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2nd Edition

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Russell Rhoads, PhD

Financial analyst and trader



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[FIGURE 15-3: A chart of AAPL stock with a reversal and eventual downtrend.](#)

[FIGURE 15-4: Two bearish necklines in a chart of Bitcoin prices.](#)

[FIGURE 15-5: A chart of QQQ with a reversal signal and a 10-day moving average ...](#)

[FIGURE 15-6: A chart of TLT combining a bearish reversal and moving average cro...](#)

[FIGURE 15-7: A 10-day moving average and bearish doji in a SLV chart.](#)

[FIGURE 15-8: A chart of MSFT stock combining a doji with a 10-day and 20-day mo...](#)

Introduction

When I wrote the first version of this book, candlestick charts were a known method of displaying and analyzing price data but weren't the default charting method for most traders. Now, more than ten years later, the charts shown in the business media are often candlestick charts. This situation is fully understandable, because candlestick charts are better visuals than line charts or bar charts. But even though candlestick charts are common nowadays, most traders still don't understand candlestick patterns, much less use them in day-to-day trading.

After the first edition of this book was published, I received some criticism that I spent too much time discussing instances in which candlestick patterns didn't work out. One of the top reasons why traders fail, however, is that they don't take losses even when it makes sense. Whenever a trader enters a trade, they should have an exit plan that involves taking either losses or profits. This book sticks with the format of showing both profitable and losing trades for each pattern.

About This Book

This book isn't intended to be an end-all-and-be-all guide to profitable trading. It's meant to provide readers some insight into how candlesticks are created and how they can be used to analyze the psychology behind what happens over the course of trading days. (When I say *psychology*, I'm not trying to conjure up images of Freud and Rorschach tests; I'm talking about the motivating factors that determine how the market behaves.)

I made an effort to use as many examples as possible in the text, and every example comes from actual charts, showing you not only how common candlestick patterns are in everyday trading, but also how they're used them in live trades. They're waiting for you to harness their power!

Also, for each new candlestick pattern that I introduce, I present at least one case that produces a useful signal and one that produces a dud. Candlesticks are terrific, but they're not perfect, and recognizing the failure of a signal is just as important as picking up on a valid signal.

I hope that the candlestick methods described in this book help you make trading and investment decisions that lead to solid profits, but unfortunately, I can't guarantee those profits. What I *can* guarantee is that after reading this book, you'll understand what candlesticks are, what they represent, and how to use them effectively in trading.

Foolish Assumptions

Knowledge of candlesticks varies widely from trader to trader. Even traders with the same amount of trading experience can differ quite a bit in their candlestick know-how. So I've made these assumptions about you:

- » You have at most a very basic understanding of what comprises a candlestick chart. (My apologies if you already know a little about candlesticks, but hey, it never hurts to review and hone essential candlestick skills.)
- » You have some sort of experience in trading a stock or at least a mutual fund.
- » You've spent some time looking over stock charts.

Icons Used in This Book

I used the following icons throughout the book to point out various types of information:



REMEMBER When you see this icon, you want to store the accompanying nugget of candlestick or trading wisdom somewhere safe in your brain.



TIP This icon offers hands-on advice that you can put into practice as you trade. In many cases, the information next to this icon tells you directly how to conduct a trade on a pattern or technical analysis method.



WARNING If you ignore this information, you might wake up one day in a den full of writhing, angry pit vipers. Okay, things won't get *that* bad, but this icon can help you avoid making costly trading mistakes.



TECHNICAL STUFF This icon flags places where I get really technical about charting. Although the information is great, you can safely skip it without missing out on the discussion at hand.

Beyond the Book

In addition to the scintillating text in your hands, this book comes with a free access-anywhere Cheat Sheet that you can use when you need a quick refresher on common candlestick patterns or trading tips. To get this Cheat Sheet, simply go to www.dummies.com and type **Candlestick Charting For Dummies Cheat Sheet** in the Search box.

Where to Go from Here

To figure out which area of this book to dive into first, think hard about what facet of candlestick charting you want to understand. Do you want to get grounded in the basics or polish up on a few candlestick fundamentals that you've forgotten since you read that online article about candlestick charting months ago? Check out [Part 1](#).

If you want to get cracking by finding out about a few real candlestick patterns and seeing how they can tell you what a market or security is going to do next, check out one of the chapters in [Part 2](#) or [3](#). I cover many candlestick patterns in those chapters — enough to give you plenty to look for as you pore over charts on the web or in a charting software package.

You may have been exposed to some other technical indicators, and it's possible that reading about candlesticks alongside some of that familiar material may help you get your feet wet. If so, make a beeline for [Part 4](#), and enjoy! I've also added some quick summaries and resources in [Part 5](#), so check that out, too.

The water's fine no matter where you choose to dive in, and you're just a few page-turns away from adding a powerful weapon to your trading arsenal.

Part 1

Getting Familiar with Candlestick Charting and Technical Analysis

IN THIS PART ...

Get familiar with the mechanics of candlestick charting and how it contrasts with other methods of charting security prices.

Discover how powerful candlestick charting is relative to other, less-illustrative types of charting.

See what price activity creates candlesticks.

Understand the mind of the market based on individual candlesticks.

Explore electronic resources for creating candlestick charts and even some for identifying bullish and bearish patterns.

Chapter 1

Understanding Charting and Where Candlesticks Fit In

IN THIS CHAPTER

- » Taking a look at options for charting and why candlesticks are superior
 - » Making sense of candlestick construction
 - » Exploring the wide variety of candlestick patterns
 - » Using technical analysis alongside your candlestick charts
 - » Understanding a few trading and investing basics
-

The advent of the Internet has leveled the playing field for securities traders. Access to markets once meant placing orders through a broker; now it's little more than a couple of mouse clicks away. Commission rates are dramatically lower and in some cases free. Additionally, access to market information is free in many cases. Getting into securities trading is easier than ever, and the result is that a whole generation of investors and traders handles their finances without professional help. Technology allows these people to enjoy many new types of market information, and one of the best tools available is candlestick charting.

Candlestick charting methods have been around for hundreds of years, but candlesticks have caught on over the past couple of decades or so as a charting standard in the United States. I've been working with candlestick charts for quite a few years, and I've seen many traders — novice to professional — develop a fierce loyalty to candlesticks after taking the time to understand their uses and potential. I think you'll feel the same way, and this book is the first step on your path to conquering candlesticks.

The material contained in this chapter exposes you to many of the facets of candlestick charting that continue to fuel its rise as one of the most popular charting techniques. I begin with the overall role of candlesticks within the context of charting. I cover the advantages of candlestick charting and the basics of candlestick construction. I also take the opportunity at the end of this chapter to discuss how to get started, as well as give you some insight into the characteristics and habits that successful traders employ in their pursuit of profits. Enjoy, and happy charting!

Considering Charting Methods and the Role of Candlesticks

With advancements in technology and the growing availability of trading and investing resources available to traders, many options exist for the charting of securities. There are several types of charts and dozens of variations and features to be configured on each type. It's important that you're clear on the options and —

perhaps more important — on why candlestick charting is at the top of the heap. This section explains.

Getting a feel for your options for charting

When it comes to alternatives to candlestick charting, the three main charting contenders are as follows:

- » **Line charts:** These charts are simple and helpful for short-term decisions, but they're quite limited in the amount of data presented.
- » **Bar charts:** These charts are the most common type and are much more useful than line charts, but they're not as versatile as candlestick charts.
- » **Point and figure charts:** These tried-and-true charting methods are great for recognizing support and resistance levels, but they're far less dynamic than candlestick charts.

Each one of these charting methods can be used effectively to ratchet up the effectiveness of your trading strategy, but they pale in comparison with candlestick charts for several reasons, a few of which I describe in the next section.

Realizing the advantages of candlestick charting

You'd be hard-pressed to find someone who's more enthusiastic about candlestick charting than yours truly. I can go on and on about the advantages that candlesticks afford. If you want to read more of my gushing about the many great advantages of candlestick charting, turn to [Chapter 2](#), but here are my top three reasons: