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Forex: Introduction to Price Action Trading Strategy

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1.Foreign Exchange(FOREX)

Foreign Exchange (forex or FX) is the trading of one currency for another. Rather, the forex market is an electronic network of banks, brokers, institutions, and individual traders (mostly trading through brokers or banks).

How **does forex trading work**?

Forex trading is the simultaneous act of buying one **currency** while selling another. The combination of these two currencies make up **what's** known as a **currency** pair. Currencies are always **traded** in pairs, and each **currency** in a pair is represented by a unique three-letter code.

What is forex used for?

Forex markets exist as spot (cash) markets as well as derivatives markets offering forwards, futures, options, and currency swaps. Market participants use forex to **hedge against international currency and interest rate risk**, to speculate on geopolitical events, and to diversify portfolios, among several other reasons.

I. BASIC TERMS AND MEANING

BROKER: A forex broker is **a financial services company that provides traders access to a platform for buying and selling foreign currencies**. ... Transactions in the forex market are always between a pair of two different currencies. A forex broker may also known be as a retail forex broker or a currency trading broker.

RISK: . Also known as currency risk, FX risk and exchange-rate risk, it **describes the possibility that an investment's value may decrease due to changes in the relative value of the involved currencies**. Investors may experience jurisdiction risk in the form of foreign exchange risk.

MANAGEMENT: Forex risk management comprises **individual actions that allow traders to protect against the downside of a trade**. More risk means higher chance of sizeable returns – but also a greater chance of significant losses.

TAKE PROFIT(TP): This is **a type of pending order that is placed to close a profitable position once the market reaches a specific price**. As the name suggests, it allows the trader to set a predefined level to lock in any profits. In other words, it takes the profit as it closes the position.

STOP LOSS(SL): A forex stop loss is a **function offered by brokers to limit losses in volatile markets moving in a contrary direction to the initial trade**. This function is implemented by setting a stop loss level, a specified amount of pips away from the entry price.

REWARD: The Forex risk reward ratio is **a metric that traders use to calculate how much they are risking in the market for how large of a reward**. If you are planning or desire to get a payout of $30 from your trade, that means that your reward ratio coefficient is 3, because 30/10 is 3.

RATIO: The Forex risk reward ratio is **a metric that traders use to calculate how much they are risking in the market for how large of a reward**. Usually, traders would set risk reward ratios of 1:3, 1:2, or anything along those lines. Let's say that you are trading with $10 and putting it all in one trade.

SUPPORT(DEAMND):Support occurs when falling prices stop, change direction, and begin to rise. ... Resistance is often viewed as a "ceiling" keeping prices from rising higher. If price breaks support or resistance, the price often continues to the next level of support.

RESISTANCE(SUPPLY): Resistance is **a price level where rising prices stop, change direction, and begin to fall**. Resistance is often viewed as a "ceiling" keeping prices from rising higher. If price breaks support or resistance, the price often continues to the next level of support or resistance.

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CANDLESTICS: A candlestick is **a type of price chart used in technical analysis that displays the high, low, open, and closing prices of a security for a specific period**.

INDICATOR: Forex Technical Analysis Indicators are usually **used to forecast price changes on the currency market**. They are calculations which take the volume and price of a certain financial instrument into account. By using Forex indicators, traders can make decisions about market entry and exit

PRICE: Forex prices are displayed in the form of **a Bid/Ask spread**. The spread is the difference between the Bid and the Ask. The Bid price or sell price of a currency pair is always the lower price in a quote. The Ask, also sometimes referred to as the 'Offer', is the price at which traders are able to buy a currency pair.

SIGNALS:A forex signal system is a set of analyses that a forex trader uses to generate signals determine whether to buy or sell a currency pair at any given time. A forex trading signal is **essentially an alert for traders to either enter or exit a position (go long or go short)**. Forex signals are often based on specific times and prices and can be identified through technical or fundamental analysis. It is up to the trader to then decide whether or not to act on the signal.

PATTERN: Forex chart patterns, which include the head and shoulders as well as triangles, **provide entries, stops and profit targets in a pattern that can be easily seen**. The engulfing candlestick pattern provides insight into trend reversal and potential participation in that trend with a defined entry and stop level.

BEARISH/SELL/SHORT: Being bearish in trading means **you believe that a market, asset or financial instrument is going to experience a downward trajectory**. Being bearish is the opposite of being bullish, which means that you think the market is heading upwards.

BULLISH/BUY/LONG: means **an investor believes a stock or the overall market will go higher**. Bullish traders believe, based on their analysis, that **a market will experience an upward price movement**. Being bullish involves buying an underlying market – known as going long – in order to profit by selling the market in the future, once the price has risen.

PATTERN: Forex chart patterns, which include the head and shoulders as well as triangles, **provide entries, stops and profit targets in a pattern that can be easily seen**. The engulfing candlestick pattern provides insight into trend reversal and potential participation in that trend with a defined entry and stop level. Patterns are the distinctive formations created by the movements of security prices on a chart and are the foundation of technical analysis. A pattern is identified by **a line that connects common price points, such as closing prices or highs or lows**, during a specific period of time.

SPREAD: The forex spread is **the difference between a forex broker's sell rate and buy rate when exchanging or trading currencies**. Spreads can be narrower or wider, depending on the currency involved, the time of day a trade is initiated, and economic conditions. In **forex** trading, the **spread** is the difference between the bid (sell) price and the ask (buy) price of a currency pair. There are always two prices given in ...

LEVERAGE: Leverage is **the use of borrowed funds to increase one's trading position beyond what would be available from their cash balance alone**. ... Forex traders often use leverage to profit from relatively small price changes in currency pairs. Leverage, however, can amplify both profits as well as losses.

STRATEGY: A forex trading strategy is **a technique used by a forex trader to determine whether to buy or sell a currency pair at any given time**. ... The trader's currency trading strategy is usually made up of trading signals that trigger buy or sell decisions.

MOVEMENT: **Foreign exchange movements are** those movements in the accounts/market between periods which are wholly attributable to movements in the exchange rates at the different points in time. **Before deciding what approach to take forex investors need to define the basics of their strategy, including what currency pairs to trade.**

MARKET: The **foreign exchange** (forex) market is the largest financial market in the world and is made up of banks, commercial companies, central banks, investment management firms, hedge funds, and retail forex brokers and investors.

TREND: A trend is **a tendency for prices to move in a particular direction over a period**. Trends can be long term, short term, upward, downward and even sideways. Success with forex market investments is tied to the investor's ability to identify trends and position themselves for profitable entry and exit points. **The direction and momentum of the price of a security or other asset**. For example, if the price of a security is going mainly downward with only a few inconsistent gains, it is said to be on a downward price trend.

II. FOREX TRADING ACCOUNT

FOREX TRADING ACCOUNT:

A foreign exchange account, or Forex account, is used **to hold and trade foreign currencies**. Typically, you open an account, deposit money denominated in your home country currency, and then buy and sell currency pairs. Your purpose, of course, is to make money on your trades.

2.1 TYPES OF TRADING ACCOUNT:

There are three common types of Forex trading account:

1. The standard
2. The mini and
3. **The micro**.

Each type of account has corresponding requirements. Take the time to know about each type before choosing the right one.

2.1.1 THE STANDARD TRADING ACCOUNT:

A **Standard Forex Account** is denominated in US Dollars and forex trade transactions are placed using standard forex lots. One standard forex lot is 100,000 units of currency. One forex lot is also known as a one forex contract. Minimum opening capital for a standard forex account - at least $10,000 USD. It is not recommended to open a standard forex trading account unless you have an account balance of at between $10,000 minimum and $50,000. Professional Money Managers recommend $50,000 Dollars minimum to open this standard forex trading account and only opening 1 or 2 forex lots maximum per every $50,000 dollars you have in your forex account. However, most online forex brokers will still open this standard forex trading account for you if you have more than $10,000. If an exchange rate for EURUSD is quoted at 1.4000, then the smallest forex trade transaction available in a standard forex trading account is worth $140,000 of currency to buy 100,000 EUR. With forex leverage of 100:1, this is only $1,400 of your money and the rest of the money you will borrow from your forex trading broker (with forex leverage of 100:1, your forex broker gives you $100 dollars for every $1 dollar that you have, therefore for this forex trade transaction using only $1,400 of your forex trading capital, the forex broker will give you $100 dollars of forex leverage for every $1 dollar you have, meaning after forex leverage you will have $1,400*100=$140,000 which you can then buy 1 standard forex lot of EURUSD).

For Standard Lots Minimum Price Movement of 1 pip = $10

2.1.2 THE MINI TRADING ACCOUNT:

Mini accounts that trade $10,000 lots can only produce $1 per pip of movement as opposed to $10 in a standard account. This type of account is recommended for beginning forex traders or those looking to dabble with new strategies. Forex Trading Account Meaning - Mini Forex Account. A Mini Account is an account that allows investors and forex traders to make trades using mini forex lots. A forex mini lot is equivalent to $10,000 which is one-tenth that of a forex standard lot. Forex brokers offer forex mini lots as a way to attract investors who do not have a lot of capital - as the minimum required starting capital for opening a mini forex account is about $1,000 USD. Mini forex lots are similar to standard forex lots; however, forex mini lots are traded in lots of 10,000 units of currency rather than 100,000 units. This lowers the initial deposit required to open a mini forex account and offers better risk management for investors without a lot of trading capita**l.**This forex mini account is recommended for those forex traders with only a few thousand dollars as trading capital. If an exchange rate for EURUSD is quoted at 1.400, then the smallest forex trade transaction size available in a mini forex account is worth $14,000 used to buy 10,000 EUR. With forex trading leverage of 100:1, this is only $140 of your trading capital and the rest of the money you will borrow from your forex trading broker (with forex leverage of 100:1, your forex broker gives you $100 dollars for every $1 dollar that you have, therefore for this forex trade transaction using only $140 of your forex trading capital, the forex broker will give you $100 dollars of forex leverage for every $1 dollar you have, meaning after forex leverage you will have $140*100=$14,000 which you can then buy 1 mini forex lot of EURUSD). A mini forex trading account is suitable for account equity balances between $5,000 and $10,000. The trade transaction

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lots are smaller so the forex traders without enough capital to open standard forex lots have better money management for their forex account equity balance.

For Mini forex account - Minimum Price Movement of 1 pip = $1

2.1.3 THE MICRO TRADING ACCOUNT:

orex Trading Account Meaning - Micro Forex Account. Micro Forex Accounts use lot sizes of only 1,000 currency units. These Micro forex trading accounts are often appropriate for investors and forex traders without a lot of trading capital and can sometimes be opened with only a $100 minimum balance. This Micro forex account option is generally best suited for account equity balances that are between $1,000 and $5,000 .This Micro forex trading account option allows the forex trader to open forex trades in micro forex lots. 1 forex micro lot is one-tenth of a forex mini lot and one-hundredth of a forex standard lot. If an exchange rate for EURUSD is quoted at 1.400, then the smallest forex trade transaction available in a micro forex trading account is worth $1,400 used to buy 1,000 EUR. With forex leverage, this is only $14 of your money and the rest of the money you will borrow from your forex trading broker (with forex leverage of 100:1, your forex broker gives you $100 dollars for every $1 dollar that you have, therefore for this forex trade transaction using only $14 of your forex trading capital, the forex broker will give you $100 dollars of forex leverage for every $1 dollar you have, meaning after forex leverage you will have $14*100=$1,400 which you can then buy 1 micro forex lot of EURUSD).

For Micro forex account - Minimum Price Movement of 1 pip = $0.1

N/A: In Forex, **one forex lot** is the standard transaction minimum of a given currency pair. But many forex brokers offer fractions of this standard forex lot to enable more retail forex traders to access the forex market. Being able to offer forex mini lots and forex micro lots reduces the minimum forex trade transaction size thus giving the forex beginner traders and also those forex traders without a lot of capital to start investing to get a feel of the foreign exchange market without investing a lot of trading capital.

There is learn forex online tutorials that a beginner forex trader can read even before opening a real forex trading account, and to get extra practice in forex trading before opening a live forex trading account - a beginner forex trader should open a practice**Forex demo trading practice account** with a forex broker - so as to practice placing forex trade transactions before opening a real forex trading account and investing with real money.

During the forex training period using the forex demo practice trading account, the beginner forex trader will learn the key factors needed to succeed in forex trading such as; forex education, forex money management, forex trading plan and forex trading systems.

The types of Forex trading strategies used and the skills required for any of these 3 forex trading accounts are essentially the same - those forex trading skills and forex trading strategies required for the Standard Forex Account or Mini Forex Account or Micro Forex Account are the same, the only difference to be adjusted are the**forex money management rules**for each forex trading account type

2.2 KEY THINGS TO KNOW CONCERNING YOUR FOREX TRADING ACCOUNT

1. Balance
2. Equity
3. Free margins
4. Margin level (%)
5. Margin

BALANCE:

When trading, the balance **refers to the amount of money a trader has in their trading account**. However, it's important to remember that this amount does not include any profits or losses a trader might have from any open positions.

EQUITY:

Equity refers to **the amount of money a trader has in their trading account** (i.e. their Balance) plus or minus any profit or loss from open positions. If, however, the trader doesn't have any open positions, his or her equity is equal to his or her balance.

FREE MARGINS:

Free Margin is simply **the money in a trading account that is available for trading**. To calculate Free Margin, you must subtract the margin of your open positions from your Equity (i.e. your Balance plus or minus any profit/loss from open positions).

MARGIN LEVEL(%):

Margin Level indicates how “healthy” your trading account is. It is **the ratio of your Equity to the Used Margin of your open positions**, indicated as a percentage. ... A good way of knowing whether your account is healthy or not

is by making sure that your Margin Level is always above 100%.

MARGIN:

Margin means **trading with leverage**, which can increase risk and potential returns. The amount of margin is usually a percentage of the size of the forex positions and will vary by forex broker. In forex markets, 1% margin is not unusual, which means that traders can control $100,000 of currency with $1,000.

2.3 SIMPLE ANALYSIS OF YOUR FOREX TRADING ACCOUNT

DAY1: Let assume that you just open a FOREX trading account and deposit $1000 into the account. Your forex trading account will be;

Balance: $1000.00
Equity : $1000.00
Free margin: $1000.00

Then after your initial deposit you decide to open the following three positions;

GBPUSD
EURUSD
AUDJPY

Let assume all the three currency pairs are running with the following profits/loss using **0.05 lot size.**

GBPUSD(0.05) = 50.00USD
EURUSD(0.05) = -35.00USD
AUDJPY(0.05) = 16.00USD

This is how your current trading account will look like with the running trade above

Balance: $1000.00
Equity: $1,031.00
Free margin will be reducing according to the lot size used.

Your current trading balance can only be sum to **$1,031** if eventually you choose to close those running positions as at that profits/loss recorded.

This is the reason why **RISK MANAGEMENT** is very necessary in forex trading.

DAY2: Assuming trading day2 you start with the following;

Balance : $1,031
Equity : $1,031
Free margin : $1,031

And you start taking the following positions with **0.10 lot** size running trades,

USDJPY(0.10) = 15.01USD
GBPAUD(0.10) = -22.05USD
CADJPY(0.10) = 6.00USD
GBPUSD(0.10) = 48.42USD
AUDUSD(0.10) = -62.05USD and the positions above are running trades. New trading account will be;

Balance : $1,031
Equity : 919.49

Free margin will certainly be dropping and if suddenly you close all the positions with the above record of profits/loss your new trading account will be;

Balance : 919.49
Equity : 919.49
Free margin : 919.49

When opening position(s), this is how to calculate and arrive at your free margin

- Subtract the margin of your open positions from Equity
- Free margin = your balance + or - any profit/loss from opening positions/running trades.

Example :

- If you have a margin call set at 40% and your account balance is **$8000.00** and you have incured or loss your trades up to **$4520** and eventually you have used up **$1000** of margin, your level would be;

$$\text{Free margin} = \frac{\$8000 - 4520}{\$1000 \times 100}$$

$$= \frac{3,480}{1000 \times 100}$$

Therefore;

- **Free margin = 348%**

If your free margin drop furthermore by another **80%,** you would reach **40%** and receive a margin call from your broker.

III. INTRODUCTION TO PRICE ACTION

Price action describes **the characteristics of a security's price movements**. In simple terms, price action is a trading technique that allows a trader to read the market and make subjective trading decisions based on the recent and actual price movements, rather than relying solely on technical indicators.

Price action is **the raw price data of a market — without indicators**. ... Price action analysis is a simpler and sometimes more accurate way to make the right decision. By combining this guide to Forex price action analysis with forex

trading tools, you'll have a good grasp of trends and how to manage your money

3.1.0 CANDLESTICK SIGNALS AND PATTERNS

Candlestick Signals and Patterns A typical candlestick has one body and two shadows. The body shows the open and close prices. In bullish candles, the close price is higher than the open price. In bearish candles, the close price is lower than the open price.Candlestick charts are a technical tool that packs data for multiple time frames into single price bars. This makes them more useful than traditional open-high, low-close bars or simple lines that connect the dots of closing prices. Candlesticks build patterns that predict price direction once completed. Proper color coding adds depth to this colorful technical tool, which dates back to 18th-century Japanese rice traders.

Steve Nison brought candlestick patterns to the Western world in his popular 1991 book, Japanese Candlestick Charting Techniques. Many traders can now identify dozens of these formations, which have colorful names like bearish dark cloud cover, evening star, and three black crows

To distinguish the bullish and bearish candles from each other, they are displayed with different colors. Usually, bullish candles are white or green, and bearish candles are black or red. In both of the bullish and bearish candles, the upper shadow shows the high price, and the lower shadow shows the low price. That was the anatomy of the typical candlesticks in simple words. However, candlesticks can have several different shapes and patterns. Each shape and pattern has a different signal that tells the traders what to do. Candlesticks are great indicators. Many of the professional traders use nothing but candlesticks to trade. Doji forms when the open and close prices are virtually equal. A Doji candlestick looks like a cross, inverted cross or plus sign. Doji means that bulls or buyers, and bears or sellers are well matched, and none of them is stronger than the other one. Therefore, Doji means indecision. It means after a Doji the trend can be continued, reversed or starts moving sideways. If you have a position, you'd better to close it and collect your profit when a Doji is formed. Look how many Doji candles we have on EUR/USD daily chart (watch the video). Many of them worked as a reversal signal. The price continued its way after many others. The price kept on going up after this Doji. The price reversed after a few Doji candles formed here (shown in the video). The majority of Japanese candlestick signals are reversals. Hammer and Hanging Man are reversal candlestick signals. They have long lower shadows and small bodies. Surprisingly, It doesn't matter whether these candles are bullish or bearish. When you find one on a downtrend, it is signal that the trend is near to an end. We call it "Hammer" when formed on a downtrend. A similar candle on an uptrend signals that the uptrend is close to an end. We call it "Hanging Man" when formed on an uptrend.5 Although these candles are known as reversal signals, it is better to wait for a confirmation when they are formed. It means, when a hanging man is formed on an uptrend, we have to wait for a bearish candle to form after that, to go short. It is the same with hammer. When formed on a downtrend, we have to wait for a bullish candle to form after that, to go long. Inverted Hammer and Shooting Star are the inverted types of "Hammer" and "Hanging Man". However, they are weaker signals. They also need confirmation. High-Wave is a Doji candle with long upper and lower shadows. A group of High-Wave candles form a strong reversal signal. The Engulfing Pattern forms by two candles. There are two kinds of Engulfing Pattern. In Bearish Engulfing Pattern a small candle with a bullish body is completely covered by the body of the next candle which has a big bearish body. "Bearish Engulfing Pattern" on an uptrend is a strong reversal signal that means the uptrend is ended and will reverse. It is a good chance to go short. In Bullish Engulfing Pattern a small candle with a bearish body is completely covered by the body of the next candle which has a big bullish body. Bullish Engulfing Pattern" on a downtrend is a strong reversal signal that means the downtrend is ended and will reverse. It is a good chance to go long. Dark Cloud Cover is a bearish reversal pattern. Like "Bearish Engulfing" pattern, it forms with two candles. The second candle opens a little above the close price of the first candle, and goes down and closes a little above the open price of the first candle. Dark Cloud Cover forms on uptrends and is a strong reversal pattern. Piercing Line is the bullish form of "Dark Cloud Cover" pattern. It forms on downtrends, and is a reversal pattern. The second candle opens a little below the close price of the first candle, and goes up and closes a little below the open price of the first candle. Harami is another reversal candlestick pattern that forms by two candles. There are two kinds of Harami. Bullish Harami forms on downtrends. And, Bearish Harami forms on uptrends. In Bullish Harami a large candlestick is followed by a smaller candlestick, while the body of the smaller candle is located within the vertical range of the larger

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body.6 In terms of candlestick colors, the bullish harami is a downtrend of negative-colored or black candlesticks, engulfing a small positive or white candlestick, giving a sign of a reversal of the downward trend. In Bearish Harami a large candlestick is followed by a smaller candlestick, while the body of the smaller candle is located within the vertical range of the larger body. In terms of candlestick colors, the Bearish harami is an uptrend of positive-colored or white candlesticks, engulfing a small negative or black candlestick, giving a sign of a reversal of the upward trend. The Harami is not a reliable reversal pattern, but it is a useful warning. When a Harami forms while you are already in a position, you should move your stop loss to a proper position, not to lose your profit if the trend reverses. "Harami" means pregnant. The reason is that the first candle with the second one, which is smaller, look like a pregnant woman. The smaller the second candle, the stronger the "Harami" signal is. When the second candle is a Doji, the pattern is called "Harami Cross", which is stronger than the regular Harami. Morning Star is a three candle pattern. This pattern forms on downtrends. The first candle should be a Bearish candle with a considerable body. The second candle is a small candle that is formed lower than the first one. This candle can be Bearish or Bullish. The third candle is a Bullish candle that is formed higher than the second one, and its body covers a significant portion of the first candle. "Morning Star" is called Evening Star when formed on an uptrend. The effectiveness and potency of the Morning Star and Evening Start patterns as reversal signals is dependent on some special factors that have to be considered. The distance (gap) between the morning or evening star with the first and third candlesticks. The bigger gap, the stronger signal. The degree of the coverage of the first candlestick by the third one is also important. The bigger the coverage, the stronger the signal. Sometimes, the Morning or Evening Star is a Doji candlestick. Again in this case, the most important thing is the gap between the first and third candlestick and the Doji.7 Sometimes, the Morning or Evening Star is a very small candlestick with small or no shadows. The gap is so big and even none of the candlesticks shadows cover any part of the Morning or Evening Star. This pattern is called Abandoned Baby which is a very strong reversal signal. Because of the high volatility, this pattern is very rare in the forex market and can only be seen in bigger time frames, but it can be seen in the stock market in smaller time frames like one hour. Abandoned baby can be seen both at the top of an uptrend or bottom of a downtrend. Tweezers is made up of two candlesticks that are next or so close to each other. They have identical highs at the top of the market or identical lows at the bottom of the market. The Tweezers usually becomes formed by the candlesticks shadows but it can also be made by the bodies of the shaven candlesticks. The two candlesticks that form Tweezers can have small bodies like Doji and Hammer candlesticks. Tweezers can not be considered as a strong reversal signals and it needs confirmation but you have to be careful when you see a Tweezers signal. The longer the shadows, the more weight we should give the Tweezers. Tweezers that are formed right under resistance lines or above the support lines, are important, specially when they are made up of two Doji candlesticks. The longer the shadows, the more potent the Tweezers signal. It is also possible that you see a few or even several candlesticks between the two candlesticks that form the Tweezers pattern. Even in this case you should not ignore the Tweezers as a potential reversal signal. When there are several candlesticks between the two that make the Tweezers pattern, they may form Double Tops or Double Bottoms patterns that show the levels of resistance or support. How to Trade the Candlestick Signals and Patterns? First, you have to wait for the candlestick signals and patterns to form completely. Then you take the proper position and set the stop loss. It is strongly recommended to wait for the confirmation candle to form. With the candlestick signals that need confirmation, you take the position after the confirmation candle. In case of long positions, the 8 stop loss has to be below the open price of the confirmation candle. In case of short positions, the stop loss has to be set above the open price of the confirmation candle.

3.1.1 HIGH WAVE CANDLESTICKS AND THEIR REVERSING PATTERN

High Wave Candlesticks and Their Reversing Power "High Wave" is a candlestick with a small body and long shadows. However, "High Wave" is known as a candlestick pattern by some traders. They say "High Wave" is a group of consecutive candlesticks with small bodies and long upper/lower shadows. I like to know "High Wave" as a candlestick pattern, because it is more applicable in practical trading. Therefore, in this post I consider high wave as a pattern, not as a single candlestick. We traders like to have something that shows us the best entry point. It is not only that. We like to know where the best place is to set the stop loss, and also where the best place is to collect the profit and exit the market.

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Candlestick patterns are great to show us the entry, SL and exit points. They are on time and reliable, if we wait for the strong ones to form. "High Wave" is a very strong reversal pattern. It tells us that sooner or later the market will reverse, and we can take the advantage of a strong movement. "High Wave" also helps us set a reasonable stop loss which is usually tight enough to let us have a x3 or even x5 target. Therefore, "High Wave" is a nice reversal pattern for trading. It is also good to know that they are so frequent in the forex market. Let's analyze one of the markets and see how "High Wave" showed the market reversal in two occasions. On the GBP/CAD daily chart there are two sets of "High Wave" candles. They formed when the market started ranging while it was strongly going up before. In both cases, they clearly indicated that the market would reverse, and it really did. When the first set formed, the market was going down, but suddenly it changed the direction and went up for over 550 pips. When the second set started forming, the market was going up for several candles, but suddenly changed the direction and a big and long bearish candle formed. In fact the second set is a newly formed signal

Now the question is when is it the best time to enter when a high wave is formed? There are a few ways to enter when a high wave is formed. One way which is a little riskier is that you enter when a few high wave candles form consecutively. You set your stop loss a little below the high wave candles low price if you go long and visa versa. This is a riskier way, because you enter when the confirmation candle still is not formed. For example, if you wanted to trade the above two high waves with this method, it would be like this: For the first set, the entry would be at the close of the 2014.02.10 or 2014.02.11 candle on the daily chart. For the second set, the entry level would be at the close of the 2014.06.19 candle on the daily chart:11

Source: signal forcast fx

The other way which is a little harder, but less risky is that when a high wave forms on a time frame, you switch to a shorter time frame, locate a support (when you are waiting to go short) or resistance (when you are waiting to go long) and wait for its breakout. This gives more credit to the high wave pattern and when the support or resistance is broken you can take your position with more peace of mind. Besides, your stop loss can be more reasonable and tighter and your target can be wider. This method is much harder because you have to monitor the market for a longer time, and it is possible that you miss the chance to enter. I prefer the first method. It is riskier, but we can lower the risk by taking a smaller position. There is another way too. When a high wave forms at the bottom of a bear market, you set a buy stop order few pips above the high price of the high wave candles. Therefore, when the market reverses and starts going up, you will have a long position if the price breaks above the high price of the high wave candles. It is the same when a high wave forms at the top of a bull market. You should set a "sell stop" below the low price of the high wave candles.12 There are a few more things that you have to know about the high wave pattern:

1. The longer the shadows and the smaller the bodies of the high wave candles, the stronger and more reliable the reversal power.
2. The number of high wave candles to form a high wave reversal pattern should be at least three. Usually after 3-6 candles the market will reverse.

Why High Wave Is a Reversal Pattern?

"High Wave" forms when the market has been going up or down for a while. This "while" can be a few to several candles. Usually after going up or down for a while, the market goes to an

"indecision situation", because - for example - when the market is bullish, many of the bulls stop buying and many of them start closing their positions and collecting their profit. They ask themselves whether the market will keep on following the same direction or it will reverse. This means indecision, and it is while the Doji candles that have small or no body and long shadows will form. A few of these candles means creates fear of losing of the profit. And it is the time that most of the position holders close their positions to collect their profit. And so, the market will reverse. That is why they say the candlesticks reflect the psychological situation of the markets. Now, try to locate some high wave candles/patterns on different markets and explain why they caused the markets to reverse. What would you do it you were to trade the high wave patterns you locate? When would you set your stop loss and target orders?

3.1.2. ANALYSIS OF STRONG PIERCING LINE AND BULLISH ENGULFING CANDLESTICK PATTERNS.

In our trading strategy, we only take the strong candlestick patterns that meet some special requirements. We ignore the other candlestick patterns. I had to talk about the Dark Cloud Cover and Bearish Engulfing Candlestick Patterns in two separate articles, because they are more frequent on the Forex market. To have a better understanding of the strong Piercing Line and Bullish Engulfing patterns, I suggest you to read my Dark Cloud Cover and Bearish Engulfing articles first, because Piercing Line and Bullish Engulfing Patterns are the bullish forms of the Dark Cloud Cover and Bearish Engulfing Patterns. In this article, I am going to explain about the strong Piercing Line and Bullish Engulfing patterns. These patterns form less frequently compared to the bearish patterns, maybe because bulls are not used to attack as aggressively as bears, but usually bears' attack is sudden and strong, and this sudden and strong attack ends to the engulfing of the previous candlesticks by a big and strong bearish candlestick. The reason is the bears' attack is because of fear, but bulls' attack is because of greed. Fear comes suddenly and aggressively, whereas greed is a milder emotion. Piercing Line Candlestick Pattern Piercing Line is the bullish form of Dark Cloud Cover. It is a bullish reversal pattern. It is "bullish", because it makes the price go up, when it forms. It is "reversal", because it forms at the bottom of the bear markets, and makes the price reverse. This pattern forms by two candlesticks. The first candlestick has to be a bearish candlestick. The second candlestick has to be a bullish candlestick that opens a little below the close price, and closes below the open price of the first candlestick. If it goes up and closes above the open price of the first candlestick, then it will not be called Piercing Line, and it is Bullish Engulfing pattern, which is even stronger than Piercing Line.31 Please look at the below chart. Candlestick #1 which is the first candlestick in Piercing Line pattern, is formed by on EUR/USD daily chart. The second candlestick which is the main candlestick in Piercing Line pattern, and indeed is the candlestick that forms the pattern, is a bullish candlestick. As you see, the second candlestick is opened a little below the close price of the first candlestick. Additionally, it has engulfed some part of the first candlestick's body, but is closed below the open price of this candlestick. So this is a Piercing Line pattern.

3.1.3. FEATURES OF A STRONG BEARISH ENGULFING CANDLESTICK PATTERN

What Are the Features of a Strong Piercing Line Pattern?

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

Like Dark Cloud Cover Pattern, a Piercing Line Pattern has to meet some requirements to be known as a strong candlestick pattern.

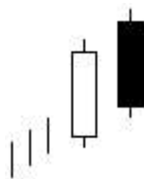
1. The first candlestick has to be a relatively big bearish candlestick. The longer the first candlestick, the stronger the pattern and the signal.
2. The second candlestick which has the main role in formation of the Piercing Line Pattern, has to be a relatively big bullish candlestick that engulfs most part of the first candlestick's body. The more it engulfs, the stronger the pattern.
3. A Piercing Line Pattern which has met the above three requirements has to be formed where bears are not very strong. It has to form where bears look exhausted, and they don't have the the full control.

If a Piercing Line Pattern with the above three conditions forms at the bottom of a too strong bear market, then it has to be ignored, because it is too risky to go long at the bottom of a too strong bear market.

3.1.4. DARK CLOUD COVER AND PIERCING LINE CANDLESTICK PATTERNS IN FOREX TRADING

Dark Cloud Cover is a bearish candlestick pattern. It means when it forms at the top of an uptrend, the uptrend can reverse and go down after that. Dark Cloud Cover forms by a bearish candlestick that opens above the close price of the previous bullish candlestick.

The bearish candlestick goes down and covers most part of the body of the previous bullish candlestick. It finally closes a little above the open price of the previous candlestick



Below is a Dark Cloud Cover pattern formed on GBP/CAD daily chart:

Piercing Line is the bullish form of Dark Cloud Cover pattern. It forms at the bottom of a downtrend or a bear market. It forms by a bullish candlestick that opens below the close price of a bearish candlestick. The bullish candlestick goes up and covers most part of the body of the bearish candlestick. It finally closes a little below the open price of the previous bearish candlestick. A good and strong Piercing Line Pattern on GBP/CAD Daily chart:

These two patterns, Piercing Line and Dark Cloud Cover, are reversal patterns, but not all of them can be taken as reliable trade setups. Therefore, you have to learn how to choose the best and strongest patterns to trade.

3.1.5. FEATURES OF A STRONG DARK CLOUD COVER CANDLESTICK PATTERN

"Dark Cloud Cover" is among the candlestick patterns that I love, maybe because so far it has created a lot of profitable trade setups, and so many great opportunities for me. So many candlestick patterns form on the price charts every day. However, those that are good to take and make money with are not more than a few. "Dark Cloud Cover" is one of them. In this article, I am going to explain what "Dark Cloud Cover" is, how it forms, and above all, I am going to explain under what condition "Dark Cloud Cover" should be taken as a strong trade setup. We have explained about this pattern in some of the other articles. Therefore, we have to explain about the Dark Cloud Cover pattern in details, because it is a very important candlestick pattern for us.

"Dark Cloud Cover" is a bearish reversal candlestick pattern. It is a "bearish" pattern, because it is a signal that indicates the beginning of a downward movement. I mean when it forms on the chart, we know that most probably the price will go down. It is a "reversal" pattern, because when it forms at the top of an uptrend, or after a few or few bullish candlesticks, the price usually changes its direction. When it forms at the top of an uptrend, this pattern is the bulls exhaustion's signal indicating an incoming bearish attack. "Dark Cloud Cover" consists of two candlesticks. The first one has to be a bullish candlestick, and the second one which is the main candlestick in this pattern, has to

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

be a bearish candlestick.58 The second candlestick has to open a little above the close price of the first candlestick. Then it has to go all the way down and close somewhere above the open price of the first candlestick. Look at the below screenshot. It is showing a typical examples of Dark Cloud Cover pattern formed by candlesticks on GBP/CAD daily chart. Candlestick #1 which is the first candlestick in this Dark Cloud Cover pattern, has closed at 1.8506. Candlestick #2 which is the second and the main candlestick in our Dark Cloud Cover pattern has opened at 1.8507, which is one pip above the close price of the first candlestick. In Dark Cloud Cover patterns, usually the second candlestick opens several pips above the close price of the first candlestick, but this is not that important. The most important thing to have a Dark Cloud Cover pattern is that the second candlestick closes above the open price of the first candlestick, otherwise the pattern cannot be called a Dark Cloud Cover anymore. If it closes below the open price of the first candlestick, it is called Bearish Engulfing Pattern which is a strong bearish reversal pattern also. In the below example, the first candlestick is opened at 1.8386, and the second is closed at 1.8394, which is 8 pip above the open price of the first candlesticks. So this is a Dark Cloud Cover pattern.

It is very easy to locate so many Dark Cloud Cover patterns on the price charts and on different time frames. However, not all of them are good enough to be known as a trade setup. Many of them are weak and can not be trusted, and so we should not enter the market based on them. To go short, we need Strong Dark Cloud Cover patterns. Look at the below chart, which is the same GBP/CAD daily chart I showed you above.60 The difference is that in the below chart there was three more Dark Cloud Cover patterns marked at left side of the chart. And at the right, we have the same typical Dark Cloud Cover pattern that I showed you above. It is the strong Dark Cloud Cover pattern we need to go short:

Source: FxKeys.com

What is the difference of the Dark Cloud Cover Patterns at the left, and the one at the right side of the above chart? Why are the left patterns weak, but the pattern at the right, strong? What Makes a Dark Cloud Cover Pattern Strong enough to be known as a trade setup? There are some requirements that make a Dark Cloud Cover Pattern Strong When a Dark Cloud Cover pattern meets all of these requirements, then it can be known as a strong pattern, otherwise it has to be skipped:

1. The first candlestick has to be a big bullish candlestick. The bigger the first candlestick, the better.
2. The second candlestick which is indeed the Dark Cloud Cover candlestick, has to be a big bearish candlestick that covers over 90-95% of the first candlestick's body. When such a Dark Cloud Cover pattern forms, it should be known as a strong bearish candlestick pattern compared to the other Dark Cloud Cover patterns already formed on that chart. However, there is one more requirement that I am going to add to the two above requirements.

It is true that when a Dark Cloud Cover pattern meets the above requirement, it is a strong Dark Cloud Cover pattern. It is Bollinger Upper Band BreakoutIf so, we take it as a strong short trade setup. If not, we have to skip it. Now let's add Bollinger Bands indicator to the above chart and compare the four Dark Cloud Cover patterns, and see why the three patterns at the left are weak, and

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

the one at the right is strong. Please see the below chart.

Dark Cloud Cover pattern #1 doesn't meet any of the 2 requirements, because: The first and the second candlesticks are not strong enough compared to the previously formed candlesticks. The second candlestick (the bearish or black candlestick) has covered most of the first candlestick's body, but the problem is, it has closed with a relatively longer than usual lower shadow that reflects a little bit of extra bullish pressure, and this adds to the risk of going short based on this pattern. Above all, Dark Cloud Cover pattern #1 is formed below the Bollinger Middle Band which is indeed at the middle of nowhere. It has not broken out of the Bollinger Upper Band. Therefore, pattern #1 has to be skipped. Pattern #2 is formed by a strong bullish candlestick as the first candlestick of the Dark Cloud Cover pattern. The second candlestick is a relatively strong bearish candlestick too. However, (1) the first candlestick is notengulfed strongly by the second one.

(2) Additionally, none of the candlesticks have broken out of the Bollinger Upper Band.

Indeed, the first candlestick has broken above the Bollinger Middle Band, and then the second candlestick has tried to retest the broken Bollinger Middle Band, but the middle band has worked as a strong support. This is not a good sign for a short trade setup, because it reflects a high bullish pressure. Therefore, this pattern should not be known as a short trade setup. In pattern #3, the first candlestick is big and strong, but the second candlestick has not been able to engulf even 25% of the body of the first candlestick. Although both candlesticks have broken out of the Bollinger Upper Band strongly, this pattern has to be skipped too, because of the second candlestick size. Pattern #4 which is the king of Dark Cloud Cover patterns meets all of the requirements a Dark Cloud Cover pattern must meet to be considered as a strong short trade setup:

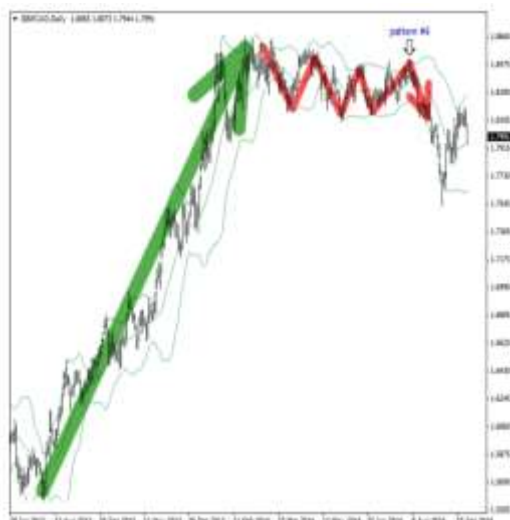
1. The first candlestick is a too big bullish candlestick.63
2. The second candlestick is a too big bearish candlestick that has engulfed more than 95% of the body of the first candlestick.
3. Both of the first and second candlesticks have broken out of the

Bollinger Upper Band strongly. Therefore, Dark Cloud Cover pattern #4 is a strong pattern by itself, and so, it is eligible to be known as a short trade setup.

This article is focused on the features of a strong Dark Cloud Cover pattern, however, to go short based on a strong Dark Cloud Cover pattern, we need to check one more condition which has nothing to do with the formed Dark Cloud Cover candlestick pattern itself, and is related to the market condition: Dark Cloud Cover is a bearish reversal pattern that indicates the beginning of a downward or bearish movement.Naturally, it has to form at the top of a bull market to be known as reversal signal and short trade setup. However, if it forms while bulls are still too strong, and uptrend is still too sharp, then a strong Dark Cloud Cover pattern like pattern #4 on the above chart, and the short trade setup it has formed, has to be ignored, because going short at the stop of a too strong bull market is stupid, and has too much risk. Dark Cloud Cover pattern #4 is a too strong bearish candlestick pattern by itself, but it has to be skipped if formed at the top of a too strong bull market.

Now, let's zoom out and see where pattern #4 is formed. Has it formed on a strong bull market, or it has formed while bulls were exhausted? According to the below chart, pattern #4 is formed when GBP/CAD market has been ranging for a long time (the thick red arrow), after a too strong uptrend (the thick green arrow). If pattern #4 was formed where the big green arrow ends, then it had to be ignored, because it is right at the top of a strong bull market there. However, pattern #4 is formed after a long sideways (ranging) market, while the range had a tendency to go down (you can see the lower highs on the range), which means bulls were getting disappointed and were converting to bears, and the market was about to be controlled by bears. That is a good condition to have a strong Dark Cloud Cover pattern formed. Therefore, pattern #4 is a

perfect short trade setup. That is why we compare all of the short trade setups we locate, with this short trade setup formed on GBP/CAD daily chart by 2014.08.05 and 2014.08.06 candlesticks.



Source: FxKeys.com

Am I saying that a strong Dark Cloud Cover that forms at the top of a too strong bull market, will not reverse the price?
Absolutely not.

Even a weak Dark Cloud Cover that forms at the top of a too strong bull market, "may" reverse the price very strongly. But, do we know this before the price really goes down, or we can only see it when the price has already collapsed? Nobody knows what will happen after formation of a trade setup, either strong or weak. We have to decide based on what is already formed on the chart. We have to analyze the conditions, and choose a good trade setup that has the minimum risk.You can go short at the top of a strong bull market, and it is possible that you make a good profit. However, those who take the risky trade setups, can not be profitable in long term. They make profit periodically, but can not be profitable consistently.
Am I saying that a strong Dark Cloud Cover that forms while bulls were already exhausted, can reverse the price definitely?
Absolutely not.

There is no guarantee that even a too strong Dark Cloud Cover formed while bulls were already exhausted, result in the price reversal and a strong bearish movement. That is why we should always set a reasonable stop loss in all the positions we take.

Source: FxKeys.com

3.1.6. HAMMER AND INVERTED HAMMER CANDLESTICKS

The Hammer candlestick looks like a hammer :) The lower shadow forms the handle and the small body forms the headThe Hammer candlestick forms at the bottom of a bear market.
Hammer is a reversal signal, but it is not that strong by itself and it needs confirmation:

Hammer is so frequent on the forex market. But, you should be careful not to go long as soon you see a Hammer at the top of a bear market, or after formation of a series of consecutive bearish candlesticks. To go long, you always have to wait for the confirmation candlestick which has to be a bullish candlestick. The bigger the body of the confirmation candlestick, the stronger the reversal long trade setup signal:

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

This is how a Hammer candlestick forms: After the formation of several bearish candlesticks on a bear market, another bearish candlestick forms. It forms a reasonable bearish body, but suddenly bulls (buyers) decide to take the control. They start buying, and so, the price goes up and the bearish body of the candlestick turns into a long lower shadow. However, still bulls are not strong enough to take the price too high, and so, the candlestick closes with a small bearish body. If bulls succeed to take the price higher when the next candlestick
opens, they form a bullish confirmation candlestick which is what we need to have a long trade setup.You can go long and set your stop loss a little below the low price of
Hammer candlestick.
The longer the lower shadow of the Hammer and also the body of the confirmation candlestick, the stronger the reversal signal and long trade setup.
Look at the below strong reversal signal that formed on EUR/USD 15min chart.
The Hammer has a too long lower shadow and the confirmation candlestick has a too long body. Therefore, this reversal candlestick pattern is very strong:

Source: FxKeys.com

3.1.7. INVERTED HAMMER

It is the inverted form of the Hammer candlestick. This candlestick closes below its open price which means bears are still strong. Therefore, its reversal effect can be weaker than the regular Hammer. However, if a strong bullish candlestick forms after an Inverted
Hammer, you can go long and set your stop loss below the close price of the Inverted Hammer candlestick.

3.1.8 HAMMER CANDLESTIC WITH BOLLINGAN BAND

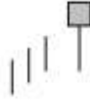
If you add Bollinger Bands to your charts, you can have more confirmation to know whether the Hammer and the confirmation candlesticks are strong enough to be taken as long trade setup, or not. If the Hammer lower shadow breaks out of Bollinger Lower Band strongly, then the long trade setup is stronger. In the below chart, the first Hammer candlestick has broken out of Bollinger Lower Band very strongly. Then the confirmation candlestick(s) form a few candlesticks after, and so, the long trade setup forms. As you see, the price goes up very strongly. The second Hammer candlestick also breaks out of Bollinger Lower Band, but not as strong as the first Hammer. The confirmation candlestick forms right after the Hammer. The price still goes up, but not strongly, because bulls were already exhausted.
The third Hammer hasn't broken out of Bollinger Lower Band strongly.
It is because the bulls' pressure was not strong enough, and so, no confirmation candlestick formed. Therefore, the third Hammer candlestick hasn't formed a long trade setup.

Source: FxKeys.com

Please note that the typical form of the Hammer candlestick doesn't have an upper shadow. However, on the Forex market, most of the Hammer candlesticks have a small upper shadow too. This is because the Forex market is very volatile and the price fluctuation is usually very strong.

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

3.1.9 HANGING MAN



Hanging Man is a Hammer candlestick that forms on a bull market. It means Hammer forms after some bearish candlesticks and it is considered as a reversal signal on a bear market. But Hanging Man forms after some bullish candlestick and it is considered as a reversal signal on a bull market. In spite of this, Hanging Man and Hammer candlesticks' shapes are the same. Therefore, it is better to learn about the Hammer candlestick first and then read about the Hanging Man. Hanging Man is a reversal candlestick, however like Hammer it has to be confirmed. It means you shouldn't go short right when you see a Hanging Man formed at the top of a bull market. A confirmation candlestick has to be formed first. The confirmation candlestick has to be a bearish candlestick. The bigger the bearish body of the confirmation candlestick, the stronger the reversal signal. When the Hanging Man and its confirmation is formed, you can go short and place your stop loss above the open price of the Hanging Man. When you see the confirmation candlestick is not strong enough, you can simply ignore the signal and wait for another trade setup. Do not lose your money on weak signals.

Source: FxKeys.com

On the below chart, you can see Hanging Man that has formed at the top of a bull market (the big green arrow) on EUR/USD weekly chart. A typical Hanging Man candlestick doesn't have an upper shadow. However, you can hardly find a typical Hanging Man on Forex market because it is so volatile and the price fluctuation is high, and so, a candlestick with no upper shadow can hardly form. As you see, the price reverses after the Hanging Man and the confirmation candlestick:

3.2.0. BULLISH ENGULFING AND BEARISH ENGULFING CANDLESTICK PATTERNS IN FOREX MARKET

3.2.1 Bullish Engulfing Candlestick Pattern

Bullish Engulfing pattern forms on the forex market very frequently. Like Bearish Engulfing Pattern, Bullish Engulfing pattern is a too strong reversal pattern. This pattern has to form at least by two candlesticks. The first candlestick has to be a bearish candlestick, and the second candlestick has to be a bullish candlestick that goes all the way up and engulfs the body of the first candlestick. Sometimes when the first candlestick is not that long, the second candlestick goes up and engulfs the body of a few of the previously formed candlesticks including the first candlestick. The below chart shows a strong Bullish Engulfing pattern formed on GBP/CHF daily chart. As you see, this candlestick is formed as a too strong bullish candlestick, and it has engulfed the body of several previously formed candlesticks.

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

A Bullish Engulfing pattern is strong when...

1. The bullish candlestick which is the main candlestick in the Bullish Engulfing Pattern closes with a long body, and it engulfs the body of the first candlestick and preferably a few of the previously formed candlesticks.
2. The second candlestick and preferably the previous candlesticks, or at least the first candlestick breaks out of the Bollinger Lower Band strongly. As you see on the above chart, the bullish candlestick is not only long enough (it has engulfed several previous candlesticks), but it has broken out of Bollinger Lower Band strongly. Two of the previously formed candlesticks have broken out of Bollinger Lower Band also. Therefore, the above pattern is a strong Bullish Engulfing Pattern. However, a strong Bullish Engulfing Pattern will be known as a strong long trade setup, if it forms when the bears are already exhausted, not 41 when the bears are still too strong at the bottom of a too strong downtrend.

What Is "Bearish Engulfing" Candlestick Pattern?

"Bearish Engulfing" is a bearish reversal candlestick pattern. It is "bearish", because it forms on bull markets, and is a signal that indicates the price reversal. It is the beginning of a down or bear movement. It is "reversal", because it reverses the uptrends. Bearish Engulfing Pattern consists of at least two candlesticks, but sometimes there are more than a few candlesticks involved in this pattern. In Bearish Engulfing pattern, at least one bullish candlestick has to form, that we call it the first candlestick. Then the next candlestick has to go all the way down to engulf the whole body of the first candlestick. It has to close either at the open price of the first candlestick, or below it. It doesn't matter where the second candlestick opens. It can open above the close price of the first candlestick or below it. Something that matters is that the second candlestick completely engulfs the body of the first candlestick. If the second candlestick opens above the close price of the first candlestick, and then it doesn't cover the whole body of the first candlestick, it still is a Bearish Engulfing Pattern, but we specifically call it Dark Cloud Cover.

Bearish Engulfing and Dark Cloud Cover patterns are so similar to each other. Sometimes either the first candlestick is not that big, or the second candlestick is too big, and so, the second candlestick not only engulfs the body of the first, but also one or a few of the candlesticks before. In this case, more than two candlesticks are involved in the Bearish Engulfing Pattern. From the above explanations, it is clear that in Bearish Engulfing pattern, the second candlestick is the main candlestick, and indeed it is the candlestick that forms the pattern. A typical example of a Bearish Engulfing Pattern can be found in the below screenshot. Of course there are some more Bearish Engulfing Patterns on the same screenshot too, but the one that is formed by the 2010.11.05 candlestick (#2) is stronger and looks like a typical sample of a strong Bearish Engulfing Pattern. As you see, the second candlestick has completely engulfed the body and lower shadow of the first candlestick, and also the body of the candlestick before (candlestick #0)

EXAMPLES BEARISH ENGULF PATTERN CANDLESTICK ARE SHOWN BELOW;

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

When Is a Bearish Engulfing Pattern Strong Enough to Be Taken as a Short Trade Setup?

You can locate so many Bearish Engulfing Patterns on the price charts, but you have to know which one can be known as a short trade setup, otherwise you can lose money. Like a strong Dark Cloud Cover pattern, a strong Bearish Engulfing pattern has to meet some requirements to be known as a "Strong Short Trade Setup" by us:

1) The Second Candlestick Size The second candlestick is the most important part of a Bearish Engulfing Pattern. Indeed, it is the second candlestick that creates the pattern. The second candlestick in a Bearish Engulfing Pattern has to be a too long bearish candlestick. It has to engulf the body of the first candlestick completely. In case the first candlestick is not that big, 47 then the second candlestick has to be long enough to engulf the body of a few of the previously formed candlesticks, like the candlestick #2 on the above chart that has engulfed two previous candlesticks. The above requirement ensures that the Bearish Engulfing Pattern is strong by itself. When the second candlestick is long enough to engulf the body of the first or a few of the previous candlesticks, then we have a strong Bearish Engulfing Pattern formed on the chart. However, having a strong Bearish Engulfing pattern doesn't mean that we have a "Strong Short Trade Setup" also. A strong Bearish Engulfing pattern has to meet two more requirements, to be known as a Strong Short Trade Setup.

The Weak Bearish Engulfing Patterns

Now, let me show you a few weak Bearish Engulfing Patterns. Please look at the below chart. The red arrows are pointed to the weak Bearish Engulfing Patterns. The second candlestick is too short in all of the three patterns. Besides, they've formed while the uptrend was too strong and bulls still had the full control

Below is the example of a very strong Bearish Engulfing patterns formed by on EUR/USD daily chart. As you see, it meets all the three requirements strongly:

International Journal of Advances in Engineering and Management (IJAEM)
Volume 4, Issue 7 July 2022, pp: 1226-1247 www.ijaem.net ISSN: 2395-5252

3.2.2 ABANDONED BABY CANDLESTICK PATTERN

There are some special candlesticks with special names. However, the way that some candlesticks form against each other, forms some special candlestick pattern. Abandoned Baby is one of these candlestick patterns.

Abandoned Baby is a small Doji candlestick (a candlestick without body.) The difference is this small Doji forms at the top of an uptrend or bottom of a downtrend. But there is a distinguishable gap between this candlestick, the previous candlestick and the next candlestick. That is what they call the candlestick pattern Abandoned Baby. It is because it looks like a small candlestick that is left alone. The gap has to exist, otherwise the pattern can not be called Abandoned Baby anymore. Abandoned Baby is a reversal pattern. It means when it forms on a trend, the trend will change the direction most probably. But it doesn't necessarily mean that the whole trend will change. Sometimes this pattern forms at the top of a small up movement which is formed inside a downtrend. And then after forming of the pattern, the up movement will be finished and the downtrend will be continued.

3.2.3 BULLISH AND ABANDONED BABY CANDLESTICK

An Abandoned Baby that forms at the bottom of a downtrend is called Bullish Abandoned Baby. And, the one that forms at the top of an uptrend is called Bearish Abandoned Baby:

As Forex market is volatile and liquid and is open 24 hours a day, I have rarely seen Abandoned Baby pattern forms on any of the time frames. On Forex market, Doji candlesticks usually have long shadows, and so you can't see any gap between the previous and the next candlestick. That is why it is really hard to see an Abandoned Baby pattern forms on the Forex market. Therefore, here I show you a real example from the stock market. Below, is a Bullish Abandoned Baby that has formed on Genzyme General daily chart. As you see, the market has been going down before the candlestick pattern forms. But it changed its direction and went up strongly after the pattern formed. The market has been moving above a support level for few days before the formation of the candlestick pattern.

Below is a Bearish Abandoned Baby that has formed at the top of an uptrend on Delta Air Lines daily chart. In this example, the gap between the previous and next candlesticks is more visible and distinguishable.

The bigger the gap, the stronger the pattern in its reversal impact on the market.

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3.2.4 INSIDE DAY CANDLESTICK AS A STRONG REVERSAL PATTERN

Those of you who have been trading stocks should be familiar with this name: "Inside Day Candlestick" .Inside Day is a candlestick pattern. Although it hardly forms on the price charts, it is usually very strong reversal signal.

Bollinger Bands indicator can be used to empower this signal. We don't have to have Bollinger Bands on the charts to recognize this pattern. But Bollinger Bands helps a lot in locating and taking this pattern as a reversal signal. This is what even the most professional stock traders also admit. Many of them also use Bollinger Bands to locate and trade the "Inside Day Candlestick".

What Exactly Is The "Inside Day" Candlestick?

Do you remember Harami and Harami Cross patterns? "Inside Day" is exactly the same. In fact, "Inside Day" is the second candlestick (the baby) in the Harami pattern which is engulfed by the previous candlestick (the mother). Like all the other patterns like Dark Cloud Cover, here we need two candlesticks to have the pattern formed. However, with the "Inside Day" pattern, in fact the second candlestick is the "Inside Day" candlestick. American stock traders know the Harami pattern as "Inside Day Candlestick".

Why The Second Candlestick (THE BABY) Is Called "INSIDE DAY"?

Those traders who traded the daily chart, chose such a name for the second candlestick in the "Inside Day" or Harami pattern. Of course you can see the pattern in all time frames too, and it works on them as a strong reversal signal as well, but it is called "Inside Day" because it was initially used on the daily time frame. I recommend you to trade this pattern on the daily or longer time frames too. They call the second candlestick as "Inside Day", because it is small enough to be entirely engulfed by the previous candlestick (the mother candlestick in the Harami pattern). It means, the Inside Day Candlestick's high and low prices fall within the high and low price range of the previous day candlestick. The below screenshot shows 4 inside day candlesticks on EUR/USD daily chart. There are a few more Inside Day Candlestick on this screenshot, but I am just showing you 4 of them. See the below screenshot first, and then we add Bollinger Bands to the chart:

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It is a big to have Bollinger Bands on the chart to choose the best Inside Day pattern as a reversal signal. So many other professional stock and currency traders also emphasize on having Bollinger Bands on the charts to trade the Inside Day candlestick. Jamie Saettele is one of them. According to Jamie Saettele, Inside Day works as a good reversal signal when there is a visible Bollinger Upper or Lower band breakout either by the first candlestick (the mother), or the second candlestick (the baby), or preferably both. He says when the price hits Bollinger Upper or Lower Band on the daily chart, then we can wait for an "Inside Day" candlestick to form. While the candlesticks are hitting the Bollinger Upper or Lower Band, if a candlestick opens and closes while its high and low price range falls inside the previous candlestick's high and low price range, then we have an Inside Day Candlestick, and we can take a position.

This is how the above chart looks after adding Bollinger Bands:

Therefore, according to what Jamie Saettele says, only the candlestick #1 and #3 should be considered and taken as a reversal signal. Candlestick #2 formed on Bollinger Middle Band. It reversed the price strongly but it did not follow our Bollinger Bands breakout rule. Candlestick #4 and its previous candlestick did not hit Bollinger Upper Band, and so they had to be ignored (the trade setup is not complete). However, if you took candlestick #3 as a proper and complete trade setup to go short, then candlestick #4 would follow your position and can be known as the complementary trade setup that proves that you have the right position. The below chart shows two strong Inside Day candlesticks formed consecutively at the bottom of a bear market. It is an interesting screenshot, because it shows one inside day candlestick formed (#1) 88 and then another one that formed inside the first inside day candlestick (#2). There is a nice and strong Bollinger Lower Band breakout, both by the first candlestick (the mother), and the first inside day (#1). There is another inside day candlestick which is marked with ~ symbol on the below chart. Although it is engulfed by the previous candlestick, it has to be ignored because neither the previous nor the inside day candlestick have not hit the Bollinger Lower Band:

How To Use Inside Day Candlestick To Trade?

When you locate an inside day candlestick on the daily chart, while there is a good and visible Bollinger Band breakout too (the way you learned above), you enter at the close of the inside day candlestick (which is the open of the next candlestick) If formed on a bull market while hitting the Bollinger Upper Band, you go short, set the stop loss several pips above the high price of the inside day candlestick, or preferably above the high price of the previous candlestick (the mother). If formed on a bear market while hitting the Bollinger Lower Band, you go long, set the stop loss several pips below the low price of the inside

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day candlestick, or preferably below the low price of the previous candlestick. The target can be at least x2 or x3 of the initial stop loss size. If the Inside Day candlestick you locate is the beginning of a strong trend, then you can make up to x10 of your stop loss size.

Why Does The Price Changed It's Direction When The Inside Day Candlestick Form?

What is the reasoning behind this? Before you read the answer I have given to this question below, think about the question and see if you can answer it. I give you a clue: candlesticks reflect the psychology of the markets (buyers and sellers).

Answer

When the price is moving up strongly and several bullish candlesticks are formed, it means traders are buying and money is being flooded to the market. All of a sudden, when a candlestick forms "inside" the high/low range of the previous candlestick, it means traders have stopped buying as strongly as they were used to during the previous days and the money that was injected into the market was not enough to take the price higher than yesterday's high. It means buyers have started changing their minds, and now they are thinking about selling what they had bought, or no new buyer is being added to the market. Some of the buyer have already started to sell to collect their profit. So the price will go down the next day after the Inside Day is formed. There is the same reasoning behind forming of an Inside Day candlestick on a bear market.

This is very easy to understand, isn't it? Now, it is your turn to do your homework.90 Locate the Inside Day Candlesticks on EUR/USD or other currency pairs daily, weekly and monthly charts. We can call it Inside Week and Inside Month candlesticks on the weekly and monthly time frames :)

Consider the Bollinger Bands breakout too. See how you would trade the Inside Day patterns you locate. "Inside Day" candlestick is enough as the only trading system you choose. It forms on the currency pairs daily charts frequently enough for all of us to make money. To locate the Inside Day pattern, you only need to check the daily chart once every day when the new daily candlestick is opened. Have this pattern in your trading arsenal and enjoy the steady stream of profit.

IV. TYPICAL PRICE ACTION TECHNICAL ANALYSIS CHARTS SHOWN BELOW;

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