all time frames too, and it works on them as a strong reversal signal as well, but it is called "Inside Day" because it was initially used on the daily time frame. I recommend you to trade this pattern on the daily or longer time frames too.

They call the second candlestick as "Inside Day", because it is small enough to be entirely engulfed by the previous candlestick (the mother candlestick in the Harami pattern). It means, the Inside Day Candlestick's high and low prices fall within the high and low price range of the previous day candlestick. The below screenshot shows 4 inside day candlesticks on EUR/USD daily chart. There are a few more Inside Day Candlestick on this screenshot, but I am just showing you 4 of them. See the below screenshot first, and then we add Bollinger Bands to the chart:

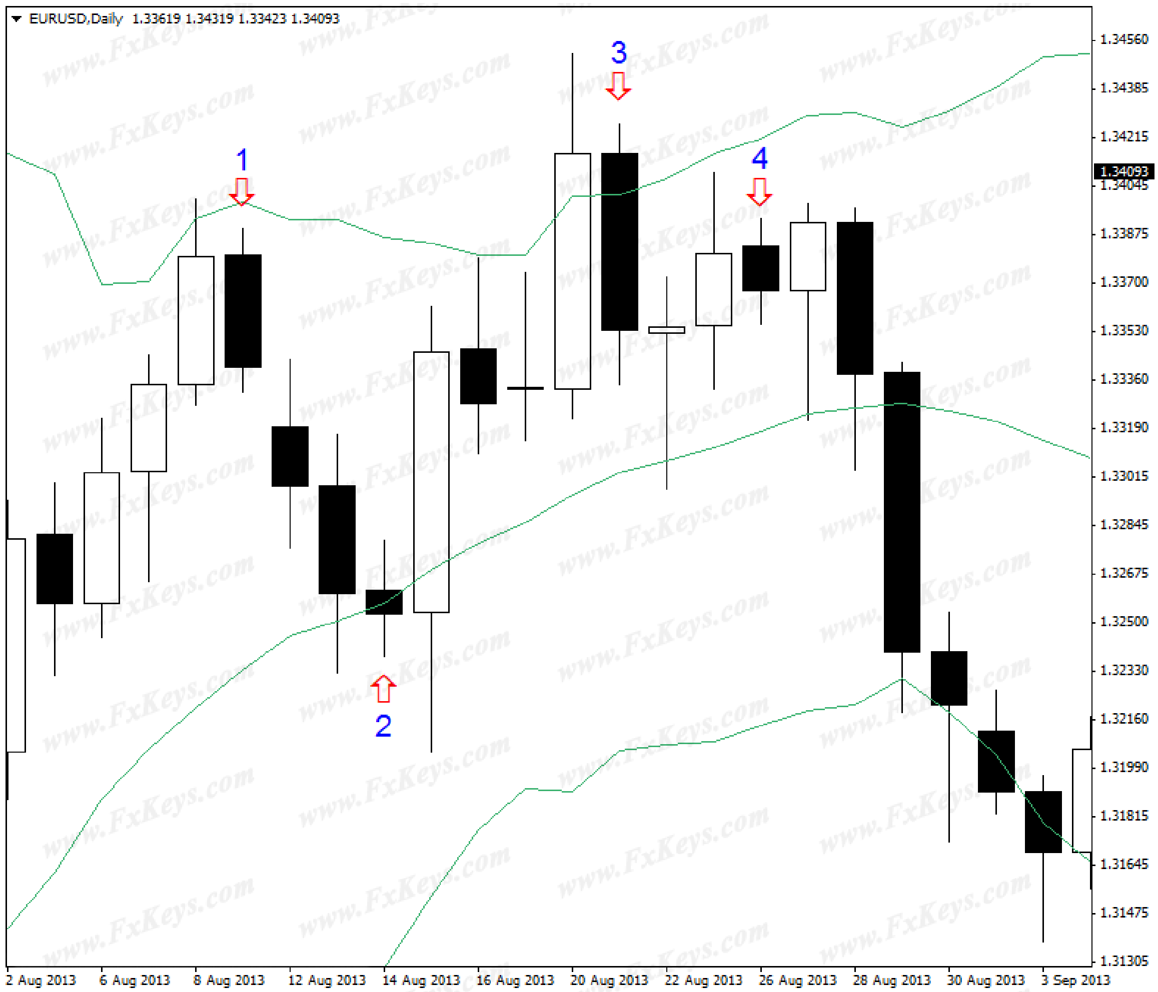


It is a big to have Bollinger Bands on the chart to choose the best Inside Day pattern as a reversal signal. So many other professional stock and currency traders also emphasize on having Bollinger Bands on the charts to trade the Inside Day candlestick. Jamie Saettele is one of them.

According to Jamie Saettele, Inside Day works as a good reversal signal when there is a visible Bollinger Upper or Lower band breakout either by the first candlestick (the mother), or the second candlestick (the baby), or preferably both.

He says when the price hits Bollinger Upper or Lower Band on the daily chart, then we can wait for an "Inside Day" candlestick to form. While the candlesticks are hitting the Bollinger Upper or Lower Band, if a candlestick opens and closes while its high and low price range falls inside the previous candlestick's high and low price range, then we have an Inside Day Candlestick, and we can take a position.

This is how the above chart looks after adding Bollinger Bands:



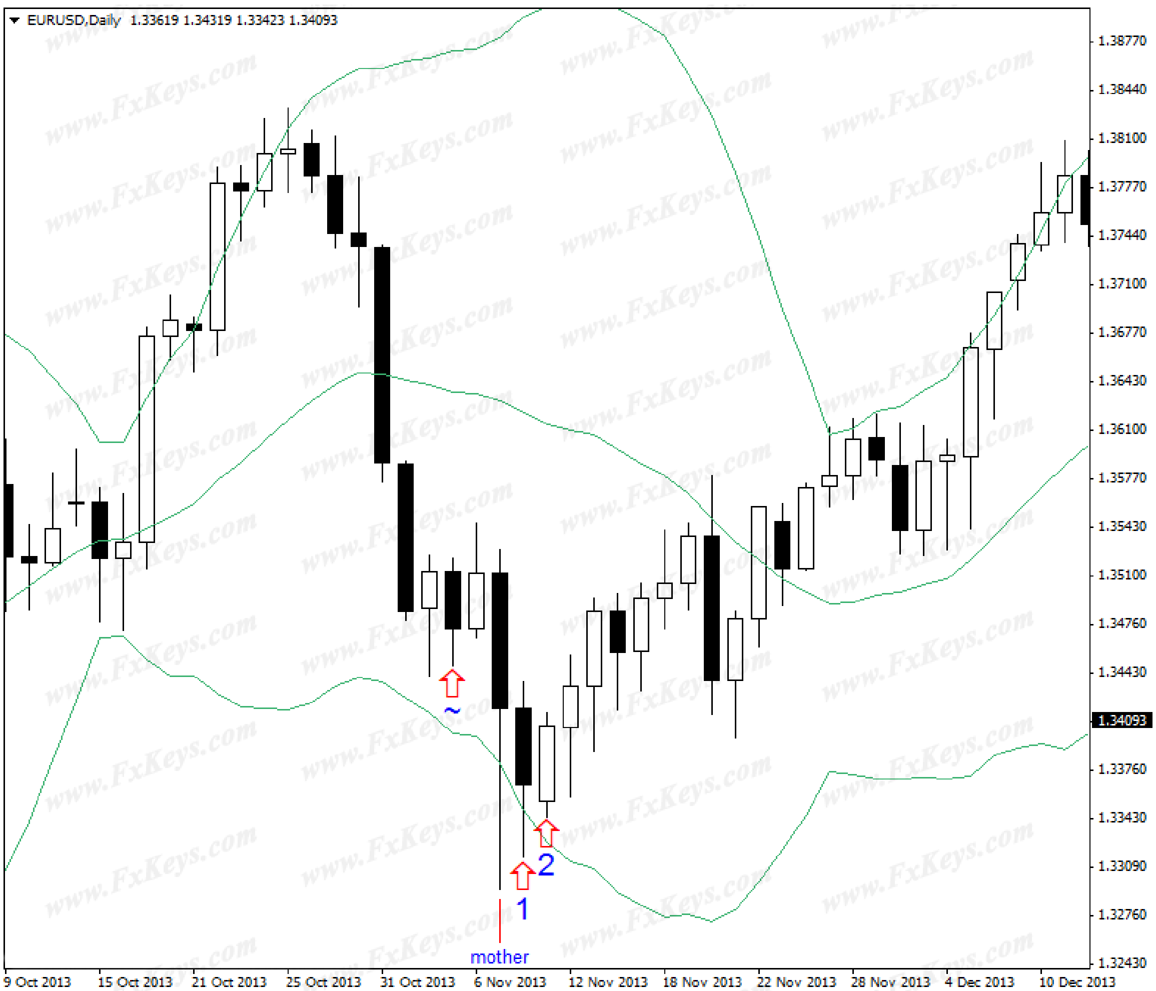
Therefore, according to what Jamie Saettele says, only the candlestick #1 and #3 should be considered and taken as a reversal signal.

Candlestick #2 formed on Bollinger Middle Band. It reversed the price strongly but it did not follow our Bollinger Bands breakout rule.

Candlestick #4 and its previous candlestick did not hit Bollinger Upper Band, and so they had to be ignored (the trade setup is not complete). However, if you took candlestick #3 as a proper and complete trade setup to go short, then candlestick #4 would follow your position and can be known as the complementary trade setup that proves that you have the right position.

The below chart shows two strong Inside Day candlesticks formed consecutively at the bottom of a bear market. It is an interesting screenshot, because it shows one inside day candlestick formed (#1) and then another one that formed inside the first inside day candlestick (#2). There is a nice and strong Bollinger Lower Band breakout, both by the first candlestick (the mother), and the first inside day (#1).

There is another inside day candlestick which is marked with ~ symbol on the below chart. Although it is engulfed by the previous candlestick, it has to be ignored because neither the previous nor the inside day candlestick have not hit the Bollinger Lower Band:



How to Trade the Inside Day Candlestick?

When you locate an inside day candlestick on the daily chart, while there is a good and visible Bollinger Band breakout too (the way you learned above), you enter at the close of the inside day candlestick (which is the open of the next candlestick).

If formed on a bull market while hitting the Bollinger Upper Band, you go short, set the stop loss several pips above the high price of the inside day candlestick, or preferably above the high price of the previous candlestick (the mother).

If formed on a bear market while hitting the Bollinger Lower Band, you go long, set the stop loss several pips below the low price of the inside day candlestick, or preferably below the low price of the previous candlestick.

The target can be at least x2 or x3 of the initial stop loss size. If the Inside Day candlestick you locate is the beginning of a strong trend, then you can make up to x10 of your stop loss size.

Why Does the Price Change Its Direction When the Inside Day Candlestick Forms?

What is the reasoning behind this? Before you read the answer I have given to this question below, think about the question and see if you can answer it. I give you a clue: candlesticks reflect the psychology of the markets (buyers and sellers).

Answer:

When the price is moving up strongly and several bullish candlesticks are formed, it means traders are buying and money is being flooded to the market. All of a sudden, when a candlestick forms "inside" the high/low range of the previous candlestick, it means traders have stopped buying as strongly as they were used to during the previous days and the money that was injected into the market was not enough to take the price higher than yesterday's high. It means buyers have started changing their minds, and now they are thinking about selling what they had bought, or no new buyer is being added to the market. Some of the buyer have already started to sell to collect their profit. So the price will go down the next day after the Inside Day is formed.

There is the same reasoning behind forming of an Inside Day candlestick on a bear market.

This is very easy to understand, isn't it?

Now, it is your turn to do your homework.

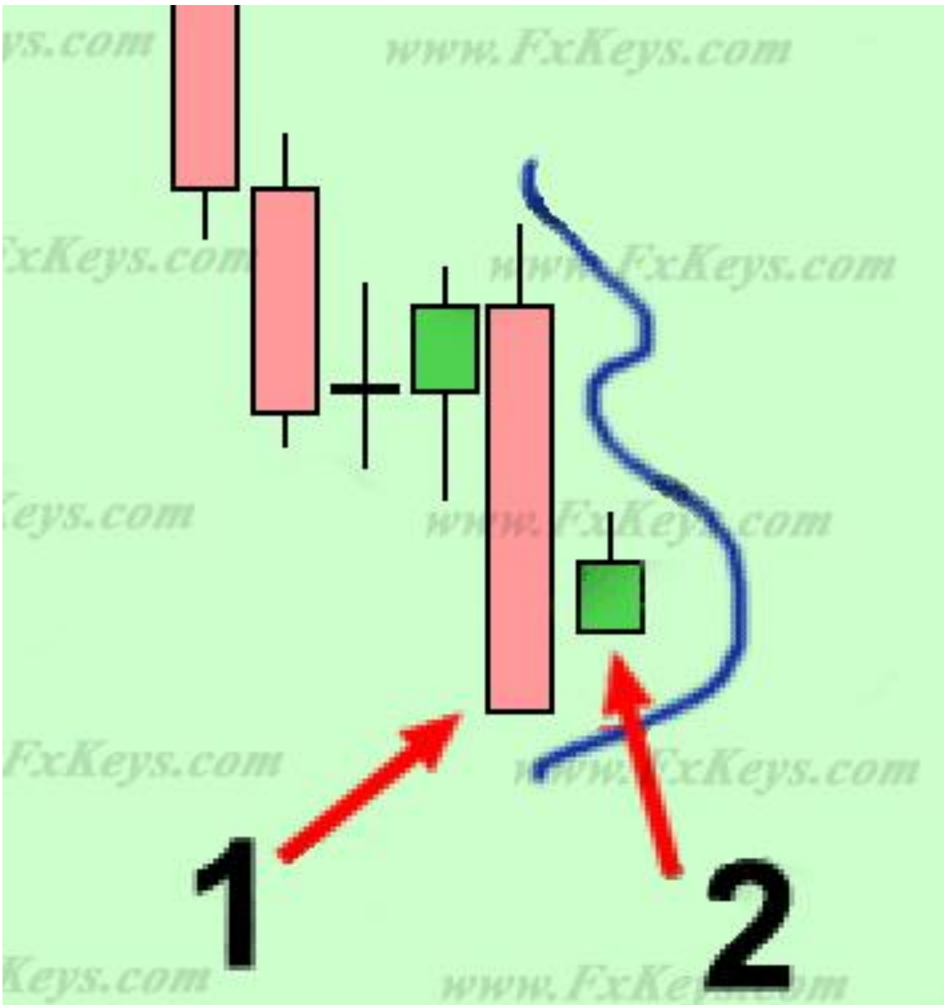
Locate the Inside Day Candlesticks on EUR/USD or other currency pairs daily, weekly and monthly charts. We can call it Inside Week and Inside Month candlesticks on the weekly and monthly time frames :)

Consider the Bollinger Bands breakout too. See how you would trade the Inside Day patterns you locate.

"Inside Day" candlestick is enough as the only trading system you choose. It forms on the currency pairs daily charts frequently enough for all of us to make money. To locate the Inside Day pattern, you only need to check the daily chart once every day when the new daily candlestick is opened. Have this pattern in your trading arsenal and enjoy the steady stream of profit.

15) Harami and Harami Cross Candlestick Patterns

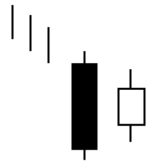
Harami in Japanese language means pregnant. This pattern forms by two candlesticks, the first one is bigger and the other one is smaller. The smaller candlestick is completely engulfed by the body of the first candlestick. It looks like a pregnant woman looking from the side:



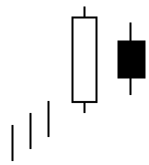
There are two kinds of Harami. The one that forms at the bottom of a bearish market is a Bullish Harami. And the pattern that forms at the top of an uptrend is a Bearish Harami.

Harami is a reversal pattern.

Bullish Harami Pattern:

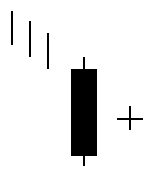


Bearish Harami Pattern:

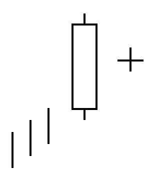


There is another kind of Harami which is called "Harami Cross". This pattern is exactly the same as the regular Harami. The only difference is that in Harami Cross the small candlestick is a small Doji.

Bullish Harami Cross:



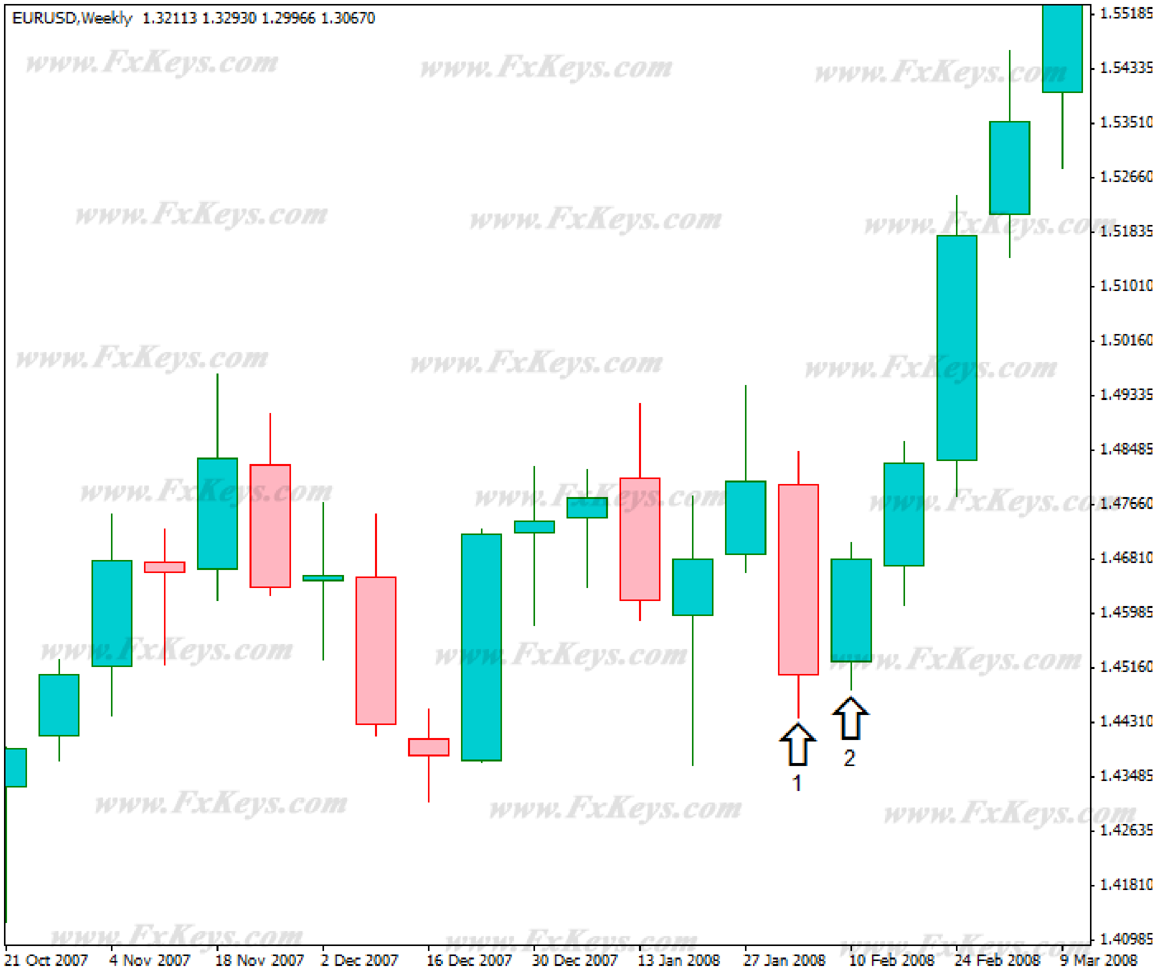
Bearish Harami Cross:



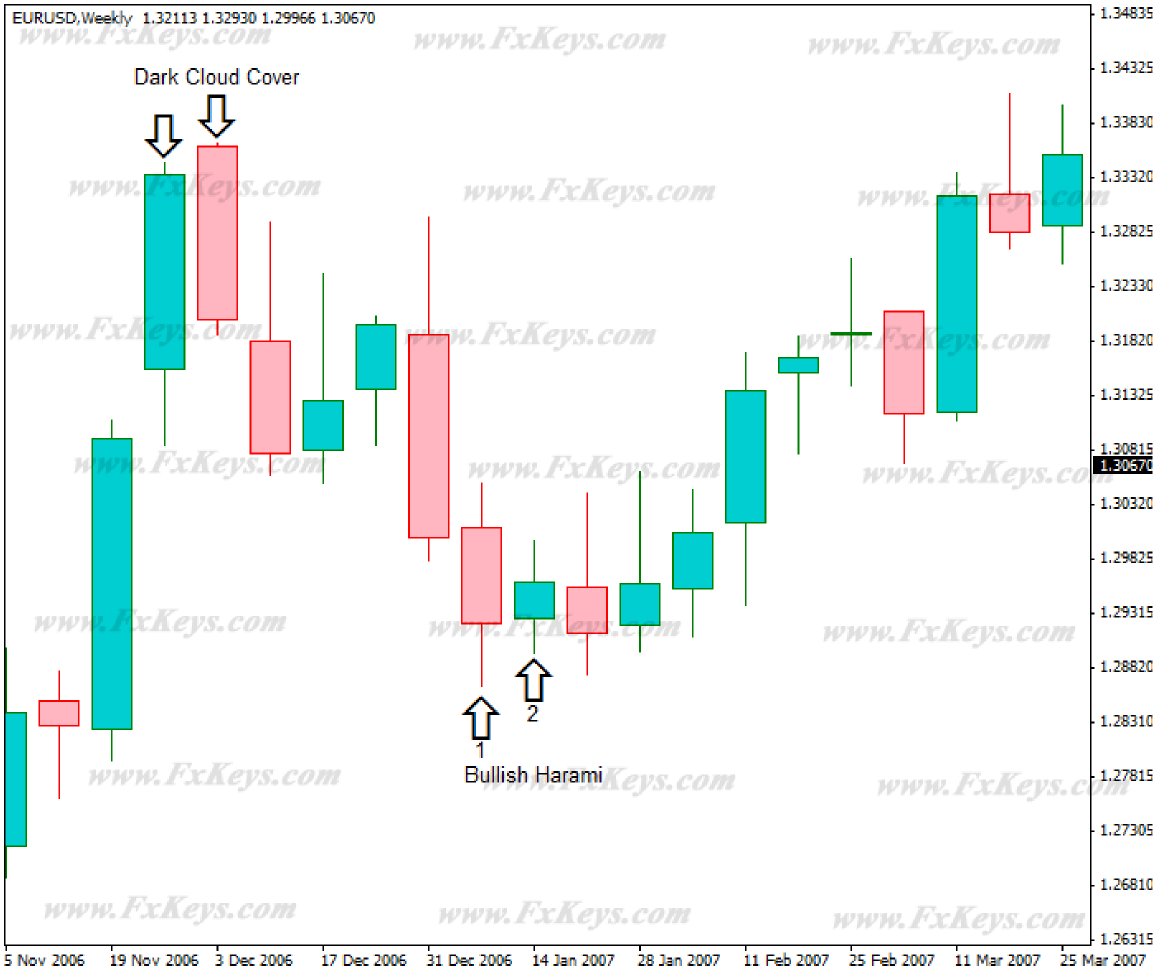
Although Harami is known as a reversal pattern, you have to be careful not to take any positions as soon as you see a Harami pattern forms on the chart, because this pattern is not that strong. Only on the longer time frames like weekly and monthly it can be considered as a reliable reversal pattern. I do not trust it on the smaller time frames at all. Even if you trade this pattern on the longer time frame, having a reasonable stop loss is a must.

Only under one condition the Harami Pattern can be known as a strong reversal pattern. It is when it crosses Bollinger Upper or Lower Band. Some traders know this pattern as Inside Day Candlestick while its combination with Bollinger Bands makes it a profitable and strong reversal candlestick pattern.

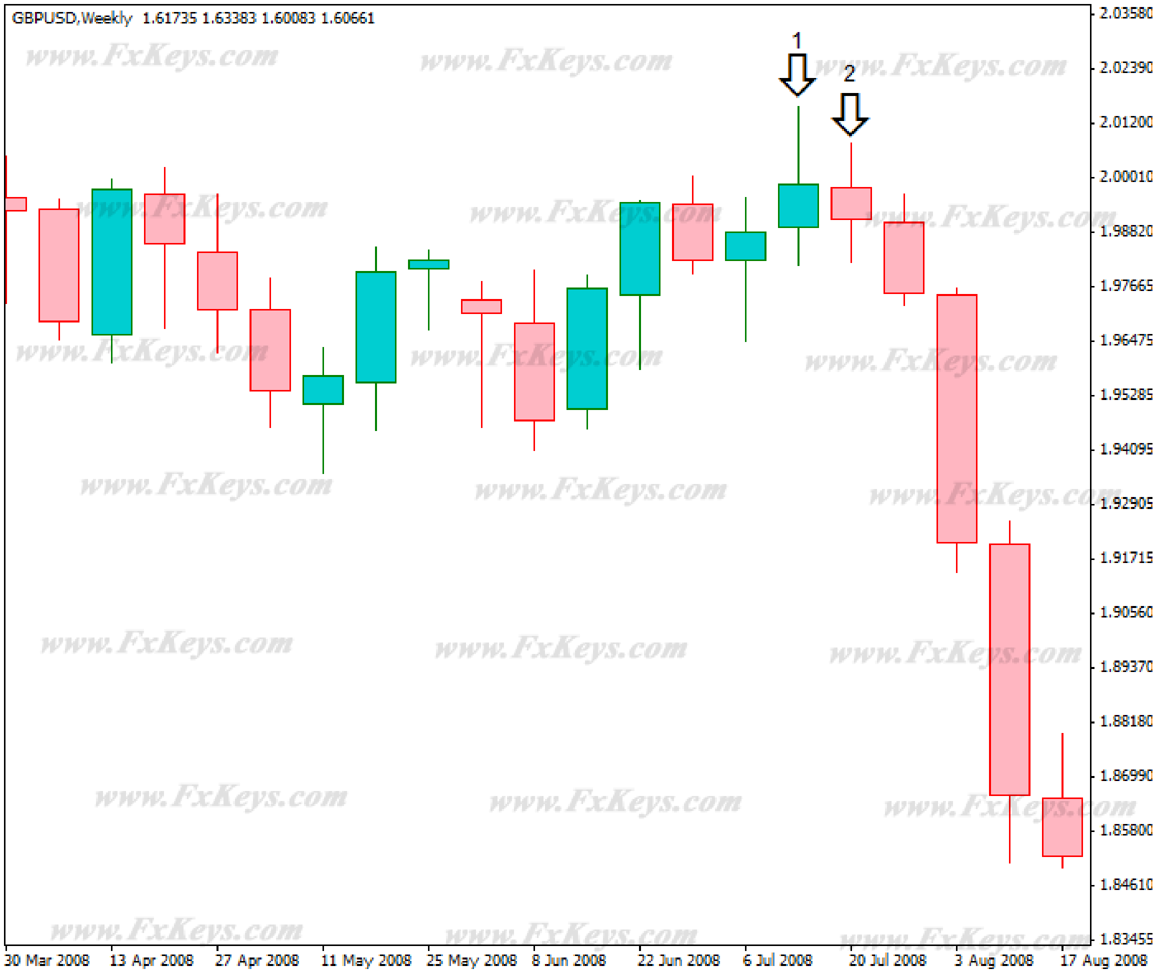
The below screenshot shows a Bullish Harami formed on EUR/USD weekly chart. As you see in this case it worked as reversal pattern and the price went up strongly after forming this pattern:



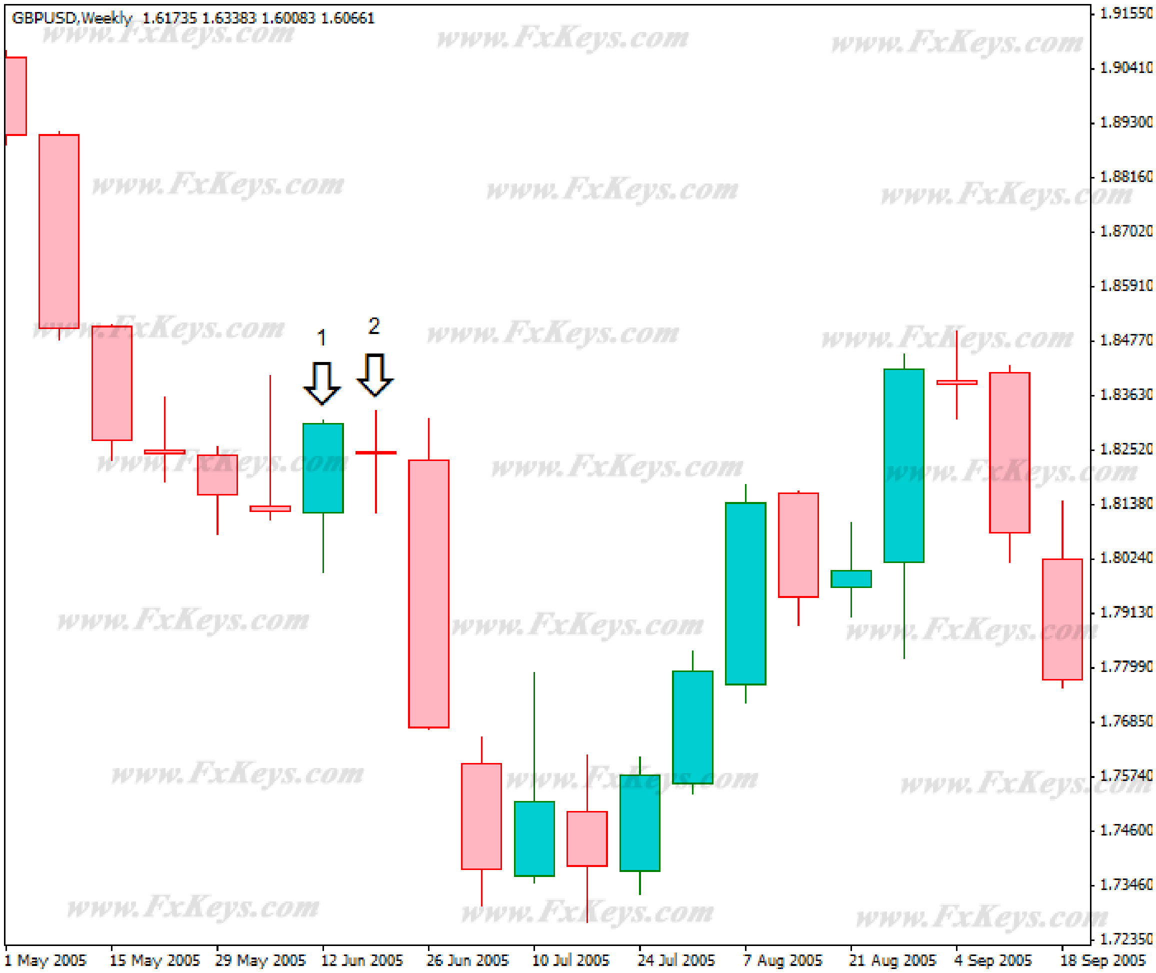
This is another one. Also look at the Dark Cloud Cover:



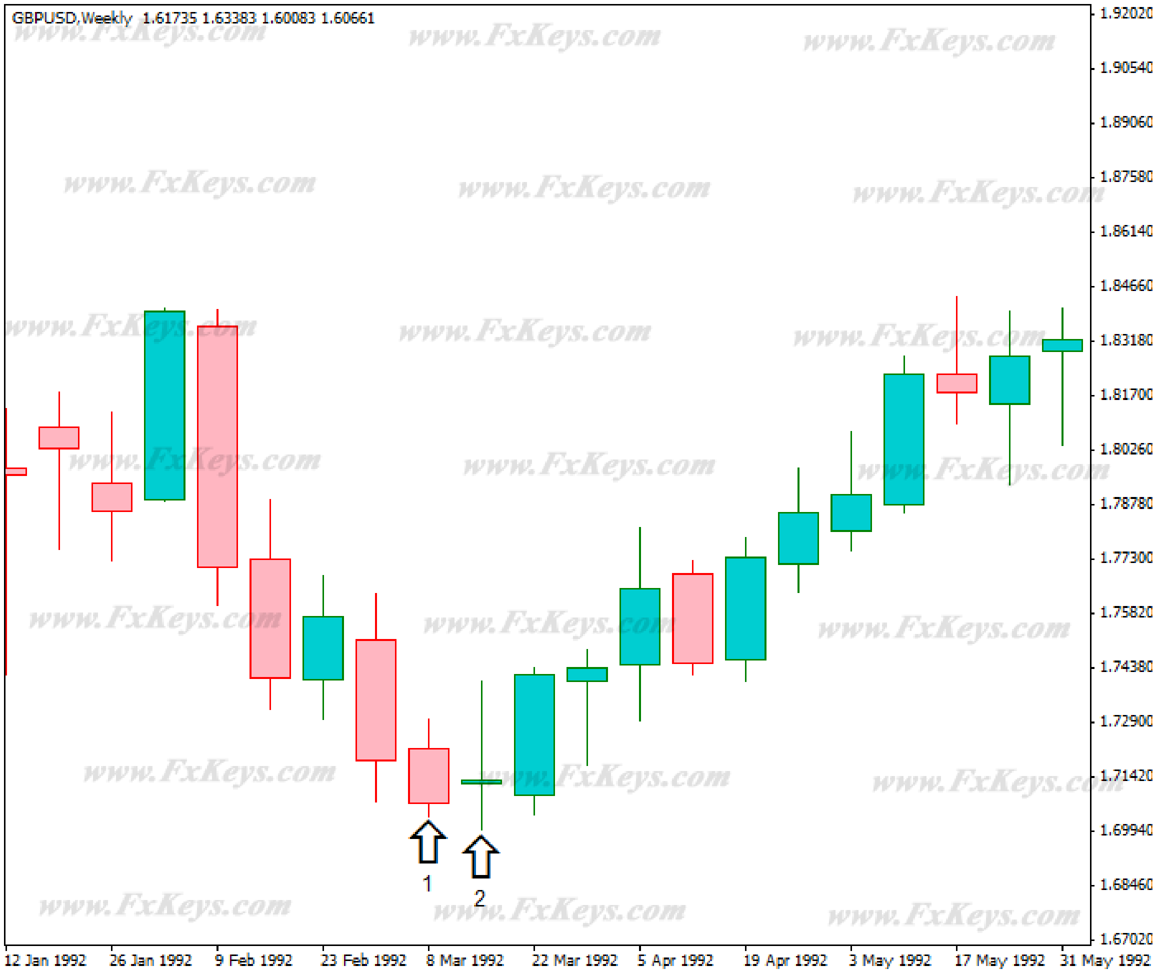
And this is a Bearish Harami that worked strongly to reverse the price on GBP/USD weekly chart:



Bullish Harami Cross on GBP/USD weekly chart:



Bullish Harami Cross on GBP/USD weekly chart:



Candlesticks are the only real time indicators. It is strongly recommended to learn the candlesticks signals: [Candlestick Trading – The Language of Japanese Candlesticks]

16) Dragonfly Doji Candlestick: A Frequently Forming Doji

Dragonfly Doji Candlestick is a kind of Doji candlestick that forms on different markets, Forex and stock, more frequently than the Gravestone Doji Candlestick. It usually forms strong reversal signals. Indeed, all kinds of Doji candlesticks first indicate the market's indecision in reversing or continuing of the same direction. But once they are confirmed by the next candlestick that forms against the direction of the market and trend, or in case the Doji itself is really strong, it means a strong reversal signal.

Before learning about the Dragonfly Doji candlestick, if you are new to candlesticks and you don't know what they are exactly, I recommend you to read this article to learn about the candlesticks in details. Also, to learn about the Doji candlesticks and the way you can use them to trade the different markets, you can read this article.

There are 3 kinds of Doji: (1) Rickshaw Man; (2) Gravestone; (3) Dragonfly

Dragonfly Doji is a kind of Doji candlestick that has no upper shadow and body. Having no body is the general feature of all kinds of Doji candlesticks, but when they don't have an upper shadow as well, they are called Dragonfly Doji because they look like the dragonfly insect.

That is how a typical Dragonfly Doji should look like. However, sometimes when the open and close price of the candlestick are not exactly the same, the Dragonfly Doji can have a small bullish or bearish body. And sometimes there is a small lower shadow as well. You can still call such a candlestick a Dragonfly Doji but that's the atypical form of this candlestick.

The atypical forms of Dragonfly Doji form on the Forex market and on different time frames very frequently, but the typical form of this candlestick forms on this market very rarely because the Forex market is so volatile and you can barely find a Doji candlestick with no upper shadow and body.

When the body becomes a little bigger, then the candlestick can't be called a Doji. It is a Hammer if formed at the bottom, or a Hanging

Man if formed at the stop. This can be a little confusing. However, the good news is all of these candlesticks are indecision and then reversal signals, so that you don't have to learn what to call them. You just need to know that the market is in an indecision situation. Then the next candlestick tells you what new decision the market has taken. So all of these candlesticks have to be confirmed by the very next candlestick or one of the few to a few candlesticks.

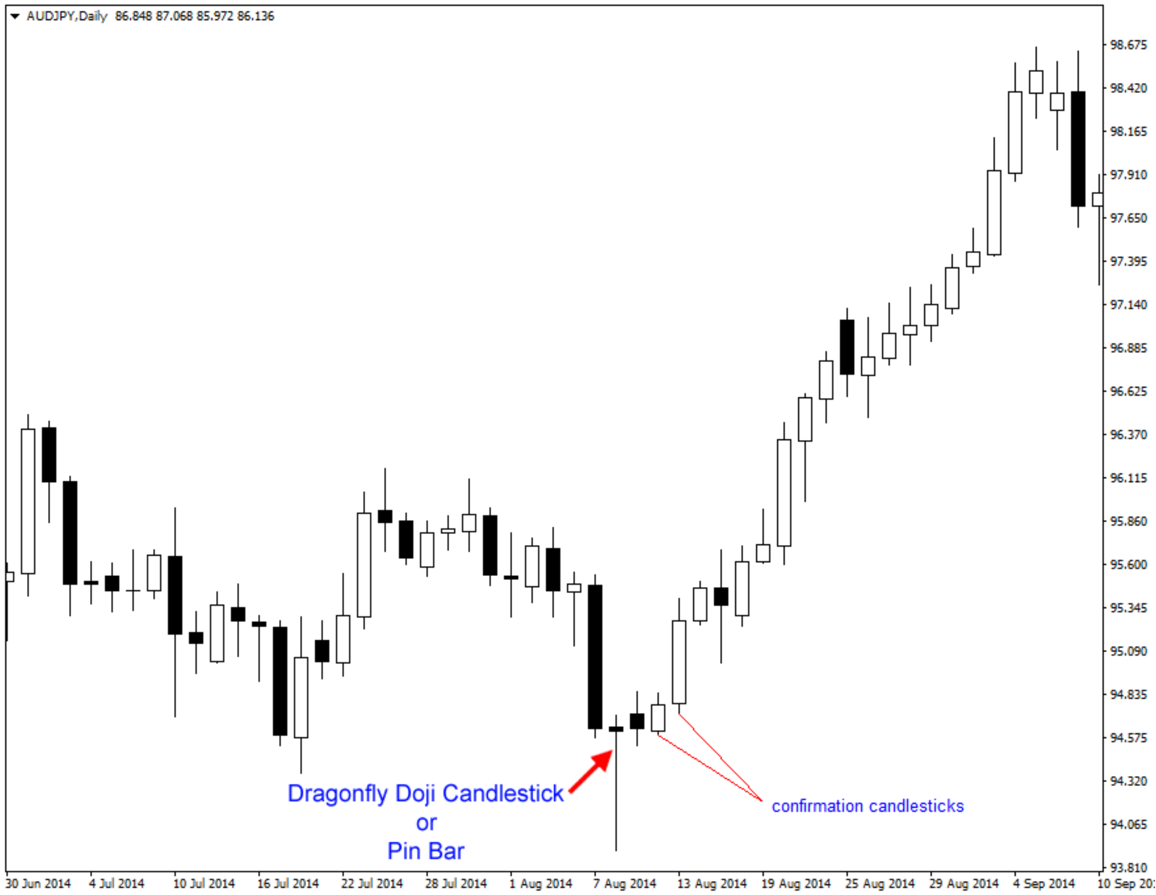
There are some other names for these candlesticks too. For example some traders know the Dragonfly, Gravestone and even the Hammer and Hanging Man as the Pin Bar candlesticks.

Names are not that important. So don't get confused by the names and don't try to find the name of any of the candlesticks that form on the charts. All you have to know is reading the signal that each candlestick sends despite the name the candlestick has. You don't have to know the name of the candlestick to know what signal it is giving you. You just need to know what its long or short shadows and body mean.

The below chart shows an atypical form of the Dragonfly Doji Candlestick that has formed on AUD/JPY daily chart. As you see it has a small body and upper shadow, so it is not the typical form of the Dragonfly Doji. But it is the candlestick that many traders call Pin Bar.

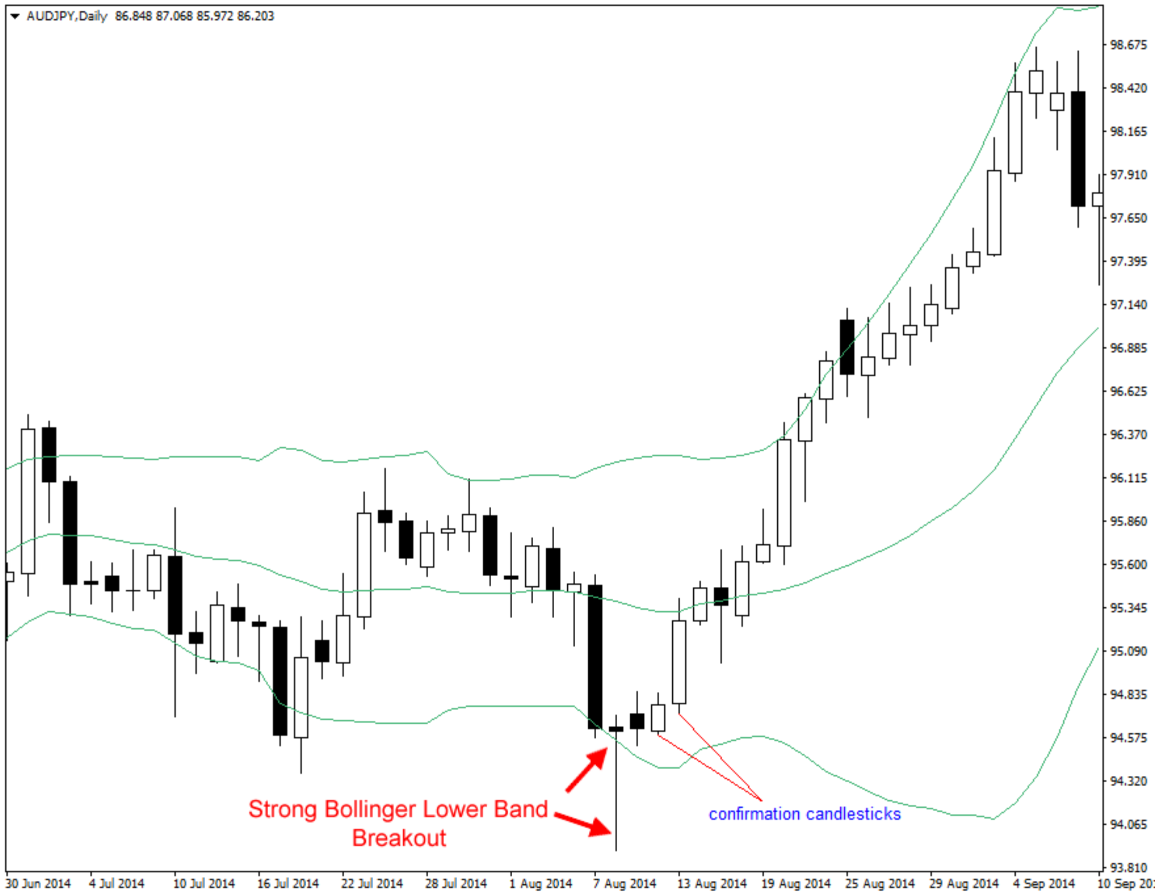
The most important thing here is the long lower shadow of this candlestick. This is something that really matters. What does this long lower shadow mean?

It means bears had the full control first, and so they could take the price a lot lower. However, bulls took the control before the candlestick close and took the price up, and so, the candlestick closed with a long lower shadow. This means a reversal signal on a bear market. Under such a condition, it is recommended to wait for one of the few next candlesticks to confirm that bulls still have the control. They can do this by forming a reasonably long bullish body. Their bullish body means that bulls have taken the full control and took the price higher and closed it there. That is the time that you can go long:



As you see on the above chart, the very next candlestick didn't confirm that bulls had the full control, but the second and the third candlesticks formed the confirmation we needed to go long. And, the price went up for hundreds of pips after that. So a Dragonfly Doji with a long lower shadow which is confirmed by the next candlestick, is a strong reversal signal and long trade setup if formed at the bottom of a bear market.

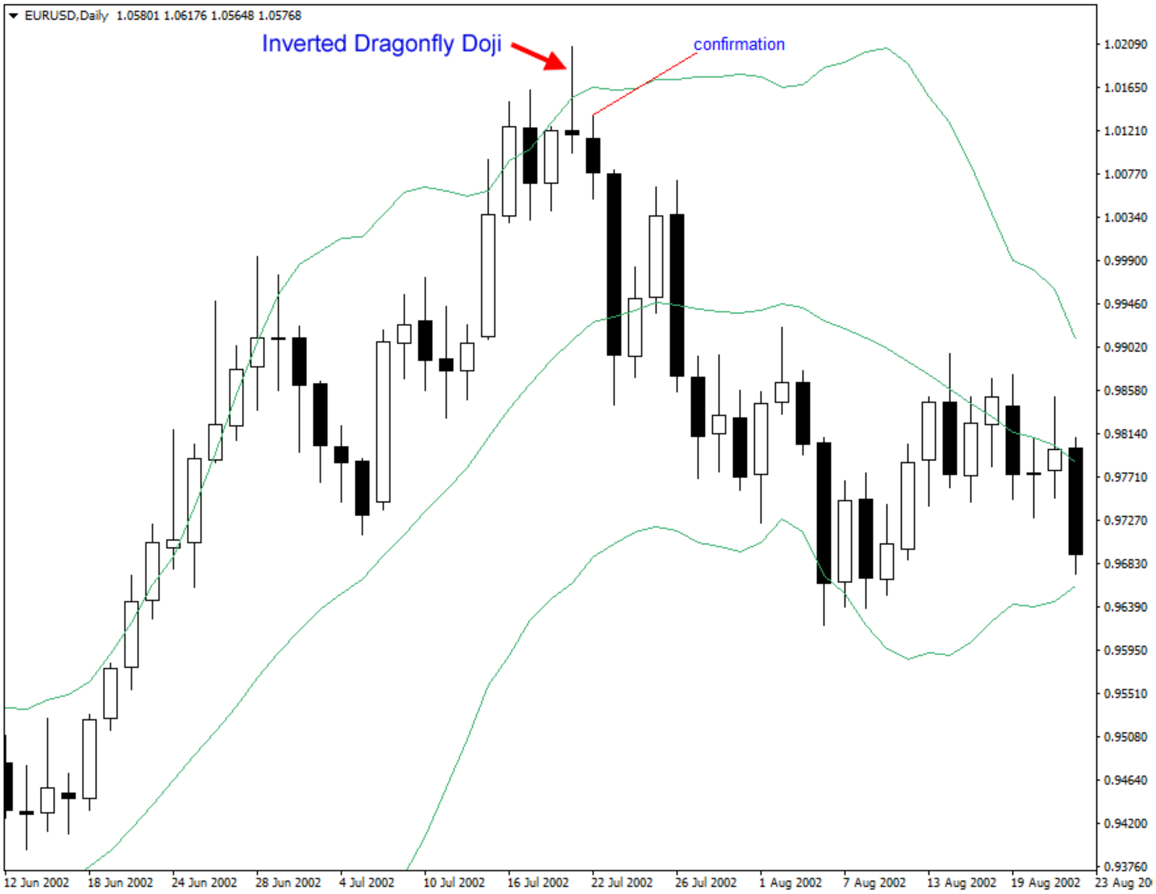
To make it easier to know whether the reversal signal is really strong or not, and to filter out many of the false signals, you can add Bollinger Bands to the charts. If the Dragonfly Doji's lower shadow breaks out of Bollinger Lower Band strongly, then the signal is strong. The longer the Dragonfly Doji's lower shadow and the stronger the Bollinger Lower Band breakout, the stronger reversal power of the candlestick.



The inverted form of Dragonfly Doji can form on the bull markets. In this case, if the Inverted Dragonfly Doji closes with a long upper shadow that breaks out of Bollinger Upper Band strongly, and then the next candlestick closes with a reasonably long bearish body, it means a strong reversal signal and short trade setup.

Here also, (1) the longer the Dragonfly Doji upper shadow and (2) the stronger the Bollinger Upper Band breakout, and also (3) the stronger the confirmation candlestick bearish body, the stronger the reversal signal and short trade setup.

The below chart shows an Inverted Dragonfly Doji that has formed a short trade setup after it was confirmed by the next candlestick. However, this short trade setup is not as strong as the long trade setup I showed you above. Now you know why. Because the Inverted Dragonfly Doji's upper shadow is not long enough and has not formed a strong Bollinger Upper Band breakout:


EURUSD,Daily 1.05801 1.06176 1.05648 1.05768
Inverted Dragonfly Doji
confirmation

17) Daily Candlesticks and Bollinger Middle Band

I think my yesterday's article has made you analyze the daily charts and find some trade setups based on what I explained there. You should always be careful not to push yourself to take a position every day. Sometimes there is no setup, and sometimes there are some setups but you can't locate them. Therefore, you should close your platform and come back the next day.

Keep in mind that you should always look for the strong setups like the ones I showed you yesterday. In most cases it is possible to guess the color and direction of the next daily candlestick, but it is not good to risk your money when the signal is not strong enough. In this article I am showing you some examples from the signals that form around the Bollinger Middle Band which is a risky and tricky area.

Bollinger Middle Band is a 20 simple moving average. I do not like to trade the moving averages but Bollinger Middle Band is strong, because big market participants pay a lot of attention to it and take decisions based on it. So the markets usually react to this moving average reasonably.

Continuation Signals

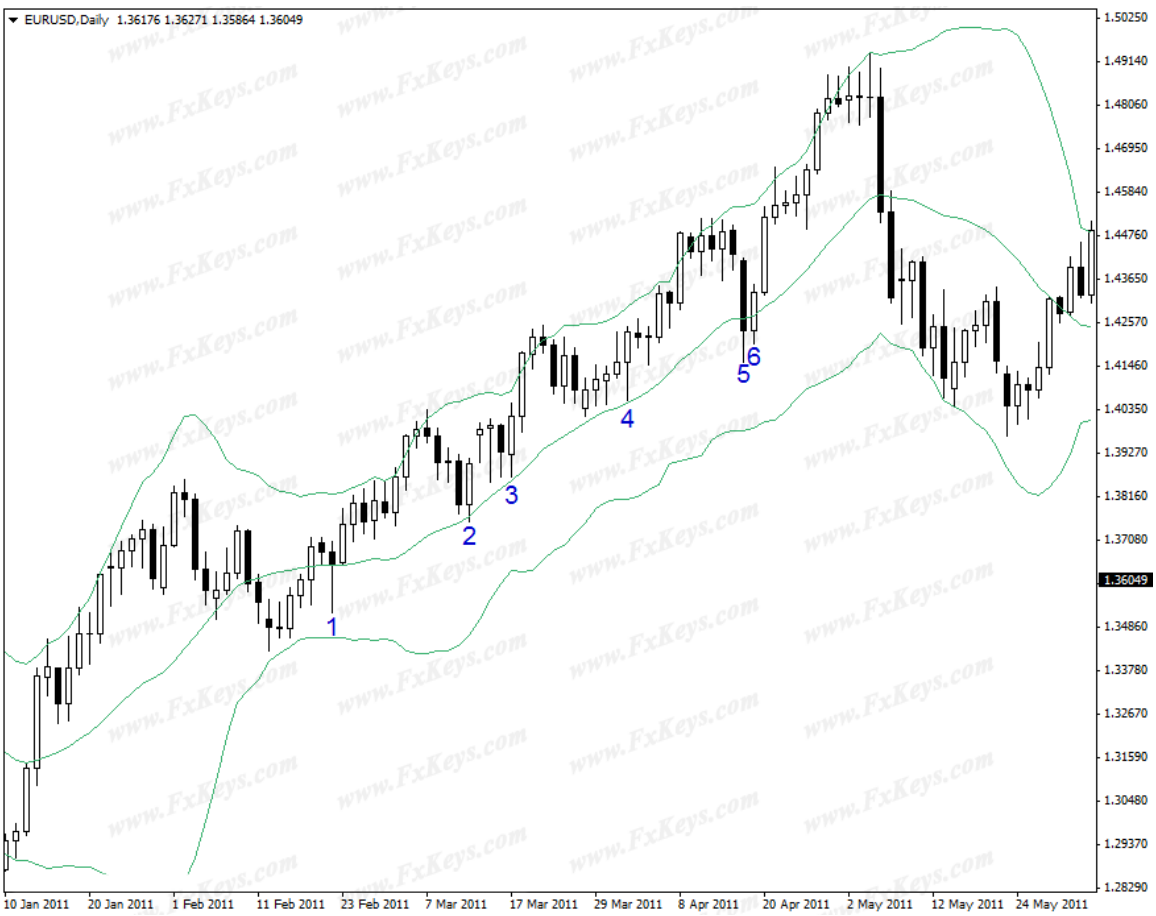
When there is a strong trend, sometimes the price tests the middle band but then it forms a continuation signal around it. This signal indicates that the trend will be continued. In spite of this, middle band is a tricky area and if you are among those traders who only want to look for the strongest setups, you'd better to ignore the setups you locate around the middle band.

There is a strong uptrend on the below chart and some buy signals are formed around the middle band. Only when there is such a strong uptrend, we can take the buy signals that form above the middle band.

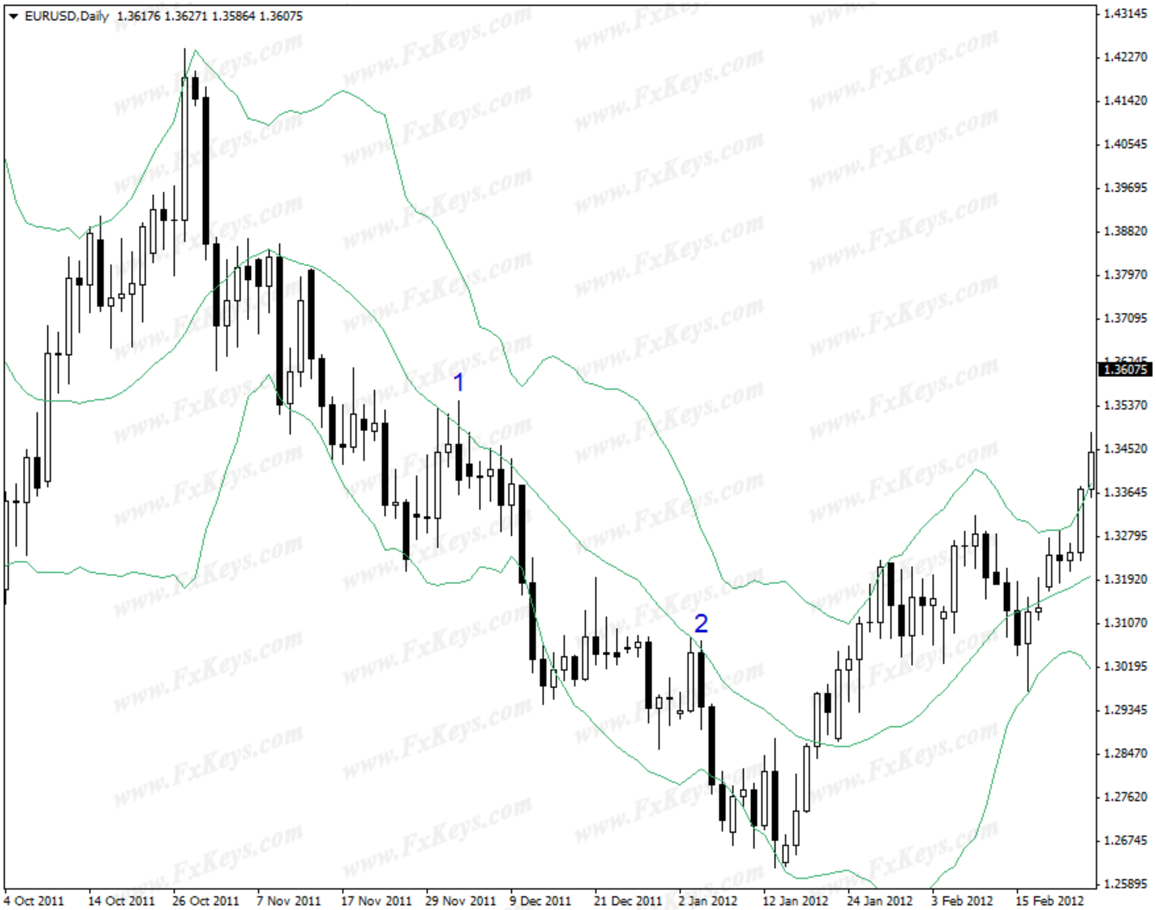
Candlestick #1 strongly tests the middle band, but the middle band works as a strong support while the market is already bullish. This candlestick closes with a long lower shadow and then the next candlestick forms a bullish body. The combination of candlestick #1, the next candlestick and Bollinger Middle Band has formed a strong buy signal. You can go long at the close of the next candlestick and set the stop loss few pips below the open price of this candlestick.

Candlestick #2 is also a good buy signal that is formed above the middle band while the market was still bullish and the uptrend was strong. You can go long at the close of this candlestick and set the stop loss below its open price. Candlestick #3 and #4 have also formed a similar continuation signal like candlestick #2.

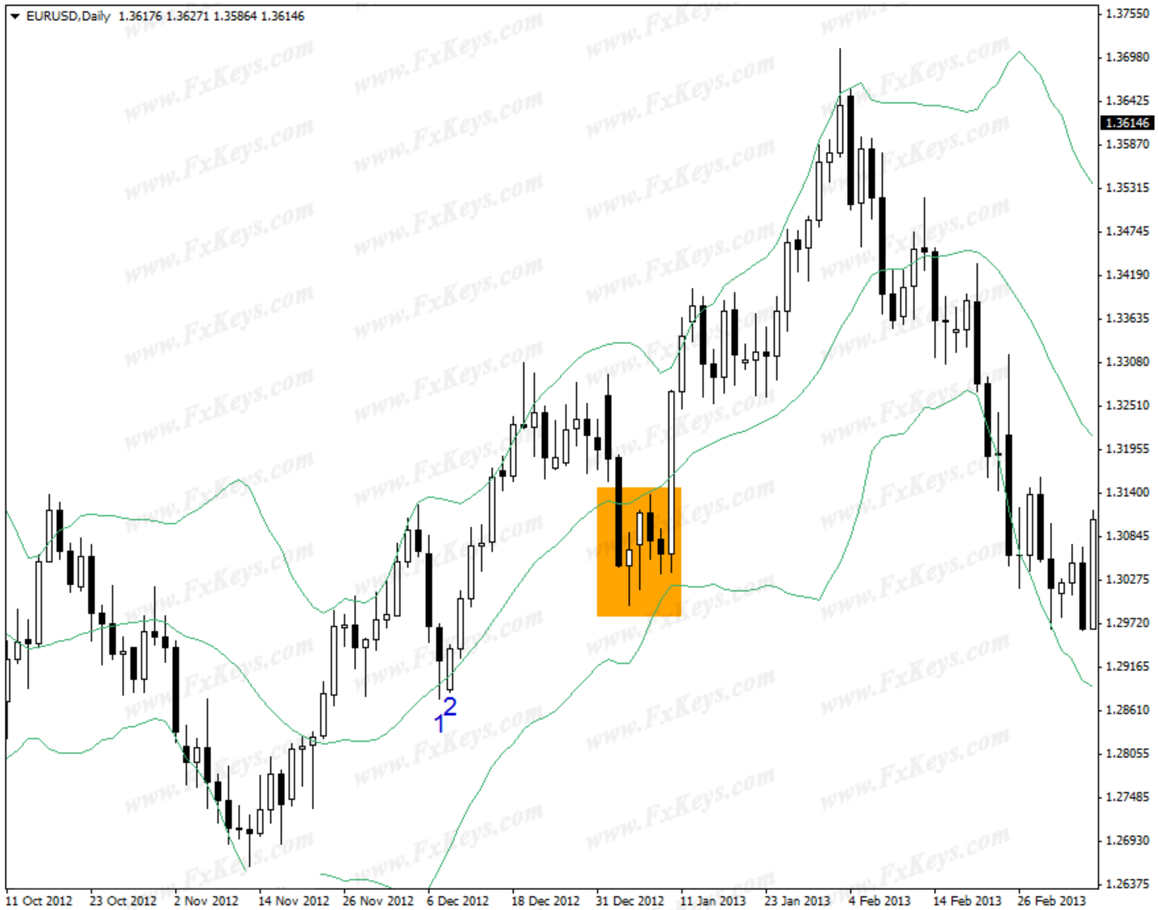
Although candlestick #5 and #6 broke below the middle band, they formed another buy signal finally. However, I would ignore this signal because candlestick #6 which is the confirmation candlestick, is NOT strong enough. Yes, the price went up very strongly after that, but we never know. We should decide based something that is already formed on the chart.



The below chart shows two examples of the sell signals that formed below the middle band while there was a strong downtrend. Candlestick #1, two candlesticks before and several candlesticks after, prove that the market really reacts to Bollinger Middle Band. I say this because some traders believe that the markets don't react to the middle band but it seems they really do. Candlestick #2 is also a strong sell signal below the middle band. Please note that we consider them as strong signals only when there is a strong trend.



As I mentioned, middle band is a tricky area and sometimes, unlike the examples I showed you above, candlesticks don't close right above (when there is an uptrend) or below it (when there is a downtrend). The below chart is an example. Candlestick #1 and #2 formed a nice buy signal above the middle band. But the orange area shows some candlesticks that closed below the middle band and didn't form a buy signal above it.



If you check the daily charts you will several setups like the ones I showed you above. Please note that the Bollinger Bands settings in the above charts is the default settings which is 20, 2.

18) What Do the Candlesticks Shadows Tell You?

I see an article on LuckScout titled "The Language of Japanese Candlesticks". I like this title because candlesticks really talk to you. They have a language. They inform you about the psychology of the markets. "Market" means buyers and sellers. It is the buyers and sellers that create the market, and of course there have to be something to buy and sell which is called commodity. Buyers and sellers make the price go up or down. When most of the market's participants buy, the price goes up. When they sell, the price goes down. This is what we call "market". It is a place, physical or virtual, where you can buy and sell; and there is a commodity that can be bought or sold.

Now if someone or something tells you whether the market's participants want to buy or sell, then you can choose the right direction to get in the market and make some money as a trader.

Fortunately we have such a tool: Japaneses Candlesticks

They are alive and they have a language. They talk to you lively. They are not like "lagging" indicators. You just need to understand their language to make money.

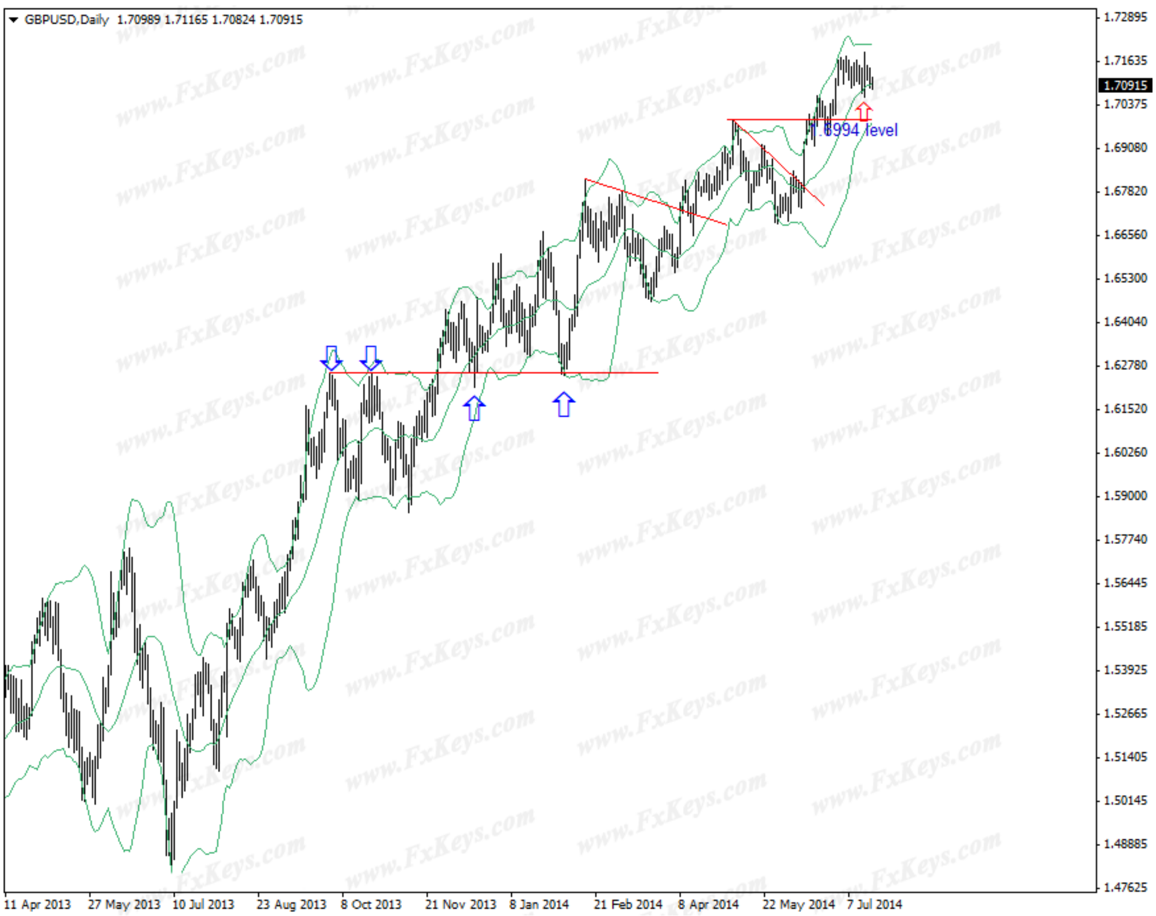
Candlesticks have a body and two shadows (refer to this article to learn the candlesticks anatomy). The candlesticks language is not too complicated. It is very easy to learn and understand. You can learn it within a few hours. The body gives you few signals. The Shadows give you few signals too. I do not want to talk about the candlesticks language, signals and patterns here. LuckScout is full of invaluable information on this. However, in each articles I show you a few examples to tell you how I use the candlesticks to know whether I should buy, sell or do nothing. Before you go ahead, please make sure to read my previous articles carefully. They are so important:

1. I Trade the Daily Chart, But I Am a Day Trader
2. Daily Candlesticks and Bollinger Middle Band®
3. Does Technical Analysis Work?

You are a good trader when you know when and where to enter, and when and where you should stay away from the market and not to take any positions. Candlesticks tell you both. They not only show you the strong setups that you have to take and make money, but also they inform you about the situations that you have to stay out. From my point of view, the second one is even more important. I mean it is more important to know when and where we should not get it, because before we learn to make money, we should learn not to lose money.

In my previous articles, I talked about the candlesticks signals a lot. Here, I want to show you one example from the cases that candlesticks told me not to enter.

You know that GBP/USD is strongly bullish both on the daily and weekly charts (this article was originally published on Jul 18, 2014).



I trade based on the candlesticks signals and their combination with Bollinger Bands. For me, "uptrend" means that I should wait for the long trade setups and I go short only when there is an extremely strong sell signal while the uptrend is already exhausted. You learned how I use the Bollinger Middle Band to locate the trend continuation signals.

A few days ago, a strong buy signal formed on GBP/USD daily chart, above the Bollinger Middle Band. There is no doubt that it was a good opportunity for me to go long. But I didn't do it.

The 2014.07.15 (the red arrow on the below screenshot) candlestick formed a strong buy signal above the middle band. Its strong body says that bulls still have the control and succeeded again to defeat bears who took the price down to test the middle band. In spite of this, this candlestick has something that prevented me from going long. Its "upper shadow" told me that bulls succeeded to take the control back from bears, but bears are still serious to take the price down and they are not fully defeated.

Candlestick 2014.07.15 opened at 1.70824. It went down to 1.70583 to test the middle band, but the middle band worked as a support and made the price go up. It went up for over 131 pips to reach 1.71904. But it went down because of the bears counter-attack, closed at 1.71415 and left a relatively long upper shadow. Its last movement (going down to 1.71415) formed the upper shadow. This is what the long upper shadow mean. It tells you not to go long, because it is highly possible that the price goes down probably to test the middle band again. And as you see it was true. The price did not go up after the 2014.07.15 candlestick and is currently trying to test the middle band:


GBPUSD,Daily 1.70989 1.71165 1.70824 1.70893
1.72400
1.72040
1.71670
1.71310
1.70893
1.70590
1.70220
1.69860
1.69500
1.69140
1.68770
1.68410
1.68050
1.67690
1.67320
1.66960
1.66600
1.66230
1.65870
1.65510
1.65150
27 Mar 2014
8 Apr 2014
18 Apr 2014
30 Apr 2014
12 May 2014
22 May 2014
3 Jun 2014
13 Jun 2014
25 Jun 2014
7 Jul 2014
17 Jul 2014

19) Candlestick Patterns and Signals that Make Money

It can take you a long time if you want to learn and understand all candlestick patterns, their names and meanings. It can look too confusing and tiring when you start reading about them.

Sometimes I see traders argue for several hours about the name of a candlestick pattern. That doesn't make sense to me when I see people waste their time on the topics that have no importance at all and make no difference. The name of the candlesticks and the patterns they form is not that important in trading. What matters is that you know which pattern is strong and can be taken as a trade setup, and which pattern has to be ignored. You don't even have to know their names to do that.

In this article, I am going to simplify the candlestick trading as much as possible. I am trying to prevent you from getting confused in locating the proper candlestick patterns. You will see that how easy it is to trade using this strong and accurate tool known as candlestick.

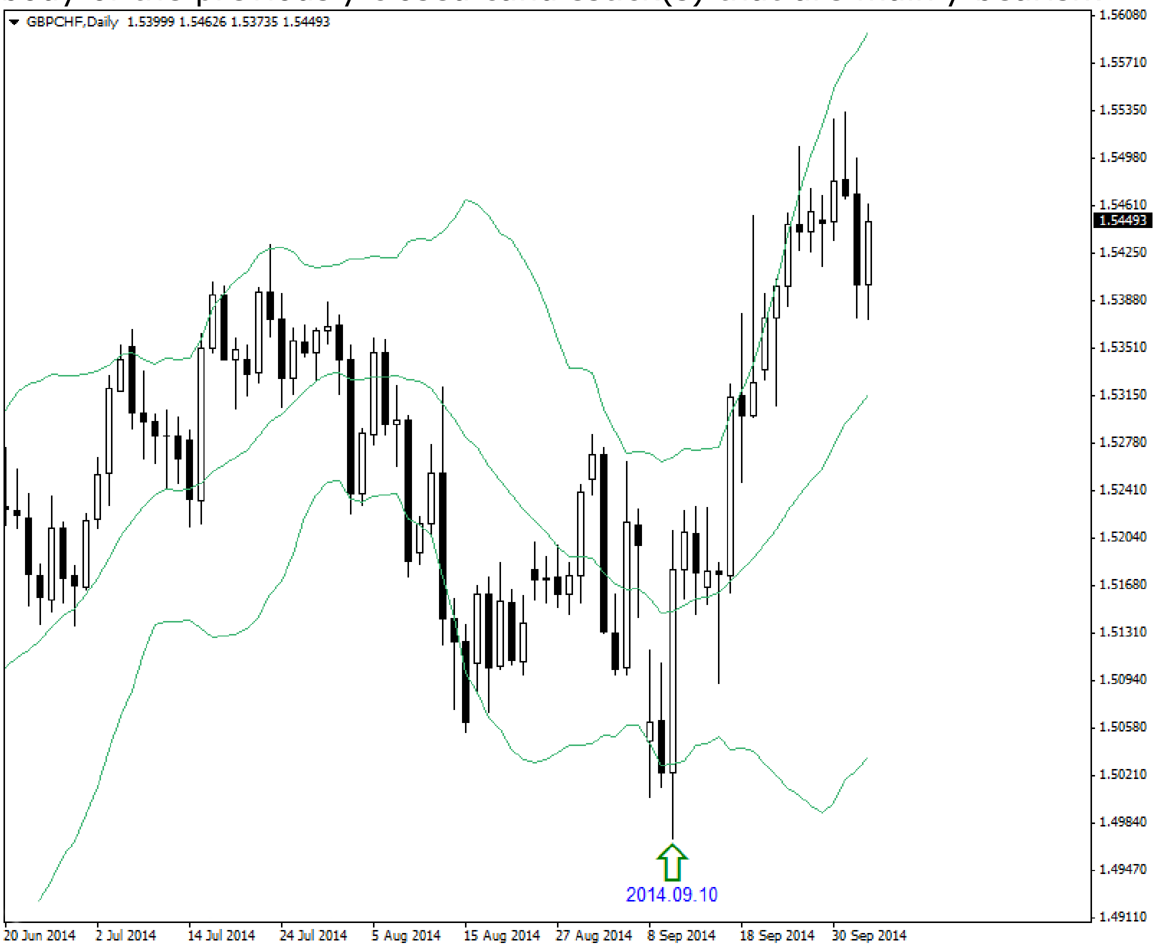
There are so many candlestick patterns. However, I have learned to ignored most of them and follow only the ones that are effective and strong:

1. Engulfing Patterns

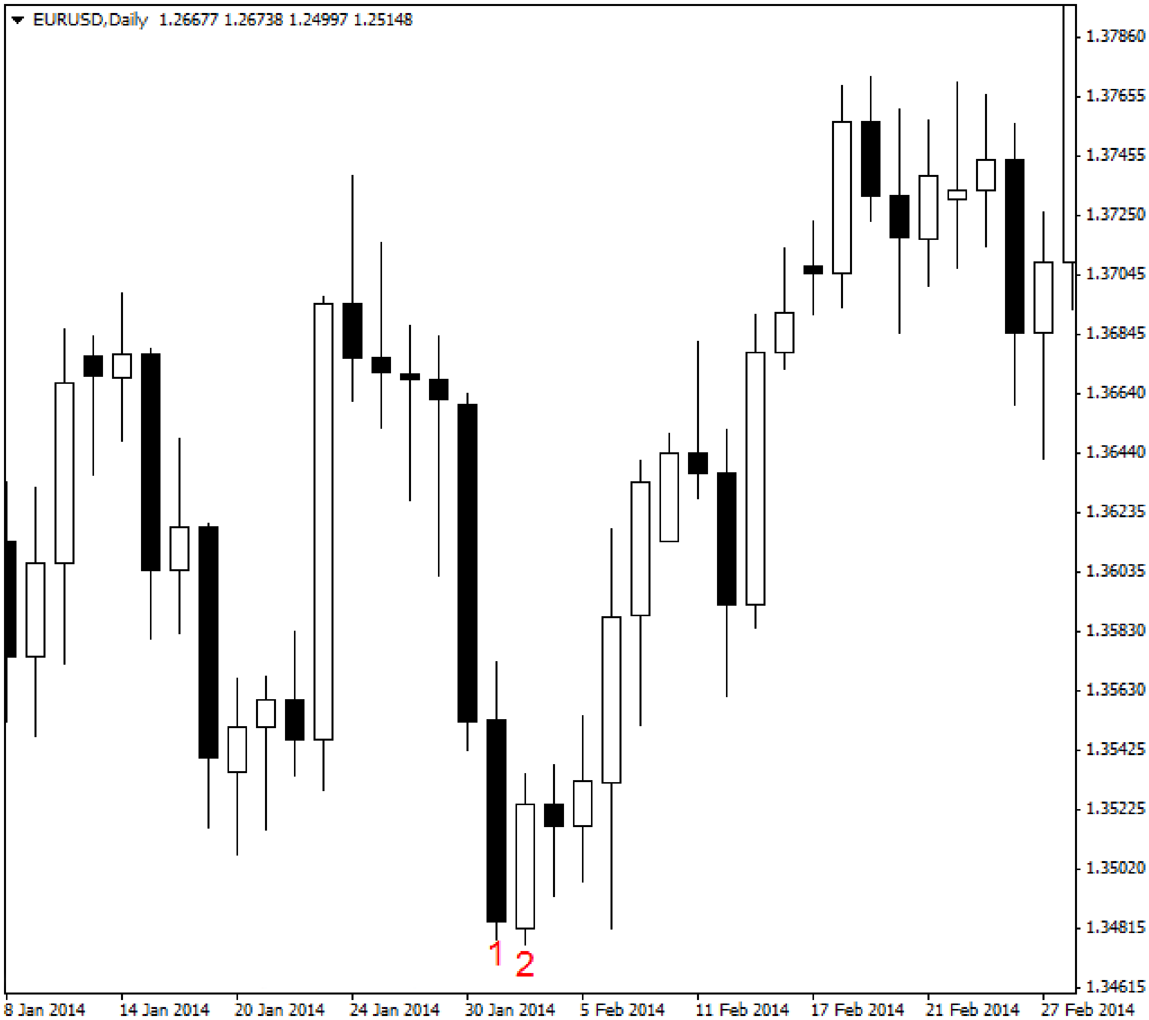
There are two kinds of Engulfing Patterns:

1. Bullish Engulfing
2. Bearish Engulfing

Bullish Engulfing Pattern forms when the body of a Bullish candlestick, which is a candlestick that its close price is higher than its open price and has a white or green body on the price chart, engulfs or covers the body of the previously closed candlestick(s) that are mainly bearish:

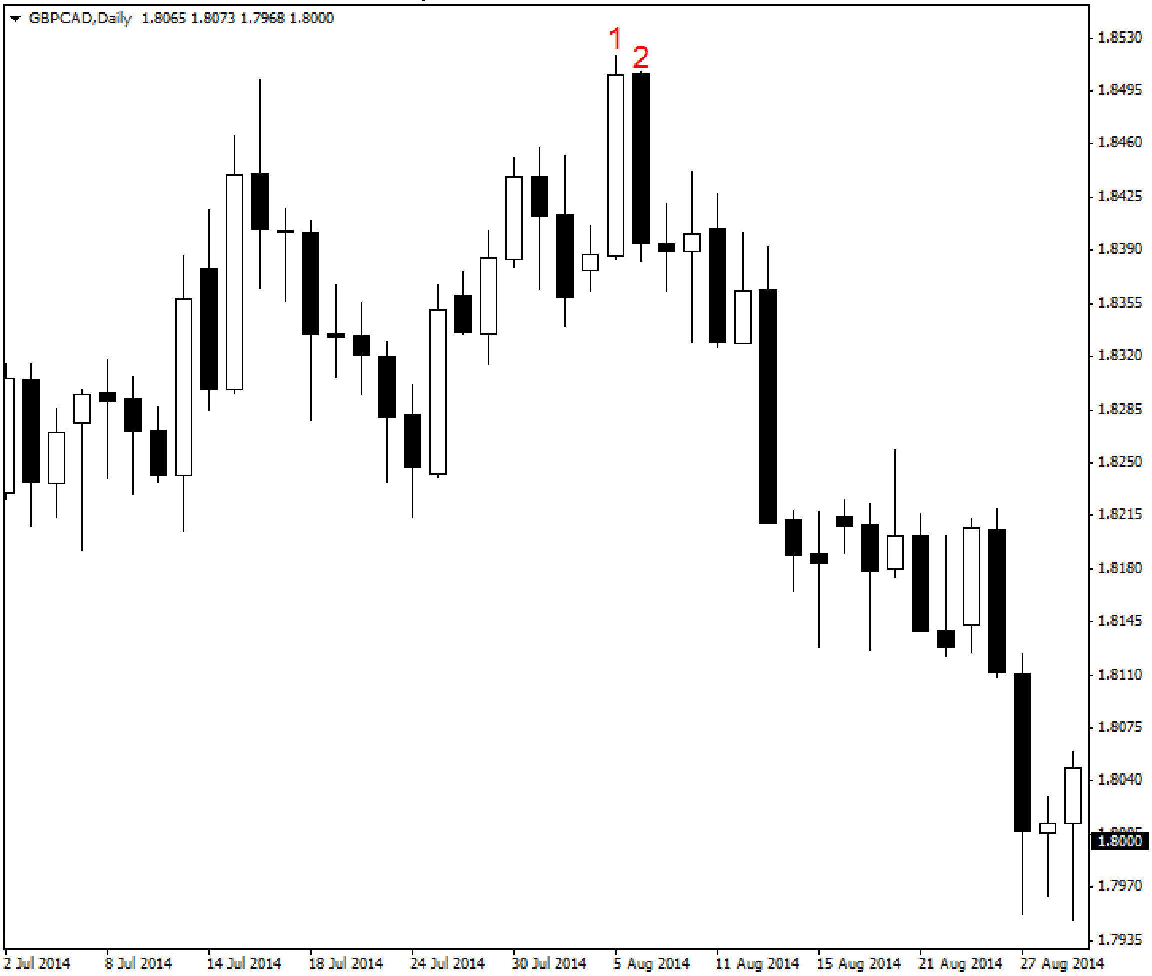


There is another candlestick pattern which is called Piercing Line. This pattern is a kind of Bullish Engulfing Pattern. However, in Piercing Line Pattern, the bullish candlestick opens below the close price, and closes a little below the open price of the previous candlestick which is mainly bearish:



Bearish Engulfing Pattern forms when the body of a Bearish candlestick, which is a candlestick that its close price is lower than its open price and has a black or red body on the price chart, engulfs or covers the body of the previously closed candlestick(s) that are mainly bullish:

There is another candlestick pattern which is called Dark Cloud Cover. This pattern is a kind of Bearish Engulfing Pattern. However, in Dark Cloud Cover Pattern, the bearish candlestick opens above the close price, and closes a little above the open price of the previous candlestick which is mainly bullish:



Engulfing patterns are the strongest candlestick patterns. I am used to take only these kinds of candlestick patterns, and ignore the rest, because they work much better, and they are easier to locate and distinguish. The other patterns are weak and tricky.

Additionally, I am used to add a supplementary tool to these patterns. It is the Bollinger Bands indicator. Experience shows that when a too strong Engulfing Pattern strongly breaks out of Bollinger Upper (in case of Bearish Engulfing) or Lower (in case of Bullish Engulfing) Band, it can be trusted more, and there is a higher probability that the price moves accordingly after that:

Engulfing Patterns are indeed reversal patterns or signals. When they form at the top of an uptrend or bottom of a downtrend, it means the trend is trying to reverse. However, we don't take these reversal patterns when they form while the trend is still too strong. As the reversal patterns, they have to be taken when the trend is exhausted: [Forex Market Trend Strength and Exhaustion and Forex Trend Indicators]

Although Engulfing Patterns are reversal signals, they can be used to follow the trends also, which is what I am more interested in. They can be used as trend continuation signals, when they form on consolidations like Triangles and Flags that form after a too strong up/down movement. When there is a too strong uptrend, the price goes sideways and forms a consolidation after a while of upward movement. The uptrend will be continued if the price breaks above the resistance line of the consolidation. This happens usually when a too strong Bullish Engulfing Pattern forms on or above the consolidation support line. That is the time I get in, and usually the price breaks above the consolidation resistance line when I am already in. It is the same in case of downtrends.

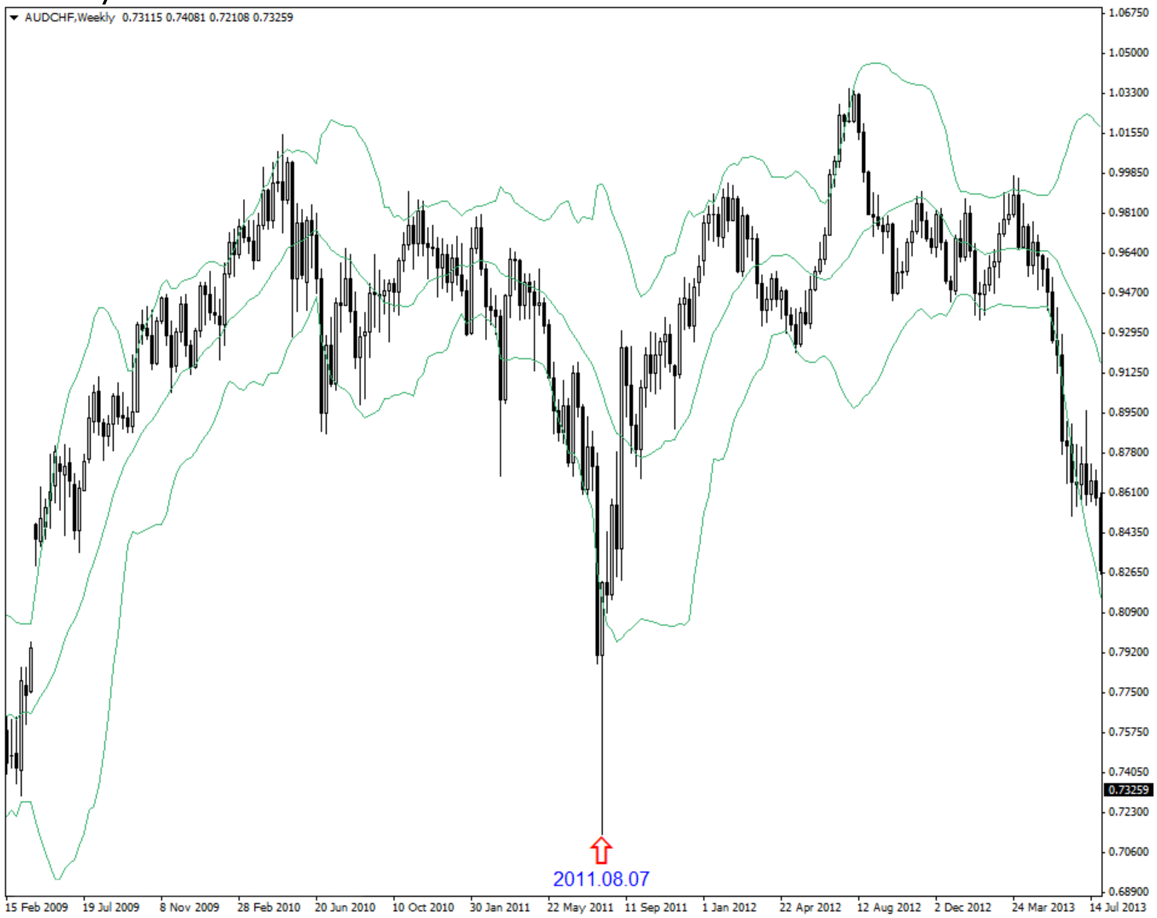
2. Doji

Doji forms on the charts a lot. However, I am not used to take any Doji that I see. The ones I like to take, have too strong and long shadows, along with strong Bollinger Bands Breakout. Unlike Engulfing Patterns that don't need to be confirmed by any of the next candlesticks, Doji candlesticks have to be confirmed by the next or one of a few next candlesticks. However, when a Doji is really too strong and has formed a too strong Bollinger Bands breakout, and there are some other positive points like a strong support or resistance level that boosts the Doji effect, I dare to enter the market before the confirmation candlestick forms.

In general, I rarely take any positions based on the Doji candlesticks, because the ones that I like to take form very rarely.

3. Long Tail Candlesticks and Pin Bars

These are also like Doji candlesticks with this difference that they have bigger bodies. Like Doji, the longer the tail (shadow) of a pin bar candlestick, and the stronger the Bollinger Bands breakout, the stronger the signal and its reversal power. This is the example of an exceptional pin bar with a long bullish body that I took without waiting for any confirmation candlestick:



Like Engulfing Patterns, Doji and long tail candlesticks are reversal signals. However, they can be used to follow the trends as well, the way I explained how to use the Engulfing Patterns to follow the trends.

Strong Engulfing Patterns, Dojis and Pin Bars, while there is a strong Bollinger Bands breakout, are the only candlestick signals I take. I ignore the other candlestick forms and patterns.

20) Gravestone Doji Candlestick: What Does It Mean Exactly?

"Doji" is one of the most important kinds of candlesticks, and one of the most famous kinds of Doji is called Gravestone Doji.

If candlesticks are new to you and you don't know what they are exactly and how you can use them in your trades, I suggest you to read this article first to learn what candlesticks are. Then you can read our Doji article to learn about the Doji candlesticks specifically. After that, you can come back to this page and read the rest of this article which is focused on Gravestone Doji.

There are 3 main kinds of Doji: (1) Rickshaw Man; (2) Gravestone; (3) Dragonfly

Rickshaw Man is the typical Doji which has both of the upper and lower shadows. You can see it more frequently on different markets and time frames.

Gravestone is a Doji that has no lower shadow, so that it looks like a gravestone, of course if you look at a gravestone from the side. It has no lower shadow; can have a long upper shadow, and if the open and close price of the candlestick are exactly the same, then it will have no body as well. This is the description of the typical Gravestone Doji candlestick. However, when the open and close prices are not exactly the same, then it can have a small bullish or bearish body. It most cases it has a small lower shadow as well. But a typical Gravestone Doji candlestick has no lower shadow and body.

Why Do the Traders Call It Gravestone?

This candlestick is not called Gravestone just because it looks like a gravestone. This name has a deeper meaning that comes from stock trading. In the past, traders couldn't trade online. It was not possible to sell short, and they could only buy long. Therefore, to make some money, they had to wait for the uptrends to form. They couldn't make any money from the bear markets. That is why the experienced old-school stock traders hate to go short even now that it is possible to do it. This is the habit that comes from that time.

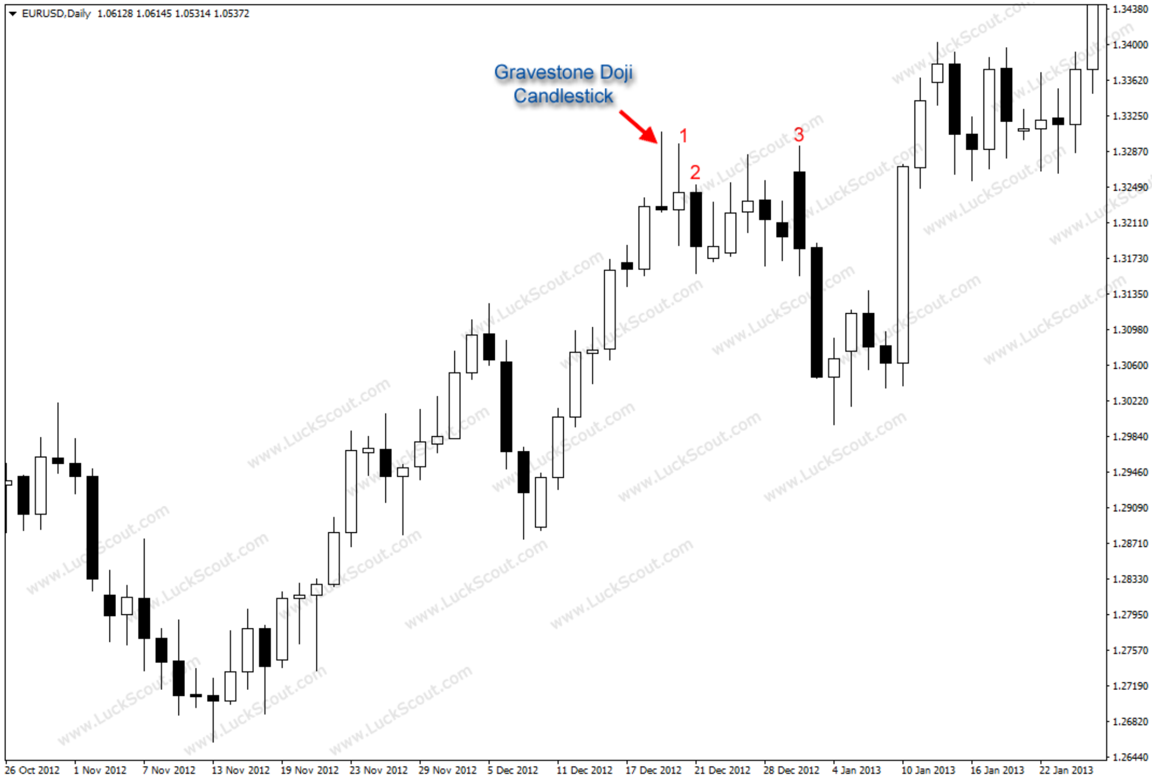
Doji candlesticks are reversal signals. Therefore, when stock traders saw a Doji on a bull market or uptrend, they felt sad. They knew that they had to sell sooner or later to collect their profit and get out of the market because the uptrend was close to end.

A Gravestone Doji candlestick with a long upper shadow at the top of a bull market, is a strong reversal signal. It means bulls are exhausted and have already started to sell, so that the price can't go higher for now. There was no news worse than this for the stock traders. A Gravestone Doji candlestick at the top of a bull market meant burying all the hopes and joys of making money with an uptrend. That is why when such a candlestick formed on a bull market, traders called it Gravestone.

How Does a Gravestone Doji Candlestick Look?

As I mentioned earlier, it is a Doji candlestick with no lower shadow and just an upper shadow. The typical ones usually don't have a body. This candlestick forms on the stock market more frequently, but you can barely see it on the currency or Forex market because it is volatile and liquid and the price movements doesn't allow a candlestick that has no lower shadow and body to form. Therefore, usually atypical shapes of the Gravestone candlestick forms on the currency market. For example, they have a small body and lower shadow. You can't call such a candlestick a Gravestone anymore, but it is the atypical form of the Gravestone candlestick.

It is really hard to find the typical form of the Gravestone Doji candlestick on the Forex market. But the other kinds of Doji candlesticks, Rickshaw Man and Dragonfly, form so frequently on this market. The other kinds of candlesticks like Hammer and Hanging Man also form on the currency market a lot. But Gravestone is so rare. You can find the atypical forms of Gravestone on different markets. They have a small lower shadow and also a small body, but you can still call them Gravestone Doji.



The above chart shows a Gravestone Doji Candlestick that has formed on EUR/USD daily chart. This one also is not the typical form of Gravestone because it has a small lower shadow and also a small bearish body. But you can still call it Gravestone Doji.

What Does Gravestone Doji Candlestick Mean?

Gravestone is a reversal signal. When it forms on an uptrend it means it is strongly possible that the uptrend reverses or at least it stops going up and moves sideways for a while.

Gravestone has to be confirmed by the next candlestick to be known as a sell signal or short trade setup. The next candlestick or one of the next a few or few candlesticks have to confirm the Gravestone by forming a reasonably strong bearish body, otherwise the formed Gravestone has to be ignored and the uptrend will most probably be continued.

As you can see on the above chart, the next candlestick after the Gravestone Doji (#1) didn't confirm it properly, but the market went sideways for few candlesticks. It means, although a strong short trade setup didn't form by that Gravestone Doji and the next candlestick, still they meant that bulls were exhausted and the uptrend couldn't be continued at least for a while.

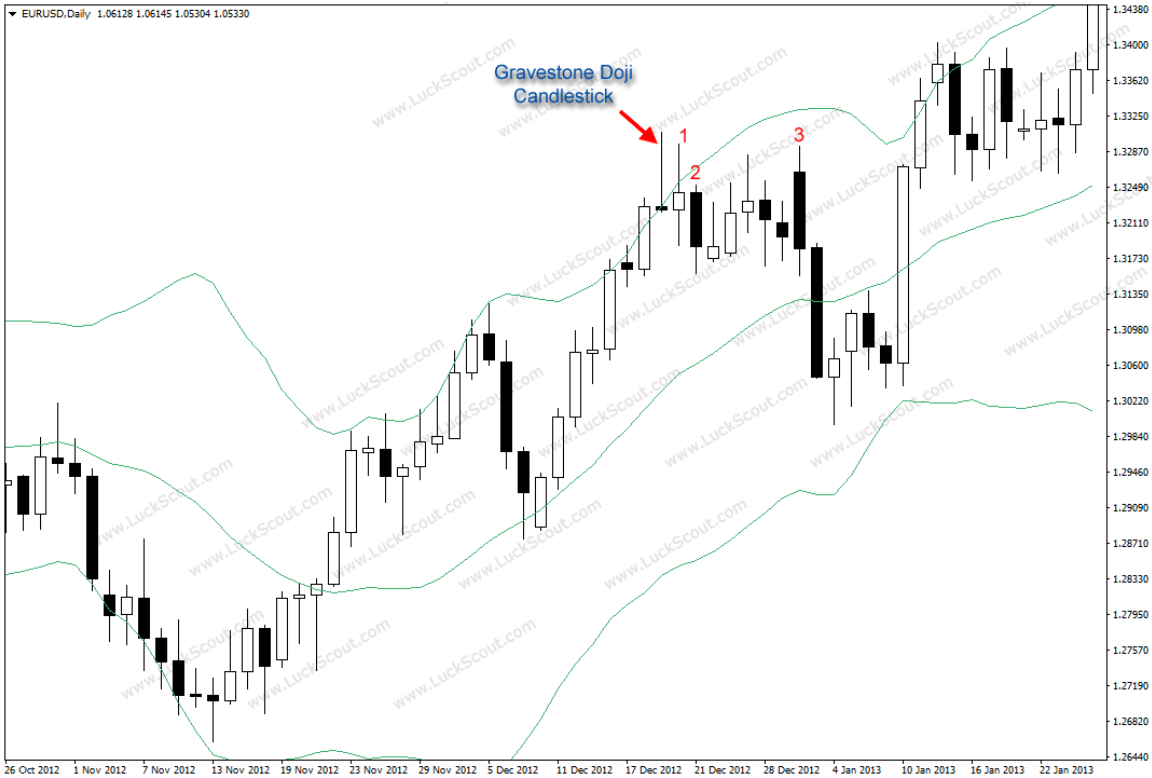
Candlestick #2 formed a bearish body but its lower shadow which is relatively long, reflects the bulls' pressure. It means bears haven't taken the full control yet, and so the sell signal has to be ignored at least for now.

None of the next candlesticks also confirmed the formed Gravestone Doji candlestick until candlestick #3 finally did it and the short trade setup or sell signals was formed. Although a downtrend didn't form after this short trade setup, the price went down for over 180 pips, which means how meaningful a Gravestone Doji and the confirmation candlestick can be for traders.

Combination of Gravestone Doji Candlestick and Bollinger Bands

Bollinger Bands is a strong indicator that can help you distinguish the strength of the candlestick patterns and signals. A strong Bollinger Upper Band breakout for a Gravestone Doji means a stronger reversal signal.

Below, is the same chart you saw above, after adding Bollinger Bands. As you can see, our Gravestone Doji candlestick's upper shadow has broken out of Bollinger Upper Band strongly. Almost the whole upper shadow is formed out of Bollinger Bands. Most part of the next candlestick upper shadow has broken out of the upper band also.



What Makes the Gravestone Doji a Stronger Signal?

There are few factors that make a Gravestone Doji candlestick a stronger reversal signal. Keep in mind that when the signal doesn't look strong enough, you have to ignore it.

Upper Shadow's Length

The longer the upper shadow of the Gravestone candlestick, the stronger the reversing power and bearish pressure. It is the same with all the other kinds of candlesticks including Doji.

A long upper shadow means when the candlestick has been forming, bulls had the control and took the price up. But before the candlestick close, bears took the control and took the price all the way down, and so a long upper shadow formed. Therefore, a long upper shadow means bears have been strong enough to take the price control and take it down.

When the upper shadow is too long and strong, specially when it has strongly broken out of Bollinger Upper Band, the reversal signal will be much stronger. If such a Gravestone Doji candlestick or any other kinds of Doji forms on the chart while the uptrend was already exhausted, then it forms a short trade setup that can be trusted even without a conformation candlestick.

Bollinger Upper Band Breakout

Bollinger Upper Band breakout is also an important factor that makes the reversal signal even stronger. The stronger the Bollinger Upper Band breakout, the stronger the reversal power of the Gravestone Doji.

Confirmation Candlestick

Confirmation is a must to trust the Gravestone Doji candlestick as a strong short trade setup and reversal signal on a bull market. The confirmation candlestick has to be a reasonably long bearish body. Of course when the confirmation candlestick's body becomes too long, then a pull back is more probable because the market is already oversold at least on the shorter time frames. However, only a strong bearish candlestick can confirm that bears have taken the full control and can take the price down.

The Trend's Strength and Exhaustion

A Gravestone Doji candlestick that forms on a strong uptrend has to be ignored because a strong uptrend can't be reversed so easily. So, when the uptrend is fresh and strong and there are several bullish candlesticks formed consecutively, and suddenly a Gravestone Doji forms, you have to be careful not to go short. It is better to ignore such a reversal signal and wait for a continuation signal to go long and follow the uptrend because usually a strong trend will be continued again.

When a reversal signal like Gravestone Doji candlestick forms on an uptrend which is already exhausted and has been moving sideways for a while, while there is a strong Bollinger Upper Band breakout formed by the Gravestone Doji upper shadow, and also a strong bearish candlestick has formed as the confirmation, then you can trust the reversal signal and go short. Sometimes, such a reversal signal can be the beginning of a strong downtrend.

21) Doji Candlestick with Bollinger Bands Are Good Trading Tools

Doji is the most famous candlestick among all different kinds of candlesticks and Doji Star is the most famous Doji pattern.

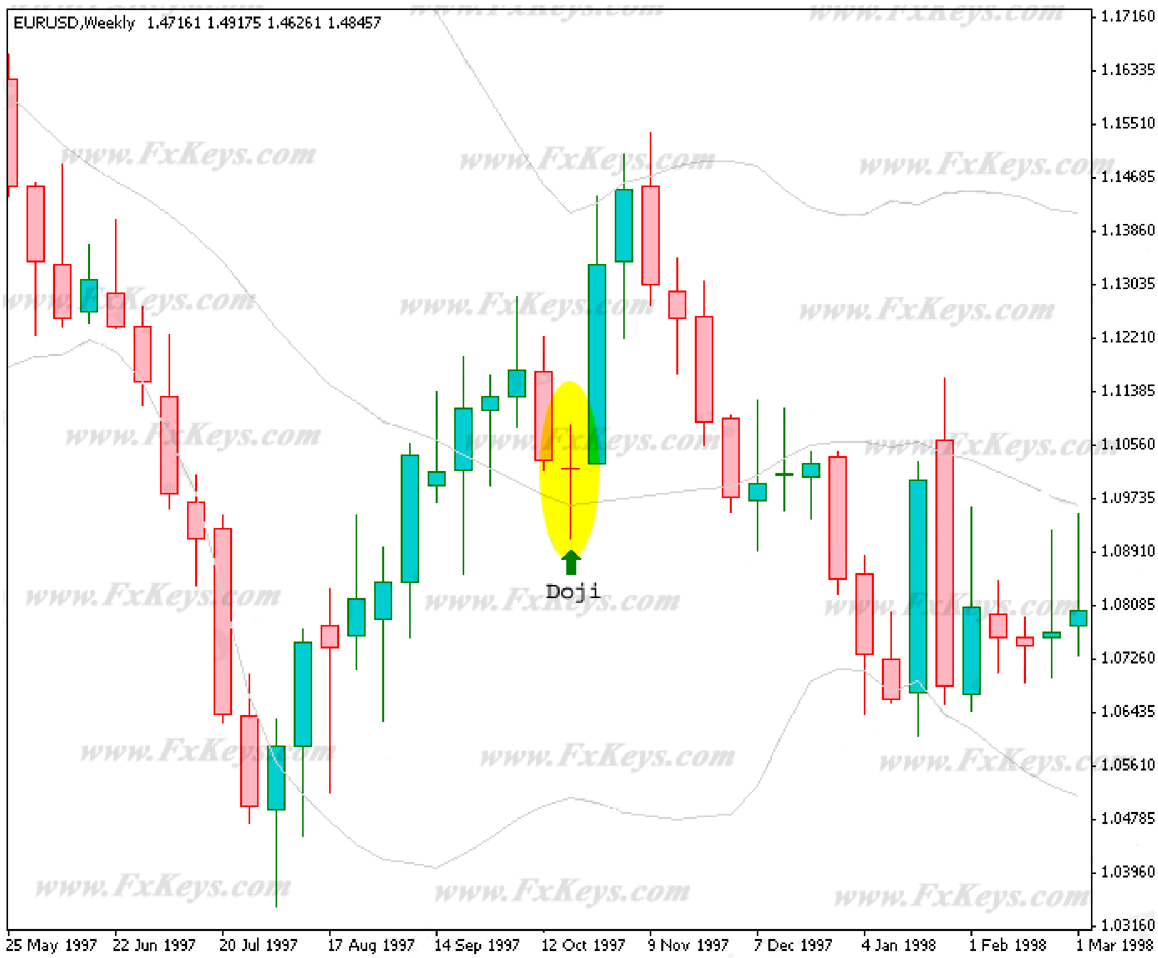
Candlesticks are the only real time technical analysis indicators. All the other indicators used in technical analysis are lagging indicators. Candlesticks are the only indicators that reflect the psychology of the markets big participants, buyers and sellers. There is no other indicator with such an ability and efficiency.

I trust you already know candlesticks' anatomy. If not, please click here and learn it. Before you read the rest of this article, you should know what bullish and bearish candlesticks are; what body and shadow mean; what open, close, high and low prices are.

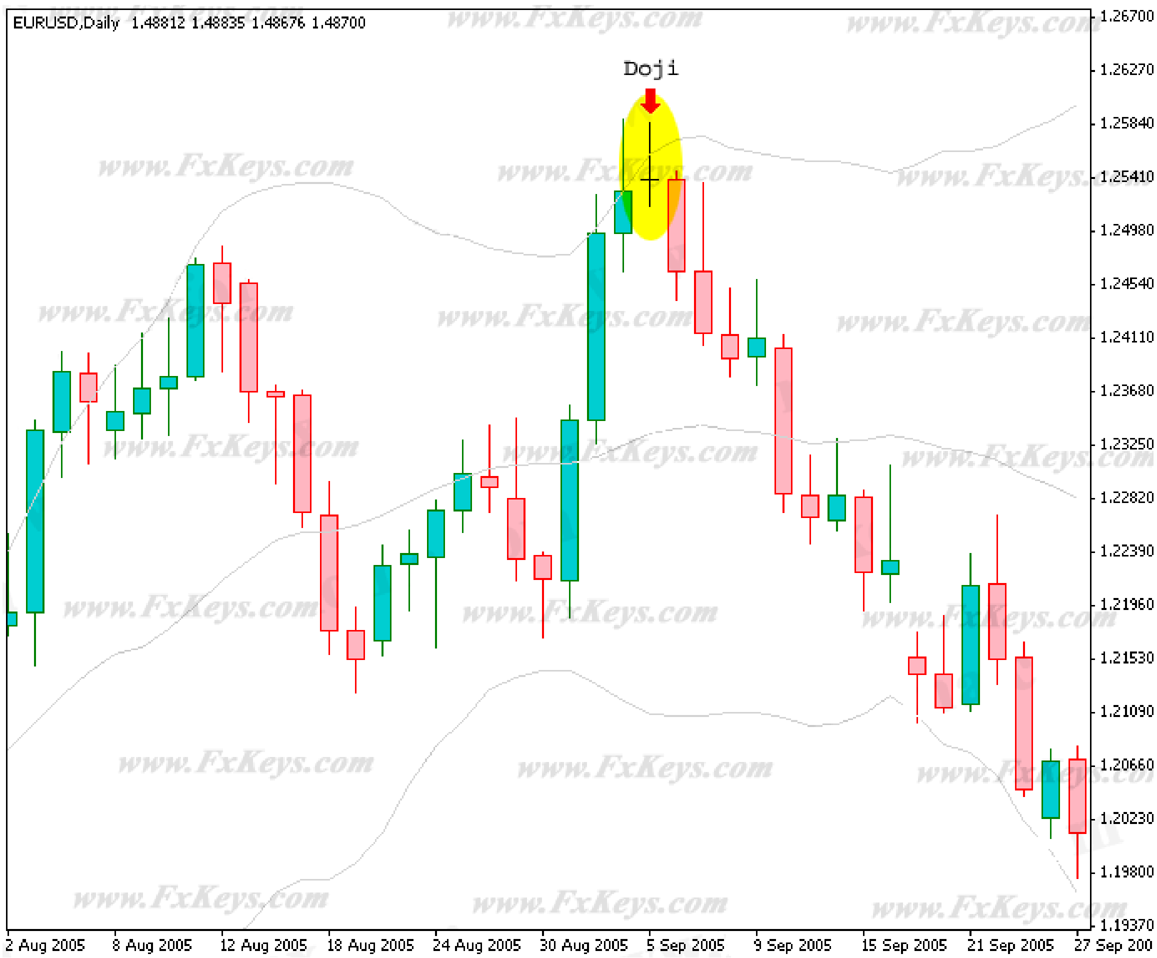
What Is the Doji Candlestick?

Doji is a kind of candlestick that its open and close prices are the same or very close to each other, and so it has no or a very small body. However, a Doji candlestick can have long shadows. Lets take a look at some examples to know Doji candlesticks better and then I tell you how you can trade using Doji patterns and signals with the help of Bollinger Bands as a supplement indicator.

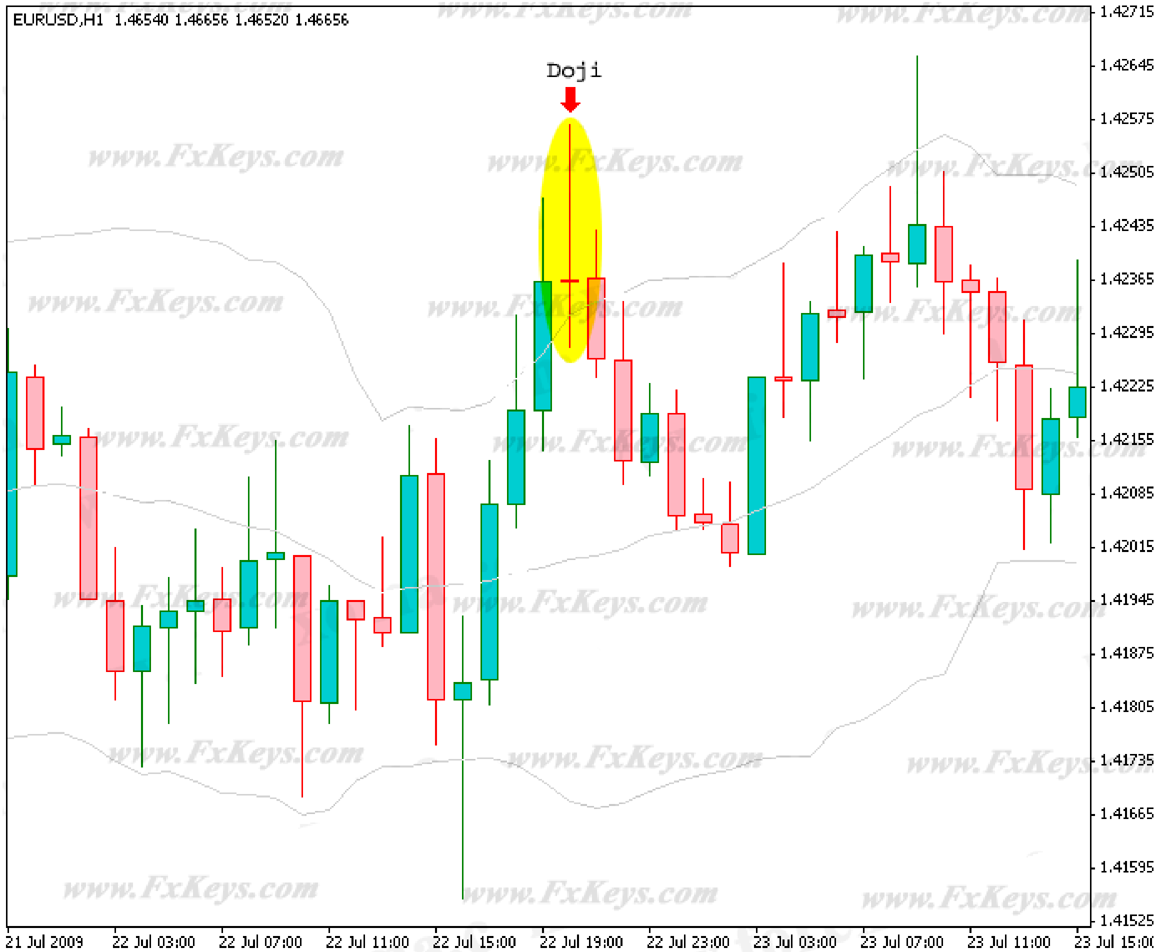
The below chart, shows a Doji candlestick on EUR/USD weekly chart. As you see it has no body, because its open (1.1020) and close (1.1019) prices are almost the same. It is amazing, isn't it? It took one week for this candlestick to mature, but it closed exactly where it was opened 7 days ago. What does it mean? We will talk about it later. Let's see some examples for the Doji candlestick first.



Below, is another Doji candlestick on EUR/USD daily chart. This candlestick's open and close prices are exactly the same as well:



Another Doji candlestick on EUR/USD one hour chart... This candlestick's open and close prices are almost the same too.



Different Kinds of Doji Candlestick

There are a few kinds of Doji candlestick: Rickshaw Man Doji, Gravestone Doji and Dragonfly Doji.

Rickshaw Man Doji Candlestick

In Rickshaw Man, the open and close prices are placed at the middle. This kind of Doji is called Rickshaw Man by Japanese traders, because when you look at a Rickshaw man from the front side while he walks, you will see something like the below image:

Gravestone Doji Candlestick

Gravestone candlestick is another kind of Doji that has no lower shadow. It means its open, close and low prices are the same. If you look at a gravestone from side, you will see something like the below image, but this kind of Doji is called gravestone because of a different reason, not because it looks like the side view of a gravestone. As a reversal signal, Gravestone Doji forms at the top of a bull market. In the past that traders were not able to sell short and buying long was the only way to make money, a Gravestone Doji at the end of a bull market was the end of making profit for traders. It was the point that they had to "bury" their hope of making any more profit. So they called it Gravestone:

Dragonfly Doji Candlestick

An inverted Gravestone Doji is called Dragonfly Doji. A typical Dragonfly Doji has no upper shadow.

Doji can have many other shapes. Some of them are called Long Legged Doji candlesticks because they have extremely long shadows. The Doji on EUR/USD one hour chart above, is a Long Legged Doji. The longer the shadows, the stronger the signal.

Sometimes Doji has a small bullish or bearish body, because its open and close prices are not exactly the same.

Doji Candlestick Patterns

Doji candlestick forms some important patterns. Memorizing the name of the candlesticks and their patterns is not that important. We just need to be able to recognize the signals. Sometimes you cannot find any name for a candlestick pattern, but still you know that it has formed a good and strong trade setup or signal.

There is an important Doji pattern which is called Doji Star. There are two kinds of Doji Star: Evening Doji Star and Morning Doji Star.

A Doji Star forms at the top of an uptrend or bottom of a downtrend. A gap between the Doji Star and its previous candlestick is effective on the strength of the signal that the Doji Star candlestick forms.

Evening Doji Star

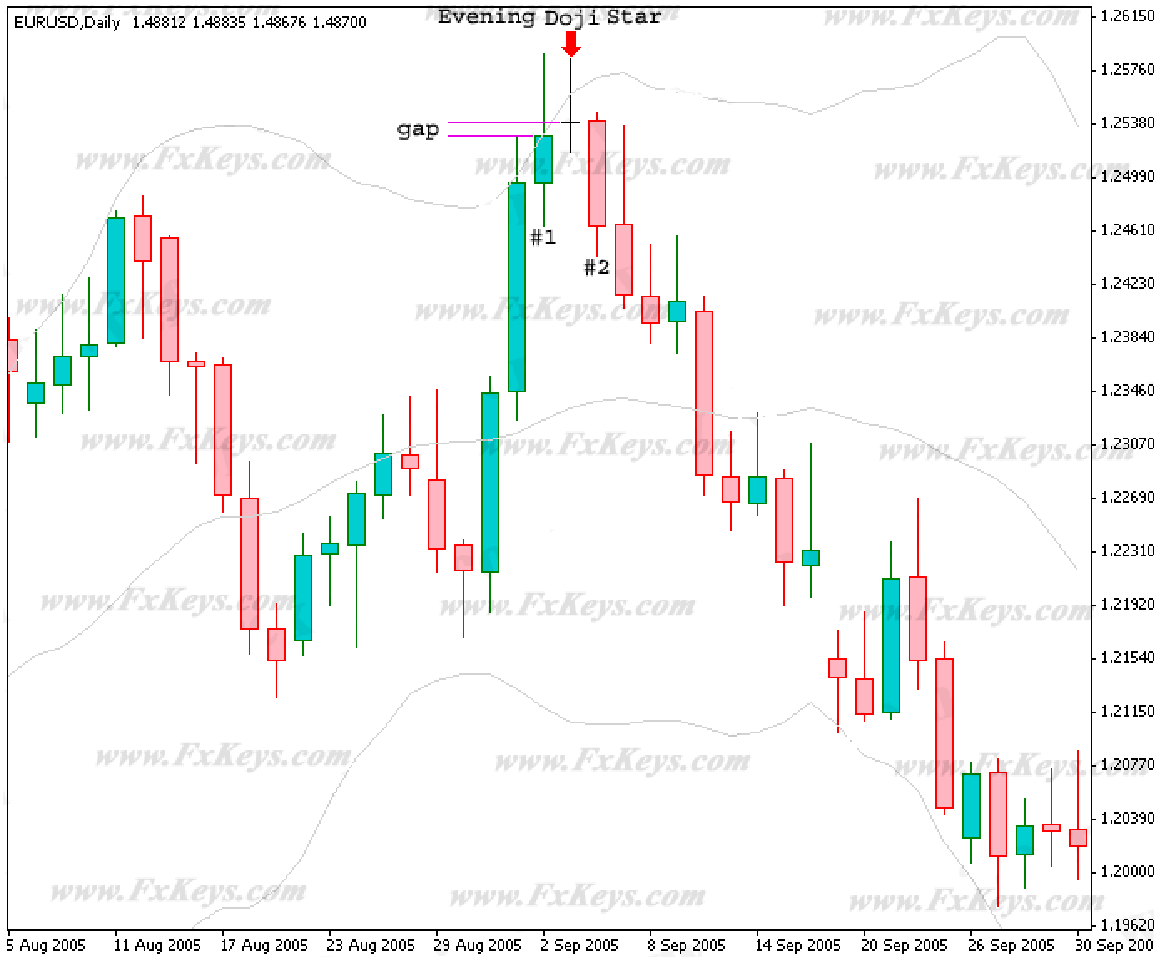
When a Doji Star forms at the top of an uptrend, it is called Evening Doji Star, but when it forms at the bottom of a downtrend, it is called Morning Doji Star.

Let's look at the EUR/USD daily chart again. As this candlestick is formed at the top of an uptrend or we'd better to say at the end of of bull market, it is an Evening Doji Star.

Why is it called evening...?

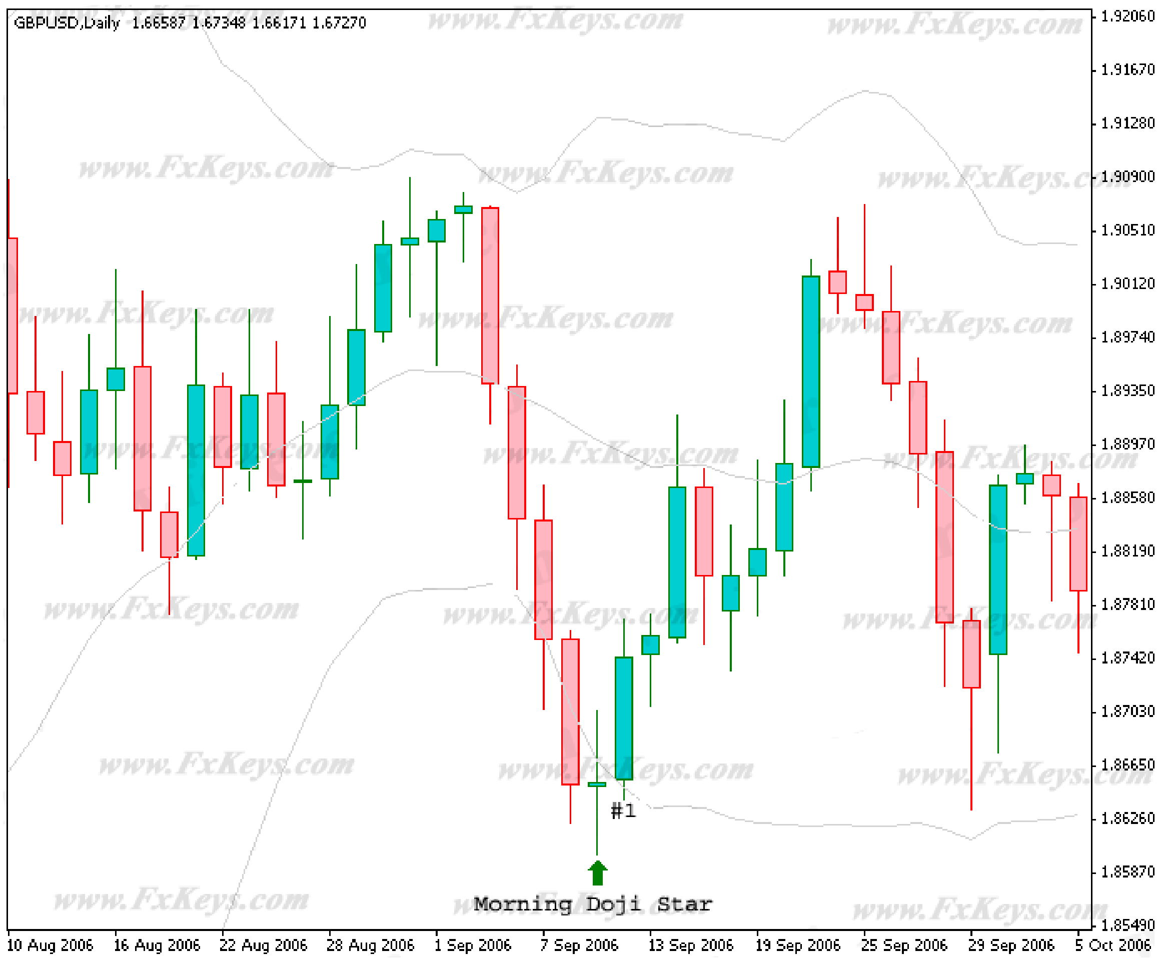
It goes back to the time that stock traders could buy long only and they could not sell short. So they loved to see uptrends or bullish movements, but when a reversal signal formed at the end of an uptrend or on a bull market, they got upset because it meant that they had to wait maybe for a long time to have another bullish movement to go long and make some money. So having a reversal signal on a bull market was like the end of the day which is the end of the daily business and making money. That is why a Doji Star on a bull market is called Evening Doji Star.

As you see on the below chart, there is a gap between the Doji Star and its previous candlestick (#1). This gap makes the Doji Star signal stronger. The bigger the gap,the stronger the signal (we will talk about the meaning of Doji candlesticks and the way we can trade using the signals they form.) Candlestick #2 is a confirmation candlestick. To trade using a Doji candlestick signal, we should have a confirmation which is usually the next candlestick. We will explain about it later in this article.



Morning Doji Star

A Doji Star that forms at the bottom of a bear market is called Morning Doji Star. On the below chart which is the GBP/USD daily chart, a Morning Doji Star is formed at the bottom. As you see, this candlestick has a small body, because its close price is a little higher than its open price, but it is still a Doji. Look at the next candlestick (#1) which is a big bullish candlestick and is the confirmation candlestick that I talked about. GBP/USD went up for over 320 pips after the candlestick #1 was closed.



What Does Doji Mean?

Doji candlestick forms when the market is indecisive. Imagine a Doji candlestick on a weekly chart. At the beginning of the week that the candlestick opens, it goes up or down throughout the weekdays, and forms its upper and lower shadows, but when the week is about to become over, the price gets closer to the market price at the beginning of the week, and finally our candlestick closes with the same or almost the same market price the market opened at the beginning of the week.

It means the market has not been able to take any special direction during the week and after a lot of struggle, it went back to where it was at the beginning of the week. This indecision happens while the market has been going up or down at least for a few candlesticks (weeks). So the market is not sure if it should keep on following the same direction, or it should reverse and take the opposite direction.

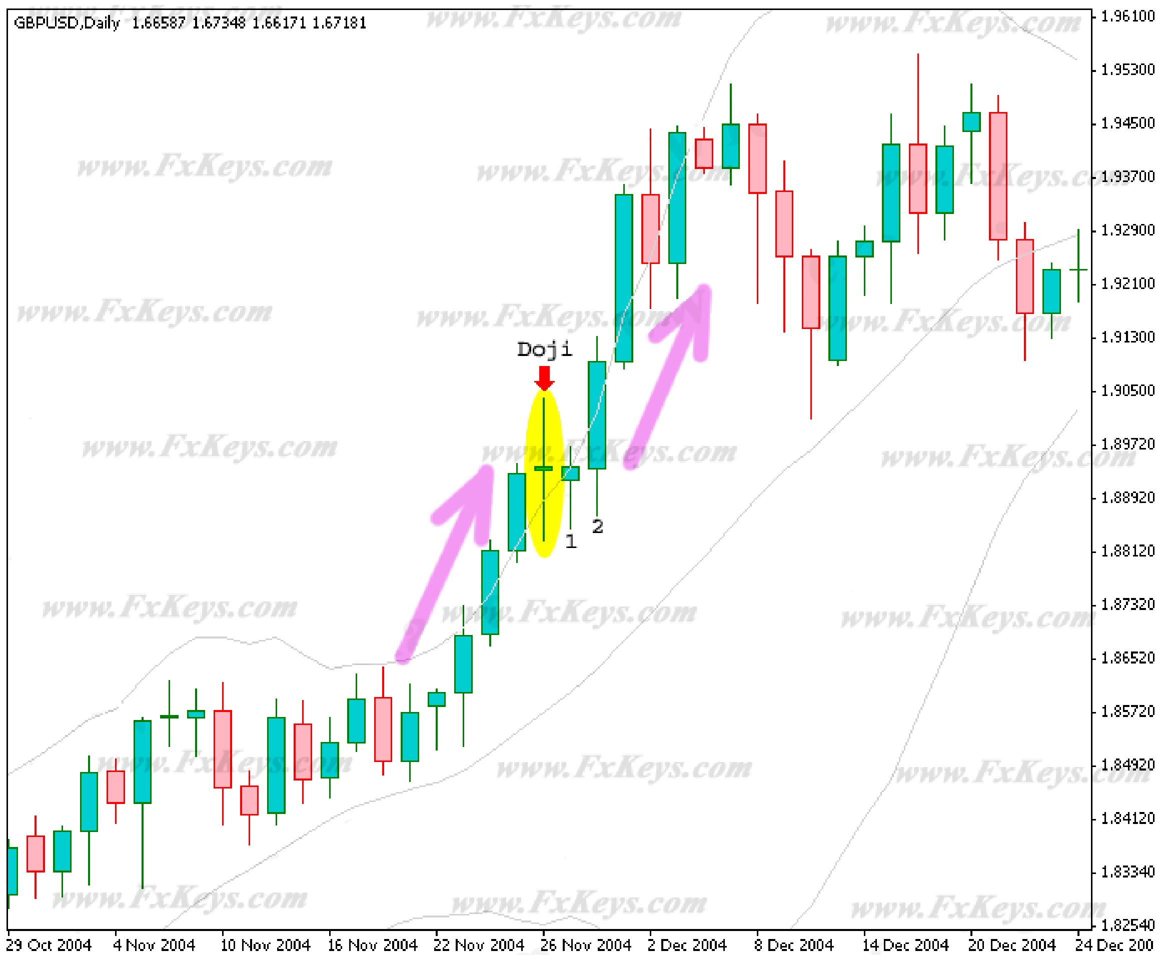
Why Does This Happen?

Markets move and prices go up and down because of two things: supply and demand or selling and buying.

When there is more buying than selling, market is bullish and price goes up and visa versa (bearish market). So price goes up when most people decide to buy and it goes down when most people decide to sell. When the price goes up and down for a period of time, but then goes back to the level that it was at the beginning of the period, it means buyers and sellers or bulls and bears have the same power and none of them is stronger. When this happens at the end of a bull market that there was a stronger buying activity, it means buyers (bulls) do not want to buy anymore.

They stop buying, and at the same time some of them start selling to collect the profit they have made. So the price will not go up anymore and it moves around the same level for a while. It is when a Doji candlestick forms. Now, if more buyers decide to sell, the price will go down and a reversal forms. It is when the next candlestick after the Doji will forms (the confirmation candlestick). If its direction is against the direction of the market before the Doji candlestick formation, it means market wants to change its direction. If buyers decide to keep on buying again, the price will continue to go up like it was used to be before the Doji candlestick formation.

A Doji candlestick is a reversal signal, but it needs confirmation. Its confirmation is the next candlestick, or sometimes one of the next a few or few candlesticks. If the next candlestick follows the direction that the market had before the Doji formation, it means no reversing will happen and the Doji should be ignored even if it is too strong. As you see on the below chart, the a candlestick closed as a Doji Star on GBP/USD daily chart, but the next candlestick (#1) that formed after the Doji Star was still a bullish candlestick and the candlestick after (#2) continued the previous direction strongly. So the Doji Star was not confirmed by the next candlesticks and had to be ignored as a reversal signal.



A reversal signal will be formed, if the next candlestick forms against the market direction. Like the first candlesticks on GBP/USD and EUR/USD daily charts and EUR/USD one hour chart that you already saw at the beginning of this article.

Therefore, Doji is not a reversal signal by itself. To form a reversal signal, Doji needs to be followed by a candlestick that its direction is against the direction that the market had before the formation of Doji candlestick.

How to Trade Doji Candlestick and Bollinger Bands®

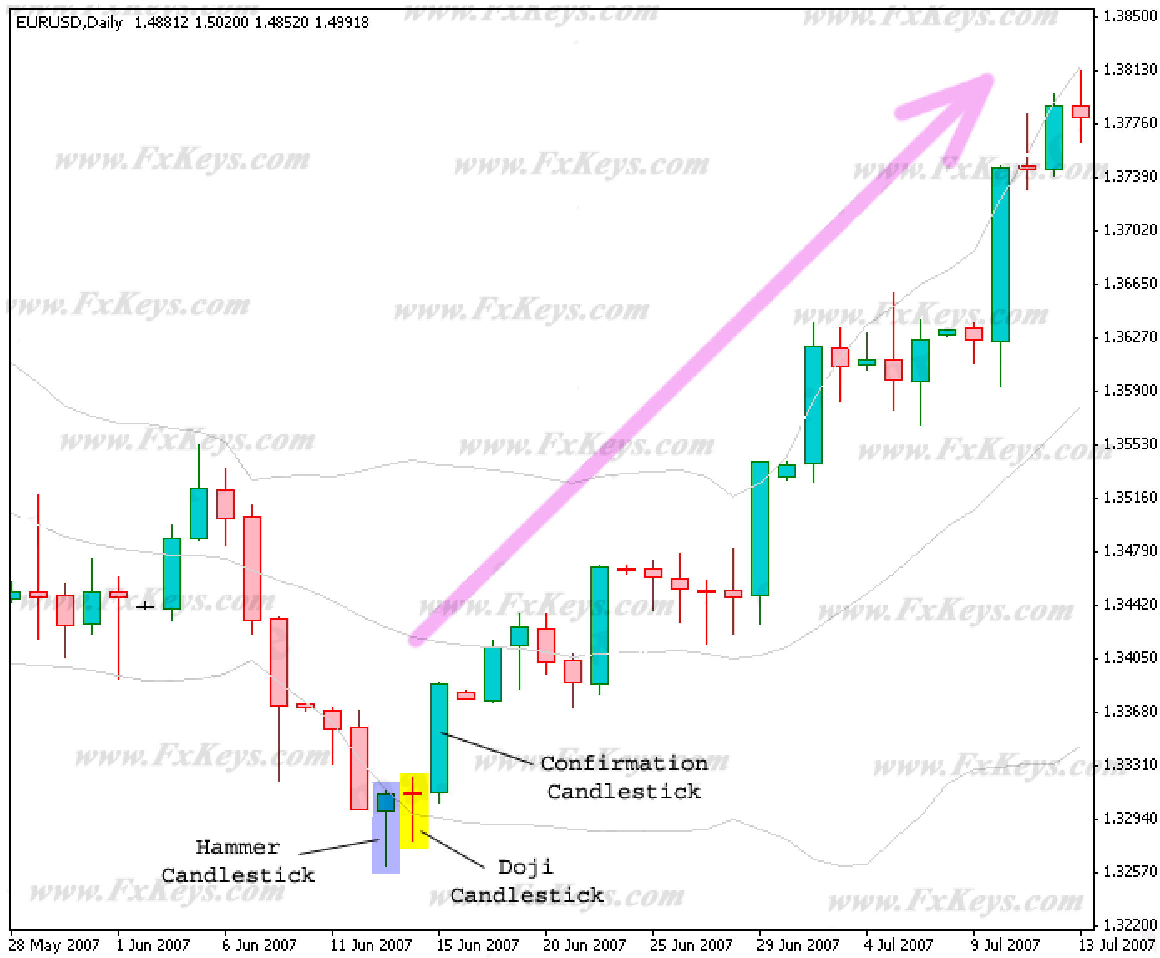
Doji candlestick signals and patterns are sometimes tricky. If we add another tool to our charts, we can avoid many of the false signals and nothing is better than Bollinger Bands to help us do that. As you can see, we already have the Bollinger Bands on all of the above examples.

The secret is in the Bollinger Bands breakout. The Doji candlestick and preferably its previous and next (confirmation) candlesticks should break out of the Bollinger Upper Band, in case of Evening Doji Star, or the Bollinger Lower Band, in case of Morning Doji Star. We will talk about the Bollinger Middle Band also and the way you have to deal with it. Let's take a look at some examples now.

On the below chart, a Hammer candlestick is formed completely out of Bollinger Lower Band. We are talking about Doji, but on the below example, the reversal signal has become stronger by the Hammer the formed previously. A Doji is formed after the Hammer.

As you see, the lower shadow of Doji has broken out of Bollinger Lower Band. However, this breakout is not strong enough and if there was only the Doji there, we have to ignore the signal, but as I said, that Hammer which is completely formed out of Bollinger Middle Band, has strengthen the signal. Then a strong confirmation candlestick formed after the Doji and as you see EUR/USD went up for hundreds of pips after the confirmation candlestick. The long position should be taken after the confirmation candlestick close. Stop loss should be placed several pips below the lower shadow of Doji, or in this case, below the lower shadow of hammer. The first target should be the same size as the stop loss size at least. You can collect a portion of your profit at the first target and move your stop loss to breakeven. Your second target can be twice of the stop loss size at least.

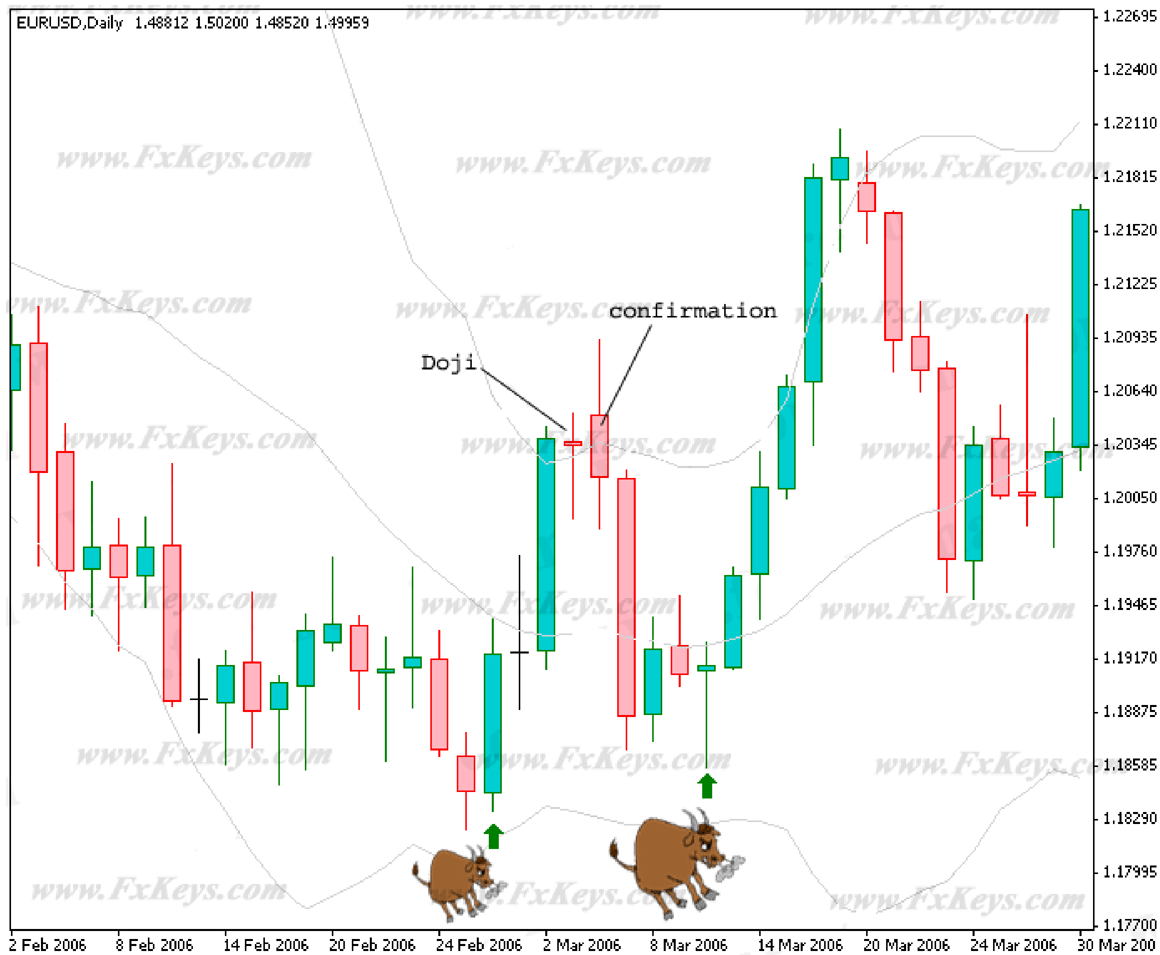
I show you some examples from the signals that worked and then will show you some false signals and the way you can avoid them.



The below chart shows a Doji formed on EUR/USD daily chart. As you see, its lower shadow and also its small body are formed out of Bollinger Upper Band.

This Doji formed a Friday. The next candlestick opened with a gap up on Sunday afternoon and went up strongly, but then it went down and closed below the Doji close price and also the Bollinger Upper Band. The upper shadow of the confirmation candlestick and about 50% of its body is out of Bollinger Upper Band. This is a strong signal. We could go short after the confirmation candlestick close, and our stop loss could be placed few pips above the confirmation candlestick upper shadow. Our second target could be easily triggered the next day.

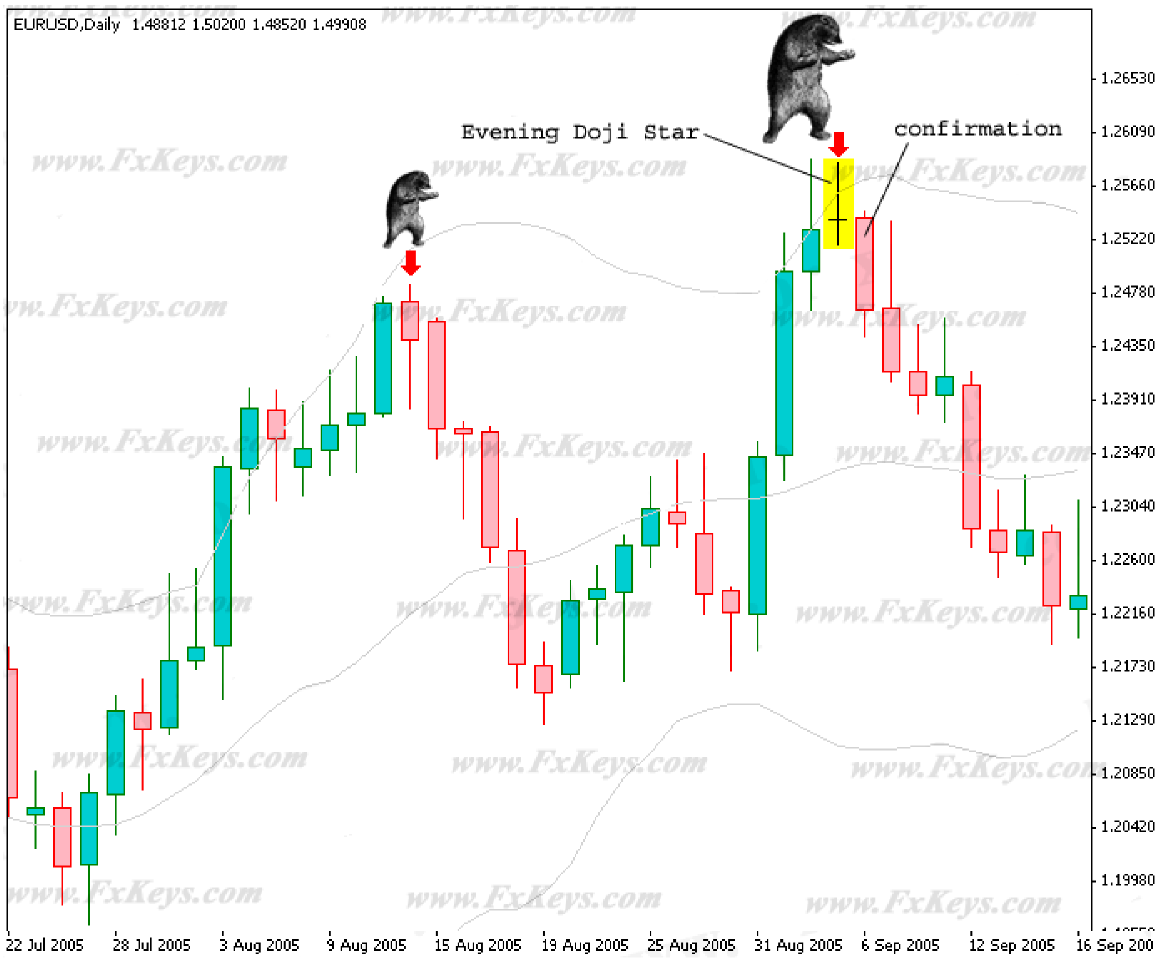
But the question is why it went down only for one candlestick after the confirmation. The reason is that market was already oversold, because it has been going down for such a long time. There were two strong bullish candlesticks already formed. Therefore, market had already changed its direction. Taking a short position right after such a strong bullish movement is not a good idea.



On the below chart, the previous candlestick and also the Doji itself have broken out of Bollinger Upper Band. The Doji breakout is not strong enough, however, the previous candlestick breakout is strong. But this is not enough to go short. The confirmation candlestick encourages you to take a short position and place your stop loss few pips above the Doji or its previous candlestick upper shadow. What if you are wrong? Never mind! Your stop loss is there.

Why did this signal take the price down strongly, whereas in the previous example (above) it didn't work the way it was expected?

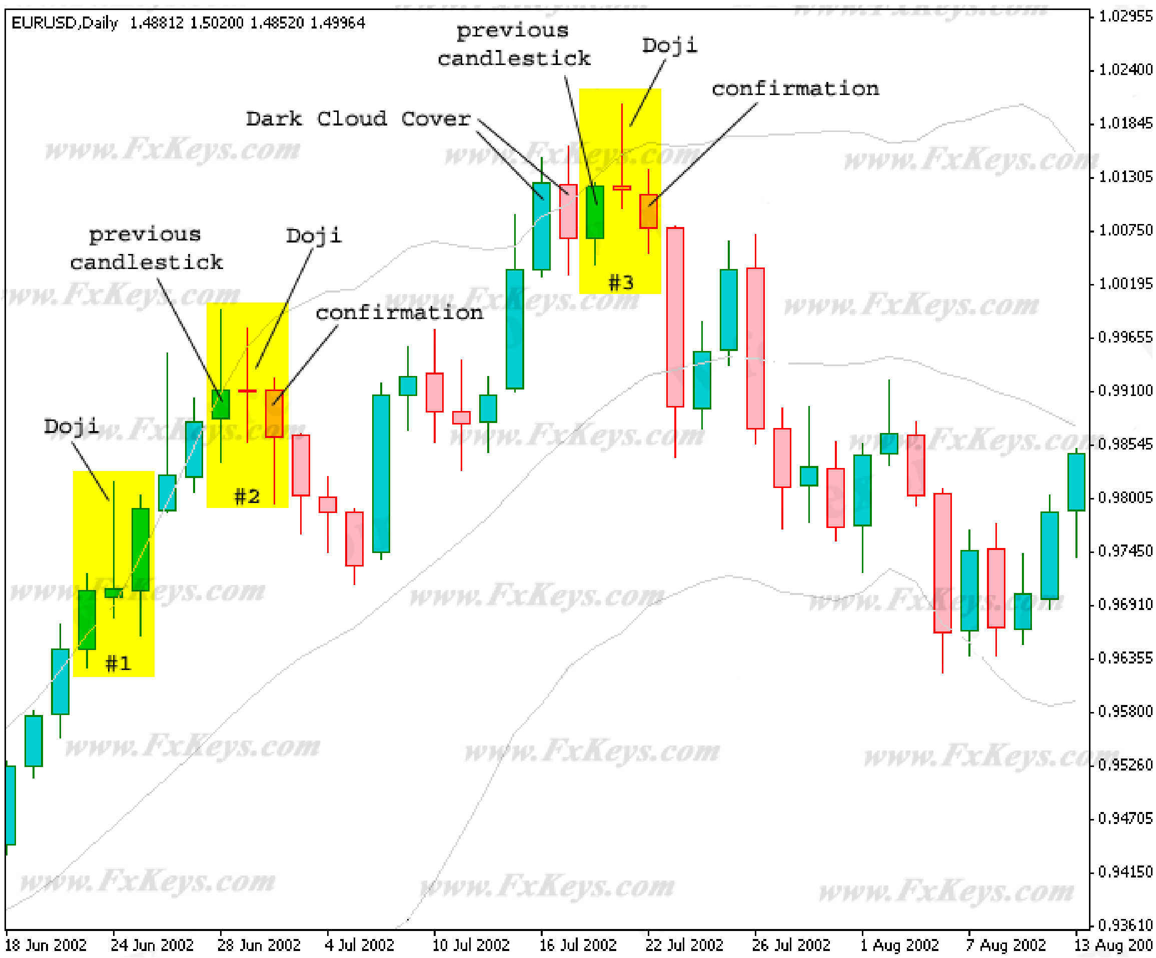
I explained about the previous example. The market was oversold already and some bullish signals were formed. But Doji Star sell signal worked in the below example because the market was overbought and another sell signal was already formed 16 days before. That signal tells us that bears are getting stronger and they are able to take the price down.



The below screenshot shows three signals. The first one is the signal that has to be ignored. Although the Doji and its previous and next candlesticks have strong breakouts, the confirmation candlestick is strongly bullish. So you always have to wait for the confirmation candlestick to close before you enter the market.

The second signal is a good signal, but I would ignore it. I do not take the first reversal signal that forms at the top of a bull market or bottom of a bear market. The reason is that usually markets follow the same direction after the first reversal signal.

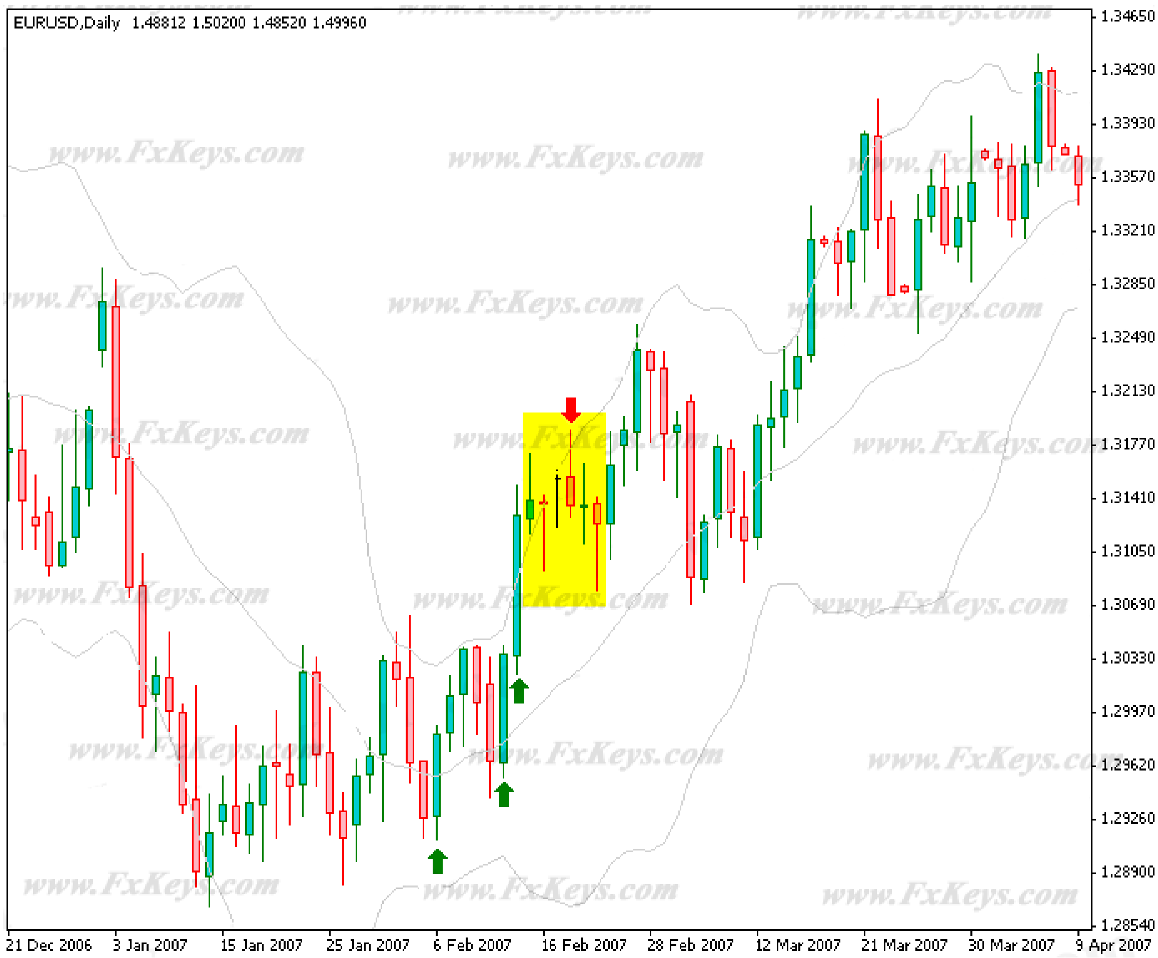
The third signal is an ideal reversal signal. It is an Evening Doji Star formed on EUR/USD daily chart. Its previous candlestick doesn't have anything to say, but two candlesticks before formed another kind of candlestick patterns that is called Dark Cloud Cover. So after the formation of the confirmation candlestick, we could trust the signal to go short and place our stop loss above the Doji upper shadow.



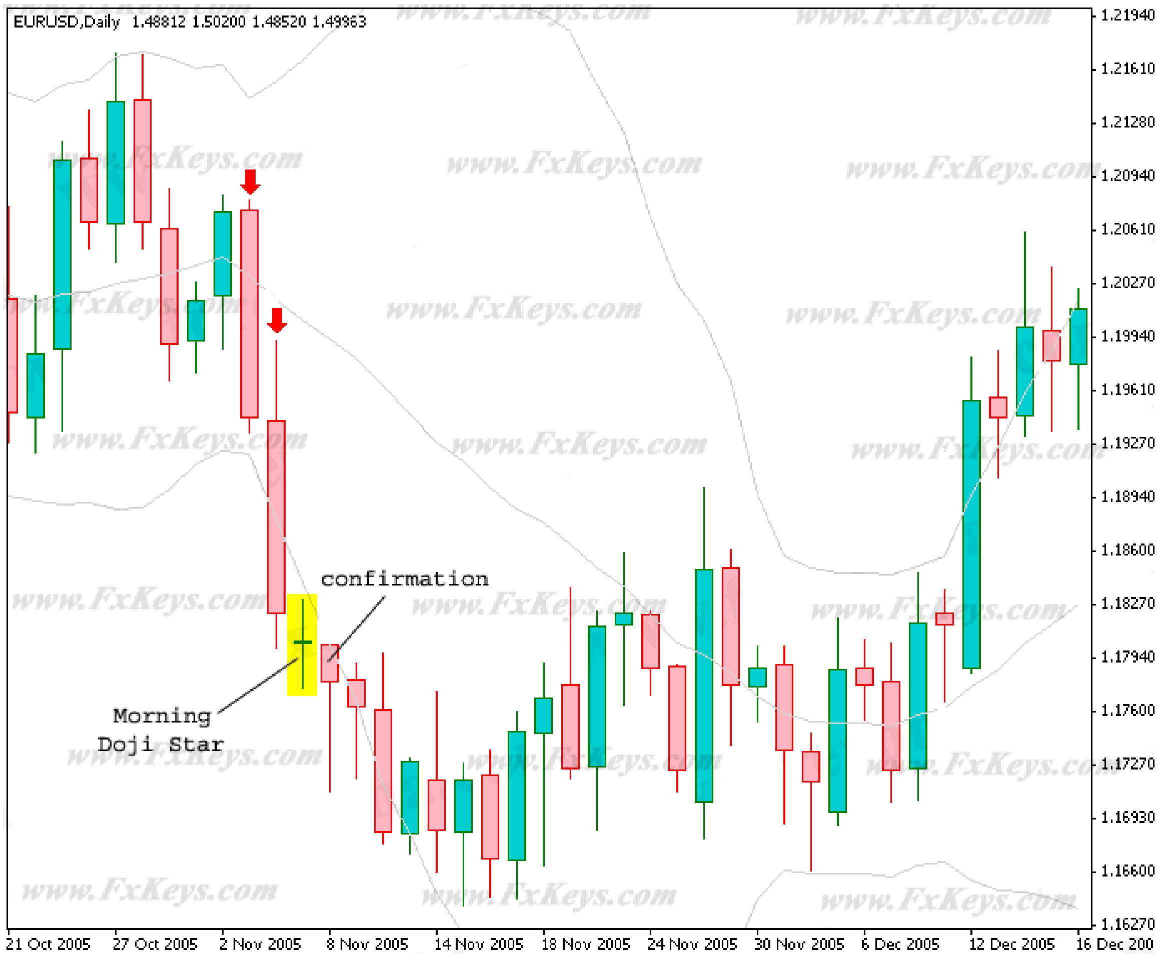
It is time to ask me whether I trade these signals or not. I trade the strong candlestick signals with strong Bollinger Band breakout. Both the candlestick pattern and the Bollinger Band breakout have to be strong.

Now let's see some false signals or some signals that didn't work the way it was expected.

On the below chart, the signals in the yellow zone are among the signals that we have to ignore (I already talked about the signals that I ignore. This is another example.)



The below chart also shows a Doji signal that has to be ignored. This Doji formed completely out of Bollinger Lower Band on EUR/USD daily chart. Almost half of the previous candlestick also formed out of Bollinger Lower Band. However, the down movement that formed after the Doji, could trigger the stop loss because the next candlestick (confirmation), didn't confirm a reversal signal, but even if it did, it was not a good idea to go long after two huge bearish candlesticks (the red arrows).



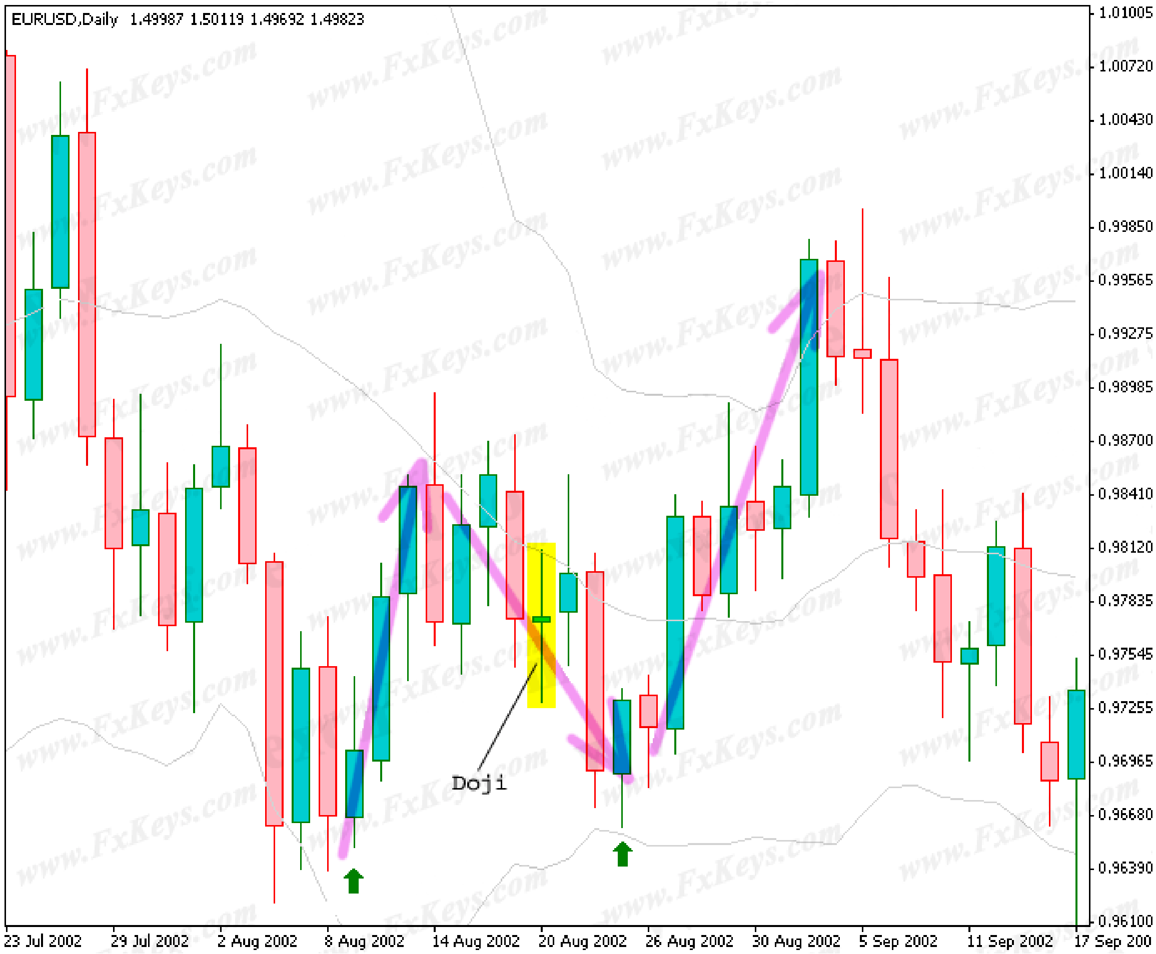
In general, to have a reliable reversal signal, we need something more than a Doji which is the confirmation candlestick. Additionally, Bollinger Bands breakout is very important.

We have to know where the reversal signal is formed. If it is at the middle of a strong bull or bear market, it has to be ignored. The first reversal signal that forms at the top of a strong and fresh bull market or at the bottom of a strong and fresh bear market is not a reversal signal. Indeed, we'd better to consider it as a continuation pattern because the price follows the same route after that.

What About Bollinger Middle Band?

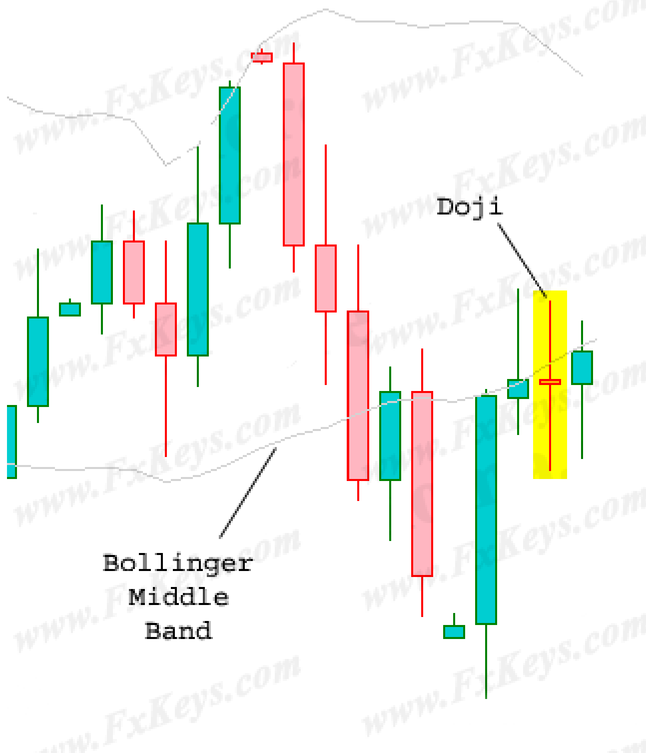
Bollinger Middle Band is a tricky area. You should avoid taking any positions when the price is moving around this area, unless there are enough evidences that help you guess the next market direction.

The Doji on the below chart is not a trading signal. It is just a candlestick that reflects the market indecision. However, an experienced trader knows that the market would break above the Bollinger Middle Band sooner or later, but as it is not clear when, he doesn't take any positions until it really breaks above the Bollinger Middle Band.



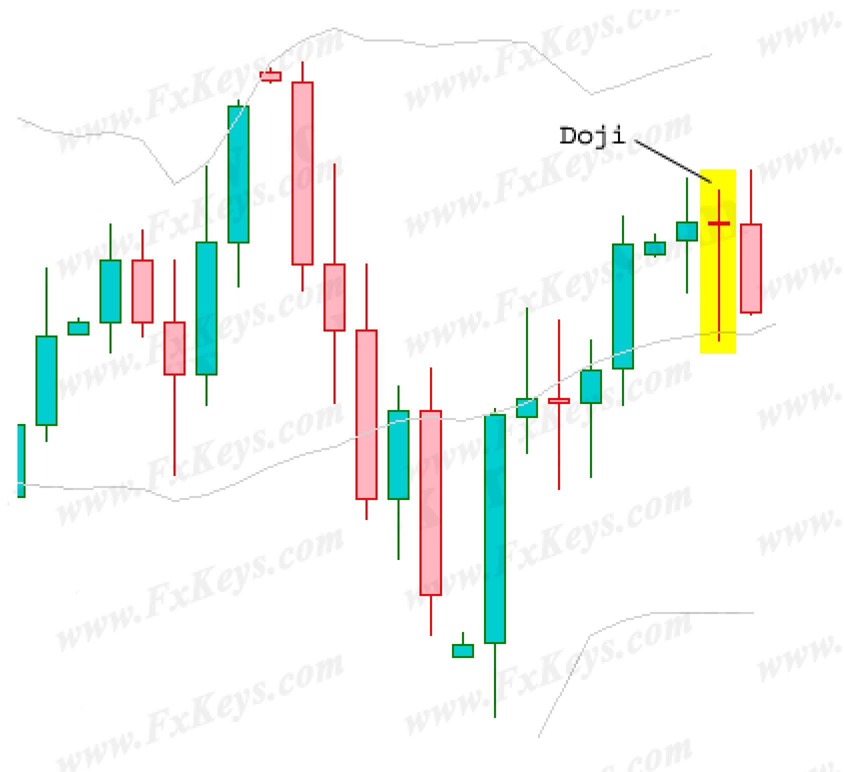
Now, let's have some exercises:

What position would you take after this Doji and its next candlestick?



It is not easy to guess. If you say it will go up because of the long and big bullish candlestick that formed below the Bollinger Middle Band, I would say what about the several bearish candlesticks that formed before. It may go down because it has been going down before and it broke below Bollinger Middle Band and it is just retesting now. So it will go down. Both ideas can be correct.

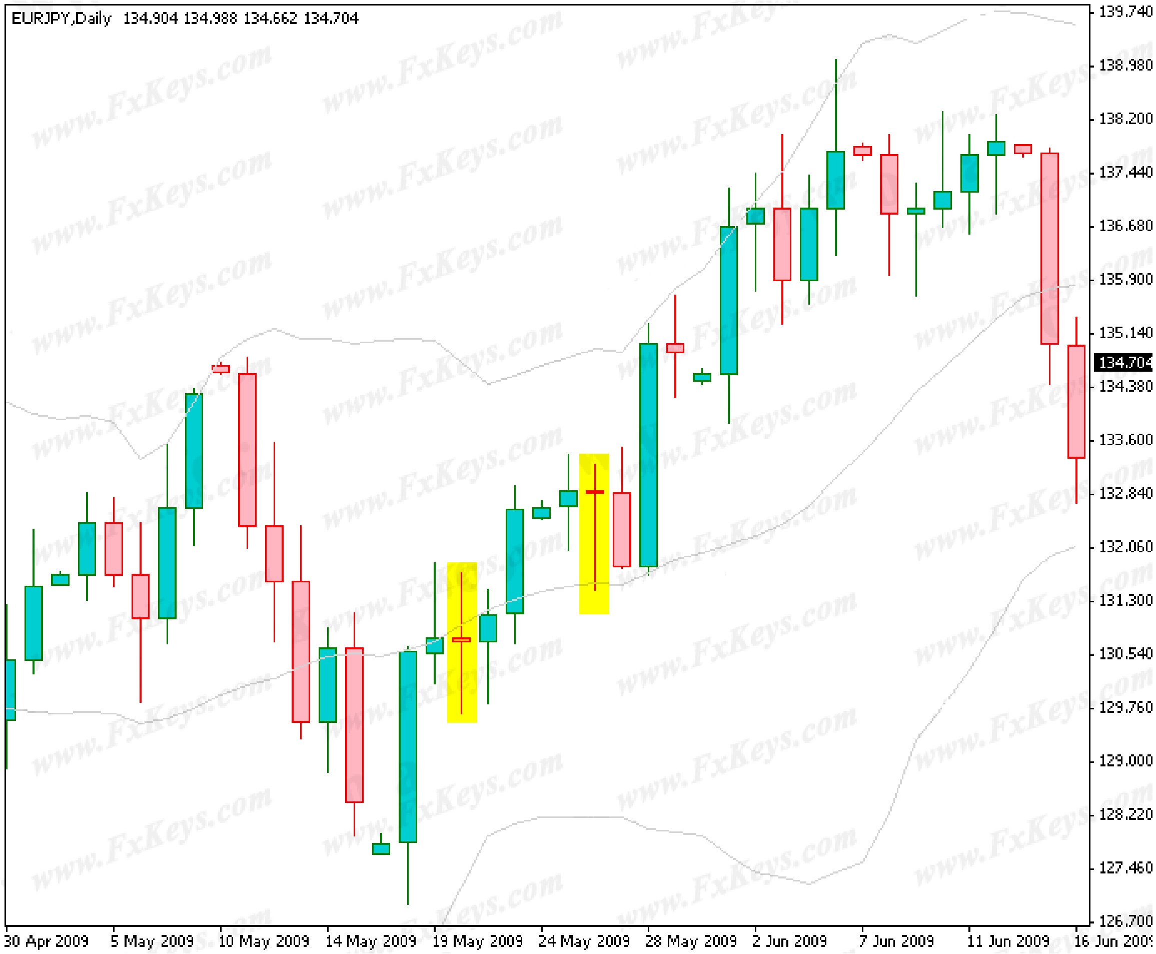
It went up and broke above Bollinger Middle Band, but then went down to retest the Middle Band and formed another Doji there. The confirmation candlestick also is a strong bearish candle. This Doji and its confirmation have formed a good reversal signal. Would you go short now?



I would not because both of these candlesticks are closed above Bollinger Middle Band. Let's see what happened then:

The below chart shows the whole story. One Doji below Bollinger Middle Band and another one above it. Both f them were retesting candlesticks. It is not impossible to guess the market direction when it is around Bollinger Middle Band but it needs more experience.

These two Doji candlesticks are formed on EUR/JPY daily chart.

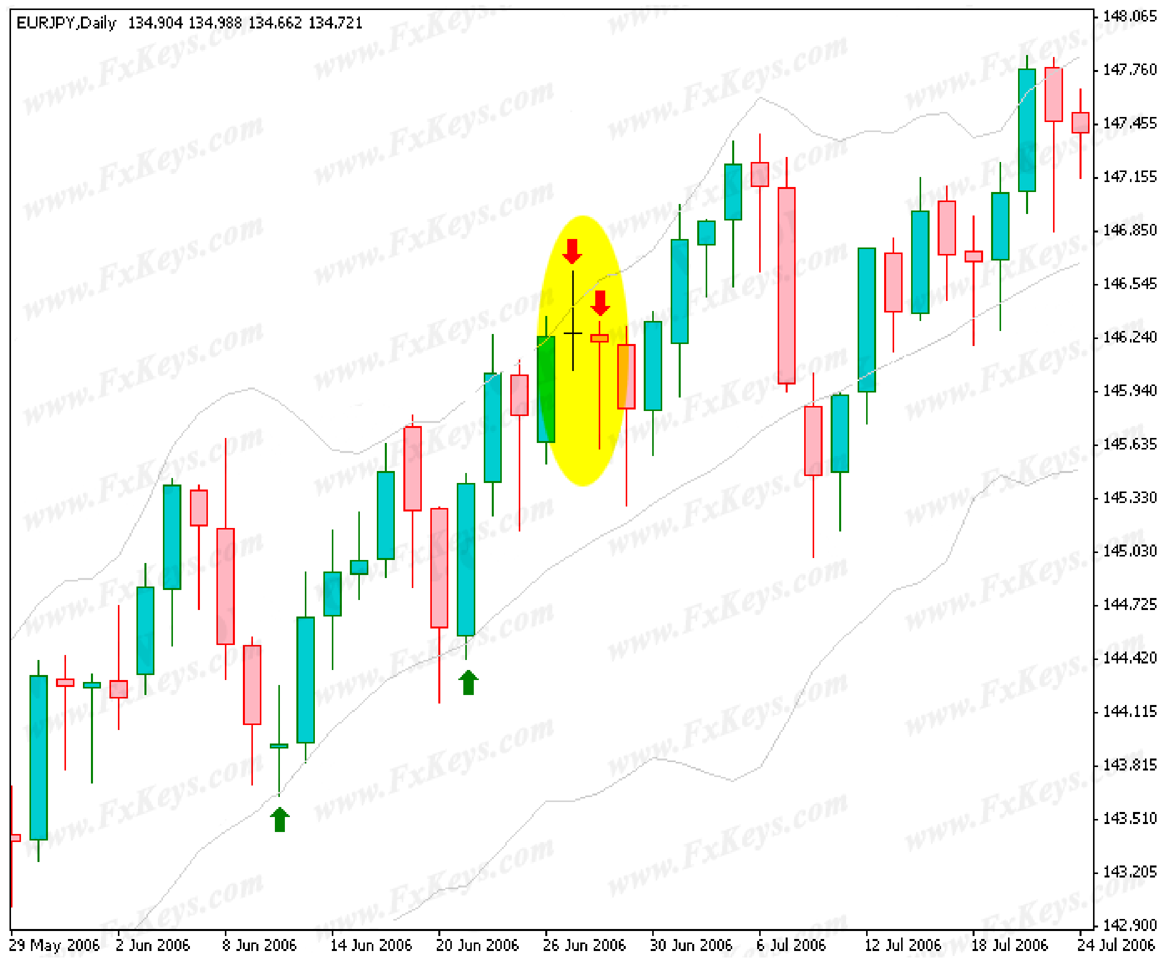


EURJPY,Daily 134.904 134.988 134.662 134.704
139.740
138.980
138.200
137.440
136.680
135.900
135.140
134.704
134.380
133.600
132.840
132.060
131.300
130.540
129.760
129.000
128.220
127.460
126.700
30 Apr 2009
5 May 2009
10 May 2009
14 May 2009
19 May 2009
24 May 2009
28 May 2009
2 Jun 2009
7 Jun 2009
11 Jun 2009

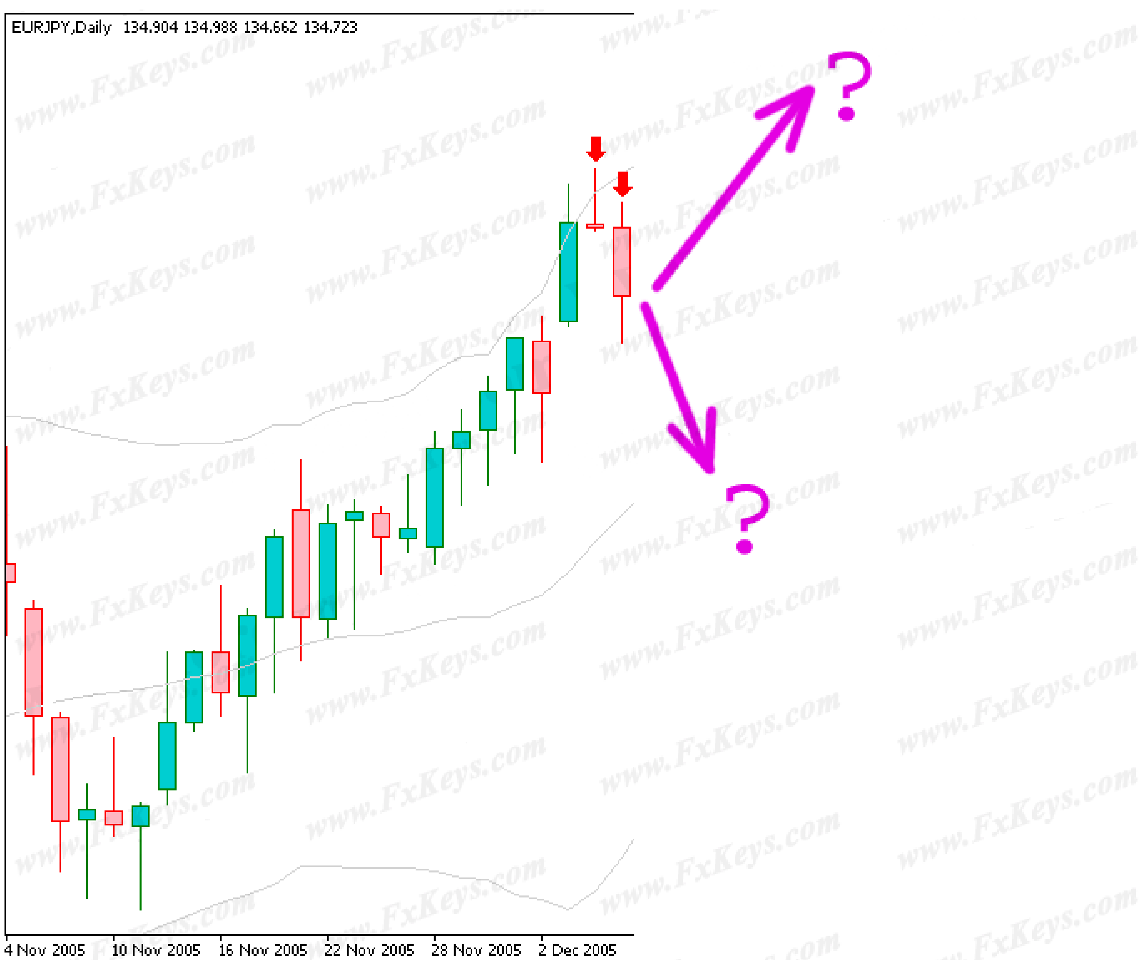
Would You Go Short Here?

I would not, because...

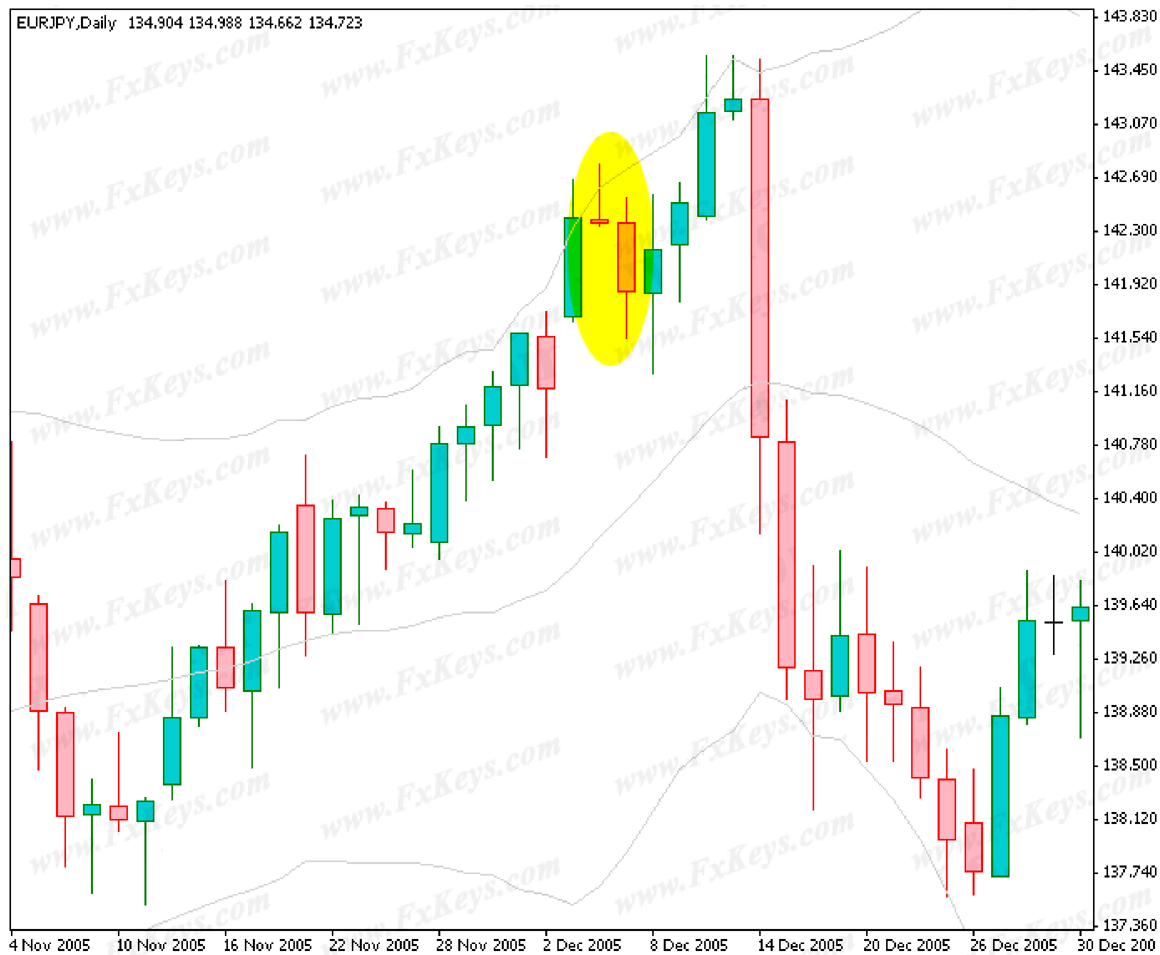
1. The uptrend is strong; 2. the Doji candlestick and its Bollinger Band breakout is not strong enough; 3. the confirmation candlestick has a long lower shadow which means there are still a lot of bullish pressure.



Another question:



It looks like a relatively good signal to go short, but it wouldn't work. The Bollinger Upper Band breakout was not strong enough at all. Also, both the Doji and confirmation candlesticks are too weak to be known as a reliable reversal signal on such a strong bull market. Above all, the signal was the first sell signal after a strong bull movement. So we should have ignored it.



A Doji candlestick can be known as a strong reversal signal when it is strong enough itself and it is strongly confirmed by the next or one of the next a few candlesticks. A Bollinger Bands breakout is a must to trust a Doji candlestick signal and to filter out the false signals.