PROFITABLE CANDLESTICK TRADING

Pinpointing Market Opportunities to Maximize Profits

Stephen Bigalow

John Wiley & Sons, Inc.
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To keep from possibly blemishing any reputations associated with those acknowledged as providing something toward the completion of this book, it should be noted that any factual errors or omissions found within this book are solely my responsibility.

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PREFACE

Japanese Candlestick charting and analysis is one of the most effective technical methodologies in the universe of technical analysis. This bold statement is consistent with the same statements that were made one to two decades ago in books written about Candlesticks when they were first introduced into the United States. The exact same problems that appeared to keep the Candlestick method out of the limelight back then have persisted to make Candlesticks still a fairly underused method today. Through the years, the number of people who have become proficient users of Candlestick analysis has been minimal. Nearly two decades of using the signals have produced two basic revelations: the signals are extremely accurate, and it is unusual that more people have not become advocates of the technique.

One of the most powerful investment techniques has been sitting in front of the U.S. investment community, yet it has not exploded in popularity as one would expect. Years of informal surveys have reached this conclusion. There is a definite perception about Candlestick trading. It is seen as requiring a long time to learn and become proficient at it. That is the major reason the majority of investors have stayed away from Candlesticks. That misconception is what spurred the writing of this book. Other books on the topic were written nearly a decade ago. Those books were informational and well written, however, they were published in somewhat of a vacuum. Once the books were read, each investor was out there on his or her own. The number of people to confer with after first becoming exposed to the Candlestick method was minimal. The ideas were new in the United States and there were few places to turn to for guidance.

For the past two decades, most investors have been aware of Candlesticks. The most common statement is, "They know about Candlesticks; they just don't know how they work." An extremely high percentage of chart followers have the Candlestick formations on their charts versus the standard bar charts. This is due to the favorable visual impact. The illustrative properties of the Candlestick chart make viewing much easier.

Four hundred years of research by profitable Japanese rice traders was the inception of statistical analysis. What may take computers one afternoon to perform, the Japanese rice traders assembled over centuries of time. However, there is a definite benefit involved with human interpretation of these signals. The Japanese traders were able to describe the investor sentiment behind the formation of the signals. This becomes an extremely powerful asset for exploiting profits from markets that involve human emotions.

Being thoroughly convinced that Candlestick analysis surpasses all other technical analysis induced me to eliminate the misperceptions. Japanese Candlesticks is definitely not a passing fad. It is here stay and effectively extract profits from the trading markets—profits for those who take the little time required to become acquainted with the Candlestick thinking process.

Not only does the knowledge of what a signal looks like benefit the candlestick educated investor, but learning the common-sense psychology that formed the signal provides the investor with a whole new perspective into successful investing. Somebody is making huge profits in the markets. It is not the conventional wisdom advocates, buy and hold. The big winners are those who have developed successful methods for interpreting when to buy and sell. Candlestick analysis is that method. Read this book and your investment abilities will be forever improved, improved to the point of not just constantly exceeding market averages, but being able to exploit the indications of the signals to amass extraordinary profits.

Once you learn the Japanese Candlestick technique, your understanding of how investment markets work will dramatically alter your investment psychology. The probabilities of producing magnificent profits will always be in your favor. Learn Candlesticks and reap the knowledge that has led to centuries of successful trading.

Stephen W. Bigalow
Houston, Texas

Chapter 1

INTRODUCTION

> **The learning of books, that you do not make your own wisdom, is money in the hands of another in time of need. Japanese Proverb**

Japanese Candlestick analysis is a highly effective, but under-used investment decision-making technique. Most people in the United States' investment community are aware of Candlestick analysis, but few understand how or why it actually works. Candlestick charts reveal many insights using well-recognized Japanese candlestick formations, yet few people understand the ramifications or significance of the signals that are clearly and reliably displayed.

This book was written to educate investors on how to use the Japanese Candlestick technique profitably. The easy-to-follow procedures detailed in this book provide the reader with profit-making techniques that can be learned quickly. More importantly, learning the principles of market psychology underlying the Candlestick methodology will revolutionize the reader's overall investment psyche forever. While this may sound bold and far-fetched, fortunes have been made using the Japanese Candlestick techniques. Knowing how to use the candlesticks and why they work will immediately improve the reader's investment profitability and permanently alter overall investment perceptions. This newly acquired perception will produce consistent profits along with an associated mental re-programming designed to maximize investment returns. Once an investor becomes convinced of the reliability of the Candlestick methodology, that investor also acquires a pre-programmed investment discipline. As a result, Candlesticks add a whole new dimension to enhancing the investor's profit-making abilities.

Most readers will be surprised at how the knowledge gained from a close reading of this book dramatically enhances investment abilities across all investment vehicles and over all trading timeframes. More than 400 years of refined reversal-identification and trend continuity projection is now at the reader's disposal. Mastering the candlestick methodology will be the next major step for maximizing investment returns.

Why aren't the Candlestick signals used more? Why, if the signals demonstrate such a high degree of accuracy, are there not many more investors, whether institutional or individual, using these signals? The answer is that the Candlestick technique in the past has been too labor-intensive and required a long and steep learning curve before the investor gained proficiency. This book was written to provide the reader with an easy and fast training program to circumvent those obstacles.

The Benefits from the Candlestick System

Japanese Candlestick signals possess one major attribute that is not present in other technical systems: The signals are created by the change in investor sentiment. This point is the crux of the success of Candlestick analysis. Again, to emphasize the importance of what you have just read: *The signals are created by the change in investor sentiment.* Understanding this truism will make it easier to acclimate your investment psychology to this successful trading discipline.

The secrets of the effectiveness of the signals can be learned in a fast and easy process. An investor does not need to be knowledgeable about technical charting to take immediate advantage of the signals. The graphical formation of a signal makes reversals immediately visible. A Candlestick formation provides a visual graphic of investor psychology during a specific time period. For the purpose of illustration in this book, the standard timeframe is one day, and the trading entity is stock—equity as opposed to commodity. Investment strategies can be structured, of course, for whatever time period is suited for your trading style: minute-to-minute or monthly. Applicable trading instruments include any vehicle that has the key elements of investor fear and greed.

The graphics of a Candlestick chart have greater appeal than Western charts (commonly known as *bar charts*). The amount of data displayed is exactly the same, but the ease of visual interpretation is dramatically different. The immediate representative depiction of price movement as the result of investor sentiment is visually in front of you. Recognizing the change in investor sentiment is made easier when the graphics are clear and easy to understand.

Once you become accustomed to the Candlestick charts, all other charting will seem diminished in terms of effectiveness. That is not to say that other charting techniques cannot be used as "alert" functions. Candlestick signals, incorporated with other types of charts, fine-tune the reversal identification process. Watch your profits soar by simply combining Candlesticks with basic technical charting methods.

A Successful History

Knowing the history of the formations inevitably imparts confidence in the Japanese Candlestick technique. Japanese rice traders developed the system over a 400-year period. Logic dictates that a system that has persevered that long must have credible features. The history of the rice traders that developed the signals reinforces that assumption. With its 400 years of development, the Candlestick methodology got its major refinement in the mid-1700s.

Kosaku Kato (1716–1803) was born in the city of Sakata (now Tamagata Prefecture) during the Tokugawa Period (Eighth Shogunate). Adopted by the Honma family, he became known as Sokuta Honma. His successful interpretation of the candlestick formations made him the most feared and respected rice trader in Japan, and the wealth he produced for his family became legendary.

Success is a ladder that cannot be climbed with your hands in your pockets. Japanese Proverb

Songs were written about the Honma family's untouchable wealth, as reflected in the lyric, "Nobody could ever be a Honma, but everybody would like to be at least a lord." Their mastery of the rice market price movements was popularized in verses such as, "When it shines in Sakata, it's cloudy in Dojima. And in Edo (Tokyo), it rains." In other words, when there is good weather in Sakata (the growing region), the prices fall on the Dojima exchange and rice prices plummet in Tokyo.

Honma's methods are divided into two categories: the Market Sanmi No Den and Sakata's Method. The Market Sanmi No Den rules can be summarized as:

A. Without being too greedy, analyze the time and price ratio by reviewing its past movements.
B. Aim at selling at the ceiling and purchasing at the bottom.
C. Increase the position after a rise of 100 bags from the bottom or 100 bags from the top. (The price stayed the same; the volume measured in bags changed in those days.)
D. If a trade is not working, analyze it as fast as possible. Once it is discovered to be a bad trade, liquidate it immediately and rest before putting on the next trade.
E. Liquidate 70 to 80 percent of a profitable trade, liquidating the remainder after the price has indicated a top or bottom.

The Market Sanmi No Den rules A, B, and C require that the investor study charts. Rules D and E represent investing philosophies.

Sakata's Method is the first verifiable beginning of pattern recognition.

Although, Honma did not originate Candlestick analysis, his rules and philosophies gave the technique credibility. When in his early 50s, Honma wrote 160 rules that became the cornerstone of Japanese Candlestick analysis, as well as the basis for Japanese investment disciplines. His use of three-period patterns is the foundation for Japanese charting, along with other Western charting practices.

Through Candlestick recognition, the name Sokyu Honma is associated with successful investing in Japan, as the name Bill Gates is associated with successful computer program marketing in the United States. Learning to "consult" the market, as Honma did a few hundred years ago, will greatly enhance your investing probabilities in the markets today, as you will see in the next section.

Consult the Market about the Market

When analyzing the market, pay attention to the market movement itself—in other words, *consult the market about the market*. The would-be investor has to follow the market movement like the cat that wishes to catch the mouse. Charts reflect the past. Theoretically, it is not possible to predict the market's future; yet, analyzing identifiable patterns as a prelude to a high probability result is as close as an investor can get. Repeating patterns are not 100 percent accurate, but visually verifiable probabilities can adjust the odds immensely in your favor. Identification of certain events provides a basis for predicting an occurrence. Otherwise, admonitions such as "Red skies at night, sailor's delight" would not be in existence. Hundreds of years of weather observations produced a high probability for a reliable prediction about tomorrow's weather. The same historical observations have made Candlestick signals highly accurate.

Candlestick Charts Versus Bar Charts

After using the Candlestick charts, you will find that bar charts do not provide the same clarity. Despite the fact that the exact same information is being conveyed, the Candlestick charts, through greater visual appeal, provide information that is more communicative than bar charts. Candlestick patterns allow the investor to identify pertinent information in a relatively fast and unencumbered manner.

Bar Charts

A vertical line, seen here in Figure 1.1, represents the daily price movement on a bar chart. The top of the line is the high of the daily trading range; the bottom is the low of the day. A notch to the right side of the line represents the closing price. In more recent years, a notch has been added to the left side of the line to designate the opening price. Opening prices have not been as readily available in stock transactions until a few years back. Futures and commodity charts have had access to this information for a longer period of time.

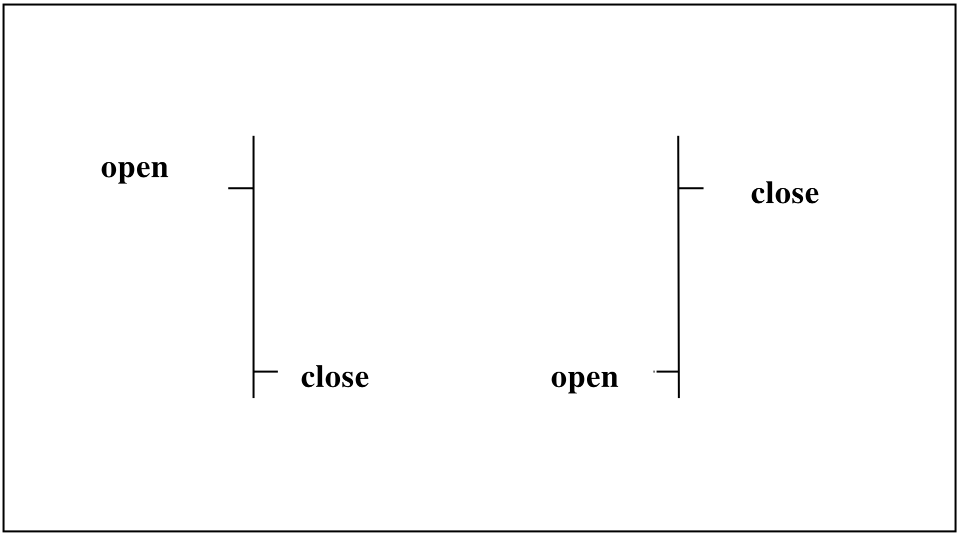

Figure 1.1 Daily price movement.

Internet charting services and software vendors provide a large number of additional technical indicators along with the charts. Fortunately, we are living in a time when software packages are constantly being developed to provide more and more technical information. This is mentioned to illustrate the benefits of technology that can be applied to better enhance the investor's evaluations. Upon becoming accustomed to the Candlestick charts, an individual can fine-tune the probabilities of successful trades many times greater than what the capabilities would have been just a few short years ago.

Candlestick Charts

Using the same information provided in a bar chart, Japanese Candlestick charts provide immensely more illustrative graphics. As in bar charts, the open, close, high, and low are all that is required. Yet, the manner in which they are depicted provides a great amount of information to the Candlestick analyst.

Forming the Candlesticks

Horizontal lines represent the open and the close. (See Figure 1.2.) Once both lines are added to the chart, they are boxed. This box is called the BODY. If the close is higher than the open, the body is white or empty. If the close is lower than the open, the body is black or filled. Keep in mind, this does not necessarily mean that a white body represents that the price was up for the

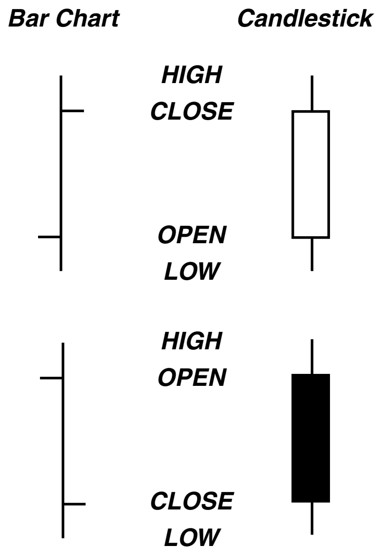

Figure 1.2 Forming the Candlesticks.

day or that a black body represents that the price was down for the day. The body color only illustrates where the close was compared to the open.

The contrasting colors of the bodies provide for rapid visual interpretations. A declining column of dark candles interrupted by the appearance of a white candle attracts the attention of the eye immediately. This is something that would not occur when viewing conventional bar charts.

The lines extending from the body represent the extremes of the price movement during the day. These are known as the *shadows*. The shadow above the body is known as the *upper shadow*. In some Japanese analytical circles, the upper shadow is also described as the hair. The shadow below the body is known as the *lower shadow* or the tail. The length of the shadows has important implications to the strength of reversal moves.

The bodies with shadows look much like candles—thus the name Candlesticks. But don't let the unsophisticated name throw you. The information provided by the formations puts the Candlestick analyst giant leaps ahead of other technical analysts.

The colors of the boxes are not important. For visual clarity, white and black easily show contrast. Some computer software uses green for up and red for down. The purpose of the chart is to provide a clear indication of what signals are being formed.

Figures 1.3 and 1.4 are included for comparison purposes. Once you have become accustomed to the candlestick charts, the visual aspects of the candlestick charts will make all other charting techniques seem obsolete.

Figure 1.3 Bar chart.

Figure 1.4 Candlestick chart.

Contrasts between the information conveyed by Figure 1.4 and that conveyed by Figure 1.3 will become dramatically apparent by the time you finish studying this book.

Exploiting Reason while Eliminating Emotion

Japanese Candlesticks perform a dual function. Investor fear and greed create the signals. Knowing this information creates a frame of mind to anticipate how formations might be developing. What is the glib response to the question, "How do you make money in the stock market?" Buy low and sell high! That simple. Yet reality reveals over and over that John Q. Public is going to buy a stock *after* it has already made a major move upwards. This decision is based on greed. You can see the evidence for yourself as the daily price range expands and the volume increases at the top of up moves.

Conversely, rational investment decisions are overpowered by fear when prices reach the lower end of their decline. When prices are getting lower, common sense says to be buying. However, the same expansion of daily volatility and volume can be seen as investors get panicky. It is at these stages that the Candlestick signals will enable you to make inordinate profits. Observing uniquely accurate Candlestick signals will provide you with a much more positive investment frame of mind. Doubt and fear will give way to confidence. Knowing that a signal creates a high probability occurrence allows you to make rational, not emotional decisions about your portfolio.

There is a time to take counsel of your fears, and there is a time to never listen to any fear. General George S. Patton, United States Army

The logic conveyed by the Candlestick formations is simple. For a quick illustration (also seen later in this book in the section describing "windows" or "gaps"), consider the common investor psychology when a stock has been going down steadily for the past eight trading days. Each day the stock price goes lower and lower. Finally, everybody just wants out of the stock at any price. They can't stand it anymore. Fear now takes control. The stock price gaps down the next day on big volume. Investors are finally relieved of the pain and fear of holding that stock any longer.

Note after the long decline (shown in Figure 1.5), the fear gets so painful, that the price gaps down. The first question that should come up is, "Who was buying all that stock to relieve everybody's pain?" In other words, who was using the concept of buying low? Candlestick analysis allows investors to be prepared and profit from these moves.

Figure 1.5 After an extensive decline, prices gap down when the pain is too great.

Improve Investment Skills Permanently

Japanese Candlestick analysis will improve your investment skills permanently. Knowing how investors react to price movements provides the Candlestick analyst with powerful advantages. First, the knowledge of what bottoming signals look like keeps the investor from grabbing for the falling knife. Patience is essential while waiting for a signal. Secondly, Candlestick investors now have an investment platform for buying at the bottom and selling at the top. Knowing that bottoming signals occur with a high degree of accuracy takes the emotion out of getting into or out of a position. Looking for signals to occur at the low end of a trading range creates an unemotional discipline. The risk factors are greatly diminished when buying at the bottoms and selling at the tops. Yet this practice is not taught at any institution of learning.

The experience most investors obtain to become reasonably proficient investors, unfortunately comes from the school of hard knocks. Apparently, some people get a handle on good discipline much easier than others do. Otherwise, everybody would be doing well in the markets. But for those who require a stronger framework for establishing a good investment regimen, the

Japanese Candlestick method has those qualities. Not only does the methodology direct you to buy at the bottoms and sell at the tops, it gives you the background psychology that makes you understand why a reversal is occurring. Buying the "hot tips" becomes much more controlled by being able to analyze when the first buying waves came into the " hot stock's" most recent move.

Becoming a Profitable Candlestick Investor

Most investors do not have an investment plan. This is simple to confirm. Ask friends and associates how they find their investment picks. The answers will range across the board: a tip from a friend of a friend, an article about a company in a magazine, a news clip about a firm or product on CNBC, the number one stock pick from an investment newsletter. On top of it all, it is usually a combination of these and many other mishmash approaches. The performance is inconsistent. To make matters worse, if the performance is decent, there usually is no way to measure the successful sources. This book will provide you with strategies that will dramatically increase your investment returns. You will be exposed to techniques that teach you how to remember and utilize the signals, quickly.

The descriptions of the signals in this book will be provided in a "condensed" version. Again, the point is to educate you in an efficient, yet expeditious manner. There are other books on the market that will be recommended for your full learning process. Those books will be more descriptive in how the signals were named and the psychology behind their formation. The primary value of this book to you is learning how to produce consistent profits from the signals.

This book is divided into two sections. The first section is oriented towards

- Learning the signals.
- Evaluating the most profitable trades quickly.
- Learning what confirming indicators are the most effective.

The implementation of this information will be used to eliminate "false signals." Search results will be quantified for harvesting the trades with the greatest potential.

The second section focuses on how to maximize profits. This includes trading strategies that minimize the downside risk. You will learn how to close out losing trades with minimal loses and no emotional attachment. At the same time, profit maximization procedures and philosophies will be demonstrated when closing out profitable trades.

Creating Maximum Trade Probabilities

The Candlestick methodology focuses on the investor's main objective: How do I maximize profitability? There are always rationalizations that move away from this vital outlook. Common investment counseling states, "Long term investing is the only way to make good returns: you can't time the market." Or, "Find a strong fundamentally sound company and it will grow." These reasons are heard all the time. But that is usually the advice for a person who doesn't want to or can't focus on maximizing the returns with the minimum of risk—the point of investing.

Whether one is managing money for others or whether they are managing their own funds, the same basic question should arise each time an investment decision is required: "Is this the best possible place for my investment funds to maximize returns, based upon my risk tolerances?" The use of the Candlestick method keeps the investor focused on that question. The cultivation process is directed to finding the *best* place for investment funds. This step-by-step procedure (explained in Chapter 9) builds in a self-directing discipline for maintaining profit maximization.

To enhance those probabilities, you will have the benefit of reading about subtle signal variations that will keep you from losing money. You will be exposed to common mistakes that can be avoided when producing a profit maximization program. This book introduces you to software programs with excellent search capabilities. You will be exposed to search formulas that produce highly profitable trade situations in a matter of minutes. Step-by-step trade implementation procedures describe how to place all the probabilities in your favor. This is a powerful, common sense trading process that the signals create for the candlestick-educated investor. Not only does Candlestick analysis provide a mechanical investment game plan, it produces a blueprint for establishing a non-emotional investment procedure.

Fundamental Analysis Versus Technical Analysis

Fundamental analysis influences 90 percent of all investment decisions. For the long-term investor, it is the reasonable basis for committing long-term funds. Yet, is it the way to maximize returns? Consider what is involved when analyzing the future potential of a stock price. Projecting the future of a company's capabilities has hundreds of different variables. Is the management capable? Is the product line sustainable? What are their competitors doing? How are government regulations affecting this industry? Any one of many fundamental elements can change at any time, creating a reversal in the growth potential of a company.

Most financial "experts" advise buying the good quality company and hanging on to it for the long term. The stock market has averaged approximately an 11 percent return annually over the course of history. These statistics have been skewed during the past four years. Until 1997, the market never had more than two years in a row of double-digit growth. Most investors today have not experienced a severe bear market. A bear market does not give a hoot about fundamentals. When the market tide goes down, all corporate ships are lowered. Conversely, the worst stocks in the world can get a boost when the markets are skyrocketing.

Perception — The Major Investment Truism

One truism about making money in any market is that *perception overpowers reality*. Even during periods of great economic growth, holding on to the stock of fundamentally sound companies may not make you any richer. If investors perceive that better profits can be made elsewhere, that is where the money is going to go. Evidence of this is apparent in the titles "old economy" and "new economy." The returns on stock of fundamentally sound companies over the past few years have paled next to the returns produced by owning a "new economy" stock—at least prior to the bursting of the technology stock bubble in March, 2000. It may be true that you make more money by holding a good fundamentally sound stock for the long term, provided that the only alternative is to hold non-fundamentally sound stocks for the same timeframe.

If your intent is to maximize portfolio growth, the logical method of investing includes buying what has the most upside potential today. That brings us back to investor perception. The Candlestick signals identify where investor funds are going today, this week, this month. The Candlestick signals pinpoint the turns in investor sentiment. Using this knowledge produces trading strategies that minimize downside and maximize upside probabilities.

Buy on the Rumor

If it is obvious, it is obviously wrong. Joseph Granville

How often have we witnessed a company announcing good earnings or a beneficial contract or disclosing information that would appear to be advantageous for the stock price, yet the price of the stock immediately declines? "Buy the rumor, sell the news" is an oft-repeated Wall Street adage. Unless you are positioned in the "in-the-know" Wall Street crowd, how can you possibly know the scuttlebutt on each and every company followed in the investment arena? A major advantage of identifying Candlestick signals is the lack of need to maintain expansive information networks.

A Candlestick buy signal provides you with the knowledge of when the buyers are stepping into a stock. You do not need to know why that is occurring. The only fact that should concern an investor is what stocks are going up and what stocks are going down. If there is a rumor that implies that a company's earnings are going to be good or that they are going to be bought out, who cares? A Candlestick buy signal represents the probability that this stock is positioned to make you money. Your identification of the buying in a particular stock presents a favorable probability of being in positions that eventually announce good "surprise" news. If something good is happening to a company, the people "in-the-know" will be accumulating the stock before the announcement. The Candlestick signals identify that action.

"Buy the rumor, sell the news." Quite often, this is the correct investment strategy. But how do you determine whether the news is more or less of a surprise as to what was anticipated? That can be easily determined by the candlestick that is formed, putting you days, sometimes weeks, ahead of the rest of the investment community. A gap down, at the bottom of a trend resulting from bad news, may *not* indicate the time to buy. A black-bodied candle formation that day means something completely different than a white-bodied candle. This will be dealt with in detail in Chapter 9.

Where Do We Learn How to Invest?

Where did you learn how to invest? Where does anybody learn how to invest? There are no official courses that are taught to investors. In school, we are taught about the different investment vehicles and strategies. But there are few forums for teaching the actual psychology of a professional investor. Even if there were a qualified investment education program, teaching the emotional disciplines may be nearly impossible. *Experience* is the major factor when becoming successful in most investment disciplines. Experience is the only education for developing the proper mental process. This is the most difficult hurdle in the path to proficient investing practices.

A person who has had a bull by the tail once has learned 60 to 70 times as much as a person who hasn't. Mark Twain

Putting one's own money on the line creates new dynamics. Investing and love are in the same category: Despite any amount of logical reasoning, intellectual analysis, and preplanning in a decision involving either, emotion takes over as the dominant component. The power of investment discipline can be harnessed. Investment rationale, which is the foundation of Candlestick formations, is implemented in a sensible and logical methodology. Reading this book will expose you to highly defined pattern recognition techniques. With this knowledge, an investor—whether a beginner or vastly experienced—can employ the basics of investment logic in a calculated program.

So where *do* we learn how to invest? Was there a point in *your* investment life where you decided to make a study of the most successful investment programs? If so, did you sit down and consciously investigate strategies and learn how to use specific trading philosophies? Unfortunately, most investors start their investment programs because they have a little money to invest. Where do they turn for investment advice? A stockbroker, banker, parent, friend, investment newsletter service, or a multitude of sources, some of whom probably started out the same way they did. Beginning investors are looking for somebody to direct them about where to find a good investment, not a good investment strategy.

And once you've begun investing, who do you turn to when you have permitted fear to scare you out at the bottom or greed suck you in at the top *again*? Who do you blame when you sell out of your profitable positions too early because you are afraid they will pull back and turn into losses? Or you hang on to your losing positions as they ratchet down, each little up-tick giving you hope, but finally sell out at the bottom because the pain is too great? This syndrome is described as "eating like a bird and pooping like an elephant."

Identifying the Candlestick signals puts you in control of your investment program. Emotion is eliminated. You will not have to "hope" that the last trade you put on will work. This book will put you in the position of feeling confident that the vast majority of your investment positions will work. You will be able to sleep well every night. You will learn to quickly identify the trade that is not working, immediately liquidate it, and then put those funds into the next position where the probabilities are greatly in your favor.

Learn How to Fish

Many people spend more time and energy on buying a car than they do in researching how to build their financial wealth. And there is a good explanation for that. The experience of buying a car—the haggling with salespeople and then hoping nobody finds out that you could have negotiated a $600 better price if you knew what you were doing—occurs every three, five, or seven years. Buying a car, even finding out that you paid too much for it, ends with the decision process. You own it. You paid too much for it. Too bad! Now life goes on.

The investment decision has a constant decision-making aspect to it. Each month, week, day, or minute has the potential for making another decision. The decision-making process required for producing good returns on your portfolio is a constant and scutinizable activity, one that can have many embarrassing throwbacks, such as buying at the peak, selling out at the bottom, picking the wrong company in an industry, selling too early, or selling too late. Without the use of a definable investment strategy, most investors go through life hoping that their investment decisions are going to work out. They had no game plan going in; they usually have no game plan for exiting. Fortunately, the markets overall growth, in general, has "raised all boats" over the years.

The Candlestick signals work equally well on both sides of a trade. They are as accurate for showing when selling comes into a stock price as they are for showing when buying comes into a position, thereby enabling investors to control their entry and exit strategies.

Human Emotion

Why do most investors repeatedly make the same trade mistakes? That great bugaboo *emotion*. Investment logic and investment emotions create a vast decision-making divergence. Have you ever analyzed a stock situation, whether fundamentally or technically, and planned your entrance and exit strategies thoroughly before putting on the trade? Once the trade is on, the circumstances that you analyzed occur, but all the preplanning for the establishment of the trade now disappear. You don't follow through with your game plan. Why? This phenomenon is a common occurrence among investors—easily explained, but hard to overcome: human ego! We all think we are intelligent. We analyze an investment situation and put our stamp of intellectual prowess on the line. Buying a stock position immediately declares that, with the same investment criteria available to everybody else, we have made a statement, subconsciously, that our analytical abilities are better than the average investor. Of course, when a stock price moves against us, that is just a temporary misreading of the market factors.

Man who toot in church sit in his own phew. Proverb??

Ego—Our Investing Hurdle

Part of our minds—our egos—assure us that our assessments were correct and everybody else will eventually see this stock price moving in the direction that we first anticipated. Unlike making a decision to buy a car, a book, a vacuum cleaner, or anything else that required a one-time decision about the expenditure of funds, investments have an additional emotionally debilitating element. The decision process continues each tick after the initial purchase.

You buy a stock and the price immediately goes down. Do you sell it here or is it at the bottom? It keeps going down, the same question occurs every day, every tick. Conversely, the stock price is going up. Is it time to take profits? How embarrassing it would be if it went back down to where you bought it. Or worse, if after it was up at this price, you eventually sold the position for a loss. Each position becomes an emotional conquest—your intellect versus the rest of the market players.

> **Man is the only kind of varmint that sets his own trap, baits it, and then steps in it. John Steinbeck**

Candlestick formations take the emotional factors out of investing. In Chapter 7, you will learn how to take the emotion out of owning each individual position. The signals provide a discipline that can be inherently adhered to. If you follow the signals, the percentage of correct trades becomes more evident as you invest. If you trade against what the signals are indicating, common sense or investment pain will readily illustrate that you need to follow the signals. The percentage of correct trade results, produced from properly analyzed signals, will reinforce a trading platform that you will learn to follow faithfully.

What is the optimal trading system? Isn't that the "golden goose" we are all looking for? What trading program will eliminate the flaws that we each have in our investment psyche? How can we find the investments that will produce profits NOW? When do we get in? When do we get out?

Ultimate Criteria for the Optimal Trading Program

- Proven and tested results.
- Easy to identify reversal indicators.
- Elimination of emotional decision-making aspects.

Using any trading discipline will produce greater returns than the normal non-structured investment approach. Using the Candlestick signals, however, will produce a greater profit-potential investment strategy than you can imagine. Hundreds of years of honing the visual identification process —the initial form of statistical analysis—provide a well-founded investment stratagem. You can reasonably assume that the percentage of positive results from Candlestick signals is significantly worthwhile. Otherwise, those signals would not be in existence today.

Additionally, it is extremely useful to implement a trading strategy that can be documented and analyzed. Each new trade provides an analytical tool. What went right with this trade? What went wrong with this trade? The post trade results can be compared to existing results produced by similar signal formations. An investor should be able to evaluate each trade in order to better the results of the next trade. Being able to identify the potential of a high-probability trade, days ahead of the other market participants, has obvious advantages. The downside risk is reduced. The signals alert you to the first change in investor sentiment. You get into and out of positions before the masses. Upside potential is enhanced, exploiting the next round of buying by the investment analysts.

"Why isn't everybody using Candlesticks?" You will be asking that same question when you finish this book. Candlesticks provide all of the elements needed for successful investing:

- They identify where the buying or selling is occurring.
- They are accurate enough to still be in use 400 years after their beginning.
- They eliminate emotion and instill discipline.
- They enhance existing technical methods.
- They tell you when to get into and out of a trade.

Once you finish this book, your mental investment procedures will be radically altered. Mastery of the Candlestick technique will provide the mindset of a successful professional investor. You will also gain valuable insights into human nature. You will be able to cash in on low-risk, high-potential opportunities overlooked by the common investor. The inherent nature of the signals instills common sense disciplines. You are about to be exposed to the most refined signal generating system in all of financial history. Hundreds of years of observation have produced results with a system that has thrived through the centuries.

Are you tired of settling for mediocre returns? Does the rationale of losing less than what the indexes lost not impress you anymore? Do recommendations from major Wall Street brokerage firms appear to have lukewarm potential by the time they are presented to you? Why settle for watered down investment programs when you can pinpoint exact bottoms and tops? Why forego profit potential that can be extracted from the markets directly into your pocket? The effort required to master the Candlestick technique is minimal when going about it in a structured manner. Practical insights derived from the visual aspects of the signals will point out the real profit potential of investing.

The following chapters explain the formations, the psychology behind the formations, and give illustrations of the signals. Read these sections at your own pace. It is not necessary to remember each signal and the psychology behind it to a high degree. Learning how the signal is created aids in remembering the signal, but it is not required for making profits. Of the 40 or so signals, there are approximately ten major signals. Become familiar with what the signals look like. Later chapters outline the process for learning the signals easily and rapidly.