

Working Money™



Candlesticks vs Bar Charts

When you look at your charts, do you understand everything they're telling you?

by Rudy Teseo

Most books and articles on candlestick charting point out that any patterns occurring in bar charts (cup with handle, head and shoulder, triangle, and so forth) are also identifiable in candlestick charts. The reverse is also true: Any pattern that can be identified in candlestick charts can be seen in bar charts (Figure 1). However, traditional technical analysis references do not illustrate nor

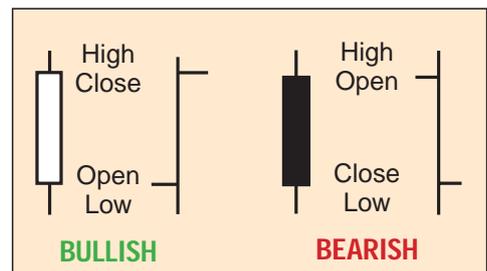
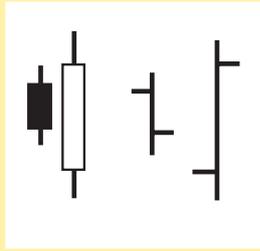


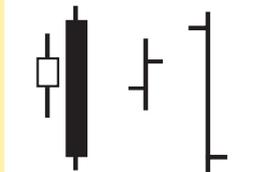
Figure 1: Candlesticks vs. bars.

CANDLESTICK/ OHLC CONVERSION



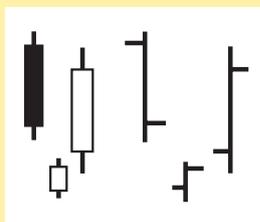
BULLISH ENGULFING PATTERN

At first glance it may look like an outside day, but that is misleading. In a bar chart outside day, the range of the second day exceeds the range of the first day. In the candle pattern, only the range of the open/close is relevant. This is a very bullish pattern and often needs no confirmation. It follows a downtrend and signifies the beginning of a reversal.



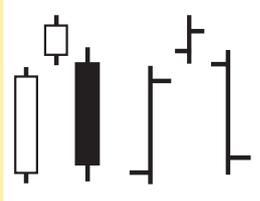
BEARISH ENGULFING PATTERN

This is the bearish counterpart of the bullish engulfing pattern. Occurring in an uptrend, it forecasts a bearish reversal.



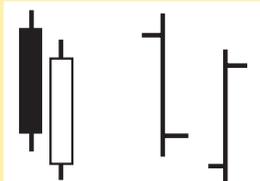
BULLISH MORNING STAR

This is another bullish reversal pattern. Following a downtrend, the star (second day) indicates a potential bottom; therefore, a bullish reversal. If the star is a doji (see below), this becomes a more significant pattern. The third-day open bar confirms the reversal. A gap before and after the star is a more bullish pattern.



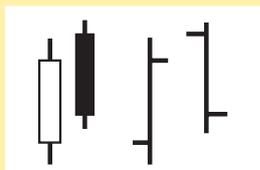
BEARISH EVENING STAR

This is the bearish counterpart of the morning star. Following an uptrend, it forecasts a bearish reversal. The same comment applies if the second day is a doji and if there are gaps.



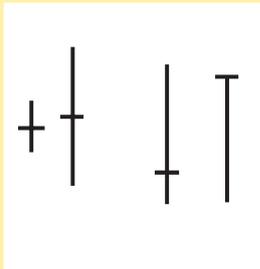
BULLISH PIERCING LINE

Another bullish reversal pattern. The second day opens lower than the previous day's low but closes above the midpoint of the previous day's open/close range. This is one of the few patterns that uses the high/low range rather than the close/open range.



BEARISH DARK CLOUD COVER

This is the bearish counterpart of the piercing line. The second day opens above the previous day's high but closes below the midpoint of the previous day's open/close range. This pattern also uses the high/low range.



DOJI

This pattern is the same in both systems. It denotes indecision — a possible turning point. The stock opens, then may have a wide or narrow range above or below the open, then closes at the open price. It can, therefore, be bullish or bearish, depending on whether it occurs in an uptrend (bearish) or a downtrend (bullish). A double doji (two adjacent dojis) implies a very forceful breakout following the indecision.

Figure 2: Table of bar/candlestick conversion.



Figure 3: Candlesticks with patterns labeled.



Figure 4: Bar chart version. Can you see the similarities?

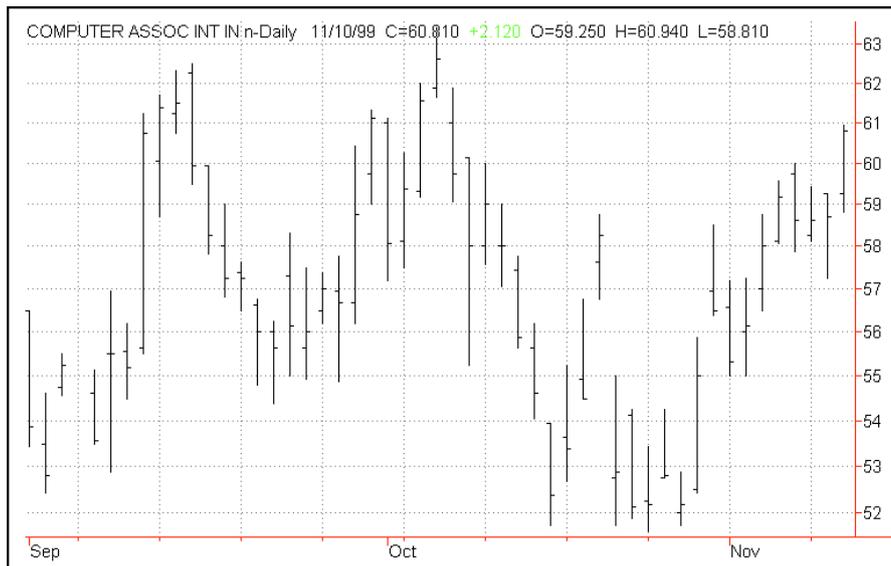


Figure 5: Try it.

A rose is a rose is a rose, and a bullish harami is a bullish harami, whether you're looking at a candlestick chart or a bar chart.

explain candlestick patterns, although they go into great detail on bar pattern analysis.

Mind you, I'm not trying to talk you into switching entirely to candlesticks. But I *would* like to suggest that a limited study of selected candlesticks and their corresponding bar charts will make you aware of patterns that you've seen but not attached any importance to. A rose is a rose is a rose, and a bullish harami† is a bullish harami, whether you're looking at a candlestick chart or a bar chart. But since standard bar chart-oriented texts do not illustrate or explain these patterns, it's unlikely you would recognize them.

As a bar chart user, you are familiar with key reversals, inside and outside days, isolated highs and lows, and many other common patterns touted in general technical analysis books and magazine articles. But there are other, equally important patterns you should consider adding to your repertoire. (I'm speaking here of patterns made up of two, three, or four individual bars — not flags, pennants, triangles, and the like.)

ACTION IN GRAPHIC FORM

A candlestick is merely a different form of graphic representation of the day's stock price action. Candlesticks and bars both portray the open-high-low-close (OHLC) of the stock's price, as can be seen in the sidebar, "Candlestick/OHLC conversion." One of the most significant reversal candlestick patterns is the *doji*. It looks the same

Try to forecast what's about to happen. Would you buy? Would you sell?

in both systems because it is merely a *cross*, meaning the open and close of the day were the same. This is an indication of indecision and, therefore, a forewarning of a possible reversal of the current trend. You've probably seen it many times without realizing its significance, since it isn't usually covered in your traditional textbook on technical analysis.

Figure 2 shows the corresponding bar patterns of several candlesticks. The brief analysis explains what each pattern is trying to tell us. There are approximately 65 recognized candlestick patterns, roughly 75% reversal patterns and 25% continuation patterns. I've only shown the most popular here, those that are always included in magazine articles or book appendices (as a rule merely introductions to the candlestick method). Make a copy of Figure 2 and refer to it as you analyze your charts. See if these new patterns tell you a different story than you would have come up with if you had ignored them. If you find this exercise worthwhile, see the suggested readings for complete coverage of all the candlestick patterns.

To illustrate that candlestick patterns exist even if you're looking at bar patterns, Figure 3 displays a candlestick chart with the patterns identified. Figure 4 is the same chart, but with bars replacing the candlesticks. At Figure 3 point A, a bearish engulfing pattern emerges immediately after a hanging man, which is another bearish reversal. A minor downturn follows. At point B, a bullish engulfing pattern signals a possible upturn, which then occurs. Shortly into the upturn we find an evening star at point C, which is followed by a downturn. The next pattern, at point D, is a morning star where the star is a doji and, as expected, another upturn is soon under way.

After studying Figures 2 and 4, see if you can identify any of these candlestick patterns in Figure 5.

Of course, the patterns will not look exactly like those in Figure 2 because of the different ranges of the bars in Figure 4. However, the relationship of the open and close ticks will be the same, and that is what defines patterns. Perhaps the up and down movement of the price bars will give you a clue as to the type of pattern you would expect to find. To test yourself, place a sheet of opaque paper over the graph

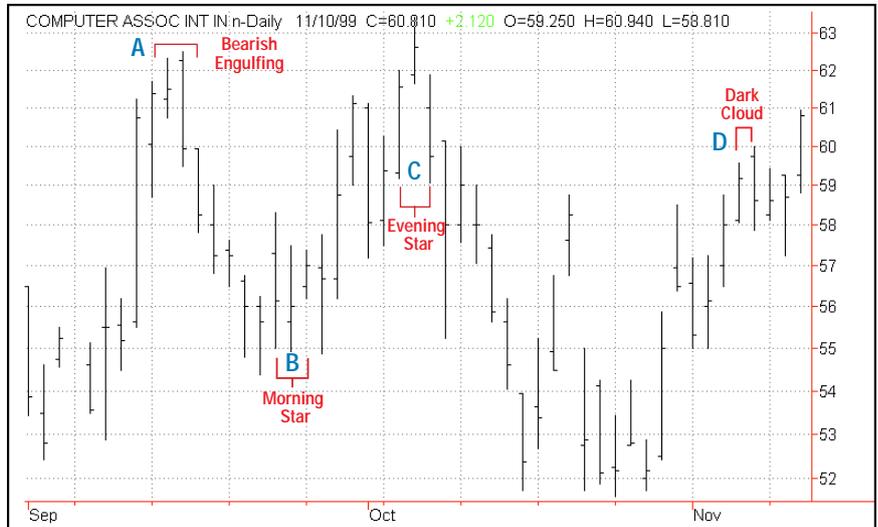


Figure 6: How did you do?

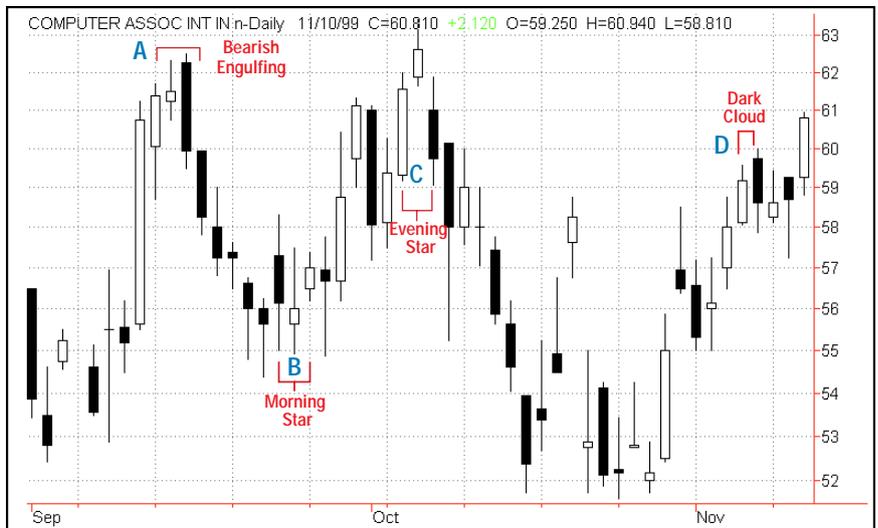


Figure 7: Did you find candlestick charts easier to use than bar charts?

and then slowly move it to the right, exposing the bars one by one to simulate daily updating. Try to forecast what's about to happen. Would you buy? Would you sell? When you're finished, refer to Figures 6 and 7 to see how you did.

There is one danger if you follow these suggestions: you may become a candlestick convert.

Rudy Teseo is a retired communications and computer consultant. He has also taught courses in investing, technical analysis, and options trading.

SUGGESTED READING

Morris, Gregory L. [1995]. *Candlestick Charting Explained: Timeless Techniques For Trading Stocks And Futures*, McGraw-Hill.

Nison, Steve [1991]. *Japanese Candlestick Charting Techniques*, New York Institute of Finance/Simon & Schuster.



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