JAPANESE
Trading Systems

# Class 1: Introduction

In This Lesson:

- History of Japanese Trading

- Candlesticks meet Clouds

- Introduction to Cloud Charts

- How to Build a Cloud

The Rich History of Japanese Trading

Political Unrest

- Trading in Japan evolved out of extreme political unrest

- From around 1600-1868

- Known as the "Edo Period"

- Japan was cut off from the rest of the world

- Emphasis on Central Government
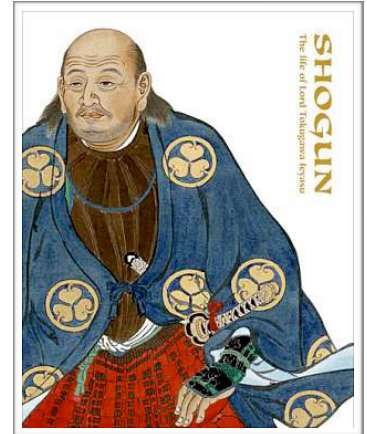
Count the Rice

- All land was assessed and taxed for their yield of rice crops.

- Peasants paid 40% in rice tax.

- Finance, Commerce, and trade grew exponentially with the pooling of resources.

- Rice became the primary currency of choice.

Dojima Rice Exchange

- The rice trade led to the creation of the Dojima Rice Exchange.

- Seen as a forerunner of modern banking

- Established in 1697

- Played a major role in the modernization of Japanese banking

- An early concept in futures trading

Paid in Rice?

- The culture at the time used rice as the primary trading tool in place of currency.

- A rice surplus might be stored in the "rice bank."

- In exchange for a deposit the bank customer would receive a note.

- These "notes" could be traded as money.

> HANSATSU of Silver 1 Monme RICE Trade Note issued by YATSUGAMURA in YAMATO (NARA). Issued in KEIOH 1st Year, (1865). EARLY TYPE. This scarce rice note type is about 6 inches in length and 1-1/2 inches wide, and is made of thick, high-quality paper. Both sides are printed with black ink, and each side is overprinted with two red validation stamps. One of these red stamps shows a large bale of rice, bound with thick rope. On the top of one side is a reclining water-buffalo, and the rest of the note is covered with Japanese characters from top to bottom. The denomination is 1 monme, which was the equivalent of 3.75 grams of silver.
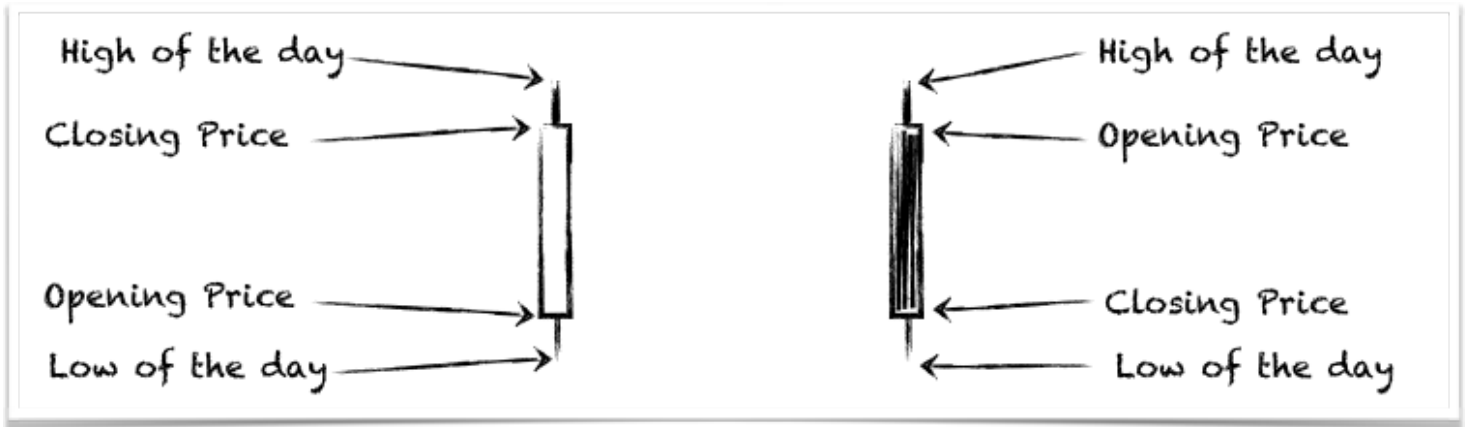
Cash, Backed by Rice

- In America, the US Dollars were backed originally by Gold.

- In 1700 Japan, this paper currency (Hansatsu) was backed by rice.

- Unlike Gold, the production of rice can fluctuate heavily.

- This leads to a shift in currency value.

Trade the Future of Rice

- As crop yields would fluctuate, the value of the "hansatsu" (Paper money) fluctuated

- As you know, price fluctuation is an opportunity to make money!

- This is why the rice trading exchange was so huge and important in Japan

Tools of the Trade

- The Japanese quickly began tracking value fluctuations

- They tracked the Open, High, Low, and Closing trade prices for the day

- As they plotted them, they developed a system for documenting the prices

High of the day ———→   High of the day

Closing Price ———→   Opening Price

Opening Price ———→   Closing Price

Low of the day ———→   Low of the day

A "Black" Candle is actually "full" vs a white candle which is "open"

Candlesticks

- Candlesticks were used to track the trade

- The picturesque nature of the candles told a story about the trading sentiment

- The result - a very visual form of trading, based on the fluctuation of "what people were willing to trade for"

Candlestick Trading

- One of the earliest forms of technical trading

- The most developed early form of technical trading

- Just as valuable today as it was in 1710!

- Depicts in pictures, what the trading sentiment is of the instrument you are trading
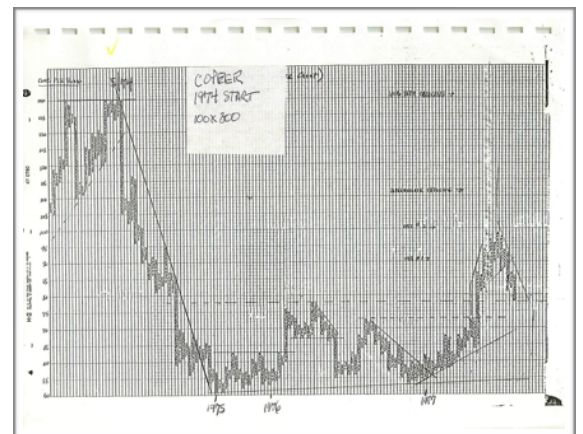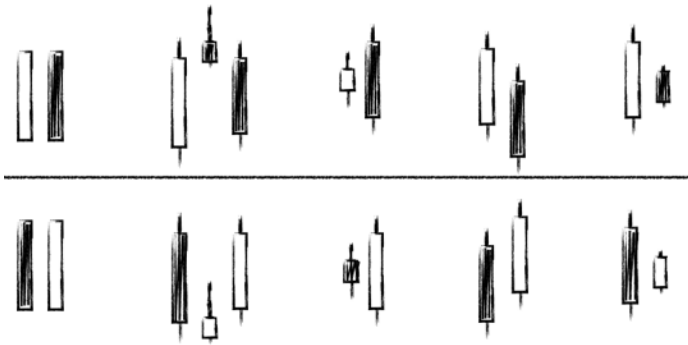
Candlestick Evolution

• Candlestick trading evolved into a very complete form of technical trading.

• Many of the developments are nearly identical to what ultimately developed in the west.

• Chart patterns like "3 Mountain Tops" or "Three Buddha Tops."

Sakata Method

• Developed by Sokyu Honma (1724-1803)

• Famous Japanese Trader

• Wrote a book translated "The Three Monkey Record of Money"

• He argues "psychological factors are the reason for price movement"

• Lays out the Sakata Method

Japanese Evolution

• Throughout the 1800s techniques evolved

• Kagi, Renko, 3-line break, and Heiken-Ashi are all similar to western Point & figure

• Then in 1940 another breakthrough
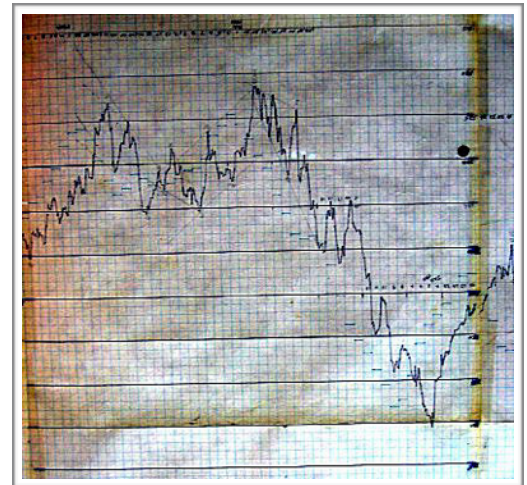
Rich History of Japanese Trading

Meet Mr. Sanjin

• Japanese Journalist in 1940s

• Wanted a trend following system to compliment candlesticks

• Needed something to quickly outline the bigger trend

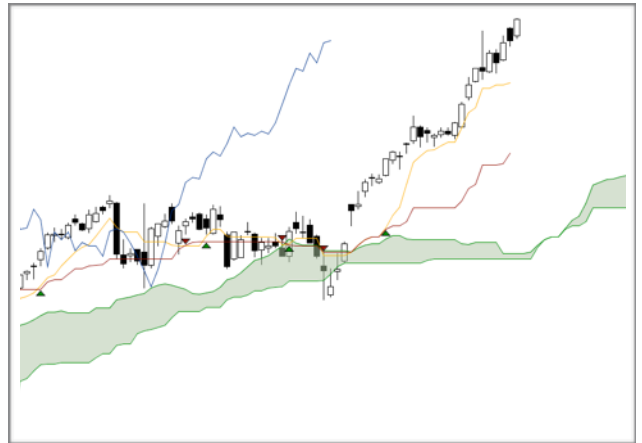• Ichimoku Clouds are the result!

• Ichimoku means "at a glance"

Ichimoku Kinko Hyo

- Ichimoku = "At a glance"

- Kinko = "Balance"

- Also Called:

  ➡ Ichimoku Charts

  ➡ Ichimoku Clouds

  ➡ Cloud Charts

Why Ichimoku?

- Candles are very valuable

- Candles only focus on the short term swing

- It is easy to get "too close" to the trade

- "Can't see the forest for the trees!"

In the Clouds

- Clouds are a medium to long-term tool

- Outline the larger trend

- Present Support & Resistance levels

- Serve as a "gate" to help confirm a primary trend direction

With Candles

• Ichimoku Clouds are intended to be used *with candles*

• They add a big picture perspective to the candle data

• You should already be familiar with your candle patterns - we will not review patterns in this program

Introduction to Ichimoku Clouds

At A Glance

Ichimoku Clouds provide:

- Support & Resistance
- Trend Identification:
  ➡ Up
  ➡ Down
  ➡ sideways
- Buy/sell signals
- Volatility
- Stop Location

Components of the Ichimoku Cloud	
Historical Component	Comparison of the current price to historical price
Current Component	Reflection of current trend
Future Component	Future insight into trend sentiment & support & resistance
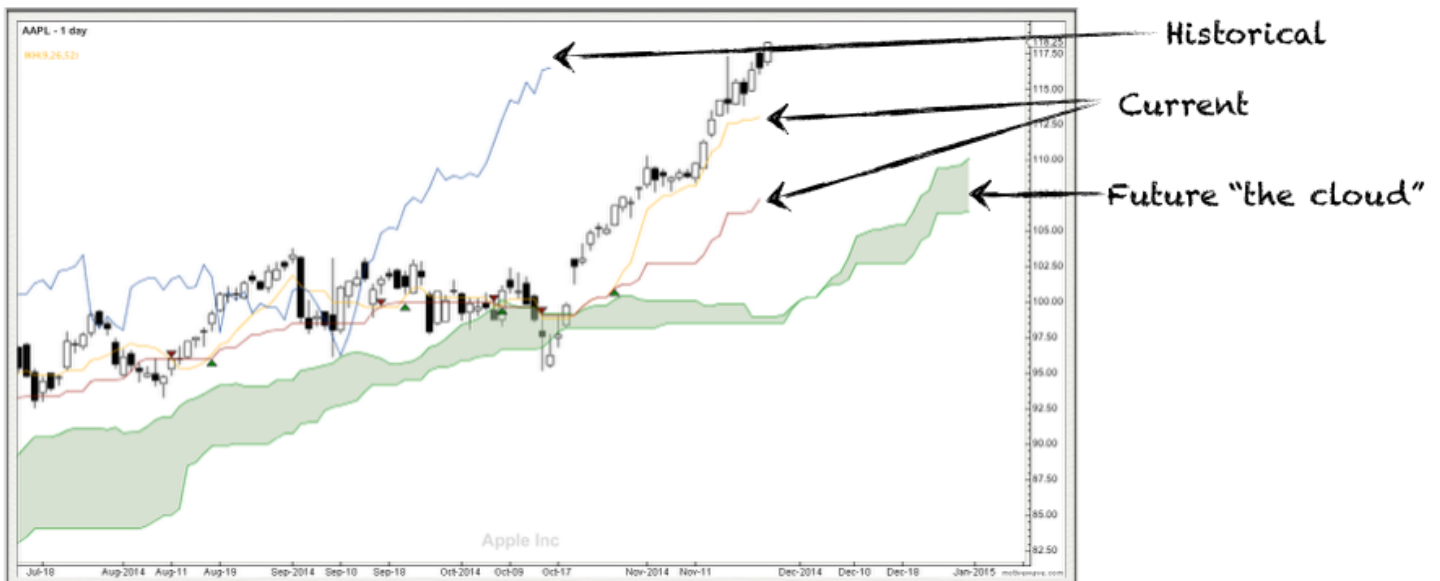
Components of the Ichimoku Cloud

- Historical:
    - ➡ Called "Chikou Span"
    - ➡ Compares current price to historical price
    - ➡ Represents momentum in price
    - ➡ Indicates support & resistance signals
    - ➡ Helps signal a trend "in the clear"
- Current:
    - ➡ Made up of 2 lines:
    - ➡ 1) Tenken Sen
    - ➡ 2) Kijun Sen
    - ➡ Variations of Moving Averages
    - ➡ Provide basic MA data of trend
    - ➡ Indicates MA cross signals
    - ➡ Useful for stops
    - ➡ The foundation to the other lines

- Future "the cloud":
    - ➡ Made up of 2 lines:
    - ➡ 1) Senkou A
    - ➡ 2) Senkou B
    - ➡ Derived from Tenken & Kijun Lines
    - ➡ Anticipate Support & resistance
    - ➡ Form the cloud
    - ➡ Signals current & future sentiment
    - ➡ Signals of strength vs weakness
- The Candles:
    - ➡ Candles are the actual price data
    - ➡ Every line is derived from the data seen in the candle
    - ➡ Candles will signal reversals
    - ➡ Signal day to day sentiment
   - ➡ Everything you have already learned about candles applies

The Best Success:

- **Use all of the signals together**

- **Not using all of the signals will give incomplete trade insight**

- **Be sure to interpret the candles as well - they are a critical component**

How to Build a Cloud

Constructing the Chart

- Every Cloud chart is made up of 5 lines

  1. Tenkan-sen

  2. Kijun-sen

  3. Senkou A

  4. Senkou B

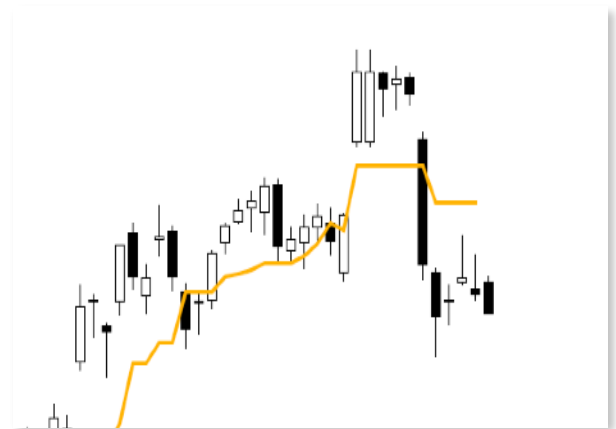 5. Chikou

- PLUS the candlesticks
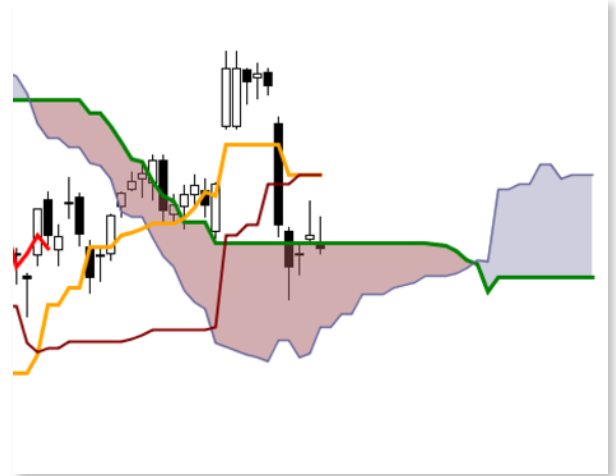
Tenkan-Sen

- A variation on a simple moving average

- The Average uses a "mid-point" price

- Tenkan-sen uses a 9 Day setting

- Average mid-price of last 9 sessions

$$\frac{9\ day\ High\ +\ 9\ day\ Low}{2}$$

Mid-Price Moving Average

Caterpillar Inc

9 Day Simple Moving Average

Caterpillar Inc

9 Day Simple Moving Average
vs.
Tenkan-sen

Caterpillar Inc

Kijun-Sen

- Same formula as the Tenken-sen

- Uses a 26 session calculation

- Often called the "standard" or "Base line"

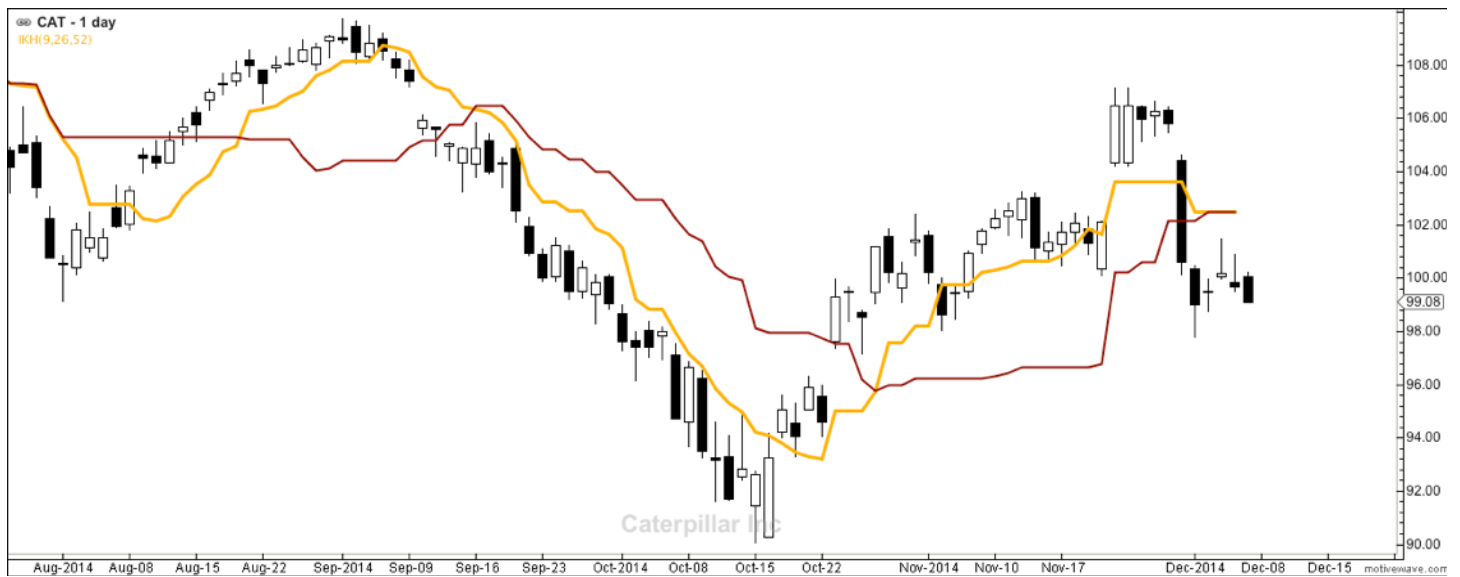$$\frac{26\text{day High} + 26 \text{ day Low}}{2}$$

Kijun-sen

26 Day Simple Moving Average
vs.
Kijun-sen

Together

- Tenken & Kijun provide the "current" portion of Ichimoku.

- Work very much like a moving average

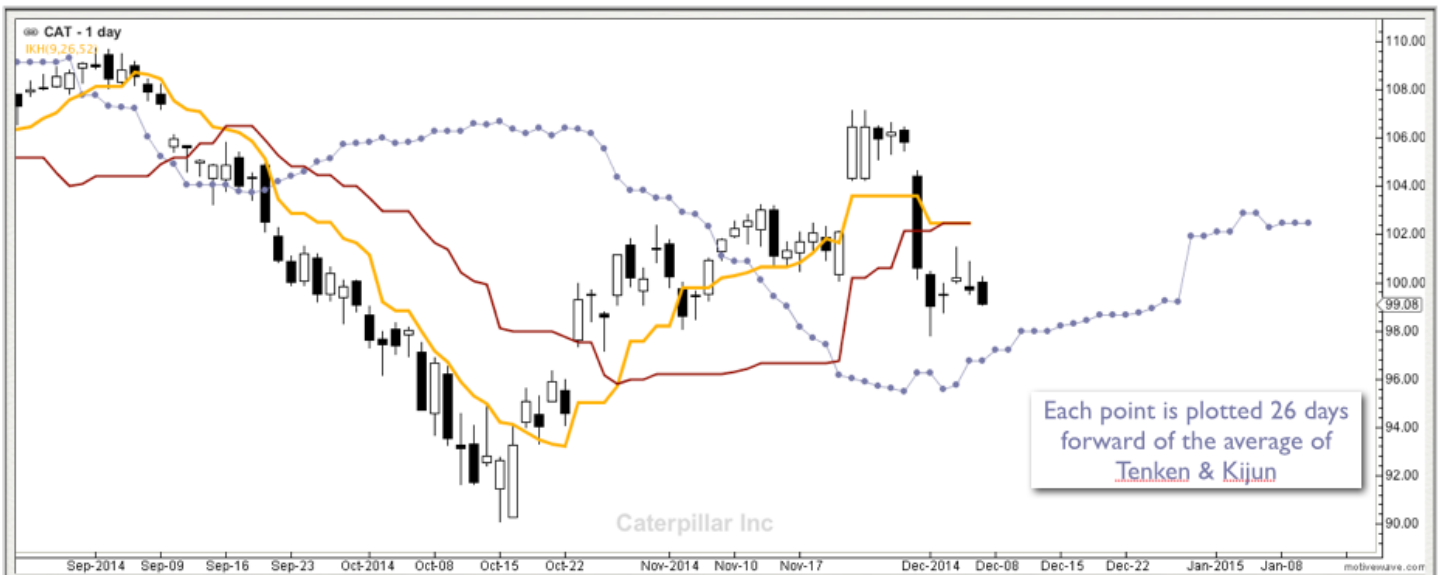- We get some signals from these two lines but they are most important as the foundation for the other 3 lines.
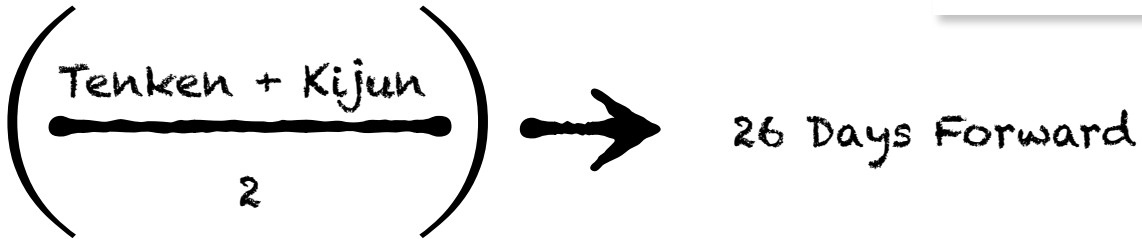

"The Cloud"

- The "cloud" portion is made up of two lines:

  ➡ Senkou A

  ➡ Senkou B

- Both lines are plotted 26 days in the future
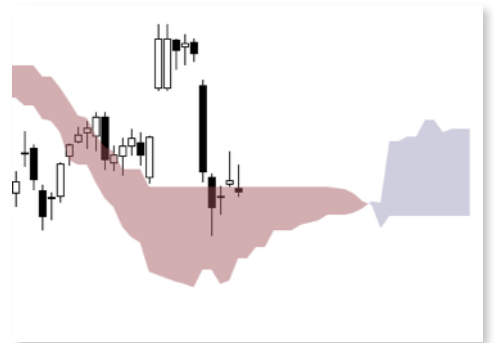
Senkou A

- The first line of the cloud

- An average of the Tenken & Kijun lines

- Plotted 26 sessions in the future

$$\left(\frac{Tenken + Kijun}{2}\right) \longrightarrow \quad \text{26 Days Forward}$$

Each point is plotted 26 days forward of the average of Tenken & Kijun

Senkou B

- The second line of the cloud

- Calculate like Tenkan & Kijun

- Plotted 26 sessions in the future

- Uses 52 period mid-point average

$$\left(\frac{52 \text{ day high} + 52 \text{ day low}}{2} \right) \longrightarrow 26 \text{ Days Forward}$$
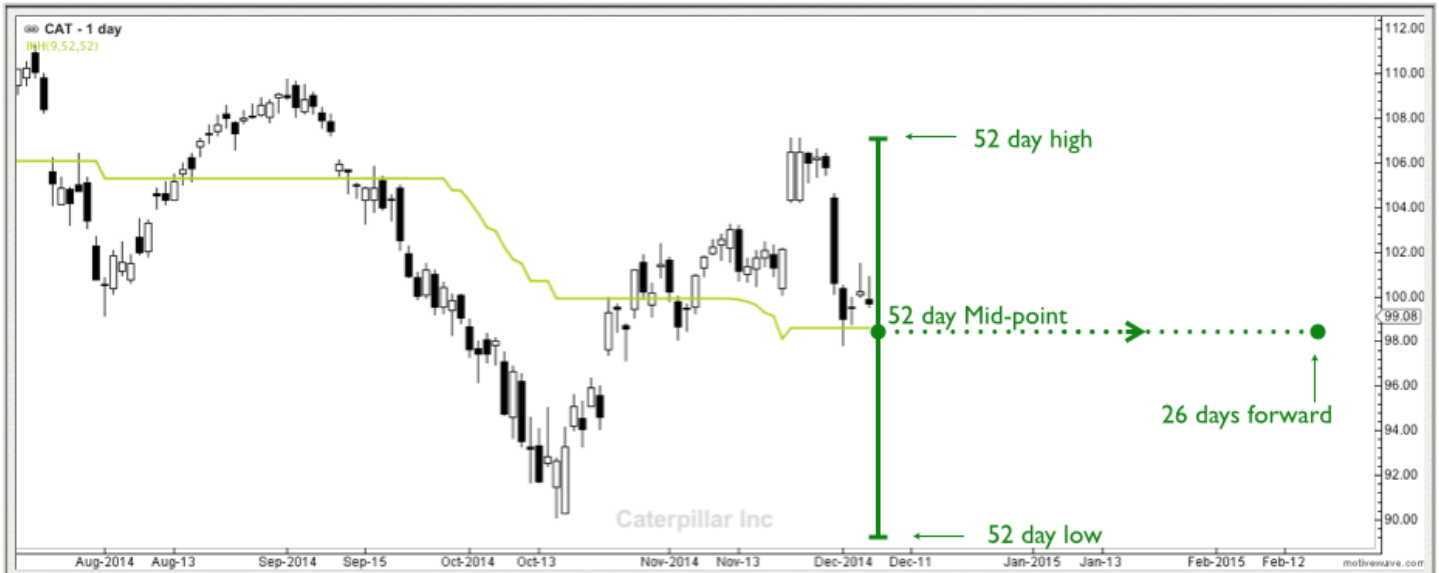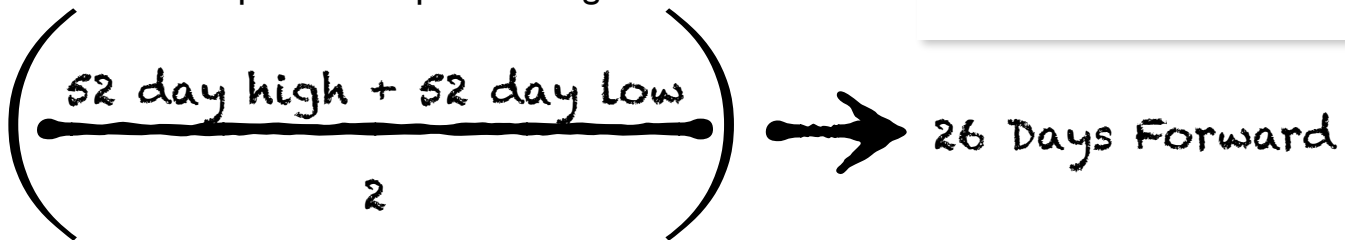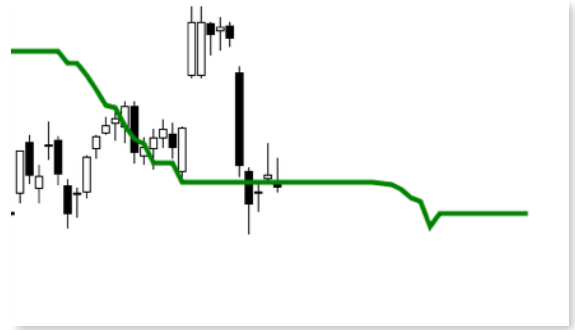
Together

- Senkou A & B create the "cloud"

- This is the "future" portion of Ichimoku

- Forms a key part of the system

- Serves several functions:

  ➡ Support & Resistance
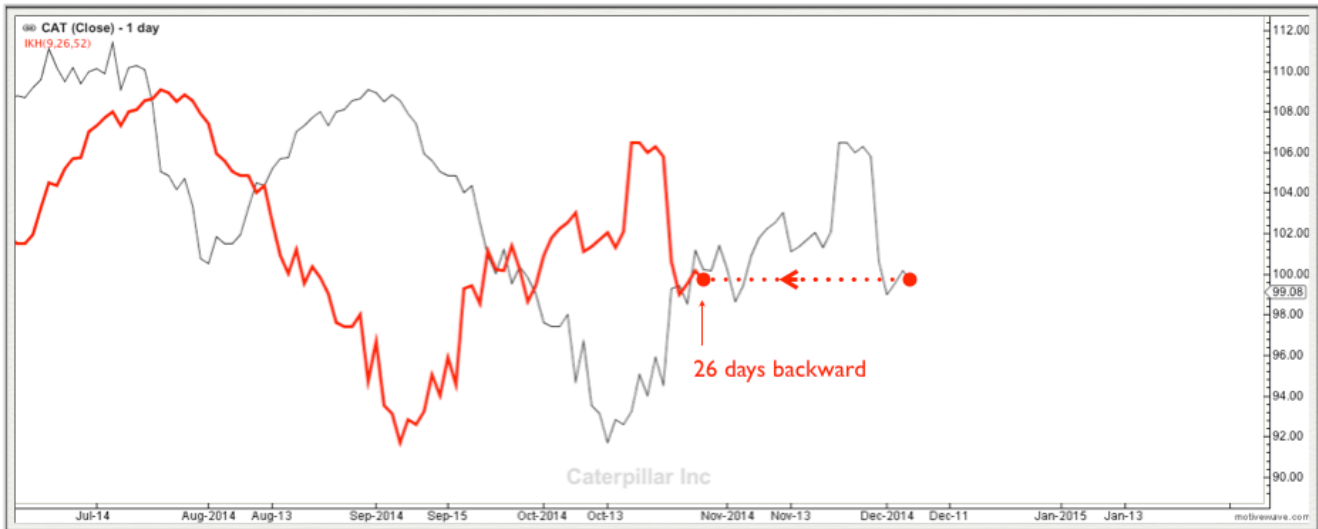
  ➡ Bullish/Bearish signals

  ➡ Cloud Thickness
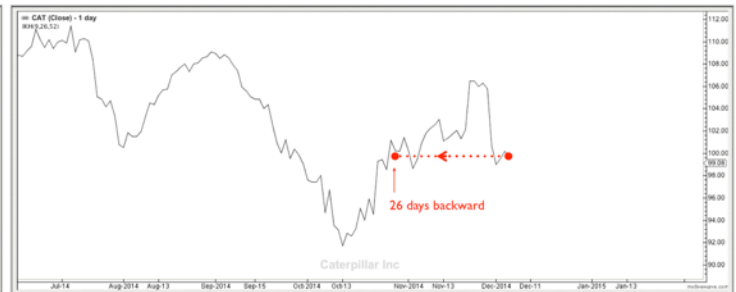
Chikou

- Chikou is the lagging line

- Closing price of chart

- Shifted backwards 26 days

26 Days Backwards ← **Closing Price**

26 days backward

CAT (Close) - 1 day
IKH(9,26,52)

26 days backward

Caterpillar Inc

CAT - 1 day
IKH(9,26,52)

Chikou is the closing price shifted 26 days back

All Together

- Together everything creates the Ichimoku Kinko Hyo picture

- "At a glance" we can now interpret a lot of data

- We get buy & sell signals, support & resistance, consolidation, and more

Homework

- Set up the Ichimoku Clouds in your charting software

- Watch "How to" videos in the members area for your software

- Come to next class ready to learn about the signals!