

ABOUT THIS BOOK

A picture is worth a thousand words.

This book was born from the idea that life can be made simpler and time can be used more wisely. As Leonardo da Vinci once said, “Simplicity is the ultimate sophistication.”

With specific reference to trading and investing, candlestick trading and chart reading can be made simpler, easier to analyze, and used for better decisions. And these are the objectives of this first book on the subject of heikin-ashi.

Many people use traditional Japanese candlesticks. Thousands of books and software packages are available on the subject, and one can find courses, seminars, and webinars about this visual representation everywhere in the world. The same could be said about the number of newsletters and websites that discuss candlesticks and identify and recommend reversal or continuation patterns. Cheat sheets, like the ones we may have used in school, have been developed to help people memorize candlestick patterns.

Japanese candlestick patterns are very popular today. They have very flexible rules and interpretations “in the context.” Everyone translates them, more or less, in a subjective manner. My personal interpretations may be different from yours, the reader, or from

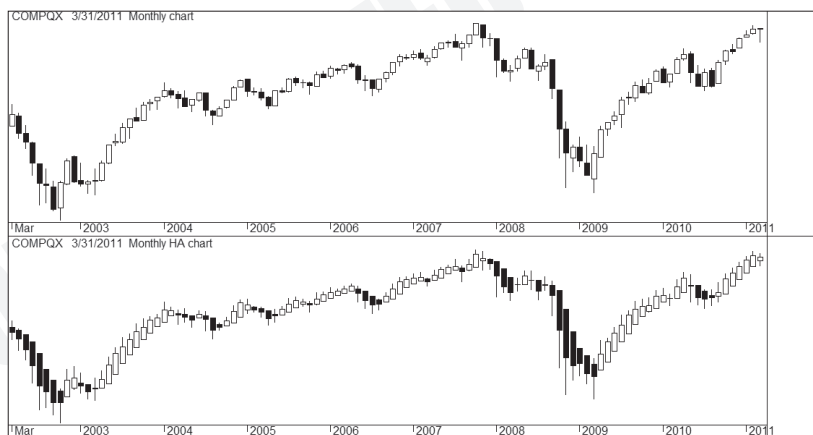
that of the top experts in this field. These facts lead to the reality that candlestick patterns are subjective, artistic, and challenging, so traders need a more objective, quantifiable tool. And this is the main subject of this book.

While it is true that things work as they are now, they could work even better with a little help from new our friend, heikin-ashi.

Obviously then, this book is intended for readers who already have some familiarity with Japanese candlestick patterns and is not intended to teach readers how to use them in trading.

Rather, the main objective of this book is to bring the heikin-ashi technique to a wider audience and consider it vis-à-vis traditional candlestick patterns. There is no competition between the two; rather, there is a *synergy*.

While traditional price candles appeal to the more artistic and subjective judgement (Right Brain people), heikin-ashi candles are a far more evident way to display trends and reversals, as shown in the figure below.



For instance, consider this compare-and-contrast example for the monthly NASDAQ Composite Index (COMPQX). The upper pane displays the index using Japanese candlesticks, and the lower

pane shows a chart using heikin-ashi candles. Both representations cover the same period in a monthly time frame. The visual difference is the striking clarity of the upward/downward trends and the consolidations introduced by heikin-ashi charting. The color changes with the trends, and doji-like candles with upper and lower shadows point to trend reversals. Series of heikin-ashi candles with both high and low shadows define periods of price consolidation. Turning points are sharper, and trend analysis improves.

Furthermore, the very simple quantification makes the heikin-ashi technique attractive to those who tend to take a more analytical, more precise approach (Left Brain people). In other words, **heikin-ashi appeals to both sides of the brain in a complementary and efficient way.**

Throughout this book we will use terminology like *heikin-ashi candles* and *modified candles* to refer to candles on a heikin-ashi chart. *Doji-like candles* are references to candles with smaller bodies and upper and lower shadows.

The learning objectives of this book are intended to help you become more effective and efficient in analyzing markets and making trading decisions. For instance:

- You will learn how to trade better with a lot less time and effort.
- You will learn how to reduce dependency on candlestick patterns or how to use the two techniques together—and to your advantage.
- You will get a crash course in the heikin-ashi technique for better trading and investing.
- You will learn to quantify heikin-ashi candles, with direct and improved impact on trends and reversals.

- You will learn how to detect earlier indications of trend weakness and change.
- You will review popular Japanese candlestick patterns and learn how to easily translate them using only five simple heikin-ashi rules.
- You will walk through examples and discussions on charts using both traditional Japanese candlestick patterns and heikin-ashi candles and quantification.
- You will see charts using heikin-ashi for different instruments and time frames.
- You will learn how to use heikin-ashi with technical indicators.
- You will learn how heikin-ashi works with Ichimoku charts.
- You will learn how heikin-ashi can be used to gauge market strength.
- You will get ideas to develop your own strategies based on modified candles.

This book consists of three major parts, each of which has been organized into short chapters for easy understanding and comprehension. Each chapter concludes with a “30-Second Summary” that highlights key points.

Part One offers a crash course by total immersion in heikin-ashi charting. At the end, you should understand the essential fundamentals of this technique.

Chapter 1 defines what heikin-ashi is and is not. The second chapter outlines the five simple rules to define modified candles and applies them on charts for quick understanding and use of this technique. How are trends and consolidations identified on any heikin-ashi chart using the new rules? Chapter 3 shows the technique.

In Chapter 4 you are introduced to a novelty: quantification of the heikin-ashi candles. The two indicators defined in this chapter are a complement to the visual side of the technique. The first indicator, haDelta, is of leading nature, sometimes too nervous and rough but easily smoothed with a moving average. The benefits resulting from using haDelta singularly or together with other analysis tools are evident.

Volume is considered by many a secondary variable used to confirm a trend. Chapter 5 describes how heikin-ashi charts are used with this new dimension.

Modified candles are a unique visual representation of trends and consolidations. In addition, there are other indicators used for trend analysis that quantify traditional price candles and their frequency. They offer another view of trends and turning points on price charts. Chapter 6 discusses two very simple, yet powerful, relatives of heikin-ashi: Qstick and psychological line indicators.

Before going to Part Two, it is time for a warm-up in Chapter 7 where we discuss some Japanese candlestick patterns vs. their heikin-ashi translations.

Part Two is the arena where traditional and modified candles meet *mano a mano* (hand to hand). We review popular Japanese candlestick patterns and compare each of them with the heikin-ashi technique in both formats, visual and quantifiable. You will see how time and money investment in Japanese candlestick patterns is significantly reduced by simple heikin-ashi chart reading. The compare-and-contrast charts will easily convince you to add the heikin-ashi technique to your trading and investment analysis tools.

Chapters 8 through 20 look at 28 Japanese candlestick patterns used by most traders and discuss the challenges of using these patterns. Although this book is not specifically about Japanese candlestick patterns, each of these chapters looks at candlestick pattern definitions, raises questions about their objectivity, and compares pattern expectations with heikin-ashi resulting signals. Most of the examples presented show the benefits brought by the heikin-ashi technique both as a visual tool and technical indicator.

Before going further, we must reiterate that heikin-ashi complements interpretations of Japanese candlestick patterns. Heikin-ashi helps to confirm, or not confirm, the expected outcome on Japanese candlestick charts.

Should heikin-ashi totally replace the traditional candlestick analysis? Should it work together with what you already know and use in terms of candlestick knowledge? Is heikin-ashi a tool that saves you time and money, and improves your trading and investing? Part Two ends with answers to these and other questions about using heikin-ashi.

Part Three is where we marry heikin-ashi with other technical analysis tools. Averages are simple, yet powerful, tools for traders. Chapter 21 describes how to use modified candles with averages.

In Chapter 22 you see how heikin-ashi works in multiple time frames. This is a powerful approach where the new technique is easily applicable, with better results. Use of time frames is very important; the correct approach is even better. Usually two time frames are sufficient; three are best. Alignment of entry and exit signals in two time frames is better than in one. The same results apply and are expected in three time frames vs. two. More identical signals in two or three consecutive time frames generate safer and better results, and the degree of confidence improves dramatically.

About forecasts Yogi Berra once said, "It is tough making predictions, especially about the future." We take a calculated risk here and discuss in Chapter 23 a simple method to compute the profile of the next heikin-ashi candle. Will it be white or black? With all risks involved and accepted, an educated computation about the immediate future is an advantage.

Volatility is an important variable to deal with in any market and time frame. The use of Bollinger bands with oscillators or ADX is already a component of many strategies. In Chapter 24 you will see how volatility works with heikin-ashi charting. As a novelty for many traders, we will discuss the use of the z-score indicator with heikin-ashi. Why z-score? It improves the visual perception of the volatility.

Chapter 25 looks at a popular indicator, Relative Strength Index (RSI), and its use with modified candles.

The new, yet rather old, kid on the block in recent years is Ichimoku charting. It is considered a complete trading system: trend identification, trend strength, entry, stop-loss, trailing-stop, and exit, except for bring-your-own money and risk management strategy. Chapter 26 builds the foundation for a productive partnership between the heikin-ashi technique and Ichimoku Cloud charts.

Even at this early stage, the monthly heikin-ashi NASDAQ chart shown previously in this section hints that this technique can be used to measure the strength of a market or sector. Chapter 27 shows the steps to quantify the strength.

Everyone loves turning points (pivots) and especially buying and selling at market sweet spots. There are many ways to define stronger or weaker pivots. Chapter 28 shows how to associate price pivots with heikin-ashi charting.

Since the publication of my article about the heikin-ashi technique in *Technical Analysis of Stocks & Commodities* in February 2004, many FOREX traders started using this technique in its original format or with modifications. Chapter 29 covers the use of heikin-ashi as a visual and technical indicator for those interested in FX markets.

The examples illustrated and discussed in this book are part of the wide range of markets and techniques with which heikin-ashi can be used. By the end of this book, I hope that you, the trader or investor, will seriously consider adopting modified candles. Be nice with them, and they will reward you.

I am convinced that the journey that follows will benefit you; the door to better trend trading and investing is open.

Feedback is a powerful tool to improve products, services, and trading results. Feel free to drop a message at ha@educofin.com with questions, thoughts, or ideas about heikin-ashi. I am delighted to keep in touch. Great heikin-ashi trading!

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