

Viper Trading Lesson

The Most Profitable Candle Formations

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In training new investors and traders I always urge them to look at candle charts as they can give you important information that is not available from bar charts. The formation that I play the most attention to is the doji candle. It is formed when the open and close of the time period are about the same.

This is a sign that a market is indecisive as the bulls and bears have not been able to move the market very far from the opening price. The behavior of the market after the doji is formed can be helpful in determining a change in trend.

As is the case with all technical methods the longer time periods have more reliable signals. Therefore the monthly signals are more reliable than the weekly and the weekly are more reliable than the daily signals.



The signals occur when the market closes either above the doji high or below the doji low. Part of my regular daily, weekly and monthly routine is to look for the formation of dojis. The monthly chart of Apple Inc. (AAPL) from 2012 to 2016 demonstrates several good examples of doji signals. In September 2012 AAPL opened at \$87.45 and closed at \$87.62 thereby forming a doji, point 1.

In October 2012 (point 2) AAPL closed at \$78.20 which was well below the doji low at \$87.62 which triggered a sell signal.

This meant that it would take a move above the doji high of \$92.61 to reverse this signal. In April 2013 (point 3) AAPL had dropped to a low of \$51.11 but then rallied to close at \$58.77. This was very near the month's open at \$58.65 so a doji was formed.

The large gap between the low and the close is called a tail and suggests that the market had stopped out many longs at the lows before it rallied. In May AAPL closed at \$60.08 (point 4)

which was above the doji high of \$58.77. Therefore a buy signal was generated that would only be reversed on a drop below the doji low of \$51.11. The following month AAPL reversed to close at \$52.98 but with a monthly low of \$51.95 the doji buy signal was still intact. Then in July the stock rebounded to close at \$60.46 which was the start of a rally to the 130 area.



By the time the monthly doji sell was generated in October 2012 with the close at \$78.20 AAPL was already down 10.7% from the prior month's close. This is why it is important to also look for doji signals on the weekly charts. The week of September 21, 2012 (point 1) AAPL formed a doji with a close at \$91.96 and a low of \$91.11.

The following week AAPL opened at \$90.22 and closed the week at \$87.62 which was well below the doji low as a sell signal was triggered with a stop above \$92.61. The next week AAPL rallied as high as \$88.89 before closing at \$85.72.

As I explained in an earlier trading lesson on entry strategies (email us if you did not get a copy) one can often determine an initial entry from the prior week's range. In this case the range for AAPL was \$4.56 as the high was \$91.30 and the low was \$86.74. By adding 1/3 of the range to the low $\$1.50 + \86.74 you get \$88.24 as the initial entry on the short side which would have been filled the following week.

In the next six weeks AAPL dropped as low as \$66.73. It then rebounded for 2/12 weeks as AAPL reached a high of \$78.41 which was just below the 50% Fibonacci retracement resistance . By April 2013 AAPL had dropped as low as \$51.11.



The most reliable buy signals occur after a market has been declining and the most relevant sells come after a stock or ETF has rallied. Linear Technology Corp. (LLTC) was on the buy list several times this year before it was bought out. On April 20th and 21st LLTC reached the daily starc+ bands, point 1. Therefore it was in a high risk buy and a low risk sell area.

This set the stage for a pullback as it corrected for almost the next two weeks as it hit a low of \$42.97 on May 4th (point 2) and formed a doji. Two days later LLTC closed at \$43.72 which was above the doji high of \$43.62. By early June LLTC had reached a high of \$47.50.



It can give you more confidence when the doji signal the other technical studies also support the doji buy or sell decision. The iShares Russell 2000 peaked in late April and then embarked on a three-week correction. On May 19th (point 1) IWM formed a doji as the Russell 2000 A/D line had dropped back to support at line a.

The next day (point 3) IWM rallied to close at \$110.19 which was well above the doji high of \$109.17. Those traders who watch the markets during the day could have gone long in the last 10 minutes or so of trading as they were confident that IWM would close above the doji high.

If it is a daily doji signal then those who buy the next day should look to establish a position near the previous close. In this example IWM opened the next day at \$110.17 and traded as low as \$109.90. Two days after the doji buy IWM closed strong. This was accompanied by the Russell 2000 A/D line moving strongly above its WMA and overcoming the downtrend, line b. The A/D line continued to rise strongly confirming the doji buy signal.



Noah Holdings (NOAH) dropped to a low of \$12.89 the week of October 3, 2014 which was well above the May low of \$12.35. Two weeks later it formed a doji, point 1, as is it had a tight range with a high of \$14.24 and a low of \$13.38. The week's open was \$13.86 and it closed at \$13.88.

The next week NOAH closed at \$14.95 which was well above the doji high and the volume was twice the previous week. The weekly OBV had dropped to support (line a) prior to the formation of the doji and was above its WMA as the doji was formed. Just seven weeks later NOAH made a high of \$25.60 before correcting for the next seven weeks. The weekly OBV stayed positive as NOAH made a high of \$37.96 in May 2015.



As you start looking for dojis you will often see the formation of multiple dojis in the same stock or ETF. In my experience this just amplifies the importance of the original doji. The daily chart of Bank of the Ozarks (OZRK) illustrates this point.

On November 11th 2015 OZRK formed a doji (point 1) with a high of \$54.36. The following day it closed at \$52.28 and below the doji low generating a sell signal. The stock corrected for two more days but then turned higher. On both Wednesday November 25th and Friday November 27th (points 2 and 3) it formed dojis with the Thanksgiving holiday in between.

The stock continued higher the next day but peaked at \$54.30 which was still below the November 11th doji high. On Thursday of the following week OZRK closed at \$52.12, point 4, which was below the twin doji lows. OZRK moved sideways for two days before dropping 7.3% to a low of \$48.29. This was the early stages of a slide that took OZRK to a low of \$40.31 in late January.



Frequently you will also observe that doji buy or sell signals will often occur near key Fibonacci or pivot levels. Often tops are formed when a market forms a weekly doji at monthly pivot resistance.

Monolithic Power Systems (MPWR) dropped sharply in late August of 2015 and then in early September gave a weekly buy signal. This was the start of a sharp rally that peaked out in December 2015. This made it a stock to watch on the next correction.

The Fibonacci retracement levels on the weekly chart can help you target where a correction in the stock might end. The 38.2% support was exceeded in early January and then five weeks later it hit a low of \$54.85. This was just above the 50% support at \$54.38 and there was quarterly pivot support at \$52.45.

Two weeks later on February 26th MPWR formed a doji (point 1) which coincided with a rising OBV. As the doji was formed the OBV had traced out a typical corrective pattern as there was key resistance at line b. The next week (line 2) MPWR closed at \$61.40 which was well above the doji high of \$59.41. Over the next two weeks MPWR traded as low as \$57.64 which was still well above the doji low of \$54.70.

In the Viper Hot Stocks Report each Monday the results of my weekly stock scan include a table on those stocks where I have identified weekly doji formations. I identify the doji high and low so that readers can determine whether there is a weekly close above or below the doji's ranges. I



also note in the table when the doji high or low is exceeded. This is an excerpt of the table from February 26, 2016.

Weekly Dojis - Feb. 26, 2016				
Symbol	Doji High	Doji Low	Since Doji	Trigger
INTC	29.28	27.91	1	29.32

Those stocks the trigger doji buy or sell signals are often recommended in Monday's report. Occasionally I will recommend a stock a week or two after it has triggered a doji sell signal if the entry level is within my parameters. Sometimes I will recommend a stock based on other evidence the week before a doji signal was triggered.

This was the case on Thursday February 25th as I recommended Intel Corp (INTC) based on positive daily studies and the potential for a weekly doji buy signal. Traders therefore went 50% long at \$29.06 on 2/25 with a stop at \$28.23. The next day (Friday) INTC closed at \$29.32 which was above the doji high.

On March 18th the position in INTC was sold at \$31.90 for a 9% profit as my original target was \$32. As it turned out INTC did reach a high of \$32.23 in early April before it corrected back to \$29.28.

Both finziz.com and stockcharts.com provide free daily doji scans but I am not aware of anyone who provides this service based on the weekly or monthly data.

As always if you have any questions about this or any of the other trading lessons please do not hesitate to contact me.