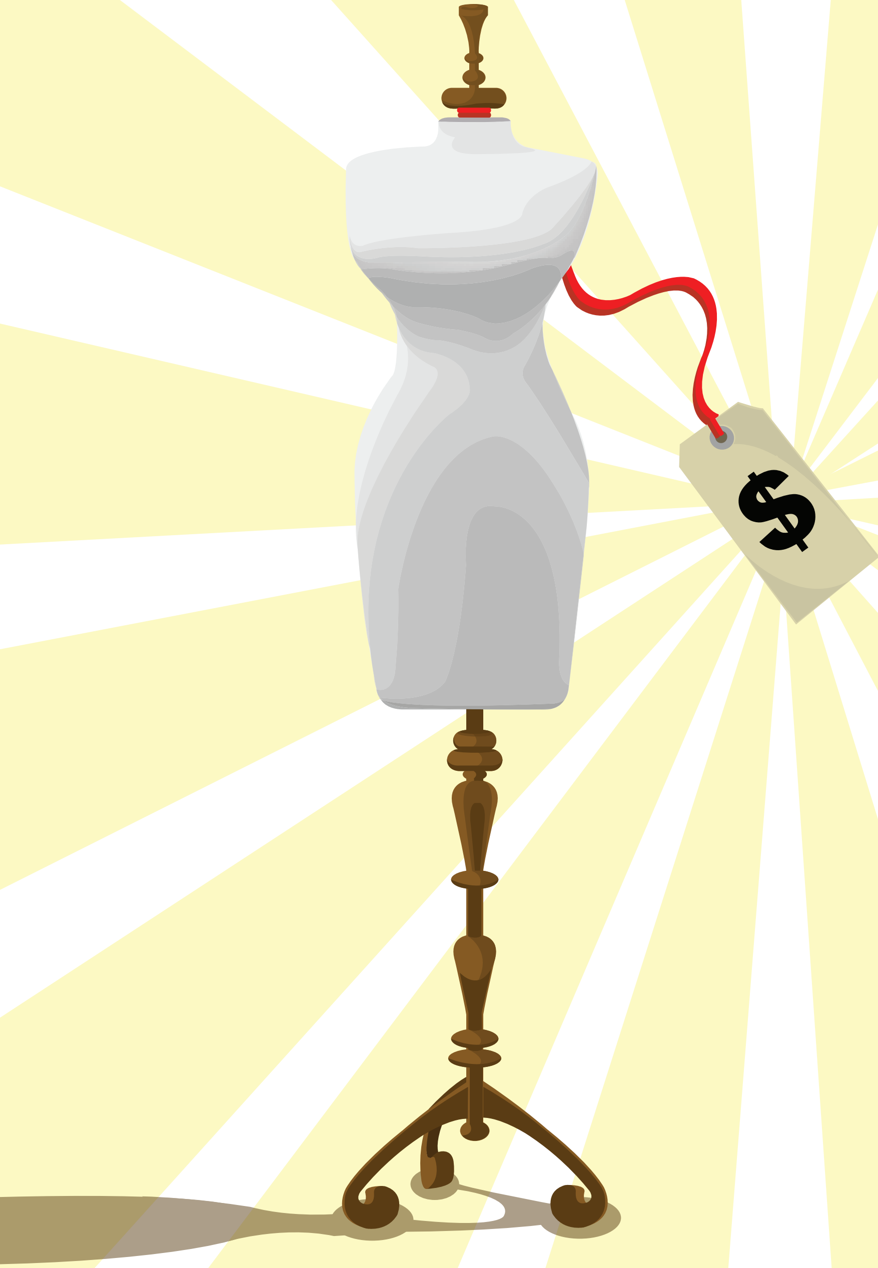


Go Naked With Price

Price is the Key to Market Sentiment

By Soh Tiong Hum

Go naked with price. Why Naked? We're not talking about selling a position we don't own. Neither are we suggesting streaking during the F1 race. If I got your attention, this article is about a minimalistic approach to chart reading by using candlesticks to understand market sentiment.

Many newcomers to trading based on chart reading cannot resist experimenting with technical indicators. Technical indicators offer simplicity by producing buy and sell indicators. After all, it is easier to follow than to make decisions. If it were so easy, why is the list of technical indicators still growing? Is it because nobody has found a good one? I hope that I have served some food for thought.

There are many sophisticated trading strategies but many of those that work consistently have some common features including:

1. Capture the sentiment or mood of the market and act in the same direction as the flow.
2. Work on price–based information, usually candlesticks as well as support and resistance levels.
3. Use price action as confirmation; candlesticks are employed for this purpose by looking at the closing price.
4. Indicators only serve a secondary function, usually as filter.

MASTER CHART READING BY GOING NAKED

For those reasons above, a group of professional traders go 'naked'. That is, they take away indicators and focus on price alone. Their belief is price alone offers the fastest and most reliable indication.

They use the following:

1. Candlesticks.
2. Support and resistance levels.
3. Chart patterns.
4. Wave patterns and Fibonacci ratios.

I would like to discuss all of them but for this article, let's look at the use of candlesticks.

THE OLD YARDSTICK

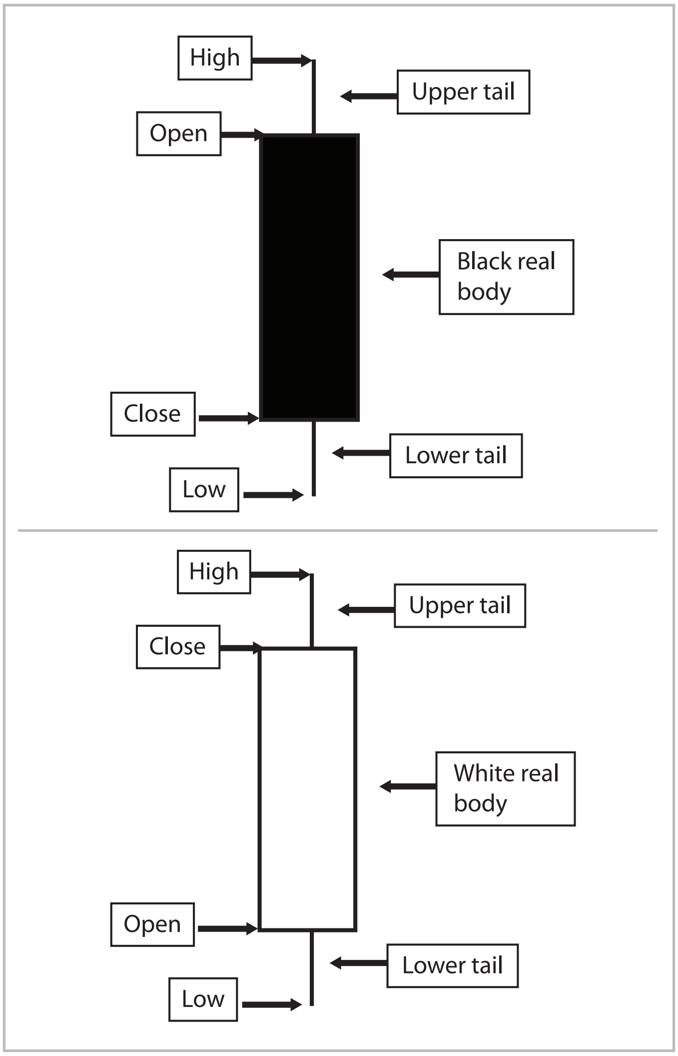
Candlesticks may the oldest documented form of technical analysis. Its development was credited to Japanese rice merchant Homma Munehisa (1724 – 1803). In 1755, Homma wrote the first book on market psychology and in this book, he claims that the psychological aspect of the market was critical to trading success.

Candlesticks are very easy to read and incorporates opening, closing, high and low prices. These four pieces of input tell us immediately the emotional state of the market that is, bullishness, bearishness or indecision. They are also color coded so that the emotion of the market stands out visually.

Let's look at the illustration to the right:
Each candlestick contains four pieces of information.

1. **Open** – First transacted price at the open of each trading period
2. **Close** – Last transacted price at the close of each trading period
3. **High** – Highest transacted price during the trading period; this price is often associated with the power of bulls as it is the highest level that bulls are able to push price to
4. **Low** – Lowest transacted price during the trading period; this price is often associated with the power of bears as it is the lowest level that bears are able to push price to

As mentioned earlier, candlesticks are color coded. If close price is lower than open, the market is bearish. Therefore bearish candles are often coded with black or red color although different users may customize their own charts to use other colors. If close price is higher than open, then the market is bullish and the candlestick is likely to be colored in white or green.



CANDLES GALORE

There are many types of candles depending on the length of each tail or body. There are colorful names with different implications but the most important information candlesticks provide is the emotion of the market. Readers can follow some simple rules to read candlesticks:

1. Candlesticks give a lot of clue of underlying sentiments in the market.
2. Candles with long bodies show decisive price movement; long white candles show strong rallies while long back candles show steep falls in price.
3. Candlesticks with small bodies but long tails tell of struggle; they indicate the to–and–fro struggle between bulls and bears to establish direction but in the end the small body suggests indecision.
4. Short candles indicate a lack of volatility in the market; they can mean indecision due to lack of ideas or just the calm before an important event.
5. Candlesticks give the strongest indication of market sentiment when they occur near to critical support or resistance levels.
6. Candlesticks can be used to validate support and resistance.
7. Candlesticks are used in the equities market, forex market, commodity market and derivatives trading.
8. Candlesticks can be used from trading periods as short as one second to as long as a month; most commonly encountered are daily candles that depict the open, high, low and close of a single day's trading.

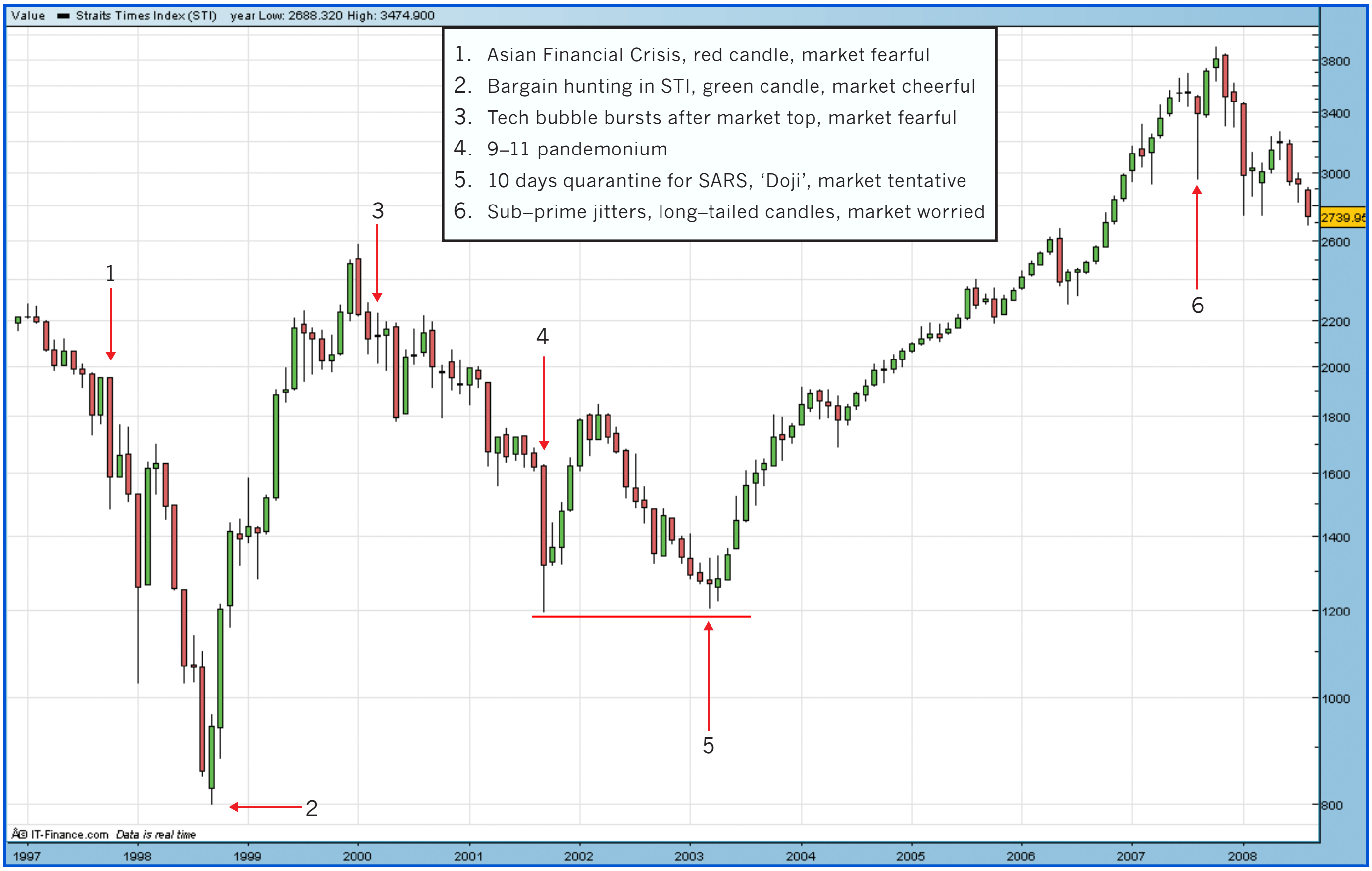


ILLUSTRATION USING A CHART OF THE STRAITS TIMES INDEX

The chart shows the STI going back to December 1996. Each candlestick shows Open, High, Low and Close price for one month.

Look at the chart while following the table of events below. While you do so, try to identify the mood of the market at that time and see if you can capture the feeling through each candle. Now before we start, recall that the red candles are bearish and green candles are bullish. Ready? Let's see how well you can apply candlesticks.

Events affecting the STI in chronological order:

1. October 1997 – Asian Financial Crisis spills over to Taiwan and Hong Kong. Three months earlier, the crisis started in Southeast Asia. The long red candle shows the importance of the Hong Kong and Taiwan financial market to market participants.
2. September 1998 – The STI reaches a low of 800.22 points. The big green candle indicates bargain hunting.
3. March 2000 – The tech bubble bursts on the March 10, 2000. There was prior warning since market already fell two months ahead.
4. September 2001 – The event on 9–11 created a huge sell–down. See the big red candle.
5. March 2003 – Singapore invokes the Infectious Diseases Act to combat SARS. The candle for this month is called a 'Doji'. The small body but long tails indicates that bulls and bears struggle to find a direction. The low here also coincided with the low level set by the September 11 tragedy. Two months after, the green candle indicates that the support level is agreed and market is confident to rally.
6. In the months following August 2008, the STI chart shows a series of candles with long tails. This gives market watchers insight of the struggle between bulls and bears and market participants determine whether the sub–prime crises will affect the STI.

ADVANCED CONCEPTS OF CANDLESTICKS

Whatever that I have covered of candlesticks until here are cursory at best. There is definitely a lot more to learn. I hope that this article has ignited some interest on your part to find out more about candlesticks. They are widely used by experts and can be highly rewarding. Once you look at a chart and can tell a story about the sentiment of the market, I think you are in the right direction. The moment you can tell what's going at the moment, you can make plans. If you are lost, take action to find out more.

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