

“Profitable Candlestick Entry and Exit Strategies”

How To Recognize The Exact Right Time To Buy Or Sell

A Candlestick Forum publication – Years of Candlestick Analysis made available in concise formats. Information that when learned and understood will revolutionize and discipline your investment thinking.

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Introduction

The Candlestick signals are in existence today because of their statistical probabilities. As can be imagined, the signals would not be in existence today if they did not produce profits. Profits noticeable through history, significantly more than random luck or normal market returns. The purpose for utilizing the Candlestick signals is to put as many probabilities in your favor as possible.

The fact that the signals are still around is due to results over centuries of observations. Assuming that the probabilities of making a profit from a signal is above 50%, maybe 60%, 70% or even 80%, those percentages can be enhanced by an additional factor. *(To date, statistical performance has been difficult to obtain. The fact that there have been severe misunderstandings by most investors of when a signal is truly a signal has been a deterrent. That lack of knowledge and the multitude of parameters needed to do statistical analysis makes programming for statistical results an overwhelming task. The Candlestick Forum is currently directing local university projects to accumulate those statistics. They will be made available to Candlestick Forum members as results are obtained. Because of the magnitude of this project, information will probably be released in bits and pieces as they are completed.)*

How the position is acting once the signal has appeared is an immediate filtering element. Being that we all eternal optimists, we want every position to go up as soon as we buy it. But keep in mind, even with phenomenal results of 80% positive trades, that still leaves 20% that will not work. The more steps that can be taken to reduce the bad trades, the better the results of your placed investment funds.

The information revealed in this book and on the Candlestick Forum website is not the telling of ancient “secrets” or the new development of sophisticated computer generated formulas. It is the assembling of common sense observations from centuries of actual profitable experience. As you may have noticed yourself, Candlestick information has been around for several decades. Everybody knows about them, they use the graphics for better viewing of charts, but they just don’t know how to use the signals themselves. You, by taking the time and effort to research the Candlestick method, are still in a small minority of the investment community. All the concepts conveyed in this book and the rest of Candlestick analysis is just common sense. Remember, the Japanese rice traders made huge profits from the Candlestick method. They used rice paper to draw charts and backlit them in candle boxes. The concepts applied to Candlestick analysis eventually became the backdrop of the Japanese investment culture.

Common Sense

As you learn about the Candlestick method, keep in mind that the common sense approach is what distinguishes this investment technique from most other trading practices, with those practices being heavily weighted by emotional decision-making processes. The information you are receiving is knowledge available to everyone. However, you have the benefit of getting the correct **interpretation**, which means you get the desired results. Take advantage of this knowledge. It will create confidence in investing that most people never experience.

Just as the signals produce valuable information as to when to buy a position, they are just as valuable for demonstrating when to sell. This sometimes is much sooner than is expected. Simple logic tells us that if a Candlestick “buy” signal appears in the right place with the right confirming indicators, that the trade should be ready to go. Unfortunately, reality may show a different outcome. How a price opens the next day is also a very important indicator as to how aggressive the buyers are. (The same parameters can be applied to sell / short transactions, but for illustration purposes, the buy side will be used to represent all trades.) Utilizing that information can be instrumental in weeding out less favorable trades.

The logic behind the results of an open the next day after a signal is simple. Is there evidence that the buyers are still around? That information is readily available through inexpensive live-feed services. We recommend the TCNet program (see more information about all the investment benefits that TCNet provides for investors on our site, www.candlestickforum.com). Being able to view how a stock is going to open before the market opens improves an investor’s positioning dramatically. Watch your returns multiply by eliminating the bad trades.

The shorter the trading period, the more critical the opening placement. Options are trading vehicles that require the most exact timing possible. Longer-term investors have more leeway when putting on a position. A six-month trade or a one-year trade is usually being bought when the monthly, weekly and daily candlestick charts all coordinate, each chart showing it is time to buy. (The monthly and daily charts are the pivotal charts for long-term investors; the weekly chart is often out of sync with the other two, which does not affect the results).

“Buy stocks that are going up. If they don’t go up, don’t buy them.” Will Rogers

Each formation is not necessarily a signal. A Candlestick “buy” signal in the overbought area does not mean the same as a Candlestick “buy” signal in the oversold area. Conversely, a Candlestick “sell” signal does not mean the same in the oversold area as it does in the overbought area. Many investors confuse the formations as signals, but do not take into consideration where the stochastics are.

As you learn more about the signals, you will become acquainted with where the real signals occur. The majority of the time, that will be in the overbought or oversold ranges. Occasionally it will be in a midrange area, as in the J-Hook pattern. But there should be one simple, basic parameter for entering a position after the appearance of a buy signal. Are the buyers still present?

When do most investors want to buy into a stock? Usually after the price has gone up consistently for the past number of days or weeks. Finally they become convinced that the stock is going to go up forever. That is the reason inordinate amount of volume is usually seen at the tops. Everybody has gained enough confidence to get in. There has been broadcast after broadcast on the T.V. financial stations about how great the company or the industry is doing. To not get in means you are going to be left behind. Of course that is just about the top of the run. It starts to pull back because of profit taking. You hang on because after the profit taking, the up trend should continue. However, the pullback lasts a few weeks longer than you expect. Then it moves slowly up to the area that you bought, bumps into resistance, and pulls back again. Pretty soon you are sitting in a stock that you’ve owned for three months and it still isn’t back to where you bought it. Not a good return on your invested dollars!

Or consider the investor who has a little more thinking in his approach. He is going to buy a stock he has followed because it has pulled back a hefty percentage. This is at least more logical than buying a stock because it has gone up a great deal. But this also has its flaws if done without using any buying parameters or signals. Enron is a prime example of not buying a stock just because it has backed off a good percentage from its high. The person buying a stock because it has gone down, without any buying signals, is just grabbing for the falling knife. One of three things can happen from that point, and two of them do not make you money. The price could easily continue its downward trek. Buying because you think that the sellers have sold enough may not be a viable approach. Or the stock price could level out and trade flat for the next six months, not a profitable endeavor.

Finally, because you have a wonderful sixth sense, you happened to buy the stock at the bottom and it turned up reasonably quick. If that is the case, you do not want to read this book or any book that would screw up that talent.

The best investment strategy is to buy a stock that has bottomed and the buying is becoming more prevalent. Tall order? Not really, when you can visually see the buy

signs. The probabilities are much greater in finding stocks that are just starting to make an up move. It is better to buy a stock where fresh buying is recently coming into the stock and getting in on strength. Participating with other buyers at least indicates that there *are* other buyers, logical. As in the famous investment strategy of Will Rogers, “Buy stocks that are going up. If they don’t go up, don’t buy them”. As backward as that philosophy appears in the real world, the Candlestick signals get investors close to that concept.

How Stocks Open Reveals Huge Knowledge

After that wordy dissertation, we now get to the meat of the subject - being aware of how to get into trades properly. What is the message of a “buy” signal? As expressed in the “Profitable Candlestick Trading” book, **a signal is the cumulative knowledge of all investors participating in that stock that day.** If this is the only statement that you remember about Candlestick analysis, you will easily comprehend the ramifications behind the signals. A “buy” signal is formed by the reversal of the psychology of a downward trend. That is the formation that becomes visually evident to the Candlestick investor.

Simply stated, the signal is showing the evidence of buyers coming into a stock, reversing the previous downtrend. Those signals, 10 major signals and approximately 40 secondary signals and continuation patterns, can be identified by the Candlestick trader. As discussed earlier, the signals each provide a positive percentage of profitable trades, and bad trades. The best test for determining placing a position from that signal is based upon one simple question. On the open of the next day, are the buyers still there?

This may appear to be elementary, but it is the basis for getting into the position in the first place. The Candlestick signal represents a change of direction. The magnitude of the presence of buyers has an important factor on how strong that reversal will be.

Figure 1, Pinnacle Entertainment opens near the previous close. This clearly indicates that the buyers have not backed away. Witnessing the price advance from the opening trades reveals that buyers are stepping in without hesitation. Buy immediately. You have all the parameters evaluated. The probabilities are in your favor. There should be no reason not to get into the position.

Figure 1, Pinnacle Entertainment



Note in Figure 2, Province Healthcare Co. the buyers were still present. The open, by remaining in the area of where the buyers closed the price the day before, indicates that there was not a change of heart overnight. "In the area" can mean a slightly lower opening price. Consider the action of the price the day before. It had a big up day. As the close was getting near, the shorts may have realized that selling was not coming into this stock. They may have covered, pushing the price up further on the close. Profit taking or sellers still wanting to get out of the stock could lower the price on the open. The next morning, prices opening slightly lower and immediately heading higher indicates that the buyers have not disappeared. As soon as the first few minutes of trading transpire after the open, an investor should be able to ascertain how the stock and markets are performing.

If the market is not falling out of bed and the stock price doesn't appear to want to head lower, it is time to start putting on the position. A prudent method would be to buy half the position at the slightly lower level and putting a buy stop at the previous day's close for the other half. The rationale being that if the price comes up through yesterday's price, the buyers are still present.

Figure 2, Province Healthcare Co.



The most promising form of evidence that the price is getting strong buyers' attention is the gap up. Note in Figure 3, Meritage Corp., a gap up formed. As defined by the gap, (see "Big Profit Patterns Using Candlesticks Signals and Gaps") the strength from the buyers is very strong. A gap at the bottom of a downtrend and after a reversal signal is one of the best signs of buying strength possible. One should be committing funds immediately.

The gap up at a beginning of a trend bodes very well for an extended rally. Whether the indexes are opening up weak or strong, a gap up in a stock requires immediate attention. There is buying going on in this stock that is not concerned about the status of the markets. Try to get into the stock as fast as possible. The advantage of being able to view the bid and ask prices prior to the open is that it prepares you for your entry strategy. Seeing a stock price being bid up before the open, and knowing what a gap up indicates after a Candlestick signal, allows you to place a market order on the open.

Use that buying force to your advantage. Get in as early as possible. Again, the probabilities are in your favor and this time the gap is adding to the force of the move.

Figure 3, Meritage Corp.



Sometimes you are going to see a gap up, you get in and then watch the price head back the other way. Don't worry. The buy signal was the reason to buy. The buyers were still around to gap prices up. If profit taking occurs after that, no big deal, the buyers are still around. Wait a day or two and the signal should confirm itself.

A substantial gap up may require watching to see if there is any immediate profit taking. This position might be better entered by buying half the position on the open, and the second half after observing the price move. In some substantial gap ups, the opening price might be the high for that day, creating a black candle. The fact that it had many buyers and some immediate profit taking still reveals that there was a strong change in sentiment.

Note in Figure 4, Meridian Gold Inc. how the large Bullish Engulfing pattern clearly illustrated that the bulls had stepped in. This shows great buying influence. The next day gaps up. This could be the beginning of a very strong rally. This has all the makings of a strong run up. There would be no reason not to get into the position. However, once the position was filled, the profit taking set in. Is this time to worry? Remember what the Bullish Engulfing pattern told you. The buyers were coming into this stock with great force for some reason. It would seem very unusual that the next day they would all of a sudden disappear. It should not be so strange to see some profit taking after a 10% to 15% run up in two days. The underlining factor remains that the buyers have come into this position with vigor. Sit comfortably for a day or two to see what happens after the

profit taking disappears. In this case, the strong buy signal was the prelude to more buying.

Figure 4, Meridian Gold Inc.



The appearance of a gap up is a clear indication that the “buy” signal is having the follow through required to sustain a strong rally. Figure 5, The Exploration Co. has every sign of strong buying. A Bullish Engulfing pattern is the first signal. The gap up and the strong buying afterwards is more evidence. There would be no reason for not getting into the position on the next show of strength.

Once you have gotten into the position, the price rolls back. It could be profit taking, or the rest of the market starting to get weak. Your peace of mind is still in the strong buy signals. As in this illustration, it took a few days for the trend to start back up. During those few days, note that the sellers could not knock the prices down. It may have tested some nerves, but after 3 or 4 days, the bulls starting gaining confidence the sellers did not have enough strength to push the price back down. This led to the continuation of the upward trend. It took a few extra days, but that is reality. Some positions look great when you get in, but will lag for a few days. But if the message of the signals is correct, the trend will be continuing. Sometimes that will take patience but the probabilities will be in your favor.

Figure 5, The Exploration Co.



BUY on a Strong Open

“Buy on a strong open.” What does that mean? Once a Candlestick “buy” signal has made itself present, investors want to see one obvious element in the next day’s open price; that the buyers are still committing. The signal in itself reveals that buyers have moved into the stock. Will that buying continue? That is what can be easily identified the next morning.

Establishing an initial position requires a small amount of research. What is the direction of the indexes? What is the direction of the sector index most related to that particular stock? How are the other stocks doing, the ones closely associated to the stock you are ready to buy?

The entry instruction “Buy on a strong open” has two definable variables. What is considered “strong” and what is considered the “open”. First let’s discuss the definition of the open. Some investment gurus recommend not trading in the first thirty minutes of trading. The volatility is too great during that time. Most traders know that the best opportunities are produced in the first and last hour of trading each day. Probably more than 60% of the total daily volume occurs in the first hour and the final hour of the trading day. The pent-up research of the night before, since the close of the previous day, is implemented during the opening hour of the next day. This is the time to take advantage of Candlestick signals.

A new dynamic is put into force during the first hour of trading. All the investment decision-making processes are put into action with buy and sell orders in the opening hour. The inordinate volume is crossed and matched in market conditions. Once this volume is consumed by the joining of buy volume and sell volume, the price will begin moving in the direction of the remaining order balances. This inordinate volume makes the first hour more volatile than the other trading hours during the trading day. It also impacts the direction and the magnitude of the move.

Use Pre-Open Indicators to Improve Profits

Knowing that the open consists of a period of inordinate volume, the Candlestick investor can watch the movement of the stock price. If it is consistent with the other factors of a strong or weak open, the trade can either be executed or withheld until the proper factors are evident.

The other factors are simple indicators of what the market direction should be once the market opens. Each morning the futures can be observed in many places. CNBC has the DOW, Nasdaq, and S&P 500 futures posted in the lower right hand corner of the T.V. screen. If a position is ready to be implemented, it would not be prudent to place the trade on the long side if the futures were illustrating heavy selling on the open. The signals need continuing confirmation that the buyers are still around. Dramatic selling pressure on the futures before the markets open is an indication that the buyers may not want to fight the selling pressure that morning. The direction of the index may be projected by observing the formations that appeared prior to the next open. If it is expected to be in an upward direction that day, then the futures should be confirming that sentiment in their activity before the open.

If the direction of the market is projected to go higher, a small pullback of the futures should be tolerable. If the futures leave the “open” as questionable, check the pre-open price of the stock itself. Having software that shows pre-market bid and ask prices provides a clear indication of what is happening in the demand for that stock as it gets near opening time. That will be the most important illustration of how the buyers and sellers are lining up on the open. That does not mean it is the final indication. Sometimes a buyer or seller will commit their buy or sell order immediately after the market opens, not wanting to show their hand too early.

If the level of the bid and ask does not produce any concrete decisions, investigate how some of the same type of companies are acting on the pre-open. If they are opening above or below the previous night’s close, that information should add some insight as to how the stock in question is going to act.

The first thirty minutes after the market opens will swing around a bit. Your general analysis should have reduced some of the potential possibilities of what might happen the next day. Logically, you would not be looking to buy long if there was overwhelming evidence that the indexes were going lower. That is probably why you picked out the potential long trade in the first place, because you thought the next day had better bullish probabilities.

Buy on a strong open. Your analysis leans toward an “up” day. The stock you are trying to buy had a bullish signal the prior day. There are four combinations that can occur on the open:

1. The indexes/futures appear to be opening positive. The pre-market indication on the stock price is that it is opening higher than the close of the night before. The buyers have

not disappeared. This is the scenario that best fits with your analysis. In this case, there is no reason why you would not want to get into the position as quickly as possible. Buy at the market on the open.

2. The indexes/futures are showing strength but the stock position is opening lower than the close of the previous day. Analyze the situation. If the “buy” signal was created by extensive buying, which created the signal, some of that buying may have been fearful short covering near the close, causing an extra boost in the price on the close. There may be some traders taking some quick profits off the table, moving the price slightly down on the open. If this scenario happens, watch how the price acts during the early minutes of trading. If there doesn’t seem to be any sustained selling and the rest of the market seems to be staying strong, pick up a partial position. The “buy” signal showed a reversal the day before, the market is staying up, and there isn’t any major selling going on in the stock. Anticipate that the lower open was just some quick profit taking. As soon as you notice buying coming in, fill out the rest of the position. Or if you want to be more conservative, try this strategy. When the price opens lower, put a buy stop at the previous day’s close. The rationale being if it opened lower but came back up through the previous day’s close, then the buyers were still around.

3. The indexes/futures appear to be opening weaker and the stock price is opening higher. The signal from the previous day is the overriding factor; the buyers are still around. But the indexes are not acting well. The buyers of the stock are witnessing the weaker market indexes also. In this case, watch what the stock price is doing. If it appears that the buyers are coming into the stock despite the lower market in general, then the buying force is not regarding the market conditions, they want the stock. Buy it. Conversely, if the stock opens higher and the market indexes are heading lower, watch to see if the price doesn’t fizzle and start backing off. Lay back for awhile, and see what the markets are going to do for the day. A safe approach under these conditions would be to put a buy stop at the open price. Again, the rationale being that if the price came up through the open price, the buyers were back in control.

4. The worst scenario in the grid is a weak open on the indexes and the stock opening lower. Not too much of a decision here. The trade shouldn’t be considered. But a buy stop at the previous day’s close acts as the same beneficial strategy as before. In this situation, if the markets and the stock price start coming back up before the end of the day, the buyers should be back.

The primary element that should go into every entry decision is simple. Is there evidence of buying present, continuing the trend as indicated by the reversal signal? Being able to recognize which trends are going to get stronger buy participation will increase your portfolio returns impressively.

The signal has indicated the trend has reversed. It may be a slow reversal, or it may be a power move. The signal revealed a new trend was probable. Our e-book “Finding and Learning Candlestick Signals Fast and Easy” recommends reviewing past charts to see what signals occur at the reversal points. The same practice can be applied to the same

charts to become acquainted with the formations seen during the first day or two after the signal. Learning to recognize how a strong uptrend acts in the early stages of its development once again puts the probabilities in your favor. The signals are going to reveal plenty of buying opportunities. How to evaluate the follow through of the signals will allow you to filter the best of those opportunities.

Play the Probabilities

Not every trade is going to shoot straight up after the buy signal appears. There will be many entry points that fit the perfect buying conditions, yet fade just after you fill your position. Mistake? Depends on how the rest of the day finishes. Will every trade you get into work the way the signals indicate? Definitely not! But go back to the basics. You are looking for the best possible place for your money to make the best returns with minimized risk. Hopefully the signal itself is representing well above a 50/50 probability of making money. This ratio may be 60%, 68%, or 74%. Fine-tuning the entry process may increase the probabilities another 3%, 4%, 5%. A good evaluation of the entry also has the element of limiting the losses. If a trade is placed, and the basis of being in the trade disappears immediately, i.e. the buyers have disappeared, then the trade should be liquidated immediately. The loss may only be 1%, 3%, maybe as much as 5% if it is liquidated that day or on the next day's open.

The gains have an opportunity to run when the buy signal is not negated. The losses get trimmed immediately if the signal fizzles. All from a simple premise, "Are the buyers still in control"?

A good rule of thumb for protecting a newly established position is: If the close of the entry day, the day after the formation of the buy signal, is more than one-half way down the body of the previous day, close the position. Statistically this represents that the sellers still have the upper hand. However, keep in mind that a buy signal did form at the bottom of the trend. Despite having to exit the trade at a small loss, be prepared to see new buying evidence soon. If so, re-establish the position. The buy signal occurred for some reason.

It is professed in other investment programs that a stop loss should be put 6%, 8%, 10% behind the price as a trailing stop. Due to the fact that Candlestick signals are not created by numeric thresholds, a numeric stop is not valid. A trend created by the force of the buyers over the sellers has nothing to do with a percentage move. It is purely based on the directional sentiment of investors. A 10% pullback for some stocks may be an everyday occurrence. For others a 4% pullback would be unheard of. Analyze what the trend is doing.

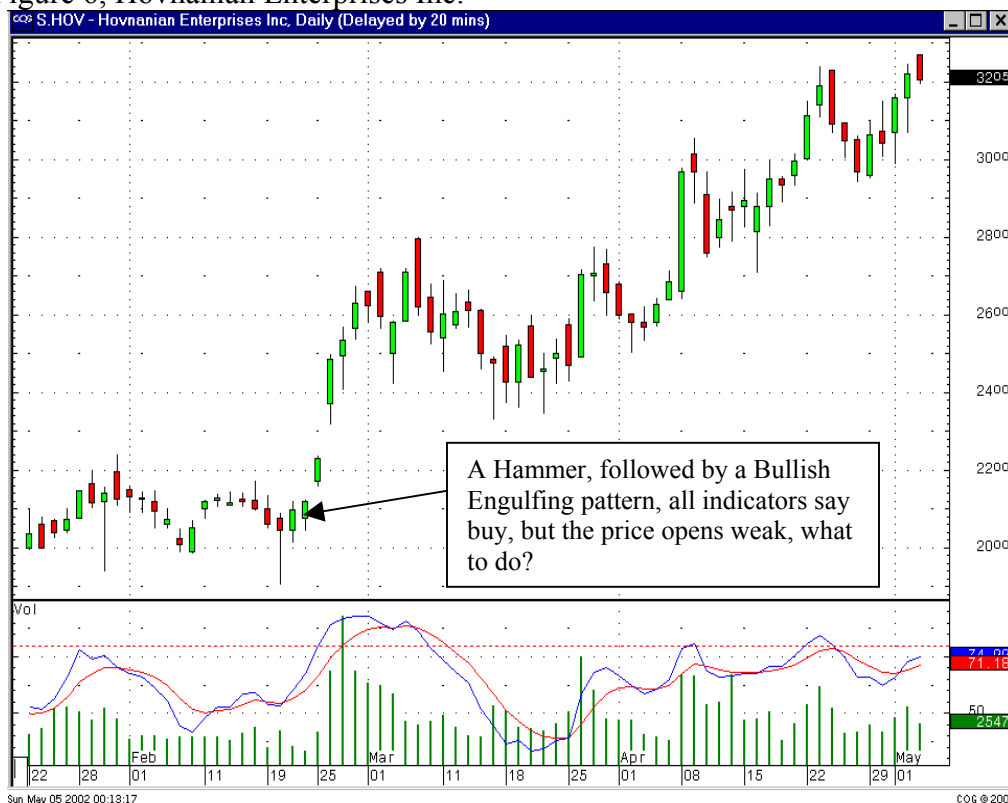
The most important area is at the reversal point. Is it a reversal or just a jig in the trend? That is where the analysis and monitoring are most important. A buy signal requires follow through. The weight of a sustained downtrend needs strong change of sentiment to reverse its course. If the reversal has only two or three days of up move, don't be hesitant to take quick profits once a weak signal appears. There may be a more opportune time to get into a position if a pullback occurs. The current low may hold. But if it doesn't hold and goes lower, you are not in the position. This is true whether you are a short-term trader or a long-term holder.

Figure 6, Hovnanian Enterprises Inc. illustrates the Candlestick investor's minor dilemma. All the parameters say to buy this stock. A Hammer is followed by a Bullish

Engulfing pattern. The stochastics have turned up, volume is picking up. But the next day the price opens much lower than what would indicate buyers were still active. What is the best way to enter this position? Are the sellers taking back control for some reason? Maybe the indexes opened much lower. In keeping with the practice of buying a stock that is going up, the best entry strategy would be to put a buy stop at the close of the previous day. If the buyers are still participating, it would be evident if they moved the price from the lower open back up through the close of the previous day. Buying the stock at a slightly higher price is a small premium to pay for knowing that you are getting in when the buyers are around.

If the buy stop never gets executed, the lower open and a close below the previous day's close would form a Harami. This formation would indicate that the buying had stopped. You are not in a position where the sellers may be taking control again. If your buy stop does get executed, you know that the buyers are still in control.

Figure 6, Hovnanian Enterprises Inc.



As described in “Profitable Candlestick Trading”, a Harami can show the investor great amounts of information. In the example of Hovnanian Enterprises Inc, the buyers did come into the stock, executed the stop, and continued to show strength. This made for a good trade.

If market conditions are weaker or profit taking comes into a stock, it can create a different evaluation after the close. Figure 7, Movie Gallery Inc., for example, creates an evening of less positive possibilities for the next day. In this case, the price opened lower,

came up during the day and executed the buy stop. Now you are in a position that has closed lower than where you bought and has formed a Doji/Harami. That could lead to a few days of consolidation. However, it is still early in the uptrend. Stochastics are heading up. Fortunately the buying continues the next day and moves prices to the positive. Again, the overriding factor boils down to the appearance of a Morning Star “buy” formation. As seen in the chart, the Morning Star formation was the bottom reversal point for a strong uptrend.

Figure 7, Movie Gallery Inc.



One of the most common chart patterns is the Doji after a big up day. Consider the dynamics occurring in the investors’ minds. In an example such as Figure 8, Scansoft Inc., there has been a recent distinct downtrend. All of a sudden a Bullish Engulfing pattern emerges. The buyers are stepping in. They have overwhelmed the sellers to the point of reversing the trend. The following day, after the big up surge, there will still be sellers taking advantage of being able to get out at a higher price than just a couple of days ago. This continued selling is met with the buyers coming in. It is not unusual to see a Doji day after a big up day. However, when the sellers see that the buying is now sopping up all the selling, they get concerned and step out of the way. The following day should see higher prices.

Don’t let the Doji Day concern you. It is the transfer of stock from selling hands into buying hands. If the price opens higher the next day, you can be assured that the buyers have now gained control. The rally should continue.

Figure 8, Scansoft Inc.



Entering a trade involves a combination of evaluations. Just as you would make a decision about what to wear today involves a number of observations. You may have heard the weather report saying that it is going to be cold and rainy today. You peer out the window to see what conditions are. You look at the thermometer to see what the temperature is doing. You may open a door to see if it is windy or calm. The same process is done when you are ready to enter a trade.

You investigate. You have already done your research and decided on what position you want to buy in the morning if the conditions are right. You check the futures in the morning to see what the general market sentiment appears to be. You can check to see if the bid and ask have moved one way or the other during the non-market hours. You can check on other stocks in the industry to see how they will open. You may look for any news that might have been reported since the close yesterday that would influence the stock price.

If nothing seems out of kilter based upon what the “buy” signal was directing to make your “buy” decision, then the final input will be how prices are actually opening. If nothing appears to be out of line, purchase the position. That is what the Candlestick signal indicated to do. Fine-tuning the entry process will minimize getting into a bad trade. For each bad trade you avoid, the more opportunity you have to put your investment funds into a good trade. Eliminating a very small percentage of losing trades will increase your returns in geometrical proportions. Avoiding a loss negates having to

make back those losses with a positive trade, while using up that next trade and time to get back to even.

When Is It Time To Get Out?

O.K., you have the position on. You are in it to maximize your profits. We all want to see a huge rally once the position is put in place. But reality tells us that hitting the right stock at the right time in the right market conditions is a very long shot. A multitude of events are going to happen that will make us question whether to stay in or get out of a position. Fortunately, the Candlestick formations provide a simplistic, visual depiction of what is going on in the minds of participating investors.

The probabilities of being in an uptrend after a bullish Candlestick signal are extremely good. However, the uptrend may last for a day or two, or it may last for three weeks. That is not information that can be conveyed by the signal itself. As illustrated from some of the examples, there are signals that will show more potential than others. The Gaps and Kicker signals are likely to precede a strong rally.

The uptrend is assumed, but many factors can terminate a rally. Market conditions, news events, rumors, many outside influences can affect a stock's upward move. Profit taking is another common pullback factor. Having knowledge of the common "sell" signal formations improves the exit strategy. Combining the knowledge of "sell" signal recognition with the status of the stochastics helps the Candlestick investor distinguish between sellers stopping an uptrend or whether profit taking is occurring. There are a number of continuation patterns that reveal profit taking versus reversal patterns.

Logic should be incorporated in the exit strategies as they are in entry strategies. The bottom-line thinking should be, "Have the sellers taken over?" This can be easily analyzed by evaluating the buying that got the price to the current level and the condition of the stochastics. Numeric formulas do not work for Candlestick formations. The buys and sells are based upon a change in investor sentiment. If the last candle represents buying, the trend should continue until the sellers demonstrate that they have overpowered the buying; a sell signal or a price move that will represent that the buyers were stepping out of the way.

Note in Figure 9, Meridian Gold Inc. had strong buy signals a few days before the actual major run up. A gap up (Kicker Signal) formed and was followed by another day of buying. Nothing in this chart would have indicated the next three down days. How do you protect yourself from this event? Each evening, analyze each position. What would the price action have to do the next day to reveal that the sellers had taken over, more than just some profit taking? In the Meridian Gold price movement, it would have been logical that if the price closed below the halfway point of the previous day's trading range, the sellers may have taken over control.

How do you protect yourself from this action? When a buy signal is negated by what is considered a "sell" signal, there should be some immediate evaluation as to what the trend is doing. In this day of inexpensive commissions, if the situation is causing some doubt as to the direction of a trade, get out. With Candlestick signals providing more

excellent picks every day than what any investor could possibly handle, why stay in a position that is casting doubts? Liquidate the trade and go on to a high probability trade.

Figure 9, Meridian Gold Inc.



As mentioned in “Profitable Candlestick Trading”, there will be a common price action described as a “scary” day. A scary day usually occurs about two, three, or four days into a new trend. After moving up for a few days, the sellers or profit takers knock the price of the stock down hard. However, by the end of the day, some of the sell-off is recovered. It creates an evening of great investment decision turmoil. Was this day just a last gasp sell-off or was there some new dynamic that was changing the trend direction? If the stochastics, as well as the other indicators, appear to be acting strong, let the price play out the next day. Stocks do not go straight up. Expect a trend to have some pullback days.

The ultimate uptrend is a majority of white-bodied candles with an occasional dark body candle created by profit taking. Note in the uptrend of Figure 10, Horizon Offshore Inc., how the appearance of dark candles scattered through the uptrend never showed a “sell” signal, just periodic profit taking days.

Figure 10, Horizon Offshore Inc.



Exiting a trade uses the simple premise that the buying side of the trade uses. Are the buyers still present? It is not uncommon to witness a double bottom at the bottom of an extended downtrend. It represents the buyers coming into a stock, moving it up, then the last of the sellers come back. This moves the price back down to or close to the recent lows. This formation is observed when, after a few days of an up move, the trend experiences some small sell signals and moves back down to the area of the last lows. Recognizing the small sell signals may take some time to get accustomed to, but it is easy to review the price action at the beginning of trends by looking through past charts. Find uptrends. Examine what price actions occurred.

This will accomplish two functions: If you are still learning the signals, it will reinforce the recognition of signals at the turns. The next thing you want to become familiar with is what formations appear in strong up-moves, and what formations appear in rallies that fizzle out quickly. The visual advantage of the Candlesticks is the definite contrast created by the dark and light candle bodies. As can be imagined, the more dark bodies seen in a trend, the tougher that trend is having moving to the upside. The earlier you witness dark bodies, the greater the probability the trend is experiencing new selling.

Studying this chart, for example, provides the insight that a trend will continue because no definable Candlestick “sell” signal appeared. There were some potentially doubtful moments, but the up-trend was completed because the selling candles showed consolidation versus outright reversal, i.e. no major change of investor sentiment.

Simple Rules

Being that the Candlestick signals are formed by price moves, and not by any numeric quotas, percentage stop points cannot be applied. The basic for stop losses in Candlestick analysis is simple. If a signal is created by the evidence of buying, then a complete retracement of that signal reveals that the sellers have undone what the buying did. Simply stated, if the confirmation of one of the Candlestick formations was a price move from \$10.50 to \$11.25, then it would be assumed if the sellers pushed that price back down through \$10.50, the sellers were back in control. In other words, if prices come back down through the beginning of a buy signal, then the buy signal has been negated by the sellers.

Once an uptrend starts, if an open appears at more than one-half way down the previous white body, be ready to liquidate immediately. This implies that something changed during the non-market hours. Be prepared to sell if prices appear to want to head lower. Especially if there is major bad news reported overnight, a stock price may gap way down. Our E-book “Big Profits With Candlestick Signals and Gaps” describes what to do in that event, depending on the trend prior to the announcement.

The most effective method for setting stop losses can be done by visual analysis. Keep asking yourself where would be the most logical place, that a price would have to come back to, to demonstrate that the sellers were taking control.

Some charts will reveal a day that shows strong buying. The next day some selling, not to be unexpected as a new trend is developing. The next day more buying is seen. The next day more selling. Now this becomes a concern. The sellers have had good reasons to step out of the way, but are still selling into this trend. Don't be afraid to take a flat or a tiny profit and go find a trade that has much more upside potential.

When in doubt, get out. There is no economic reason not to get out of a trade if it shows some weak indications after you have just bought it on a strong buy signal. First, there are many more trades to be found. Second, there is no rule to negate saying that if a position looks doubtful, get out and watch for the next buy signal. Not all stocks go up on a “buy” signal. The majority do! It is sometimes prudent to get out of a position, then come back in later when the signals demonstrate a more bullish situation. The point is not to make the most money from each trade; the purpose is to make the most with the dollars available.

The Trend Has Started

Once the trend has gotten out of the initial upturn, it becomes much easier to set stop losses. Buying because of a buy signal now becomes selling because of a sell signal. The beginning of a trend reversal has the additional weight of clearing out all the original trend sentiment. That is why double bottoms are so prevalent. The initial reversal moves prices up, and the sellers, feeling that they are able to get out at a better price, start selling again. Be alert for the typical bottoming patterns. The advantage is knowing the signals that prepare you instantly for the way a pattern may set up.

As a trend begins to move, create your own mental image of what would have to happen to indicate that the forces of that trend have been altered. The review of charts showing turning of trends will give you an idea of what price movements occur as the reversals get underway. It is basically visual. Occasionally a sell signal will appear after a few days into the uptrend. The stochastics may be the indicator revealing that profit taking is occurring and not a trend reversal.

But the most important investment defense should be, "When in doubt, get out." If your original game plan was to trade the position, or hold it for a two-week move, two-month move, six-month move, it makes little difference if you liquidate a trade because it does not appear to be maintaining a direction. There is absolutely nothing wrong with closing out a trade when it doesn't look good and buying it back when it does, even if it is at a higher price. The hang-up about buying a position, closing it when things look sloppy, then buying it back when all indicators look good again is our own ego's. "What if after I sell it, it turns right around and goes back up?" That is what most of us are afraid of. How foolish we would look after selling out of a position, then it made a major move up without us being in it! But that would have been true ten years ago. Back when it took thirty minutes to hear back from your broker and the cost was \$250 or more in commissions.

Today, if you decide to get out of a position, or you get stopped out, and then the position turns back up, buy it! Today's commissions, getting in and out, can be as low as \$10.00, maybe as high as \$54.00 roundtrip. If you have a \$12,000 position on, \$54.00 to get out when things look bad and to get back in when everything in that price movement looks good again is very small insurance to protect your downside.

Our egos get really bent out of shape if there is the possibility of having to get back into a position at a higher price than we got out. How stupid we look! We could have just left our position alone and made out much better. Except for two things: 1. The position was closed when all indications were that the price could head lower and 2. Look stupid to whom? 99% of the time nobody else is seeing any of the trades you are making. A punch of a button and you are out of a bad situation. A touch of a button and you are back into the position. If you had to get back in at a little higher price than what you just sold for, so what! The point of maximizing profits is not to make the most on each stock move, the maximizing of profits is to make the most of your invested dollar. Nobody cares that a stock you were in went up ten dollars and you only netted seven dollars by being in and

out. If the probabilities were not always good to stay in the position, the prudent strategy was to be out. ***The most important function of investing is to make the most from your invested dollar, not the most from every trade.***

Get in when the probabilities say to get in. The signal, the stochastics, market direction, sector activity and any other parameter that indicates that it is time to buy. Get out when the signals tell you to get out. Sometimes that will be tomorrow, sometimes that will be two weeks, two months, or two years. The signals reveal when the buyers have taken over. The signals reveal when the sellers have taken over. There is nothing in the structure of today's investment world that requires you to stay in a position any longer than you need to. If a trade does not appear to be doing what it is suppose to after being in it twenty minutes or two days, get out. Go find a trade that has all the probabilities in your favor. There are dozens of profitable trades every day.

Use Today's Investing Strategies For Today!

www.candlestickforum.com provides Japanese Candlestick information for all aspects of the analysis process. This includes the psychology behind the formations and signals to the ease of identifying and learning the signals themselves. Once your knowledge encompasses the general thought processes behind the signals, your investment acumen will expand immensely.

There is a vast difference in the investment philosophy of buying stocks that have the fundamental potential of going up and identifying stocks that **are** going up. Most investors live and die by the theory that a good company, held long-term will reap the best returns. That is not the best investment strategy today. Look at Enron, Lucent, Worldcom, or dozens of other stocks that were the leaders of their industries just two years ago.

Today's market requires today's investment strategies. Those strategies require the ability to identify when a trade is not working. Use the insights developed by the Japanese rice traders to decide when a trend has been stifled. There is nothing wrong with taking two or three 3% losses, keeping from taking a 20% loss, to finally get into the 30% gain.

Profits should be your ultimate motive.

Good Investing!

Stephen W. Bigalow

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