



NeoTrader

Certified Market Xpert



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About Our Founder

Hello! I am Dr. CK Narayan, the Founder of NeoTrader. I am multi decade veteran of the financial markets and have seen many market cycles and been part of all businesses associated with the financial markets- such as stockbroking, market making, retail and Institutional sales (including FII's). I have practiced technical analysis for over four decades and have been conferred with the Life Time Achievement for TA award from ATMA in 2015. I have also been trading and investing actively in the markets all thru those years. All these have given me a unique 360 degree perspective on the markets that I have now brought forth in the form of an outstanding piece of software called NeoTrader.

In NeoTrader I have digitized all my knowledge and experience and wisdom and coded those into formats that are easily usable by individual traders and investors and advisors and the general public too.

NeoTrader therefore carries the essence as well as details of my analysis formats and the different trading and investing methods



I have designed over the years - all coded into simple, easy to follow structures. This can help any kind of market player - from newbie to professional - to master the difficult endeavour of market analysis and successful trading and investing.

Message from the Cofounders.



Hello there! We are absolutely thrilled to bring you India's #1 Analysis and Trading Software – NeoTrader. Along with our Founder, Dr C K Narayan, India's finest technical analyst, we have strived to digitize and code the vast, endless knowledge base of our Founder and strung everything together in the form of Algos that create Analysis Process as well as Trading Strategies that make life in the markets an absolute zip for everyone who uses NeoTrader.

Not only does NeoTrader create Readymade

trades but it also gives ready-to-use Processed Information that can help the user arrive at quick decisions in the market. Everyone knows that speed is of essence in the markets. Our decisions have to be made fast and the execution has to be even faster!

With NeoTrader, our focus has been just that! How to analyse some situation swiftly so that the decision to buy or sell can be made without hesitation and action taken on the same with complete confidence such that it shall carry high probability of success.

We invite you to find out for yourself the power of NeoTrader. It seeks to eliminate analysis clutter and sharply reduce your time and efforts to arrive at trading and investing decisions.

There's also a lot more! And there will be many more in future versions.

NeoTrader- India's #1 Trading and Analysis software – there will simply be nothing like it out there!

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CHAPTER 1:

Introduction

The methods used to analyze securities and make investment decisions fall into two very broad categories: fundamental analysis and technical analysis. Fundamental analysis involves analyzing the characteristics of a company in order to estimate its value. Technical analysis takes a completely different approach; it doesn't care one bit about the "value" of a company or a commodity. Technicians (sometimes called chartists) are only interested in the price movements in the market.

In other words, technical analysis attempts to understand the emotions in the market by studying the market itself, as opposed to its components. If you understand the benefits and limitations of technical analysis, it can give you a new set of tools or skills that will enable you to be a better trader or investor.

CHAPTER 2:

Basic Assumptions

What Is Technical Analysis?

Technical analysis is a method of evaluating securities by analyzing the statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

Just as there are many investment styles on the fundamental side, there are also many different types of technical traders. Some rely on chart patterns; others use technical indicators and oscillators, while still others use more esoteric methods of past masters like W.D. Gann and R.N Elliott and most use some combination of all the methods. In any case, technical analysts' exclusive use of historical price and volume data is what separates them from their fundamental counterparts. Unlike fundamental analysts, technical analysts don't care whether a stock is undervalued - the only thing that matters is a security's past trading data and what information this data can provide about where the security might move in the future.

The field of technical analysis is based on three assumptions:

1. The market discounts everything.
2. Price moves in trends.
3. History tends to repeat itself.

The Market Discounts Everything

A major criticism of technical analysis is that it only considers price movement, ignoring the fundamental factors of the company. However, technical analysis assumes that, at any given time, a stock's price reflects

everything that has or could affect the company - including fundamental factors. Technical analysts believe that the company's fundamentals, along with broader economic factors and market psychology, are all priced into the stock, removing the need to actually consider these factors separately. This only leaves the analysis of price movement, which technical theory views as a product of the supply and demand for a particular stock in the market.

History Tends To Repeat Itself

Another important idea in technical analysis is that history tends to repeat itself, mainly in terms of price movement. The repetitive nature of price movements is attributed to market psychology; in other words, market participants tend to provide a consistent reaction to similar market stimuli over time. Technical analysis uses chart patterns to analyze market movements and understand trends. Although many of these charts have been used for more than 100 years, they are still believed to be relevant because they illustrate patterns in price movements that often repeat themselves.

Not Just for Stocks

Technical analysis can be used on any security with historical trading data. This includes stocks, futures and commodities, fixed-income securities, forex, etc. In this tutorial, we'll usually analyze stocks in our examples, but keep in mind that these concepts can be applied to any type of security. In fact, technical analysis is more frequently associated with commodities and forex. Now that you understand the philosophy behind technical analysis, we'll get into explaining how it really works.

CHAPTER 3:

Fundamental Vs. Technical Analysis

Technical analysis and fundamental analysis are the two main schools of thought in the financial markets. As we've mentioned, technical analysis looks at the price movement of a security and uses this data to predict its future price movements. Fundamental analysis, on the other hand, looks at economic factors, known as fundamentals. Let's get into the details of how these two approaches differ, the criticisms against technical analysis and how technical and fundamental analysis can be used together to analyze securities.

The Differences

Charts vs. Financial Statements

At the most basic level, a technical analyst approaches a security from the charts, while a fundamental analyst starts with the financial statements.

By looking at the balance sheet, cash flow statement and income statement, a fundamental analyst tries to determine a company's value. In financial terms, an analyst attempts to measure a company's intrinsic value. In this approach, investment decisions are fairly easy to make - if the price of a stock trades below its intrinsic value, it's a good investment. Although this is an oversimplification (fundamental analysis goes beyond just the financial statements) for the purposes of this tutorial, this simple tenet holds true.

Technical traders, on the other hand, believe there is no reason to analyze a company's fundamentals because these are all accounted for in the stock's price. Technicians believe that all the information they need about a stock can be found in its charts.

Time Horizon

Fundamental analysis takes a relatively long-term approach to analyzing the market compared to technical analysis. While technical analysis can be used on a timeframe of weeks, days or even minutes, fundamental analysis often looks at data over a number of years.

The different timeframes that these two approaches use is a result of the nature of the investing style to which they each adhere. It can take a long time for a company's value to be reflected in the market, so when a fundamental analyst estimates intrinsic value, a gain is not realized until the stock's market price rises to its "correct" value. This type of investing is called value investing and assumes that the short-term market is wrong, but that the price of a particular stock will correct itself over the long run. This "long run" can represent a timeframe of as long as several years, in some cases.

Furthermore, the numbers that a fundamental analyst analyzes are only released over long periods of time. Financial statements are filed quarterly and changes in earnings per share don't emerge on a daily basis like price and volume information. Also remember that fundamentals are the actual characteristics of a business. New management can't implement sweeping changes overnight and it takes time to create new products, marketing campaigns, supply chains, etc. Part of the reason that fundamental analysts use a long-term timeframe, therefore, is because the data they use to analyze a stock is generated much more slowly than the price and volume data used by technical analysts.

Trading Versus Investing

Not only is technical analysis more short term in nature than fundamental analysis, but the goals of a purchase (or sale) of a stock are usually different for each approach. In general, technical analysis is used for a trade, whereas fundamental analysis is used to make an investment. Investors buy assets they believe can increase in value, while traders buy assets they believe they can sell to somebody else at a greater price. The line between a trade and an investment can be blurry, but it does characterize a difference between the two schools.

The Critics

Some critics see technical analysis as a mumbo jumbo. Technical analysis has only recently begun to enjoy some mainstream credibility. While most analysts focus on the fundamental side, just about any major brokerage now employs technical analysts as well.

Much of the criticism of technical analysis has its roots in academic theory - specifically the efficient market hypothesis (EMH). This theory says that the market's price is always the correct one - any past trading information is already reflected in the price of the stock and, therefore, any analysis to find undervalued securities is useless.

There are three versions of EMH. In the first, called weak form efficiency, all past price information is already included in the current price. According to weak form efficiency, technical analysis can't predict future movements because all past information has already been accounted for and, therefore, analyzing the stock's past price movements will provide no insight into its future movements. In the second, semi-strong form efficiency, fundamental analysis is also claimed to be of little use in

finding investment opportunities. The third is strong form efficiency, which states that all information in the market is accounted for in a stock's price and neither technical nor fundamental analysis can provide investors with an edge. The vast majority of academics believe in at least the weak version of EMH, therefore, from their point of view, if technical analysis works, market efficiency will be called into question.

Can They Co-Exist?

Although technical analysis and fundamental analysis are seen by many as polar opposites - the oil and water of investing - many market participants have experienced great success by combining the two. For example, some fundamental analysts use technical analysis techniques to figure out the best time to enter into an undervalued security. Oftentimes, this situation occurs when the security is severely oversold. By timing entry into a security, the gains on the investment can be greatly improved.

Alternatively, some technical traders might look at fundamentals to add strength to a technical signal. For example, if a sell signal is given through technical patterns and indicators, a technical trader might look to reaffirm his or her decision by looking at some key fundamental data. Oftentimes, having both the fundamentals and technicals on your side can provide the best-case scenario for a trade.

While mixing some of the components of technical and fundamental analysis is not well received by the most devoted groups in each school, there are certainly benefits to at least understanding both schools of thought.

CHAPTER 4:

What is a chart?

In technical analysis, charts are similar to the charts that you see in any business setting. A chart is simply a graphical representation of a series of prices over a set time frame. For example, a chart may show a stock's price movement over a one-year period, where each point on the graph represents the closing price for each day the stock is traded:

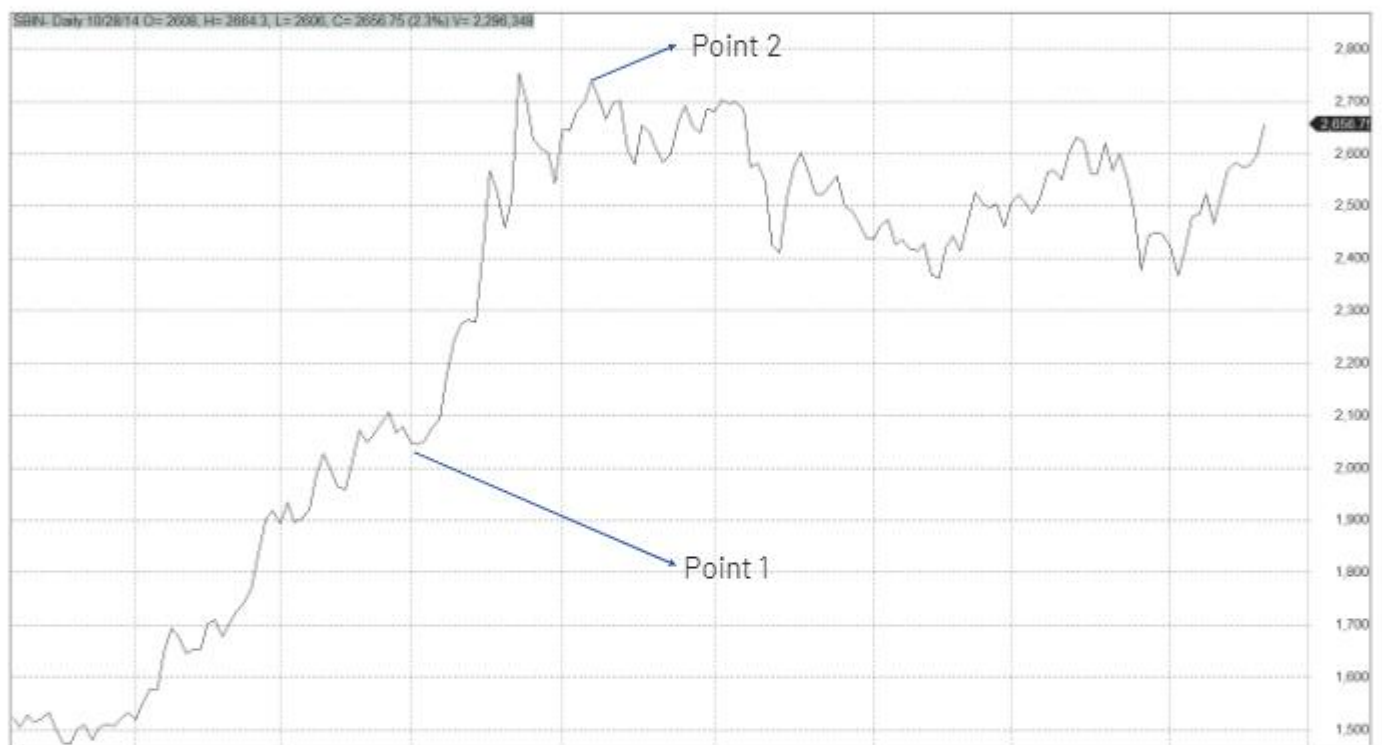


Figure 1

Figure 1 provides an example of a basic chart. It is a representation of the price movements of a stock over a 1.5 year period. The bottom of the graph, running horizontally (x-axis), is the date or time scale. On the right hand side, running vertically (y-axis), the price of the security is shown. By looking at the graph we see that in May 2014 (Point 1), the price of this stock was around 2044, whereas in June 2014 (Point 2), the stock's price is around 2740. This tells us that the stock has risen between May 2014 and June 2014.

Chart Properties

There are several things that you should be aware of when looking at a chart, as these factors can affect the information that is provided. They include the time scale, the price scale and the price point properties used.

The Time Scale

The time scale refers to the range of dates at the bottom of the chart, which can vary from decades to seconds. The most frequently used time scales are intraday, daily, weekly, monthly, quarterly and annually. The shorter the time frame, the more detailed the chart. Each data point can represent the closing price of the period or show the open, the high, the low and the close depending on the chart used.

Intraday charts plot price movement within the period of one day. This means that the time scale could be as short as five minutes or could cover the whole trading day from the opening bell to the closing bell.

Daily charts are comprised of a series of price movements in which each price point on the chart is a full day's trading condensed into one point. Again, each point on the graph can be simply the closing price or can entail the open, high, low and close for the stock over the day. These data points are spread out over weekly, monthly and even yearly time scales to monitor both short-term and intermediate

trends in price movement.

Weekly, monthly, quarterly and yearly charts are used to analyze longer term trends in the movement of a stock's price. Each data point in these graphs will be a condensed version of what happened over the specified period. So for a weekly chart, each data point will be a representation of the price movement of the week. For example, if you are looking at a chart of weekly data spread over a five-year period and each data point is the closing price for the week, the price that is plotted will be the closing price on the last trading day of the week, which is usually a Friday.

The Price Scale and Price Point Properties

The price scale is on the right-hand side of the chart. It shows a stock's current price and compares it to past data points. This may seem like a simple concept in that the price scale goes from lower prices to higher prices as you move along the scale from the bottom to the top. The problem, however, is in the structure of the scale itself. A scale can either be constructed in a linear (arithmetic) or logarithmic way, and both of these options are available on most charting softwares.

If a price scale is constructed using a linear scale, the space between each price point (10, 20, 30, 40) is separated by an equal amount. A price move from 10 to 20 on a linear scale is the same distance on the chart as a move from 40 to 50. In other words, the price scale measures moves in absolute terms and does not show the effects of percent change.



Figure 2

If a price scale is in logarithmic terms, then the distance between points will be equal in terms of percent change. A price change from 10 to 20 is a 100% increase in the price while a move from 40 to 50 is only a 25% change, even though they are represented by the same distance on a linear scale. On a logarithmic scale, the distance of the 100% price change from 10 to 20 will not be the same as the 25% change from 40 to 50. In this case, the move from 10 to 20 is represented by a larger space on the chart, while the move from 40 to 50, is represented by a smaller space because, percentage-wise, it indicates a smaller move. In Figure 2, the logarithmic price scale on the left leaves the same amount of space between 10 and 20 as it does between 20 and 40 because these both represent 100% increases.

CHAPTER 5:

Chart Types

There are four main types of charts that are used by investors and traders depending on the information that they are seeking and their individual skill levels. The chart types are: the line chart, the bar chart, the candlestick chart and the point and figure chart. Notice how the data used to create the charts is the same, but the way the data is plotted and shown in the charts is different.

Line Chart

The most basic of the four charts is the line chart because it represents only the closing prices over a set period of time. The line is formed by connecting the closing prices over the time frame. Line charts do not provide visual information of the trading range for the individual points such as the high, low and opening prices. However, the closing price is often considered to be the most important price in stock data compared to the high and low for the day and this is why it is the only value used in line charts.

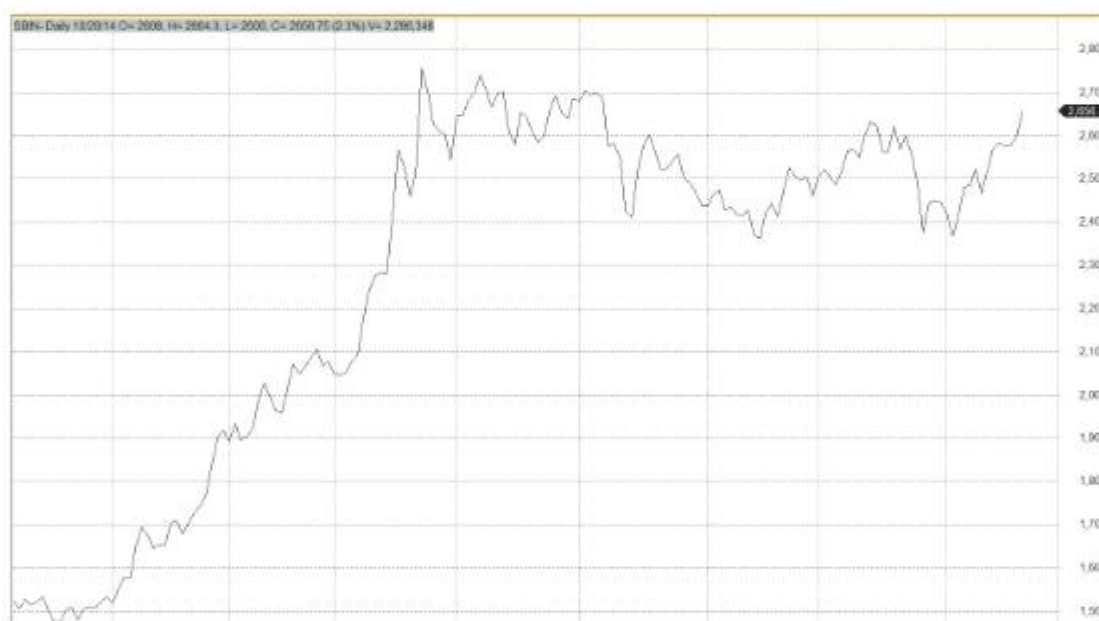


Figure 1: A line chart

Bar Charts

The bar chart expands on the line chart by adding several more key pieces of information to each data point. The chart is made up of a series of vertical lines that represent each data point. This vertical line represents the high and low for the trading period, along with the closing price. The close and open are represented on the vertical line by a horizontal dash. The opening price on a bar chart is illustrated by the dash that is located on the left side of the vertical bar. Conversely, the close is represented by the dash on the right. Generally, if the left dash (open) is lower than the right dash (close) then the bar will be shaded black, representing an up period for the stock, which means it has gained value. A bar that is colored red signals that the stock has gone down in value over that period. When this is the case, the dash on the right (close) is lower than the dash on the left (open).

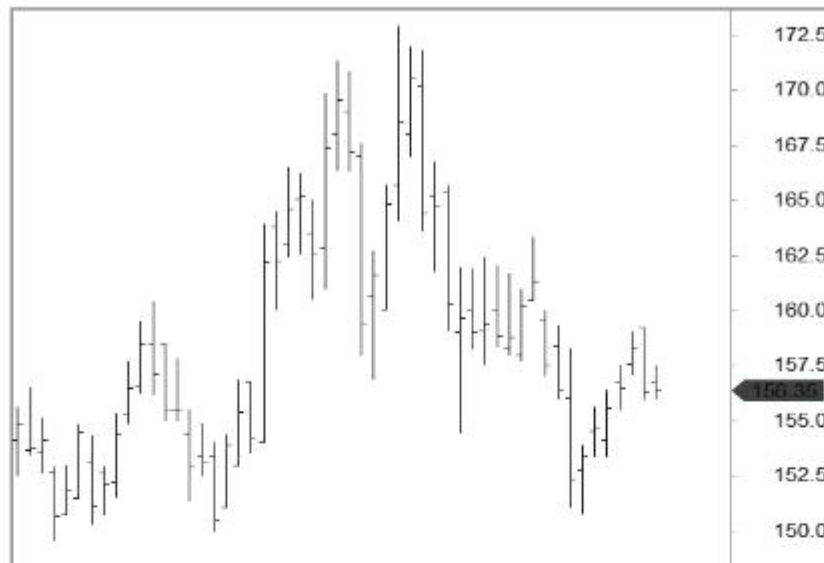


Figure 2: A bar chart

Candlestick Charts

The candlestick chart is similar to a bar chart, but it differs in the way that it is visually constructed. Similar to the bar chart, the candlestick also has a thin vertical line showing the period's trading range. The difference comes in the formation of a wide bar on the vertical line, which illustrates the difference between the open and close. And, like bar charts, candlesticks also rely heavily on the use of colors to explain what has happened during the trading period. A major problem with the candlestick color configuration, however, is that different sites use different standards; therefore, it is important to understand the candlestick configuration used at the chart site you are working with. There are two color constructs for days up and one for days that the price falls. When the price of the stock is up and closes above the opening trade, the candlestick will usually be white or clear. If the stock has traded down for the period, then the candlestick will usually be red or black, depending on the site. If the stock's price has closed above the previous day's close but below the day's open, the candlestick will be black or filled with the color that is used to indicate an up day.



Figure 3: Candlestick Chart

Point and Figure Charts

The point and figure chart is not well known or used by the average investor but it has had a long history of use dating back to the first technical traders. This type of chart reflects price movements and is not as concerned about time and volume in the formulation of the points. The point and figure chart removes the noise, or insignificant price movements, in the stock, which can distort traders' views of the price trends. These types of charts also try to neutralize the skewing effect that time has on chart analysis.



Figure 4: A point and figure chart

When first looking at a point and figure chart, you will notice a series of Xs and Os. The Xs represent upward price trends and the Os represent downward price trends. There are also numbers and letters in the chart; these represent months, and give investors an idea of the date. Each box on the chart represents the price scale, which adjusts depending on the price of the stock: the higher the stock's price the more each box represents. On most charts where the price is between 20 and 100, a box represents 1, or 1 point for the stock. The other critical point of a point and figure chart is the reversal criteria. This is usually set at three but it can also be set according to the chartist's discretion. The reversal criteria set how much the price has to move away from the high or low in the price trend to create a new trend or, in other words, how much the price has to move in order for a column of Xs to become a column of Os, or vice versa. When the price trend has moved from one trend to another, it shifts to the right, signaling a trend change.



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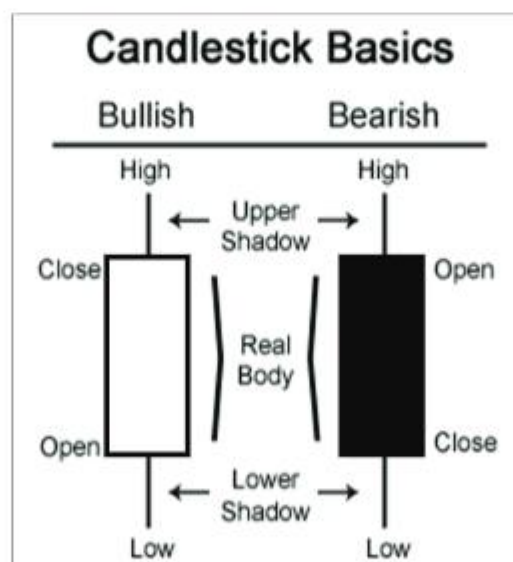
CHAPTER 6:

Candlesticks

In the 1700s, a Japanese man named Homma, a trader in the futures market, discovered that, although there was a link between price and the supply and demand of rice, the markets were strongly influenced by the emotions of traders. He understood that when emotions played into the equation, a vast difference between the value and the price of rice occurred. Japan was a country which had lot of wars that time. So the methodology of candle stick is based on war terminology and so you will find many candle stick patterns having names related to war terminology. Candlestick represents a war between buyers and sellers. That's why the color of the body as per the closing price respective to opening and not related to previous closing. Each day is a new day of war. Candlesticks are like bar charts but the area between the opening and closing is shaded this gives a better pictorial representation.

Drawing Candlesticks:

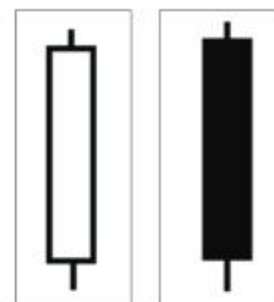
Candle stick is similar to bar charts. Every candle shows 4 pieces of information. 1) Open, 2) High, 3) Low, and 4) Close. The candle stick has 2 parts: 1) the body, 2) shadows. The vertical line represents the high to low. The body represents open to close. Open to close is given more importance than closing prices. If $\text{Close} > \text{Open}$ then the candle is white or green. If $\text{Close} < \text{Open}$ then the candle is black or red. It does not consider with regards to previous close. The upper wick is called upper shadow and the lower wick is called lower shadow.



Candlesticks Patterns:

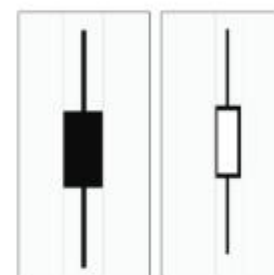
Long Body candlestick:

Long body candlestick has very less upper and lower shadow. Long white means that the stock opened and then moved down a little and then selling got absorbed and there came a good buying all through the day. The smaller upper shadow is due to some intraday profit booking. On the whole it signifies the strength of the bulls. If the long body white candlestick is accompanied by heavy volume then it states good amount of participation.



Spinning Top:

Spinning top is a pattern with a short body found in the middle of two long wicks. It states that neither buyer nor seller have won. And the market close was relatively unchanged to open. The upper and lower long wicks, however, tell us that both the buyers and the sellers had the upper hand at some point during the time period the candle represents. When a spinning top forms after a run up or run down in the market, it can be an indication of a pending reversal, as the indecision in the market is representative of the buyers losing momentum when this occurs after an uptrend and the sellers losing momentum after a downtrend.



Doji:

Doji is one of the commonly found candlestick. It is characterized by being small in length a small trading range with an opening and closing price that are virtually equal. The doji represents indecision in the market. A doji is not as significant if the market is sideways. If the doji forms in an uptrend or downtrend, this is normally seen as significant. In an uptrend the doji implies the weakness of buyers and vice-versa. A doji is a key trend reversal indicator. This is particularly true when there is a high trading volume following an extended move in either direction.



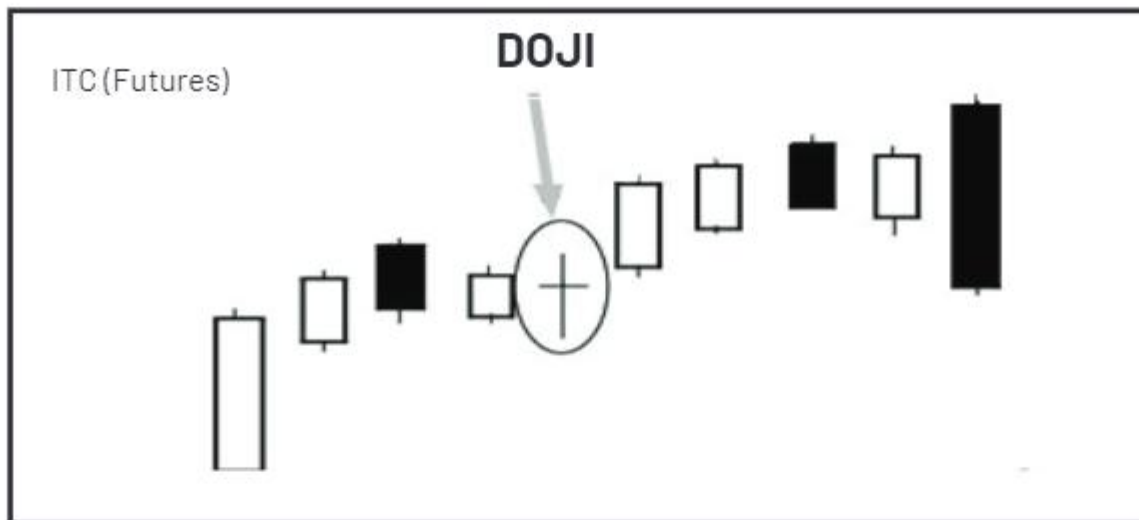
Types of Doji:

Long Legged Doji:

A type of candlestick formation where the opening and closing prices are nearly equal despite a lot of price movement throughout the trading day. This candlestick is often used to signal indecision about the future direction.

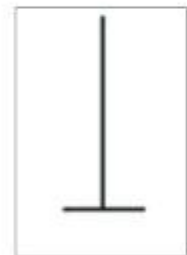
The long-legged doji suggests that the forces of supply and demand are nearing equilibrium and that a shift in the direction of the trend may be coming. If the open and close are at the center then it is called "Rickshawman".





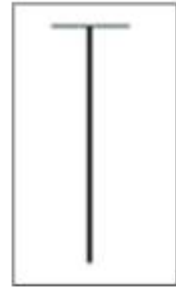
2. Gravestone Doji:

The Gravestone Doji is created when the open, low, and close are the same or about the same price. The most important part of the Gravestone Doji is the long upper shadow. The long upper shadow is generally interpreted as the market is testing to find where supply and potential resistance is located. The construction of the Gravestone Doji pattern occurs when bulls are able to press prices upward. However, an area of resistance is found at the high of the day and selling pressure is able to push prices back down to the opening price. Therefore, the bullish advance upward was entirely rejected by the bears.



3. Dragonfly Doji:

The pattern is formed when the stock's opening and closing prices are equal and occur at the high of the day. The long lower shadow suggests that the forces of supply and demand are nearing a balance and that the direction of the trend may be nearing a major turning point. It is often deemed to be a reliable signal that the trend is about to change direction. The close near the day's open suggests that demand is again starting to outweigh supply.

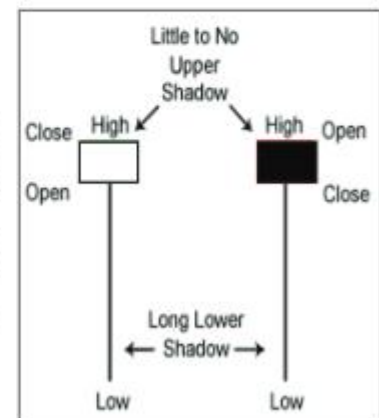


Reversal Patterns:

For reversal pattern there should be a trend to reverse. Also what many people make mistake to take reversal's as they think that the existing trend will and there will be opposite trend. Reversal just stops the existing trend, the price may then reverse or also go sideways. In candle sticks there is no target measurement described.

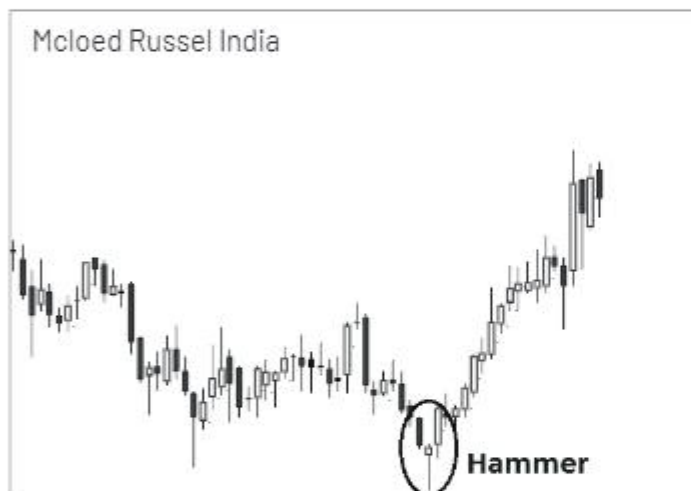
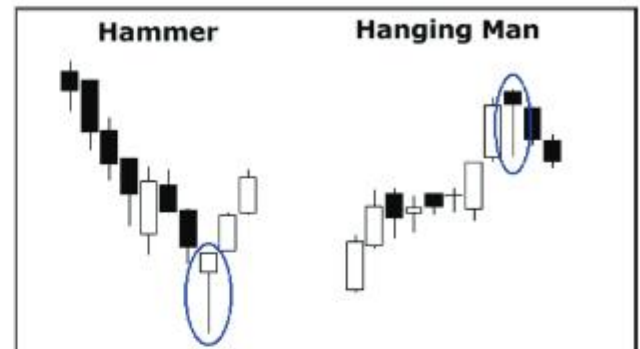
1. Hammer and Hanging man:

These are candlesticks with long lower shadow and small real bodies. The real body is at the top of the range. The colour is not so important at top or bottom. If after a downtrend either of these emerge then it is called "Hammer". Thus Hammer is a bottom reversal pattern. Inverse with Hanging man. If after a rally these candlestick emerge then it is a top reversal formation called "Hanging Man". This name because it looks like hanging man.



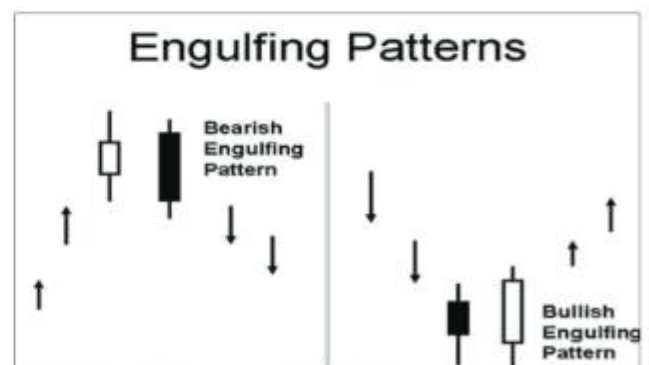
Important Criteria:

1. Real body should be at the upper end of the trading range.
2. The colour of the body is not important.
3. The long lower shadow should be twice the length of the real body
4. It should have no or very short upper shadow
5. The greater the gap after the hammer or hanging man the next day, the more powerful it to be a top or bottom.



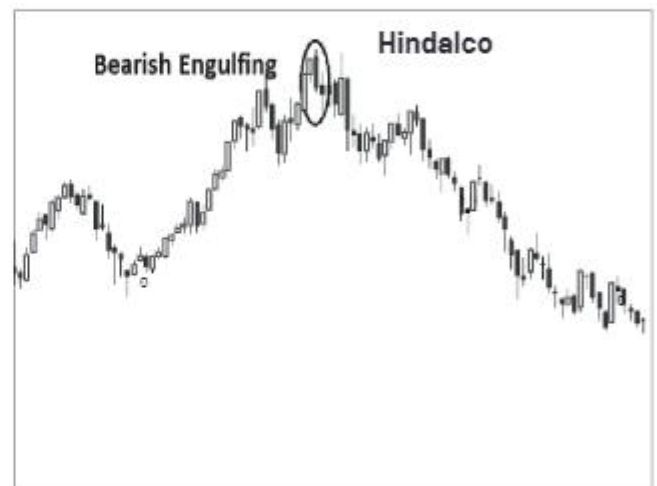
2. Engulfing Pattern:

It is a 2 candle stick pattern. It is a major reversal pattern with 2 candles of opposite colour. Engulfing pattern at the top is called "Bearish Engulfing" and at bottom "Bullish Engulfing". In bullish engulfing there is a downtrend and there forms a Red candle and then the next candle is a green candle which eats or wraps or engulfs the entire red body. In bearish engulfing there is a uptrend and there forms a Green candle and then the next candle is the red candle which eats or wraps or engulfs the entire green body.



Important points about Engulfing Pattern:

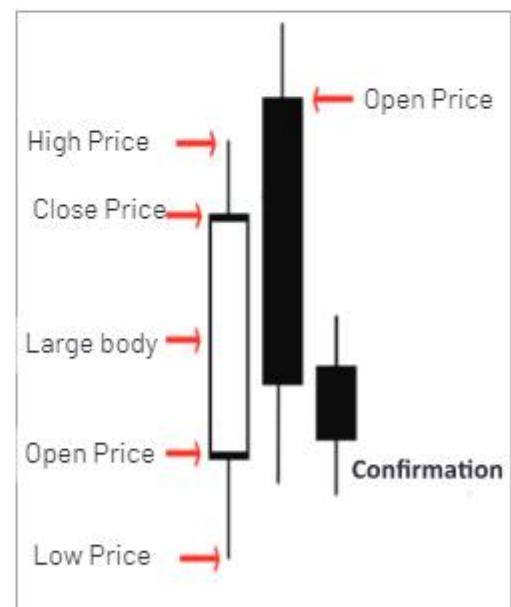
1. The market is clearly definable in trend i.e. uptrend or downtrend.
2. The 2nd candle engulfs or wraps around the 1st candle. Its important for the 2nd candle to engulf the entire body of 1st candle not necessarily the shadows.
3. The 2nd day real body is of opposite color.
4. If the engulfing is after a fast move that indicates a sudden shift form seller to buyer in case of Bullish engulfing and vice-versa.



3. Dark Cloud Cover:

It's a 2 candle reversal pattern. The 1st candle is a strong white body in an uptrend. The next day opens above the prior sessions high (above the upper shadow) but by the end of the day the market closes near the low and well within the previous white body. The 2nd body should penetrate the 1st by at least 50% of the white candle. Greater the penetration better it is. If the 2nd day opens at a big resistance level and then fails, it would mean that bulls failed to take control and it would become a significant top. Also heavy volume on 2nd day increases the strength of the pattern.

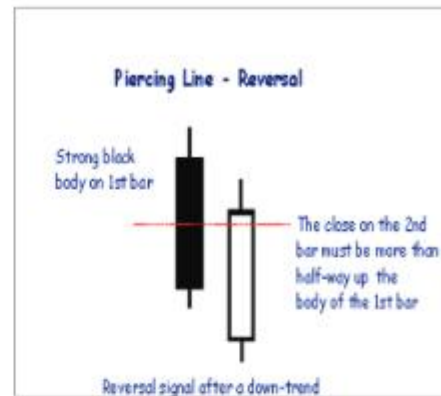
Its always better to have confirmation.



4. Piercing Pattern:

It is simply opposite of Dark cloud cover. Piercing pattern is a bottom reversal pattern.

After the downtrend there forms a white body which had gapped down the previous candle but the buyers take charge. The white candle to penetrate more than 50% of the previous black candle body. Good volume on 2nd candle increases the strength.



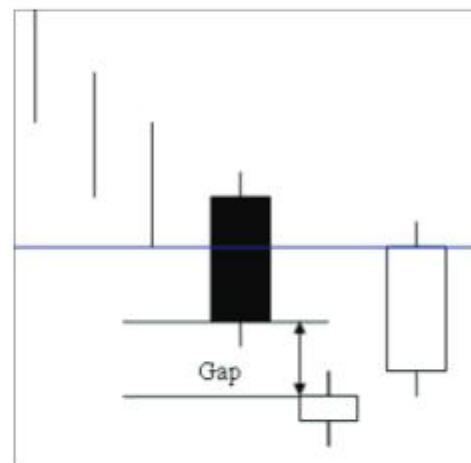
5. Stars:

A star is a small Body that gaps away from the previous large body. The color of the star is not important. But it should not be overlap the prior real body. The logic of star is that it creates a deadlock between buyers and sellers.

Morning Star:

It's a 3 candle Bottom reversal pattern:

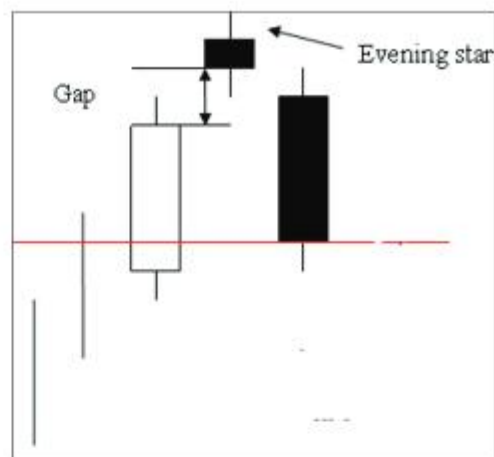
1. The first bar is a large red candlestick located within a defined downtrend.
2. The second bar is a small-bodied candle (either red or white) that closes below the first red bar.
3. The last bar is a large white candle that opens above the middle candle and closes near the center of the first bar's body.
4. Ideally the star would have a gap before and after the middle candle. But lack of it does not invalidate the pattern.



Evening Star:

It's a 3 candle top reversal pattern, inverse of morning star:

1. The first bar is a large white candlestick located within an uptrend.
2. The middle bar is a small-bodied candle (red or white) that closes above the first white bar.
3. The last bar is a large red candle that opens below the middle candle and closes near the center of the first bar's body.



The Doji Stars:

A doji is a candle which has same opening and closing price is same or very near about. A doji morning star and doji evening star are same as morning star and evening star, just the star body is replaced by doji. A doji star is more significant.



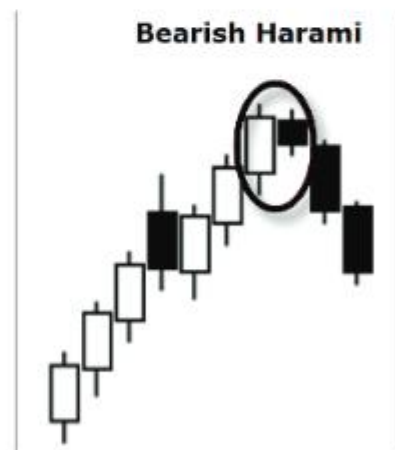
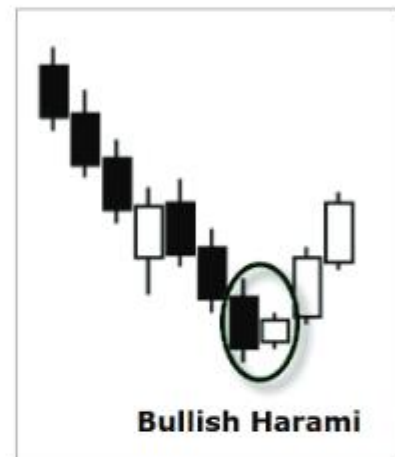
6. The Shooting Star and Inverted Hammer:

As we see, the shooting star has a small real body and long upper shadow. The color of the star is not important. It is not usually a major reversal. It tells us that market opened near its low, then rallied and finally backed off to close near its opening. The rally could not be sustained. And next day the red candle confirms that. An ideal shooting star gaps away from the previous candle. Shooting star shaped candle after a downtrend is said Inverted hammer. It is a Bullish reversal. But confirmation next day is compulsory as the candle is more of bearish nature. Confirmation can be in terms of gap up next day or strong session holding above the real body of inverted hammer.



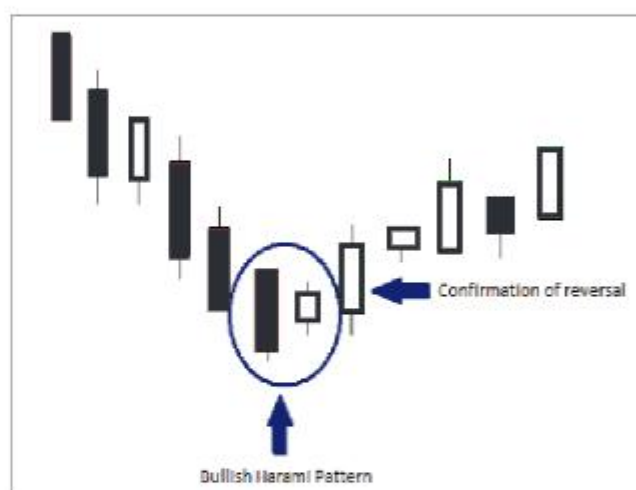
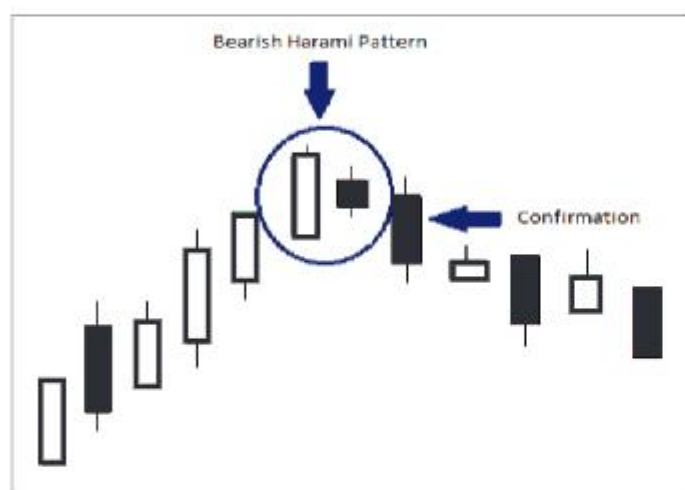
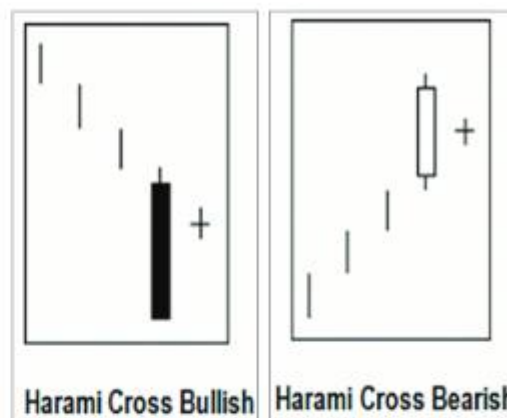
7. The Harami Pattern:

1. The harami pattern is a reversal pattern but not the major one like hammer or engulfing, but harami cross is major reversal pattern.
2. Harami pattern is a small real body inside the previous candle.
3. Its inverse of Engulfing pattern.
4. It is similar to Western inside day.
5. In a downtrend there is a red candle which is followed by the next candle whose body is small and is inside the body of previous candle as shown in the alongside figure.
6. The color of the next body is not important.
7. The harami displays the disparity of the market health. In uptrend the strong candle is followed by the small uncertain candle.
8. This shows that the bulls updrive has weakened and vice-versa for downtrend.



8. Harami Cross Pattern:

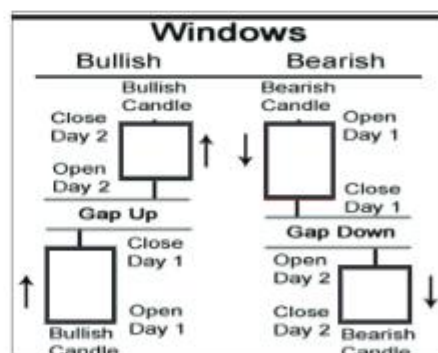
1. The Harami Cross starts out the same as that for the basic Harami pattern.
2. A trend has been in place when, all of a sudden, the market gyrates throughout a day without exceeding the body range of the previous day.
3. What is worse, the market closes at the same price as it opened. Volume of this a Doji day also dries up, reflecting the complete lack of decision of traders. A significant reversal of trend has occurred.

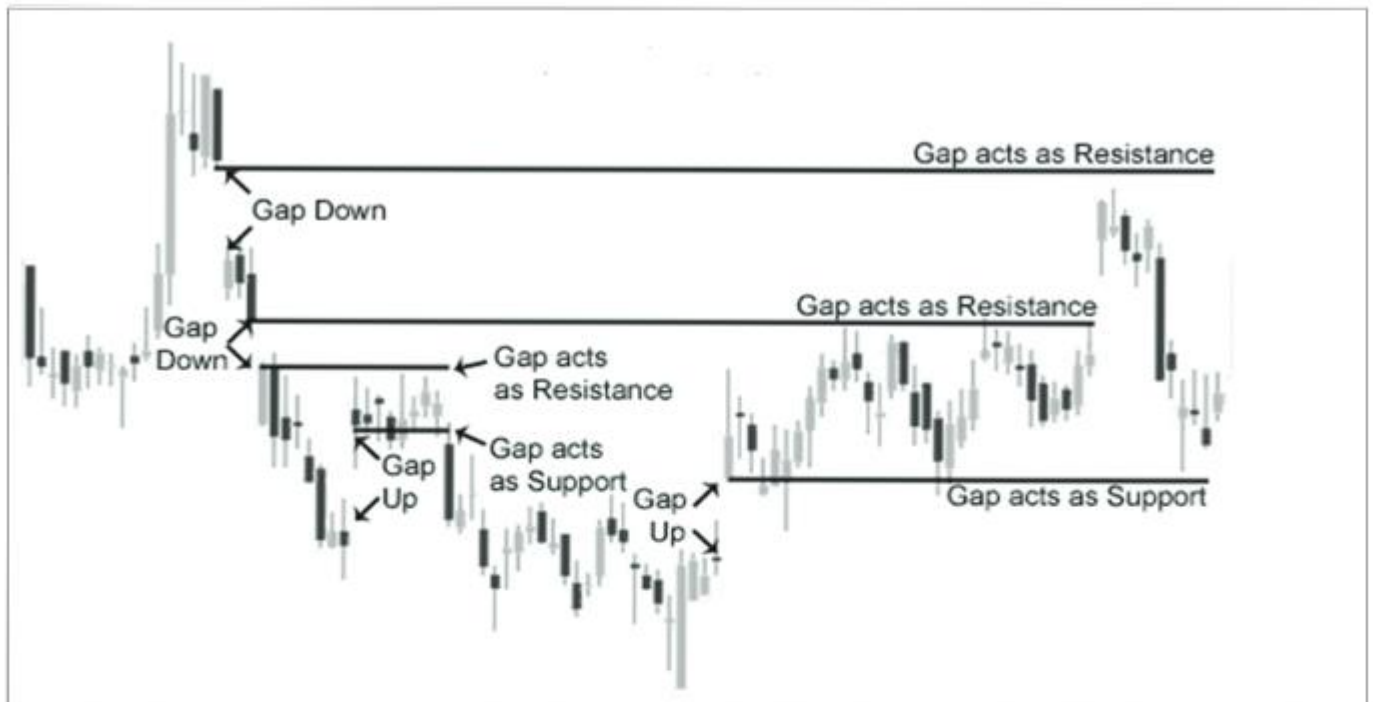


Continuation Pattern:

1. Windows:

Japanese refer Gaps as "Windows". A window is a gap between the prior and current session's price. It is said to go in the direction of the Gap. Windows also act as support and resistance.





Upward and Downward Gap Tasuki:

A candlestick formation that is commonly used to signal the continuation of the current trend.

The Pattern requires following:

1. The bar is a large white candlestick within a defined uptrend.
2. The second bar is another white candlestick that has gapped above the close of the previous bar.
3. The last bar is a red candlestick that closes within the gap between the first two bars. It is important to note that the red candle does not need to fully close the gap.
4. If the market fills the gap and selling is still evident, then the bullish outlook of the gap is voided.
5. Downside Tasuki is just the inverse of upside Tasuki.

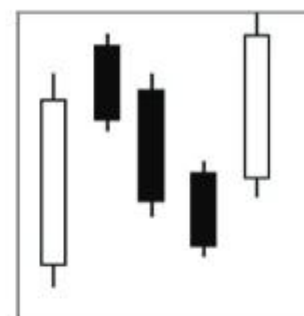


Rising Three Methods:

The Rising Three Methods pattern is considered a rest from trading. The psychology behind a move like this is that some doubt creeps in about the ability of the trend to continue. Once the bulls see that a new low cannot be made, the bullishness is resumed and new highs are set quickly.

This pattern is formed when the candlesticks meet the following characteristics:

1. The first candle in the pattern is a long white candlestick within a defined uptrend.
2. A series of descending candlesticks that trade within the range of the first candlestick.
3. A long white candlestick creates a new high, which suggests that bulls are back in control of the direction.

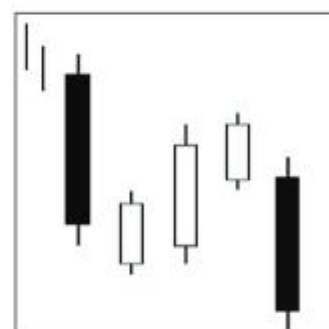


Falling Three Methods:

Its reverse of rising three method.

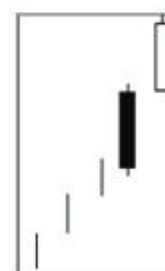
This pattern is formed when the candlesticks meet the following characteristics:

1. The first candle in the pattern is a long red candlestick within a defined downtrend.
2. A series of ascending small-bodied candlesticks that trade within the range of the first candlestick.
3. A long red candlestick creates a new low, which suggests that the sellers are back in control of the direction.



Separating Lines Bullish:

While the market is in an uptrend, the forming of a long black body should be cause for concern, as this is unusual for a strong market. However, the next day opens much higher, in fact, it opens at the previous black days opening price. Prices then move higher for the rest of the day and close higher, which suggests that the prior uptrend should now continue.



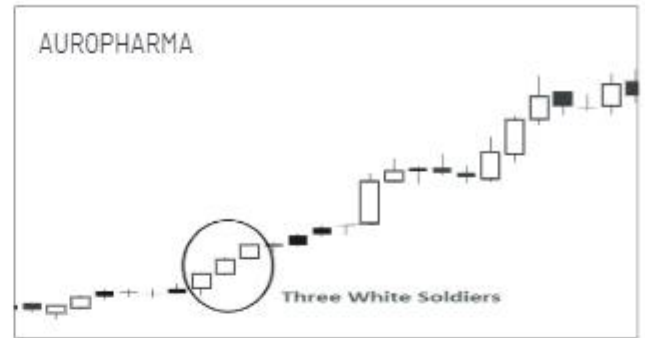
Separating Lines Bearish:

You can see immediately that the bearish separating lines pattern is the exact opposite of the bullish separating lines pattern, so it does not need any further explanation.



Three White Soldiers:

A bullish candlestick pattern that is used to predict the reversal of the current downtrend. This pattern consists of three consecutive long-bodied candlesticks that have closed higher than the previous day, with each session's open occurring within the body of the previous candle. These long-bodied candlesticks are a sign of the change in investor sentiment and are used by traders to confirm a shift in momentum.



Three Black Crows:

A bearish candlestick pattern that is used to predict the reversal of the current uptrend. This pattern consists of three consecutive long-bodied candlesticks that have closed lower than the previous day with each session's open occurring within the body of the previous candle.



CHAPTER 7: The Use of Trend

One of the most important concepts in technical analysis is that of trend. The meaning in finance isn't all that different from the general definition of the term - a trend is really nothing more than the general direction in which a security or market is headed. Take a look at the chart below:



Figure 1

You can figure out that in the above chart the trend is clearly visible (Uptrend).

However, now look at the below chart, the trend is not visible because the stock is in sideways trend.



There are lots of ups and downs in this chart, but there isn't a clear indication of which direction this security is headed.

A More Formal Definition

Unfortunately, trends are not always easy to see. In other words, defining a trend goes well beyond the obvious. In any given chart, you will probably notice that prices do not tend to move in a straight line in any direction, but rather in a series of highs and lows. In technical analysis, it is the movement of the highs and lows that constitutes a trend. For example, an uptrend is classified as a series of higher highs and higher lows, while a downtrend is one of lower lows and lower highs.

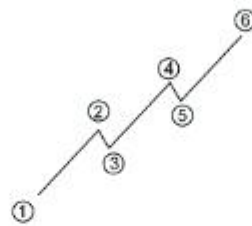


Figure 3

Figure 3 is an example of an uptrend. Point 2 in the chart is the first high, which is determined after the price falls from this point. Point 3 is the low that is established as the price falls from the high. For this to remain an uptrend, each successive low must not fall below the previous lowest point or the trend is deemed a reversal.

Types of Trend

There are three types of trend:

1. Uptrends
2. Downtrends

Sideways/Horizontal Trends As the names imply, when each successive peak and trough is higher, it's referred to as an upward trend. If the peaks and troughs are getting lower, it's a downtrend. When there is little movement up or down in the peaks and troughs, it's a sideways or horizontal trend. If you want to get really technical, you might even say that a sideways trend is actually not a trend on its own, but a lack of a well-defined trend in either direction. In any case, the market can really only trend in these three ways: up, down or nowhere.

Trend Lengths: Along with these three trend directions, there are three trend classifications. A trend of any direction can be classified as a long-term trend, intermediate trend or a short-term trend. In terms of the stock market, a major trend is generally categorized as one lasting longer than a year. An intermediate trend is considered to last between one and three months and a near-term trend is anything less than a month. A long-term trend is composed of several intermediate trends, which often move against the direction of the major trend. If the major trend is upward and there is a downward correction in price movement followed by a continuation of the uptrend, the correction is considered to be an intermediate trend. The short-term trends are components of both major and intermediate trends. Take a look at Figure 4 to get a sense of how these three trend lengths might look.

Figure 4



When analyzing trends, it is important that the chart is constructed to best reflect the type of trend being analyzed. To help identify long-term trends, weekly charts or daily charts spanning a five-year period are used by chartists to get a better idea of the long-term trend. Daily data charts are best used when analyzing both intermediate and short-term trends. It is also important to remember that the longer the trend, the more important it is; for example, a one-month trend is not as significant as a five-year trend.

Trendlines:

A trendline is a simple charting technique that adds a line to a chart to represent the trend in the market or a stock. Drawing a trendline is as simple as drawing a straight line that follows a general trend. These lines are used to clearly show the trend and are also used in the identification of trend reversal.



Figure 5

As you can see in Figure 5, an upward trendline is drawn at the lows of an upward trend. This line represents the support the stock has every time it moves from a high to a low. Notice how the price is propped up by this support. This type of trendline helps traders to anticipate the point at which a stock's price will begin moving upwards again. Similarly, a downward trendline is drawn at the highs of the downward trend. This line represents the resistance level that a stock faces every time the price moves from a low to a high.

Channels:

A channel, or channel lines, is the addition of two parallel trendlines that act as strong areas of support and resistance. The upper trendline connects a series of highs, while the lower trendline connects a series of lows. A channel can slope upward, downward or sideways but, regardless of the direction, the interpretation remains the same. Traders will expect a given security to trade between the two levels of support and resistance until it breaks beyond one of the levels, in which case traders can expect a sharp move in the direction of the break. Along with clearly displaying the trend, channels are mainly used to illustrate important areas of support and resistance.



Figure 6

Figure 6 illustrates an ascending channel on a stock chart; the lower trendline has been placed on the lows and the upper trendline is on the highs. The price has bounced off of these lines several times, and has remained range-bound for several months. As long as the price does not fall below the lower line or move beyond the upper resistance, the range-bound uptrend is expected to continue.

The Importance of Trend

It is important to be able to understand and identify trends so that you can trade with rather than against them. Two important sayings in technical analysis are "the trend is your friend" and "don't buck the trend," illustrating how important trend analysis is for technical traders.

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CHAPTER 8:

Support And Resistance

Once you understand the concept of a trend, the next major concept is that of support and resistance. You'll often hear technical analysts talk about the ongoing battle between the bulls and the bears, or the struggle between buyers (demand) and sellers (supply). This is revealed by the prices a security seldom moves above (resistance) or below (support).

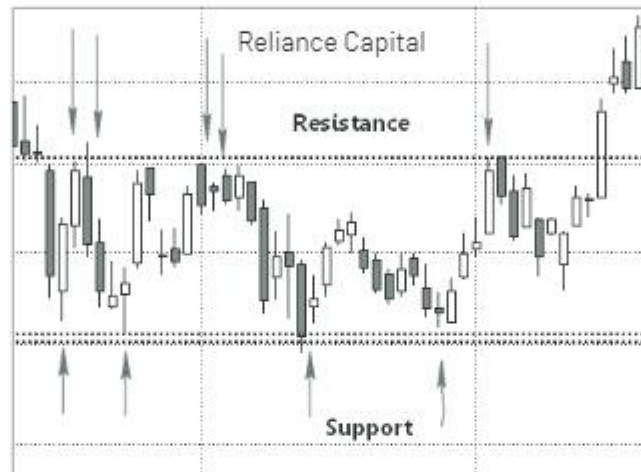


Figure 1

As you can see in Figure 1, support is the price level through which a stock or market seldom falls (illustrated by the blue arrows). Resistance, on the other hand, is the price level that a stock or market seldom surpasses (illustrated by the red arrows).

Why Does it Happen?

These support and resistance levels are seen as important in terms of market psychology and supply and demand. Support and resistance levels are the levels at which a lot of traders are willing to buy the stock (in the case of a support) or sell it (in the case of resistance). When these trendlines are broken, the supply and demand and the psychology behind the stock's movements is thought to have shifted, in which case new levels of support and resistance will likely be established.

Round Numbers and Support and Resistance

One type of universal support and resistance that tends to be seen across a large number of securities is round numbers. Round numbers like 10, 20, 35, 50, 100 and 1,000 tend to be important in support and resistance levels because they often represent the major psychological turning points at which many traders will make buy or sell decisions.

Buyers will often purchase large amounts of stock once the price starts to fall toward a major round number such as 50, which makes it more difficult for shares to fall below the level. On the other hand, sellers start to sell off a stock as it moves toward a round number peak, making it difficult to move past this upper level as well. It is the increased buying and selling pressure at these levels that makes them important points of support and resistance and, in many cases, major psychological points as well.

Role Reversal

Once a resistance or support level is broken, its role is reversed. If the price falls below a support level, that level will become resistance. If the price rises above a resistance level, it will often become support. As the price moves past a level of support or resistance, it is thought that supply and demand has shifted, causing the breached level to reverse its role. For a true reversal to occur, however, it is important that the price make a strong move through either the support or resistance.

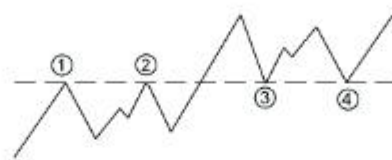


Figure 2

For example, as you can see in Figure 2, the dotted line is shown as a level of resistance that has prevented the price from heading higher on two previous occasions (Points 1 and 2). However, once the resistance is broken, it becomes a level of support (shown by Points 3 and 4) by propping up the price and preventing it from heading lower again.

Many traders who begin using technical analysis find this concept hard to believe and don't realize that this phenomenon occurs rather frequently, even with some of the most well-known companies. For example, as you can see in Figure 3, this phenomenon is evident on the chart between 2003 and 2006. Notice how the role of the 51 level changes from a strong level of support to a level of resistance.

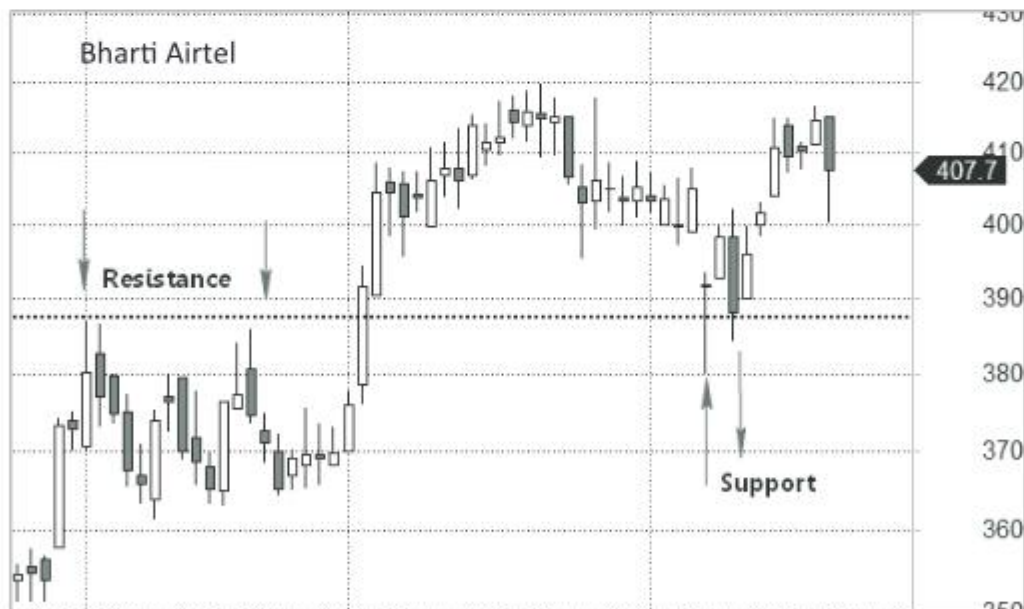


Figure 3

In almost every case, a stock will have both a level of support and a level of resistance and will trade in this range as it bounces between these levels. This is most often seen when a stock is trading in a generally sideways manner as the price moves through successive peaks and troughs, testing resistance and support.

The Importance of Support and Resistance

Support and resistance analysis is an important part of trends because it can be used to make trading decisions and identify when a trend is reversing. For example, if a trader identifies an important level of resistance that has been tested several times but never broken, he or she may decide to take profits as the security moves toward this point because it is unlikely that it will move past this level.

Support and resistance levels both test and confirm trends and need to be monitored by anyone who uses technical analysis. As long as the price of the share remains between these levels of support and resistance, the trend is likely to continue. It is important to note, however, that a break beyond a level of support or resistance does not always have to be a reversal. For example, if prices moved above the resistance levels of an upward trending channel, the trend have accelerated, not reversed. This means that the price appreciation is expected to be faster than it was in the channel.

Being aware of these important support and resistance points should affect the way that you trade a stock. Traders should avoid placing orders at these major points, as the area around them is usually marked by a lot of volatility. If you feel confident about making a trade near a support or resistance level, it is important that you follow this simple rule: do not place orders directly at the support or resistance level. This is because in many cases, the price never actually reaches the whole number, but flirts with it instead. So if you're bullish on a stock that is moving toward an important support level, do not place the trade at the support level. Instead, place it above the support level, but within a few points. On the other hand, if you are placing stops or short selling, set up your trade price at or below the level of support.

Retracement Or Reversal: Know The Difference

Most of us have wondered, at some point, whether a decline in the price of a stock we're holding is long term or a mere market hiccup. Some of us have sold our stock in such a situation, only to see it rise to new highs just days later. This is a frustrating and all too common scenario, but it can be avoided if you know how to identify and trade retracements properly.

What Are Retracements?

Retracements are temporary price reversals that take place within a larger trend. The key here is that these price reversals are temporary, and do not indicate a change in the larger trend.



Figure 1

Figure 1 shows us an example of retracements in the price action of a particular stock. Notice that despite the retracements, the long-term trend shown in this chart is still intact – that is, the price of the stock is still going up.

The Importance of Recognizing Retracements

It is important to know how to distinguish a retracement from a reversal. There are several key differences between the two that you should take into account when classifying a price movement.

Factor	Retracement	Reversal
Volume	Profit taking by retail traders (small block trades)	Institutional selling (large block trades)
Money Flow	Buying interest during decline	Very little buying interest
Chart Patterns	Few, if any, reversal patterns - usually limited to candles	Several reversal patterns - usually chart patterns (double top, etc.)
Time Frame	Short-term reversal, lasting no longer than one to two weeks	Long-term reversal, lasting longer than a couple of weeks
Fundamentals	No change in fundamentals	Change or speculation of change in fundamentals
Recent Activity	Usually occurs right after large gains	Can happen at any time, even during otherwise regular trading
Candlesticks	"Indecision" candles - these typically have long tops and bottoms (spinning tops, etc.)	Reversal candles - these include engulfings, soldiers and other similar patterns

So, why is recognizing retracements so important? Whenever a price reverses, most traders and investors are faced with a tough decision. They have three options:

1. Hold throughout the sell-off, which could result in large losses if the retracement turns out to be a larger trend reversal.
2. Sell and re-buy if the price recovers, which will definitely result in money wasted on commissions and spreads. This may also result in a missed opportunity if the price recovers sharply.
3. Sell permanently, which could result in a missed opportunity if the price recovers

By properly identifying the movement as either a retracement or a reversal, you can reduce cost, limit loss and preserve gains.

Determining Scope

Once you know how to identify retracements, you can learn how to determine their scope. The following are the most popular tools used to do this:

1. Fibonacci retracements
2. Pivot point support and resistance levels
3. Trendline support and resistance levels

Fibonacci Retracements

Fibonacci retracements are excellent tools for calculating the scope of a retracement. They are most widely used in the foreign exchange market, but are also used in the stock market. To use them, simply use the Fibonacci retracement tool (available in most charting software) to draw a line from the top to the bottom of the latest impulse wave. Figure 3 shows an example of this tool at work:



Figure 3

In most cases, retracements will stay around 38.2% (daily) or 50% (intraday). If the price moves below these levels, then a reversal may be forming.

Pivot Points

Pivot point levels are also commonly used when determining the scope of a retracement. Most traders look at the lower supports (S1, S2, S3) - if these are broken, then a reversal may be forming.

Trendline Supports

Finally, if major trendlines supporting the larger trend are broken on high volume, then a reversal is most likely in effect. Chart patterns and candlesticks are often used in conjunction with these trendlines to confirm reversals.

Dealing with False Signals

Even a retracement that meets all the criteria outlined in our table in Figure 2 may turn into a reversal with very little warning. The best way to protect yourself against such a reversal is to use stop-loss points. Here is how you can do this:

1. You can estimate retracement levels using technical analysis and place your stop-loss point just below these levels.
2. Alternatively, you can place the stop-loss just below the long-term support trendline or moving average.

Ideally, what you want to do is lower your risk of exiting during a retracement, while still being able to exit a reversal in a timely manner.

Conclusion

As a trader, you need to be able to differentiate between retracements and reversals. Without this knowledge, you risk many things: exiting too soon and missing opportunities; holding onto losing positions and losing money; and wasting money on commissions/spreads. By combining technical analysis with some basic identification measures, you can protect yourself from these risks and put your trading capital to better use

CHAPTER 9:

Using Pivot Points for Predictions

We often hear market analysts or experienced traders talking about an equity price nearing a certain support or resistance level, each of which is important because it represents a point at which a major price movement is expected to occur. But how do these analysts and professional traders come up with these so-called levels? One of the most common methods is using pivot points, and here we take a look at how to calculate and interpret these technical tools.

How to Calculate Pivot Points

There are several different methods for calculating pivot points, the most common of which is the five-point system. This system uses the previous day's high, low and close, along with two support levels and two resistance levels (totaling five price points) to derive a pivot point. The equations are as follows:

$$R2 = P + (H - L) = P + (R1 - S1)$$

$$R1 = (P \times 2) - L$$

$$P = (H + L + C) / 3$$

$$S1 = (P \times 2) - H$$

$$S2 = P - (H - L) = P - (R1 - S1)$$

Here, "S" represents the support levels, "R" the resistance levels and "P" the pivot point. High, low and close are represented by the "H", "L" and "C" respectively. Take a look at the following example of the five-point system, which illustrates a projection of a stock movement. Note the pivot point and the support and resistance levels.



Another common variation of the five-point system is the inclusion of the opening price in the formula:

$$P = ((\text{Today's } O) + \text{Yesterday's } (H + L + C)) / 4$$

Here, the opening price, "O", is added to the equation. Note that the opening price for foreign exchange markets is simply the last period's closing price. The supports and resistances can then be calculated in the same manner as the five-point system, except with the use of the modified pivot point.

Yet another pivot point system was developed by Tom DeMark, a famous technical analyst and president of Market Studies, Inc. This system uses the following rules:

Condition	Calculation	Tomorrow's Projections
Today's Close < Today's Open	Today's high + today's low + today's close + today's low = X	High = X/2 - today's low Low = X/2 - today's high
Today's Close > Today's Open	Today's high + today's low + today's close + today's high = X	High = X/2 - today's low Low = X/2 - today's high
Today's Close = Today's Open	Today's high + today's low + today's close + today's close = X	High = X/2 - today's low Low = X/2 - today's high

As you can see, there are many different pivot-point systems available. Some popular ones include as many as nine different price levels; meanwhile, others predict only one pivot point, and no additional levels of support or resistance.

Interpreting and Using Pivot Points

When calculating pivot points; the pivot point itself is the primary support/resistance. This means that the largest price movement is expected to occur at this price. The other support and resistance levels are less influential, but may still generate significant price movements.

Pivot points can be used in two ways. The first way is for determining overall market trend: if the pivot point price is broken in an upward movement, then the market is bullish, and vice versa. Keep in mind, however, that pivot points are short-term trend indicators, useful for only one day until they need to be recalculated. The second method is to use pivot point price levels to enter and exit the markets. For example, a trader might put in a limit order to buy 100 shares if the price breaks a resistance level. Alternatively, a trader might set a stop-loss for his active trade if a support level is broken.

Conclusion

Pivot points are yet another useful tool that can be added to any trader's toolbox. It enables anyone to quickly calculate levels that are likely to cause price movement. The success of a pivot-point system, however, lies squarely on the shoulders of the trader, on his or her ability to effectively use the pivot-point systems in conjunction with other forms of technical analysis. These other technical indicators can be anything from MACD crossovers to candlestick patterns - the greater the number of positive indications, the greater the chances for success.

CHAPTER 10:

Definition of Volume

Volume is one of the most important technical analysis tools to learn and understand how to apply to price movements. Volume increases every time a buyer and seller transact their stock or futures contract. If a buyer buys one share of stock from a seller, then that one share is added to the total volume of that particular stock. Volume has two major premises:

When prices rise or fall, an increase in volume is strong confirmation that the rise or fall in price is real and that the price movement had strength.

When prices rise or fall and there is a decrease in volume, then this is interpreted as being a weak price move, because the price move had very little strength and interest from traders.

Volume is an important indicator as it is used to measure the worth of a market move. If the markets have made strong price move either up or down the perceived strength of that move depends on the volume for that period. The higher the volume during that price move the more significant the move.

Volume tells investors about the market's liquidity. Higher volume means higher liquidity and better order execution. When investors feel hesitant about the direction of the stock market, futures trading volume tends to increase. Volume also tends to be higher near the market's opening and closing times, and on Mondays and Fridays. It tends to be lower at lunchtime and before a holiday.

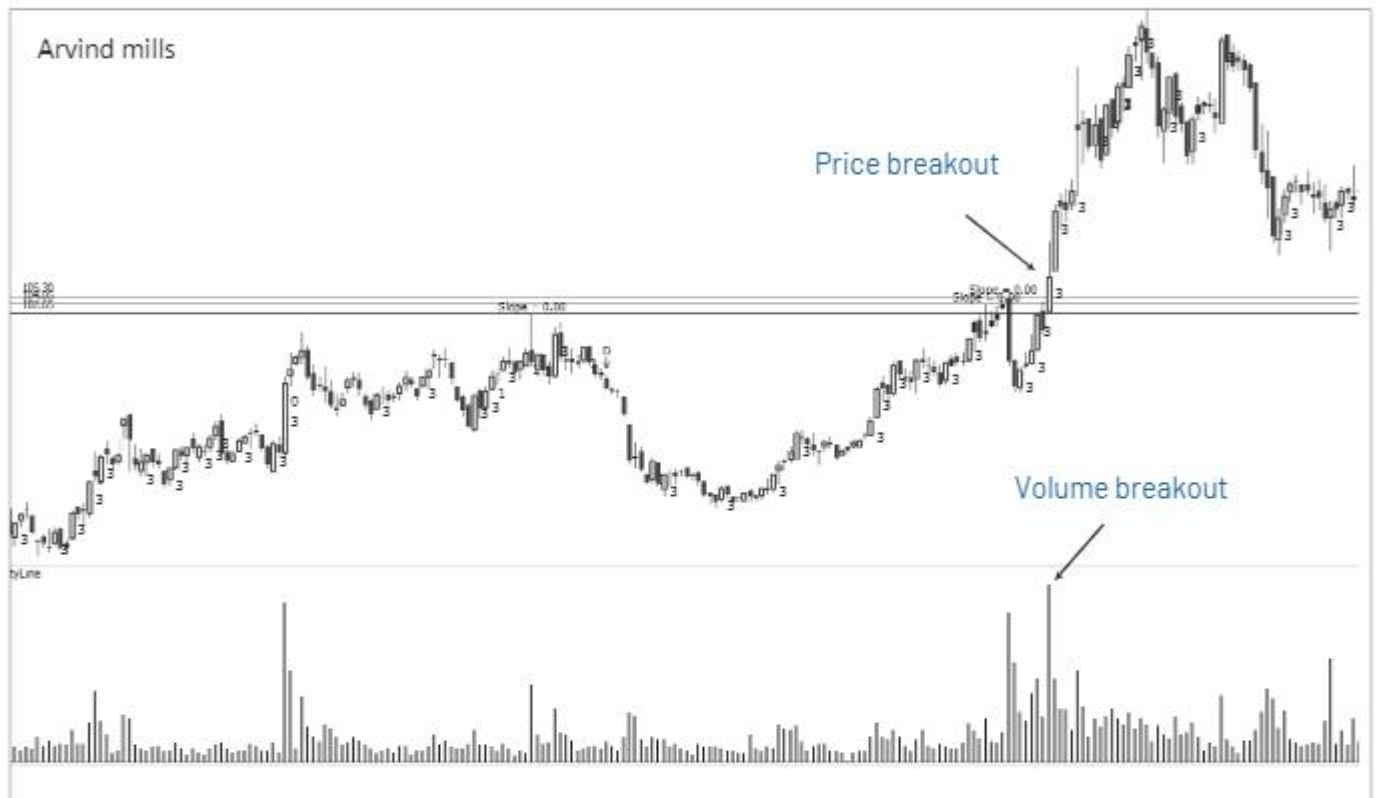
Volume as a Confirmation Tool

For technical analysts, volume is most useful as a confirmation tool. That means that volume levels suggest the importance of a technical move. A breakout may be a trading signal, but a breakout on high volume is a much stronger one. That makes a lot of sense when you think about the fact that volume represents transactions in a stock; high volume on an upward move means that an increasing number of buyers are bidding up shares.

When viewed in conjunction with price action, volume can tell traders about the strength of a move because of how new prices are made in the market. For a stock's price to increase, sellers must decide that they want to ask for higher prices for a stock, and buyers must be willing to increase their bids to match them. When that sort of trading takes place under high volume, it means that buyers' demand is overwhelming sellers. It also means that there's bullish conviction among traders. For that reason, declining volume in an uptrend means that bullishness is waning (called a negative divergence) and that a break of the trend could be forthcoming. As a rule, increased volume is a necessary element of upward moves, but because a lack of demand can kill prices just as quickly as an excess of supply, it's not a prerequisite for downward moves.

Interpreting Volume Data

There are a few different ways to interpret volume data. One involves looking at a regular chart and watching for trends in volume that confirm the moves taking place in price. Because the number of shares traded at a price is so important, charting methods have been developed to integrate the two.



There are also a number of indicators that have been developed to try to interpret volume data. One of the most popular, known as on-balance volume, or OBV, is essentially a running tally of volume in which up-days are counted as positive and down days counted as negative. Inflection points in OBV gives traders an idea of where buyers or sellers have control of the market.

Most volume-driven indicators – including accumulation/distribution and all money flow indicators – show similar results, so it's best for technicians to pick a preferred indicator rather than using many that will show similar signals.

At the end of the day, volume is an incredibly important piece of information that is inseparable from price action but is frequently not used to its full potential. That said, it's important to remember that volume is a secondary indicator; while it's incredibly useful to determine the importance of a move or the strength of a trend, it needs to be used alongside price action.

Market BREADTH

A technique used in technical analysis that attempts to gauge the direction of the overall market by analyzing the number of companies advancing relative to the number declining. Positive market breadth occurs when more companies are moving higher than are moving lower, and it is used to suggest that the bulls are in control of the momentum. Conversely, a disproportional number of declining securities is used to confirm bearish momentum.

A large number of advancing issues is a sign of bullish market sentiment and is used to confirm a broad market uptrend. Traders will specifically look at the number of companies that have created a 52-week high relative to the number that created a 52-week low because this data can provide longer term information about whether the bullish or bearish trend will continue.

Market Breadth: Volume Studies

Fortunately, the basic signals conveyed by volume data are easy to read. When a stock is traded, the transaction is recorded and included in the daily volume. When volume levels spike for a stock, index or exchange, the spike points to a price at which a large portion of ownership has changed hands. These prices are significant because they mark a break-even point for the new shareholders and are likely candidates for support/resistance levels - the larger the spike, the more significant the price.

Over time, if price moves steadily upward with strong volume, this indicates that buyers are accumulating shares and supply is becoming increasingly limited: bulls are winning the fight. Conversely, if price moves steadily downward with strong volume, sellers are unloading shares and outstripping demand: bears are taking this battle.

Because of the broad market implications and forceful nature of new 52-week highs/lows, market technicians keep a close eye on this statistic. The field of technical analysis has designed a number of indicators to grade the underlying momentum created by the events driving the market in either direction.

Rallies from a new 52-week high can be explosive, picking up steam as traders migrate to stocks that are making a consistent profit. If the broader market begins to see many shares making new highs, that has the power to drive most everything up, squeezing short sellers and igniting a rally - perhaps even a new bull market.

ADVANCE/DECLINE

Fifty stocks make up NIFTY. If Nifty moves up 25 points, there's no way to tell from that number if the increase is the result of only one stock going way up or many stocks each going up a small amount. The advance/decline data for the Dow can answer this question. If five stocks advance and 10 stocks decline (while 15 remain unchanged), then only a few stocks are responsible for carrying the market higher. Therefore, the rally is not broad-based.

In this section, we examine the many ways market technicians use advance/decline data to interpret the breadth of the market. The advance/decline numbers for the NIFTY and the SENSEX are reported each day, and some of the related charts are the most popular internal indicator.

Market Breadth: Conclusion

This directory on market breadth introduces traders to how they can gain an advantage in the market, but it will take time to master the movements of each individual indicator. Always rely first on the price data of the vehicle you're trading, and then check that the internal indicators reinforce your position.

CHAPTER 11:

The Importance Of Volume

To this point, we've only discussed the price of a security. While price is the primary item of concern in technical analysis, volume is also extremely important.

What is Volume?

Volume is simply the number of shares or contracts that trade over a given period of time, usually a day. The higher the volume, the more active the security. To determine the movement of the volume (up or down), chartists look at the volume bars that can usually be found at the bottom of any chart. Volume bars illustrate how many shares have traded per period and show trends in the same way that prices do.



Why Volume is Important

Say, for example, that a stock jumps 5% in one trading day after being in a long downtrend. Is this a sign of a trend reversal? This is where volume helps traders. If volume is high during the day relative to the average daily volume, it is a sign that the reversal is probably for real. On the other hand, if the volume is below average, there may not be enough conviction to support a true trend reversal.

Volume should move with the trend. If prices are moving in an upward trend, volume should increase (and vice versa). If the previous relationship between volume and price movements starts to deteriorate, it is usually a sign of weakness in the trend. For example, if the stock is in an uptrend but the up trading days are marked with lower volume, it is a sign that the trend is starting to lose its legs and may soon end.

When volume tells a different story, it is a case of divergence, which refers to a contradiction between two different indicators. The simplest example of divergence is a clear upward trend on declining volume.

Volume and Chart Patterns

The other use of volume is to confirm chart patterns. Patterns such as head and shoulders, triangles, flags and other price patterns can be confirmed with volume, a process which we'll describe in more detail later in this tutorial. In most chart patterns, there are several pivotal points that are vital to what the chart is able to convey to chartists. Basically, if the volume is not there to confirm the pivotal moments of a chart pattern, the quality of the signal formed by the pattern is weakened.

Volume Precedes Price

Another important idea in technical analysis is that price is preceded by volume. Volume is closely monitored by technicians and chartists to form ideas on upcoming trend reversals. If volume is starting to decrease in an uptrend, it is usually a sign that the upward run is about to end.

Now that we have a better understanding of some of the important factors of technical analysis, we can move on to charts, which help to identify trading opportunities in prices movements.

Gauging the Market's Psychological State

When volume is high, those traders unlucky enough to be losing money in their positions feel the sharp sting of their losses. In order to alleviate the pain, these traders quickly close their positions (at a loss). As losers exit the market, a trend based on high volume is likely to be short lived. But a trend based on moderate volume can last an extremely long time since small losses can accumulate over time into what may become very large losses. The longest trends are probably driven by markets either going nowhere, changing moderately or even moving both up and down day after day, forming only a gradual trend, which is apparent when viewed in retrospect.

On-Balance Volume (OBV)

Devised by Joseph Granville, on-balance volume is a running total, which rises or falls every trading day, based on whether prices close higher or lower than on the previous day. OBV is a leading indicator, so it typically rises or falls before that of the actual prices. A new OBV high indicates the power of bulls, the weakness of bears and the likely resultant rise of prices. A new OBV low indicates an opposite pattern: the power of bears, weakness of bulls and a possible decrease in value. When OBV shows a signal differing from that of actual prices, it indicates that volume (emotion of the market) is not consistent with consensus of value (actual prices) - a shift in price, which would alleviate this imbalance, is imminent.

Accumulation/Distribution (A/D)

Accumulation/distribution is also a leading indicator pertaining to volume, but it takes opening and closing prices into account. A positive A/D indicates that prices were higher when they closed than when they opened; a negative A/D indicates the opposite. But the bull or bear winners are only credited with a fraction of each day's volume, depending on the day's range and the distance from opening to closing price. Obviously, a wide range between open and close produces a stronger signal A/D, but the pattern of A/D highs and lows is most important. If a market opens higher and closes lower, thereby causing A/D to turn down, an upward-trending market may be weaker than it initially appears.

The significance of accumulation/distribution lies in its insight into the activities of the distinct groups of professional and amateur traders. Amateurs as a group are more likely to influence the opening price of the market since these amateurs base their first trades on the financial news they have read overnight as well as on the corporate news that was issued by their favorite companies after market close. But as the trading day wears on, the professionals determine the day's ultimate results. If the professionals disagree with the amateurs' bullishness at the open, the professionals will drive prices lower for the close. When the pros are more bullish than amateurs, the pros will drive prices higher all day and into the close. As indicators for future trends, the activities of professionals are generally more important than that of the amateurs.

Open Interest

Shifting from our discussion of volume, we find open interest as the next major indicator of crowd psychology. Open interest applies to the futures market and refers to a reading of future contracts or options expiring at a certain time in the future. Open interest adds the total long and short contracts in the market on a given day, and the absolute value of open interest corresponds to a cumulative long or short position. Open interest only rises or falls when a new contract is created or destroyed - one long and one short seller must enter the market to increase the open interest, and one long and one short seller must close their positions for open interest to fall.

Open interest is only of interest (pun intended) when it deviates from its norm. An absolute value is of no interest (bad pun again intended). Open interest reflects the psychology of the market by way of the market's inherent conflict between bulls and bears. To move the open interest indicator up or down, both bulls and bears must be equally confident that their long or short position is correct (or incorrect). A rising open interest demonstrates that bulls are confident enough to enter into contracts with bears, who are equally confident in their bearishness to enter into the position. One group will inevitably lose, but as long as potential losers (either bulls or bears) enter contracts, the rise or fall in open interest will continue. But there is more to the open interest picture than immediately meets the eye.

A rising open interest points to an increase in the supply of potential losers, propelling the trend forward. Open interest that increases during an uptrend reveals that a certain number of bears believe the market is too high; but, if the uptrend increases, their short positions will be squeezed, and their subsequent buying will propel the market even higher; however, open interest that remains relatively constant during a market uptrend indicates that the supply of losers has stopped growing as the only potential candidates to enter into a contract are previous buyers who are looking to make a profit from their position. In this case, the uptrend is likely nearing its end.

During a downtrend, shorts are selling aggressively while the only participants that are buying are bottom pickers. But even value investors exit their positions when prices fall too far, so prices will go even lower. If open interest rises in a declining market, the downtrend is likely to continue. If open interest remains flat in a downtrend, there are few remaining bottom pickers, and the only remaining candidates for the contract are additional bears that shorted earlier and now want to cover and leave the market. Bears that exit with a profit cause a flat open interest in a downtrend, meaning that the best gains from the downtrend have probably already been had.

Finally, a falling open interest shows that losers are exiting positions while winners are taking profits. It also shows there are no additional losers to take the place of those who have given up. The falling open interest is a clear signal that winners are taking their profits and running for the border while losers are giving up hope. A loss of a contract (and a declining open interest) points to the likely end of a trend.

Volume Oscillator

When volume is low but gains and loss are big, the professionals are most likely getting overly excited about a possible turn in market direction. That's because many have been taught that without strong volume, a market move is not valid. Here we look at how to interpret volume and the principles behind this doing so.

Simple but Powerful

Volume, volume, volume - it is the indicator at which chartists constantly look to determine whether or not a move in the markets, a sector or a single issue has conviction. It may also be the easiest of all indicators to understand. Add the number of shares traded in a given period, and you have the answer. It requires no weightings or exotic mathematical formulas. It simply indicates enthusiasm or lack thereof for an issue, and it has nothing to do with the price of the issue.

To confirm a market turnaround or trend reversal, the technical analyst must determine whether or not the measurements of price and volume momentum agree with each other. If they do not, it is a sure indicator of weakness in the trend, and thus a trend reversal may be well on the horizon. If we have a look at volume from the standpoint of momentum, we see a recognizable level of buying and selling activity.

The Oscillator

A volume oscillator measures volume by measuring the relationship between two moving averages. The volume oscillator indicator calculates a fast and slow volume moving average. The difference between the two (fast volume moving average minus slow volume moving average) is then plotted as a histogram. The fast volume moving average is usually over a period of 14 either days or weeks. The slow volume moving average is usually 28 either days or weeks. On a regular basis, analysts argue over whether or not the lengths of these time periods are appropriate. Some say that 14 and 28 are too conservative while others argue these numbers are not conservative enough.

Interpretation

If a market is rallying, the volume oscillator should rise. When the issue becomes overbought, the oscillator will reverse its direction. If the market is declining or moving in a horizontal direction, the volume should contract. Always keep in mind that we are measuring changes in volume, and volume expands during a sell-off. It is important to note that an increasing price together with declining volume is always, without exception, bearish. When the market is at the top, one would therefore see an oversold volume chart. Another important fact is that rising volume together with declining prices is also bearish.



A look at the chart above shows two significant run-ups in the volume oscillator after equally significant slides. The first is a result of the activity after Sept 11 and the subsequent market turnaround on Sept 21. The second is the result of the most recent fall-off this summer and the turnaround of over 1,500 points over the past three weeks or so. The stock then witnessed very low volumes with the rising market after the bounce on Sept 21. Volumes were low mostly because investors were still in shock; only the most steely-nerved investors got back in. The second case occurs in line with annual summer market conditions where, for the most part, the institutional players are gone for the month of August; furthermore, the pundits find little excitement, because of a lack of volume, when the market moves daily 100 points in either direction.

CHAPTER 12:

Moving Averages

Most chart patterns show a lot of variation in price movement. This can make it difficult for traders to get an idea of a security's overall trend. One simple method traders use to combat this is to apply moving averages. A moving average is the average price of a security over a set amount of time. By plotting a security's average price, the price movement is smoothed out. Once the day-to-day fluctuations are removed, traders are better able to identify the true trend and increase the probability that it will work in their favor.

Types of Moving Averages

There are a number of different types of moving averages that vary in the way they are calculated, but how each average is interpreted remains the same. The calculations only differ in regards to the weighting that they place on the price data, shifting from equal weighting of each price point to more weight being placed on recent data. The three most common types of moving averages are simple, linear and exponential.

Simple Moving Average (SMA)

This is the most common method used to calculate the moving average of prices. It simply takes the sum of all of the past closing prices over the time period and divides the result by the number of prices used in the calculation. For example, in a 10-day moving average, the last 10 closing prices are added together and then divided by 10. As you can see in Figure 1, a trader is able to make the average less responsive to changing prices by increasing the number of periods used in the calculation. Increasing the number of time periods in the calculation is one of the best ways to gauge the strength of the long-term trend and the likelihood that it will reverse.



Figure 1

Many individuals argue that the usefulness of this type of average is limited because each point in the data series has the same impact on the result regardless of where it occurs in the sequence. The critics argue that the most recent data is more important and, therefore, it should also have a higher weighting. This type of criticism has been one of the main factors leading to the invention of other forms of moving averages.

Linear Weighted Average

This moving average indicator is the least common out of the three and is used to address the problem of the equal weighting. The linear weighted moving average is calculated by taking the sum of all the closing prices over a certain time period and multiplying them by the position of the data point and then dividing by the sum of the number of periods. For example, in a five-day linear weighted average, today's closing price is multiplied by five, yesterday's by four and so on until the first day in the period range is reached. These numbers are then added together and divided by the sum of the multipliers.

Exponential Moving Average (EMA)

This moving average calculation uses a smoothing factor to place a higher weight on recent data points and is regarded as much more efficient than the linear weighted average. Having an understanding of the calculation is not generally required for most traders because most charting packages do the calculation for you. The most important thing to remember about the exponential moving average is that it is more responsive to new information relative to the simple moving average. This responsiveness is one of the key factors of why this is the moving average of choice among many technical traders. As you can see in Figure 2, a 15-period EMA rises and falls faster than a 15-period SMA. This slight difference doesn't seem like much, but it is an important factor to be aware of since it can affect returns.

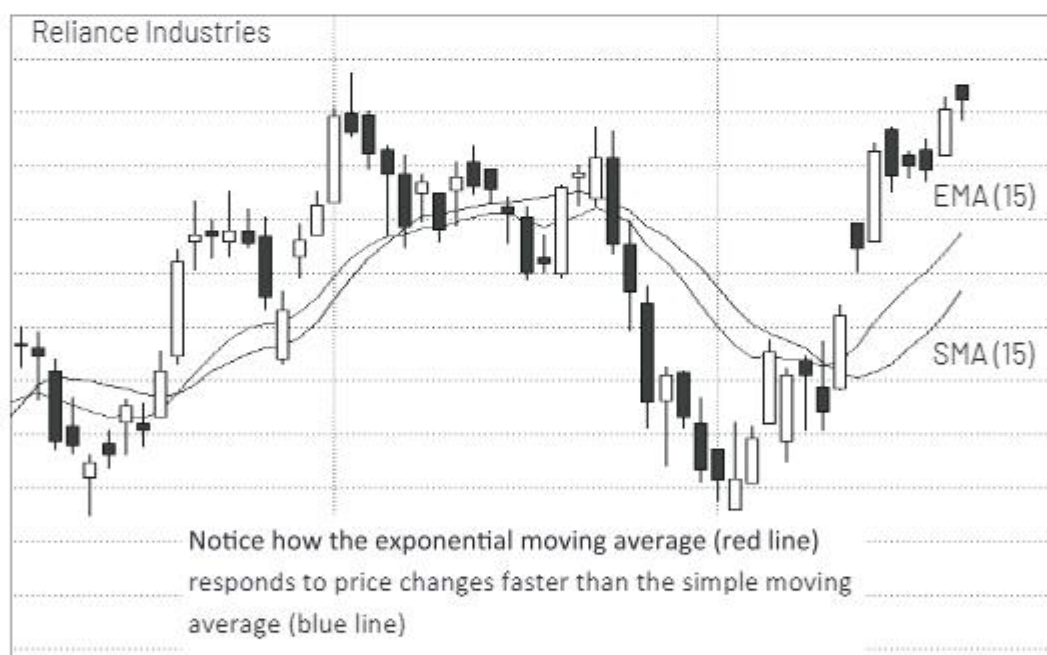


Figure 2

Major Uses of Moving Averages

Moving averages are used to identify current trends and trend reversals as well as to set up support and resistance levels.

Moving averages can be used to quickly identify whether a security is moving in an uptrend or a downtrend depending on the direction of the moving average. As you can see in Figure 3, when a moving average is heading upward and the price is above it, the security is in an uptrend. Conversely, a downward sloping moving average with the price below can be used to signal a downtrend.



Figure 3

Another method of determining momentum is to look at the order of a pair of moving averages. When a short-term average is above a longer-term average, the trend is up. On the other hand, a long-term average above a shorter-term average signals a downward movement in the trend.

Moving average trend reversals are formed in two main ways: when the price moves through a moving average and when it moves through moving average crossovers. The first common signal is when the price moves through an important moving average. For example, when the price of a security that was in an uptrend falls below a 50-period moving average, like in Figure 4, it is a sign that the uptrend may be reversing.

The other signal of a trend reversal is when one moving average crosses through another. For example, as you can see in Figure 5, if the 15-day moving average crosses above the 50-day moving average, it is a positive sign that the price will start to increase.



Another major way moving averages are used is to identify support and resistance levels. It is not uncommon to see a stock that has been falling stop its decline and reverse direction once it hits the support of a major moving average. A move through a major moving average is often used as a signal by technical traders that the trend is reversing. For example, if the price breaks through the 200-day moving average in a downward direction, it is a signal that the uptrend is reversing.



Figure 6

1. Moving averages are a powerful tool for analyzing the trend in a security. They provide useful support and resistance points and are very easy to use. The most common time frames that are used when creating moving averages are the 200-day, 100-day, 50-day, 20-day and 10-day. The 200-day average is thought to be a good measure of a trading year, a 100-day average of a half a year, a 50-day average of a quarter of a year, a 20-day average of a month and 10-day average of two weeks.
2. Moving averages help technical traders smooth out some of the noise that is found in day-to-day price movements, giving traders a clearer view of the price trend. So far we have been focused on price movement, through charts and averages. In the next section, we'll look at some other techniques used to confirm price movement and patterns.

CHAPTER 13:

Patterns

Chart patterns are an integral aspect of technical analysis, but they require some getting used to before they can be used effectively.

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.

Technical analysts and chartists seek to identify patterns as a way to anticipate the future direction of a security's price.

There is no one 'best' chart pattern, because they are all used to highlight different trends in a huge variety of markets. Often, chart patterns are used in candlestick trading, which makes it slightly easier to see the previous opens and closes of the market.

Some patterns are more suited to a volatile market, while others are less so. Some patterns are best used in a bullish market, and others are best used when a market is bearish.

That being said, it is important to know the 'best' chart pattern for your particular market, as using the wrong one or not knowing which one to use may cause you to miss out on an opportunity to profit.

Before getting into the intricacies of different chart patterns, it is important that we briefly explain support and resistance levels. Support refers to the level at which an asset's price stops falling and bounces back up. Resistance is where the price usually stops rising and dips back down.

The reason levels of support and resistance appear is because of the balance between buyers and sellers - or demand and supply. When there are more buyers than sellers in a market (or more demand than supply), the price tends to rise. When there are more sellers than buyers (more supply than demand), the price usually falls.

As an example, an asset's price might be rising because demand is outstripping supply. However, the price will eventually reach the maximum that buyers are willing to pay, and demand will decrease at that price level. At this point, buyers might decide to close their positions.

This creates resistance, and the price starts to fall toward a level of support as supply begins to outstrip demand as more and more buyers close their positions. Once an asset's price falls enough, buyers might buy back into the market because the price is now more acceptable - creating a level of support where supply and demand begin to equal out.

If the increased buying continues, it will drive the price back up towards a level of resistance as demand begins to increase relative to supply. Once a price breaks through a level of resistance, it may become a level of support.

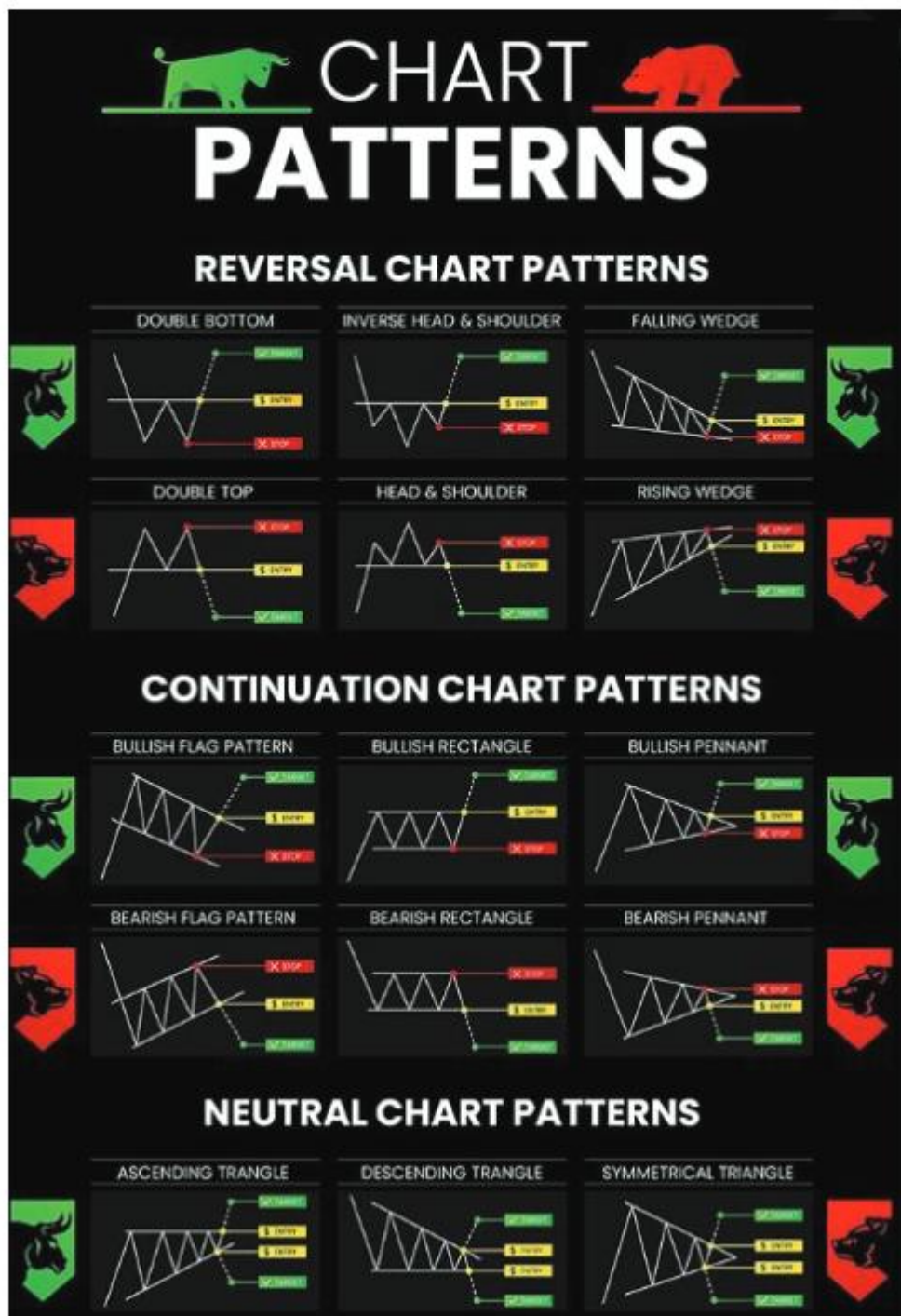
Types of chart patterns

Chart patterns fall broadly into three categories: continuation patterns and reversal patterns.

A continuation signals that an ongoing trend will continue

Reversal chart patterns indicate that a trend may be about to change direction

The most important thing to remember when using chart patterns as part of your technical analysis, is that they are not a guarantee that a market will move in that predicted direction – they are merely an indication of what might happen to an asset's price.



CHAPTER 14:

Momentum

In the stock market, momentum refers to the sustained increase or decrease in the price of an asset. The direction or trend followed by the price of the asset for a prolonged period of time, whether increasing or decreasing, is analysed by some investors to place their trades and make maximum gains.

In technical terms, momentum in stocks is a measure of the velocity at which the price of an asset changes. This is in opposition to the actual price levels. The momentum of a particular stock's price can be computed by measuring the price difference for a given time period continually.

Momentum measures the velocity of price changes as opposed to the actual price levels themselves. Momentum is measured by continually taking price differences for a fixed time period. To create a 10 day period momentum line you would subtract the closing price from 10 days ago from the last closing price. This result is then plotted around a zero line. A momentum value above zero indicates that prices are moving up, and below zero indicates moving down.

Momentum indicator has an upper and lower boundary which you must visually inspect the history of the momentum line and draw horizontal lines along its upper and lower boundaries. When the momentum line reaches these levels it may indicate that the stock may be overbought or oversold.

This makes interpreting an overbought or oversold condition subjective. When the Momentum indicator is overbought the security can continue to move higher. When the Momentum indicator is oversold the security can continue lower as well. Use the Momentum indicator in conjunction with additional indicators or price analysis when attempting to read overbought or oversold conditions.

Crossing above the threshold levels during an uptrend would be a buy signal and a crossing below the zero line during a downtrend would be a sell short signal. When using these signals users generally trade in the direction of underlying prices make a new high or low that isn't confirmed by the Momentum Indicator, the divergence may signal a price reversal.



If underlying prices make a new high or low that isn't confirmed by the Momentum Indicator, the divergence may signal a price reversal.

How does Momentum Trading work?

As per Momentum Trading, you should enter a stock when its price has just started moving up and exit as soon as it starts declining. The idea behind this strategy is that the costs of stores often don't reflect their actual value for an extended period, and they tend to move in one direction for long periods.

Momentum trading is a strategy that aims to capitalize on the continuance of existing trends in the market. Momentum traders usually buy or sell an asset moving intensely in one direction and exiting when this movement shows signs of reversing. They also seek to avoid buying or selling assets that are moving sideways.

Momentum trading requires identifying the prevailing trend and then picking stocks that have the most robust momentum within that trend.

For example, suppose you are bullish on the Indian stock market and would like to go long on stocks with solid momentum. You would first look at a chart of the Nifty index to identify the prevailing trend (upward) and then identify stocks with solid upward momentum within this broader bullish trend.


Momentum traders do not hold stocks for long periods; they enter and exit trades quickly, sometimes having stores for as short a day or even an hour or less, depending on their technical indicators.

Conclusion


Momentum traders believe that prices that have been moving in one direction over some time will continue to move in that direction for a limited period. They believe that buying high price momentum stocks and selling low price momentum stocks will result in portfolio outperformance.



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