Ichimoku Quick Start Guide

By

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Could a Japanese journalist from the 1940's help you predict the future movement of stocks?

Welcome to this "Quick Start Guide" to using the Ichimoku charts. For most of you, the term Ichimoku is a brand new term for you. You may have never heard the word, much less seen a chart example. And I'll be honest with you. When I first looked at an Ichimoku chart, I thought "No way. This is far too confusing to be of any use to me." But then I did a little study, finding bits and pieces of information, scattered here and there among various web sites. And the subject began to intrigue me. As I understood more and more about what the charts were telling me, I became hooked…because the charts reveal so much and (once understood) can improve your trading substantially.

So, in this Quick Start Guide, I'll tell how the charts began. I'll introduce the key terms and definitions. I'll show you examples. And then I'll discuss some of the key uses for these charts in your own trading.

Now, before you get carried away and think you've got to pay a lot of money to get access to these charts, let me set the record straight. These charts are becoming available on more and more chart services. Offhand, I can think of three places to find these charts. At www.worden.com, the Ichimoku charts are available on their StockFinder charts and at www.freestockcharts.com. And they are available at www.stockcharts.com.

You'll often find them as an optional overlay among the many technical indicators offered by these services.

A Short History of Ichimoku

One of our greatest imports was candlestick charting. Created for trading the rice market about 150 years ago, candlestick charts are widely used by traders today. Why? Because they give a better visual representation of price movement and investor sentiment than the old bar charts.

Well, in the 1940's a Japanese journalist by the name of Goichi Hosoda began creating moving averages for these candlesticks. Prior to the advent of computer programming, his elaborate system utilized dozens of workers who plotted his moving averages each day.

And it wasn't an ordinary system of moving averages. Goichi used a variety of moving averages, plotting them both in their current time frame and also plotting them into the future. These moving averages give support and resistance lines, much like traditional western moving averages. But Goichi also pointed these numbers into the future, giving the charts an almost predictive nature.

So let me ask you a question. If you could look into the future of a chart, looking at possible areas of support and resistance in future time (not just current time), do you think it could help your trading? Of course it could help you.

But Goichi also looked backward. He noticed that chart prices move in undulating waves (what I have called S-curves) and that future price movement can also be somewhat predicted by plotting current price into its past price curve. (I call it the historical price curve.)

So, to summarize, Ichimoku charts look at past, current, and future indications of price movement. This combination, though not simple to understand, has huge merits above our traditional western technical analysis. In fact, Ichimoku charts could replace our typical charts, just as candlesticks have replaced bar charts for many traders. In Japan, for example, Ichimoku charts are the primary charts used for trading. And, once you begin to understand them, they may become your preferred chart platform as well.

There's only one small problem. Very little has been written in English about Ichimoku charts. The primary reference tools are still in Japanese. So, unless you spend hundreds of hours studying these charts, then you may find them a bit intimidating.

There are dozens of books available about technical analysis. In fact, the interpretation of candlesticks alone has created a plethora of books to aid the trader's understanding of them. But the study of Ichimoku charts in English is very new. And this "Quick Start Guide" aims to get you started on the journey.

First, I need to make a disclaimer. This report is not intended to be a complete primer on using Ichimoku charts. My Ichimoku Swing Trading System combines both eastern and western indicators. And this system takes more than just a few pages to cover all of the material. But this "Quick Guide" will get your started. I'll cover the key terms and definitions of Ichimoku charts. And I'll cover some of the basics for how to use them in your trading. If you want to learn more, then I encourage you to read and study the entire Ichimoku Swing Trading System text.

Terms and Definitions

So, we've talked about the history of Ichimoku and I've described some of the possible value to you as a trader. Now let's go ahead a take a look at an example.

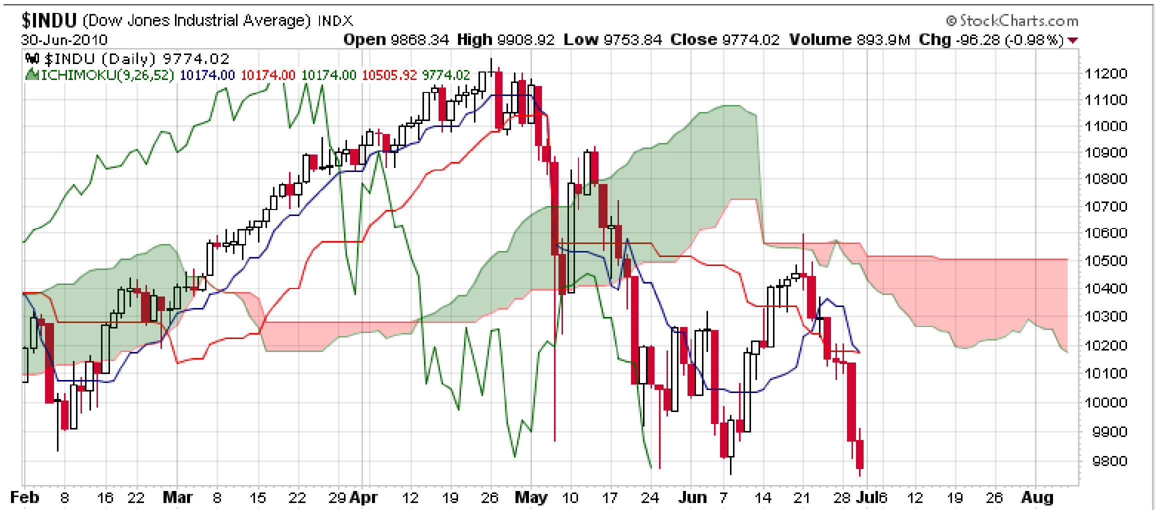

Chart 1

If Chart 1 is your first look at an Ichimoku chart, then it probably looks very confusing to you. You see a bunch of different lines and areas of green and pink. Then you see your traditional candlesticks. You’re looking at a five month chart of the Dow, during 2010. Beginning on the left side of the chart, see how price moves along the blue line and then falls beneath it in early May. Then you see price going back and forth in that green cloudy area before it falls again. Also see the green line that comes crashing through price back in late March. And notice how that cloudy area extends off to the right edge of the chart. Now let’s break down each area and see what it all means.

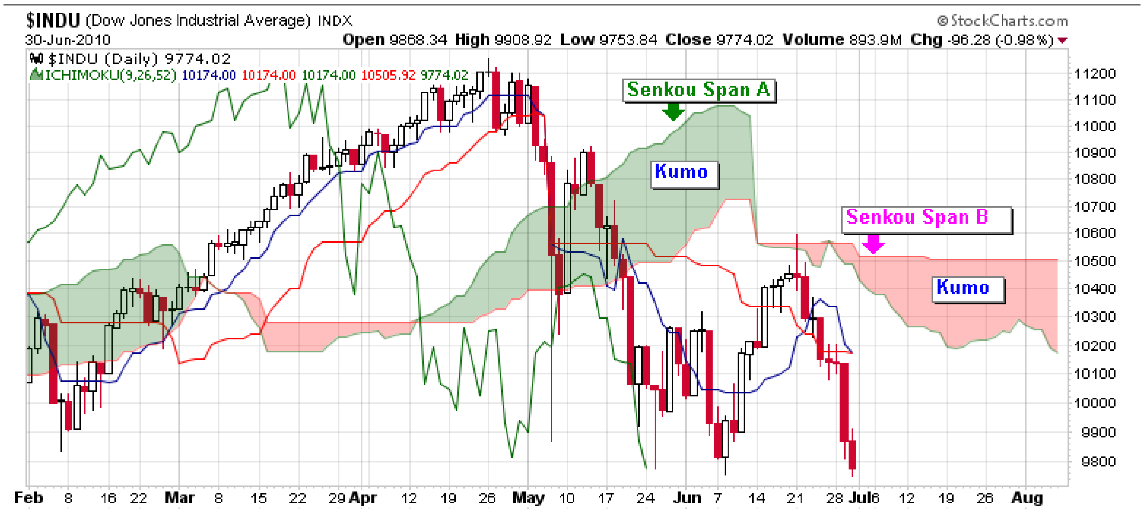

Chart 2

A central piece of the Ichimoku chart is the Kumo. Kumo means cloud, and that's what it looks like on your chart…those green and pink areas of the chart. So how are they created?

To create the Kumo, you begin with two plotted lines…Senkou Span A and Senkou Span B. Span A is created by taking the 9 and 26 moving averages (these moving averages use the mid-point of the candle, not the closing price of the candle) and dividing their total by 2. Span B is created by taking the high and low prices of the previous 52 periods and dividing that total by 2. Then, to make it more interesting, the answers to both equations are dropped onto the chart, 26 days into the future. That's why the Kumo extends to the right edge of the chart, even though the market hasn't gotten to that point yet.
Once we have Span A and B plotted into the future, we color the area in between the lines. If Span A is on top, then the Kumo is green. If Span B is on top, then the Kumo is pink.

That was fun, wasn't it? Now, think of the Kumo as an area of support and resistance. In the West, we generally draw single horizontal lines for support and resistance. But Ichimoku gives us an area. Take a look at mid-May in the above chart. You can see how the Kumo provided both support and resistance during that time, with prices often stopping right on the Span lines.

So here's the general rule. If price is above the Kumo, then the stock or index is said to be bullish. If price is below the Kumo, then the stock or index is said to be bearish. In Chart 2, we have examples of both bullish and bearish periods in the market. And you can see how price, once it moves through the Kumo, tends to stay on that side of the Kumo for a while.

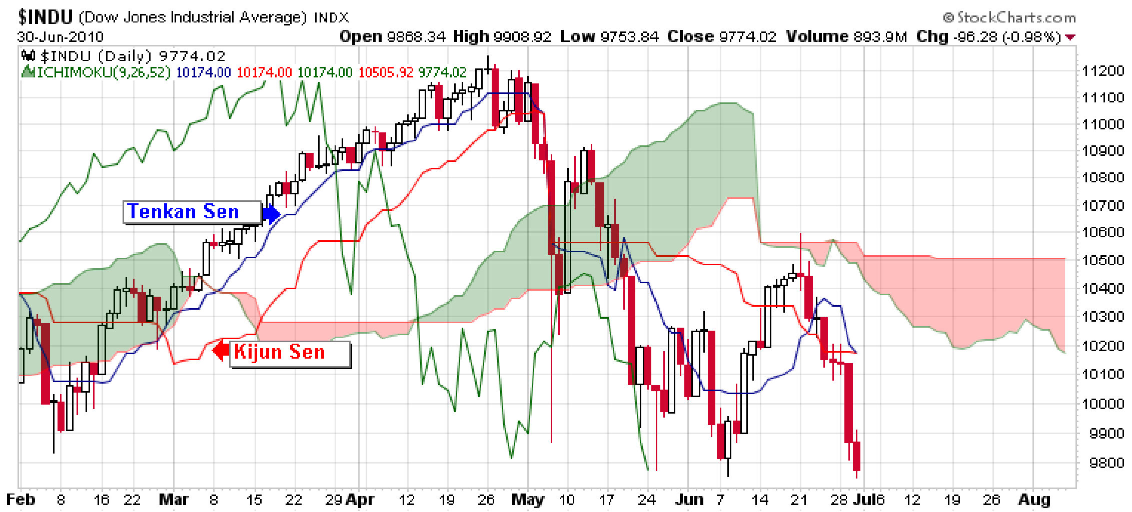

Chart 3

Chart 3 introduces two new terms to you…Tenkan-Sen and Kijun-Sen. These are simple moving averages, but once again we use the mid-point of the price candle rather than the closing price of the candle. Tenkan-Sen is a 9-day moving average. Kijun-Sen is a 26-day moving average. These averages are plotted in current time. You can also think of these lines as lines of support and resistance. As I mentioned earlier, the Tenkan-Sen provided price support during the first three months on this chart. So, price above the Kumo, riding the support line of Tenkan-Sen, is a very bullish move in price. Just as with western moving averages, the crossing of these moving averages is of great importance.

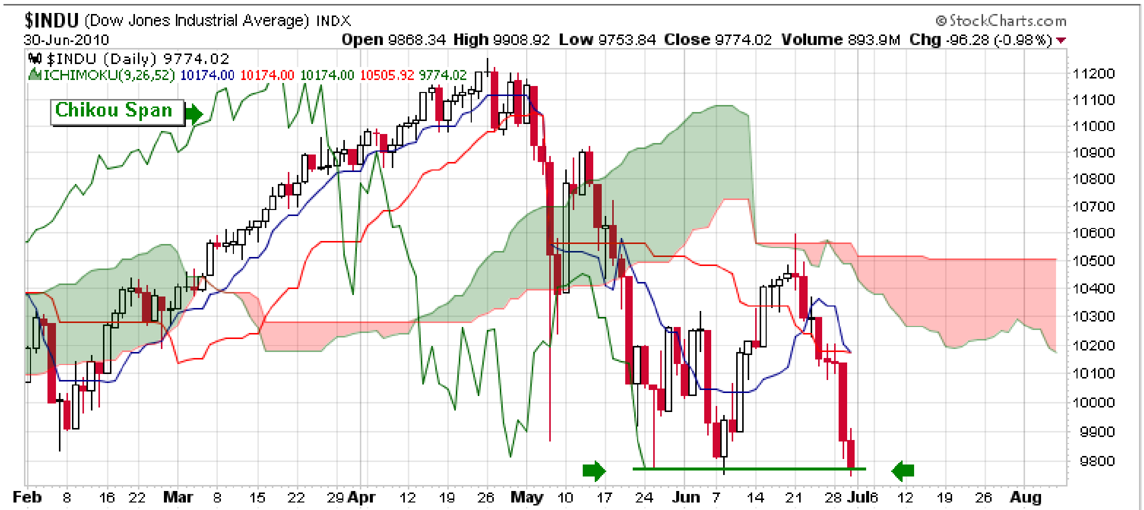

Chart 4

Chart 4 introduces the term Chikou Span, also spelled Chiku. This is perhaps the most difficult thing for western analysts to grasp, even though it is actually very simple. The Chiku is today's closing price, projected 26 days into the past.

On the above chart, I've drawn a green line with two arrows pointing to it. If you take the closing price of the last candle on this chart, and draw a horizontal line as I've done, then it shows the end point of the Chiku Span. Now, you may ask, why would I want to do that? Well, Goichi Hosoda discovered that the movement of price often repeats itself in patterns. Price patterns of the past can often influence price patterns of the future. So, he plotted this line onto the chart. Many viewers of Ichimoku charts consider this simple line one of the strongest indicators of future price movement. The general rule is this: if Chiku is below the historical price curve, then this is a bearish sentiment. If it is above the historical price curve, then this is a bullish sentiment.

So now you know the essential terms and definitions for using Ichimoku charts. Although it takes a good bit of study to begin using these charts for actual entry and exit decisions, perhaps you can already see the unique value they bring to technical analysis. Ichimoku charts looks at future price support and resistance, current price trends, and previous price patterns. Combining these three views onto one chart, you get the sense that you are looking at the stock with a wide angle lens. Or, to give my paraphrase of the term Ichimoku, "a quick glance by a man on a mountaintop".

What's the practical value?

Knowing the terms is of little practical value though. You have to begin using the information in your own analysis of stocks. And, in this Quick Guide, I cannot go into a huge amount of detail. But I can tell you some things to get you started. Let's look at a few charts together.

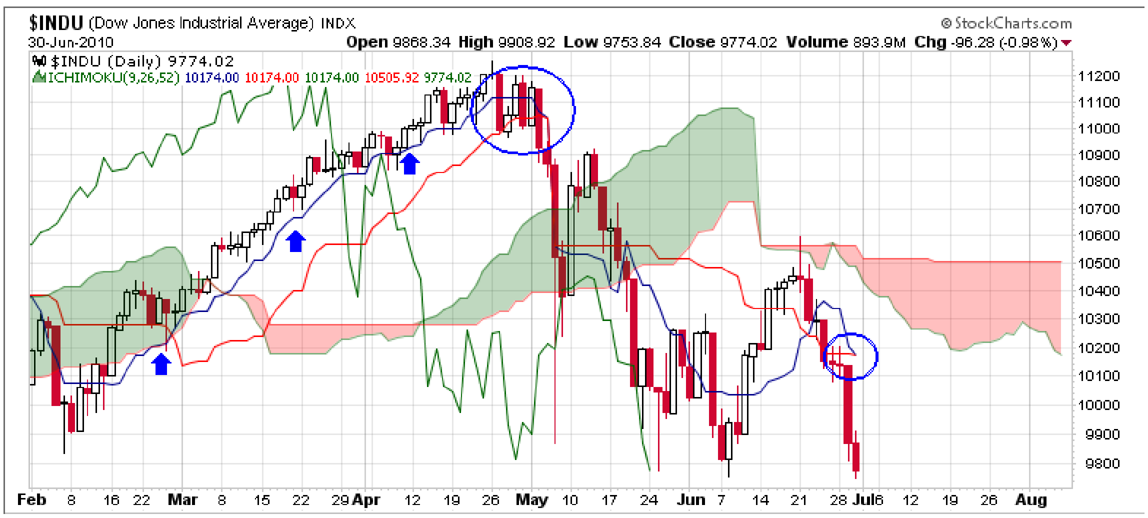

Chart 5

In Chart 5, I have drawn two blue circles. The first blue circle shows how price fell below the support line of the Tenkan-Sen. Soon thereafter, Tenkan-Sen crossed down and through the Kijun-Sen. It took a few days for the two lines to diverge. But once they did, the market saw a substantial decline.

On that same chart, the second blue circle highlights the last day of this chart. Since I am writing this Quick Guide on the day of this chart, I don't know yet if the Tenkan-Sen will cross down and through the Kijun-Sen again. If the two lines diverge, with Tenkan-Sen falling below Kijun-Sen, then watch out below. This is a very bearish indicator since the crossover occurred beneath the Kumo. If that separation occurs, then that is not a time to be buying stocks long.

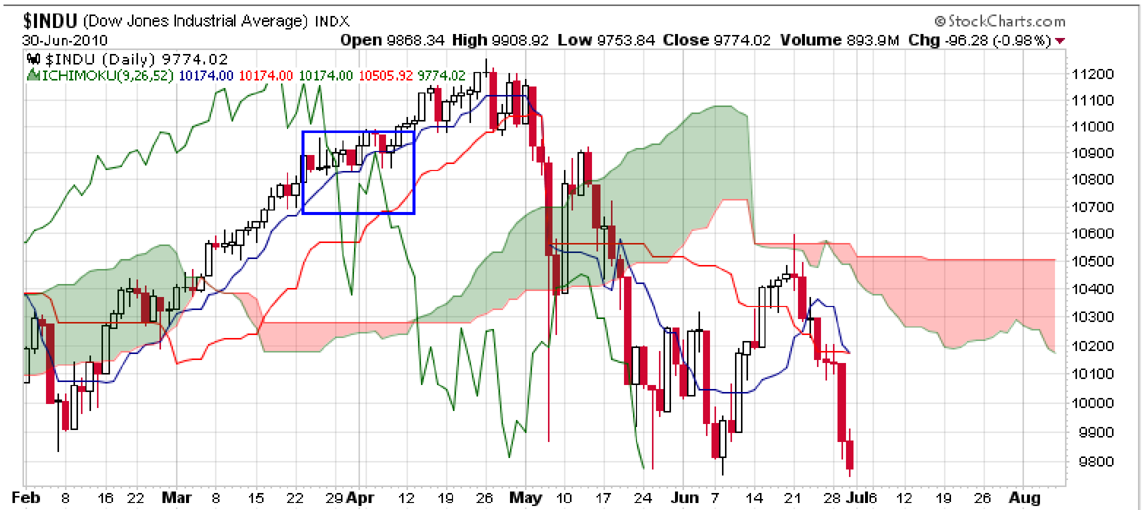

Chart 6

Chart 6 shows another important leading indicator. The blue box shows the period when Chiku Span (the green line) crossed down and through the historical price curve. You'll see that price crossed through the candlesticks during that period and then made a failed attempt to cross back up and through that line. The first cross down is a definite bearish trend indicator. The failure of the Chiku to cross back up through that line was even more bearish. Knowing these things helped me trade stocks in the correct direction.

Similarly, the market's bearish move after June 21st was expected by me. After a bullish week in the market, many traders were thinking we were on a bull run in the market again. But I knew differently. I remember studying the Ichimoku charts the weekend of June 19th. And I kept seeing one stock after another that was ready for a short entry. Even though price seemed ready to pierce the thin Kumo of that period, I knew that it wasn't going to happen. By combining Ichimoku charts with my traditional western indicators, I picked out 12 stocks to short as swing trades. At the end of three days, one of those trades was still at break even. There were no losers. And the average gain over three days was 4.5%. After seven market days, all 12 stocks were winners, with the average gain of 10.8%. Now, I don't know how those stats compare with your swing trade results. But that's a larger gain in one week than most money managers can give you after a whole year of trading. So I'll let you decide the merit of the system.

Conclusion

This concludes the Quick Guide to using Ichimoku charts. If it all seems confusing, then go back and read this document again. Better yet, place it beside your computer and use it as a reference tool as you study the stocks you're currently trading. Over time, you'll get more comfortable with the charts and their power to predict the future movement of price.

Good trading to you.