FOREX TRADING

PROFITABLE CANDLESTICK PATTERNS

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Forex Trading: Profitable Candlestick Patterns

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FOREX TRADING: PROFITABLE CANDLESTICK PATTERNS

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Forex Trading: Profitable Candlestick Patterns

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Chapter 1: Understanding Why Prices Move

If you had a crystal ball to how prices move in the Forex market, would you finally become a successful trader?

When it comes to trading candlestick patterns, most of us feel compelled to memorize all the patterns. This book provides a rationale for why particular patterns are reliable setups for traders.

The goal of this book is to allow you to change the way on reading candlestick charts into a search for who is controlling the market? Buyers or sellers?. In this way, you will get something more than a list of patterns that you can apply on the market, you will understand how and why prices move through the study of the candlesticks.

I once had attended a seminar about forex trading. It was a free event organized by a broker and they were talking about Forex charts.

I remember that the speaker pointed the chart on the wide screen and asked: "what do you see?"

As you expected most people got the same response: A chart!

I also heard someone laughing to be honest. The question maybe seemed to be too easy. So he asked: "if you focus more on the chart, what do you see?" Someone started to be interested and tried to listen carefully. Someone else then suggested candlesticks instead.

Well, that's correct.

So once again he asked: "if you focus on the candlesticks, what do you see?

Ten seconds of silence.

Questions started to seem harder and no one had any idea of where he was going with my questions.

Someone said that we could see price movements focusing on the candlesticks.

And that's correct again.

The speaker was quite proud of people there, they were right about the first three answers: chart, candlesticks and price movements.

So he asked: "if you focus on price movements, what do we see?".

Again, ten seconds of silence followed by someone who tried to give very exotic answers but there's only one answer to this question and it is supply and demand.

What you see on your charts is the result of supply and demand principle.

In other terms if demand exceeds supply the total trading volume of buyers is greater than the total trading volume of sellers causing the price to go up.

Conversely if supply exceeds demand the total trading volume of sellers overcomes the trading volume of buyers causing the price to go down. When supply and demand are equal the price will not have any direction.

That's the case of a sideways trend.

The supply and demand law are valid for any financial market and sometimes not only for financial markets.

Let me give you an example from daily life experience. Let's go on Amazon and search for a GoPro Hero 9. Using an extension on chrome, it allowed me to check for recent prices for items on Amazon. What I noticed was that if I went back a few months, price was dramatically lower now than when it first came out. Now what happens with the price here.

It happens because people wanted a new GoPro and started buying it. So many people bought the GoPro in that period such that they increased the demand for that item, pushing the price up.

This was a simple example on Amazon, just to give you an idea of how supply and demand work with something physical.

Who makes the Forex prices?

From the perspective of supply and demand, when you buy a currency pair, you are basically increasing the demand for that pair.

When you sell a currency pair, you are increasing the supply for that pair. So, we can say that buyers and sellers are responsible for the level of supply and demand. In Forex market, there are 2 different participants.

Retail Traders

The first group are buyers and sellers like me and you.

What are we doing on the market?

We speculate the market. We don't really care about fundamentals. We may be reading the economic calendar to stay away from trading when important news is released. And maybe we are trying to make profit trading the news.

But most of the time we are trying to make a profit from speculating the market imbalance.

What if euro-dollar pair collapses in a couple of weeks from 1.15 to 0.95?

Is it going to affect us?

Not at all.

Even if we had a long position, we probably had a stop loss of 100 pips or less. We don't really care if the price went down by two thousand pips in a couple of weeks. So, we can summarize our action on the market by saying that we are trying to make small profits on the market by investing an amount that can go from a few hundred dollars to hundreds of thousand dollars.

What kind of impact do we have on the markets then?

Zero! Forex has about 4.1 trillion dollars transactions every day on average. A position of $10000 is not going to affect the market.

Institutional Traders

The next category of buyers and sellers are the ones that participate in the interbank market. The interbank market is the market through which large banks transact with each other for both their customers and themselves.

Among the largest players are Citicorp and JP Morgan Chase in the United States, Deutsche Bank in Germany and HSBC in Asia.

The minimum size for a position in the interbank market is 5 million dollars. But most transactions are much larger and some can top one billion dollars in a single position.

If you think of a transaction of one billion dollars in a market that has an average of 4.1 trillion dollar transactions each day on average, probably it's still not much.

But if you think that 10 or 20 of these transactions are in the same direction, it starts to be relevant in terms of supply and demand.

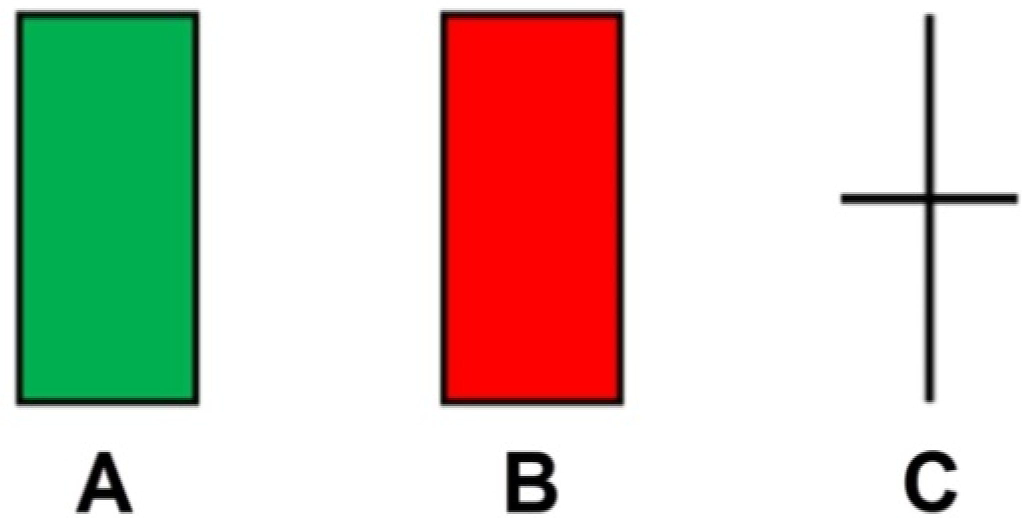
So throughout this book, I will talk refer buyers and sellers or bulls and bears as the institutional traders.

We don't have any power on the market so there's no point to study our action. We study the ones that can have a huge impact and can change the balance between supply and demand.

They are the ones who move the market. So, it makes sense to study their behaviour, how price moves as a result of their actions and formulate concepts to try to be in the same boat with them.

How to see who is in control in a candlestick chart?

Here we have three candles.



For the candle "A", we can say that the buyers were in control from the beginning to the end. The demand for the currency pair was higher than the supply.

Regarding the candle "B", we can say the opposite.

It's obvious that the sellers have the power at the moment and are pushing the price down. So we say that the demand is lower than the supply for that currency pair.

The candle "C" shows that there's an even fight between buyers and sellers.

The price went up and down creating new highs and lows for the session that we can see from the shadows.

But then it closes near the opening.

Supply and demand are in balance.

I think that it is quite easy, but I invite you to have a look at other candles and try to make your deductions on what happened during that session. An exercise that can help, especially if you're not familiar with candlesticks, is to open your MT4 platform, select 15 minutes as timeframe and have a look at the new candlestick from the beginning till the end.

It will give you an idea of the formation process of the candlestick.

But how can we know when buyers or sellers lose control of the market and there's a change in the scenario?

Or to put it in simple terms, how can we know when the trend is changing and when it is confirmed?

Starting from chapter 2, till the end of the book we are going to try to answer this question, studying the behaviour of the key players on the market through the study of the candlestick patterns.

Chapter 2: Profitable Single Candlestick Patterns

How can we know when the trend is changing and when it is confirmed? Traders watch for price clues alerting them that the trend is changing. Reversal patterns are these clues.

The term "reversal" may lead you to think of a strong trend ending and then reversing to a new trend.

This hardly ever happens.

That's why I don't like the name reversal patterns, because I think it is misleading.

A trend reversal signal implies that the trend may change but not necessarily reversing.

Compare a trend to a car traveling forward. The car's red brake lights go on and the car stops. The brake light was the reversal indicator showing that the prior trend, that is the car moving forward, was about to end.

But now the car is stationary, will the driver then decide to put the car in reverse?

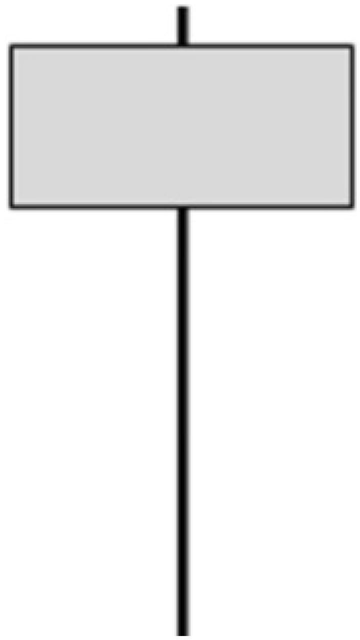
Will he or she remain stopped?

Will he or she decide to go forward again? Without more clues, we don't know.

Then we also have another category: the continuation patterns. A continuation pattern is one in which the market should continue to follow the same direction, so it should confirm the power of the current trend.

For instance, a continuation signal following a rally means that the trend remains up and we should expect that the buyers will continue to push the price up.

Hammer



The hammer is the first pattern that we are going to discuss. It has a small real body, so we can say that during the session there's been a pretty even balance between buyers and sellers.

This is also the reason why the colour of the real body is not important.

It's the size of the real body that is important.

Now let's have a look at the following conditions to check if this candlestick is telling us something more about the fight between bulls and bears.

- The real body is at the top end of the session's range.
- There's a very small or no upper shadow but there is a very long lower shadow, at least twice the height of the real body.

You don't need to buy a ruler and measure the hammer every time. The chart will show you open, close, high and low prices, if you just put the cursor over the candlestick.

But in any case, you don't need to be super rigid about this rule.

You will develop an eye for it.

The small upper shadow and the long lower shadow are saying that there hasn't been much action over the opening price because as soon as the session started the sellers were in control and immediately pushed the price down. Before the end of the session, the buyers managed to push back the price near the opening price recovering all the loss that they had during the session.

It is very simple so far.

Sellers had control at the beginning of the session.

Buyers managed to push the price back by the end of the session.

Now last condition is very important and unfortunately often forgotten. The hammer is a very strong reversal signal when it appears in a falling market, when there is a clear down move.

Here you can see three hammers appearing after a down move.

What's the logic behind this pattern?

In the previous sessions, the market sold off dramatically, then a hammer appears.

Think about what we have said about the hammer. At the beginning of the session, the sellers are in control. So nothing new because we have seen that in the previous sessions the price was going down. Everyone is expecting to see that the price continues to go down.

But, suddenly, the bulls appear and they have the power to push the price back, near the opening of the session.

This means that after many sessions dominated by the sellers, the price has become attractive enough to convince the buyers to take action and buy the pair.

To have a better understanding of this pattern, we will go inside it and check the price action that leads into the formation of a candlestick of this shape.

The best way to do it is to identify a hammer and then switch to a lower time frame to check what happened over the session.

Here we have dollar USDJPY on a daily chart.

We can see three hammers. The first two highlighted in green didn't really have success. The price went up after the first hammer, but then it started to go down again.

The second one has the shape of a hammer but I would not consider it after just two bearish sessions. I can't certainly say that the price was going down. It looks that at that point the pair was in a sideways trend more than a downtrend.

Last one, the one highlighted in yellow, is the one that we are going to analyse. The candlestick that forms the hammer pattern appeared on a daily chart, so the best thing to do is to switch to a hourly chart and check what happened in those 24 hours.

These 24 candles on a 1 hour chart form the hammer that we have seen on the daily chart.

Figure 2a: 24 candles that made the daily hammer

That's exactly what we have said at the beginning about the hammer. Starting from the left of figure 2a, the sellers start having control of the market, so the price is going down.

At one point, the price becomes convenient for buyers to open their positions. Buyers step into the market, the demand increases and the price goes higher.

Does the colour of the real body matter?

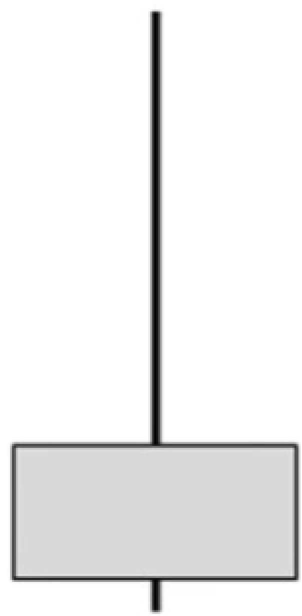
The colour of the real body doesn't matter when it comes to the hammer.

If you got the logic of the pattern, you understand that the important thing is that the buyers recovered from a very bad start of the session. So it doesn’t matter.

There can be a psychological belief that a green body is better than a red body. But in my experience the market makes no differentiation between red and green real bodies of this pattern. It's not about the colour but it's about the size. The longer the lower shadow, the shorter the upper shadow, the smaller the real body, the more meaningful the hammer will be.

Shooting Star

If we analyse the conditions needed to form the shooting star, we can see that this pattern is pretty much the opposite of the hammer.



First of all we have a small real body just like the hammer. This time the real body is at the bottom end of the session's range.

We have a very small or no lower shadow and a long upper shadow that should be at least twice the size of the height of the real body. Even for the shooting star, the colour is not important. Now last condition, is the most important one.

The shooting star requires that the market has a prior upward move.

So what does this candle say about the fight between buyers and sellers?

The small lower shadow and the long upper shadow let us know that there hasn't been much action below the opening price and the buyers started very soon to push the price up. By the end of the session, sellers step into the market and the price goes down, closing near the opening price. We can say that buyers were in control at the beginning but sellers have been stronger by the end of the session.

Here we have EURUSD on a daily chart. I have highlighted in green all the candlesticks that have the same shape of a shooting star, but that I would not have considered because they don't satisfy last condition.

That means that they don't appear during a clear upward move.

Highlighted in yellow are the real shooting stars. They satisfy all the conditions.

So let's analyse the price action before the shooting stars highlighted in yellow; the price action of the shooting stars and then we can combine them to draw our conclusions.

Before the shooting star, buyers are completely in control.

The price is clearly going up.

Then a shooting star appears. At the beginning of the shooting star, buyers push the price higher.

This is not a surprise, after all the price was going up before the shooting star. So everyone is expecting that the price continues to go up.

The surprise comes when sellers step into the market and push the price back near the opening of the session.

Putting it all together, buyers have been too strong for sellers in last sessions, so you can see a lot of big green candles.

At one point, a shooting star appears and is telling us that the sellers ended the session stronger than the buyers.

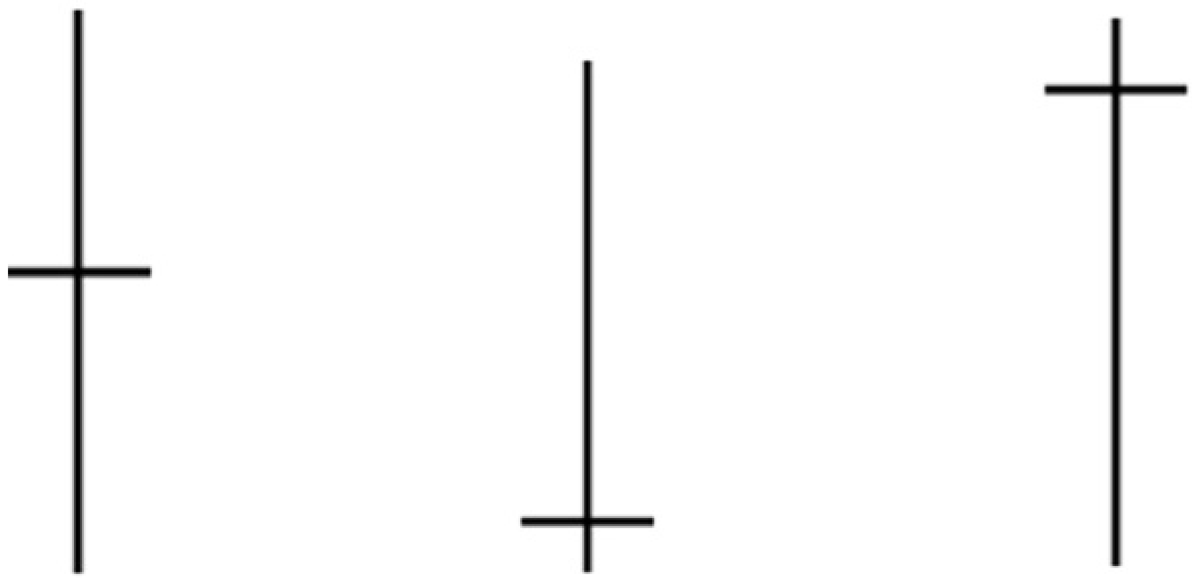
This is probably because at that point the price started to be convenient for sellers to open their short positions.

I think that now you're starting to understand better how to analyse the patterns and the supply and demand on the market.

You also understand why the color doesn't matter.

The important thing is that sellers recovered from a very bad start of the session. As for the shooting star, it is not about the color but about the size. The longer the upper shadow, the shorter the lower shadow, the smaller the real body, the more meaningful the shooting star will be.

Doji



A doji is a candle where the opening price matches with the closing price. So the opening and closing prices are the same. Even if the ideal doji is like this, we can use some flexibility to this rule.

If the opening and closing prices are within a few pips of each other, the candle could still be viewed as a doji.

There's no rigid rule about this,

I cannot say something like opening and closing prices must be within five pips, for example, for the candle to be considered a doji. It is subjective and you will develop your own opinion with time and experience.

So the doji has just one rule: opening and closing prices are the same or at least they are very close to each other.

But why am I showing you this candle with the opening and closing prices right in the middle of the session? Actually, this is just an example of a doji. As long as the opening price matches with the closing price, the candlestick is a doji.

Before we analyze the dojis one by one, let's see the action behind this candlestick and what it shows us about the fight between buyers and sellers.

While it's been easy for the previous candlesticks to understand the formation of the shadows, it's not so easy for the doji.

It can be that buyers were in control at the beginning then sellers pushed the price down and at the end buyers had the power to close at the opening price.

It can also be the opposite.

Sellers were in control, then buyers pushed the price up and sellers closed at the opening price. There are so many other scenarios and we can't really know what happened if we don't go to a lower timeframe to analyse the candle.

But don't worry, you don't need to do it.

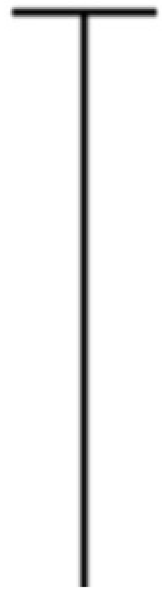
Even if we don't know exactly the action that led to the formation of the doji, we know the only necessary information: the doji represents indecision. Buyers and sellers engaged in a fight and there's no winner at the moment.

Imagine a tennis match between buyers and sellers.

The doji says that in this moment the score is tied at six to six and they are going to play the tiebreak.

Now you know what a doji is, but we need to go a bit more in depth and analyse the different types of dojis.

Dragonfly Doji



A dragonfly doji is a particular doji where open and closing prices are at the top of the session. The opening price, closing price and high are the same price.

Once again there's no need to be super rigid about these rules.

If the opening and closing prices are not exactly at the top of the session but just a few pips below the high, we can still consider it as a dragonfly doji.

What is really important is the logic of the pattern.

As you may have noticed, the dragonfly doji has more or less the same shape of a hammer and it also appears in a downtrend.

The only difference is the one regarding the real body of the candlestick, but the logic is exactly the same.

Here we have GBPUSD on a four-hour chart.

The Dragon-Fly doji is circled on the chart.

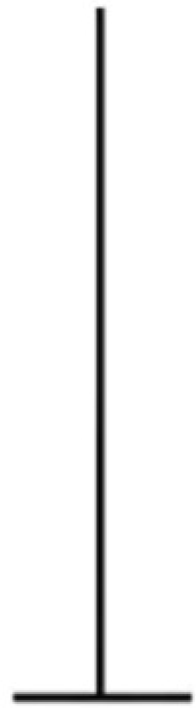
Prices are in a downtrend before our pattern. Sellers are completely in control. With the Dragon-Fly doji, the market sold off from the very beginning, then recovered the losses to end the session right back where it started.

By the end of the session the buyers took over and pushed the price up.

This means that after many sessions dominated by the sellers the price has become attractive enough to convince the buyers to take action and buy the couple.

The Dragon-Fly doji has exactly the same logic of the hammer, because it contains pretty much the same action that you see in a hammer. So we will use both of them in the same way.

Gravestone Doji



When the open and close are both equal to the low of the session, we have the most bearish of doji: the gravestone doji.

It's definitely a shooting star without a real body.

You can also see that the gravestone doji appears during an uptrend, just like the Shooting Star.

Here we have EURUSD on a four-hour chart.

The circled candle is the Gravestone Doji.

If you paid close attention, you may have noticed another Doji just two candles before the Gravestone doji. The trend before the Gravestone doji is clearly up.

Buyers are winning the fight.

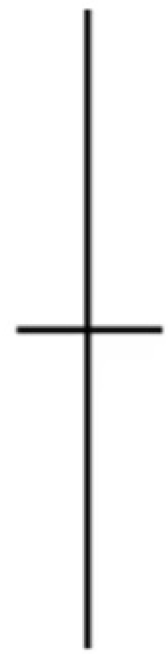
The gravestone doji expresses the same concept that we have introduced with the shooting star. Buyers push the price higher from the very beginning of the session.

Again this is not a surprise because we are in an uptrend so traders expect the price to go up. The surprise comes when sellers step into the market and manage to push the price back to the opening price.

It may be that the market reached a point where the price is very attractive for the sellers but it's not so attractive for the buyers anymore.

So the gravestone doji has the same logic of the shooting star and we will use them in the same way.

Long legged doji



The last doji we are going to analyze is named long legged doji. This is a doji with an open and close at the middle of the candle's range or very close to the middle of the candle. There's no real body or a very small real body and there are two long shadows that we can also call legs, that's why the name long legged doji.

This pattern has a condition that you will not find so easily in other patterns. The long legged doji is a reversal pattern whether it appears during a downtrend or an uptrend.

Let's see the reason of this condition.

The long upper shadow shows that the price rallied during the session. The long lower shadow shows a market that has sold off during the session.

In other words, the market rallies, sells off, rallies, sells off and continues like this only to close the session at the opening price.

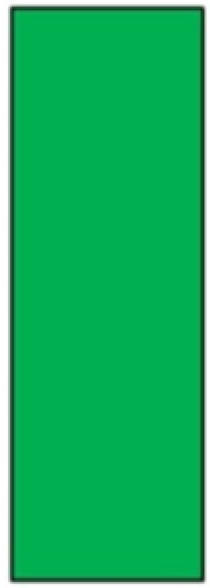
So after a downtrend or after an uptrend, this doji indicates that there has been much uncertainty in the market, after a period of directional certainty. This change of conviction **may result in a change of trend.**

Here we have EURUSD on a daily chart.

You can see a long legged doji appearing at the end of an uptrend creating uncertainty on the market. That could be the price where sellers find it attractive to sell, increasing the supply and pushing the price down.

Marubozu

A marubozu is a candle with a long real body and no shadows. If the body of the candle is green, we have a bullish marubozu



If the real body is red we have a bearish marubozu.

Even for this pattern, just catch the logic behind it, so there's no need to be super rigid about the rules.

If you see a very small upper shadow or a very small lower shadow, you can still consider the candle as a marubozu.

Let's consider a bullish marubozu for example. From the very beginning to the end of the session, buyers push the price higher.

So this candle is the most powerful sign of buyers on the market.

In Forex market, we see that buyers start to buy the couple from the beginning of the session to the end.

Now the question is: if the buyers have been so active during the session and were still active by the end of the session, is it likely that they want to buy some more when the next session opens?

Yes! That's why traders expect to see another bullish candle after a bullish marubozu.

So far, we have only seen reversal signals.

Marubozu can be used as a reversal pattern and as a continuation one as well.

Figure 2b: Reversal pattern Marubozu

If it appears going against the trend, like the one highlighted in yellow in figure 2b, it forms a reversal signal. Most of times this signal will be a bullish or bearish engulfing, a double candlestick pattern that we will study later on.

If the marubozu appears confirming the trend, like the two candles in figure 2c, it will form a continuation pattern.

Figure 2c: Continuation pattern Marubozu

In the later chapters, I will show you how I use support and resistance analysis to trade this marubozu continuation pattern. When it comes to practical trading, we aim to buy at the dips and sell rallies.

If we are to trade continuation pattern solely using a marubozu without any technical analysis, then we'd be always buying at highs and selling at lows. This is a major mistake that forex traders always make.

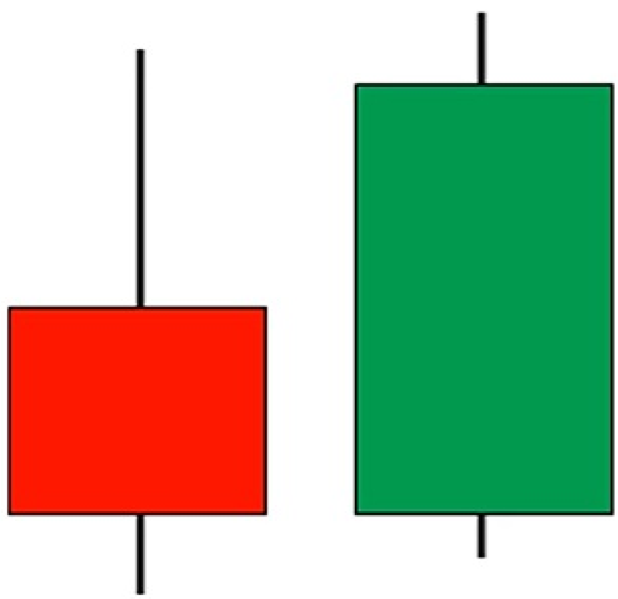
Chapter 3: Profitable Double and Triple Candlestick Patterns

Double Candlestick Patterns

We have seen single candle patterns like the hammer and the Shooting Star. Single candles can give important information about supply and demand simply through the colour, the length of the real body and the length of the shadows.

Now we're going to analyse combinations of individual candles. The engulfing pattern is a major reversal signal with two opposite colour real bodies.

Bullish engulfing pattern



Here are some properties of the bullish engulfing candle.

- The market must have a prior downward movement.

- the first candle must be red, in line with the previous move that is down.
- The second candle must be green, with a real body that surrounds, or we can say engulfs the real body of the first. This is slightly different from most books where the engulfing takes into account the high and the low. In forex, the body of the candle is sufficient to provide a signal as the forex market is very liquid.
- The position of the shadows on either candle doesn't matter.

What's the logic behind this pattern? We have a first candle that is confirming that sellers are in control of the markets. Traders are expecting then and another red candle, in line with the downtrend.

But here it comes a long green candle that engulfs the previous one, showing that buying pressure has overwhelmed selling pressure.

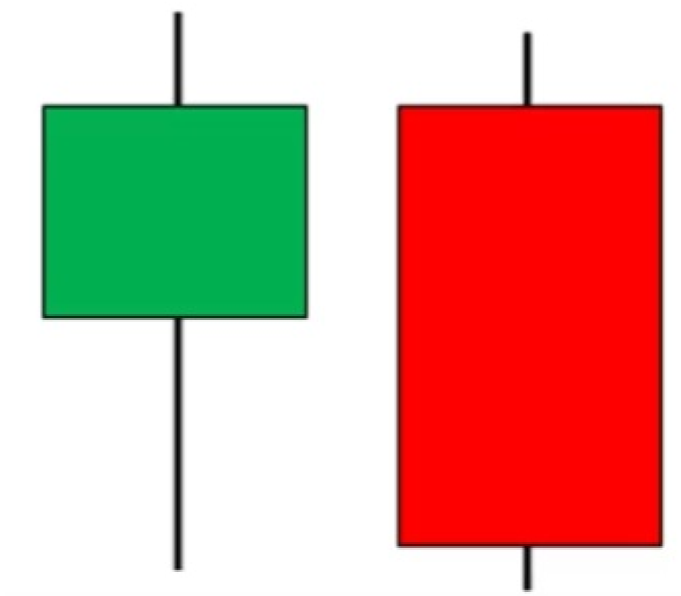
Here we have USDJPY on an hourly chart and you can see that the price is going down.

Sellers are in control in the first part of the chart. At the end of this downtrend there's a bullish engulfing pattern. By analysing the price action on the market, we can say that sellers were in control and they pushed the price down for a long time without facing any major resistance by the buyers.

At one point, we can see a bullish engulfing pattern that is basically telling us that buyers had a strong reaction compared to the previous session.

The bullish engulfing pattern is a clear signal that the demand increased maybe because the price is too low and buyers find it good to buy.

Bearish Engulfing Pattern



The bearish engulfing pattern is just the opposite of the bullish engulfing pattern.

Here are some properties of the bearish engulfing candle

- the market must have a prior up move
- The first candle then must be green in line with the previous trend that is up and the second candle must be red.
- The real body of the second candle must surround the real body of the first candle.
- position of the shadows on either candles doesn't matter.

So if you got the logic of the bullish engulfing pattern, the bearish engulfing pattern will be very easy for you.

Let's follow this example USDCHF, 4-hour chart.

The trend is clearly up but at one point there's a bearish engulfing pattern that is a clear signal that sellers are strong at that price and might have the power to change the trend.

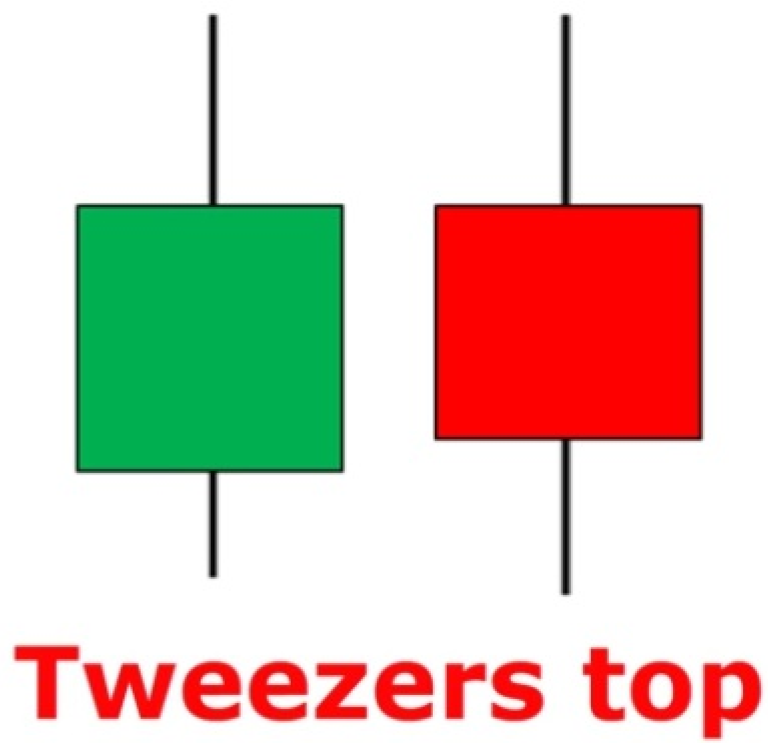
Quick tip: To increase the likelihood that the engulfing pattern will succeed. The engulfing pattern becomes more significant if the first candle has a very small body and the second candle has a very long real body.

This is because the first candle reflects a dissipation of the prior trend's force and the large second real body shows an increase in force behind the new move.

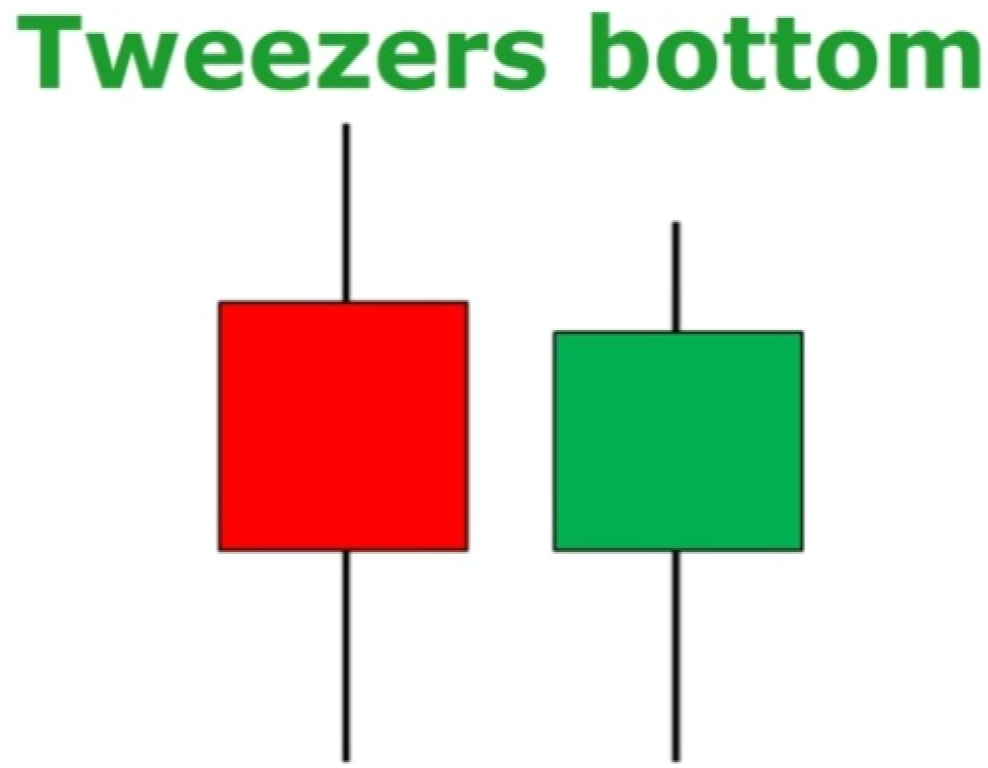
Tweezer Top and Tweezer Bottom

Tweezers top and Tweezers bottom are the candlestick version of support and resistance. Tweezers, in fact, are two or more candles with the same highs or same lows.

In an uptrend, a tweezers top is formed when two or more consecutive highs match.



In a downtrend, a tweezers bottom is formed when two or more consecutive lows match.



The logic of this pattern is that if we have two or more consecutive highs or lows, it means that that price is hard to overcome.

That's why I introduced this pattern as a candlestick version of support and resistance, because it reminds me the same logic of support and resistance.

Here we have EURUSD on a 4-hour chart. As you can see EURUSD is in an uptrend, then there are two candles that reach the same high.

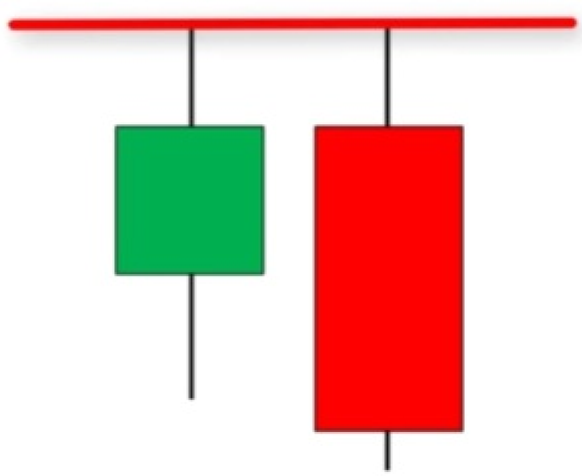
It is a sign that sellers are selling the currency pair at that price and buyers struggle to go over it.

Here we have GBPUSD on a 4-hour chart.

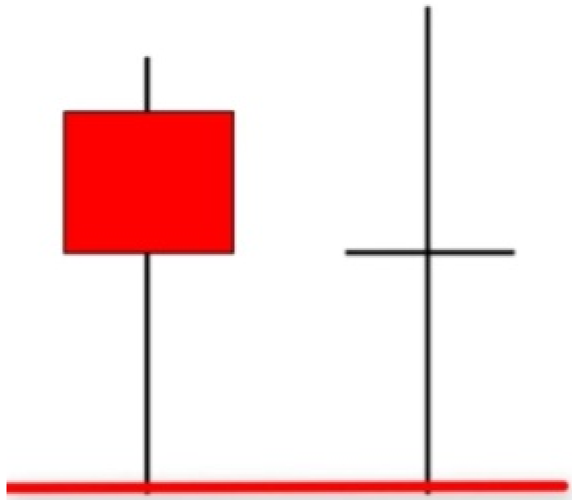
You can see that sellers are in control at the beginning but they can't break the level that is formed by the two lows of the tweezers bottom.

A quick tip based on my experience of the forex market is that the tweezers work better when they also form as another pattern.

For example, here we have a tweezers top that also form a bearish engulfing.



The next one is a tweezers bottom with a second candle that is also a long legged doji.



In general, when you have more clues that indicate the same trade to take, it is better. That's why when the tweezers also form as another pattern you have a stronger signal.

Triple Candlestick Pattern

There are so many three candlestick patterns. If you buy any book about candlestick patterns, I'm sure you will find at least six or seven three candlestick patterns.

There's the morning star, the evening star, the morning doji star, the evening doji star, three black crows, three advancing white soldiers and many others.

I'm only including the useful ones for forex trading as that is the main goal of the book for your trading.

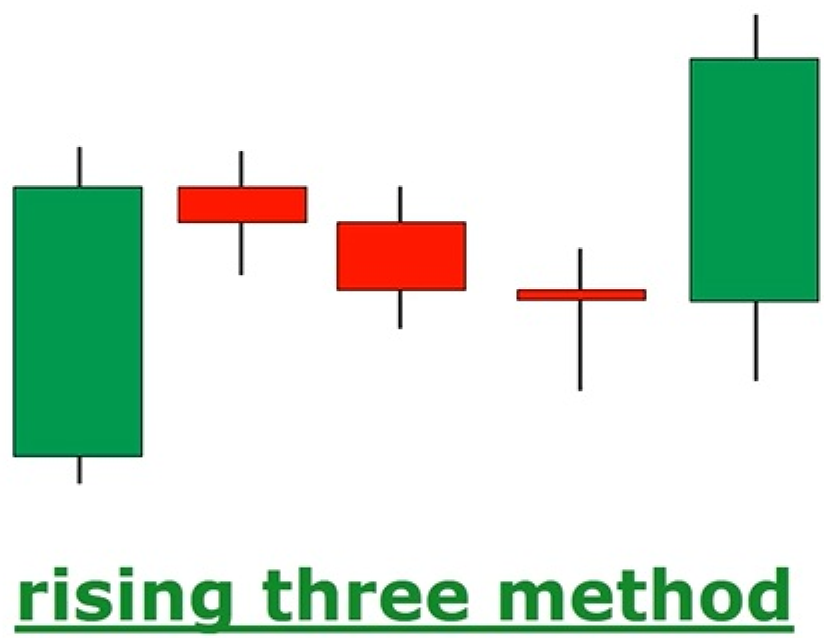
Having said that, we are going to study two powerful signals: the rising and falling three method and the master candle. Although these triple candlestick patterns seldom appear in the forex markets, it is good to know them if they ever do appear.

Rising and falling three

The rising three and the falling three are both continuation patterns. Even if many times they are introduced together with other triple candlestick patterns, they are composed of five candles.

The number three in their names refers to the market phases that this pattern shows.

Let's start with the rising three method.



The first phase is composed of a long green candle that confirms the uptrend. Then we have three falling or lateral candles that hold within the long green candle's high-low range.

Ideally, we have three red candles with a small real body and small shadows but it is still acceptable if one of these candles is green with a small real body or a doji.

This second phase is showing a period of rest from the battle between buyers and sellers. Usually, traders say that this is a consolidation phase after a strong trend.

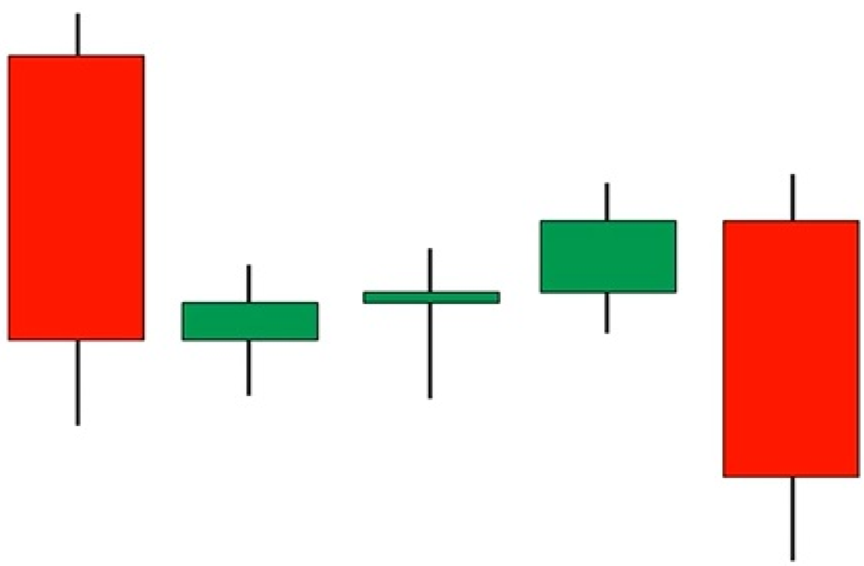
The last phase shows a strong green candle that closes above the closing price of the first candle.

This means that the market is forming a new high and the uptrend is still there.

What about the falling three method?

Well, it's just the bearish counterpart of the rising three method.

So this time we will see this pattern during a downtrend.



falling three method

Analysing again the three phases, we have a first phase with a long red candle that confirms the downtrend.

Then we have three rising or lateral candles that move inside the high-low range of the first candle.

Once again, the ideal situation is to have three small green candles. But it is fine if one of these candles is a doji or a red candle with a small real body.

This second phase is a consolidation of the market.

Sellers are not pushing the price any further and buyers don't seem to have the power to react. You can also expect that the trading volume during this period is very low. It's like sellers and buyer are playing a chess game and they are both thinking about their next move.

At the end, we have a long red candle that closes below the closing price of the first candle. The market has a new low and the downtrend is still on.

This chart shows GBPUSD 4-hour chart. This is a perfect example of a falling three method.

We can see that the first candle confirms the downtrend.

Then we have three small candles within the range of the first candle.

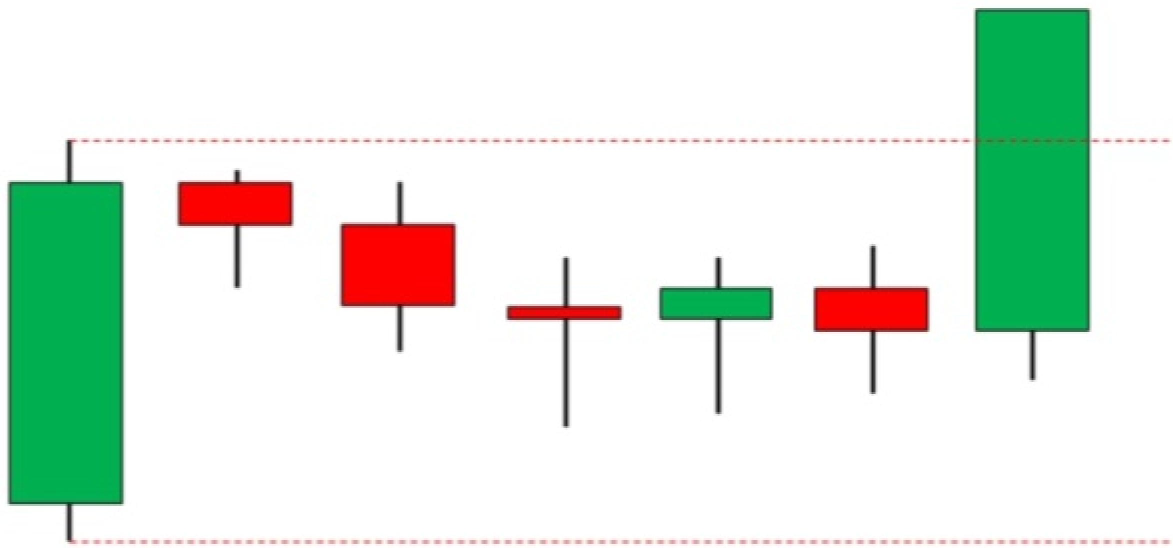
This shows that what buyers achieved in three sessions is less than what sellers achieved with just one session, that is the first candle. The last candle of this pattern shows that sellers are again on the market, pushing the price down.

So the downtrend continues.

Master Candle

A master candle is a rising or falling three method with more than three candles in the second phase.

So it will look like this.



This is exactly like the rising three methods but it has five candles in the second phase.

It can also have four candles or more than five.

In my experience this pattern works from three to nine candles in the second phase.

If there are many candles that express indecision, it may be that the power of the previous trend is decreasing.

So, we will use this pattern only if in the second phase there are three to nine candles, with three candles that is the case of a rising or falling three method.

We call master candle the first candle that identifies the trading range that you can see between the two dashed lines in red.

We will also call the entire pattern master candle for the sake of simplicity.

Let's see some examples on the market.

Here we have EURUSD on a 4-hour chart.

There's a clear uptrend before the formation of a master candle.

The second phase is highlighted in yellow and it counts nine candles. The last candle of the pattern breaks the high-low range of the first candle and the price continues to follow the uptrend.

Same situation on this 4-hour chart. This time we have GBPUSD.

The second phase, highlighted in yellow, is composed of four candles this time. The last candle breaks high and concludes this continuation pattern.

Chapter 4: High Win-Rate Support and Resistance Trading Strategy

Now that you have gone through the profitable candlestick patterns, it is time to apply them with some technical analysis.

Support and Resistance Setups

The easiest and most effective type of technical analysis in my view for forex trading is support and resistance. Support is a level where there are potential buyers and resistance is a level where there are potential sellers.

These are the levels where high probability reversals or change in the trends happen.

As forex traders, we look to sell at resistance and buy at support to increase our probability of winning. In order to enter the trades, we will look for the specific candlestick patterns discussed in previous chapters.

Here is a hourly chart on the EURUSD.

A shooting star pattern was formed at resistance marked out by the red line. This shooting star pattern tells us that sellers have come in to push prices down after a prior uptrend. Furthermore, it was at a resistance level which tells us that there are potential sellers waiting there to push prices back down.

Entry and Exits

Our entry will be the close of the shooting star, placing our stop loss at the high of the shooting star and a take profit level that gives us a 1.5 risk to reward ratio.

The blue dotted lines represent our entry and take profit levels.

Here’s another hourly chart on the EURUSD.

A bullish engulfing pattern was formed at support marked out by the blue line. This bullish engulfing pattern tells us that buyers have come in to push prices up after a prior downtrend as you can see in the charts.

Furthermore, it was at a support level which tells us that there are potential buyers waiting there to push prices back up.

Entry and Exits

Our entry will be the close of the engulfing candle, placing our stop loss at the low of the red engulfed candle and a take profit level that gives us a 1.5 risk to reward ratio.

I hope you are getting the gist with the previous 2 examples.

For every candlestick pattern you have learnt, make sure it fits the following criteria:

For Buy setups,

- Is the candle pattern at a support level?
- Did the prior price trend meet the conditions for the candle pattern to be valid?
- Is your reward 1.5 times the amount you are risking?
- Is your stop loss level below the low of the bullish candle pattern?

For sell setups,

- Is the candle pattern at a resistance level?
- Did the prior price trend meet the conditions for the candle pattern to be valid?
- Is your reward 1.5 times the amount you are risking?
- Is your stop loss level above the high of the bearish candle pattern?

Here's another example of a bullish hammer setup on the EURUSD.

A hammer pattern was formed at support marked out by the blue line. This hammer pattern tells us that buyers have come in to push prices up after a prior down move as you can see in the charts.

Furthermore, it was at a support level which tells us that there are potential buyers waiting there to push prices back up.

Entry and Exits

Our entry will be the close of the hammer candle, placing our stop loss at the low of the hammer candle and a take profit level that gives us a 1.5 risk to reward ratio.

Here’s another example of a bullish marubozu on the GBPUSD hourly chart.

Similar to previous examples, you can see that these reversal patterns occur near support levels where there is potential demand coming in. The candle stick pattern further confirms that the demand is real and prices are getting ready to change its trend.

Support level becomes Resistance

In support and resistance trading, it is also possible for support that has been broken to act as resistance. The logic is this: the broken support level was caused by huge amounts of selling at that level such that prices were driven down. When prices re visit this same level, it is a potential level where sellers might step in to push prices back down.

Here is an example on the GBPUSD hourly chart.

A gravestone doji candle was formed at a support turned resistance level marked out by the red line. As you recall from previous chapters, a gravestone doji is like a shooting star.

Buyers push the price higher from the very beginning of the session. Again, this is not a surprise because we had a prior upward move. As it approached the resistance level, sellers step into the market and manage to push the price back to the opening price. This told us that the selling pressure was back and it was time to enter a short trade.

Entry and Exits

Our entry will be the close of the gravestone doji candle, placing our stop loss further away at the previous swing high since the doji has a very small body. The take profit level that gives us a 1.5 risk to reward ratio.

Here’s another example on the GBPUSD hourly chart with a bearish marubozu.

A bearish marubozu candle was formed at a support turned resistance level marked out by the red line. This was a very convincing setup as a bearish marubozu tells us that sellers are very strong at that resistance level.

It was a no brainer to go short. In fact, support turned resistance levels can be considered as a trend continuation style setup.

Resistance level becomes support

Similarly, we also have resistance turned support levels. It is also possible for support that has been broken to act as resistance.

The logic is this: the broken resistance level was caused by huge amounts of buying at that level such that prices were driven up. When prices re visit this same level, it is a potential level where buyers might step in to push prices back up.

Here’s an example on the GBPUSD hourly chart.

A tweezer bottom was formed at the resistance turned support level marked by the blue line. Recall the logic of this pattern is that if we have two or more consecutive lows, it means that price is hard to overcome.

Furthermore, the support level signals that there are potential buyers at that level. A pattern that shows price support coupled with a support level is an extremely strong signal that prices are very likely going to form a base here.

Let’s see another example on the EURUSD 15 mins chart.

Here we have a bullish engulfing at the resistance turned support level. Again this was a very convincing setup because a bullish engulfing tells us that buying pressure has overcome selling pressure. Coupled with the support level, it was a very strong setup to take.

Additional Tips: Drawing Support and resistance levels

Now, I've seen many different ways of drawing support and resistance levels across books and forums. However, all these methods are subject to the trader's judgement. How can we definitively plot out the correct levels?

Here's what I've discovered over many years of trading the forex markets. There is an indicator called the Bill William's fractals. It can be found in most trading platforms and in metatrader.

This is how it looks on the chart.

Notice the triangles below and above the candle. These are the fractals that indicate the high and low of the past 5 candles which serves as your reference to support and resistance levels!

For support levels, draw a line across the candle low where the downward pointing triangle appears. That will be your support level. For resistance levels, draw a line across the candle high where the upward pointing triangle appears.

Let’s take a look at how we can use them to plot the levels. Here’s a 5mins chart on the XAUUSD.

The blue line was drawn across the low of the candle which shows us a potential level of support. Several candles later, a bullish marubozu formed at that potential support level. This was a winning trade that fit the criteria of a buy setup. As you can see prices flew up subsequently.

Here's another 5 mins chart on the XAUUSD showing the resistance levels.

The red line was drawn across the upward pointing triangles which shows us a potential resistance level. Several candles later, we had a shooting star pattern at that resistance level. If you had entered a short trade on that, you would have gotten very good profits in just 20 minutes.

Chapter 5: Building your own strategy

The most important concept is that there is not a standard situation that always happens on the market. Every scenario is different and needs to be analysed on its own.

This is the reason why this chapter is called How to Build a trading strategy and not how to build a trading system.

You want to have a strategy to consider some entries when you analyse the chart, but you don't want to have a system that is made by a bunch of rules that you always apply regardless what the market is really saying.

Having said that, you are three steps away from building your own strategy.

Step one: Choose the correct timeframe for you.

You can be a scalper, you can be a day trader, you can be a swing trader or you can be a position trader.

It doesn't matter.

You are the only one that can decide which time frame suits you better.

Step two: Choose your weapons to face the markets.

We have seen everything possible about the candlesticks. So candlestick patterns will be a huge weapon by your side to win the war against the market.

Do you want to have something more on your chart to filter the signals?

Well, sure, you can do it.

Go on.

We have the moving averages, the relative strength index, we have also different settings for these indicators. A common mistake is to think that the more, the better when choosing how many indicators to use. Do you think that something like this is better than something like this?

You should use whatever can help you to analyse the market, but this doesn't necessarily mean that you will have a better understanding of the market if you use more indicators.

There are many expert traders that only use the candlesticks to trade.

They don't use any other tool. It's just a matter of finding out what is the best set up for you.

Step three: Write down your money management rules.

For example, I never risk more than 1 percent per trade and I never choose a risk to reward below one to one.

How you manage your account and your risk plays a fundamental part in your strategy. Make sure to spend time to define your rules.

So you've got three steps to build your own strategy and honestly you don't need to be Einstein to come out with a strategy that works.

But then, how to proceed?

Are you going to invest $50,000 on this strategy?

Of course not.

You need to test your trading strategy.

The easiest way is to open your Meta trader, go back in time with your chart and then move the chart forward, starting to analyse all the positions that you would have taken in the past.

Record your results and be honest with yourself.

At the end, when you have your final results, if you're happy with that, you can go on and use that strategy with a Demo account for a couple of months.

Trading with the demo account will put you in a different situation because now you're dealing with a market that is moving.

If your results are still good after a couple of months of demo trading, then you can start with a real account.

Step 4: Record your findings in a trading journal

A trading journal will help you to keep track of your trades so that you can go back and review them. In the process, you might find similar patterns occurring over and over again. Take note of those. It could be the way you enter trades, or pulling the trigger before prices hit your target profit.

As you record each trade, ensure that you take a screenshot during entry and after the trade has played out. This will help you prevent trading on hindsight.

Conclusion

With that said, you’ve come to the end of the book. Trading forex should be kept easy and clean. I believe once you have mastered the candlesticks mentioned in this book, your trades will be much more profitable.

Also by Matt Anderson

Crypto Investing Millionaire: Fund Your Retirement 10x Quicker
Forex Trading: Profitable Candlestick Patterns