Doing without a real body: The doji

A candlestick that has no real body or only a very small one is named a *doji*. In a doji, the open and the close are at the same or near the same level. See Figure 8-2 for three types of dojis. On its own, a doji doesn't tell you much about market sentiment. You interpret a doji bar in the context of the pattern of the preceding bars. A doji implies that sentiment is in a transitional phase. It's a neutral bar, neither bullish nor bearish, that gains meaning from its placement within a set of bars.

When you see a doji after a prolonged uptrend, the doji may mean that the buyers are coming to the end of their bullish enthusiasm. (In Chapter 7, I discuss that when the close is at or near the open, market participants are indecisive.) A doji coming immediately after a very long white bar in an uptrend shows that the market is tired. This particular doji is named a bearish doji star. A bullish doji star is a mirror image — it comes after a big black bar in a downtrend. In other cases, it signals an impending reversal.

TIP

The doji form contains important information, regardless of the shadows, although shadows have their own additional meaning and are covered in a later section. Always take notice of a doji or series of dojis after a trend has been in place for a while. It's a transitional bar and you should always be on the lookout for any transition that can affect your trade.

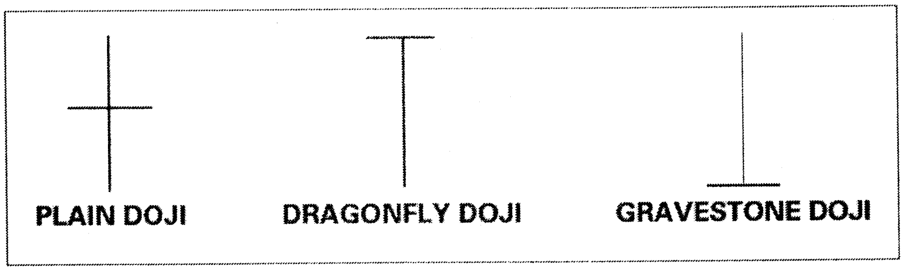

Figure 8-2: Doji candlestick patterns.

Catching the shadow

The high and the low prices are shown in the *shadows*, which you can think of as a candlewick (on the top) or a tail (on the bottom). Although the shadow is secondary to the real body in importance, shadows contribute useful information about market psychology, too, and modify your interpretation of the body. Shadows offer special interpretive clues in three instances:

- The real body is a doji.
- The shadow is missing.
- The shadow is extremely long.

Want to know more about interpreting shadows in these three situations? Keep reading.

Shadows in the doji bar

In many instances, the doji is just a plain one with ordinary, same-size shadows, as shown in Figure 8-2. However, the two most useful types of doji bars, also shown in Figure 8-2, are the following:

- **Dragonfly doji:** Look for the long, lower shadow that means the open, high, and close were the same or nearly the same. Sellers were trying to push the price down and succeeded in making a low — but they didn't succeed in getting it to close there. Because the close was back up at or near the open, buyers must have emerged before the end of trading and bought enough to move the close to the high or nearly to the high.

  How you interpret the dragonfly depends on what bar patterns precede it. Your options include the following:

  - If the price move is a downtrend, the dragonfly may mean that buyers are emerging and the downtrend may be ending.
  - If the dragonfly appears after a series of uptrending bars, buyers failed to push the price over the open to a new high while sellers succeeded in getting a low, so the uptrend may be in trouble.

- **Gravestone doji:** Take a look at that long upper shadow in Figure 8-2. This bar, the exact opposite of the dragonfly, is formed when the open, low, and close are the same or nearly the same, but a high creates a long upper shadow. Although buyers succeeded in pushing the price to a high over the open, by the end of the day the bears were fighting back and pushed the price back to close near the open and the low. This push is a failed effort at a rally, but you can interpret the bar best in the context of the other bars that precede it:

  - If the gravestone bar appears after a series of uptrending bars, buyers failed to get the close at the high. Sellers dominated and the uptrend is at risk of ending.
  - If the price move is a downtrend, the gravestone doji may mean that buyers are emerging and the downtrend may be ending.