

Introduction to Japanese Candlestick Patterns



TRADERSLOG

The Origins of Japanese Candlestick Charting

Munehisa Homma (1724-1803), also referred to as Sokyu Homma or Sokyu Honma, was a wealthy rice merchant and trader from Sakata, Japan who lived during during the Tokugawa Shogonate.

The Dojima Rice Exchange of Osaka, established in 1697, was the world's first futures exchange. Initially, only physical rice was traded, but beginning in 1710 a futures market was established where coupons representing future delivery of rice were traded. Homma was a successful trader in this secondary market of trading rice coupons.

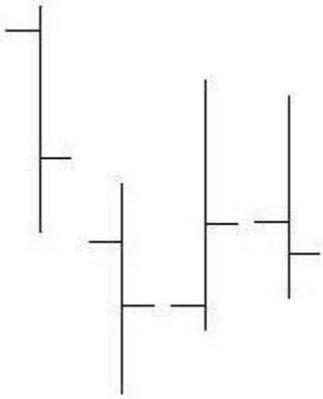
Renowned for his ability in trading the rice market, Homma became a financial advisor to the government and was even awarded the rank of honorary Samurai. He is widely credited as a pioneer in technical analysis and as the father of Japanese Candlestick charting.

In 1755, he wrote *The Fountain of Gold - The Three Monkey Record of Money*, a text focused on market psychology.

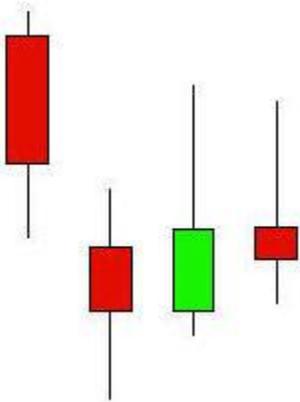
Centuries later, Steve Nison discovered Candlestick Charting from a Japanese broker and set about bringing this charting approach to the western world.

What is a Japanese Candlestick?

Firstly, let's take a look at a Japanese Candlestick chart in comparison with a traditional western Bar Chart:



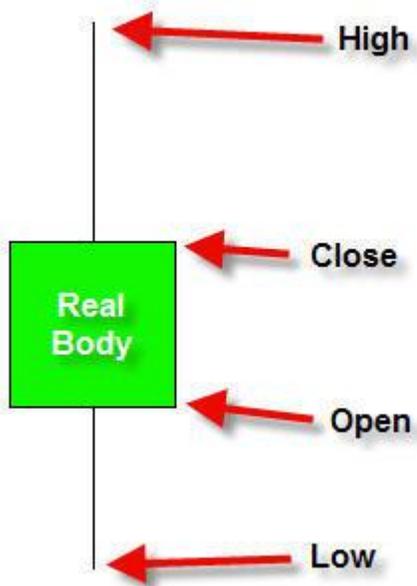
Bar Chart



Japanese Candlestick Chart covering the same time period

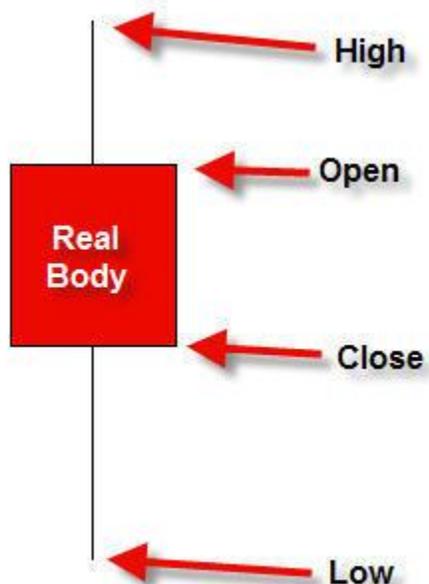
Candlestick Anatomy

Now let's take a closer look at the anatomy of a Japanese Candlestick.



In the above example the market closed above the opening price and this is reflected in the **real body** being green.

When the price closes below the opening price for the set time period the **real body** is red.



Candlestick Anatomy

The wick is sometimes also referred to as the **shadow** or **tail**.

Most commonly the colors used are red or black for a (bearish) candle that closes lower and white or green for a (bullish) candle that closes higher, although any colors can be used.

The length of the candle body and the length of the wick are both significant.

Let's take a look at some classic candlestick patterns and what they suggest in terms of forecasting future price movement.

First we'll look at reversal patterns. Reversal patterns forecast a possible turning point in an existing trend.

Reversal Patterns

Hammer Candlestick

Hammer candlesticks occur during a downtrend. In a perfect hammer, the shadow is at least twice the length of the body and the candlestick will have no upper wick. The smaller the body and the longer the tail, the more significant the hammer is as a bullish reversal indicator.



Reversal Patterns

Inverted Hammer

The **Inverted Hammer** is also a bullish reversal pattern. Occuring in a downtrend, the inverted hammer shows the market trading higher, but closing near where it opened. The candlestick has a long upper wick and a small real body.



Reversal Patterns

Harami Pattern

The **Bullish Harami** is a two candle pattern that occurs during a **downtrend** where the second candle is contained within the range of the real body of the previous candle.



Reversal Patterns

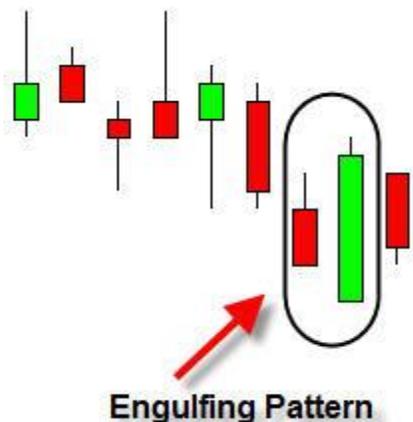
Conversely, the **Bearish Harami** is a two candle pattern that occurs during an **uptrend** where the second candle is contained within the range of real body of the previous candle.



Reversal Patterns

Engulfing Pattern

The **Bullish Engulfing Pattern** is a two candle reversal pattern that occurs during a **downtrend** where the first candle is contained within the range of body of the second candle.



The **Bearish Engulfing Pattern** is a two candle reversal pattern that occurs during an **uptrend** where the first candle is contained within the range of the body of the second candle.

Reversal Patterns

Shooting Star

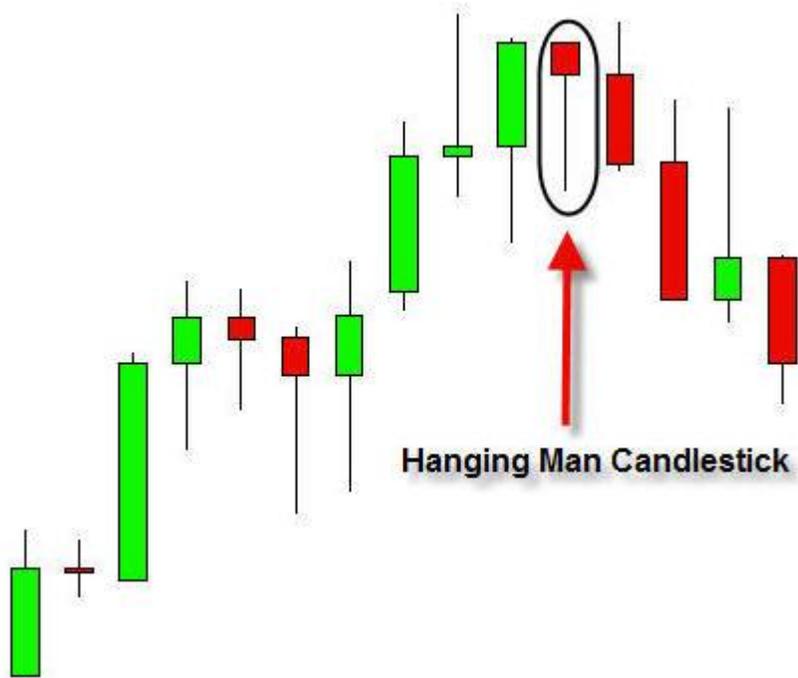
The **Shooting Star** candlestick pattern occurs during an **uptrend**. The market opens higher, trades still higher, creating a long upper shadow. It then closes near its open, leaving little or no lower shadow, and a small real body. It looks like the **Inverted Hammer** but gives a bearish signal.



Reversal Patterns

Hanging Man

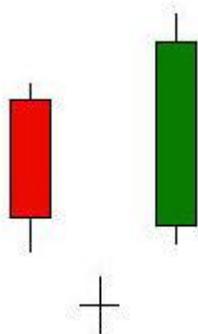
The Hanging Man candlestick occurs during an uptrend. The Hanging Man has a short body with little or no upper shadow, and a lower shadow at least twice the length of the candle body.



Reversal Patterns

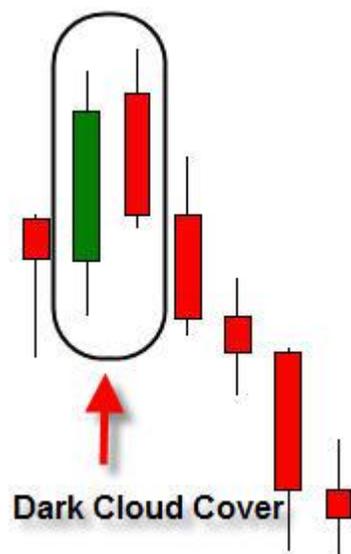
Abandoned Baby

The Abandoned Baby is a rare reversal pattern, where the market gaps, is followed by a Doji and then gaps again in the opposite direction.



Dark Cloud Cover

The **Dark Cloud Cover** is a two candle bearish reversal pattern that occurs during an **uptrend** – the first candle is long bodied and bullish, the second candle opens higher but **closes below the midpoint** of the body of the first candle.



Continuation Patterns

Continuation patterns suggest a continuation of the existing trend.

Marubozu

The Marubozu is a candlestick with no shadow or wick extending from the real body at either the open, the close or both. The Marubozu is also known as a shaven head or bald candlestick.

A bearish Marubozu has a long red body and no wick. The open is the high and the close is the low. This reflects that the bears are in control and the trend will continue downward.



Continuation Patterns

The bullish Marubozu has a long green body with no wick. The open price is equal to the low and the close is equal to the high. This reflects bullish sentiment and suggests a continuation of the existing upward trend.



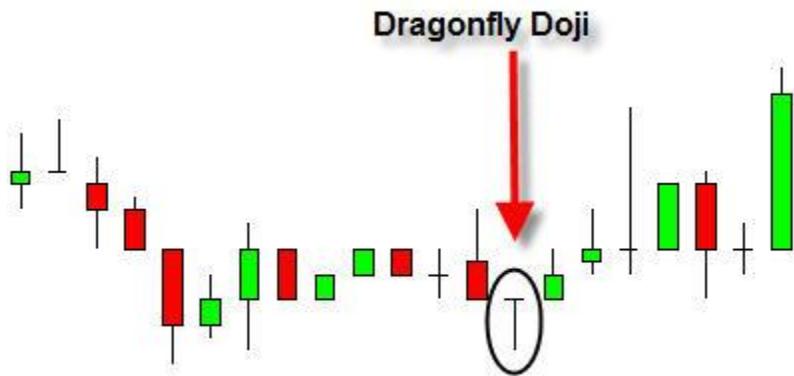
Doji

The Doji is a Japanese Candlestick that forms when open and close prices for that day are virtually equal. Dojis suggest market sentiment on their own and they also appear as an element in several important candlestick patterns.



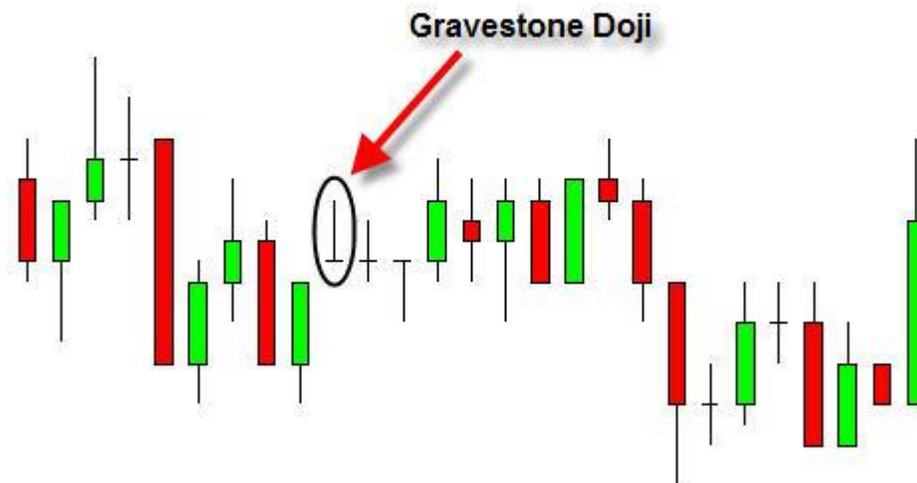
Dragonfly Doji

The Dragonfly Doji is a reversal pattern where the open and close price are at or near the high of the period. This pattern is normally considered bullish.



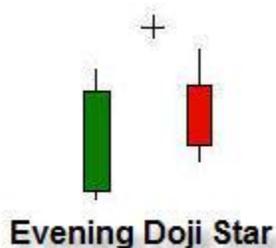
Gravestone Doji

The Gravestone Doji is the opposite of the Dragonfly Doji - a candle where the open and close price are at or near the low of the period, normally considered bearish.



Evening Doji Star

The **Evening Doji Star** is a three candle **bearish reversal** pattern that occurs during an uptrend. The first candle is green and long bodied. The second candle is a doji that shows the market opening higher, having a small range and closing where it opened. The final candle of the pattern opens lower and closes lower still, **below the midpoint** of the body of the first candle in the pattern.



Morning Doji Star

The **Morning Doji Star** is the inverse – a three candle **bullish reversal** pattern that occurs during a downtrend. The first candle is red and long bodied. The second candle is a doji that shows the market opening lower, having a small range and closing where it opened. The final candle of the pattern opens higher and closes higher still, **above the midpoint** of the body of the first candle in the series.

Candlesticks Reflecting Indecision

Spinning Top

Spinning Tops have small bodies with upper and lower wicks that are longer than the body. Spinning tops reflect uncertainty or a neutral directional bias in the market.



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