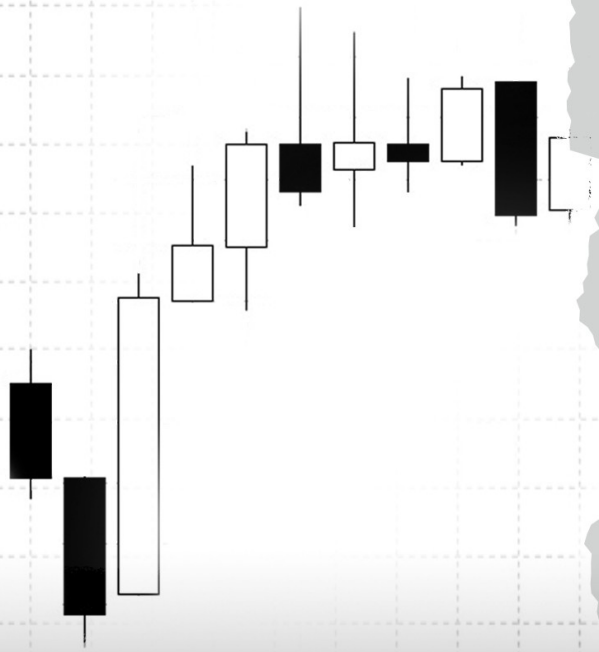
UNCOVER
THE SECRET MESSAGE
BEHIND PRICE ACTION

THE TALKING CHART



VASSIL BANOV

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Acknowledgements

As I am finishing this book, the world is in the middle of something unseen for a century. The coronavirus pandemic. The world is witnessing first-hand how fragile everything is that for so many years we took for granted.

Above all, this is a time to be grateful for what we have and to the people who helped us.

My trading journey would have never happened if my father didn’t discover that bizarre Forex trading platform. Or my mother, who gave me her own trading account where I made my first trades.

Or the legendary Larry Williams to whom I owe great gratitude. Without sharing his deep market understanding and the constant guidance through the years, I wouldn’t be where I am now.

All those people who helped me on different occasions during my life have my gratitude. They didn't ask for anything in return. They just helped me out of the pureness of their heart and with the belief and something good would come out of me someday. I hope I am fulfilling that.

And last but certainly not least, a huge thank you goes to my lovely wife and my wonderful kids who share my trading passion in their own way.

Who is this book for?

This book is intended to be useful for many categories of traders.

What do you trade?

It doesn't matter if it's Stocks, Bonds, Currencies, Commodities, Cryptocurrencies or something else. The rules described inside apply for all asset classes. The only requirement is that the asset has a chart.

Newbies or Pros?

Traders with basic knowledge of how to operate a trading platform, who know what a bar and candlestick chart are, will gain knowledge and develop skills which are essential for their future development as traders.

More skilful and experienced traders who want to improve their weak spots would also like this book. Such improvement might be the ability to better read the intentions of large players. This will help them to enter and exit with larger size positions.

Scalpers, Short-term or Swing traders?

A short-term trader will learn a proven way to increase the profit side of their trades. This will improve the risk-reward ratio. Such a way to improve exits will also work for swing traders. Although not recommended by the author, the techniques described in the book can be used intraday.

Algo or Discretionary?

Discretionary traders would enjoy the adaptability of the described techniques as they will provide insight into all kinds of market situations. Algo traders would definitely like the fact that everything mentioned inside the books is backed with test results. They will also find it interesting how the mentioned patterns can be improved.

Above all, if things like price action trading, Japanese candlesticks, and chart reading are close to your heart, this is exactly the book for you.

Introduction

Some time ago, before the Great Recession of 2008, I was a young student searching for a way to cheat the system. I did not want to do normal work, to have a boss, to have employees, to work with clients. No! I wanted to succeed in a place where only my personal efforts, hard work, and discipline mattered. I wanted to succeed in trading.

> "But how to do it? How to succeed in a space where more than 98% fail in the long-term, a place where only a few people really achieve success?"

All I had were questions. But then it came to me like a lightning strike.

> "Is it possible that all those who succeeded did it in a completely different way from the others?"
>
> "Even if there were only two successful traders, it is possible to have two different ways to succeed in trading. When we count all the legends, the proven fund managers and their trades, there must be so many more than just two, though.
>
> "But can there be 30 or 50 different ways to beat the markets? Highly unlikely. That would mean that some of the tricks of the successful traders overlap. Some part of their success is due to doing the same things."

After that revelation, it became clear to me that if I wanted to reach that success, I needed to find those similar things that most of the trading legends did.

I started reading books, articles, analysis, bought courses (a lot of them) and at some moment along the way I started to see it. I was right in my assumption: while all trading legends have differences in the way they approach the market, all of them have some things in common.

And one of those things was price action trading. One way or the other, all of them were trying to guess other's intentions by literally reading the chart, minute by minute, hour by hour, day by day.

My biggest inspiration in price action trading came from Larry Williams – the best trader I've ever seen. Back in 2004, his book, *Long-Term Secrets to Short-Term Trading*, opened my eyes to the fact that price action can be a very powerful tool in my trading arsenal.

And this is how it all began. I started reading and then back-testing everything that I could find about price action trading. Somehow, along with my father, we were able to develop a winning strategy. It was so simple, and looking back at it from now I can say it was also so stupid. But it was making money. Back then we didn't realise that without knowing it we had touched, only briefly, a letter – a singular letter of the language of charts.

The next significant moment in this story happened in October 2007. I was completing my part of a book I was co-authoring back then. I was looking at the chart to test one of the patterns I included in the book when I got hit again.

I couldn't believe it. On the screen, I clearly saw a pattern which was very effective on EURUSD (back then I was trading mostly Forex. Stocks and commodities were not a big part of my trading activity).

> "Is it really possible? Let me check the USDJPY. Wow, it is working!"

I then went to test other currency pairs with GBP, CHF, AUD, NZD, CAD, etc. In all of them, that single candlestick was showing tops and bottoms.

> "What about Crude Oil and Gold?"

Amazing. It seemed to be working on everything.

By that moment I had already gained significant trading experience and was very careful when something looked like the "holy grail". I needed more testing, including real trading, before I was going to believe it.

> "But wait a minute, this candlestick is very similar to the one my father and I programmed back in 2004. It just looks like a twisted version of it".

I didn't completely understand it back then but I had just uncovered the second letter in the charts alphabet.

It took me a few months, spent in trading based on this discovery, but soon I asked myself:

> "Those two candlestick shapes exist in the chart of all trading instruments. And everywhere they point to the same conclusion – one is showing continuation, the other reversal. What else can I see on the chart?"

Oh, there are more of them!

Once again, I was studying the charts of different instruments to uncover the building blocks, the letters of the chart's language. Those letters helped revolutionise my trading success.

Now, I want to show you how to listen, learn, and capitalise on the language of the eternally talking chart.

Chapter 1: The Understanding

To read a book we need to know the language. To learn a language, we need to know every letter of the alphabet.

Even after we know the letters, we will have to learn to read syllables. And with syllables, we'll soon be able to read words. With words, sentences, with sentences, paragraphs. Suddenly, we'll be able to read the whole book.

And knowing the letters means we don't just have to read one book. We could read any book we like.

But what is necessary to read a chart?

Just the same as with the book, we need to know the letters – or in other words, the alphabet of markets.

But there are so many instruments out there: stock, bonds, currencies, commodities, futures, options, complex derivatives. Do we have to learn the language of every single market?

Yes, there are hundreds, maybe even thousands of different instruments out there, but we don't need to learn thousands of market languages. Because:

ALL MARKETS SPEAK ONE LANGUAGE, THE LANGUAGE OF THE CHART

So, if we want to read a market, we need to learn to read the chart.

And to read the chart, we need to learn its letters.

The letters of the chart are its building blocks, the pieces which create the chart. Depending on what chart we are using – bar chart or candlestick chart – those pieces are called bars or candlesticks. Simple, right?

Here is how they look. First is the daily bar chart of the Gold futures.

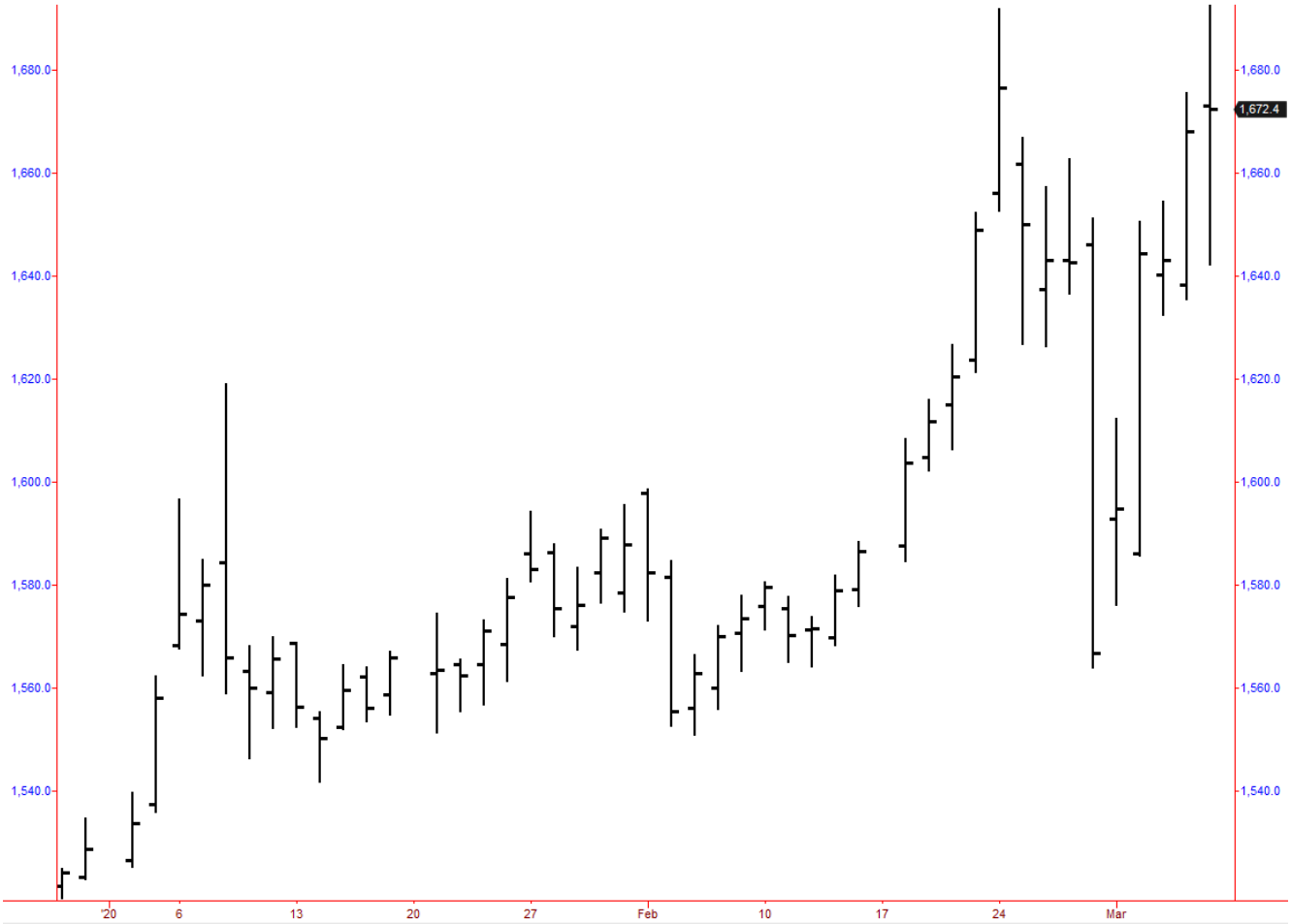


Figure 1: Daily Bar Chart of the Gold Futures. Source: TradeStation®.

Then, the same chart of Gold for the same period. But this time it is a candlestick chart.

Figure 2: Daily Candlestick Chart for Gold Futures. Source: TradeStation®.

For this book, we'll use the candlestick chart. But all we say here is relevant and 100% applicable for the bar chart.

Here is another example of a candlesticks chart, only this time it is of S&P500 futures.

Figure 3: E-mini S&P500 Futures Continuous Contract. Source: TradeStation®

As we can see, this chart is made of hundreds (only the visible area) of candlesticks, which are the letters of the chart.

But besides the fact that some go up, some down, some are big and some small, they all look the same. Does it mean that we have only 4 letters in this chart language – big up, small up, big down and small down? No, in fact, there are 8 – and we're going to learn them all.

To the untrained eye, these candlesticks all look similar. But there are big differences. To see them we need to understand that:

EVERY CANDLESTICK IS THE RESULT OF A SPECIFIC MARKET ACTIVITY OR THE LACK OF IT.

So, to learn the differences and to be able to see all the chart letters, we need to think about how every single candlestick was made. We need to consider who are the markets participants – companies, central banks, hedge funds, etc. who are contributing to that candlestick? And what kind of market actions created it?

Let's dive deeper into the chart reading.

Chapter 2: The Basic Case

Finding what stands behind a single candlestick might be very tricky. There are probably millions of different factors that can make the price go up or down, creating in the process a big or small candlestick. If we try to analyse all of those, even with today's computer power and machine learning, we'd get lost in the chaos.

So, what do we do?

We need to turn the chaos into harmony. And to do that, we need a starting point.

Let's pretend we are scientists. Some of us who read this book might actually be scientists. Traders come from various backgrounds.

If we take a scientific approach, the first thing we need to do is to start excluding. Exclude everything until we reach some basic case.

Let's see how this basic case might look.

Imagine that the instrument we are examining, let's call it the 'Basic1', is part of a closed system where participants (traders) are fixed in number. Basic1 tracks some asset which grows steadily in value over time. There is no new information which is unknown and which might change the fundamental predisposition of the Basic1. All this creates an environment where nobody would want to leave. But in case a trader leaves, let's say someone else will take their place.

Obviously, this closed system is quite different from the current financial markets. But for a very short period and under specific circumstances, such a system could exist in today's markets. That is exactly what we are trying to achieve. A very basic, yet realistic case upon which we can build everything else.

If all that is true, Basic1 will slowly move only upwards. If we look at its daily candlestick chart, every single candlestick, every single day, will move up.

Here is how the chart of Basic1 would look with these assumed parameters.

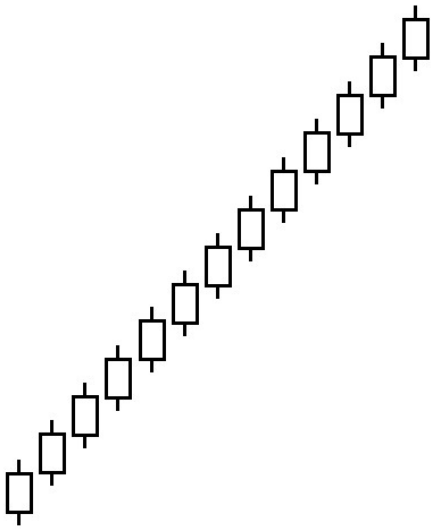


Figure 4: An Example of Basic1

As you can see, there are only up candlesticks. There are no down candlesticks because there is no synchronised closing of positions. Also, there is no new information which might change the fundamental view, and which might trigger a sell-off .

All candlesticks are equal in size because the asset which Basic1 tracks is growing steadily over time. All participants receive the same information simultaneously, which creates the perfect pricing, allowing every one of them to buy the same part of the Basic1 as the others.

Notice that every candlestick has small shadows. Those shadows might mean only one thing: selling. But if fundamentals do not change, why there is selling? Selling would mean losing a share from this ever-growing market and losing a stable profit opportunity. Well, since it's an imaginary example we can delete those shadows. But if we truly want to understand it, there is one thing we cannot exclude from the system. Traders are people and they need to eat. So, it is natural to assume that they will close a small part of their positions to take a little profit which later they spend on food – or whatever else they might need to subsist.

Why only small? Because the asset is growing steadily, and it will continue to do so in the future. Closing more would mean less profit in the future.

The takeaway from this example is that if all participants are truly equal in terms of awareness and ability to take action, this is how the chart of every instrument would look. Small, only up candlesticks with very small shadows. This is how 'the normal' should look.

Now let's return to reality. Let's take one of the candlesticks – since they are all completely the same it

doesn't matter which one. If we compare this normal imaginary candlestick to the chart of a real trading instrument, we'll see that it matches some of the candlesticks from the real chart.

That's strange. We were supposed to have an imagined example. How is it possible that our imaginary candlesticks match with candlesticks from a real market movement? Even part of our movement (3-4 candlesticks for example) also match part of real instrument charts.

See for yourself. Here is the chart of S&P500 again.

Figure 5: The E-mini S&P500 Futures, Daily Chart. Source: TradeStation®

The red arrows are pointing the different candlesticks that look the same as our normal, imaginary example. Highlighted are also two instances where a group of candlesticks shows big similarity with the chart of Basic1.

The truth is that what we isolated happens in real life. It cannot stay like this for a long time, of course. The most we could highlight was only three consecutive days. But for some period, we could have a fixed number of participants, known fundamentals and so on. That is why our normal candlesticks appear in a real chart, where they also look as normal as we can get.

But if this normal, as we call it, candlestick exists in the real charts, does that mean that we have found the first letter of the chart's alphabet?

Chapter 3: The Shape of the Letters

That's great. We've identified the normal candlestick. Now we can leave the basic case example and go to a real chart and read it.

But wait, there are other candlesticks which don't look a lot like our normal ones. Do they mean the same, or is their meaning completely different?

Different. We've learnt only one letter, but there are more – like the English language, A is the first. But it is not the only letter. The language of the chart has many other letters also.

Those other parts of the chart look different because they are. They were made by different market activity or the lack of it. Remember:

CANDLESTICKS ARE MADE FROM TRADING ACTIVITY OR THE LACK OF IT.

If we go back to our Basic1 example, every normal candlestick was made from the same trading activity as it was in the previous period. Nothing had changed. Now, what if in the next period there is no activity? Nobody wants to buy or sell, to close or take profit. Then we'll get this:

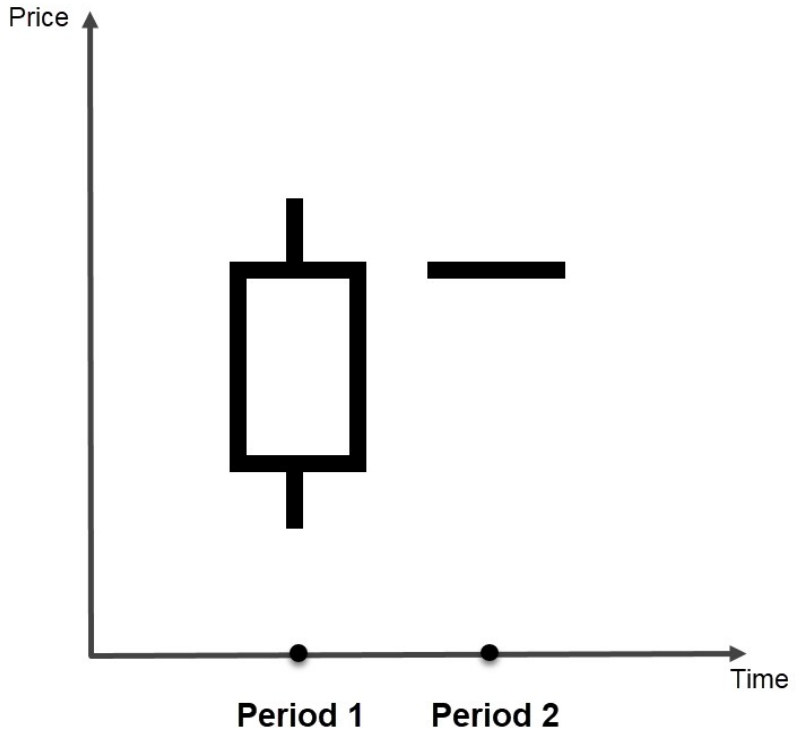


Figure 6: Lack of activity across periods on a candlestick chart

This is what the complete lack of activity looks like. See period 2? It's just a dash.

But what if it was the other way around? What if, instead of lack of activity, there was a price increase?

Again, we start from our normal candlestick. It begins like the normal candlestick in Basic1, but at some point, after the beginning of this period, new information enters the system.

That information could decrease or increase the current fundamental valuation. Let's say it increases it. That would result in the growth of our candlesticks from normal to big in size.

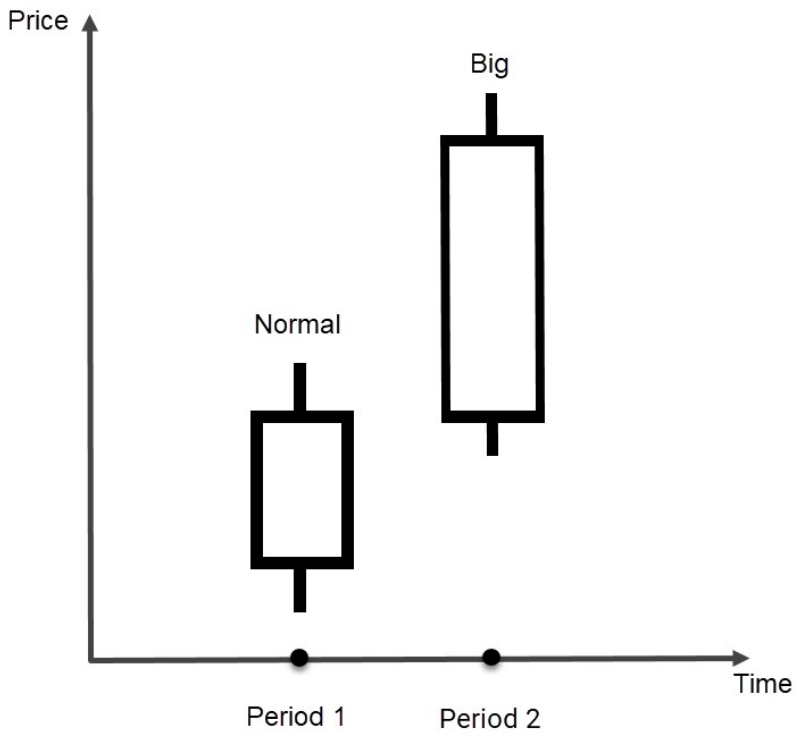


Figure 7: Candlestick Chart with New Bullish Information in Period 2

On the other hand, this new information could lead to a complete turnaround of the fundamental scenario. That will result in leaving a large shadow on one side of the candlestick, while closing to the other side. See the illustration below:

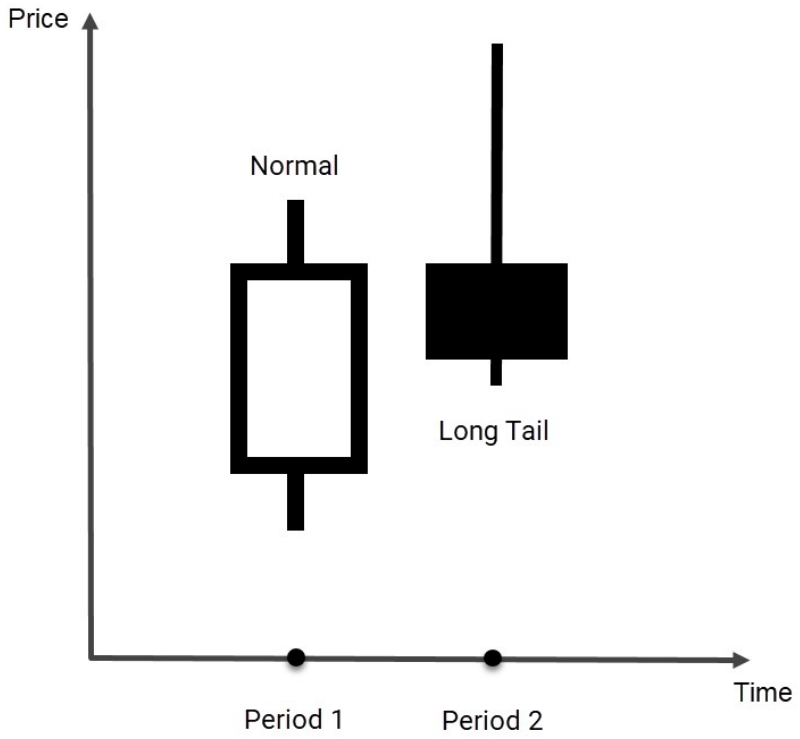


Figure 8: Candlestick Chart with New, Bearish Information in Period 2

There could be many cases which are modifications of our basic case. For example, that news might have only a temporary effect, or, there might not be news but a large market participant entering the market, or a large one is liquidating its positions, and so on.

If we take all kinds of possible trading activity and the lack of them, and all possible ways it could modify the chart, you'd think things would quickly get out of hand. But in fact, we will see that:

THERE ARE ONLY 8 POSSIBLE TYPES OF CANDLESTICKS OUT THERE

And here they are:

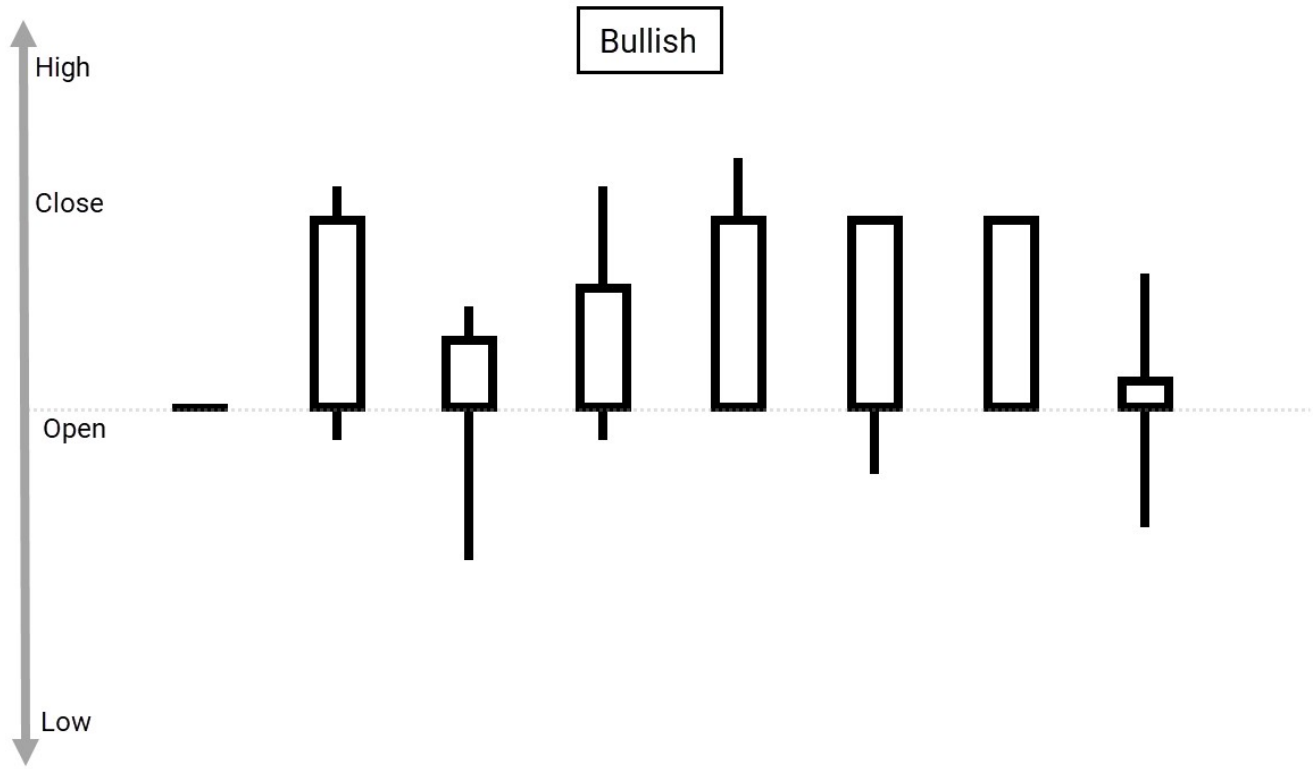


Figure 9: All Types of Candlestick in Bullish Formation

And in a bearish formation:

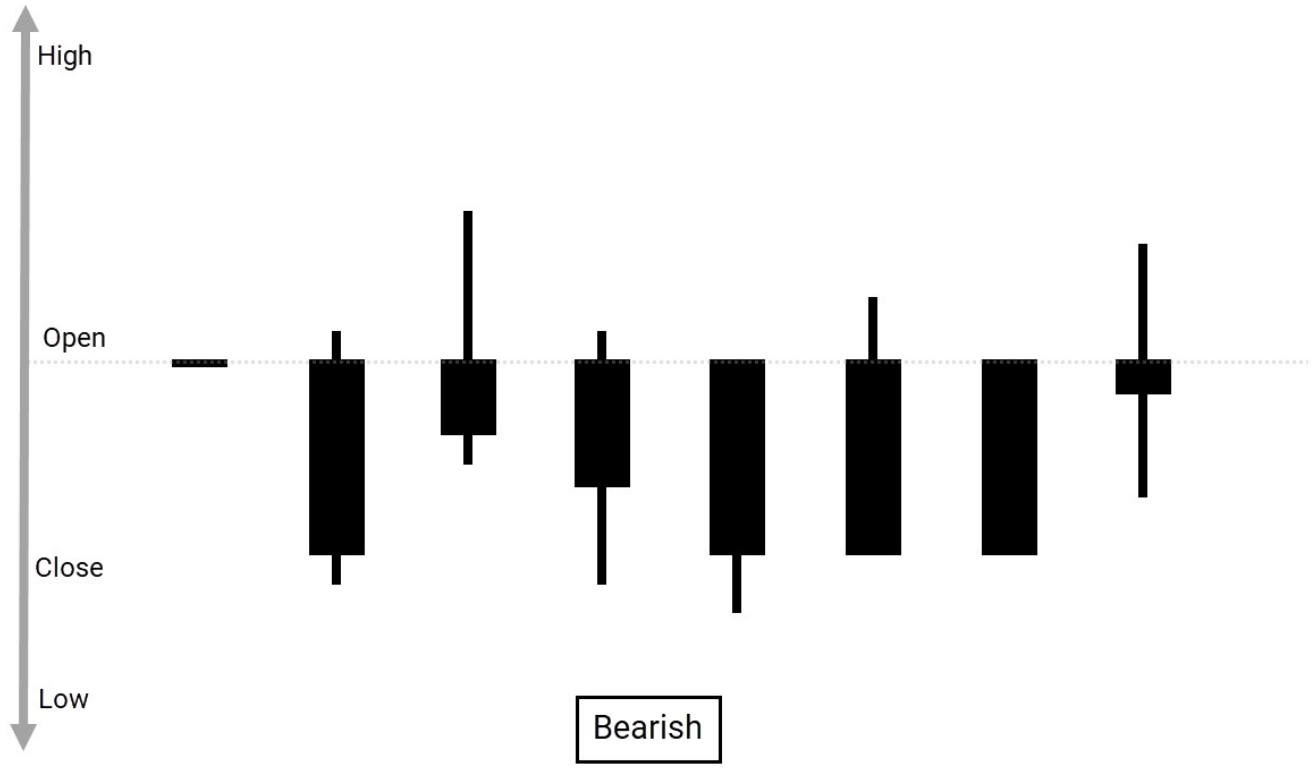


Figure 10: All Types of Candlestick in Bearish Formation

No matter what market we are looking at or what timeframe that charts are showing, we can see a maximum of eight shapes on our screen.

Now we know all the shapes a trading activity or lack of trading activity might create. But what do the shapes mean? And what happens in the markets after any of these shapes?

To understand this, let's look at those different kinds of candlestick shapes one by one.

Chapter 4: New Concepts

The purpose of using a candlestick chart type in this book is because most of the retail traders are using it. The patterns and shapes shown in this book are the same no matter if you are using a bar or candlestick chart. We think the candlestick chart will help you better grasp the concepts here. But do not mistake the current patterns with those of the Japanese candlestick theory. Because they are completely different.

Their purpose is to avoid the flaws in the Japanese candlesticks theory and improve on it.

In the past, I was using the Japanese candlestick theory a lot in my trading. That is how I learned some lessons about it the hard way. It is always easier to critique something than to build it. That is why I'll briefly discuss only a few major problems with the more commonly used Japanese theory.

- It is too complicated! Can you count all patterns which exist in this theory? Neither can I. I don't know if it was created this way but certainly during the years it became more and more complicated. As if people were trying to draw a pattern for every single market move, from the monstrous decline to the minor tick. As always, the truth lies in the very basic rules of the Japanese candlestick theory, and this is where we will look to improve.
- It is too static. By using it, I came to realise that all patterns are like a screenshot from the past which we traders try to fit with brute force in the current situation. Doing this, we ignore some things that at first glance appear to be only small differences but which later lead to significant failure. Let’s do an experiment. Open your text editor (be environmentally responsible and do not use paper), and write down how many variations of the bullish engulfing you know. Then after you finish the book go back to that file and write down how many bullish engulfing, outside days you know now. There will be a big difference. And what’s more interesting is that not all of them will mean the same!

To start with the improvements, we’ve got to introduce a few new concepts.

In classic theory, a candlestick consists of an upper shadow, body, and lower shadow. They are shown in the illustration below.

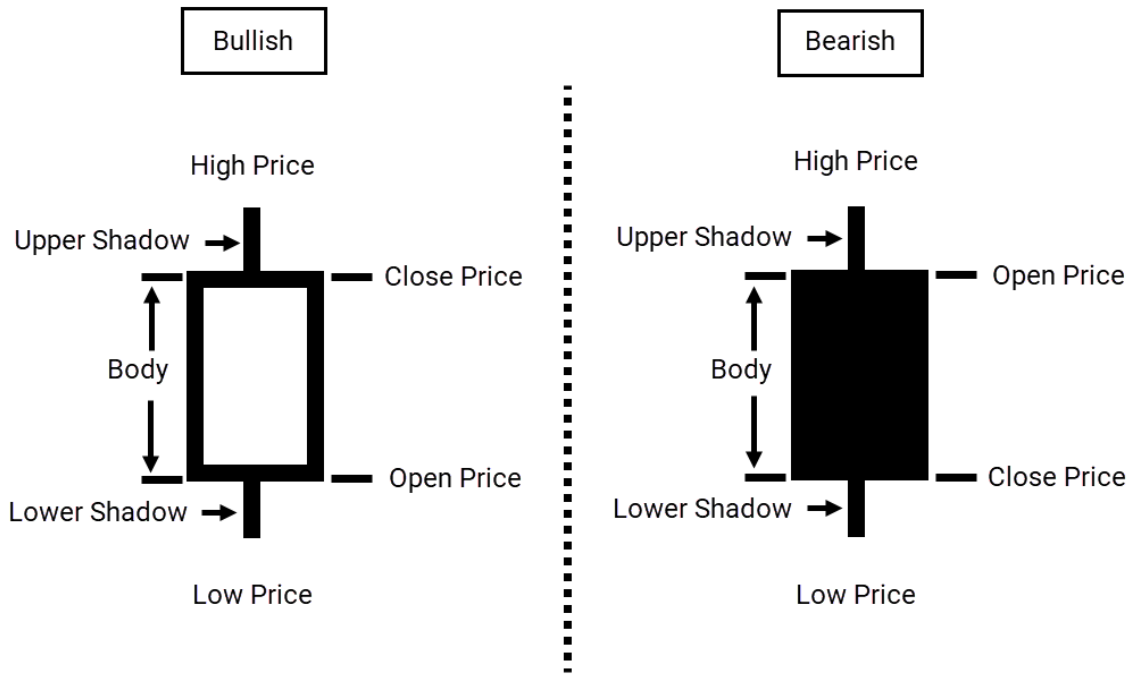


Figure 11: The Composition of a Candlestick

In order to show the real potential of every single candlestick, and to simplify the Japanese candlesticks theory, we'll introduce new labels for some of the parts.

Look at the next illustration.

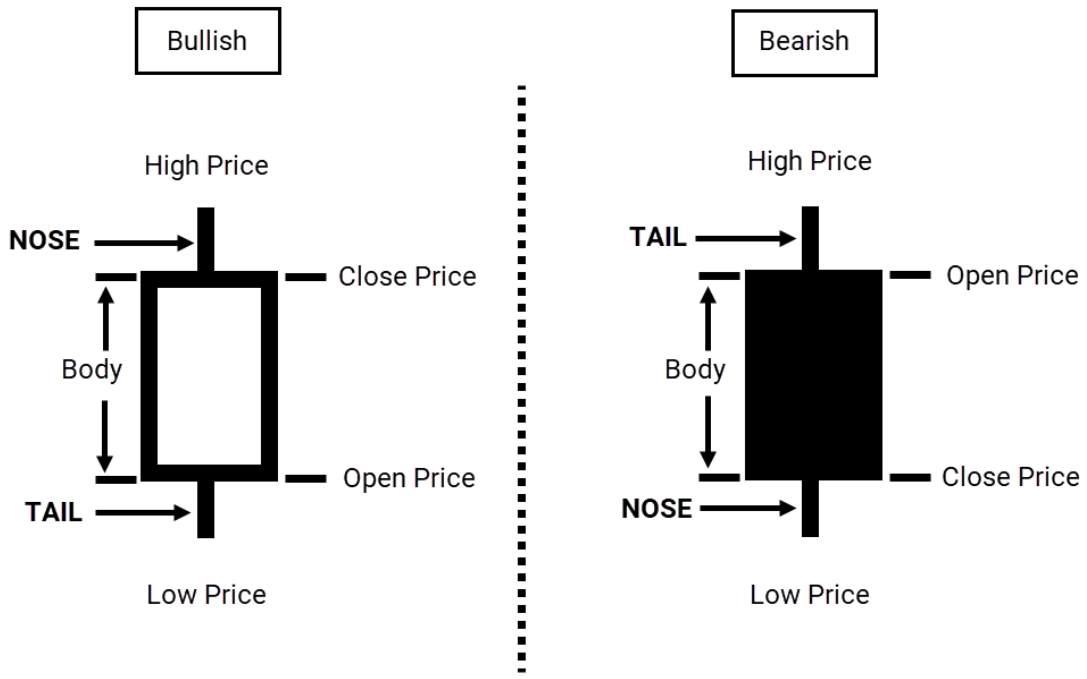


Figure 12: New Terms for a Candlestick

As you can see the 'upper' and 'lower shadows' are replaced by 'Nose' and 'Tail', respectively. Everything else stays the same.

But what are the Nose and Tail?

The Nose

The Nose is the part of the candlestick which is between the Close and the High in the case of a bullish candlestick, or between the Close and the Low if we are looking at a bearish candlestick. In classic theory, the Nose would be the upper shadow in a bullish candlestick, or the lower shadow in case we are observing a bearish candlestick.

The Tail

The Tail is the part of the candlestick which is between the Open and the Low in the case of a bullish candlestick, or between the Open and the High if we are looking at a bearish candlestick. In classic theory, the Tail would be the lower shadow in a bullish candlestick, or the upper shadow in case we are observing a bearish candlestick.

Imagine it like an airplane. No matter the direction the airplane is heading, the Nose is always at the front while the Tail is always at the back of the airplane. So, if the candlestick is moving up the upper part, above the body we'll call Nose, and the lower part, below the body we'll call Tail. And the opposite if the candlestick is going down: the Tail now takes the upper part and the Nose the lower. If a candlestick is changing direction and, for example, turns from a bullish one to bearish, then the Nose and the Tail change places also.

Again, the same would be true of the parts if we were using a bar chart. No difference.

If you are used to using the labels of the traditional candlestick theory, you might find it a little bit difficult to see which is the Tail and which the Nose at the beginning. But don't worry. You'll get used to them in no time at all. And you'll quickly see it's easier this way.

So, now we've got our terms in order, let's move to the individual candlestick shapes.

Chapter 5: The Long Body

To find this type of candlestick, let's return to our normal case. The Long Body (LB) candlestick has the same shape as every single candlestick in Basic1. We've already mentioned that the candlestick from this ideal case might appear in a real chart. So, we'll no longer call it normal or basic. Instead, we'll call it a Long Body (LB) candlestick. This is the first letter in the chart's alphabet. So, let's see how many times it crops up, what it tells us about the market, and how we can use that information.

LB is a candlestick where both Nose and Tail exist, and they are small compared with the body, which is the largest part of the candlestick.

Here is how it looks.

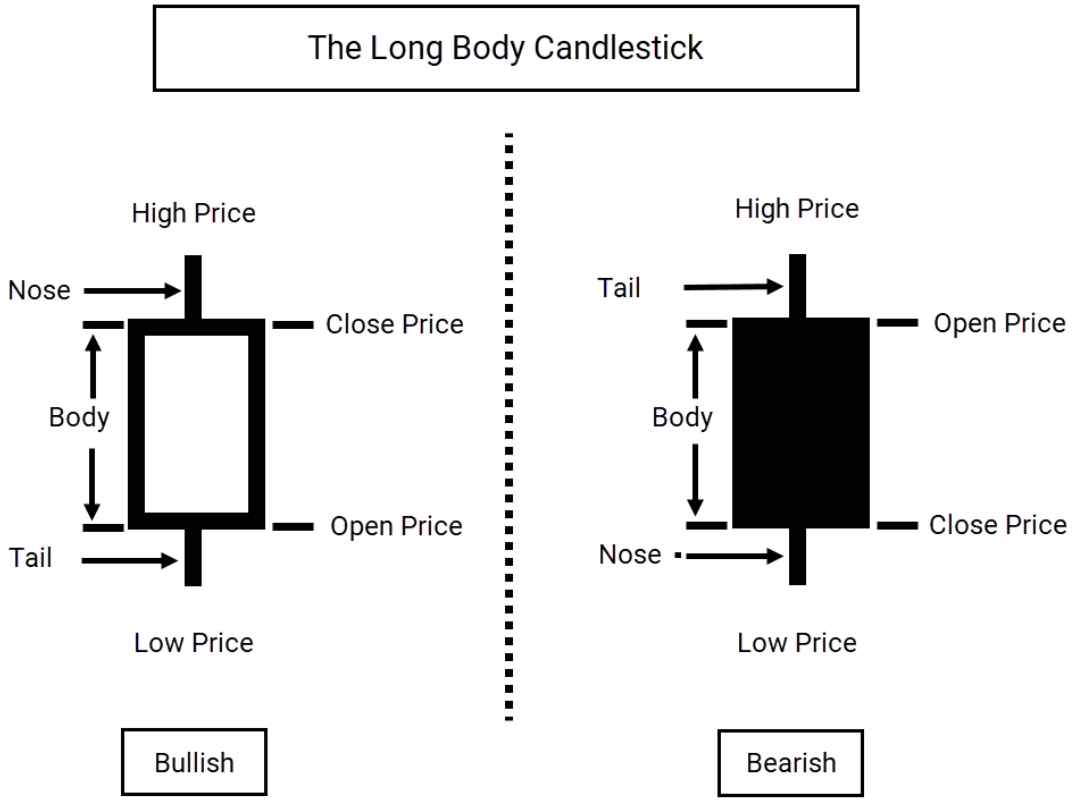


Figure 13: The Long Body (LB) Candlestick

Yes, this is the same picture I showed you above. That's because we used the Long Body candlestick to introduce you to the Nose and Tail. Here, we have a long body and it's the largest part. Also, the Nose and the Tail are small and, to make it a perfect example, they are almost equal in size.

Here is an example of how LB candlesticks look on a real chart.

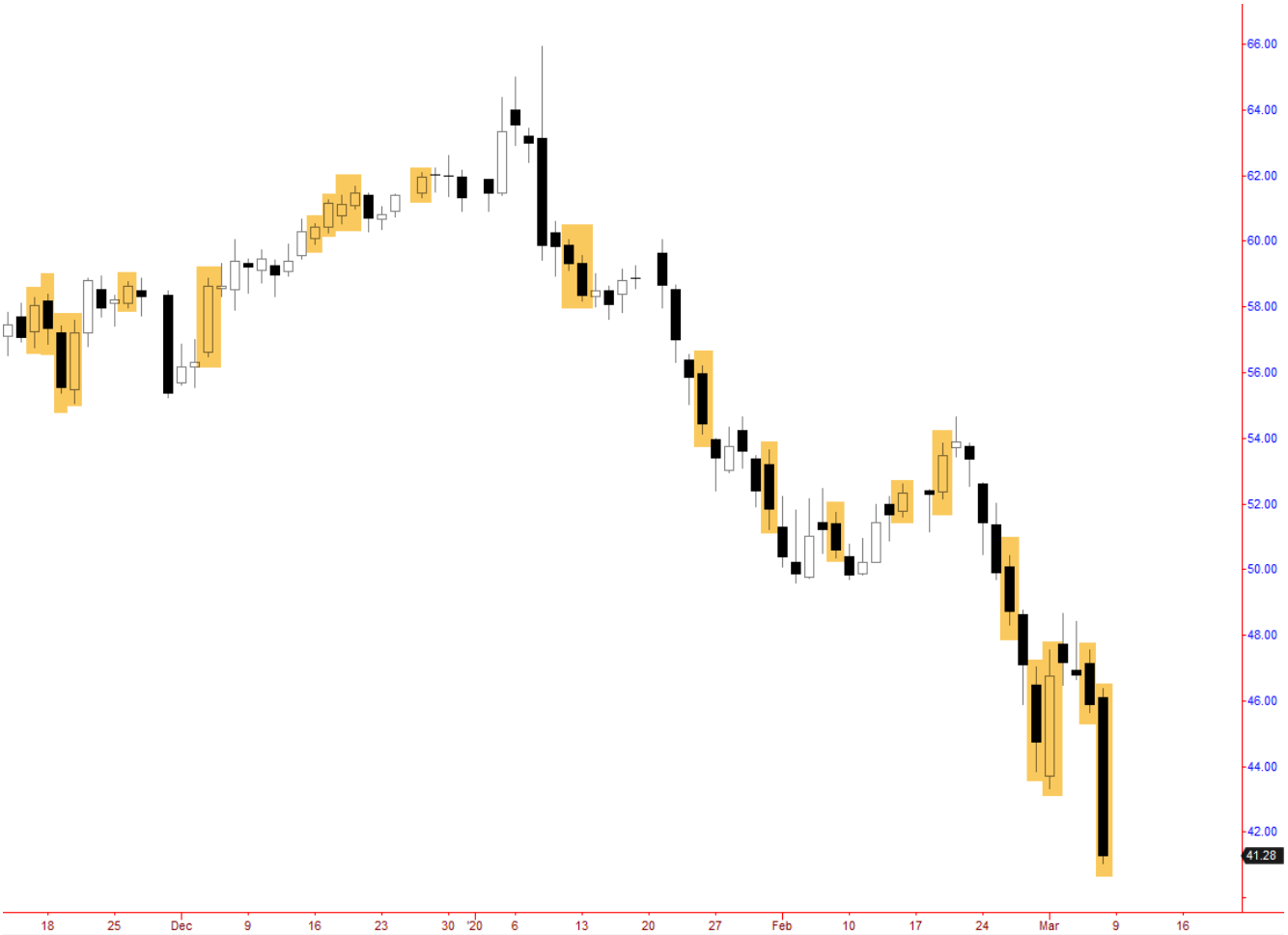


Figure 14: LB Candlesticks on a Real Chart. Crude Oil, Daily Chart. Source: TradeStation®

Now we know what LB looks like, let's see how often it appears.

The results you'll see are from a two-year test of the daily chart of the E-mini S&P500 futures.

We are looking for all candlesticks where the body is significantly larger than the Nose and Tail. Both Nose and Tail must be visible. We'll not apply the requirement for Nose and Tail being equal because that's the perfect example and in trading, nothing is perfect.

In S&P500, on a daily chart, from 20 December 2017 till 20 December 2019 (that's 504 trading days), we have 134 LB candlesticks. That's 26.59% of the time.

Approximately, one in every four candlesticks we can expect to be LB. So it is not rare at all. But what does it mean?

For us traders, it is important to look at those different shapes with two main objectives:

- How will the current candlestick behave? Does it give us information about possible entry or exit?
- What does the shape of the current candlestick mean for the next period?

Based on the test, our first impression is that this type of candlestick is likely to appear after the move has begun. We should not expect it to mark the highest/lowest point of a top or bottom.

But leaving aside tops and bottoms. What does this candle mean for the move after it?

The next day after the LB follows the same direction in 67 cases, or exactly 50% of the time. Like a coin toss. What this means is that by taking into consideration only this type of candlestick we cannot conclude whether the next day will continue in the same direction or not.

We need to include something more!

Introducing the Simple Price Action Signal

In price action trading, the simple signal occurs when the prior candlestick's high or low is penetrated. Following this, a simple price action buy would be when today's price breaks above yesterday's high. The opposite, a simple price action sell, would be signalled when the price today breaks yesterday's low.

Here's an illustrated example of the simple buy signal.

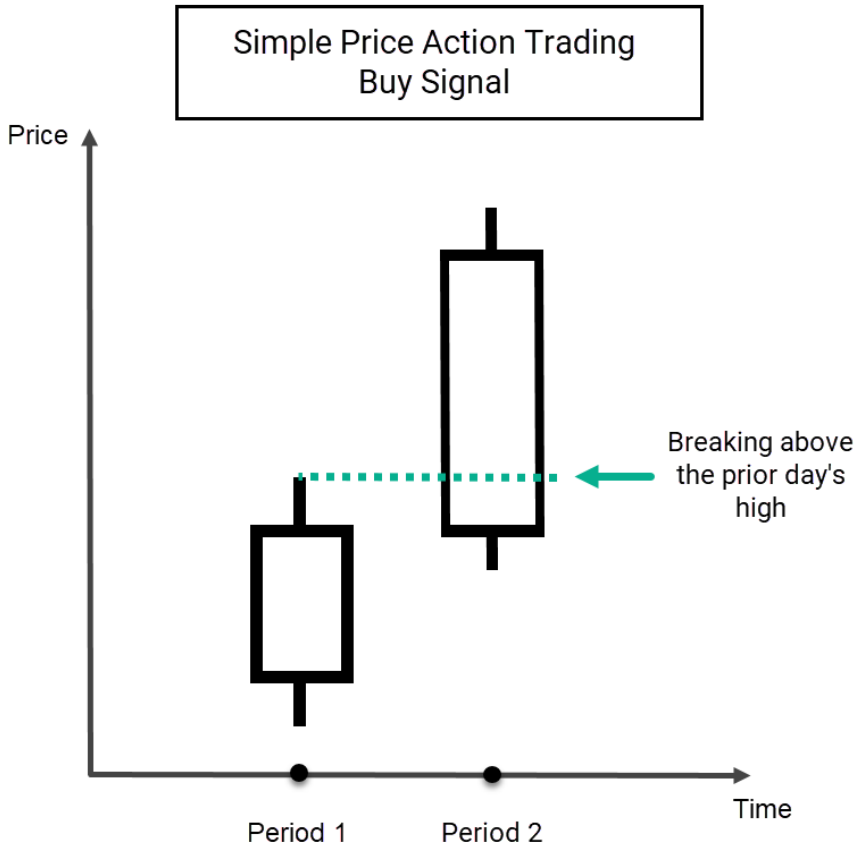


Figure 15: Simple Price Action Trading Buy Signal

And here is what the simple price action sell signal looks like:

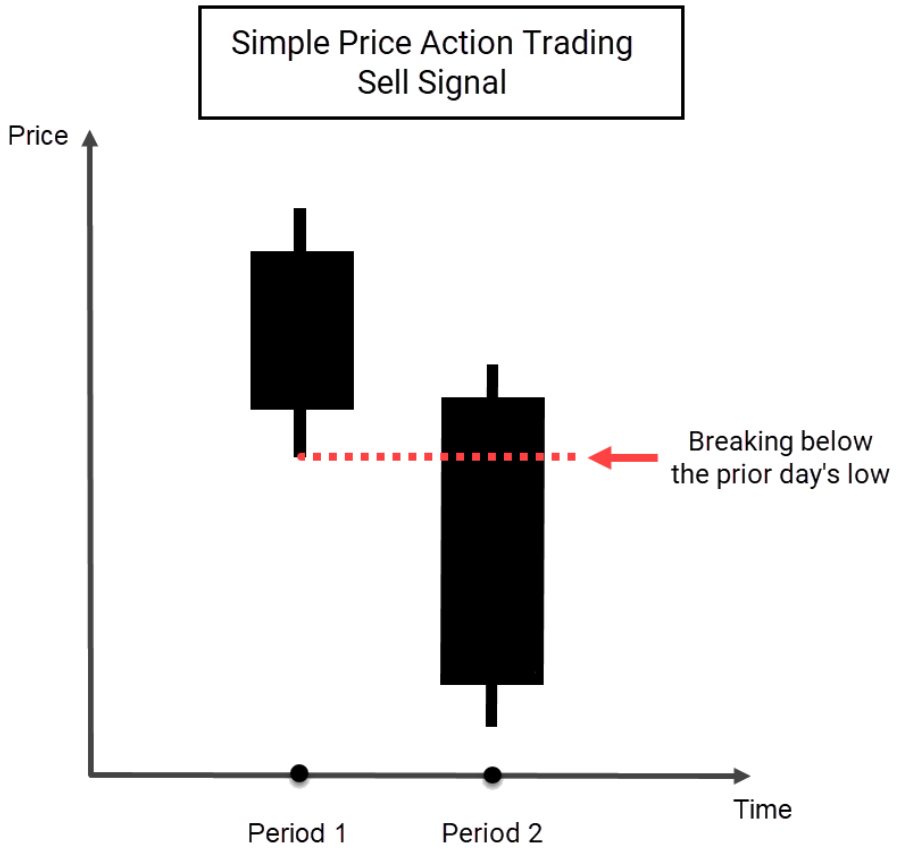


Figure 16: Simple Price Action Trading Sell Signal

Note that the above examples are showing only the cases of breaking the prior day's range in the same direction of the previous day. But a simple price action signal will occur no matter on which side the breakout occurs.

Now let's see how this simple rule of breaking the high or low will change that equilibrium we saw in the Long Body candlestick of a 50% chance to continue or reverse. We'll show the result only for breaking in the direction of the previous day. If it was up, then we'll count only breaks above the high. If the previous day was down – the breaks below its low. We do this to see whether there is any forecasting ability of the LB.

During the same period and with the same instrument, the number of occurrences where the high or low was breached dropped to 105 (from 134 total LBs). When the high or low was breached the next day, it followed the direction of the LB candlestick in 64 of them. That means that the percentage we saw earlier now increased from 50% to 61%.

Now that is something. One minor tweak leads to a significant increase.

To understand the behaviour of the LB candlestick even better, we have to include its other characteristics.

Let's consider its size. To measure the size of a candlestick, we use the Average True Range (ATR) indicator set to 1 period. This indicator is by default included in almost all trading platforms. It shows the size of the true range for a specific period (days, weeks, hours, etc). This means that if the indicator's period is set to 1, it will show the true range for the last period.

Applying ATR(1) to the S&P500 chart used in the test, we can divide the LB candlestick into three groups:

1. Small LB (SLB) – Here we put all LB candlesticks where ATR(1) is under 20.
2. Normal LB (NLB) – Those candlesticks are where ATR(1) is between 20 and 59.
3. Big LB (BLB) – Here we make the most money. Those are the biggest candlesticks where ATR(1) is above 60. You can think of them as a gift from the market.

To understand it better, let's look at the following real chart example showing all three sizes of LB candlesticks (highlighted on the chart).

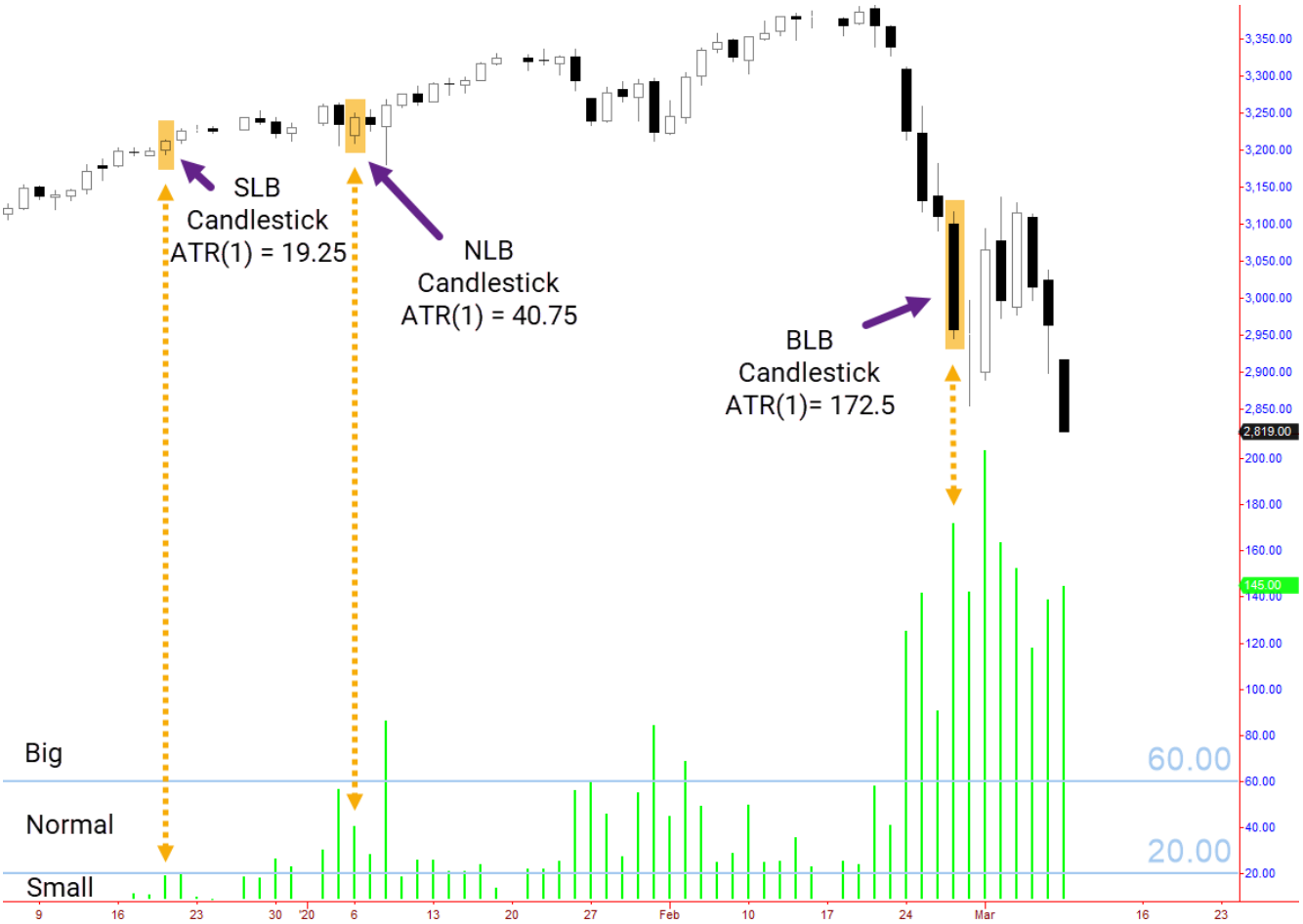


Figure 17: The Three Types of LB Candlestick. Source: TradeStation®

Not all LB candlesticks were marked on the chart. Only one example for each of the three groups where those candlesticks fall according to their size.

As you can see, there can be quite a difference. But let's turn our attention to the test results. They show that during the test period an SLB candlestick occurred only 12 times. NLB happened most of the time with 93. We saw the biggest one, BLB, 29 times.

But what does it mean?

Let's begin with the normal size or the NLB. That candlestick suggests that every piece of underlying information is already known before the candlestick was made or, if new information arrived, it was quickly absorbed by the majority of the participants.

Because of this, we can conclude that an NLB candlestick will lead to a continuation of the same

direction the next day. And our test shows exactly that, the day after NLB is following the direction of NLB in 55%.

What is even more impressive is that if NLB's high or low is broken the following day, that second day will close in the same direction as the previous day's NLB in 75% of the cases!

A practical example might help you understand that better. Let's say we are in a long position in S&P500 and yesterday's candlestick is up LB shape and normal in size. If today the price breaks the high of the yesterday's upwards (bullish) NLB candlestick, we can expect with a 75% chance that today's candlestick will close higher than the opening.

Another interesting combination is between the LB shape and the big size. The test shows that a BLB (Big Long Body) candlestick leads to a reversal the next day in almost 66% of the cases. This has a logical explanation because to reach a level above 60 in ATR(1) the market needs massive buying or selling. A lot of reasons might cause that buying or selling, but whatever they are most of the buyers and sellers have entered and driven prices a lot higher/lower. There's usually nobody else left to keep that movement going the next day. That is why there is a great chance that this next day (the day after BLB) will close in the opposite direction.

An interesting thing that is worth mentioning is the fact that with around 90% probability you can expect at least one of the extremes of the LB candlestick to be broken. Inside days following LB are rare. The same is true for the outside days, which were only 8% of all periods following LB candlesticks in the tested period. This practically means that if one side of the LB is broken, let's say the high, it has a really small chance to break the low as well and form an outside day. That low probability is showing us a good place for our stop-loss orders!

Before we proceed further with even more amazing shapes, it's time for a small warning. Most of you reading this will get carried away with those great numbers and probabilities. In some shapes you'll even see 100%. Please understand exactly what they mean, and what they don't.

For example, in this chapter we explained that if NLB's high or low is broken in the direction of the NLB you can expect the next day to be in the same direction with a 75% chance. That means that statistically in 75% of the cases if the NLB was up, for example, and its high is penetrated on the next day, that day will close higher than the opening. But it does not say how big the move will be nor whether there be enough movement to justify a normal risk/reward ratio.

We are now learning how to understand the chart language focusing on its letters - the single candlestick. To reach a conclusion to enter into a position we need to analyse more than one just one candlestick. We need to start reading whole words and sentences. We'll get to that in chapter 13.

Chapter 6: The Long Nose

So far, we've learned that a normal case candlestick is that with the long body. This means that from open to close, the market moved in one direction with only small movements in the opposite direction.

In the bullish example, after the opening, the market went down for a little bit then market participants started to buy and drove the price up. That created a small Tail. At some point, some of them closed their positions, creating a short Nose.

But what if, after the move up, more market participants started to close their positions? Because of some new information, for example, they decided to take profit. How would that profit-taking change the shape of the candlestick?

Well, the Tail would stay the same, the body would get smaller, and the Nose would get longer.

Here is how it will look:

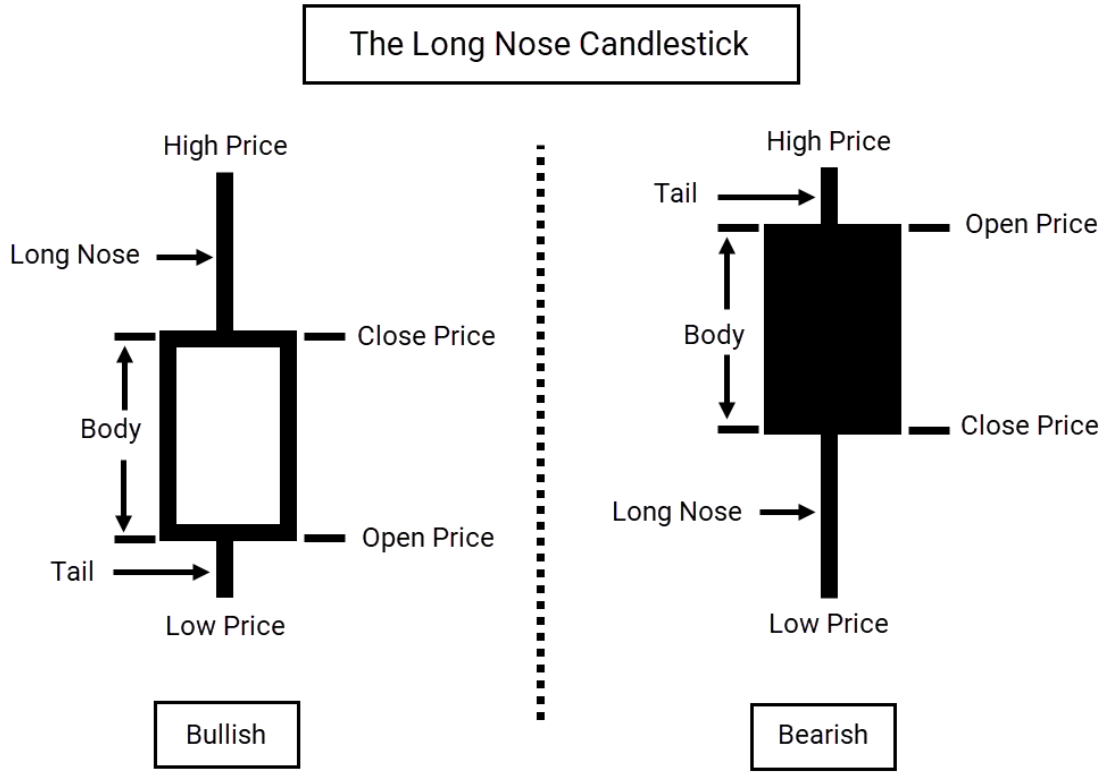


Figure 18: The Long Nose Candlestick

This typical shape we'll call the Long Nose Candlestick (LN), and it is the second of our eight letters.

It is the shape of a candlestick that suggests profit-taking. It means that the market has reached a level where some of the market participants decided to close positions. Please note that we are talking only about closing positions. This shape is mostly caused by closing and not that much by opening positions in the opposite direction.

Look at the example below.

Figure 19: Daily Chart of Euro FX Futures, LN Candlestick Highlighted

This is a daily chart of the Euro FX futures. If you are trading Forex, this would be the chart of EURUSD.

This is a very recognisable candlestick shape. It is also a very useful one.

But before we continue to learn how often we can expect it to appear and what it actually means for traders, let's understand it a little better.

Unlike the previous shape, this one has two variations.

The 1xN Long Nose Candlestick

The first variation of the LN is when the Nose is the longest part of the candlestick, meaning it is bigger than the body and the Tail. That means that the profit-taking was significant in the observed candlestick.

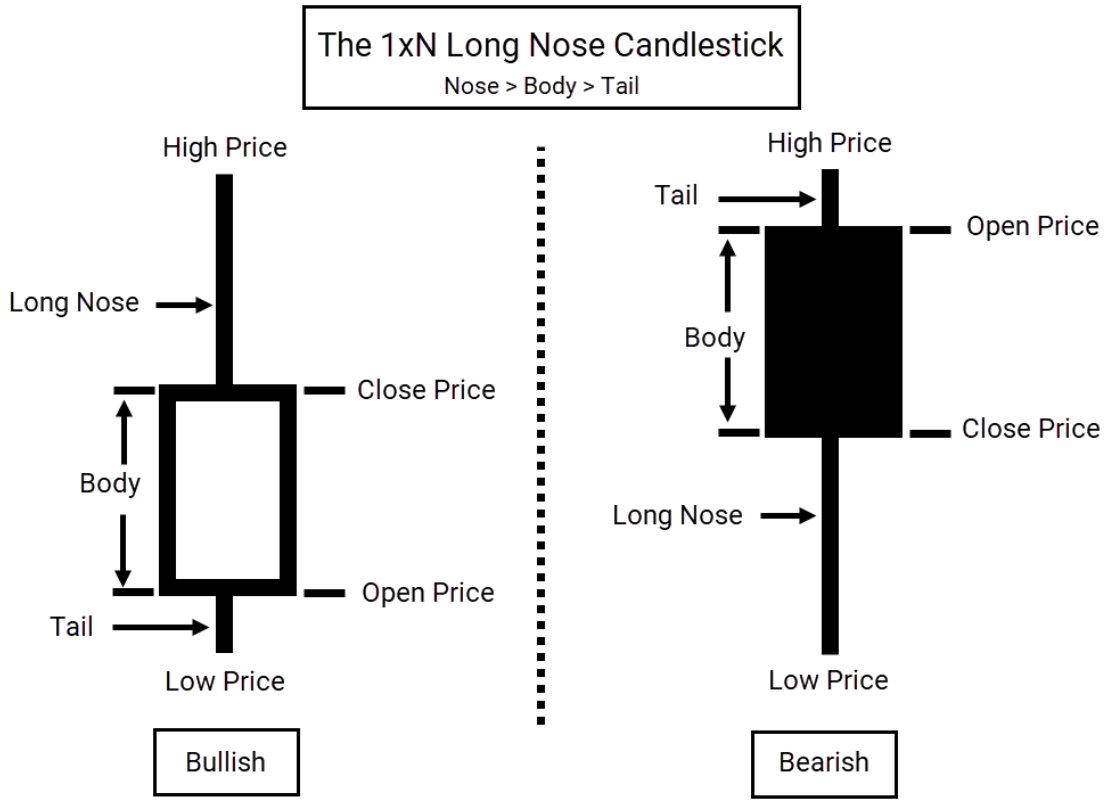


Figure 20: The 1xN Long Nose Candlestick

Below is the daily chart of Silver futures where 1xN candlesticks are highlighted.

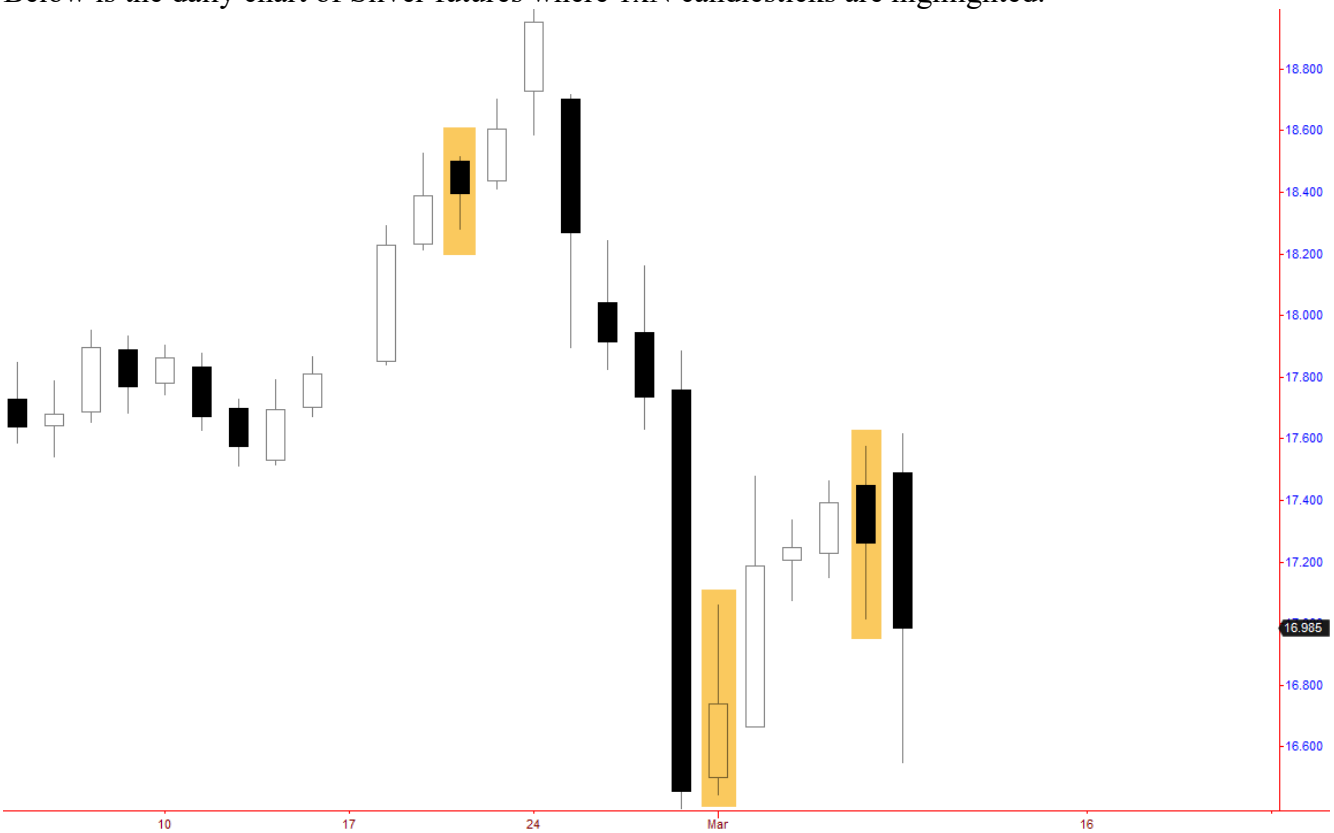


Figure 21: Silver Futures, Daily Chart, 1xN Candlestick Highlighted. Source: TradeStation®

The 2xN Long Nose Candlestick

The second variation of the LN candlestick is a little bit harder to find. In this case, the Nose is not the biggest part of the candlestick. Here the Nose is bigger than the Tail but smaller than the body. How we distinguish it from the previous shape of Long Body is that the Nose multiplied by 2 is larger than the body plus the Tail.

Nose * 2 > Body + Tail

Here is an illustration.

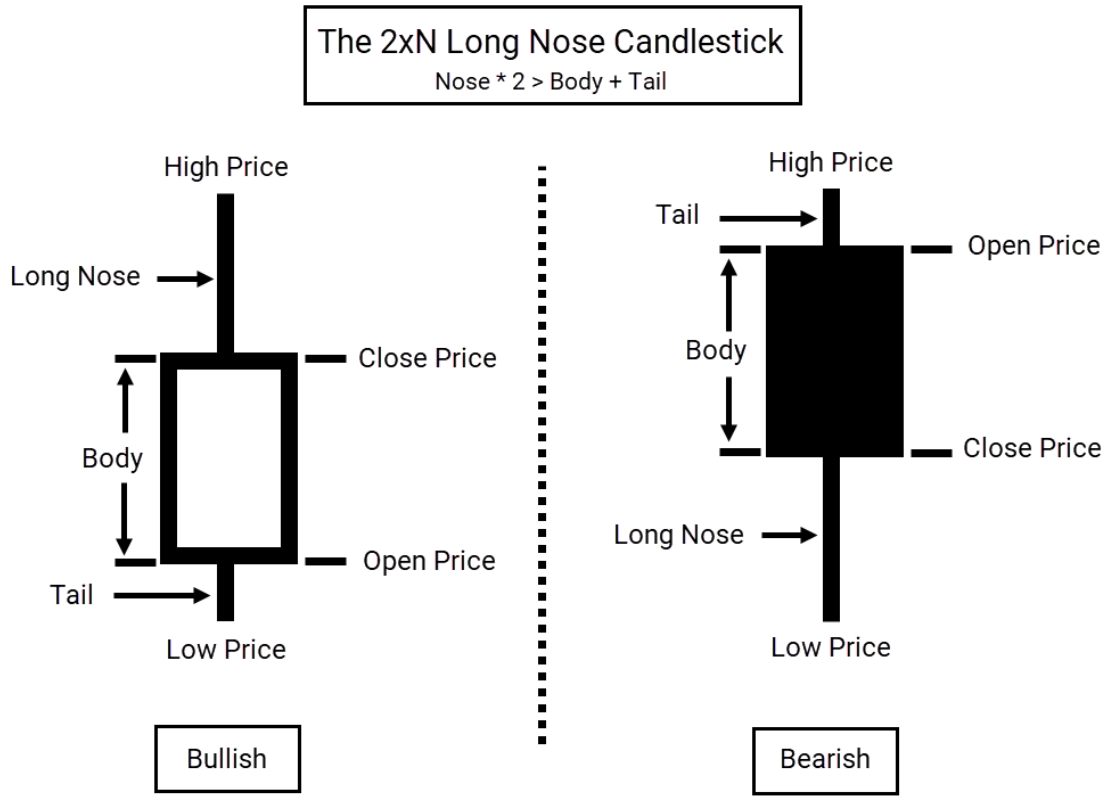


Figure 22: The 2xN Long Nose Candlestick

Also, here are some real chart examples again on the same Silver daily chart.

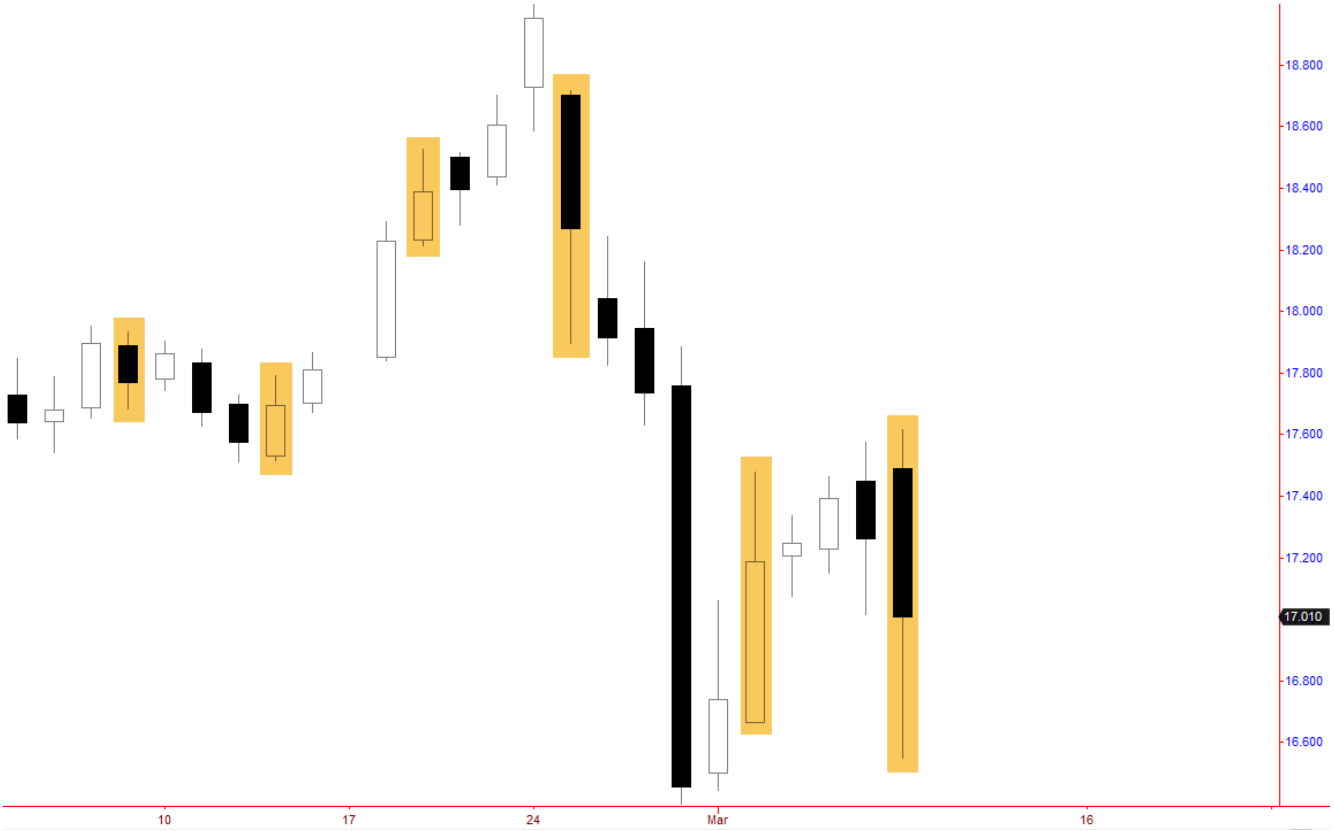


Figure 23: Silver Futures Daily Chart, 2xN Candlestick Highlighted. Source: TradeStation®

In time, you'll be able to spot it with no additional checks, but in the beginning, you can use the Fibonacci Extension tool (FE). It is a free tool available in all trading platforms. Just make sure the levels are set to 100% and 200%. The purpose is to measure quickly whether the Nose is larger than the other parts of the candlesticks.

To do that, get the Fibonacci Extension (you may find it's called Fibonacci Expansion also on your platform) and place it on the full length of the Nose. If it is an up candlestick then you place the first point of the FE on the high and then the remaining two points on the close of the candlestick. What this will do is measure the full length of the Nose and then project it down.

Then look where the 100% FE has fallen. If the FE 100% covers all the body than we have the Long Nose (1xN). If the 100% doesn't cover the body, but 200% covers the body plus the Tail and falls outside of the range of the current candlestick, then this is a 2xN. The last one means that the Nose multiplied by two is bigger than the Body plus the Tail.

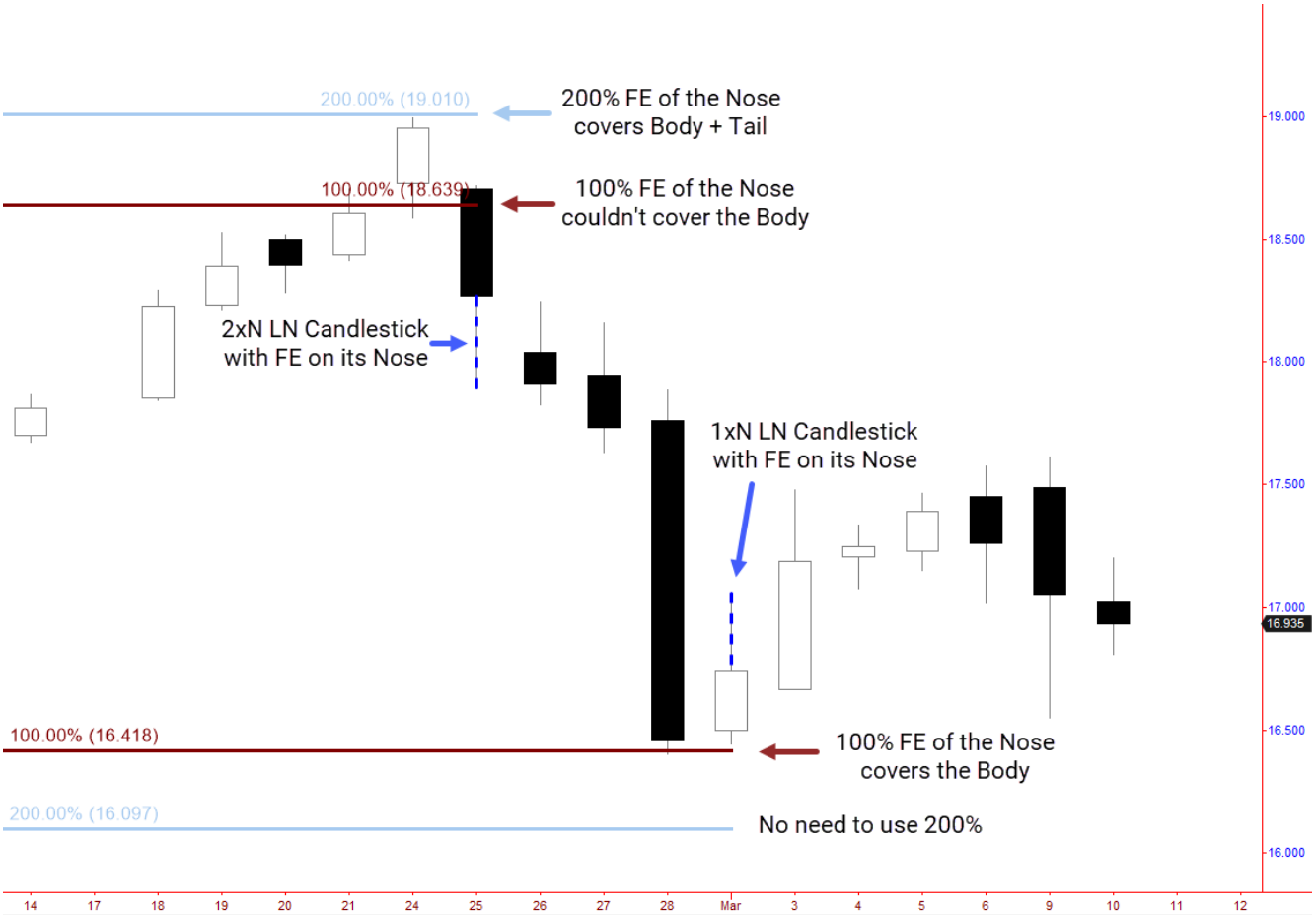


Figure 24: Using FE to Measure LN

In the test, we used this tool to check all those LN candlesticks. Speaking of, let's see the results.

In the same test period for which the Long Body candlestick was tested (20 Dec. 2017 to 20 Dec. 2019, 504 trading days) on the daily chart of E-mini S&P500 futures, there were 128 LB candlesticks. 96 of them were 1xN and only 32 were 2xN.

Again, like in the previous chapter, we need to know two things. First, what is the meaning of this shape? And second, what will happen next if such a candlestick appears?

What we've found is that in general, this shape of candlestick means a reversal. This means that the day after an LN candlestick tends to close in the opposite direction. However, the percentage for this is not big. From those 128 LN days, in 59 of them, the next candlestick closed in the same direction as the LN. Meanwhile, in the remaining 69 cases, the day after an LN candlestick, the candlestick closed in the opposite direction. This means that in 53.9% of the observed cases the next candlestick was closing in the opposite of the LN direction.

Here are how those probabilities look.

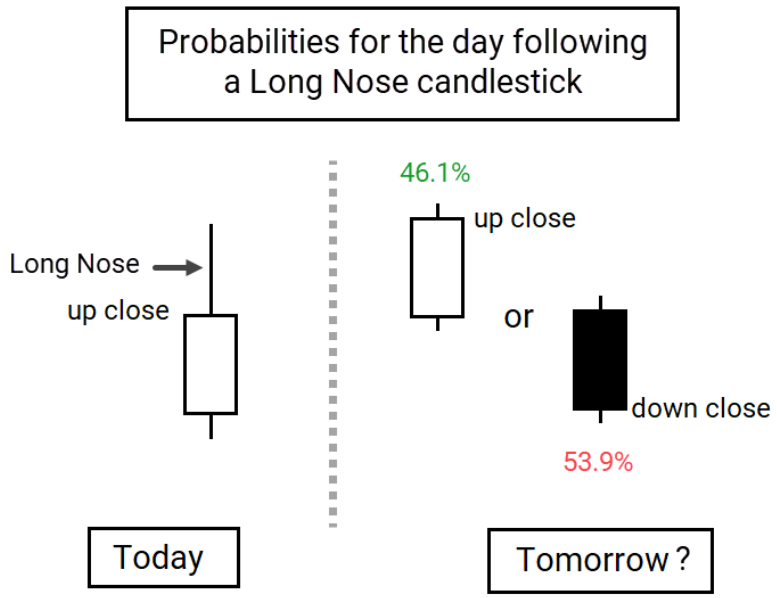


Figure 25: Probabilities for the Day Following a Long Nose Candlestick

So, if we see such a type of candlestick, we can tentatively expect the next one to close in the opposite direction.

But 53.9% is not that much, right? Can we make it better?

Let's see whether the 1xN or 2xN is causing this turnaround. Testing the size of the Nose leads to the conclusion that this turnaround comes mainly because of the 2xN. 1xN doesn't give a direction for the next day because it is exactly 50/50 (50% for a continuation and 50% for a reversal). On the other hand, 2xN is more likely to prompt a reversion. In 59.38% of the cases, the 2xN candlestick was followed by a day in the opposite direction.

We've reached almost 60%. Can we go higher?

Let's try by looking at the size of the LN candlestick.

As in the previous chapter, we'll use the Average True Range Indicator (ATR) set to 1 period. Again, we'll divide the candlesticks into three different groups:

- Big – when ATR(1) is above 60
- Normal – when ATR(1) is between 20 and 59
- Small – when ATR(1) is below 20

In 67% of the cases, the LN candlestick was normal in size. Unfortunately, this doesn't tell us much because the day after a normal LN candlestick, there is an approximately 50% to follow the direction, and 50% to close in the opposite direction.

Unfortunately, no clue for the direction of the next candlestick is given by the Big LN candlestick either. These were almost 9.4% of all LN candlesticks. Surprisingly, here again we have an equilibrium: 50% of them follow the direction, 50% are reversing.

Then, where did that slight reversal weighting of the overall LN candlestick come from?

Yes, you guessed it – from the Small LN candlesticks. The LN candlestick that has a small range, ATR(1)<20, was only 23.4% of the total LNs. But here, the reversion tendency is very strong. After such small candlesticks, the next day closed in the opposite direction of the SLN direction in almost 67% (66.67%) of cases.

Now, this is a nice-looking number. Seeing SLN candlestick might solve our trading puzzle with its 67% reversal influence.

So far, we've been able to reach 67% just by looking at the shape and the size of the LN candlestick.

Let's see, then, how the percentage will change if we include the simple price action signal, which we covered above in Chapter 5.

We'll take the same period, same instrument, a daily chart again, only this time we want to see what will happen if on the next day the Nose is broken. Just to clarify, breaking the Nose means if the price breaks above the high (up candlestick) or below the low (down candlestick).

Breaking through the high of the Nose of a Long Nose Candlestick occurred 55 times, or 43% of all cases. From those 55 occurrences, 78%, or 43 days, closed in the direction of the breakout.

That is a really significant percentage. Again, as in the previous chapter, we must remember that indicating that a candlestick is closing in the direction of the breakout doesn't mean that it will be a large candlestick bringing you a ton of money. It might only be a small gain. It might not be right every time – after all, 78% leaves a 22% chance you get it wrong. But what it does do it start to build up our picture of the language of the charts. It's another letter in the alphabet that helps us make the best trading decision.

But besides that warning, there is one other thing you should know about this specific type of shape. If you use it long enough, you'll find that those type of candlesticks very often appear at the beginning of the trend. That could mean that if the Nose is penetrated this could be the beginning of a trend.

Speaking of useful characteristics of the LN type, there are a few things worth mentioning.

The Initial Movement

After an LN candlestick, the next day usually begins with a move toward the Nose's end (being the high or the low of the LN candlestick). It represents a zone where profit-taking took place, which means market activity. That market activity and the level itself would act as a magnet for the market. That is why we can expect that the next trading day after an LN candlestick will begin with a move towards the Nose.

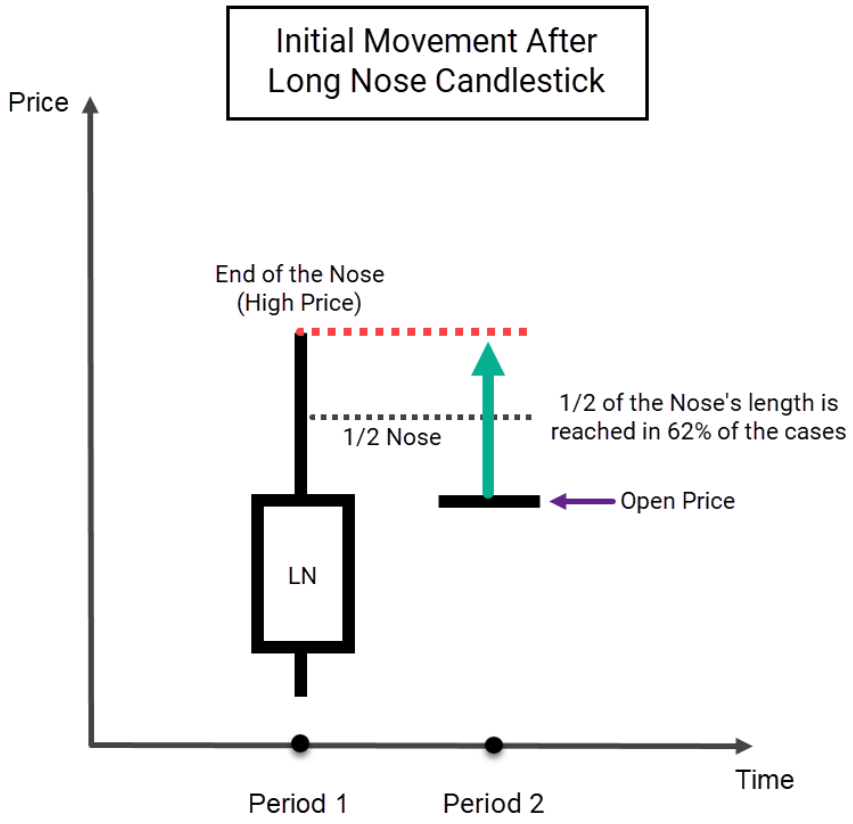


Figure 26: Initial Movement after an LN Candlestick

To prove that, I've tested how many times the market reached 50% of the Nose's length before reaching the end of the Tail. The results show that such movement occurs 62% of the time. This percentage is almost the same in both 1xN and 2xN types (2xN is performing a little bit better).

On some occasions where the candlestick is a small 2xN that means little. The Nose is simply too small and doesn't present a good trading opportunity. But remember that some Noses are actually larger than the body and the Tail together. This could mean that 50% of the Nose's length might present a good initial target. If after reaching half of the Nose the market breaks the end of the Nose that will put us in an even better situation with an already achieved better risk-reward ratio.

A Small Number of Outside Days

For our selected period of the S&P500 Futures, outside days with an LN form were lower than 5%. You already know how to use that.

The Long Body Days

One of the most useful characteristics of this type of candlestick is the fact that in more than 43% of the cases the next day, following a Long Nose, is a Long Body candlestick. This means that it moves mainly in one direction. Why is that good for traders? Because when the market is moving mainly in one direction, there is a lower tendency to get scared and close the position earlier. Also, some of those days were very large in size.

Chapter 7: The Dash

The name says it all. This is a candlestick where nothing happened. It opened and closed at the same level with no movement, neither up, nor down.

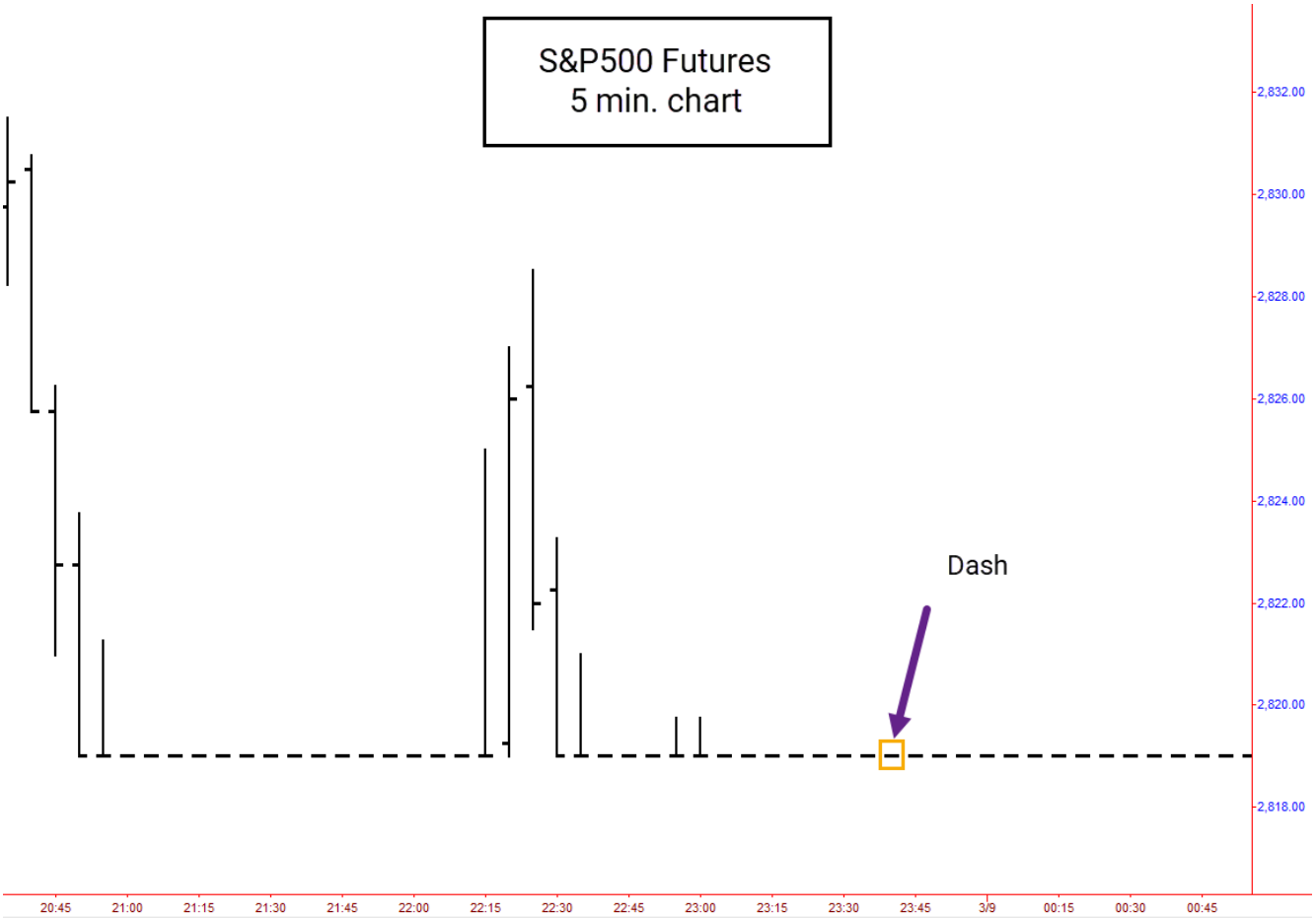


Figure 27: E-mini S&P500 Futures, 5 min. Bar Chart. Source: TradeStation®

The dash is almost impossible to see on a daily chart. I couldn't find any of them during my test. You can find it on lower timeframes like the 5-minute chart, for example, or during market holidays. The above chart is showing 5-minute bars like a dash because on that day, 9 March 2020, the S&P500 futures hit the "circuit breaker", a mechanism adopted by the Chicago Mercantile Exchange which stops trading after big declines – that's the first time that's happened since 1997.

What does the Dash mean?

Well, generally speaking, nothing. It means there was absolutely no activity and you should ignore it. It is shown here because this book is a comprehensive guide of everything you can see on a chart. It is showing the full alphabet, and the Dash is part of that.

Remember the following things when, on the off chance, you spot a Dash in the wild:

- If the Dash appeared on higher timeframe like a daily chart (probably during holidays where trading in that instrument was allowed only for a few hours or a similar situation) you should be very careful with executing a signal based on a price action pattern which appeared before the Dash. This is because, after a period with no activity, you can expect fake moves. So, you can't just ignore the Dash and trade what was before.

- The Dash can appear naturally in a normal trading day (on a lower timeframe most likely), but it might mean trouble. Price action signals are usually short-term signals. They give an indication of what might happen in the next few periods, whether those periods are days, hours, or minutes. A price action signal means that things should happen almost immediately. Starting from the next day (period), boom! Now, here is the problem. Imagine you have a beautiful price action signal. Maybe a combination between the LB and LN candlestick. It screams 'buy now'. You are preparing yourself and the next day - nothing, no activity, just the dash is sitting there on the chart. That means something is wrong. If the chart is telling you to buy but the moment the market should go up it stays put, be careful.

- The Dash is not a Doji. With the Doji, you have some activity up or down or in both directions. A Dash doesn't. And consequently it has no Tail or Nose.

Let's not waste any more time here with Dashes. Let's instead jump to the next letter, which is the influencer in the language of the chart.

Chapter 8: The Long Tail

So far, we've seen how the Long Body (LB) and the Long Nose (LN) have been formed. It all starts from the opening. The price is moving predominantly to one side. In the case of LB, the candlestick closes with the body significantly bigger than the Tail and the Nose. If it is an LN candlestick, the price is retracing from the reached maximum or minimum but still closing in the direction of this predominant move.

But what if that retrace is so big that it is able to reach back to the open price and go even further, closing in the opposite direction?

Let's use an example. Try to visualize it in your head. After the opening, the sellers are pushing hard. They drive the prices down, below the opening, maybe below the previous day's low (for a daily chart). Then something happens. News, for example, which suddenly forces the sellers to close positions and even gives control to the buyers. They lift the prices up, and that day closes above the open price.

On your chart, it should look something like a candlestick with a long Tail – so naturally we'll call it a Long Tail (LT) candlestick. It's shown on the left side of this diagram below.

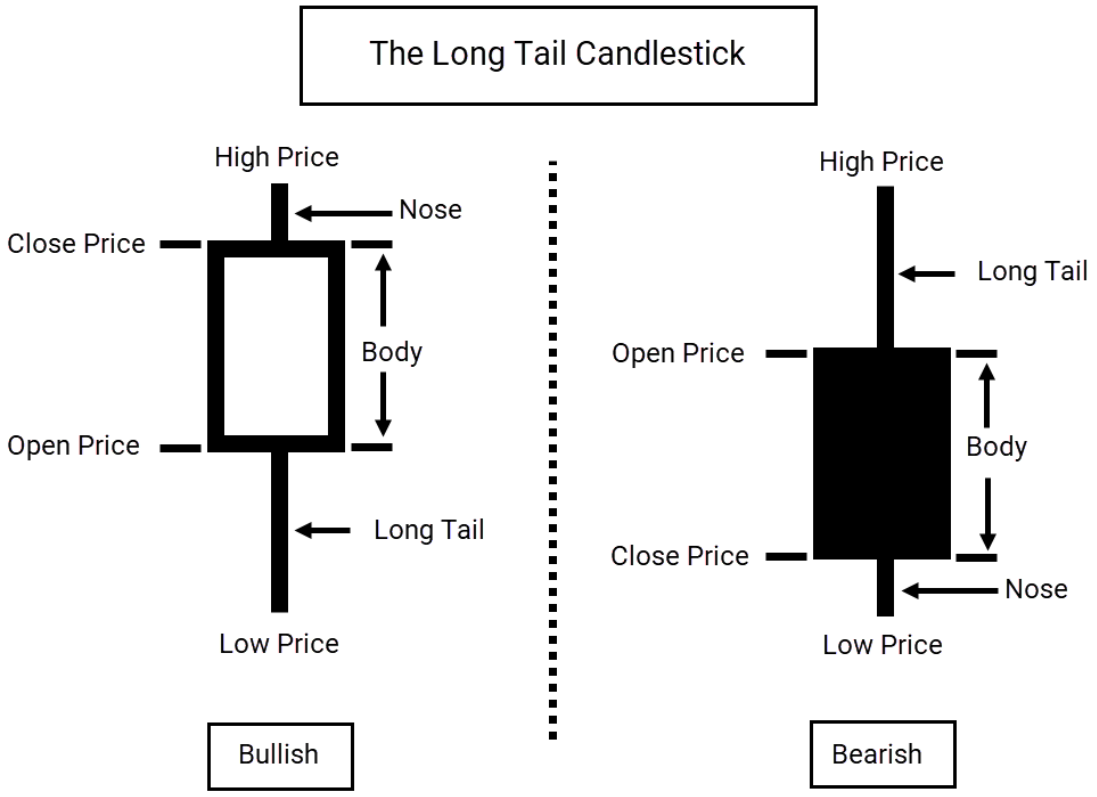


Figure 28: Long Tail Candlestick

Let's try to find some LTs on the next chart, which is of 30 Year U.S. Treasury Bonds.

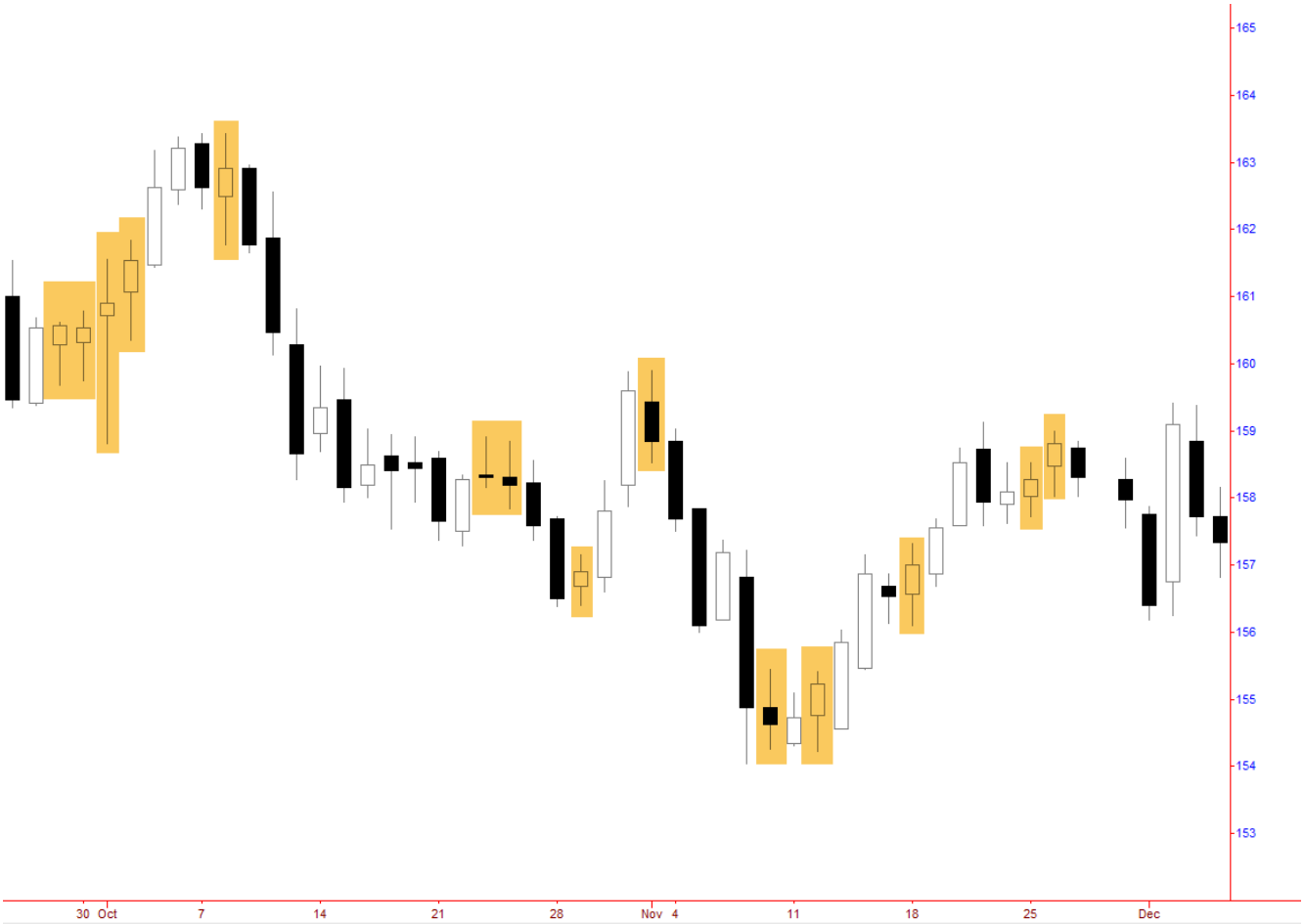


Figure 29: Long Tail Candlesticks in 30 Yr. US. Treasury Bonds, daily chart. Source: TradeStation®

The Long Tail candlestick is the most frequently occurring type of shape. The test, with same parameters on the S&P500 futures, shows that 142 or 28% of the days were LT candlesticks.

So how does an LT help us become successful traders?

Like we've discussed already, all types of candlesticks visible on a chart are the result of specific trading activity or the lack of it. And they *all* mean something. Some of them are exactly where we should aim to trade, like the Long Body candlesticks, especially the BLB type, where our profits tend to be bigger.

Others, like the Long Tail, aren't where we should necessarily trade, but they instead mean something for the upcoming candlesticks.

Since the LT was created after a sudden change, from sellers to buyers (for the bullish LT bar), it means that the market we are looking at (in our case the S&P500) is under accumulation – because buyers took control. And if it is showing accumulation, we should expect the move to continue in the next period, right?

Let's check this hypothesis.

Out test shows that the next bar follows the direction of the LT candlestick in almost 53% (52.81%) of cases. While in 47% (47.19%) of cases the next candlestick moved in the opposite of the LT. These stats consider not only a move in that direction but the actual close of the next bar.

This means that if the LT was up, the next candlestick will close higher than the open in 53% of the

days. And in 47% it will close lower.

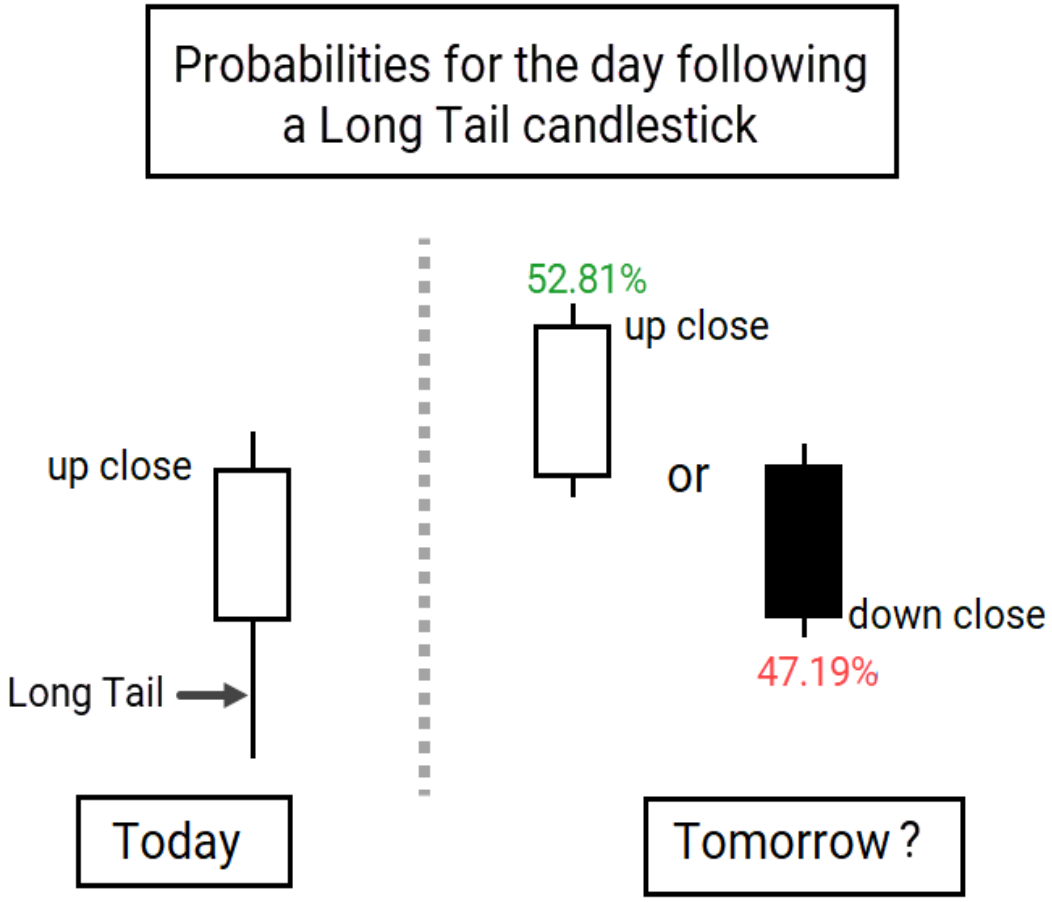


Figure 30: Probabilities for the Period Following an LT Candlestick

In the opposite case, if the observed LT candlestick was a bearish one, we can expect the next bar to close lower 53% of the time.

Now, based on price action, we know the most probable direction, from open to close, of the next day if today's bar has a long Tail.

Sounds good, but 53% is not that much! Is it enough 53% against 47%?

It looks like a small advantage, but it is bigger than the edge the house has in the roulette game. And Las Vegas was built on exactly those types of small advantages.

Also let's not forget that we are talking here about only one candlestick (a single day). It is not a combination. Imagine, if one candlestick is giving us such an advantage, what would it be if a combination is used? What if we read a word rather than a letter?

So, we turn to a combination with something very simple like the breakout of the high or low of the LT candlestick the following period – just like we've done with the LB and LN. Will that simple price action signal increase the above percentage?

Let's look at the numbers.

The test was conducted for the same period, again on the daily chart of the S&P500 futures index. 76% of the counted LT candlesticks witnessed such a breakout. The breakouts that continued and closed in the same direction as the LT day increased to 67% (66.66%) of the time.

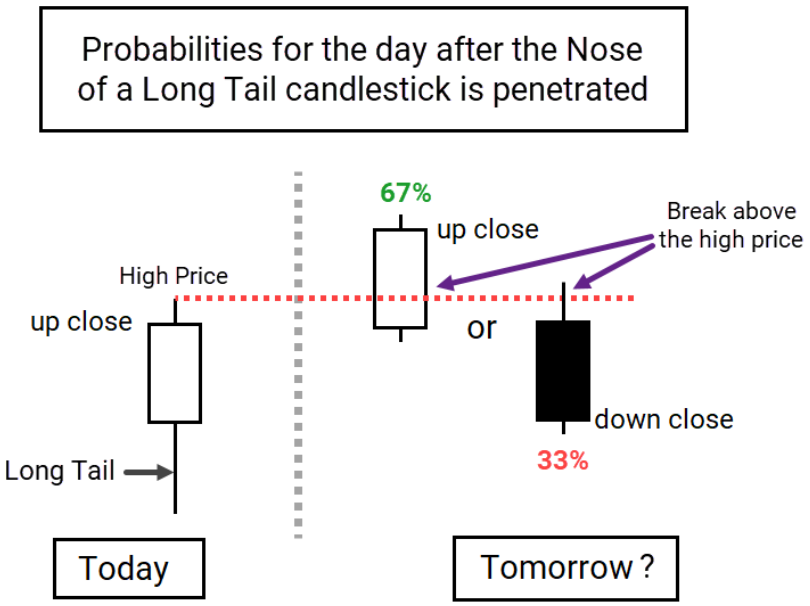


Figure 31: Probabilities of Close Direction Following a Breakout of LT's high

In other words, if the day following an up Long Tail candlestick breaks above the previous LT high, the chances this day to close higher than the open price (to follow the direction of the LT candlestick) are now 67%.

The same is true for the down scenario. If the next candlestick breaks below the low of the previous period's LT, it will close as a down candlestick in 67% of the cases.

What a jump! From 53% to 67%!

As in our previous examples, the size of the candlestick is also important (that's what we calculated using ATR). The continuation tendency of the LT candlestick is expressed most strongly through the Small and Big LT candlesticks. The test result shows that after a normal-sized (ATR (1) is between 20 and 59) the next day follows the direction in only 50.5% of the time. Hint, that's not a good probability to use in trading…

But small LT candlesticks (SLTs) lead to a continuation in the next period in 54% of the cases. The winner, however, is the big LT (BLT), which leads to a continuation in 62.5% of the observed cases.

Again, like with the Long Nose candlestick, the Long Tail candlestick comes in two variations.

- 1xT – This is an LT candlestick where the Tail is the biggest part of the candlestick.

- 2xT – This is an LT candlestick where the Tail is bigger than the Nose and smaller than the body, but, multiplied by two, the Tail is bigger than the body and the Nose together. The formula Tail * 2 > Body + Nose applies here.

Here is how they look. First is the 1xT candlestick.

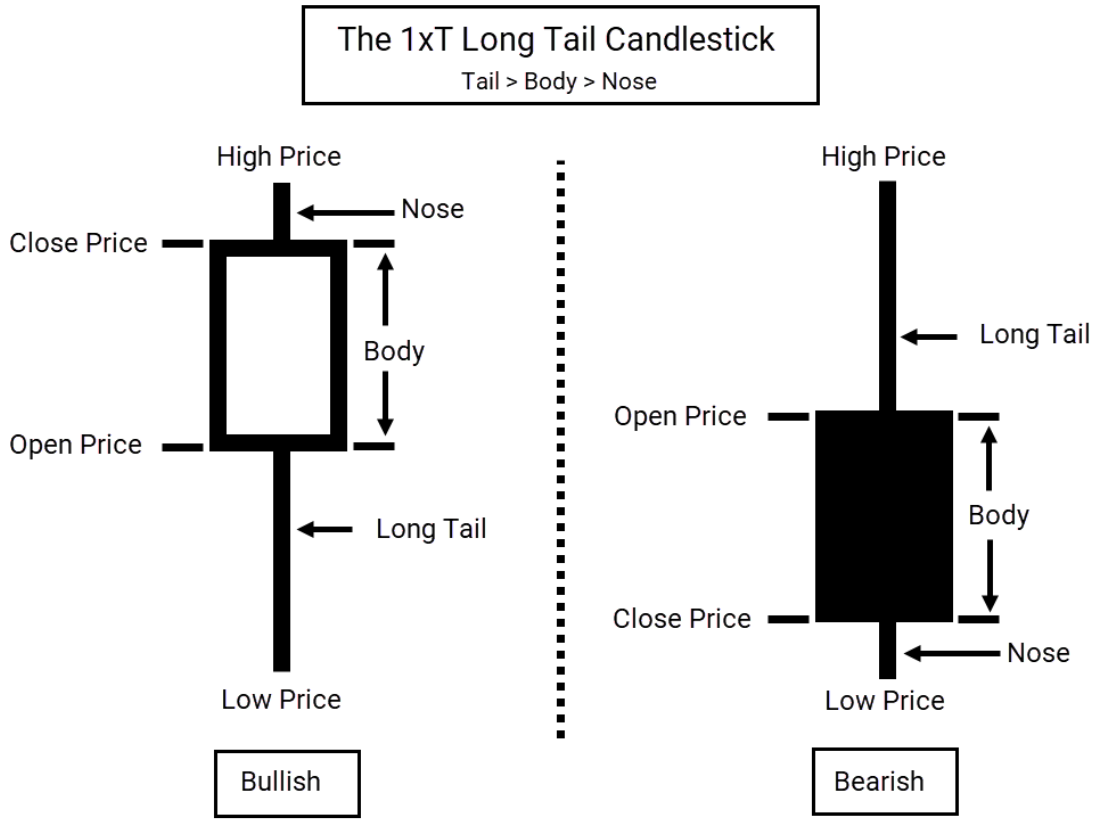


Figure 32: The 1xT Long Tail Candlestick

And now the 2xT LT.

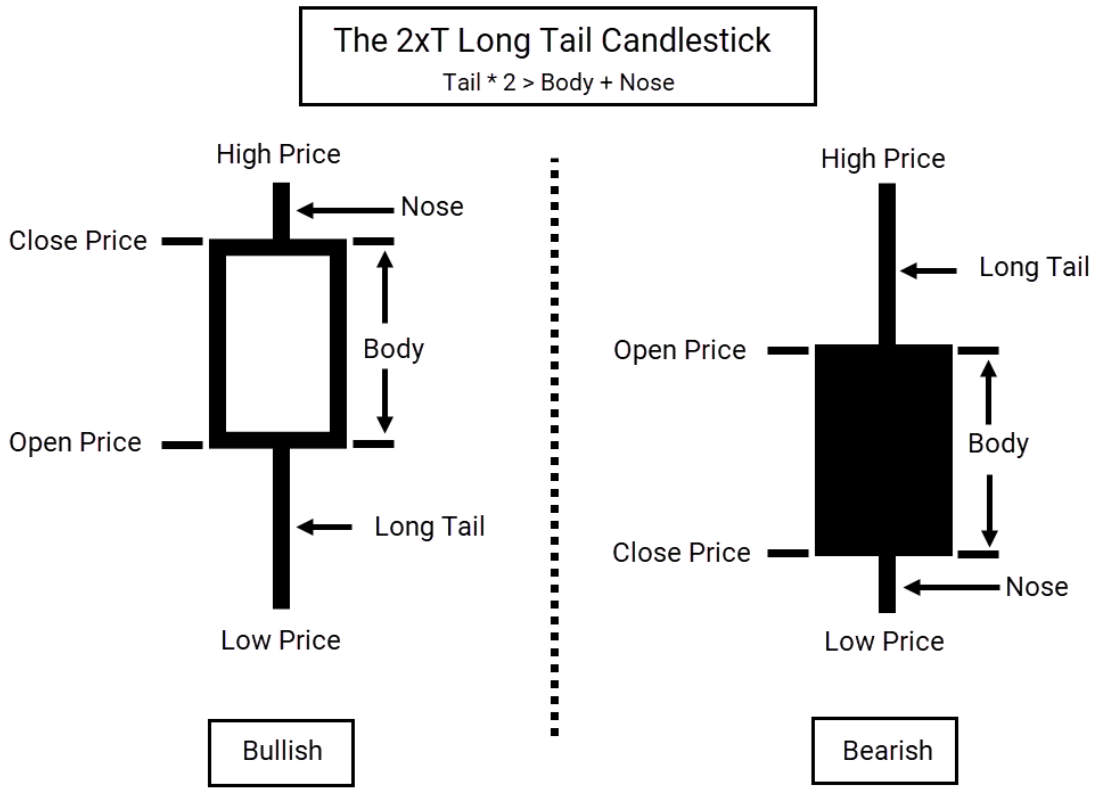


Figure 33: The 2xT LT Candlestick

The difference is only the length of the Tail. Please note that, in some cases, both Tail and the Nose would be bigger than the body. In that case, if the Tail is bigger than the Nose, that is an LT candlestick.

Again, we aren't splitting the Long Tail candlestick into two just to make things difficult. We are doing this because those different types exhibit different behaviours. Test results prove that the continuation is more probable after the 2xT candlestick. It shows that in 58% of the cases the next candlestick closes in the same as the 2xT direction. For the 1xT, this percentage is only 51%.

The probability for continuation reaches 100% if the 2xT is actually big in size with ATR(1) above 60. Of course, this result is from a small number of occurrences. That 100% probably won't hold for long, but still, this is valuable information for our trading if we see candlestick of such shape and size.

Inside days with an LT are also a reason for us to expect a continuation in the next day. Unlike the outside LT days, which are 50/50 to continue or not, the inside days have a 59% chance for the next day to continue the direction.

Based on the test and my personal trading experience I can tell you that if you see a small in size inside day, which also is an LT candlestick, the chances the next day to be in the direction of the inside are very, very high. The test actually suggests 100%, but nothing in trading is perfect so we can't expect that 100% to hold forever.

S&P500 shows something very interesting and very useful. Due to the fact that its fundamental direction is up (except for periods of recession), all of our tests are actually revealing such bullishness. And this is especially visible in the LT candlestick.

Let's go back to the beginning of this chapter. We saw that around 53% is the chance of the next day after the LT candlestick to follow its direction. And this is true for S&P500 and other instruments, which show similar percentages. But in case of S&P500, there is one thing we should have in mind: up LT candlesticks appear more often than down.

That is the first influence that the general fundamentally bullish direction is bringing. But there is more.

For example, if today we have an up LT candlestick, the probability to have an up day tomorrow is 60.5%. If the market was not skewed to one side, we could expect that in the opposite case of having a down LT candlestick today will lead to a down candlestick tomorrow in the same number of cases – 60.5%. But the real test is showing that such a combination appears in only 39% of the cases.

Yes, you read that right. Because of the fundamental direction of this instrument, having an up or down LT candlestick today would lead, in the majority of the cases, to a bullish candlestick tomorrow.

That is a very important lesson to learn. The chart language might get skewed in some instruments where the fundamentals are very specific, like with S&P500 or individual stocks which by default are going up. It is like a form of dialect – different instruments have different fundamental behaviours. Of course, this is not a problem at all because once we understand this, it gives us a tremendous advantage – like learning the local dialect does when you're visiting somewhere.

The LT is the most common candlestick, and as you can see it is providing us with a huge advantage depending on its size and type. It is a type of candlestick that speaks to us about what will happen next.

But what we can expect to happen next if we, let's say, buy or sell after the high or low of the LT is penetrated?

In around 66% of the cases the candlestick that broke the high or low of the previous day's LT had a shape of Long Body, 2xN or 2xT. In those cases, we had a candlestick in which the Body was the biggest. And that means a good opportunity for profit if we hold till the closing.

Chapter 9: The No Tail

So far, we've looked at the most common candlestick shapes, the LB, LN, and LT. But looking at the chart, any chart, we'll see that besides these three frequently occurring candlestick shapes there are others.

One of them is the case where the current candlestick, in our test case a daily candlestick, has opened and immediately shot up or down. It seems that the market participants were so sure of the direction that from the opening there was no movement in the opposite direction. The Tail is missing!

This is the No Tail candlestick or simply 0T. Here is how it looks.

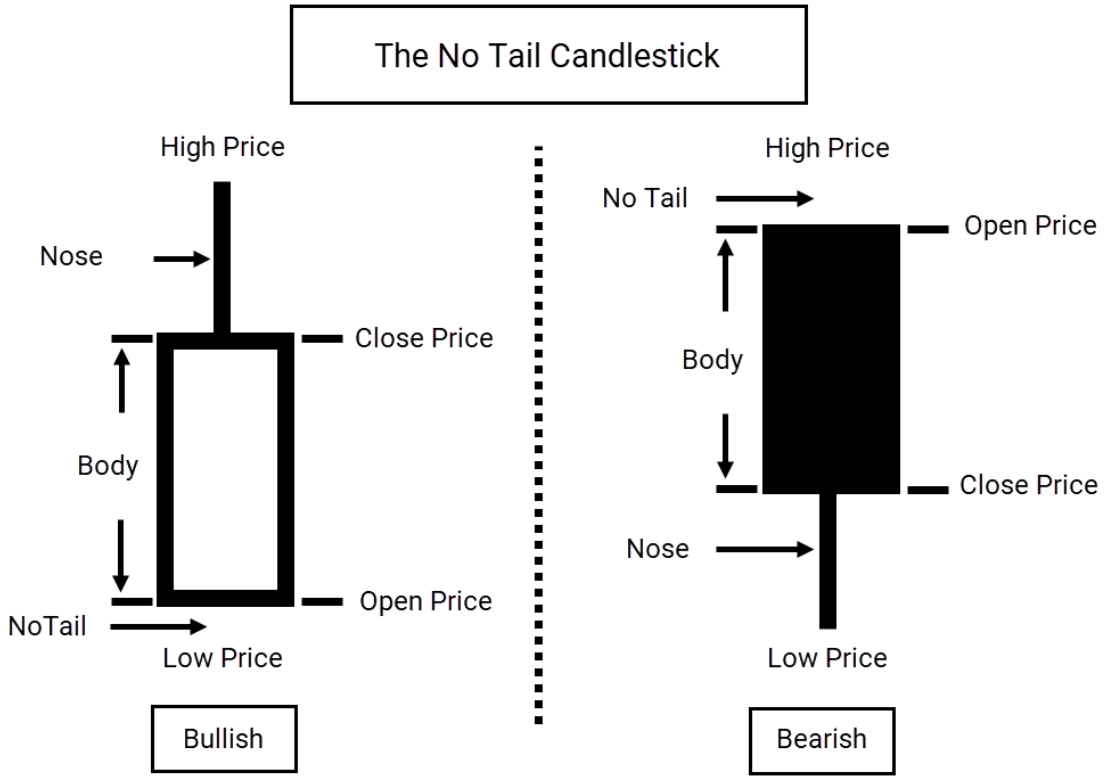


Figure 34: The No Tail Candlestick

In a real situation, it is hard to find a case where the Tail is completely missing. That is why during the test a $2 tolerance was used for the E-mini S&P500 futures. If the Tail was less than $2, we assumed that the movement happened immediately in the other direction.

Below are a few examples for both up and down 0T candlesticks which appeared in U.S. Dollar Index.

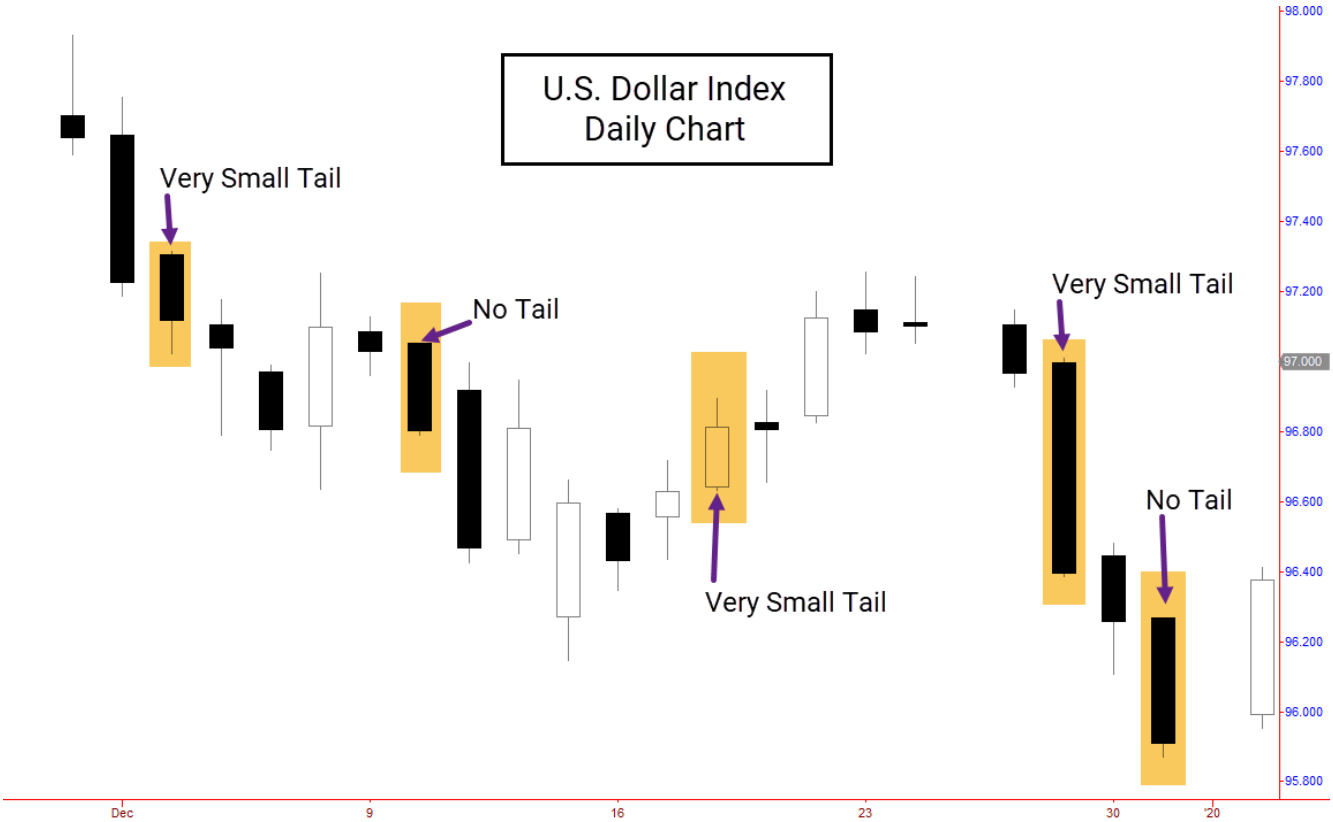


Figure 35: No Tail Candlesticks in the US Dollar Index, Daily Chart. Source: TradeStation®

Let's see what the probabilities are for this type of shape.

The test shows that this is not a very common shape. It happened only a little bit more than 15% of the time.

What is interesting is that it really enhances the power of the simple price action signal. What we mean is that, in 82% of the cases, the 0T candlestick was able to break the previous day's high or low.

From those breakout cases, 75% closed higher (respectively lower) than the breakout level. That means a profit if we were to take the simple price action signal.

Now, here we have to be careful because it's possible that a movement might begin with No Tail, then break one of the extreme points of the prior day, but then later return and make a Tail. Those cases are hard to identify with a simple test. But they do happen.

However, this does not make the signal less attractive. Why? Because of the simple fact that if from the opening we move only in the direction of prior high or low and then break it, we are witnessing a serious psychological attitude.

And there is a way to protect ourselves from fake signals like this. Most fake 0T breakouts happen when the prior day's high or low is very close to today's open price. In this situation, it doesn't take too much effort (buying or selling) to break outside of the prior day's range. That move is done to attract the crowd's attention or trigger orders above/below that near level and then continue in the other direction.

But if today's open price is not very close to the previous high or low and the markets head towards those distant extreme points with 0T, that could mean a strong signal is about to happen.

Now, what if we have actually taken that strong signal. Can the 0T candlestick tell us something about

how long to hold the position open?

The magnitude of a move is always hard to forecast, and it depends mostly on the fundamentals at the time of the signal. But those fundamentals might have already been priced judging by the fact that the current daily candlestick is making a breakout with 0T. The past might give us some clues as to what we can expect.

Let's first look at the 0T candlestick itself.

Out test suggests that in 71.79% of the cases the 0T was a candlestick with some size. From that 72%, 65.38% were a normal size candlestick (ATR(1) from 20 to 60), and 6.41% were large ones where ATR(1) was above 60). This means that if we entered into a position following a simple price action signal and currently there is 0T, we could expect the current candle to show some volatility in 72% of the cases. In the other 28%, the observed candlesticks were small in size meaning our chances for good profit are not good.

To the size, we can add the shape of the No Tail candlestick. Just to clarify, 0T candlesticks might happen in 3 forms:

1. The 0TLB – There is no Tail and the body is the longest part.

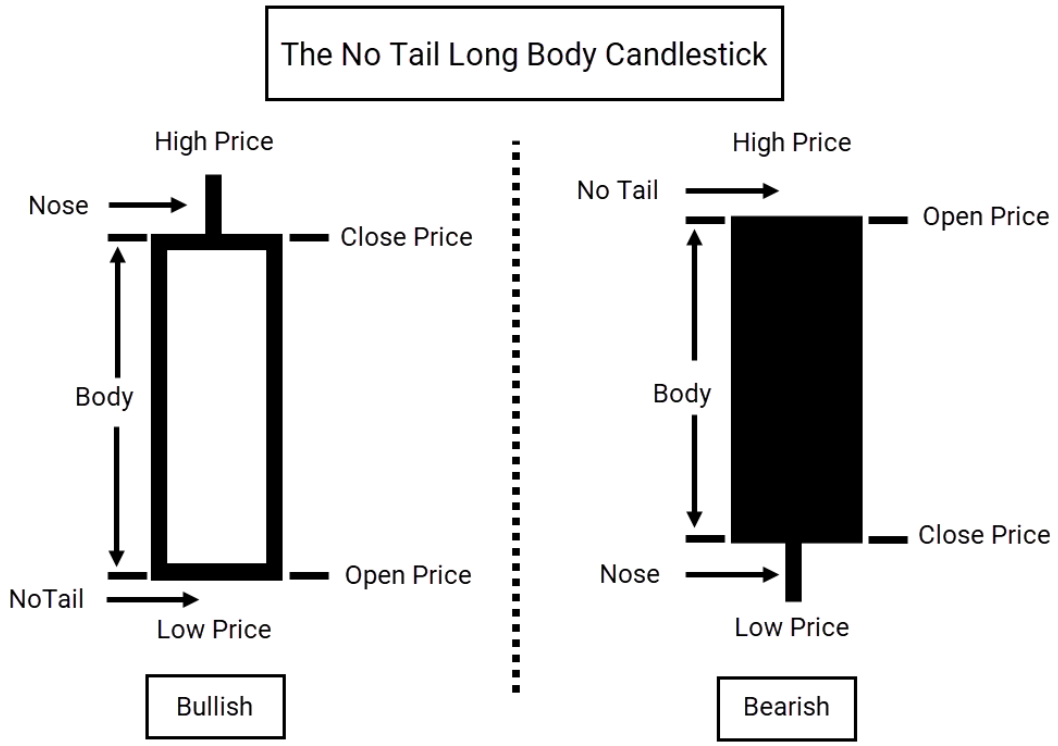


Figure 36: The 0TLB

2. The 0T1xN – No Tail, small body and the largest part is the Nose.

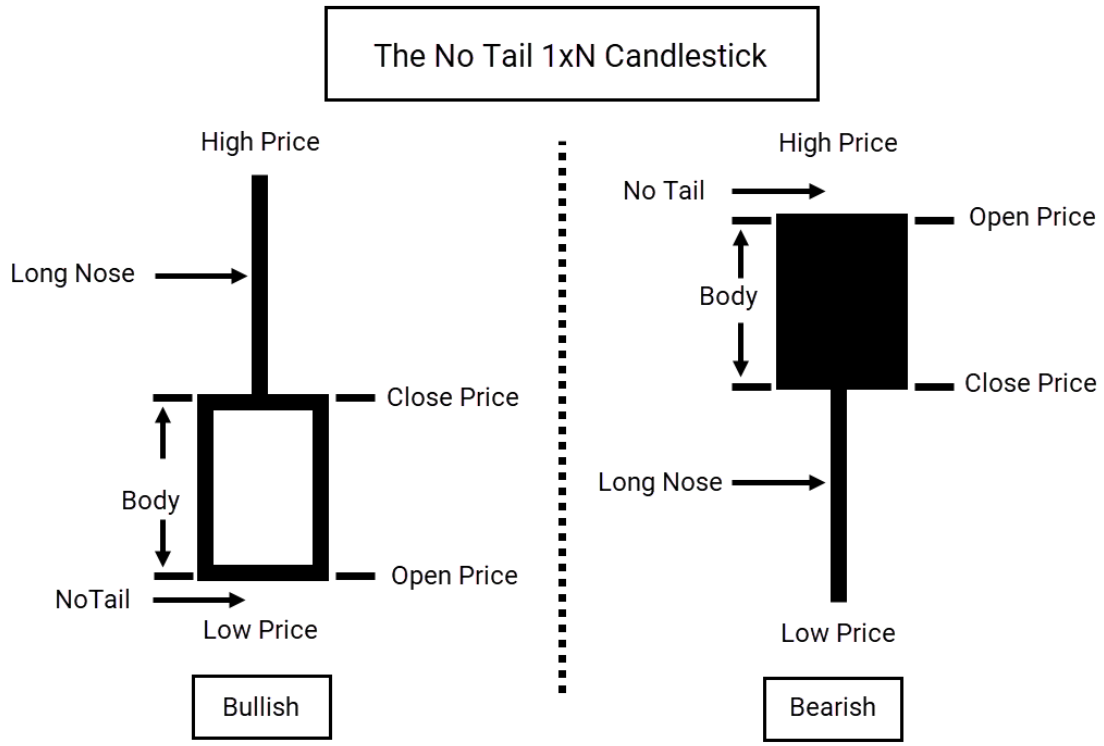


Figure 37: 0T1xN

3. The 0T2xN – Again 0T, the body is the biggest part but not big enough because the Nose multiplied by two is larger.

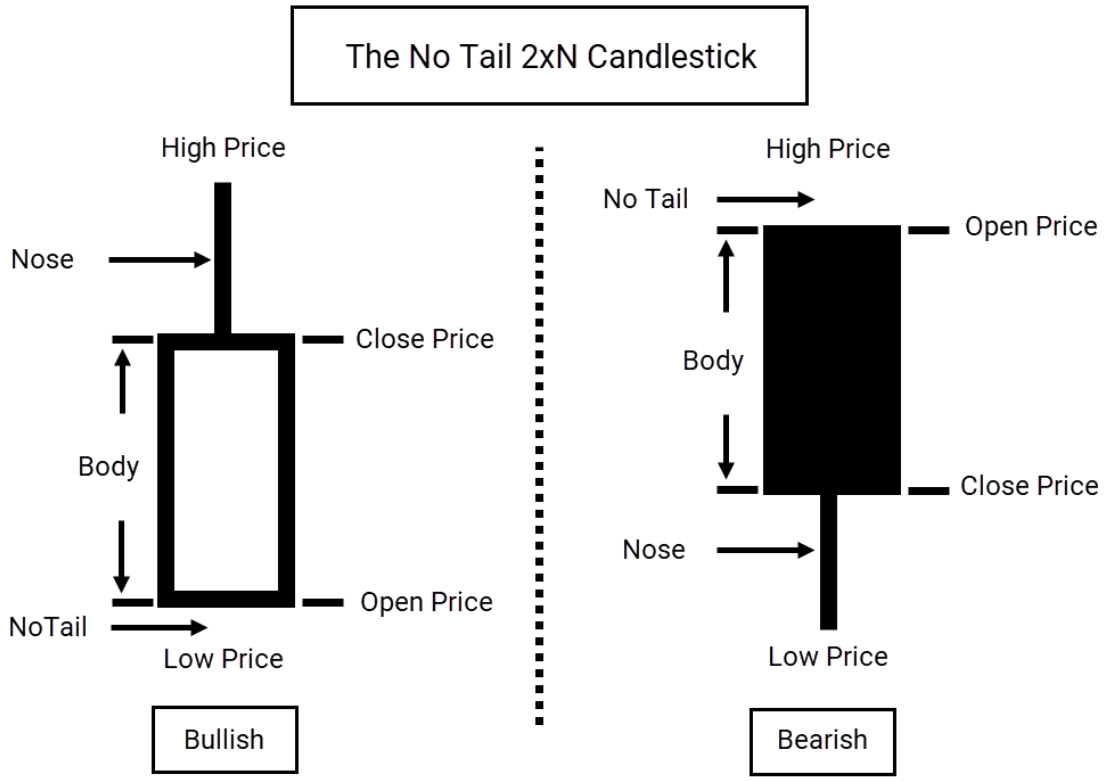


Figure 38: 0T2xN

In most of the cases identified in our test, the 0T candlesticks were of Long Body type. In 55% of the cases, the 0T candlestick is closing like LB candlestick. From the remaining 45%, 29% finish as a 1xN (Long Nose) and 16% as 2xN (Nose *2 > Body + Tail). This tells us that in 45% of the cases there was some pullback from the reached highs or lows. In 29%, the pullback was a large one.

So if we have an open position and a 0T candlestick appears, it is reasonable to wait for the closing price because the chances are that 71% (55% LB + 16% 2xN) of the time the 0T candlestick will finish closer to its high (up candlestick) or low (down candlestick).

But can we hold for longer?

The test shows that the Nose of the 0T is broken in almost 58% of the time. But from those occurrences, the next day after the 0T, the candlestick closed higher or lower than the breakout level only 51% of the time.

Unfortunately, this is pointing to the fact that most 0Ts aren't followed by a day in the same direction. And that's an important conclusion: we can't expect continuation after 0T.

What we've proven here is that if a candlestick with No Tail is breaking the previous day's extreme point (high or low) then we can expect it to close beyond that point.

Get ready for more missing candlestick parts in our language because certain, specific market actions lead to some things we've yet to see.

Chapter 10: The No Nose Candlestick

The No Nose Candlestick (0N) is even rarer than the No Tail (0T). In fact, during our test, it occurred only 10% of the time. Yes, that's one in every ten periods (in our case, days) will look like the following illustration.

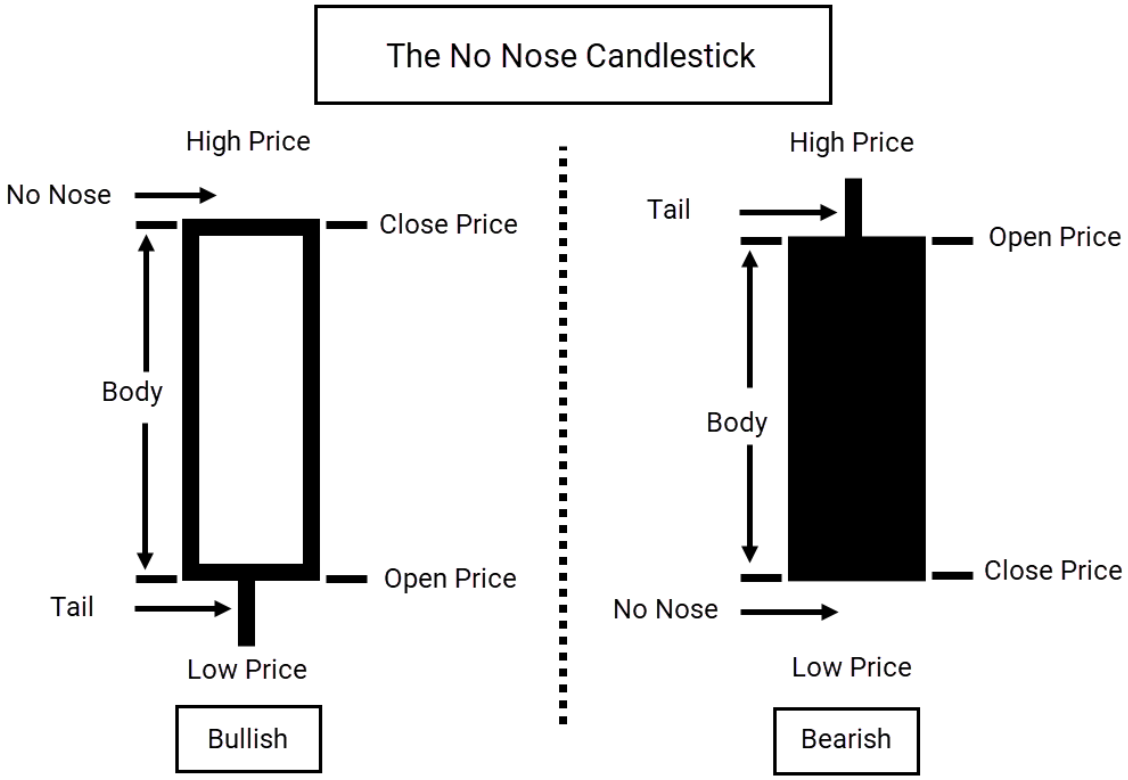


Figure 39: The 0N Candlestick

This candlestick starts as a Long Body (LB). From the opening, we have an initial move to one side. Then the market reverses and starts moving to the other side. The difference here is that it is closing almost at the high in the case of a bullish candlestick, or almost at the low during a bearish candlestick. I am using "almost" because it is hard to find the perfect case where the Nose is totally missing, just as it was difficult to find a perfect 0T, so we use an approximation.

Here is how 0N looks on the chart of Platinum futures.

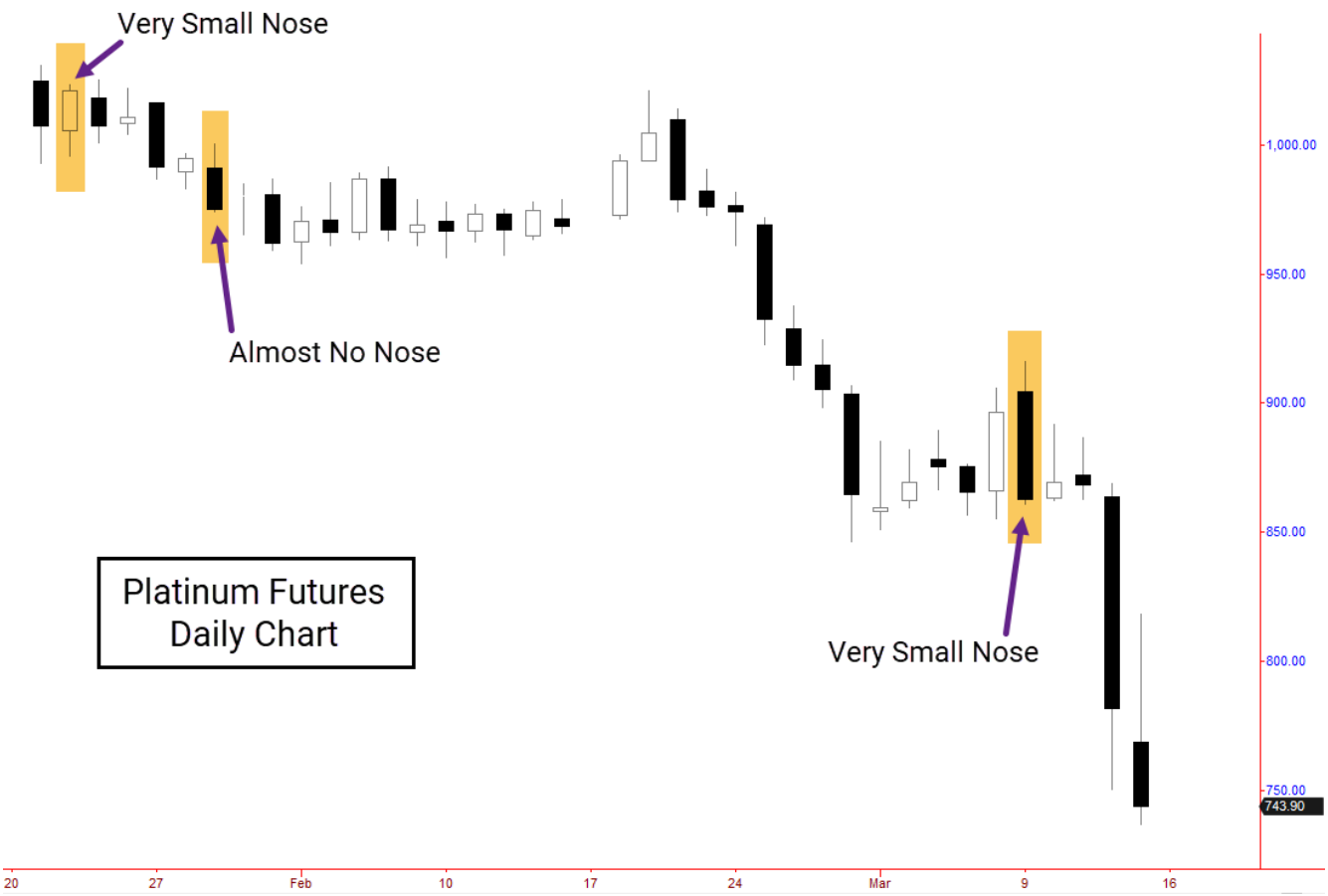


Figure 40: 0N on Platinum Futures, Daily Chart. Source: TradeStation®

Please note that again for the test we've used a $2 tolerance between high/low and the close. If the market close is less than $2 from the daily high or low, we've designated this 0N.

That raises the question, of course, can we use the $2 approximation for every market? What we use for S&P500, that $2 tolerance, works in Platinum too, as we can see here. But for currencies, it is different because of the different pricing structure. Then how do we proceed?

There are two ways (and this is true for the 0T also):

1. Measure a few candlesticks with visually short Nose and see how short they actually are. Usually, you'll find that below a certain Nose length the market starts to show the behaviour typical for the 0N. That is how I found the $2 for the S&P500. That's what we call back-testing, and it is highly important since we need strict, appropriate rules in order to get the right results.

2. To understand the second way, we need to get back to the general idea behind 0T and 0N. No Tail means immediate movement from the opening with no going back, while 0N means everybody was buying/selling and that continued with no slowing down (no profit taking) till the end of the period. Both mean that visually it has to be hard to distinguish the Nose or the Tail in those cases. The rule is simple. Just switch to bar chart view, then look at the lines which mark the Open and Close prices. If the Tail or the Nose is visually smaller than those lines, then it can be considered as a No Tail or No Nose. I advise measuring it further so you can be 100% sure.

And here is an illustration of the second method to judge whether a Tail or Nose is small enough to mean No Tail or No Nose. Shown is the No Nose case. The No Tail is the same.

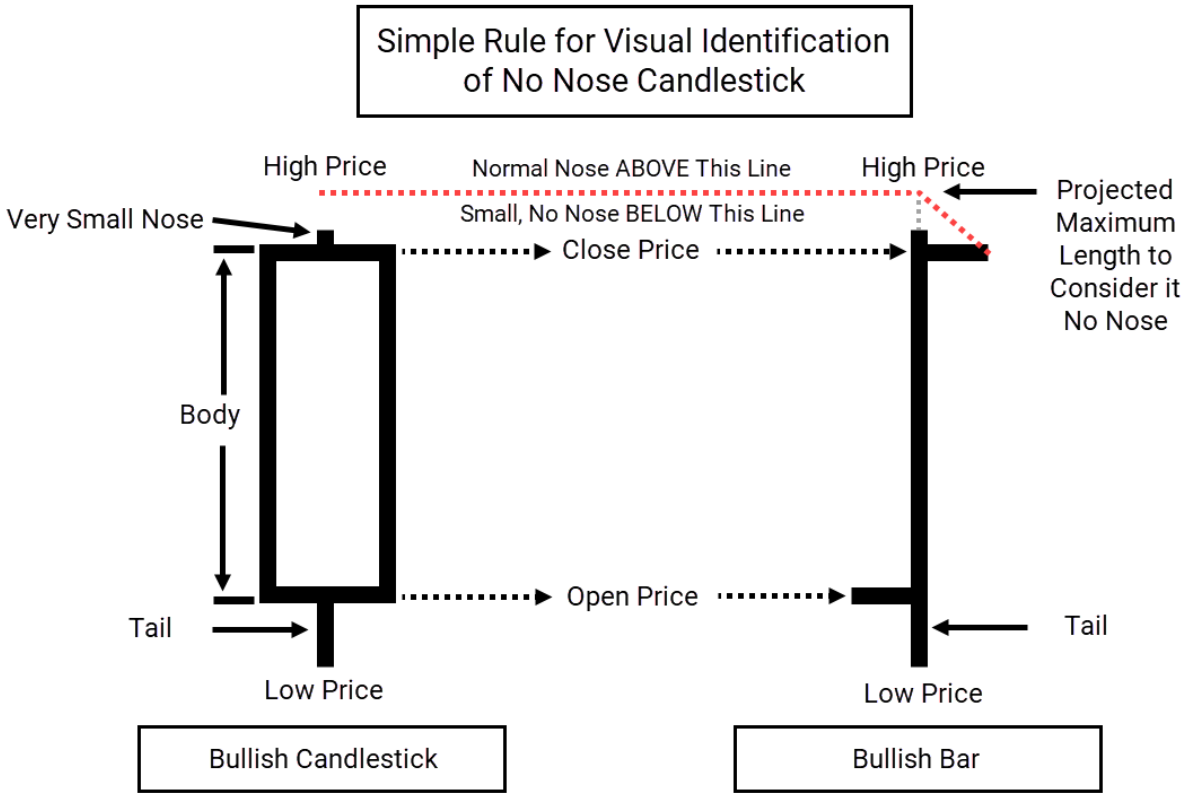


Figure 41: Simple Visual Trick to Identify 0N

Now let's return to the 0N candlestick and look at the percentages.

It is closing at the extreme because buying or selling didn't end until the market closed. Something happened during that period which made existing buyers buy more and/or more buyers enter. The same is true if it was a down period: the sellers sold more and/or new sellers entered during this period.

That's cool, but what does it mean?

The most obvious meaning is that if that many market participants bought or sold then there will be nobody left to continue the movement in the next period. That would mean at least a temporary pause or even a reversal after such a candlestick. Let's check this theory out.

During the same period, using the instrument and timeframe we did in the previous chapters, we find that the next day follows the direction of the 0N in 56% of the cases. But after a simple signal, only 50% of the next days were able to close higher (after a bullish 0N) or lower (after a bearish 0N) than the 0N itself. That shows that a pause or reversal after a No Nose is not out of the question. Still, something is missing.

What if the reversal did not happen immediately? We always want everything to be perfect, but in trading, "perfect" is a dangerous word. What if the market did not stop immediately but stopped after some distance covered by inertia? After all, the 0N was formed by strong buying (or selling), which continued till the end of the candlestick. We don't know how many market participants want to enter and it will be a perfect situation if all bought or sold till the end of the day. That means it can continue in the next period. Inertia is not out of the question.

Let's give it some tolerance and measure that inertia. A good measure would be the range of the 0N. Let's check how many times the market stopped around a level formed by the range (high-low) of the 0N added to its high if the 0N was bullish or subtracted from its low, in the case of a bearish 0N.

Here is an illustration of the bearish (down) case.

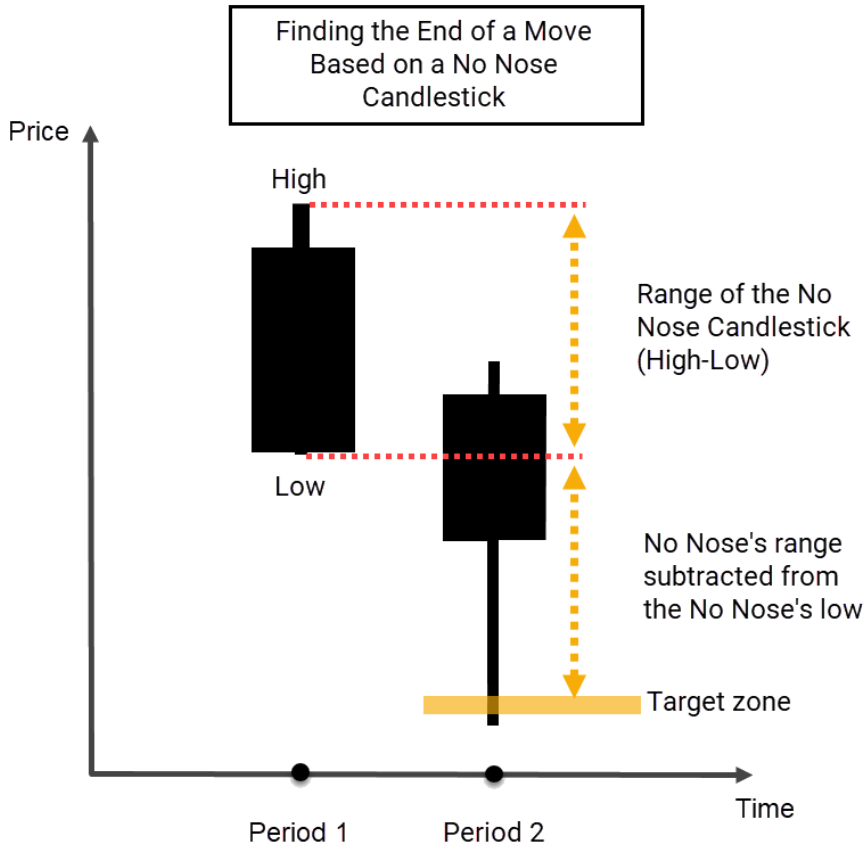


Figure 42: Finding the End of a Move Based on 0N

Doing the calculation, we find that this happens 80% of the time. Now, this is crucial to understand. That 80% means that a top, bottom or a temporary market pause can be expected within that range.

This means: after a 0N there is an 80% probability we will see a pause or a reversal of the movement.

Take the above example, the Platinum's chart. In two of the cases the pause happened immediately. In the other one, the market made a bottom followed by a pause after reaching the target zone based on the 0N's range. In that case, the level was reached almost to the tick. To measure the range, I am using the Fibonacci Extension (FE).

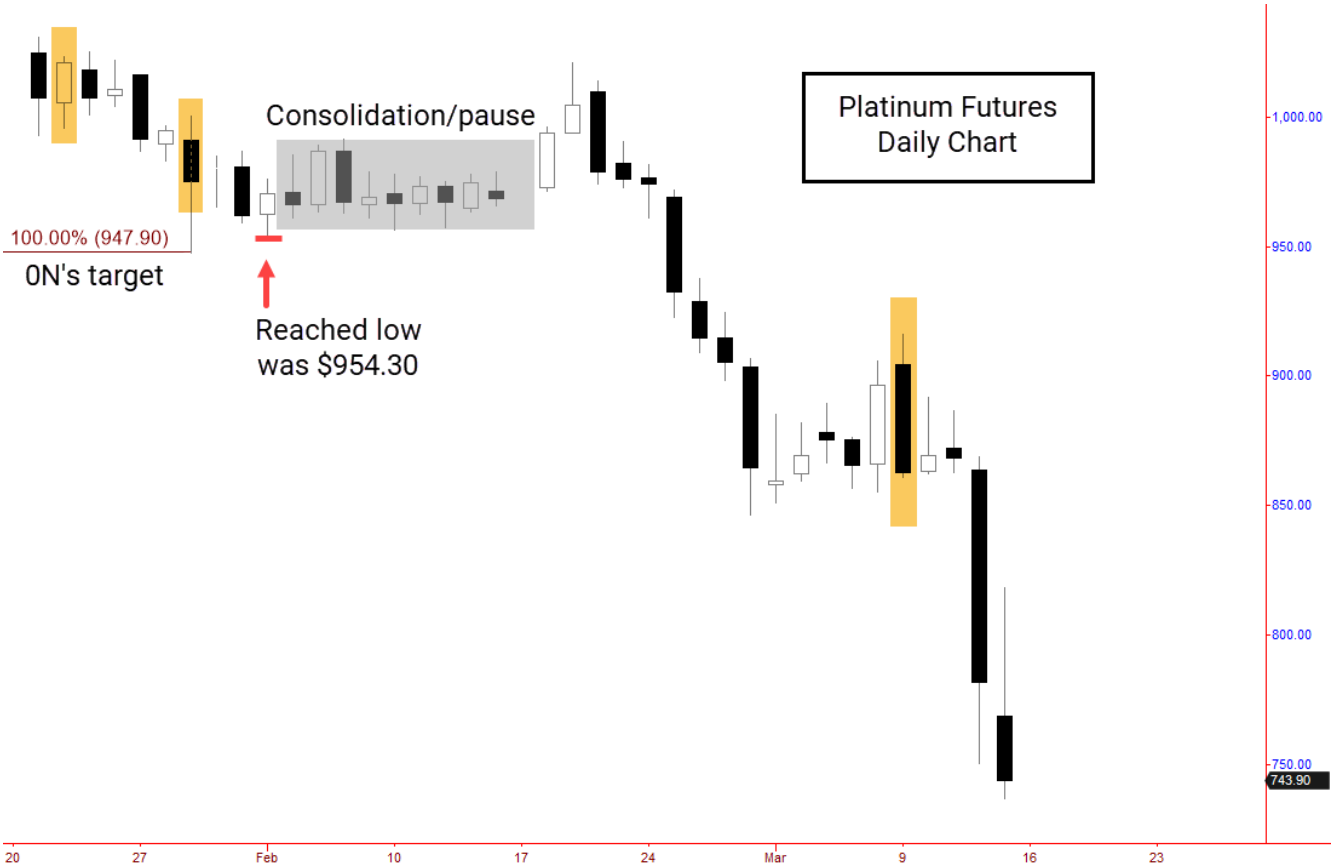


Figure 43: Finding the target range based on 0N's range. Platinum Futures, Daily Chart. Source: TradeStation®

This type of candlestick on its own is helpful when we are looking to close a position because, most of the time, the movement does not last for a very long time after a 0N candlestick. So if we see one, we ought to consider closing a trade.

Speaking of closing, here is something very important. The 0N candlestick's high (on an up day) or low (down day) is penetrated 92% of the time in the following period. This is a nice number. It suggests that the desire to buy or sell more continues on the next day after the 0N candlestick.

I use this one in my personal trading to capture larger profit. When I decide it is time to close and see that today's candlestick is closing really close to its high or low I place an order a little bit higher than the high or a little bit lower than the low depending on the direction of the 0N. How much exactly is that little bit? I can't formulate specific rules because it depends on the size of the 0N, where exactly it was formed regarding the whole movement, are there any significant support/resistance levels, and so on. Usually, it is not more than 10% of the 0N's range.

A reversal or pause is more likely to happen if the 0N appears after a series of candles before it in the same direction. Also, if the 0N itself is a Long Body candlestick (i.e. a LB closing at its high or low), then a pause or reversal are also more probable.

Just to clarify, as we saw already with the 0T, the 0N be three types. It can be a LB, 1xT, or 2xT candlestick.

But what if the 0N is actually a Long Tail candlestick?

If a 0N has a long Tail, the next day continues in the same direction in 61% of the cases. And now, hold on to your hats or else this simple trick will blow them away.

If that LT 0N appeared after a candlestick in the opposite direction, then the day after the LT 0N has a 75% chance to close in the same direction. See the next chart.

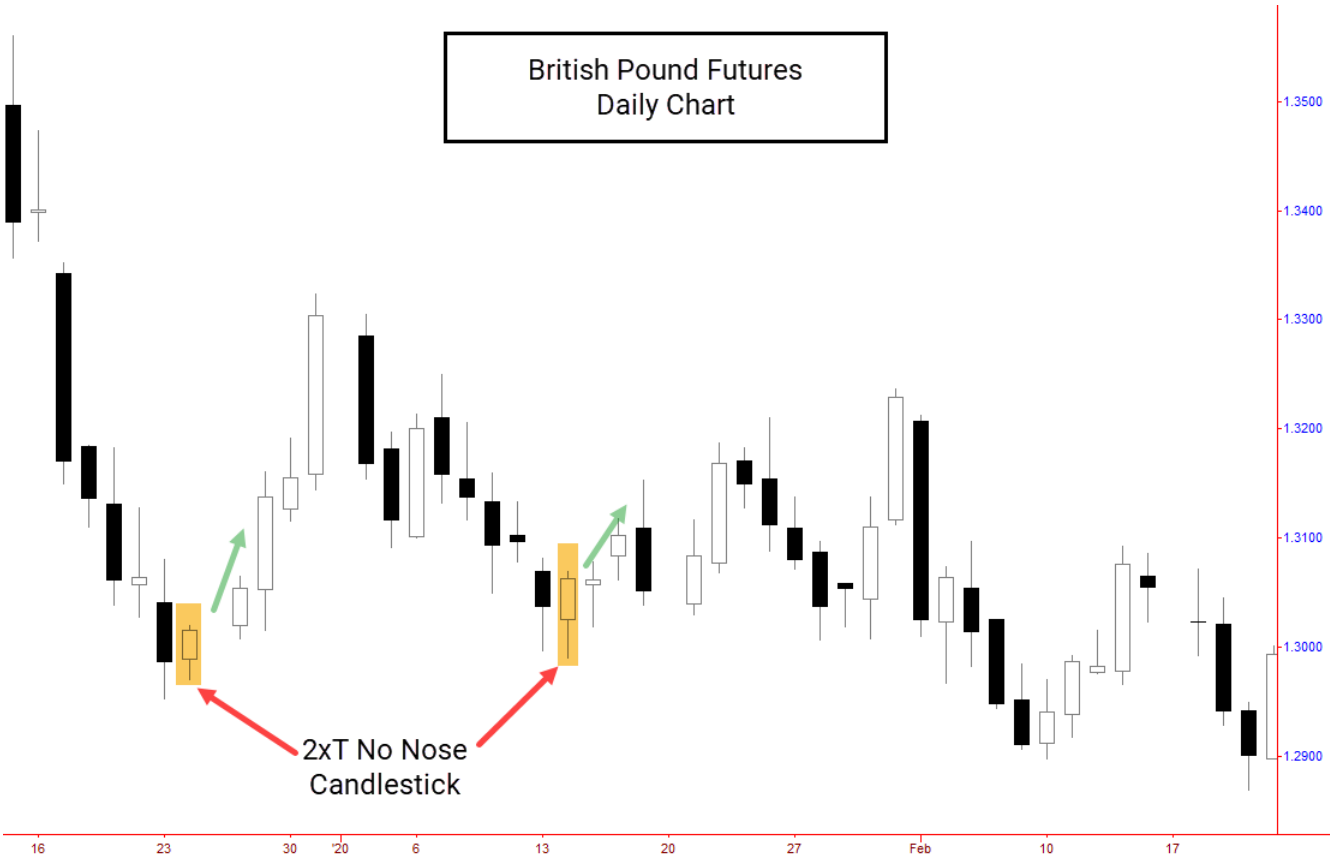


Figure 44: 0N 2xT Candlesticks. British Pound Futures, Daily Chart. Source: TradeStation®

This time the chart is taken from the British pound futures. The highlighted candlesticks are No Nose 2xT. They appeared after a candlestick was in the opposite direction (down). You can see that they successfully started a new movement on each occasion.

In those cases, the LT 0N candlesticks were formed by buying till the end of the period. But since it was the beginning of a new move, not all buyers entered during the 0N candlestick. That resulted in more players who kept the move going after the 0N candlestick. Additional strength here comes from participants who are closing their shorts.

The conclusion is that 0N is good for closing a position except in the case when the 0N is actually an LT formed at the beginning of a movement!

Chapter 11: The Equality

There is one very specific case where both Tail and Nose are longer than the body. Most of the cases where such a candlestick appears would be either LN or LT. But with those two types, you have either the Tail or the Nose significantly larger than the other parts.

The shape we are going to look at in this chapter is different. Besides being a lot longer than the body, the Tail and the Nose are actually equal in length. The right thing to say here is *almost* equal because it is close to impossible for them to be absolutely equal. Again, we are going to work with approximations here.

Now, combine that almost-equal Tail and Nose with a very small body and you have the Equality candlestick (we'll call it the EQ candlestick). A Doji with equal Nose and Tail can also be considered as an Equality candlestick. But the best representatives are those with a small body and a very large Tail and Nose.

Here's what an EQ looks like.

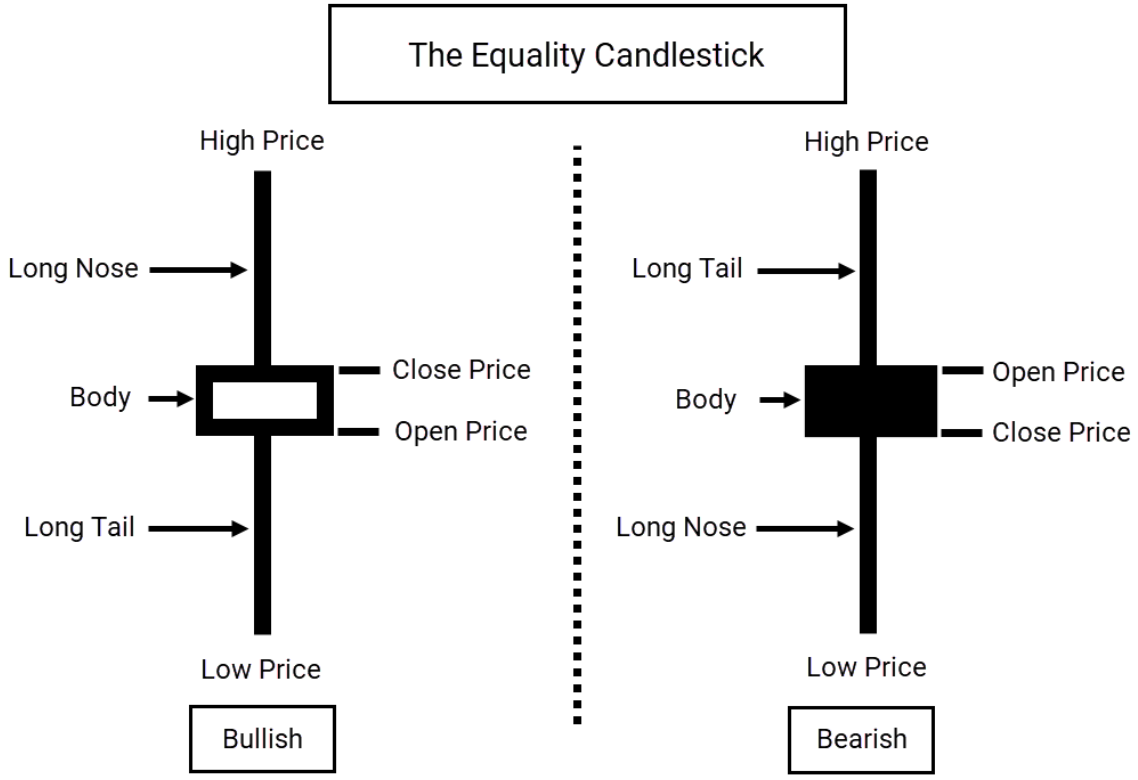


Figure 45: The Equality Candlestick

During my research for the same period conducted on E-mini S&P futures, I've found that only 4% of all candlesticks were EQs. With a pool of our size, that is a very small number, which means all the conclusions which we might make as to what happens next or how to trade an EQ must be taken with caution.

However, there are some things I can tell you based on the test and also based on my own experience

for trading price action patterns (I have been trading these patterns since 2007).

What matters is the big EQ. Imagine a candlestick with a large range, where ATR(1) is showing a big number. And, imagine that candlestick has a small body with enormous Nose and Tail.

The following example is a very large, ATR(1) = 104, EQ which appeared on the E-mini S&P500 futures daily chart.

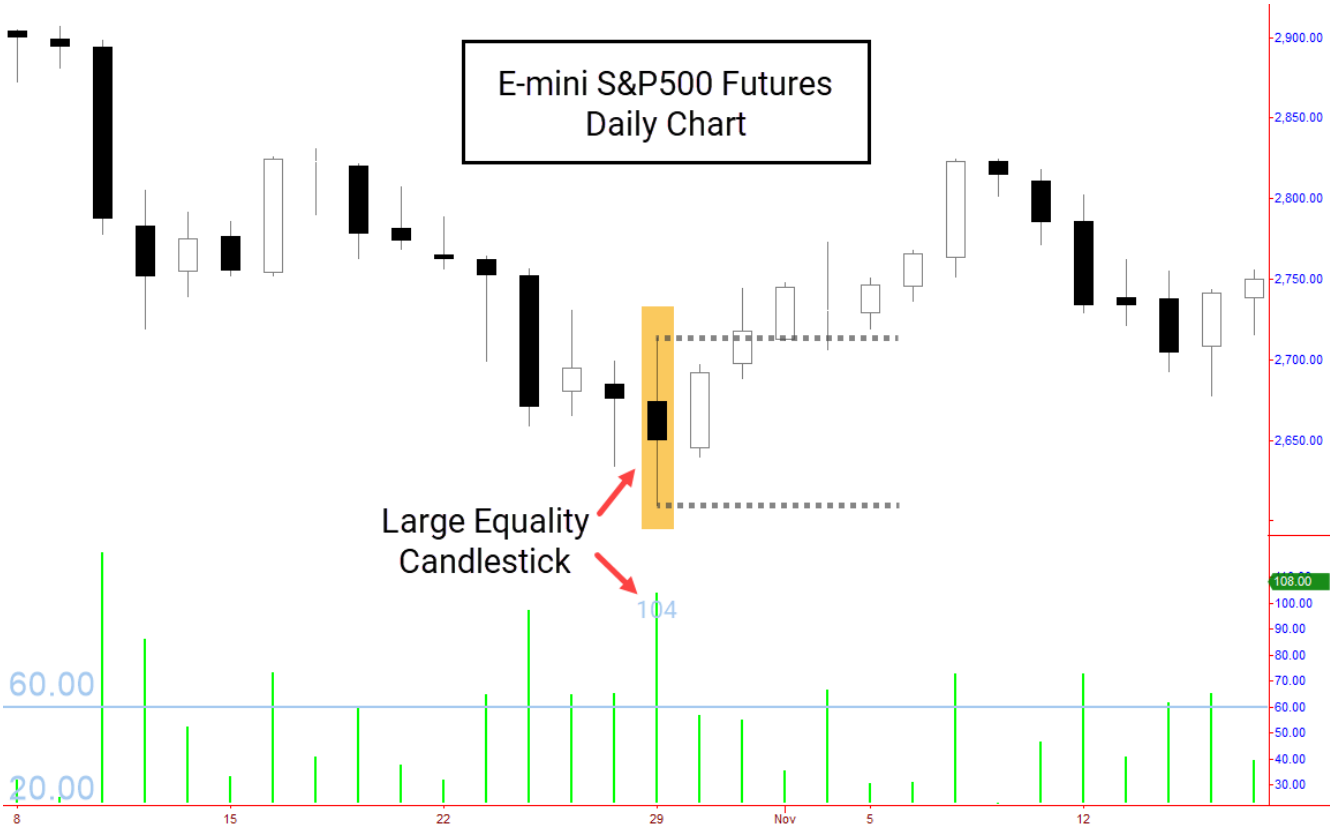


Figure 46: Large Equality Candlestick on the S&P500 Futures Chart. Source: TradeStation®

EQs usually happen around turning points. In the test, in 75% of the cases, the EQ appeared at the top or at the bottom of a turning point in the trend.

This is an interesting moment because after a market move in one direction, there's suddenly a lot of buying and selling. Market participants push the price in both directions but no group (buyers or sellers) was able to hold its gains and the price always comes back to centre, leaving the long Nose, long Tail, and small body of the candlestick. In this case, such a candlestick's proportions mean a huge outstanding interest. A lot of market players are out of the game but still interested in this instrument. They will be searching for a way in.

The high and low of those big EQs draw the current important range (see the dotted line on the example above). Often, when this range is broken in the coming days, that shows the direction for the next move.

If the candlestick is big, the next period most probably won't cross those extremes and will be an inside day.

On a daily chart, after a big EQ candlestick, you will often see a series of candles which stay inside the range of the EQ candlestick. That can create price action signals with stops and targets inside the EQ's range. Such complex price action signals inside the range measured by the high and low of the EQ

often present good opportunities. Those inside signals sometimes lead to a situation where you are in a trade and the EQ Nose or Tail is broken in your direction. That is an opportunity for an even bigger profit.

There is one more thing worth mentioning here. During the same two years, the day following an EQ candlestick closed in the opposite direction 81% of the time! If the EQ is down, for example, we can expect the next candlestick to be up.

Right, that's the EQ. It doesn't happen often, but it's important to capitalise on it when we see it. Now, if you think EQ is rare, just take a look at next one.

Chapter 12: The double 0

No, it is not the double 0 like 007 James Bond. Here, the 00 means No Nose No Tail candlestick.

It was observed it only a handful of times during the test – about 2% to be exact. Rare though it is, it's not difficult to wrap your head around. This type of candlestick is exactly what its name suggests. It's a combination of the 0T and 0N candlesticks.

The movement begins immediately after the open. The prices move only in one direction (lower timeframe fluctuations are possible but not visible on the higher chart). And the price closes at (or really close to) the high or low, depending on which way it is going, up or down.

It looks like the result of adding 0N to 0T.

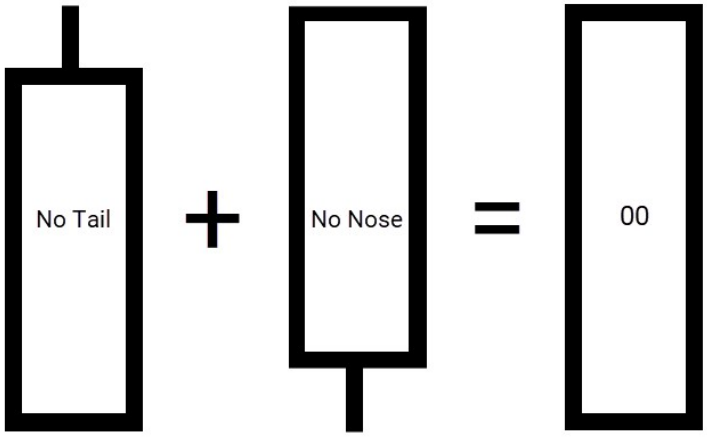


Figure 47: The Formation of a 00 Candlestick

And this is how it looks in bearish and bullish examples.

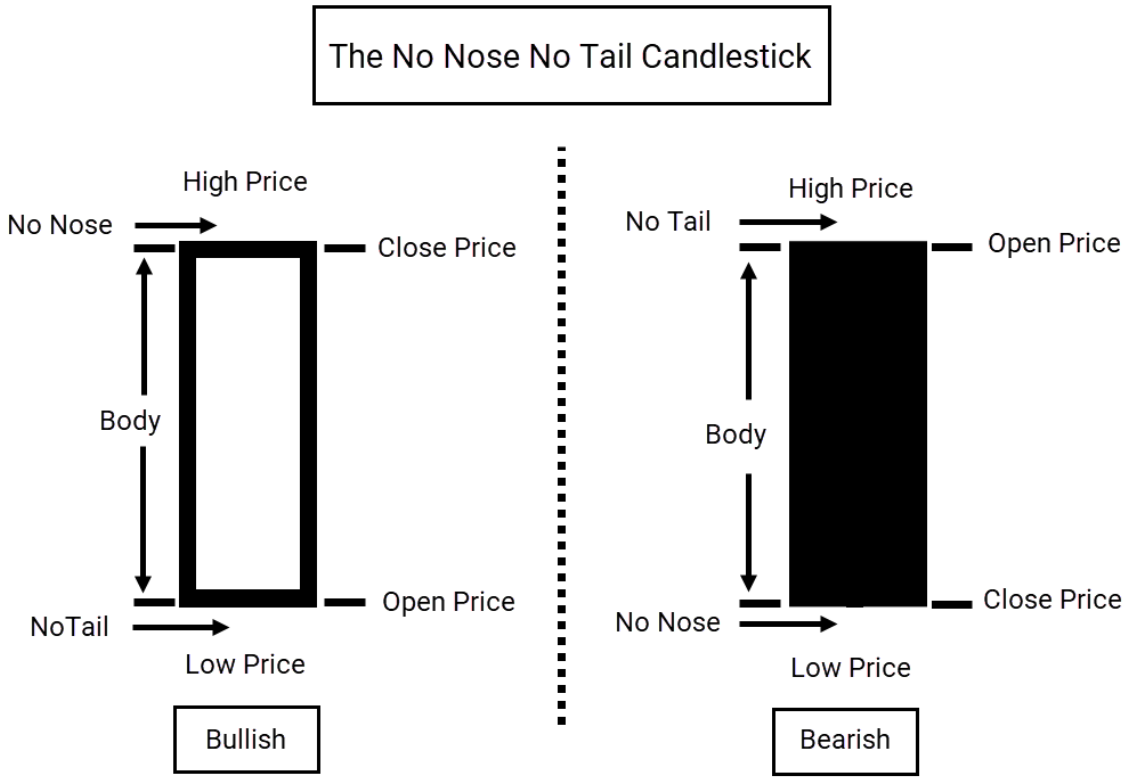


Figure 48: The No Nose, No Tail Candlestick

And here are some real examples from the Japanese stock market index Nikkei 225.

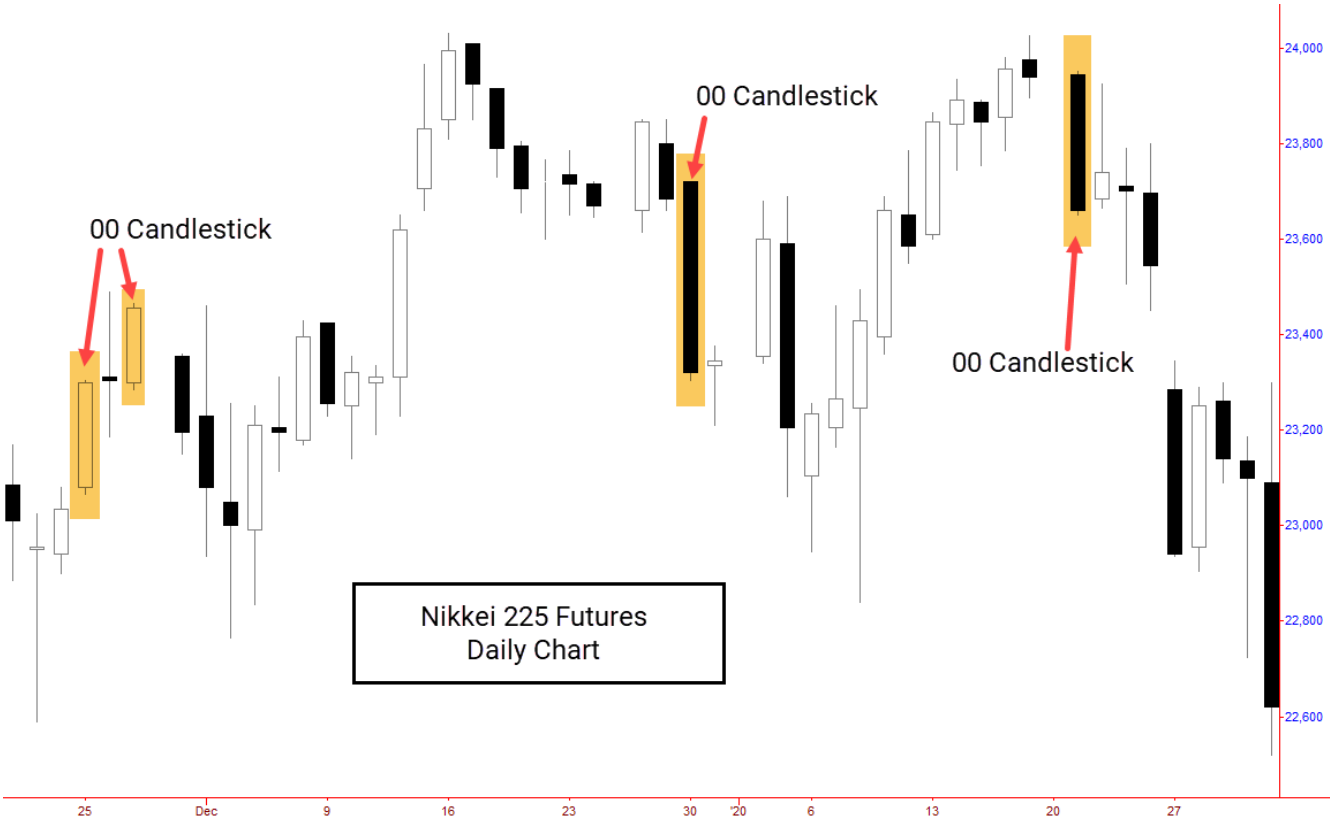


Figure 49: 00 Candlesticks on the Nikkei 225 Futures, Daily Chart. Source: TradeStation®

Since it is a combination of two other shapes, we can assume that it has the same capabilities expressed by those other shapes. If it is true, this will prove one more time what we have already observed in the prior two shapes.

If it is like the 0T, that would mean that if the 00 breaks above (or below) the previous period's high (or low), we can expect it to close above (or below) the previous day's extreme. What our test case shows us is that in the limited cases where we had a 00 candlestick, all the time (yes, 100% of the time) it closed above or below that level. That proves one more time that heading into one direction directly from the opening without a move in the other direction gives a high probability signal and that the breakout won't be fake.

But the 00 is also a 0N candlestick. That would mean that like the 0N it should signal an upcoming top/bottom, or at least a pause. The test shows that for the 00 candlesticks, 100% of the time the high or low (depends on the direction of 00) of the 00 was penetrated in the following period. In 56% of the cases the market closed higher/lower than the breakout level. This is higher than the 0N.

In 100% of the cases, the 00 was followed by a reversal or at least a temporary pause in the market. Again, like with the 0N candlestick, that pause or reversal occurred within one range subtracted or added to the 00's high or low.

Coming up, we've got the daily chart of Natural Gas futures. Two 00 candlesticks are doing exactly what they should.

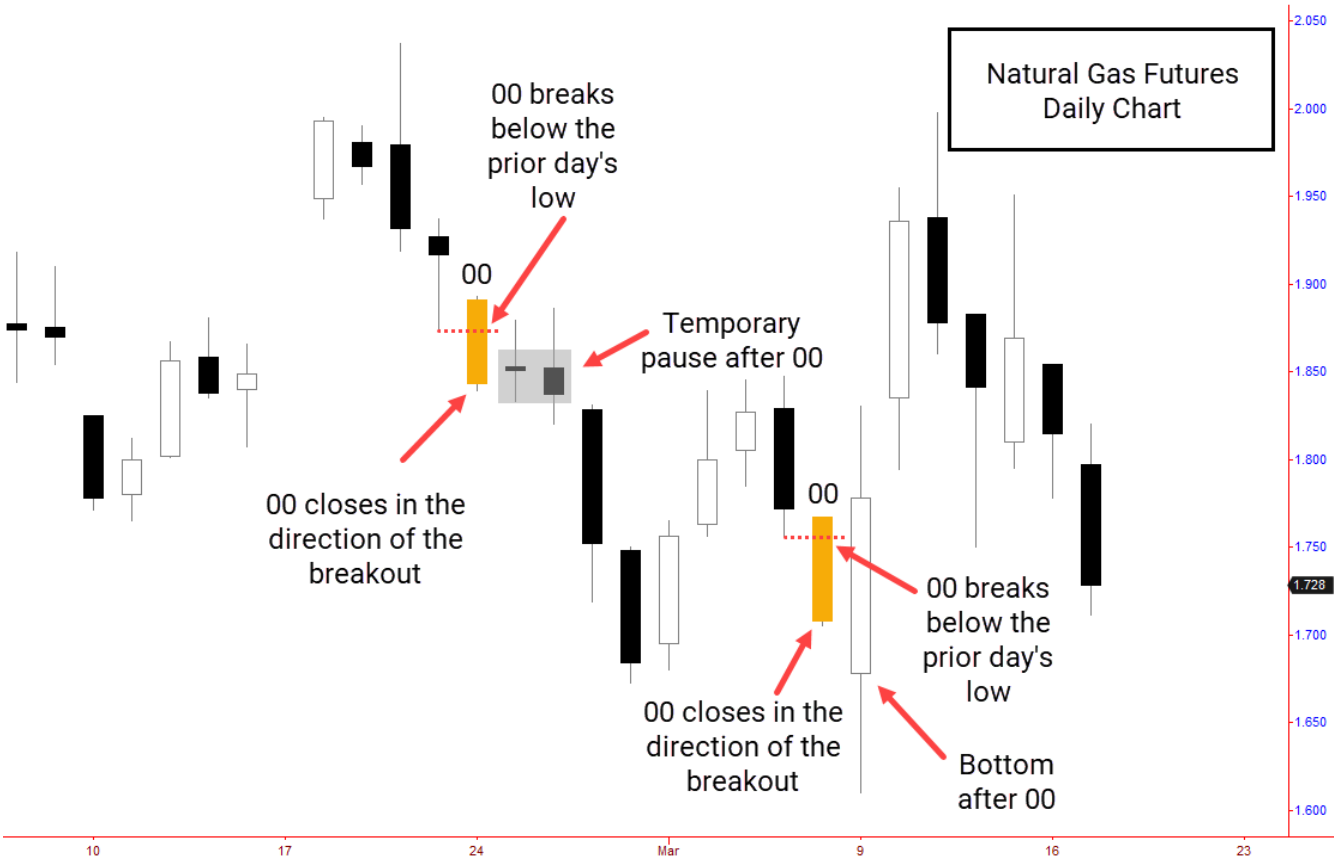


Figure 50: 00 Candlesticks on the Natural Gas Futures, Daily Chart. Source: TradeStation®

Now look again at that chart. I bet you're already starting to see all the different shapes we've talked about, not only the 00. That's because we're slowly picking up the language of the charts.

So there we've found another useful application of the price action trading which is showing 100%.

But again, be careful, that 100% comes from a low number of occurrences. That said, we conducted the test on the S&P500 and the example above is showing absolutely the same thing is happening in the most recent chart of Natural Gas. That is out of sample data. And that's promising.

Chapter 13: Reading Charts

Now you know the chart language alphabet. You might think that there are other types of candlesticks out there, but if you look closely, every single one falls into one of these eight shapes.

Study them well. See where they appear. What was the move before them? What happens after them?

In the beginning, you'll probably need some help with all those shapes and sizes. There is a special checklist available to you, my dear reader. To download, please visit www.talkingchart.com

Since three of them, the Long Tail, Long Nose and Long Body (LT, LN, and LB) candlesticks form around 80% of all candlestick, that makes them the most important. Those three shapes are showing very close percentages of appearance 28.17%, 25.40% and 26.59%, respectively. That makes them the best shapes to start with when learning the chart language. But don't underestimate the others.

So, how do we read?

Of course, it's one thing to know the letters, and another to start reading sentences and paragraphs. There are two main principles you need to learn in the beginning:

1. We are reading the chart from left to right.
2. The last candlestick is the most important. This is because it contains the most recent information.

With that said, let's read.

The chart below is the daily chart of E-mini S&P500. It begins with two ordinary candlesticks. And then boom! An outside day, 1xN. What we know already is that in the next period there will be an initial move towards the low. If that low is broken, there is a high probability for a continuation of the down move.

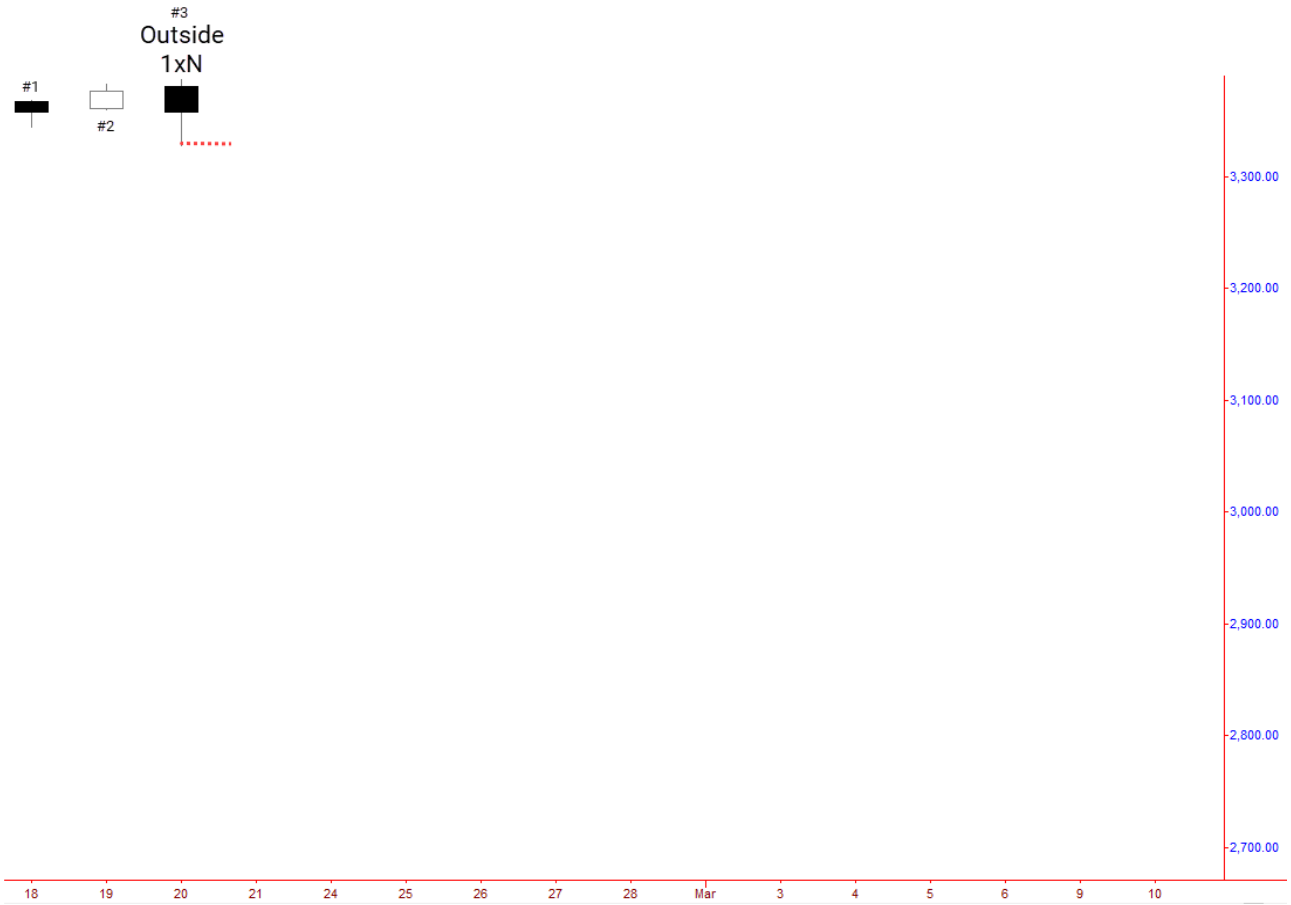


Figure 51: Learning to Read the Charts

The next day begins with a move down directly from the opening. This is a No Tail (0T) candlestick which breaks the low of the 1xN. So, what we can spot is a breaking of a low with a 0T. This is no longer a simple signal. It is turning into a complex one!

Besides being a 0T, this candlestick is also a LB shape. That means we can expect continuation, if the low is broken (in 61% of the cases).

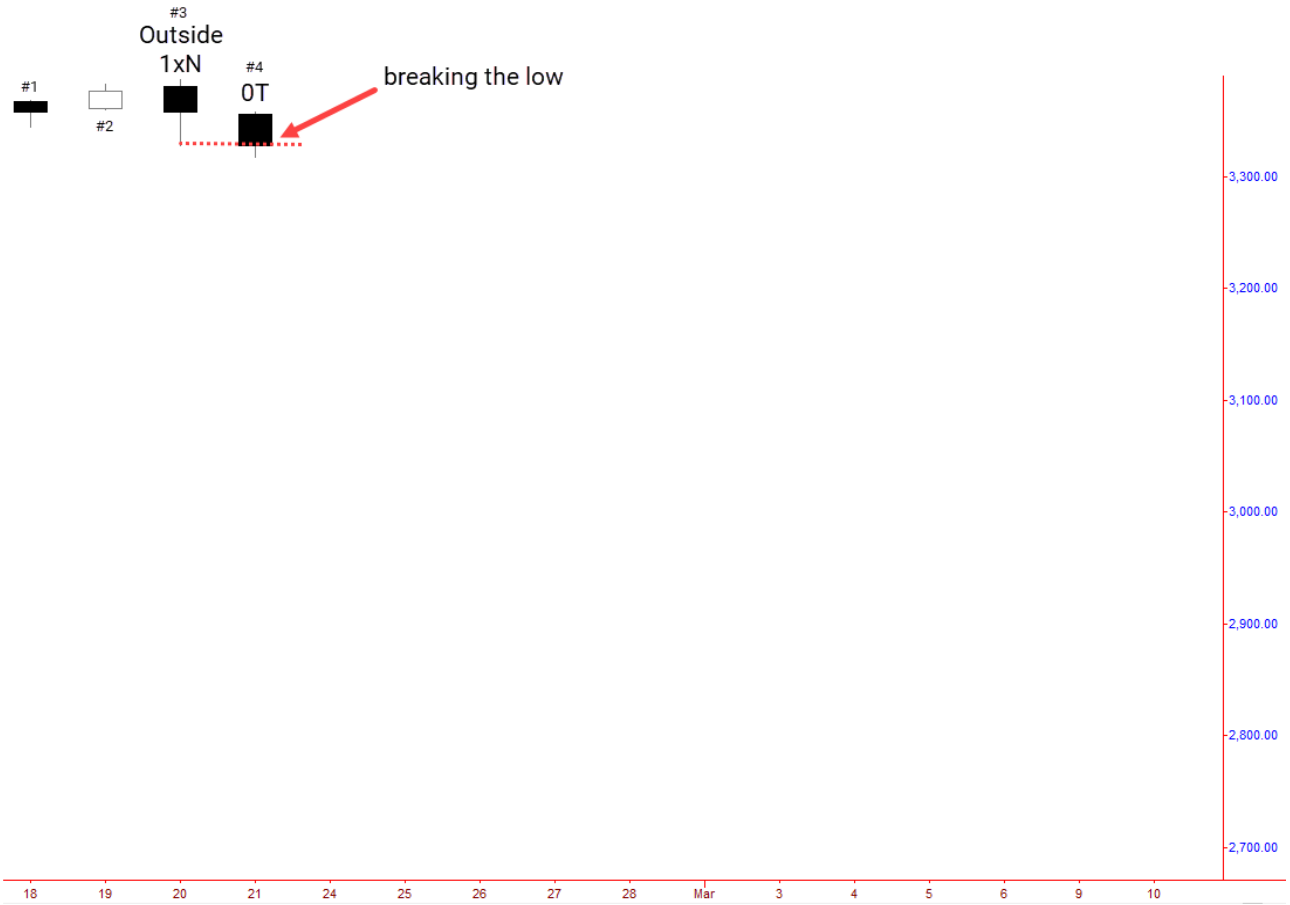


Figure 52: 0T Breaking the Previous Day's Low

The next one, period #5, opens with a gap down. That gap means the low is broken. Then directly, again with 0T, it went down, leaving an unfilled gap. The lack of a Tail here suggests no desire to close the gap. That is a strong bearish indication.

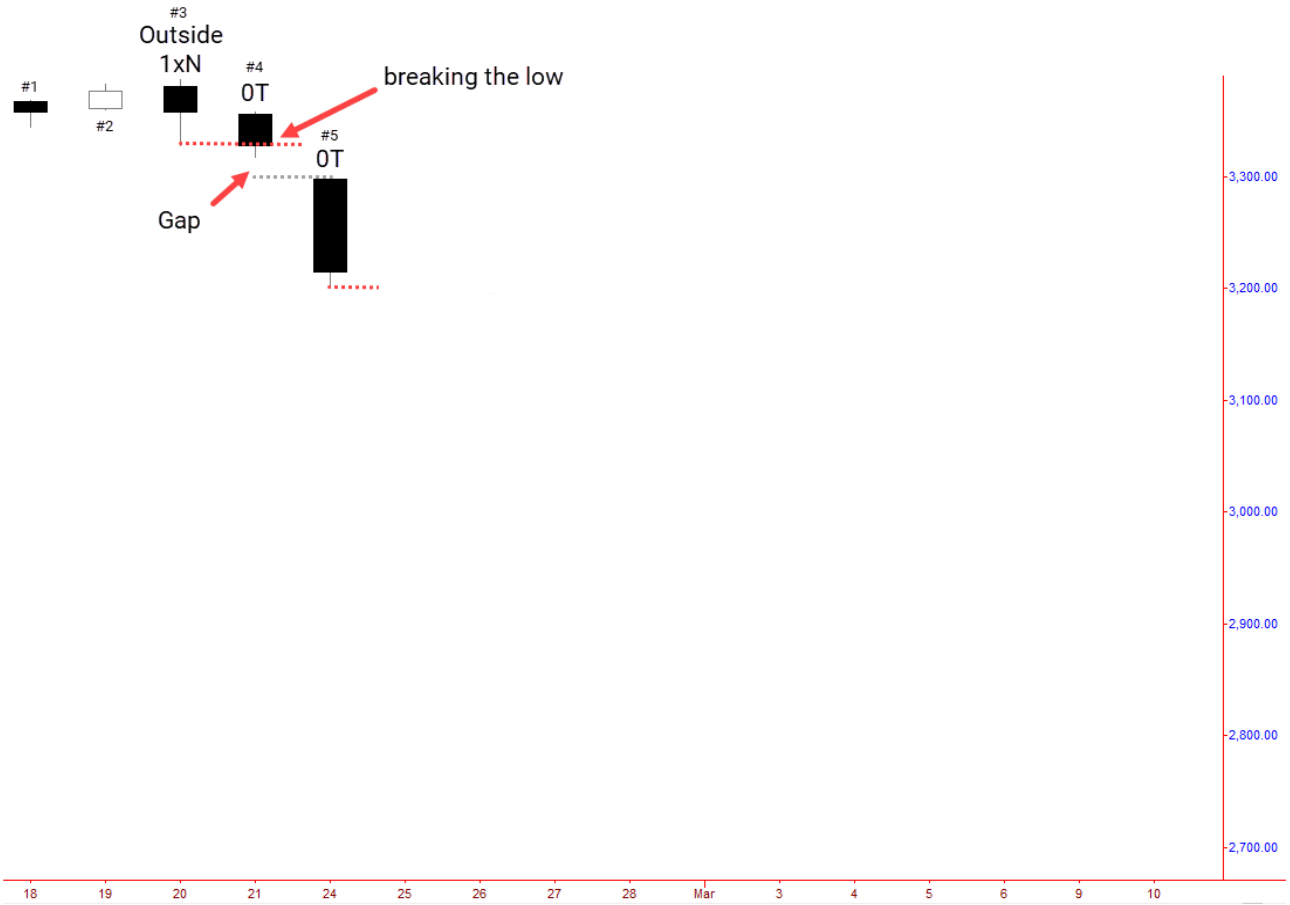


Figure 53: Another 0T Opens with a Gap Down

Candlestick #6 begins with an attempt to make a bullish candle. Since a simple sell signal is the break of the low, then simple buy would be taking out the high of the previous day. If that happens, we should look for the exit.

But it doesn't happen here, and the low is broken. What follows is a LB candlestick with the same size as the previous one. Again, its low is the barrier for a further decline.

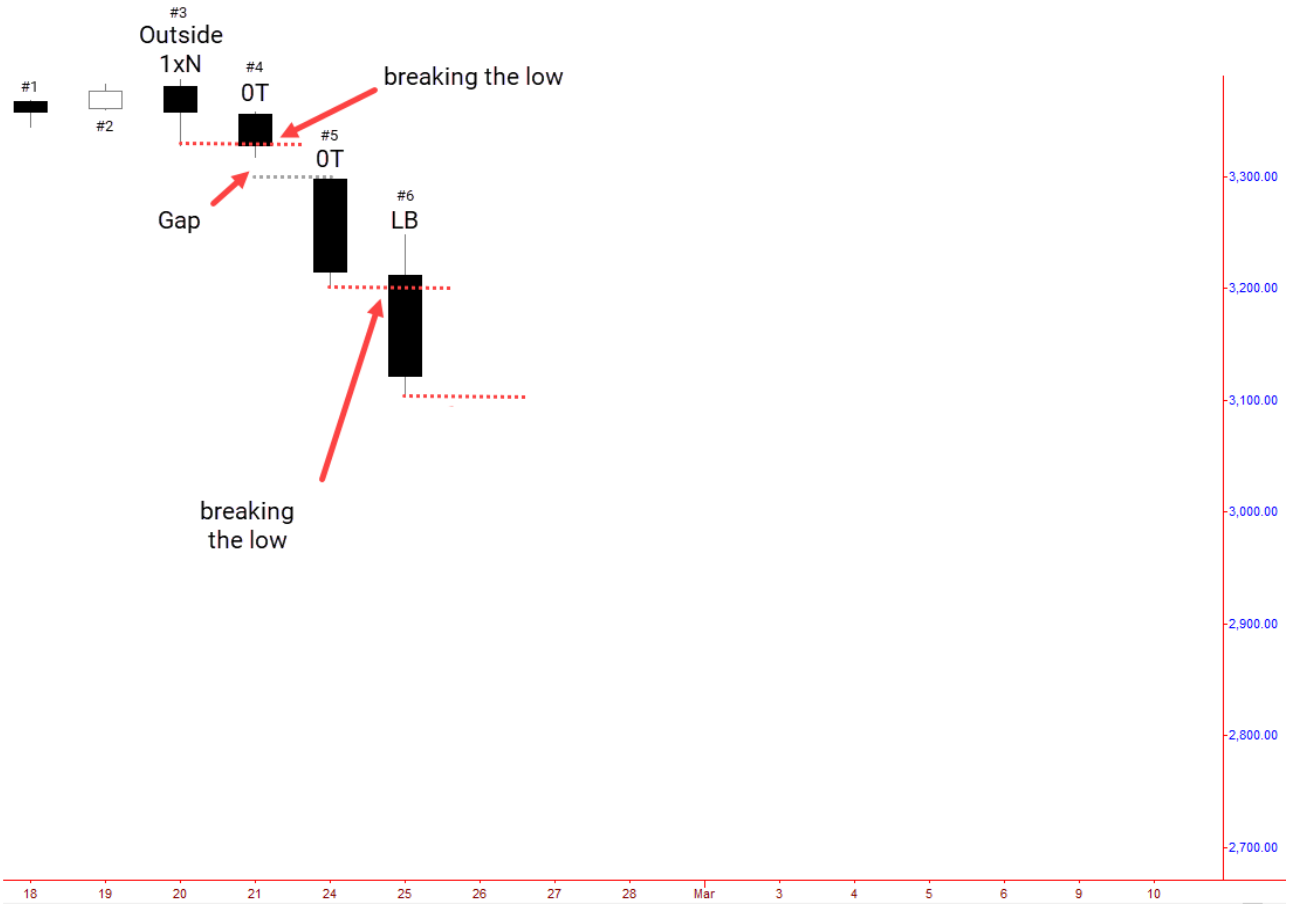


Figure 54: Another LB that Breaks the Low

So far, we've seen four consecutive candlesticks in one direction. All of them were down days. It depends on the market you trade, but generally the more consecutive candlesticks you see in the same direction, the closer we are to the top or, in our case, the bottom of the move. That makes the next candlestick crucial.

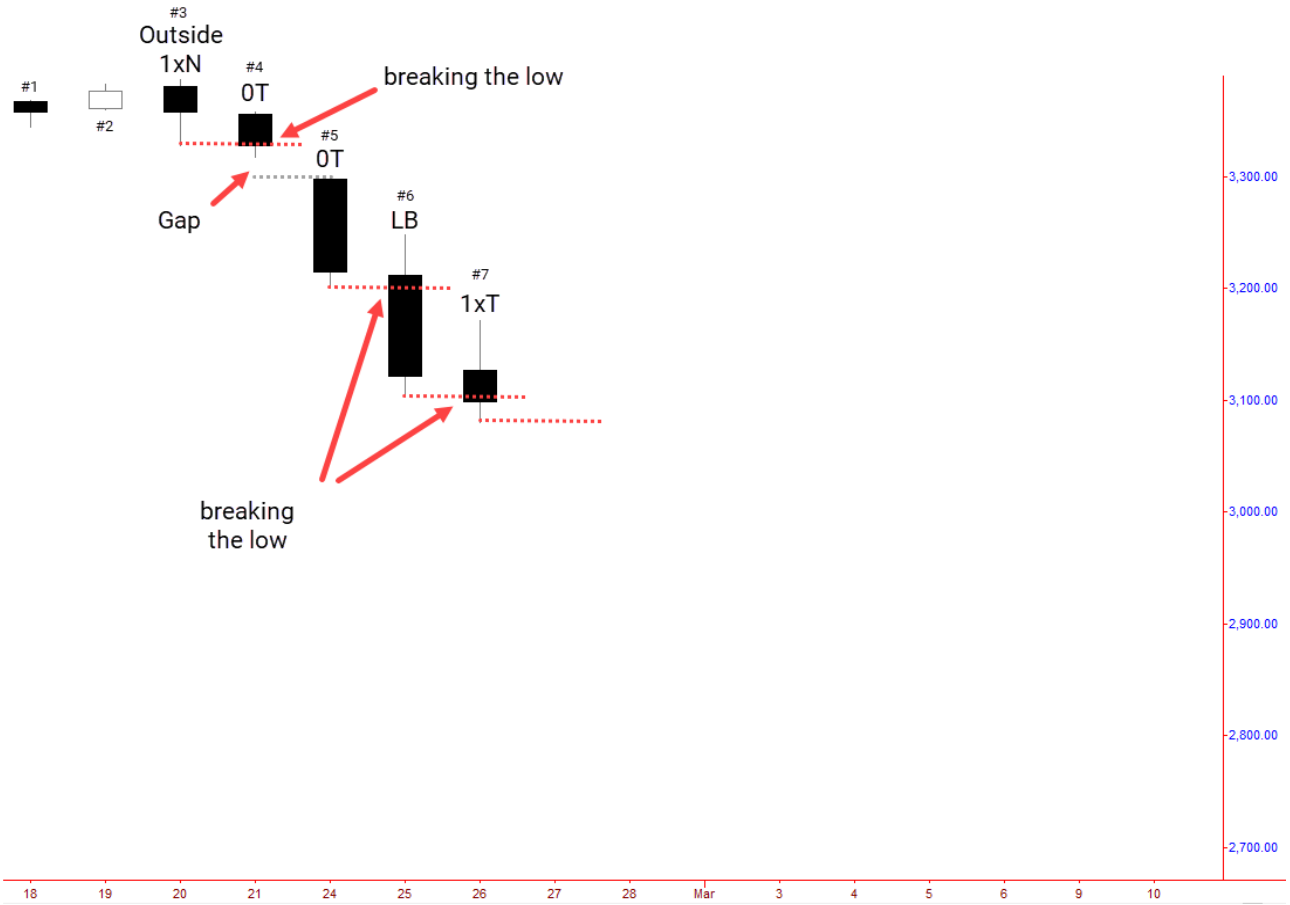


Figure 55: Approaching the Bottom of the Move, a 1xT Appears

That important candle (#7) begins with a move up. It gains some ground but can't reach the high of the previous day. Then something happens and the move reverses to the downside. The prior day's low is penetrated, and this day ends as a Long Tail (LT), 1xT to be precise.

That is strange. After four down days in a row, we have a fifth – this time a 1xT candlestick – which suggests that if its low is breached the move down should continue. Anyway, we do not have a breached high, so we wait.

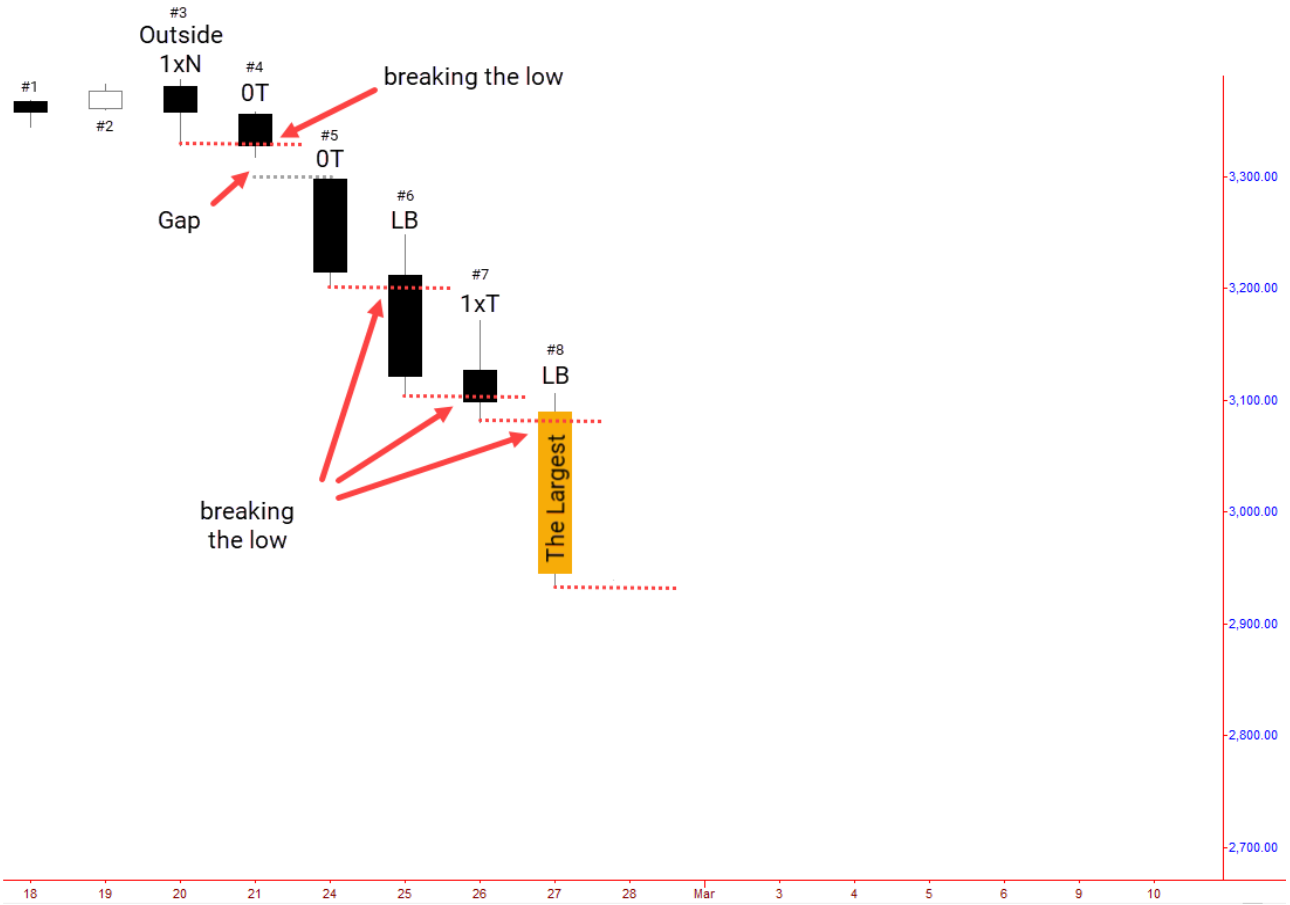


Figure 56: The Largest LB So Far

We didn't have to wait long because the next day the market made the biggest down candlestick so far.

OK, now we have an interesting situation. We have had six down candlesticks. The last (#8, in our chart) is the biggest of them all. That means a lot of selling. The chances of having an up day are getting bigger. That is a moment when I prefer to close my short positions (or long positions if it was the opposite case). Seeing so many consecutive candlesticks ending with the largest one we've seen so far is a take-profit signal.

But we don't have anything that suggests a buy signal. The high of the last (#8) candlestick is far away and even if taken out on the next day that would mean a lot of buying, exhaustion buying. This is not a buy we should take immediately. Better wait for a short pullback. But let's see, what will the market bring next?

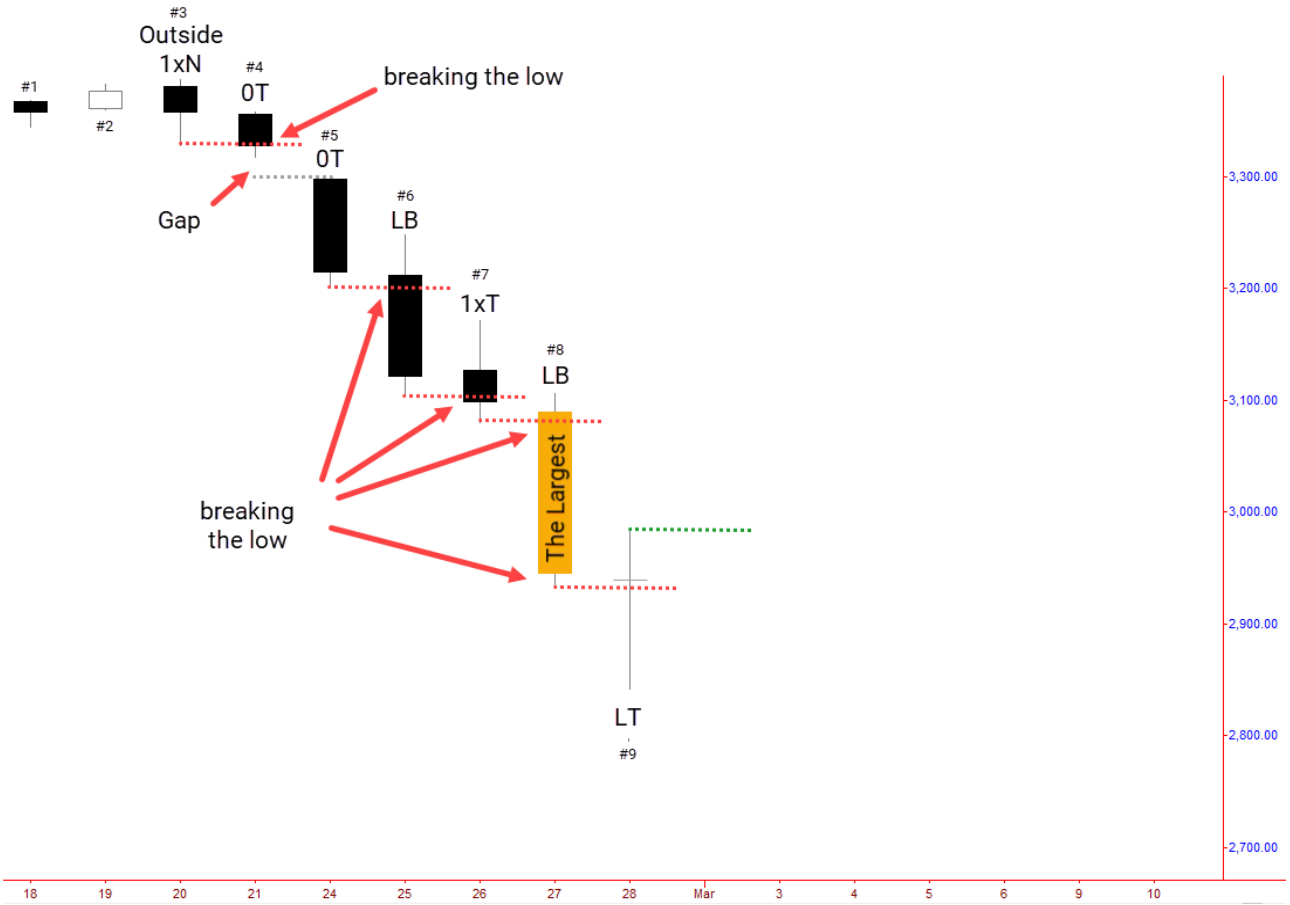


Figure 57: A Doji, or a 1xT?

During the next candlestick (#9), the low of the largest day (#8) is broken. Can it be that the decline will continue? The market goes down, but at some moment something happened. The price jumps, and the candlestick closes as a Long Tail. You could say, "this is a Doji", but the close is higher than the opening. The Tail is the longest part so that Doji is actually a 1xT candlestick.

Now, with this shape, the high of the 1xT becomes important. Here we must pay attention to an extremely important detail. After such a strong downfall, WE MUST NOT TAKE SIMPLE SIGNALS in the opposite direction. In this case, to enter long, we need a complex signal!

So, if the next day the price rises above the last 1xT high we won't be buying. Let's see.

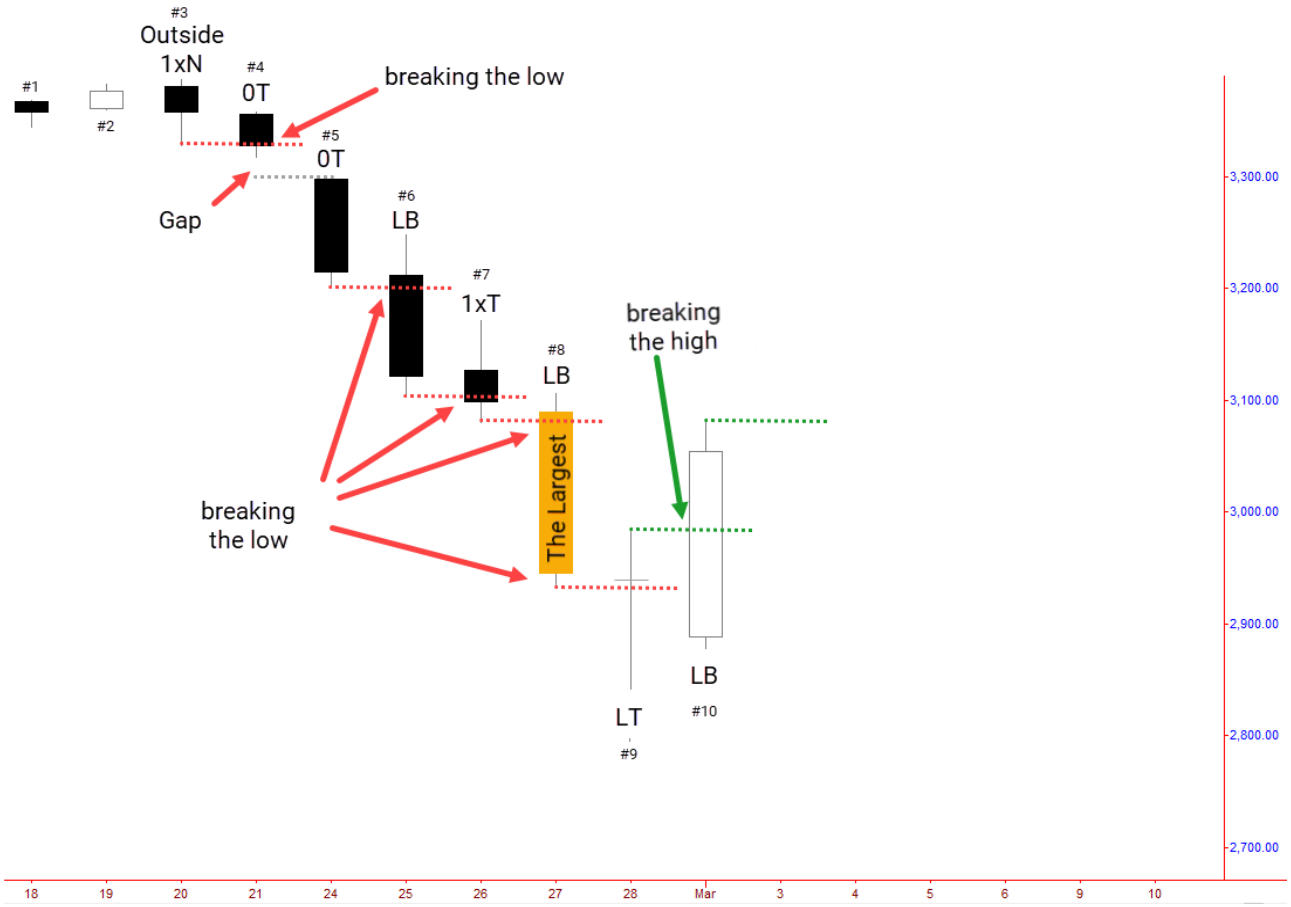


Figure 58: A Strong Start to #10

The next day (#10) that we are trying to read starts strongly and breaks the high of the up 1xT

candlestick (#9).

Can we buy? If this is a simple signal, the answer is no; if a complex signal, yes.

So, is this a complex signal? Candlestick #10 has a Tail. There is a gap that is immediately filled which is bullish. If we combine the 1xT (#9) and the gap with candlestick #8, which is the largest down LB, that creates a complex signal because more than one thing suggests an up move:

- We've had six consecutive down days.
- #8 is the largest, which suggests at least temporary exhaustion of the sellers.
- #9's Long Tail means accumulation and a continuation is most probable during the next period.
- #10 closes the opening gap and breaks the high of #9.

As you can see, there is a rationale for a long position, but trying to catch the first correction after a strong downtrend seldom provides a good risk-reward ratio (R/R). And that ratio is crucial for us traders.

The wisest thing to do is to wait. The downtrend can resume at any moment. And if you wait, this is where good R/R can be expected.

So, the high of the 1xT (#9) is broken and the day (#10) closes above the high. That, of course, would mean profit if we had taken the buy. But we can't catch everything. And we shouldn't if the signal isn't great. It'll come back to bite us more often than we'd like. There will always be a better signal. The key here is to trust the system.

Next up we have day #11

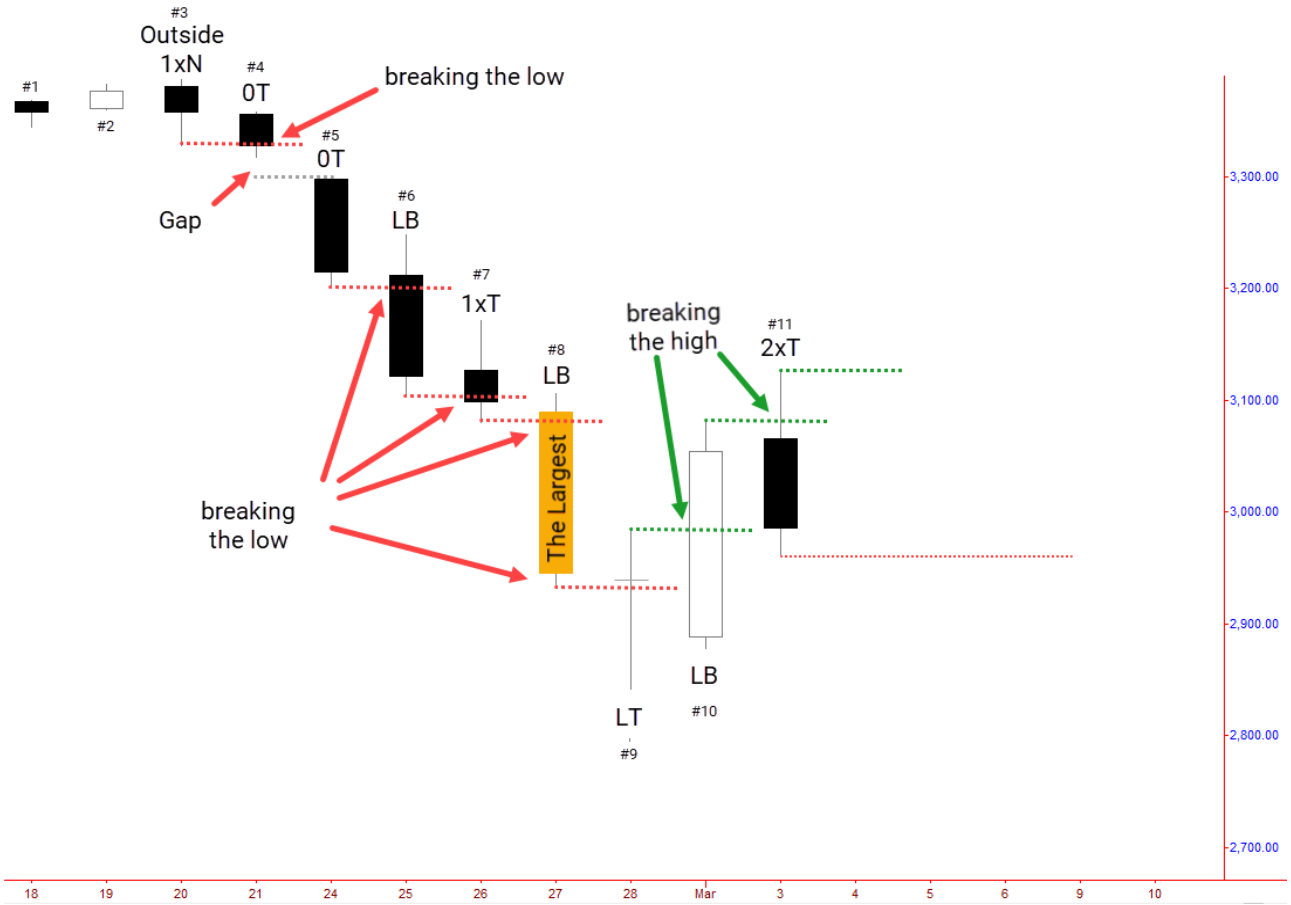


Figure 59: Day #11, a 2xT Appears

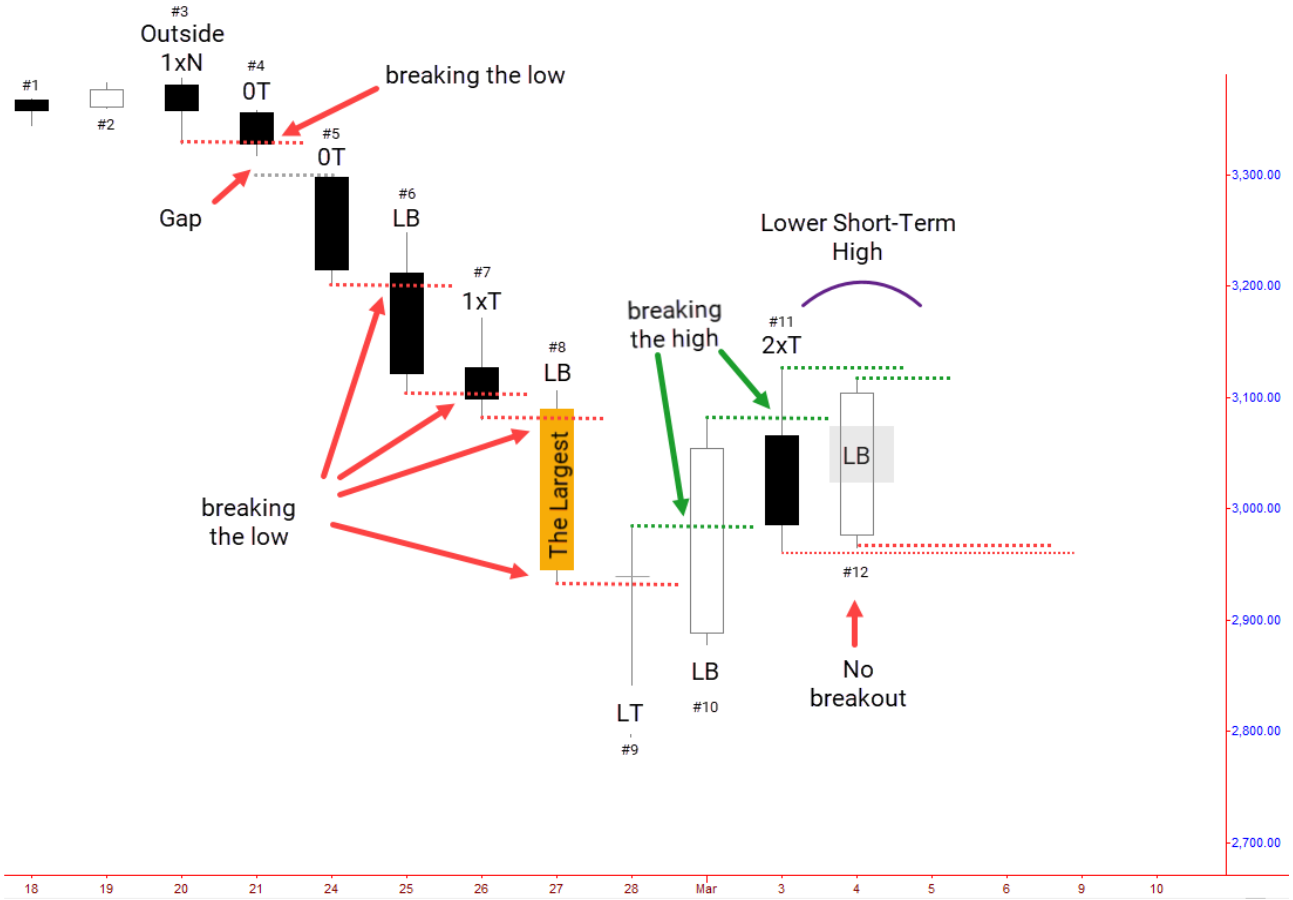
On day #11, the previous day's high is broken. It seems for a moment that #11 will continue the up move. But something happens, supply comes and day #11 ends as a 2xT. It looks like the downtrend is picking up strength.

A quick check of what this 2xT means and we find its probabilities show that if the low is broken it would mean a continuation going down. Here we have one more thing, however. If the low of the 2xT is broken, the market will create a lower short-term high.

Lower short-term high is a part of the market structure theory created by Henry Wheeler Chase and popularized by Larry Williams in his books. It means a top lower than the previous one. In our case, it would mean that if candlestick #11's low is broken, it will create a lower top than the top formed by candlestick #3.

Having a lower short-term high is something that creates a complex price action signal. Such a signal will mean to trade in the direction of the trend. And that is always good. So, if we see the low of the 2xT broken, short sell is the name of the game.

Let's see what happens.



Ready for the sell? 3, 2, 1 and … oops, the low is not broken. The high also stays untouched. We are witnessing an inside LB candlestick. Day #12 is completely inside #11's range.

Now what? We were expecting a nice short signal and now we have a LB up day. Does it mean that our short-term high is no longer valid?

To be completed, the lower short-term high needs a breakout below the 2xT's low. This means the

inside is not changing anything. Neither high nor low was breached. Actually, it is a plus for the short signal because the market made an attempt to rise but didn't have the power to break out of the prior day's range.

So what do we do? There is no entry, so we wait to see the next card dealt by the market.

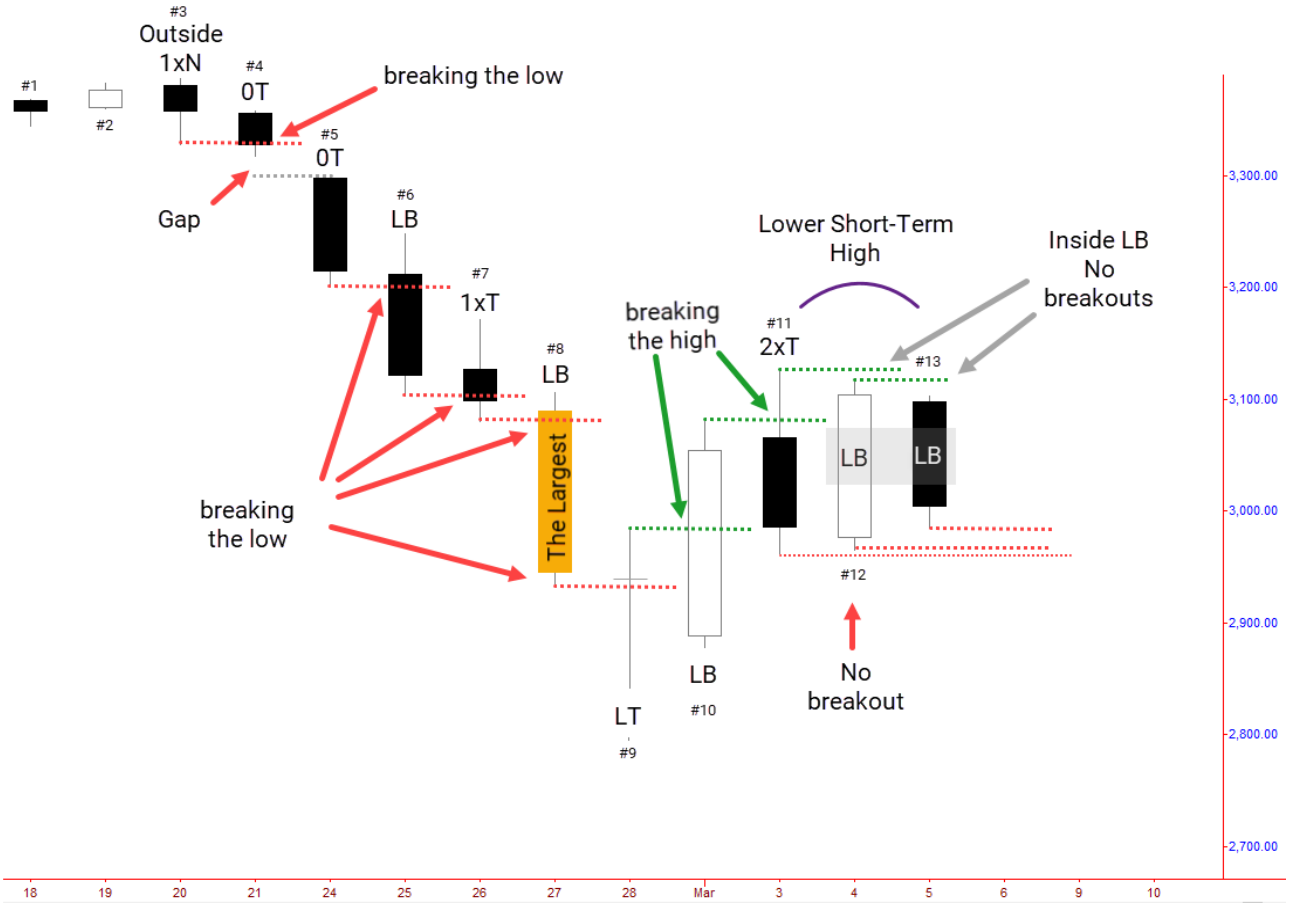


Figure 61: Day #13, Another Inside LB Candlestick

Day #13 is another inside LB candlestick. The more inside days we have, the more important the 2xT's high and low will become. Until one of them is broken, we have neither a lower short-term high nor a continuation of the up move. A good practice is to place pending orders. In the current case, the stronger signal is the breaking of the 2xT's low, so a sell stop order has to be used.

In many cases, the shape of the inside bar will provide a clue as to which side will break first. But in the current situation, both inside days are Long Body shape.

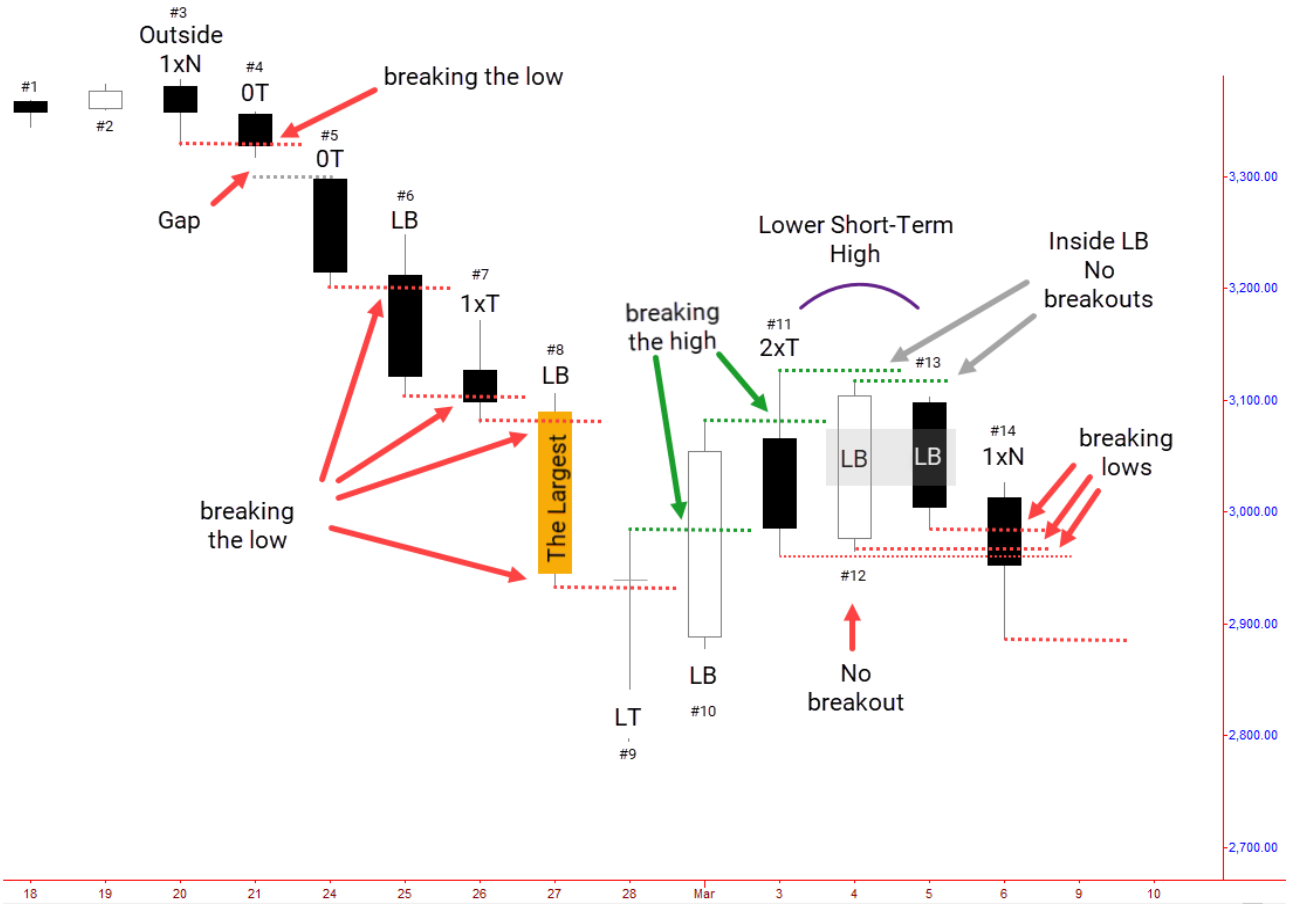


Figure 62: Day #14, Breaking Out

And here it is. Day #14 breaks out of the consolidation. It is breaking all three lows. Now we have a confirmed lower short-term high. If we had a sell stop order it would have been triggered and a position is opened. The stop-loss must be above the high of the 2xT candlestick.

We will not discuss targets here. The price action will guide us when to close.

So far, we have a small profit and the candlestick #14 closed as a 1xN. What do we know about this candlestick? An initial move down can be expected on the next day. The best-case scenario for us will be to see a breakout of the low. That would mean a continuation of the down move and more profit for us.

Here comes the next day.

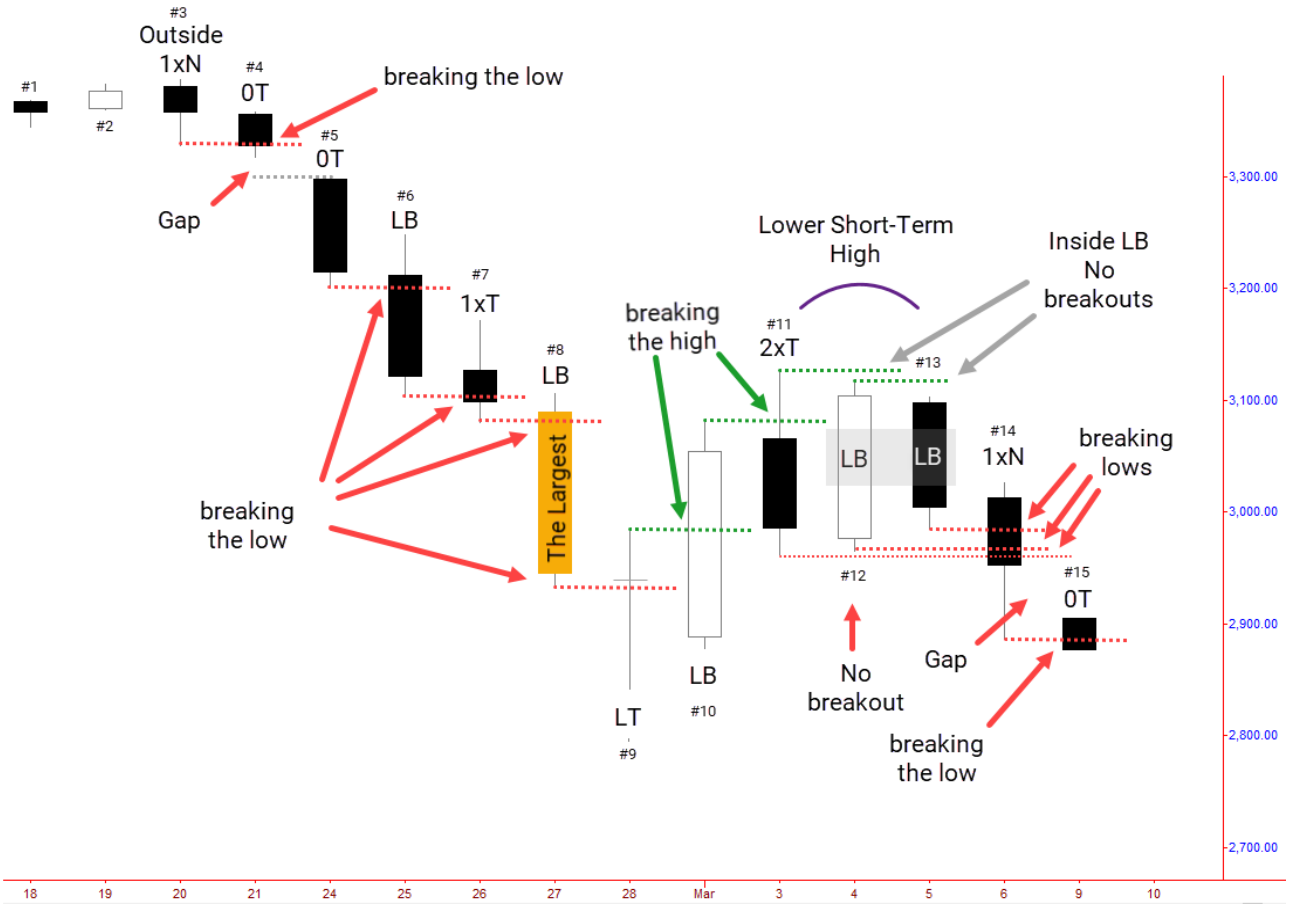


Figure 63: Day #15, 0T Breaks the Low

Day#15 is gapping down and with No Tail (0T, no upside movement to close the gap) it is breaking the previous day's low (#14, 1xN). All that creates another complex sell signal. It is weaker than the sell we've already taken because there are no lower short-term highs. But we can use it to add more contracts (lots, shares) to the position. Adding more to an already open position should not exceed 50% of the initial size. For example, if two contracts were sold at the beginning, the addition should be of one lot or less.

Should we move the stop? Yes, but where?

Always consider, what are our options? Here we can place it:

- At breakeven, protecting our profit.
- Above the gap; if the gap is filled, that would suggest demand came in.
- Above the high of the 1xN candlestick.

Closing a position is the hardest part. I wish I could have a strict rule for moving a stop-loss. It is more of an art and it depends on you, your risk tolerance, the current situation and so on. Usually, in similar situations I am placing it above the 1xN. But here we have a gap down and then, with 0T, the market is breaking below the prior day's low. That suggests strong selling and immediate continuation, which makes "above the gap" a good place for a stop-loss.

With all that said, let's see how day #15 will continue.

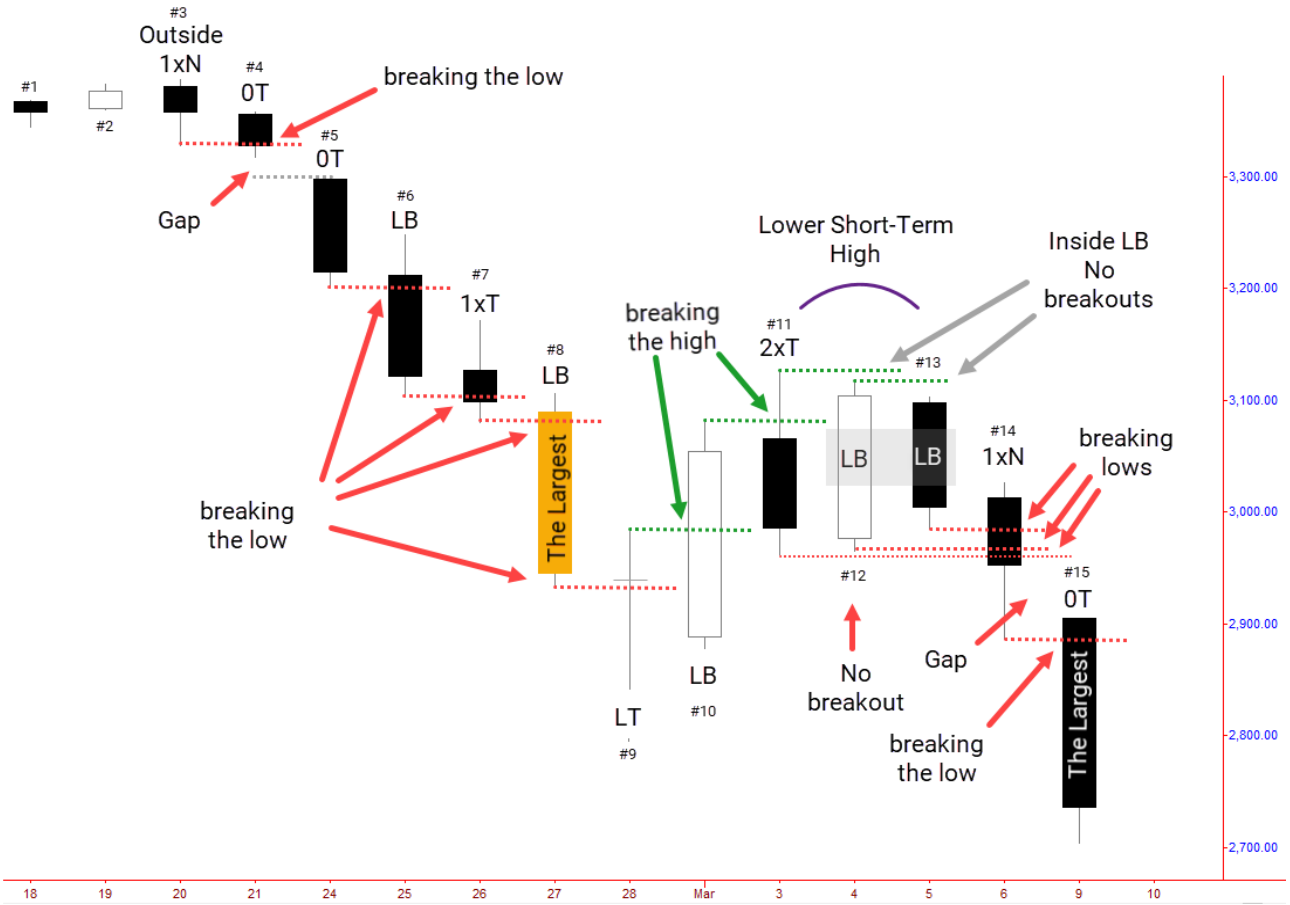


Figure 64: The Market Gives a Gift

Wow, now that's what we call a gift from the market. With no attempt to hit our stop-loss, the market made the biggest single-day decline since the beginning of that downtrend. Again, like before, this is the time to close our positions – somewhere around the close.

The chart is talking to us, "Don't be greedy, get out".

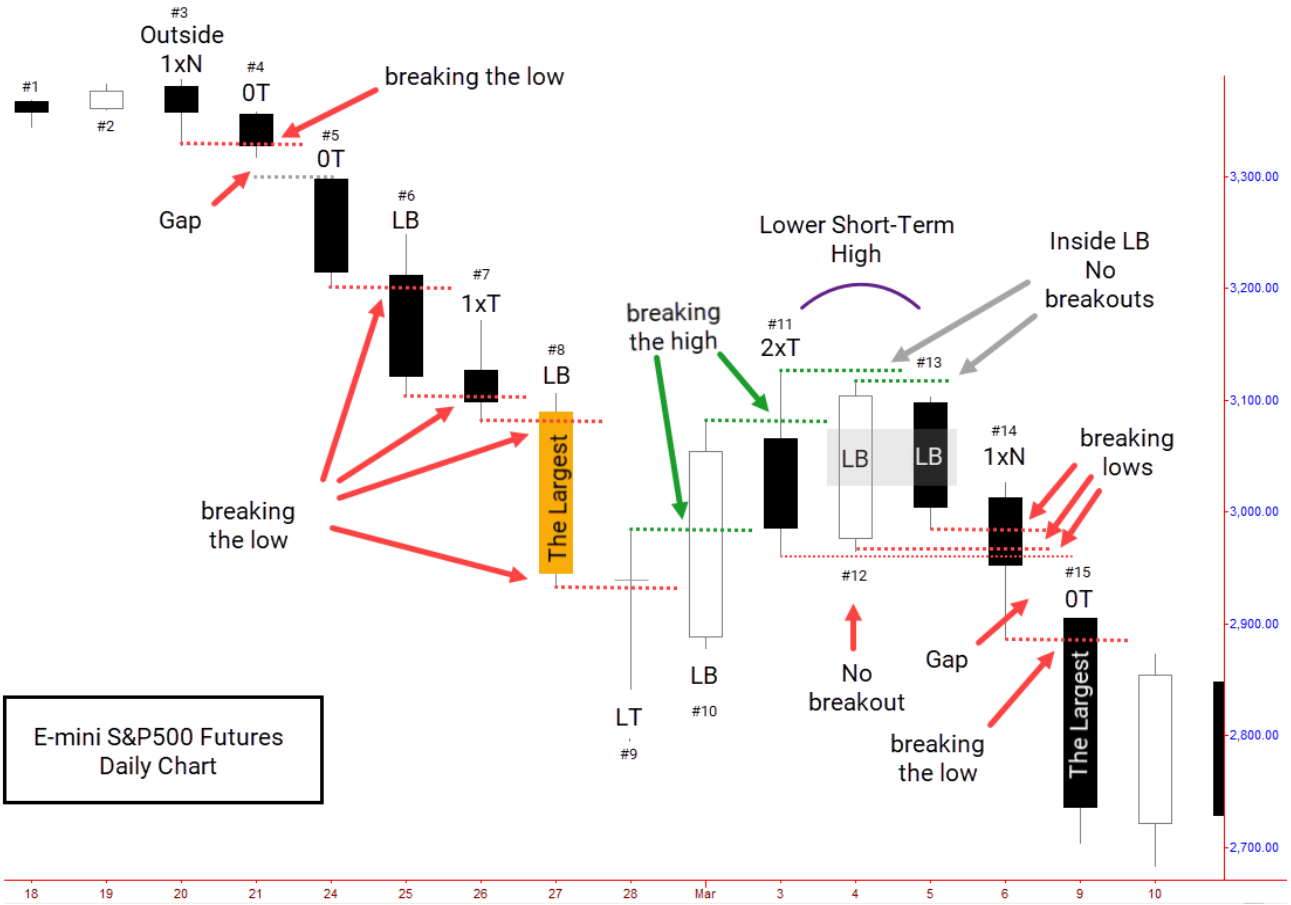


Figure 65: The Full Picture, S&P500 Futures in March 2020

As you can see, this was the daily chart of E-mini S&P500 futures showing the period when the market entered into a bear market territory in March 2020. And by reading the language of the chart, we were able to take advantage of it.

Final Words

Congratulations, you've learned the alphabet and now you can understand what the chart is telling you. This is something very powerful that can enhance your trading. You can use it in every timeframe and every instrument. I would suggest you use it with futures on stock market indices and a daily chart. Of course, there will be a difference in the percentages you get for every shape in different instruments and timeframes, but the main principles will stay unchanged.

It's a great system, and you'll probably want to put it into practice as soon as possible. But not so fast. Reading a book – even writing one is easier than putting this to work. I know it works because I've been using it for more than a decade. It has solid logic behind it, it proves itself during the back-testing and in real money tests. But it has its place in the overall trading process. Charts can exhibit random behaviour, and that is why you need to include something outside of the chart.

I know that you are probably feeling like a superhero of trading and you are ready to make money, but take it easy. Read the book one more time. Try to grasp the logic behind why a certain shape looks like it does. What processes led to its creation? Who is buying? Who is selling? And so on…

Download the free checklist. It will make it easier for you to see the different shapes and sizes. It also contains additional price action techniques and patterns. Download now from www.talkingchart.com .

Then go to the charts. Go back in time, practise what you've learned. Read, candlestick by candlestick, then pattern by pattern, hear the talking chart.

About the Author

A short-term trader in commodities and a specvestor in stocks, Vassil Banov has been crawling the financial markets for nearly two decades.

During this time there is not much he didn't do. Author of books and publications, market commentator, director of a brokerage company, certified financial advisor, co-founder and chairman of Traders Association and a startup Founder.

But among this, his passion was and will always be the trading.

Starting as a Forex trader, his journey taught him the patience of the booming stock market, the great opportunities arising in the busts, the quick reactions in the fast-moving futures and the power of options.

But no matter how many theories and concepts he tried one thing didn't change. He stayed true to what gave him his first stable results – the price action trading. The constant collision of the market driving forces with pure randomness and powerful emotions only to create a single piece of the chart has always fascinated him and driving endless efforts to study it and improve it.

Besides trading, his efforts are currently focused on the development of the innovative educational platform www.PieceofTrading.com where he teaches traders his market understanding and proprietary trading techniques.

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