

The 4 Common and Costly Mistakes Almost Every Trader Makes With Candle Charts – And How To Correct Them Instantly

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Introduction

You've probably heard of "Japanese Candlesticks" before. In the time since I revealed them to the Western world they've become part of every technical analysis platform and traders and investors vocabulary. Japanese candle chart analysis, so called because the lines resemble candles, has been refined by generations of use in the Far East.

The candle chart phenomenon has caught fire around the world with all kinds of traders, from institutional power players to individual part-timers.

Why do candlestick charts attract so many traders serious about increasing profits and decreasing risk? Because when you know how to properly use and interpret candle charts, they really work in your favor. They're reliable. You can count on them.

With the popularity of candles comes misuse. From my public and institutional seminars I have found that a large percentage of those applying candlesticks (even the so called "experts") are using them either incorrectly or not harnessing their full potential. This is why we have *Nison Candlesticks- Candlestick Training the Right Way*.

This Special Report will detail some of the three most common mistakes made with candle charts. But first let's review how to construct the candle lines and see why candles are the top choice for the world's most successful traders.

What Are Candlesticks?

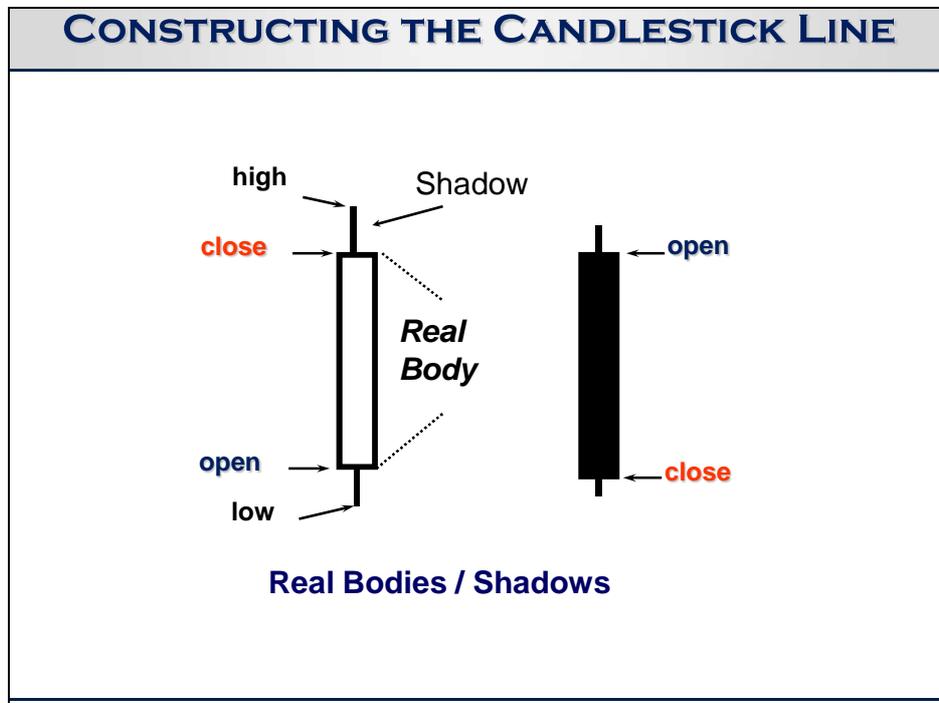
Japanese candle chart analysis, so called because the lines resemble candles, have been refined by generations of use in the Far East. These charts are now used internationally by traders, investors and premier financial institutions.

Here are some of the benefits of using candlestick charts:

- **Easy to understand:** Anyone, from the first-time chartist to the seasoned professional can easily harness the power of candle charts. This is because, as will be shown later, the same data required to draw a bar chart (high, low, open and close) is used for a candle chart.
- **They can be used in all markets and all time frames**
- **Provide earlier indications of market turns:** Candle charts can send out reversal signals in a few sessions, rather than the weeks often needed for a bar chart reversal signal. Thus, market turns with candle charts will frequently be in advance of traditional indicators. This will help you to enter and exit the market with better timing.
- **Give double the information of bar charts:** Candle charts not only show the trend of the move, as does a bar chart, but, unlike bar charts, candle charts also show the force underpinning the move.
- **Enhance Western charting analysis:** Any Western technical tool you now use can also be used on a candle chart. Candle charts, however, will give you timing and trading benefits not available with bar charts. This merging of Eastern and Western analysis will give you a jump on those who use only traditional Western charting techniques.
- **Help you preserve capital:** In today's volatile trading environment, this is of utmost importance.

Now let's look at how candlestick charts are created with market data:

Constructing The Candlestick Line



The broadest part of the candlestick line is the real body. It represents the range between the sessions' open and close.

If the close is lower than the open the real body is black. The real body is white if the close is higher than the open. The real body is white if the close is higher than the open.

The thin lines above and below the real body are called the shadows. The peak of the upper shadow is the high of the session and the bottom of the lower shadow is the low of the session.

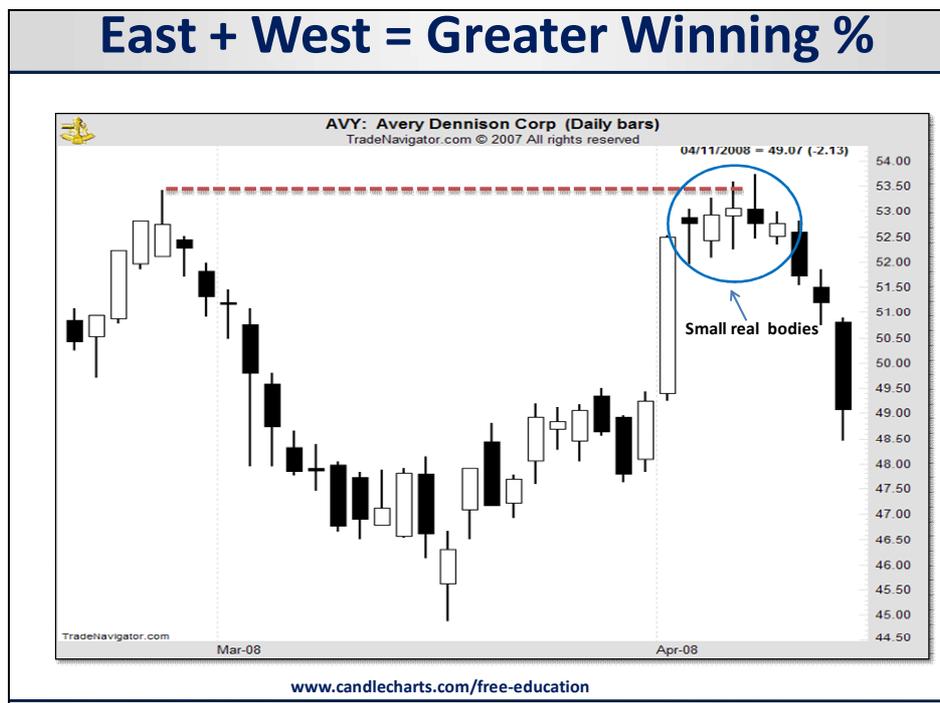
The color and length of the real body reveals whether the bulls or the bears are in charge. Note that the candle lines use the same data as a bar chart (the open, high, low and close). Thus, all Western-charting techniques can be integrated with candle chart analysis.

And this will lead us to our first candle mistake:

Candle Mistake #1: Not Using Western Indicators

Many traders think they need to abandon their current trading strategies if they're going to use candle charts. That is absolutely untrue.

In fact, you can enhance the effectiveness of your trading strategies by combining your current methods with candle charts. You'll love how simple (not to mention how powerful) it is when you combine your own favorite market indicators with the proven effectiveness of candle charts.



Before we see the power of combining candles with Western tools let's first see the market insights we get by using just one part of the candlestick line—the real body. For example a tall white candle shows the bulls are in charge.

But a small real body (white or black) indicates a period in which the bulls and bears are more in a tug of war. What this does is increase the likelihood of a market turn.

We can see on this chart in the blue circled area the small real bodies gave a warning that the market's trend may be losing momentum. As the Japanese phrase it, the "market is losing its breath." Now note the red dotted line. This would be a resistance area based on a bar chart- and so it is with the candle chart.

This is one of the secrets to using candles to their fullest potential- see if a candle signal confirms a western signal. So the small real bodies at resistance give a clear signal for those who could read the candles to vacate long positions – or sell short – or even place a bearish option trade.

Candle Mistake #2: Not Using Trade Management

The use of trade management is one of the major differences between those who have long lasting successful trading careers and those who quickly get blown of the trading waters.

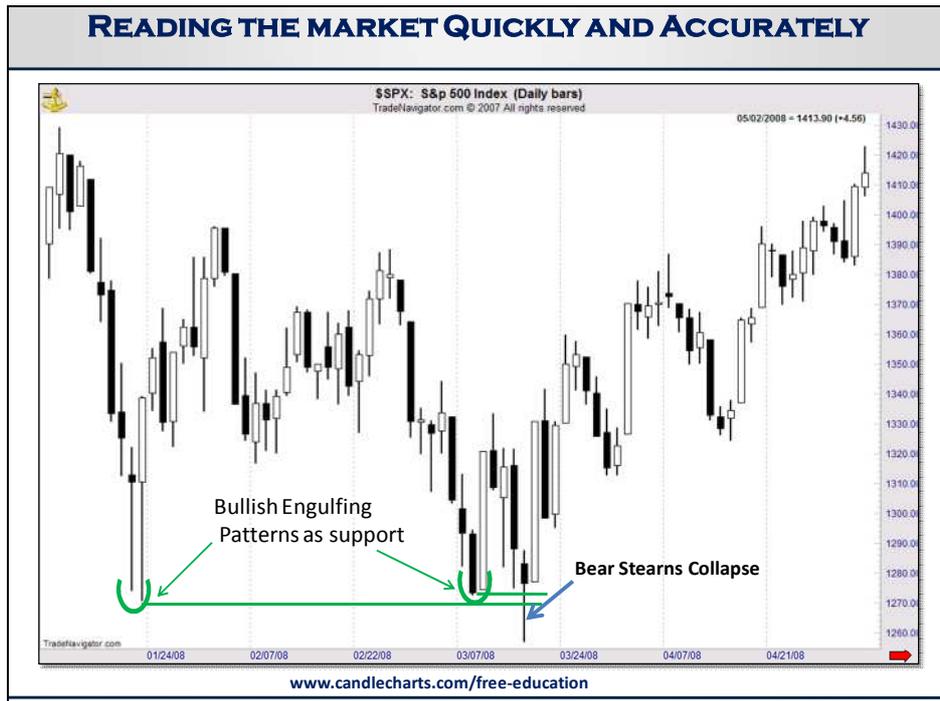
Trade management includes risk-reward analysis, protective stops, looking at the overall technical picture and many other aspects that I detail in my more comprehensive educational resources (I will be revealing my all time most important trade management rule at my upcoming free web seminar you're registered for, to be held on Tuesday, August 5th at 9:00pm Eastern.)

One of these trade management items is adapting to changing market conditions. I call this being a "market chameleon." As a chameleon changes its color according to its surroundings so traders should change their market stance adapting to what the market is telling us. Like the cartoon below there are some slow to adapt:



"ACCEPT IT, ED, — SUMMER'S OVER."

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The most successful traders adapt quickly to the market's clues. And candles, once you know how to read them correctly, let traders quickly and accurately read the "mood and manner" of the market so they can often get into a trade before other traders jump on the new move. That is the power of the candles –letting you quickly adapt to the clues the markets send out.

In January there was a classic bullish engulfing pattern. This relatively large white candle compared to the much smaller (almost a doji) black candle graphically reflected the bulls had overwhelmed the bears. Another aspect which underscored the importance of this pattern was the very long bullish shadows. These extended long lower shadows visually displayed a strong rejection of lower prices (isn't it amazing how much more information we get about who is winning the battle between the bulls and bears with candles than with a bar chart- although they both use the same open, high, low and close data!)

Most of the candle patterns (but not all) can be used as support or resistance. And the lowest low of the two sessions that make up the bullish engulfing pattern is one of those patterns we can use as support (based on a close). And note how the lows of this pattern held at the green arrow in mid March.

Now here's where being a market chameleon comes into play. On the day of the Bear Stearns collapse the S&P broke under the support of the bullish engulfing pattern- but what happened by the end of that day? Right- the bears couldn't keep prices under that support. So the market was able to shrug off the extremely bearish news. As Bernard Baruch said "It is not the news itself, but the market's reaction to the news that's important." And this was an important sign of a potential major low since the market both shrugged off very bearish news and held the support, on a close, of the bullish engulfing pattern.

So for anyone who sold on the break under the support during the day of the Bear Stearns news should have adapted their stance by the end of the day to exit because the support at the bullish

engulfing pattern held rock solid. And for those flat on that day it was a golden opportunity to buy (using the lows of the Bear Stearns news as a stop) and a target to the top end of the trading range (what the Japanese call a “box” range) near 1400.

NOTE: In this chart I showed you how the lows were called with candle signals. In the upcoming web seminar I will reveal the candle clues that signaled at the recent highs that the Dow Jones was likely to sell off.

Candle Mistake #3: Trading On Every Candle Signal

Most traders don't realize that each candle signal can have different trading implications, depending on the market situation.

This is why trading or testing candles without using other considerations – such as adding Western technicals as discussed in Mistake #1 above – is a financially dangerous misuse of candles. And will surely lead to unnecessary losses.

One of my Japanese candlestick resources said it well: Adjustments to trading using a candle signal must be made because to know where you stand is more important than pattern recognition. In other words, you should never use candle patterns in isolation.

So when a valid candle signal appears, you must ask yourself these questions: Should you buy? Should you sell? Or should you stand aside? This is why education on how to correctly use candlestick charts is so vital to your success.



One of the powerful aspects about candles is they can be used in all markets (and in all time frames.) With this in mind let's look at a Forex chart. Even if you do not trade Forex, the concepts discussed here can be used in any market.

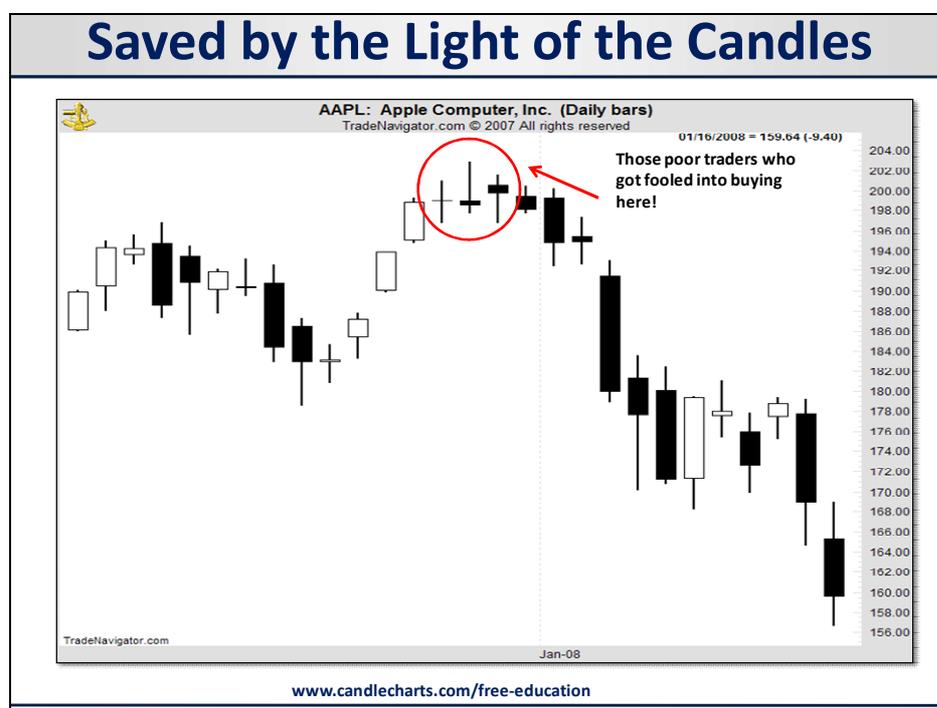
Note the rally that started with the bullish engulfing pattern shown at the green semicircle. Our focus, however, for this example is the two bearish engulfing patterns shown in the red semicircles at 1 and 2. Although these bearish engulfing patterns are potential top reversal signals, savvy candle traders would act very differently with bearish engulfing pattern 1 compared to bearish engulfing pattern 2. Look at where bearish engulfing 1 was completed - at a support area. So if you sold there you were selling at support!

Avoiding misuses of candles – like this one – would have saved you thousands of dollars.

Candle Mistake #4: Using Candles Only To Enter New Trades

I've taught thousands of traders to use candles and I get a lot of comments about how valuable candles for getting them into trades before the big moves. As one of my seminar students said, "I now get into a trade before the market does its thing."

But here's the problem. Even if you had a great entry price, whether you used candles or not, most traders have a problem knowing when to exit. When you have the proper candle knowledge you will know precisely how to use the candles to also give you good exit points.



In the red circled area, based on price, Apple looked good as it was making and holding new highs. But let's bring the unique insights of the candle into play.

Although this stock looks healthy on the outside, based on price, think about what the candle lines are relaying about the momentum. The series of small real bodies send out a strong signal to exit long positions. And these were the all time highs in Apple!

And even if you were not long, by seeing these small real bodies you would know not to enter long positions. And look how much you would have saved by avoiding being long! Again, this highlights the value of top-quality trading education.

About Steve Nison

Renowned author and speaker, Mr. Nison has the distinction of introducing candlestick charts to the Western world. Mr. Nison has authored three acclaimed books including *Japanese Candlestick Charting Techniques*. His books have been translated into 11 languages with sales of over 100,000 copies.

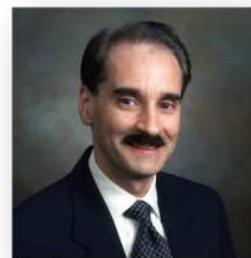
Mr. Nison is not only the acknowledged master of these previously secret candlestick techniques, but is also an expert on Western technical analysis with over 30 years real world experience.

Regarded as one of the most foremost technical analysts in the world, Mr. Nison's client list includes Fidelity, J.P. Morgan, Goldman Sachs, Morgan Stanley, NYSE and NASDAQ market makers, hedge funds and money managers.

His work has been highlighted in The Wall Street Journal, Worth Magazine, Institutional Investor and Barron's. Nison has appeared numerous times on CNBC, and his segment on FNN (the precursor to CNBC) brought in the most viewers that network ever had.

Mr. Nison's sold out seminars have been hailed as the most valuable and entertaining in the industry. He has presented his trading strategies in 20 countries to traders from almost every investment firm on how to apply - and profit from - these methods. He has also lectured at numerous universities and was guest speaker at the World Bank and the Federal Reserve.

He was among the first to receive the Chartered Market Technician (CMT) designation from the Market Technicians Association (MTA). He was previously a senior technical analyst at Merrill Lynch and senior vice president at Daiwa securities. He holds an M.B.A. in Finance and Investments.



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