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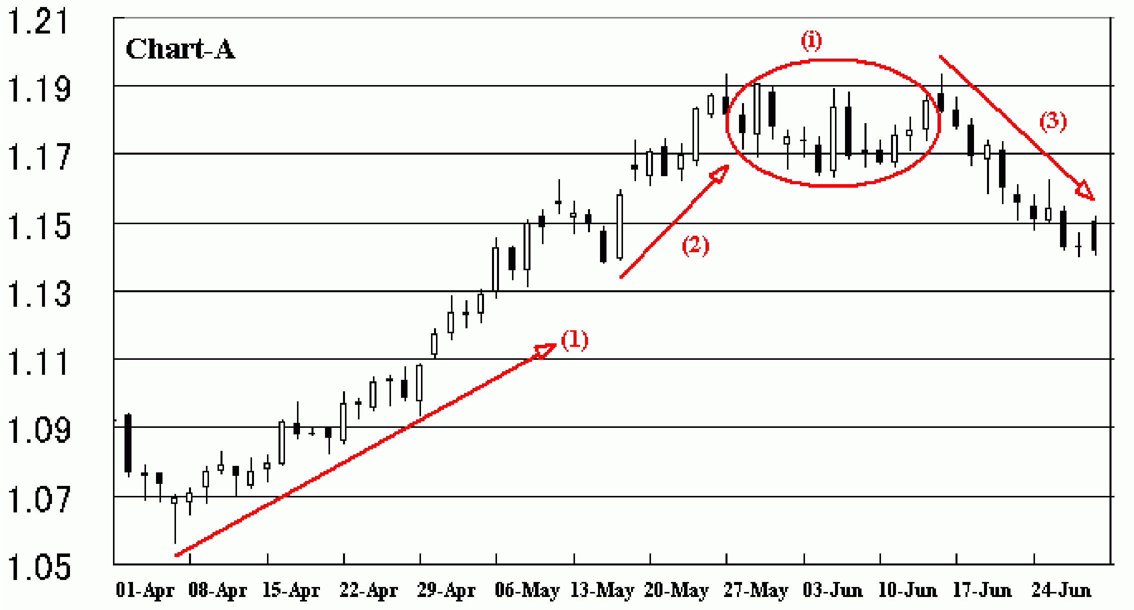
Ichimoku with Modified Candle (part)

Ichimoku has become one of the major technical analysis tools and has recently gain popularity. Its features were introduced in Chartpoint September/October 2002 issue. It is a very graphical chart designed by Ichimoku Sanjin (non de plume) in Japan where 5 calculated lines were overlaid on a candle chart. These 5 lines were used to determine the trend, support and resistance, as well as the time element.

In this article I will introduce a new style of Ichimoku using a modified candle. This new style Ichimoku is more visual and much easier in determining the trend. Modified candle is the same as an "Averaged Candle Chart" so called "Heikin Ashi" in Japan.

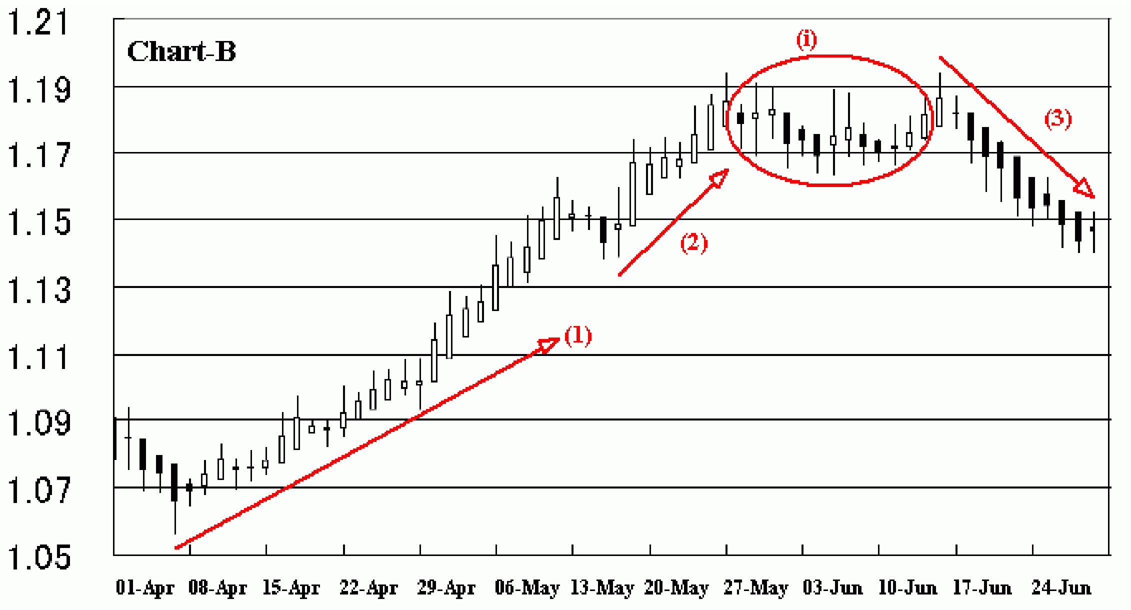
"Heikin Ashi" was introduced by a commodities trader, who made a fortune using this chart. While skills and experience is needed to read a standard candle chart, a modified candle helps you to read a trend much easily. Let's illustrate this using Charts A and B.

Chart A: EUR/USD – Standard Candle



Charts A and B are EUR/USD from April 1 to June 30, 2003. Chart-A is a standard candle and Chart-B is a modified candle. First impression will be that Chart B candles are simpler than Chart A. Allow me to illustrate. First examine the up trend from early April to early May marked as the upward sloping red arrow (1) between these two charts. Candles of Chart A are mixed during this period and it is difficult to read the formations without at least some basic knowledge of candle charting. On the other hand candles of Chart B are just a series of positive candles and they simply show EUR/USD in an up trend. Especially after late April, no negative candle appeared in Chart B and it indicates a strong up trend in this period.

Chart B: EUR/USD – Modified Candle



Let's see some more examples – the up trend from mid to late May marked by the red arrow (2) and the down trend from mid to late June marked by arrow (3). In both periods, Chart B gave a much clearer signal of the trend than Chart A. The advantage of modified candle is even more obvious during the consolidation period marked by a red ellipse (i) on both charts. Chart A has mixed candles but on the modified candle Chart B, there are only a series of short candles with shadows on both sides, an indication of consolidation.

In summary, there are only 5 simple rules for modified candle and they can be easily remembered:

Rule 1 (Basic Rule)	:	Positive candle means "BUY" Negative candle means "SELL"
Rule 2	:	Positive candle with upper shadow means "strong BUY" Negative candle with lower shadow means "strong SELL"
Rule 3	:	Positive candle with lower shadow means "weak BUY" Negative candle with upper shadow means "weak SELL"
Rule 4	:	Candle shorter than previous day means "an indication of a Change".
Rule 5	:	Very short candle (especially cross-shaped) means "a Change of the trend".

Modified candle chart works not only on daily chart but also on weekly and monthly charts. Analyzing from longer term chart to shorter term chart makes clear the current trend.

How to calculate this modified Candle? It is simple as well. Look at the sample Excel worksheet (Table 1).

Table 1: Modified Candle Calculations

	A	B	C	D	E	F	G	H	I
1		O	H	L	C	MO	MC		
2	02-Jan-97	1.2684	1.2717	1.2628	1.2671	1.2675	1.2675		
3	:	:	:	:	:	:	:		
4	01-Apr-03	1.0919	1.0925	1.0864	1.0920	1.0781	1.0907		
5	02-Apr-03	1.0938	1.0943	1.0750	1.0769	1.0844	1.0850		
6	03-Apr-03	1.0765	1.0792	1.0685	1.0759	1.0847	1.0750		
7	04-Apr-03	1.0765	1.0769	1.0680	1.0735	1.0799	1.0737		
8	07-Apr-03	1.0675	1.0703	1.0559	1.0695	1.0768	1.0658		
9	08-Apr-03	1.0680	1.0724	1.0642	1.0708	1.0713	1.0689		
10	09-Apr-03	1.0722	1.0784	1.0675	1.0773	1.0701	1.0739		
11	10-Apr-03	1.0771	1.0830	1.0760	1.0789	1.0720	1.0788		
12	11-Apr-03	1.0786	1.0787	1.0692	1.0755	↑	↑		
13	14-Apr-03	1.0727	1.0811	1.0717	1.0772	↑	ModifiedClose=(O+H+L+C)/4		
14	15-Apr-03	1.0776	1.0821	1.0737	1.0797	↑	∴		
15	16-Apr-03	1.0793	1.0920	1.0784	1.0915	↑	G11=AVERAGE(B11:E11)		
16						↑			
17						ModifiedOpen=(prev.MO+prev.MC)/2			
18						∴			
19						F11=(F10+G10)/2			

You can easily know the calculation method of modified candle from the sample worksheet. The High and Low is the same as in a normal candle. The difference is in the Open and Close. The Modified Close is just a simple average of the day's Open, High, Low and Close (See cell G11 on the worksheet). The Modified Open is a little complicated. It is an average of previous Modified Open and previous Modified Close (See cell F11 on the worksheet). But you may ask what about Day 1? How do you know its previous day's range? On Day 1 we use the Modified Close as both the Modified Close and Modified Open. This make very little difference to long term charts. However, there might be some slight difference in the formations for each period for very short term charts.

by Yasuji Yamanaka

...Continued in the Nov/Dec 2003 issue of "chartpoint" magazine