How Are Candlesticks Formed on a Trading Chart?

Candlesticks are like the X-ray vision of a market. You can see what's happening under the surface, like changes in a market's strength and direction and how emotions shape the trends.

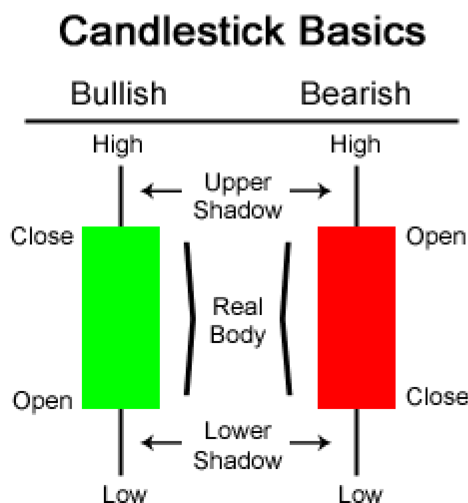
Each candlestick represents price information in a specific unit of time, such as one trading day in a daily chart, one hour in an hourly chart, and so on. By changing the time frame on a chart, the candlesticks will also change accordingly. Let's look into the components of candlesticks next to understand how they form and what they represent.

Candlestick Components

The four components of a candlestick are the **open**, **close**, **high**, and **low** prices for a specific time period.

How to Read Candlestick Charts Candlesticks summarize a period's trading action by visualizing four price points:

Let's look at an example of a daily time frame candle:



Open :- Open Price at the beginning of the period

close :- Close Price at the end of the period

High :- The maximum price achieved during that period

Low :- The lowest price of the asset during the period

What Are the Parts of a Candlestick Chart?

There are three main parts to a candlestick:

Upper Shadow (upper wick):

The vertical line between the high of the day and the closing price (bullish candle) or open (bearish candle)

Real Body: The difference between the opening price and closing prices. This is shown by the colored portion of the candlestick.

Lower Shadow (Lower wick): The vertical line between the low of the day and the open (bullish candle) or close (bearish candle)

A green (or white) body indicates that an asset's price moved higher over the day's trading.

A red (or black) body indicates that prices ended lower than they were at the day's opening.

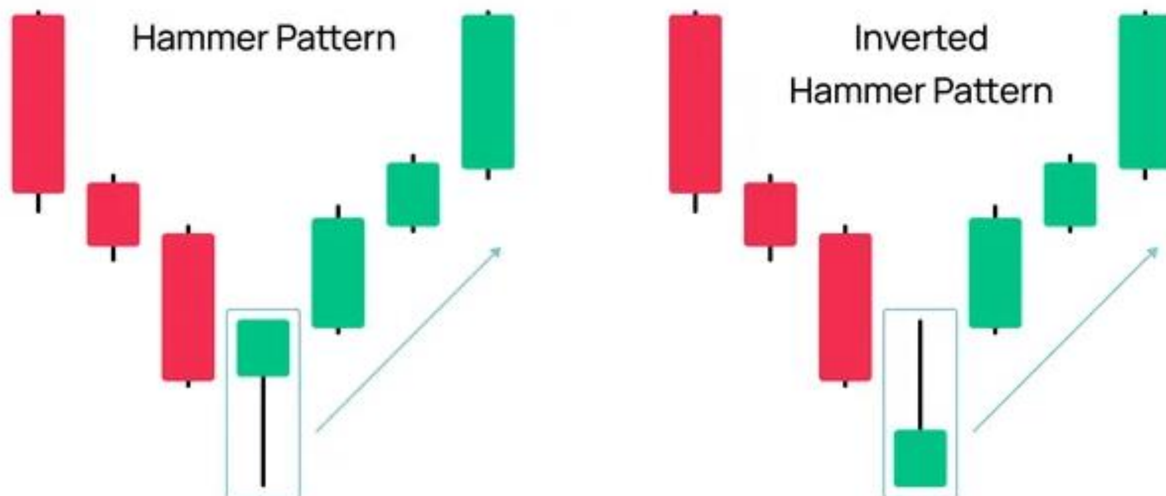
How to Interpret Price Movement on a Candlestick Chart

There are two basic candlesticks which are illustrated on the image above:

Bullish Candle: When the close is higher than the open (usually green or white)

Bearish Candle: When the close is lower than the open (usually red or black)

Hammer and Inverted Hammer

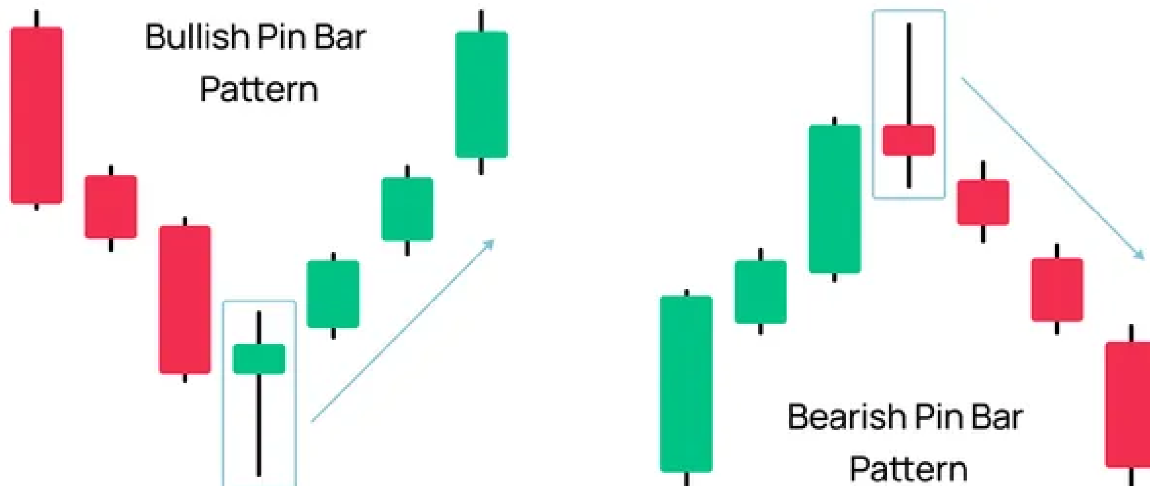


A hammer candlestick pattern is a bullish reversal pattern that is most accurate at the bottom of a downtrend. It signals that sellers are losing power and are being outnumbered by buyers. Traders look for the hammer pattern as a signal to buy, as it suggests that the price will likely rise in the near future.

The candlestick has a small body, a long lower shadow, and no upper shadow. Also, the lower shadow has to be longer in height than the candlestick's body for the pattern to be valid. The color of the body of a hammer candlestick can be either green or red.

The inverted hammer pattern looks the same as the hammer pattern. The only difference is that it's upside down. Despite being called "inverted," it's still a bullish reversal pattern. It indicates the end of a downtrend and a possible trend reversal to the upside.

Pin Bar

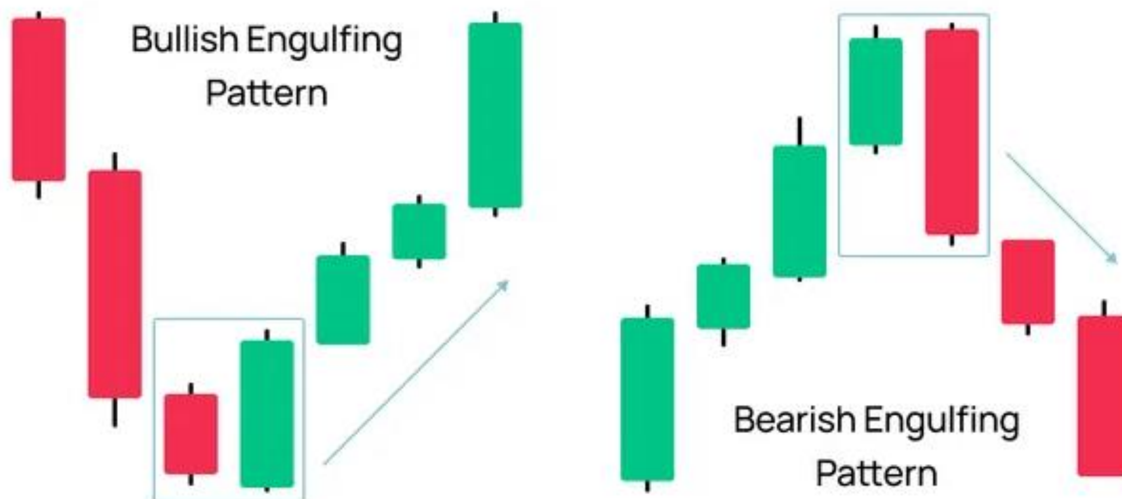


The pin bar candlestick pattern is undoubtedly the most traded pattern out there, and it is for a good reason. This pattern is used by traders to identify possible trend reversals or continuations after a pullback. Its accuracy is significantly higher when it forms around key support and resistance levels, trendlines, and moving averages.

The bullish pin bar is characterized by a long lower shadow, with a small body and a relatively short shadow on the other end. The tail of the pin bar (the lower shadow) has to be at least two-thirds of the entire length of the candlestick for the pattern to be valid.

The bearish pin bar is the opposite of the bullish pin bar. It has a long upper shadow, a small body, and a short lower shadow. This rejection of higher prices signals that the market may be losing momentum and that a bearish reversal may come soon. Once a bearish pin bar is confirmed, traders look for short selling opportunities.

Engulfing



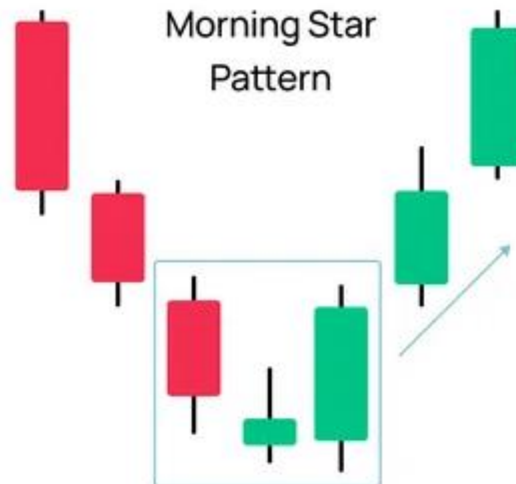
The engulfing candlestick pattern is one of the most common patterns used by traders to identify trend reversals and continuations after a pullback in the financial markets.

In a bullish engulfing pattern, the first candlestick is red, and the second one is green. The body of the green candlestick is much larger than the body of the red candlestick, with very little to no overlapping shadows. Also, the green candlestick has to open lower than the previous candlestick's close and close higher than the previous candlestick's high. The bullish engulfing pattern indicates that buyers have taken control, and the price will likely go up.

A bearish engulfing pattern is valid when a green candlestick is followed by a larger red candlestick. The exact opposite of a bullish engulfing pattern. The green candlestick must completely cover (or engulf) the previous candlestick. The pattern suggests that the bears have taken charge of the market and indicate a possible decline in price in the near future, so traders look for shorting opportunities.

The Morning Star

The Morning Star



The morning star pattern essentially implies the bullish state of the market, as the appearance of the morning star is just before sunrise. It is more accurate when it forms at the end of a downtrend. The morning star is a three-candlestick pattern:

The first candlestick is a bearish candlestick with relatively small shadows.

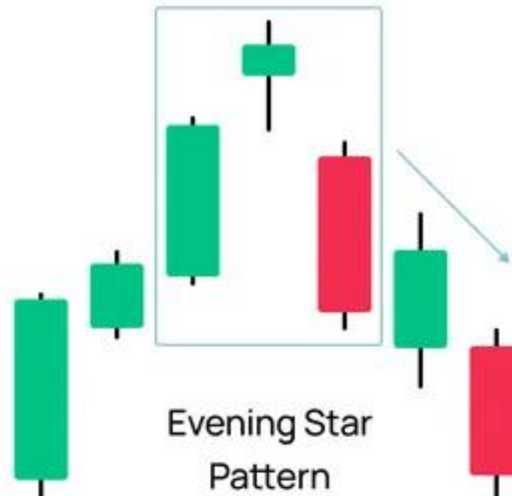
The second candlestick has a small green or red body and short shadows. This candlestick forms at the lower end of the first candlestick.

The third candlestick is a bullish candlestick that indicates strong buying pressure and a potential trend reversal. The body of this candlestick has to be at least the same size as the first candlestick or bigger.

Traders look for the morning star pattern as a signal to buy, as it suggests that the price will likely rise soon.

The Evening Star

The Evening Star



The evening star pattern is the upside-down version of the morning star pattern. It indicates the reversal of an uptrend into a downtrend. The three candlesticks are characterized as follow:

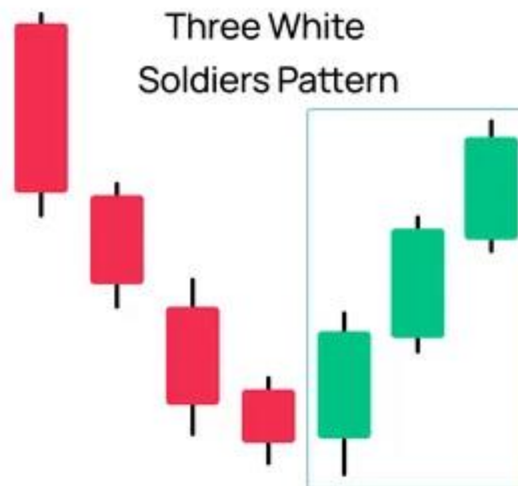
The first candlestick is a bullish candlestick with relatively small shadows.

The second candlestick has a small green or red body and short shadows.

The third candlestick is a bearish candle, and the body is bigger than the first one (or at least the same size).

Three White Soldiers

Three White Soldiers



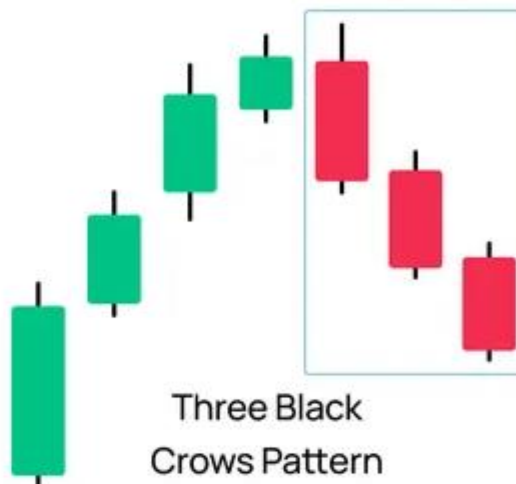
The three white soldiers pattern is a bullish reversal pattern consisting of three green candlesticks with small shadows. This pattern is more reliable when it forms in a downtrend that has been developing for a longer period of time.

For this pattern to be valid, each candlestick has to open near the previous candlestick's close price.

Traders and analysts often interpret this pattern as a signal to enter long positions or add to existing ones, expecting further price gains.

Three Black Crows

Three Black Crows



The three black crows pattern is a bearish reversal pattern that is more accurate when it forms at the end of an uptrend. Think of it as an upside down three white soldiers pattern.

This pattern is formed by three consecutive bearish candlesticks. The opening of each candlestick occurs at the previous candlestick’s closing price, and the closing price is lower than the opening price. The three black crows pattern is particularly significant when it occurs at higher price levels or after a mature advance, indicating a potential decline in prices.

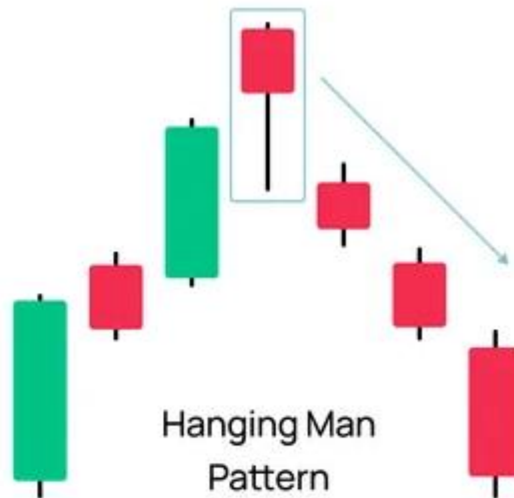
Dark Cloud Cover

The dark cloud cover “phenomenon” signals the potential end of an uptrend. It is a two-candle pattern where the first candle is a long green candlestick, followed by a long red candlestick that opens above the previous candlestick’s close. During its trading period, the price starts to decline significantly and the red candlestick closes below the midpoint of the first candlestick’s body.

This pattern suggests that the sunny days of the current uptrend are coming to an end. Bulls are losing control, and the bears are taking over.

Hanging Man

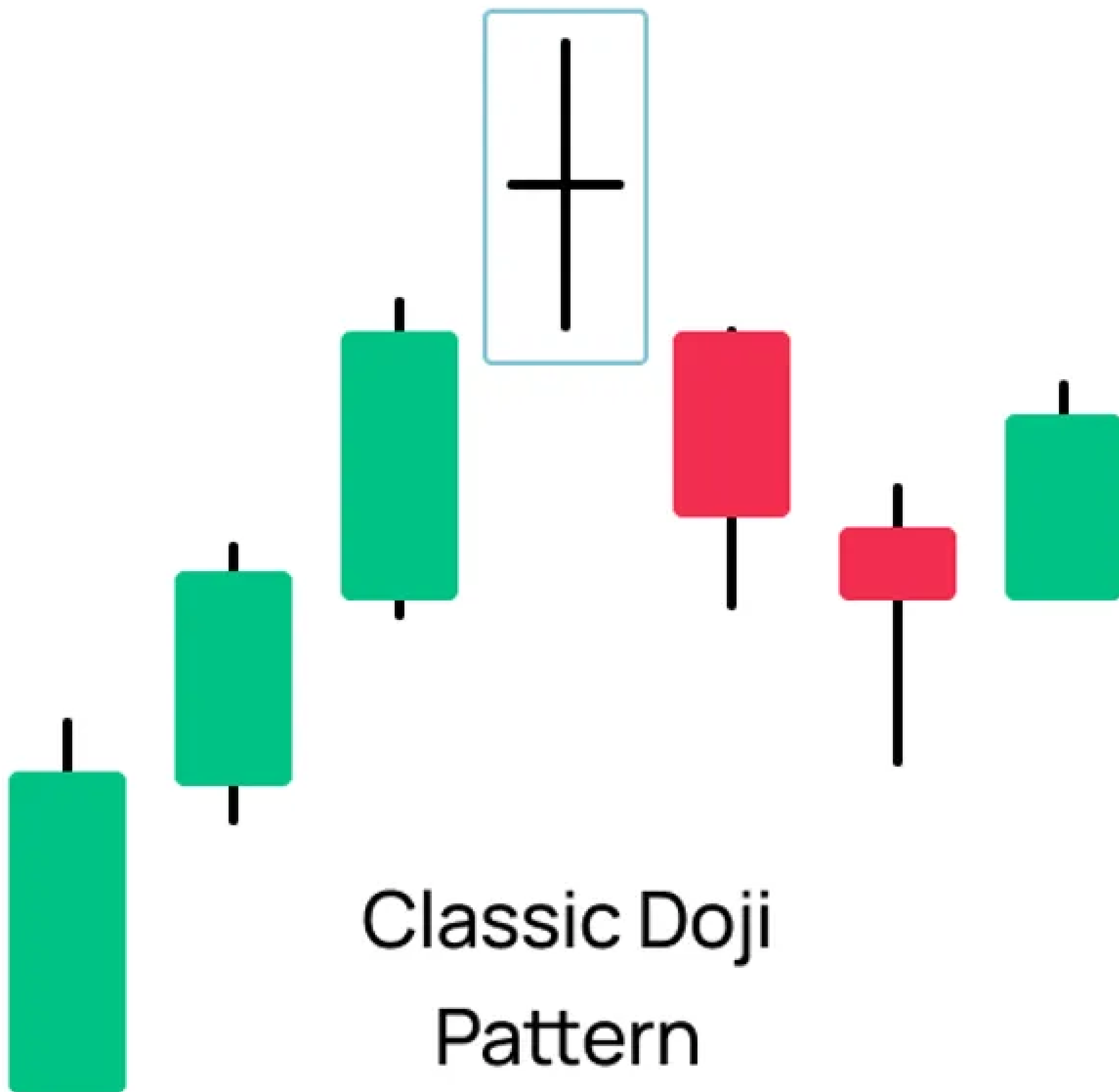
Hanging Man



The hanging man pattern is a bearish signal. The shape of the Hanging Man candlestick resembles a person hanging by their feet, hence the name. It typically occurs after an uptrend in the market and suggests that the bullish momentum may be weakening or reversing. The hanging man candlestick has a small body positioned at the top of the

candle and a long lower shadow. The lower shadow must be at least twice as long as the candle's body, and there must be a small or no upper shadow.

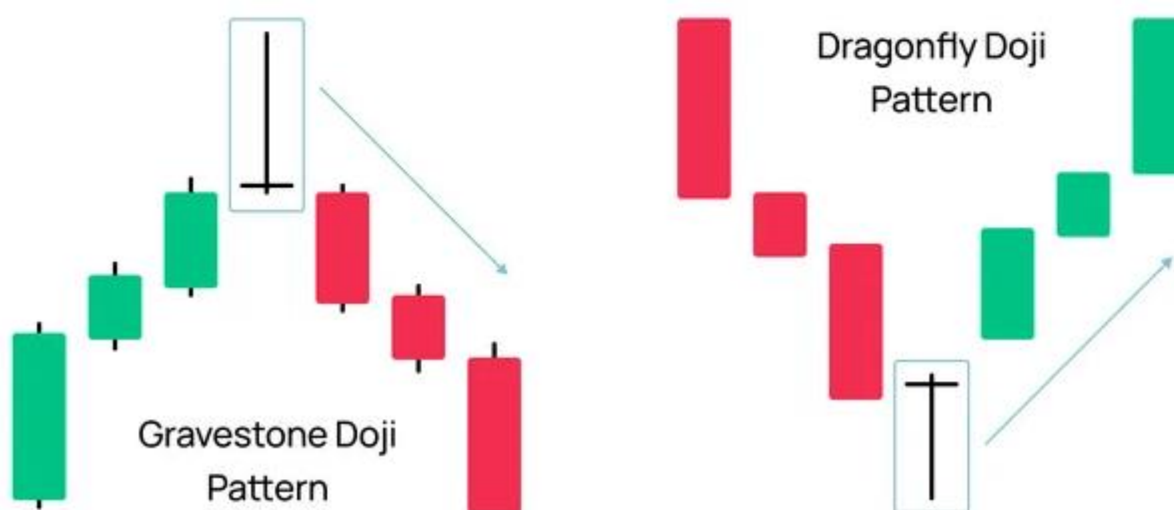
Doji



The term “doji” in Japanese translates to “the same thing,” and it refers to the candlesticks with the open and close prices more or less the same. The length of the upper and lower shadows can vary.

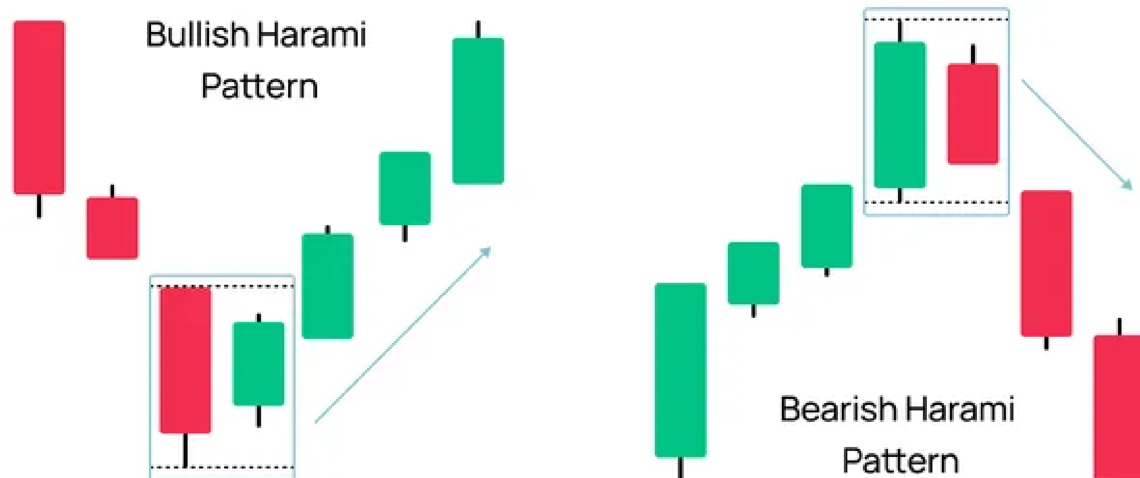
A classic doji pattern is a candlestick pattern that indicates indecision and uncertainty in the market. The pattern indicates that neither the buyers nor sellers are in control and that the market is in a state of equilibrium. Traders interpret the presence of a doji pattern as a signal to exercise caution and await further confirmation or additional information before making any decisive buying or selling decisions.

There are different types of doji patterns, including the classic doji (which was described above), gravestone doji, and dragonfly doji. Each type of doji pattern has its own unique characteristics and interpretation.



Gravestone doji and dragonfly doji are very similar to the bearish and bullish pin bar patterns except for the size of the body. A doji candlestick has no body, meaning that the opening and closing prices are virtually the same, while a pin bar possesses a small body. In general, **pin bars are more reliable than gravestone or dragonfly doji candlesticks.**

Harami



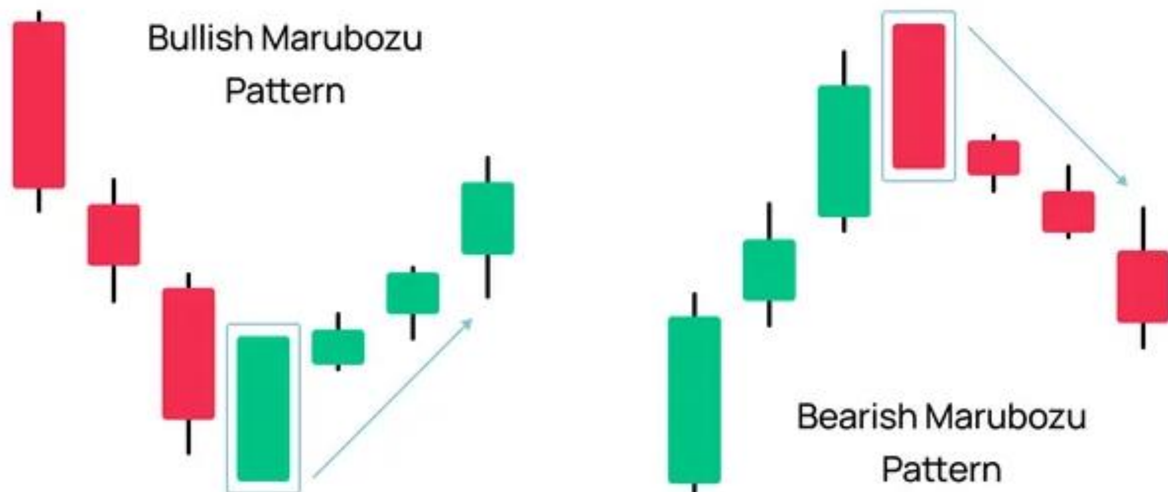
The word “Harami” in Japanese means “pregnant.” The term represents the pattern’s appearance, which resembles a pregnant woman’s body with a small candlestick “inside it.” Don’t judge. I didn’t come up with this name.

The harami pattern is formed by two consecutive candlesticks. The first candlestick has a long body and small shadows. The second candlestick is a small candle with a body that is entirely inside the previous candlestick’s body.

In an uptrend, the harami pattern will have the first candlestick green and the second candlestick red. This indicates a possible trend reversal.

Likewise, in a downtrend the first candlestick is red, and the second one is green—a good time to look for buying opportunities.

Marubozu

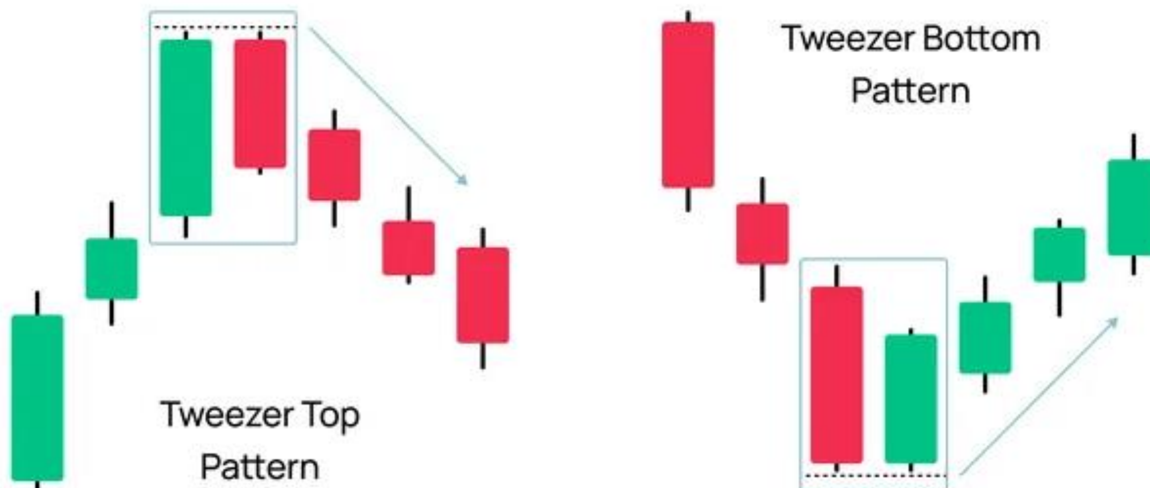


The term marubozu means “bald head” or “shaved head” in Japanese. The Marubozu pattern is a candlestick with a long body with no shadows. It can either be bullish or bearish depending on its color and is the most accurate in trend continuations after pullbacks.

A bullish marubozu is a long green candlestick with no upper or lower shadow. This candlestick indicates that buyers controlled the market price from the open to the close, suggesting a strong bullish sentiment.

A bearish Marubozu is the opposite of a bullish Marubozu. The candlestick has a long red body with no upper or lower shadow, indicating that the price opened at its high and closed at its low. This suggests that the bears were in complete control of the market and that selling pressure remained strong throughout the session.

Tweezer Top and Bottom



The tweezer pattern is a short-term reversal pattern and it forms when two candlestick bodies have the same highs (in an uptrend) or lows (in a downtrend). This pattern indicates a struggle between buyers and sellers and can signal a potential trend reversal.

In a downtrend, the pattern is called **tweezer bottom**, and requires two consecutive candlestick bodies of either color to reach the same low point. This formation indicates that buyers are entering the market, as they were able to push the price back up from the low reached by the first candlestick.

When the market is in an uptrend, traders refer to the pattern as a **tweezer top** and it requires two consecutive candlesticks to have the same highs to be considered valid. This pattern signals a shift in market momentum and a potential trend reversal as bears begin to take control of the market.