Candlestick VII: Candlestick Patterns Confirming Reversals

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Candlestick patterns are used to confirm reversals. Often when a price moves towards a support or resistance level,

it is unclear for several periods on the chart whether it is going to break through or reverse.

Intraday penetrations of important technical levels are often misleading signals, but quick bounces off support can be false signals as well. Candlestick patterns offer a means of confirming that a price has reversed itself at a key technical level. They also provide a precise entry point and ensure that the market's momentum is in the direction of the trader's position at the time of entry.

In the chart below, the Euro has made its famous double top against the US dollar. The first relative high has been established, and although there are later several intraday breaks above this level, no daily candle has closed at a new high. Shortly after, a rapid fall from the 1.29 level creates a bearish engulfing pattern that allows the trader to sell the next day with the market's momentum to the downside. The stop is placed just above the black resistance level, because a further test of the recent highs could easily lead to a breakout higher.