GOAT ACADEMY

Stock Charts for Beginners

Charts are very important to know how to read, and so is technical analysis. Why you may ask? Because you will gain critical insights into the psychology of the market. The market is an auction: buyers and sellers, supply and demand. That is all. Nothing more, nothing less.

We will discuss candlesticks, market structure, gaps, and the 50-day moving average. Let's begin.

Understanding a candlestick:

-A price candlestick shows where the price of a stock has gone.

-These candlesticks can be used for various timeframes, such as a daily, 4-hour, or even 30-minute timeframe.

-We will use a daily timeframe for these definitions**, meaning** that each candlestick will represent one day.

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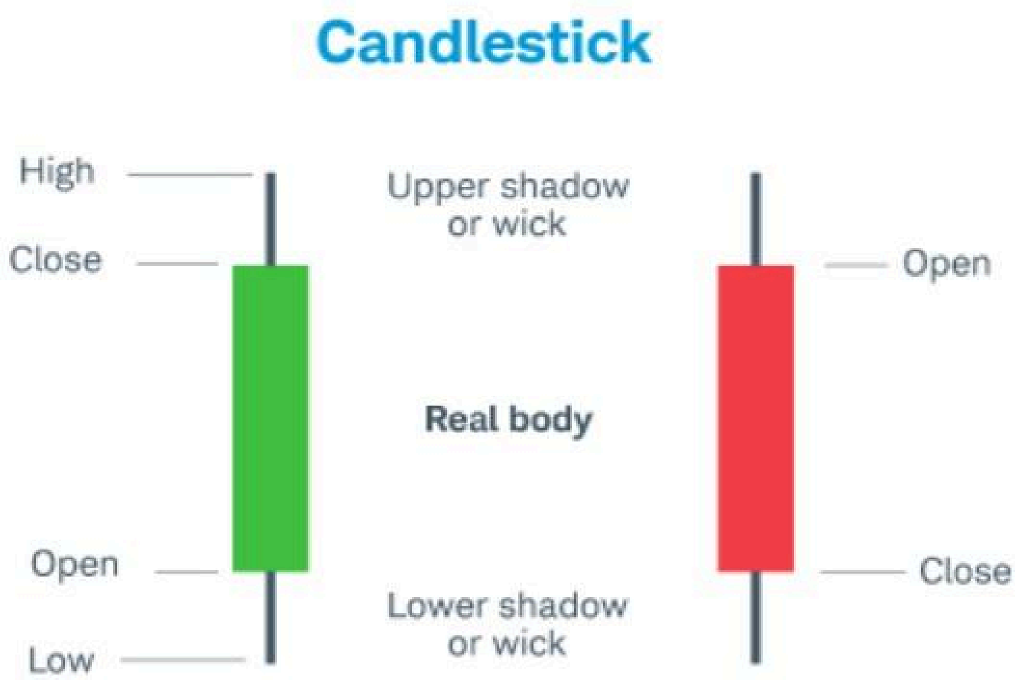


These are each part of the candlestick and what you should know about them:

High: The highest point where the price has gone during the trading day

Close: The close represents the final price where the stock closed. (For example, SPY closed at $500 at the end of trading hours.)

Open: This represents the first price the stock was when the market opened.

Low: The lowest price the stock went to during the day.

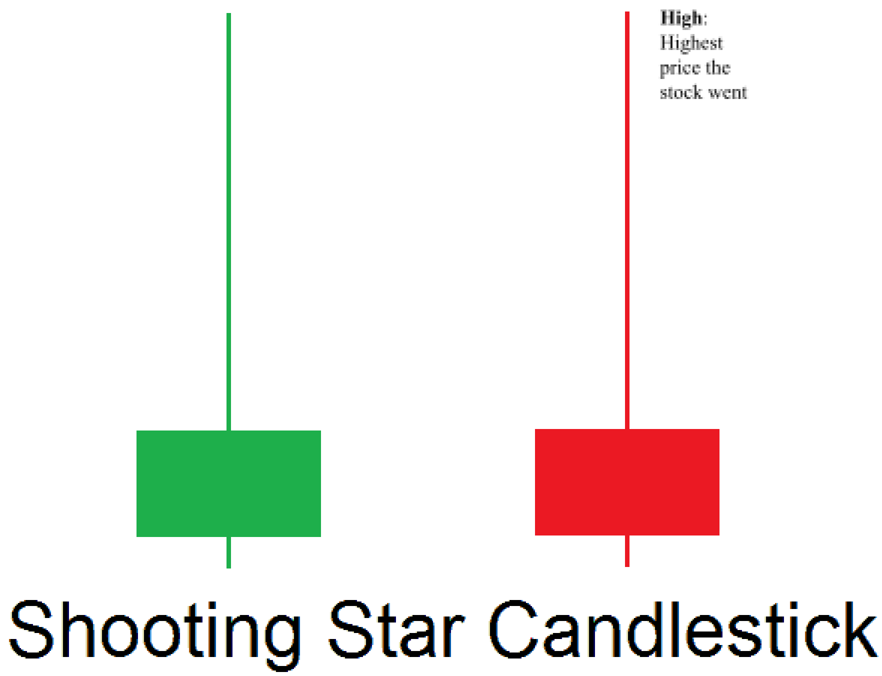
The "Shadows" or "Wicks" refer to the part of the candlestick that hangs above or below the "body."

Learning to read wicks and bodies will give you critical insights into discovering market trends.

Reversal Candlesticks

The Shooting Star Candle

Have you ever wondered how to spot reversals in the market? Here is how…



The shooting star candlestick is famous for hinting at potential market reversals.

Crazy name, right? Technical analyst terminology at its finest.

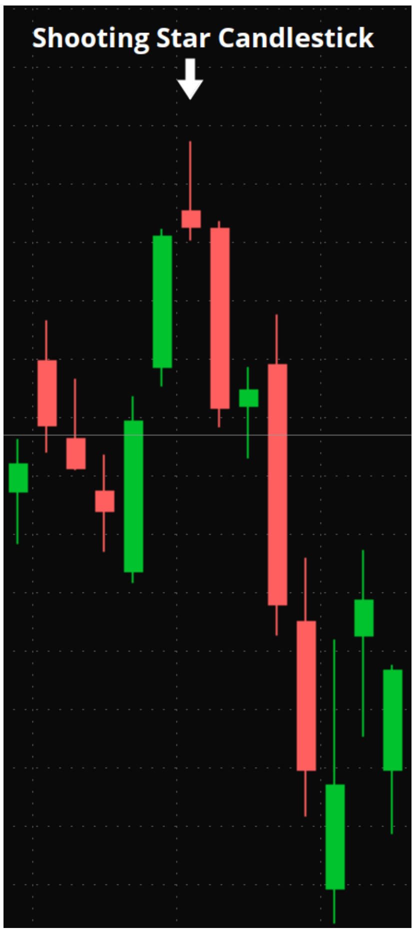
But it is imperative to understand…

Notice the long wick at the top… and the tiny body at the bottom.

The easiest way to interpret this candle is that buyers could bring the price up to the highest point, but sellers pushed the price back down. Therefore, the buyers are getting weaker and weaker…

Why is this important?

Let's take a look at an example from SPY.

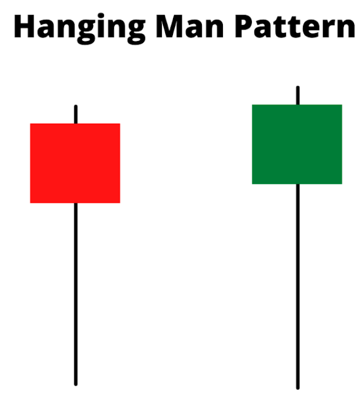


This is a great example of a shooting star. Notice how there was an uptrend, then a red shooting star candle, then a very nice downtrend.

The sellers gained strength!

It is that simple to identify opportunity by just knowing which candlesticks you are looking at. A reversal may not happen every single time, but the odds will still be in your favor.

The Hanging Man Candle



Well, isn't this an exciting name? This is almost the same as the Shooting Star Candle.

The Hanging Man is also great for spotting market reversals after an uptrend.

Think of it like the Shooting Star, just flipped upside down.

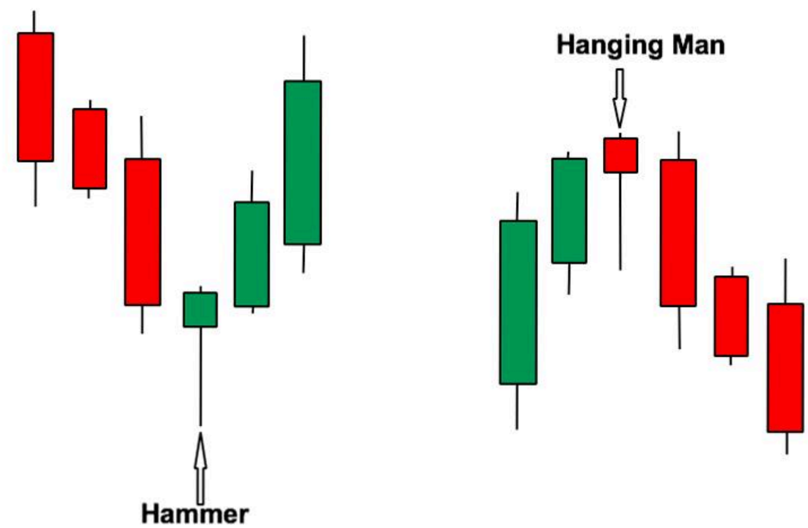
Basically, what is happening here is this: The sellers were able to push the price down to the low of the day (bottom of the wick), but the buyers were able to bring the price up. However, this candlestick reveals selling strength, and the *buyers are getting weaker and weaker*. Let's look at an example:

Uptrend to a downtrend…. Great signal from the market. Hints and clues are located in price action.

The Hammer Candlestick

Okay, so we just learned about the hanging man, which will only appear at the top of an uptrend. Remember that: "The Hanging Man will only appear at the top of an uptrend."

Now, what happens if we see a hanging man at the bottom of a downtrend? Observe below. It's called a hammer… and it looks like one too.

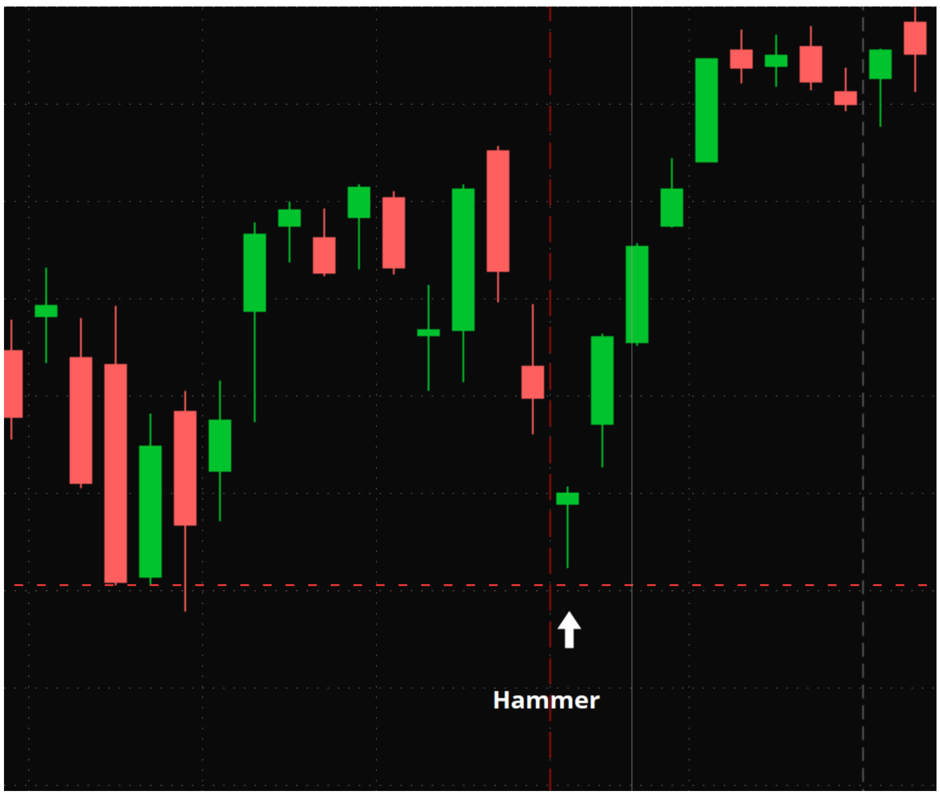


This is an example of a Hammer candle on SPY
(P.s. there are two bullish hammers in here. See if you can find the second one)

Notice this hammer candle has a long wick and a large upper body. This is indicative of strong price action. A strong candle like this may give a higher probability to begin a new uptrend, which is precisely what happened.

Of course, not all hammer candles may have long wicks and bodies. Some might be slightly more subtle.

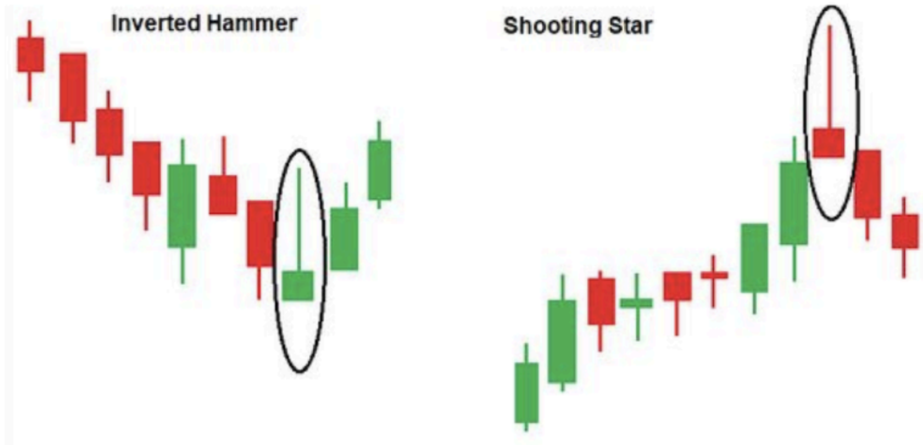
Here is another example:



The Inverted Hammer

Do you remember the first candlestick we covered? It was the shooting star candlestick. Well, the shooting star only appears at the top of uptrends.

What if we saw the shooting star at the bottom of the downtrend?

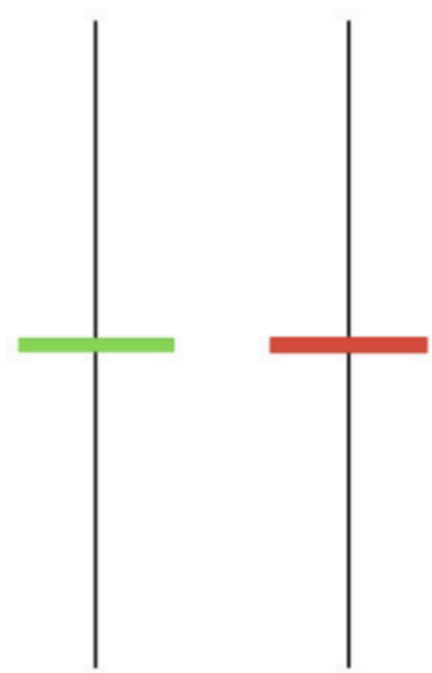


This is called an **inverted hammer**, and it could hint at the beginning of a new uptrend.

It's as simple as that. A green inverted hammer would be stronger than a red one. Here is an example:

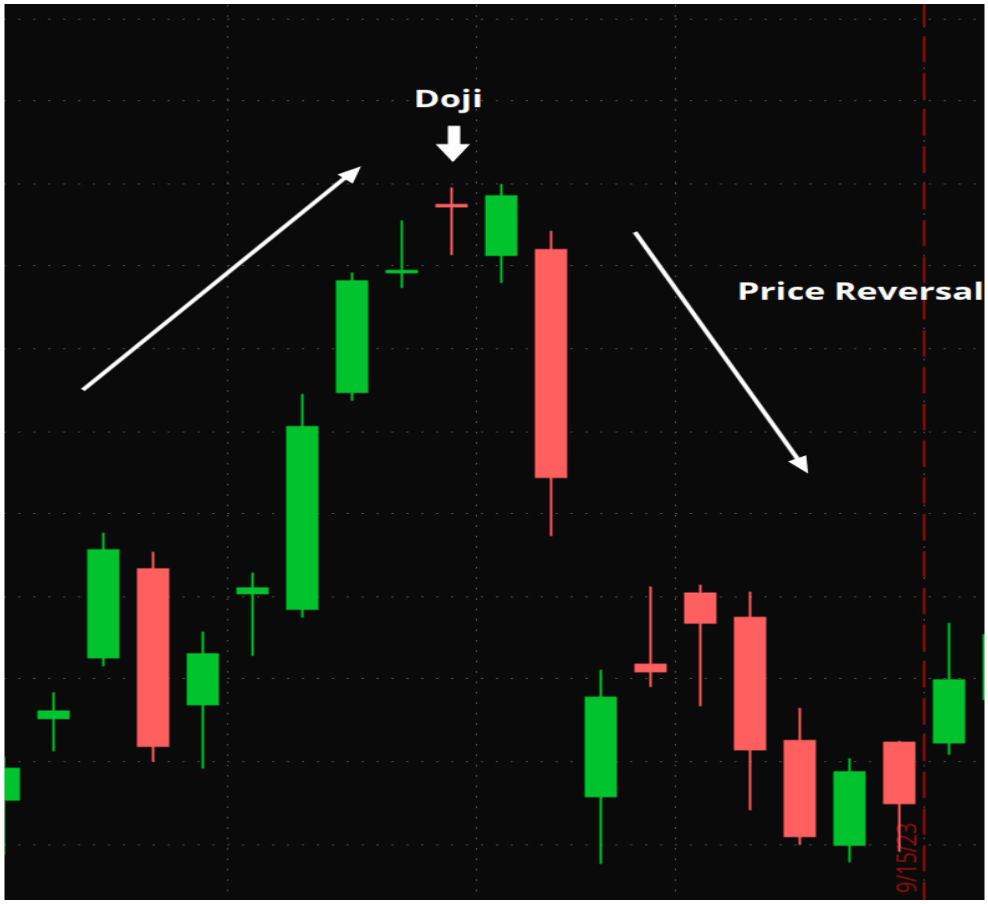
The inverted hammer revealed the strength of the buyers as they raised the price to the high of that upper wick and did not let the price go any lower. Also, take a look at the hammer candle to the right of the inverted hammer in the example above. This is how you can take the power of interpreting candlesticks and use these two patterns to place bullish trades for an incoming uptrend.

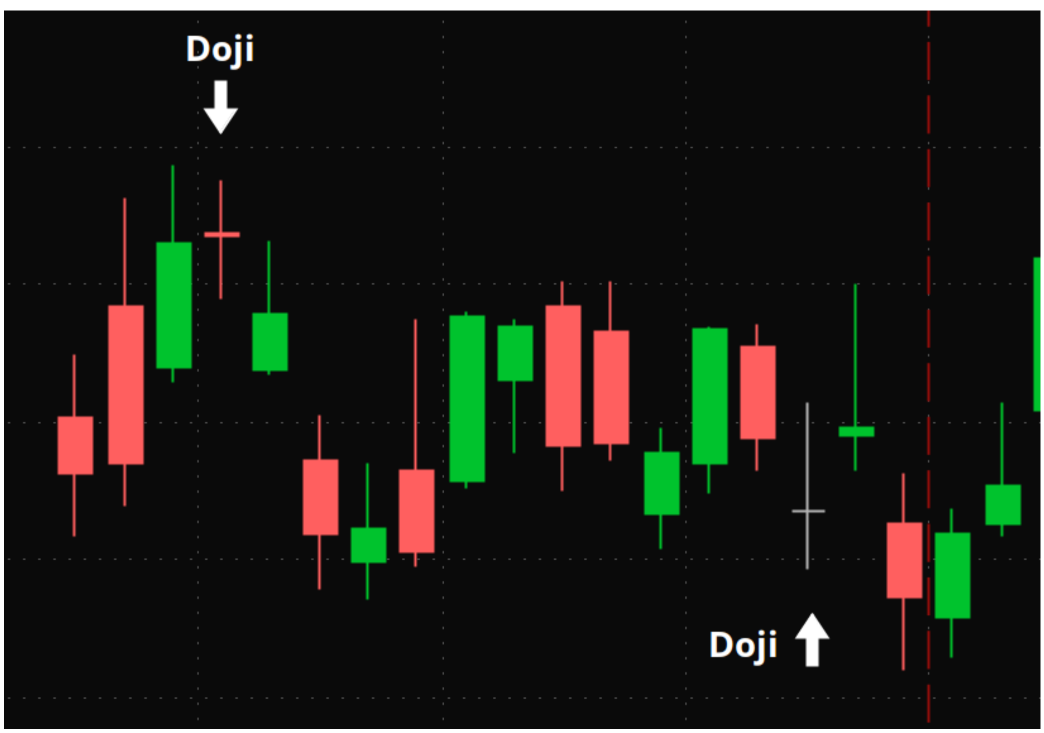
The Doji Candlestick



The Doji Candlestick. Imagine you saw this at the top of an uptrend or the bottom of a downtrend. Look at the wicks. They're pretty even in length, right? This candle looks like a cross.

These wicks and the tiny, almost nonexistent body (Some doji's have no body) proclaim that the market was indecisive. Nobody knows who the winner is: the buyers or the sellers. There is no clear answer.


Doji
Price Reversal
9/15/23

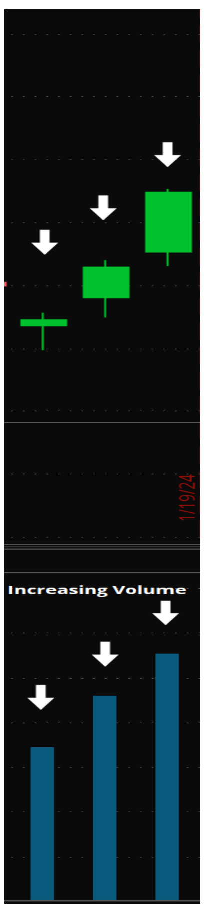

Doji
Doji

Sometimes, Doji's don't always lead to price reversals. If you look at the second example above, the price has been going back and forth in a small range. Sometimes it's best not to trade in market conditions where the stock is going nowhere unless you are taking advantage of time decay.

Volume

Let's say you're looking at some candlesticks in the market. The volume will confirm how strong that candlestick is.

For example, take these three green candlesticks:



First of all, Look at the increasing size of the candlesticks. This reveals that buyers are supporting the stock price and are bidding the price up.

Next, the **volume** suggests that these price movements are accurate. Increasing volume is what you want to see in an uptrend, and it indicates that there is a legitimate strength from buyers.

Want to see what happened after these three candlesticks? Take a look.

The result was a very nice uptrend.
Clean and simple.

Market Structure

The way markets move up and down is in trends. It is important to know first how a trend works.

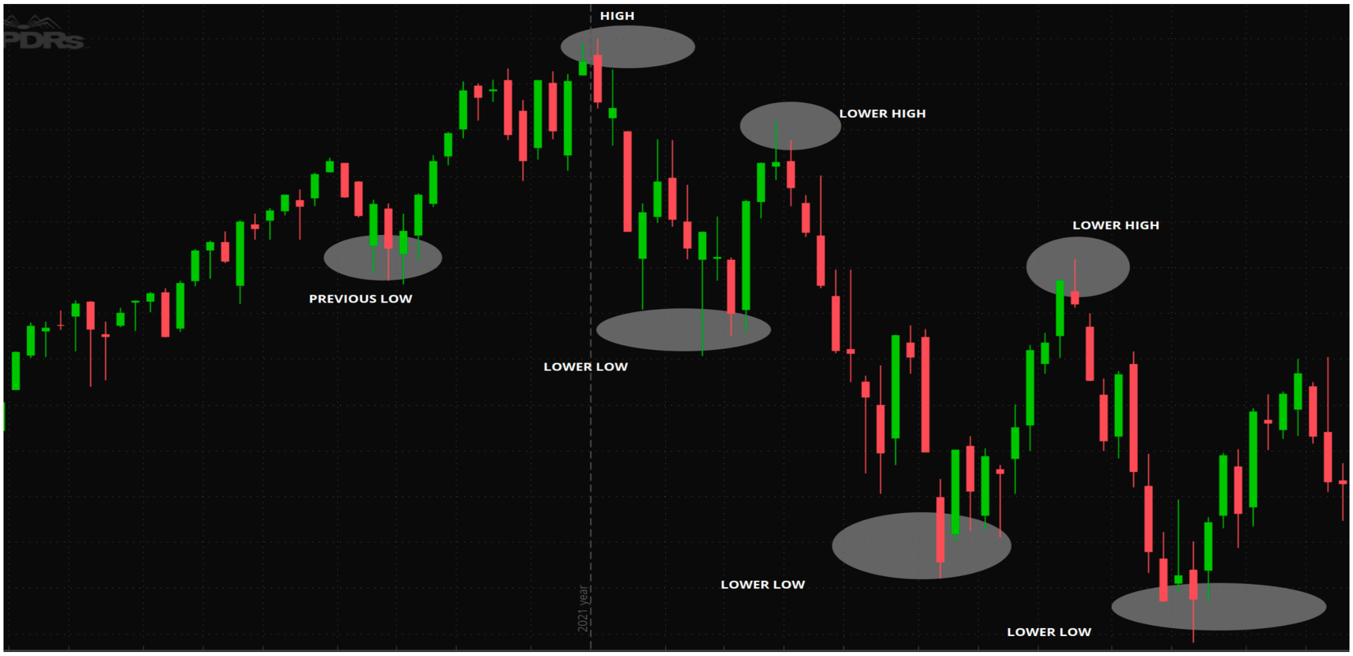
An **Uptrend** will consist of higher highs and higher lows. Memorize this: Uptrend= **Higher highs and higher lows.**

Let's take a look:

This is what an uptrend means: The buyers are continuing to support the price by buying it higher and higher. When the price of the stock comes down, the buyers support the price by defending the most recent low price and pushing it to new heights.

If someone was trying to buy the stock for $30, then someone says "I will buy it for $35!", there is that new price. All of a sudden, if the stock price comes down to $31, there will most likely be a buyer willing to purchase the stock because $30 was the most recent high price.

A Downtrend will consist of <u>lower highs</u> and <u>lower lows.</u>



Perhaps the stock is in trouble, and maybe some bad news has come out. Suddenly, nobody wants the stock anymore, and people start panic selling. The stock was trading at $40, and now the sellers are offering it as low as $25! The price of the stock therefore hits $25, then some buyers come into the market and think, "Wow, what a bargain!" The stock then moved back up to $39 because the market was offering such a hot deal.

But the news is still bad, and suddenly, more sellers come into the market and sell the stock for $39, because $40 was the most recent high, so sellers create a **lower high** so that they have a chance of getting out.

The market is simply an auction, of buyers and sellers going back and forth about what the fair market price is of a stock. This creates trends in the price.

50-Day Moving Average

Congratulations on getting this far, I am sure you have learned a lot already. Let's now talk about a key indicator we will be using: **The 50-day Moving Average**.

This will be a vital part of the system to trade SPY efficiently…

Think of the 50-day Moving Average as a calculation of all the averages of every single price the market has created over the past 50 days. That's all it is.

Therefore, this gives us an average price at which buyers or sellers can buy or sell the stock again.

Let's say the market is in an uptrend, but it may not seem like the right time to purchase the stock because the price is so high. However, there are many people like you, who are waiting for the cost of the stock to come back to an "average" price.

This "average" price is an excellent price to potentially buy the stock because you are not overpaying. It's average.

Therefore, the 50-day Moving average will be a crucial indicator to help you identify spots during the trend when it is good to buy the stock in an uptrend or sell the stock in a downtrend.

Let's take a look at a few examples:

This is the SPY during an uptrend, again on the daily timeframe. **The blue line is our 50-Day Moving Average.**


SPY 5 Y 1D [NYSE]
D: 2/9/24
O: 498.84
H: 501.65
L: 498.49
C: 501.2
R: 3.16
SimpleMovingAvg (CLOSE, 50, 0, no)
475.66
SPDRs
450
440
430
420
410
400
390
380
370
360
350
340
330
11/20/20
12/18/20
2020 year
1/15/21
2/19/21
3/19/21
4/16/21
5/21/21
6/18/21
7/16/21
8/20/21

I want you to notice each time the price came down to touch that blue line, it bounced up. And note that it is not always perfect! There will be times when the price comes below the average, but that is why it is good to know how to read candlesticks. Look out for reversal patterns.

Every time the price touched the 50-day moving average, buyers stormed into the market and started buying the SPY, therefore pushing the price back up.

Think of the Average as a support level in an uptrend, and think of it as a resistance level in a downtrend.

Let's take a look at a downtrend… because markets don't always go up.

This was SPY during the bear market of 2022-2023. Using the 50-day Moving Average and the power of reading candlesticks properly, you would have given yourself a much better chance to set up bearish positions using this blue line. Sometimes, one indicator is all you need. Keep it simple.

Gaps

Gaps are reasonably simple to understand. The stock market is not open for 24 hours. So what happens when good or bad news comes out, and it's 9:00 PM, and you are brushing your teeth and getting ready for bed? Well, it's simple, the market can still move up or down and open up at a higher or lower price the next day.

Let's say SPY is trading at $440, and then some critical inflation data comes out overnight and says that "inflation is cooling." Great news for the economy! Do not be surprised if we get a "**gap up**" tomorrow morning, and SPY opens at $445! This would be a bullish signal as long as sellers don't sell the news and "close" the gap, which would be a bearish signal.

It's the same concept for a **gap down**. Maybe there is some bad news which affects the market, so the price of SPY opens up much lower than the previous day. Well, that has happened before too…

Why are gaps significant? They reveal sentiment and can give you essential clues about the stock price and where it might go.

Gaps + 50 Moving Average Combined

We are almost done! Let's put everything together now, while still keeping these concepts as simple as they can be. Let's say SPY has a gap down and is below the 50-day Moving Average. Great, ultimately, that means the market is bearish! Remember that this is only probability, and anything can still happen, but these are the clues the market is giving us.

For example:

Next, let's take a look at an uptrend scenario:

If you were able to identify these gaps while understanding that the price is above or below the moving average, you would have given yourself a great chance of setting up trades in the direction of the trend… the path of least resistance!

The trend is your friend and always will be! Until the market reverses… so use those candlestick patterns to identify possible reversals, and use the moving average as an indicator of "bullish above" or "bearish below".

It cannot get simpler than that, and with experience, you will begin to understand market movement, making you a more skilled trader.

Risk Management

Stop Losses

A **stop loss** is an order placed with a broker to buy or sell once the stock reaches a certain price. A stop loss is designed to limit an investor's loss on a security position.

Mathematics of Setting Up a Stop Loss:

- **For a Bullish Trade (Buying):** You might set your stop loss below the current market price. For example, if you buy a stock at $100, you could set a stop loss at $90. This means if the stock drops to $90, your position will be automatically sold to limit your loss to $10 per share.
- **For a Bearish Trade (Selling Short):** You would set your stop loss above the current market price. If you short a stock at $100, setting a stop loss at $110 means your short position will be covered if the stock rises to $110, limiting your loss to $10 per share.

Trailing Stop Losses

A **trailing stop loss** is similar to a stop loss, but instead of setting a specific price, you set it at a percentage or dollar amount away from the current market price. As the price moves favorably, the trailing stop moves with it, maintaining the set distance, but if the price moves unfavorably, the trailing stop does not move.

Mathematics of Setting Up a Trailing Stop Loss:

- **For a Bullish Trade:** If you buy a stock at $100 and set a trailing stop loss of 10%, the stop loss is initially at $90. If the stock rises to $120, the trailing stop would adjust to $108 (10% below $120).
- **For a Bearish Trade:** If you short a stock at $100 with a 10% trailing stop, the initial stop would be at $110. If the stock price drops to $80, the trailing stop would adjust to $88 (10% above $80).

Examples

1. **Bullish Trade with Stop Loss:** You buy shares of Company A at $50 each and set a stop loss order at $45. If the stock falls to $45, your shares are sold, limiting your loss to $5 per share.
2. **Bullish Trade with Trailing Stop Loss:** You buy shares of Company A at $50 with a 10% trailing stop loss. If the stock price increases to $60, the trailing stop loss rises to

$54 (10% less than $60). This locks in your profits while still allowing for potential upside.

3. **Bearish Trade with Stop Loss:** You short sell shares of Company B at $30 each, setting a stop loss at $35. If the stock rises to $35, your position is covered, limiting your loss to $5 per share.
4. **Bearish Trade with Trailing Stop Loss:** You short sell Company B at $30 with a 10% trailing stop. If the stock price falls to $20, the trailing stop adjusts to $22 (10% more than $20), securing your profits while limiting potential downside.

Psychology of Risk Management

Managing risk using stop losses and trailing stop losses is not just a strategic move; it's a psychological necessity. Here's why:

- **Limits Emotional Decision Making:** Setting these orders in advance helps take emotion out of the equation. You're less likely to make panic-driven decisions.
- **Preserves Capital:** By limiting losses, you ensure that no single trade severely impacts your portfolio.
- **Encourages Discipline:** Consistently using these tools fosters a disciplined trading approach, focusing on long-term profitability rather than short-term gains.
- **Profit Protection:** Especially with trailing stops, you can protect your gains from turning into losses, which is psychologically rewarding and financially beneficial.

In summary, effectively using stop loss and trailing stop loss orders is essential for successful trading and investing. They help manage risk, protect profits, and ensure that traders and investors can survive in the market to trade another day.

Risk Management on Options

Bull Put Spreads

A **bull put spread** is an options strategy used when an investor expects a moderate rise in the price of the underlying asset. It involves selling a put option at a particular strike price while buying another put option at a lower strike price. Both options have the same expiration date. This strategy results in a net credit to the investor's account, representing the maximum profit.

Example of a Bull Put Spread:

Imagine stock XYZ is currently trading at $50. Expecting a moderate increase in the stock price, you decide to implement a bull put spread.

1. **Sell a Put Option:** You sell a put option with a strike price of $50 (closer to the current market price), receiving a premium of $4.
2. **Buy a Put Option:** You buy a put option with a strike price of $45 (lower than the $50 strike), paying a premium of $2.

Net Credit: $4 (received) - $2 (paid) = $2 per share (your maximum profit).

Maximum Loss: The difference between strike prices ($50 - $45 = $5) minus the net credit received ($2), so $3 per share.

This strategy is profitable as long as the stock price remains above $50 at expiration. The maximum profit is achieved if both options expire worthless (stock price > $50).

Bear Call Spreads

A **bear call spread** is used when an investor expects a moderate decline in the price of the underlying asset. This strategy involves selling a call option at a particular strike price and buying another call option at a higher strike price, with both options having the same expiration date. Like the bull put spread, this results in a net credit, which represents the maximum profit.

Example of a Bear Call Spread:

Consider stock ABC is trading at $100. Believing the price will moderately decline, you set up a bear call spread.

1. **Sell a Call Option:** Sell a call option with a strike price of $100, receiving a premium of $6.
2. **Buy a Call Option:** Buy a call option with a strike price of $105, paying a premium of $3.

Net Credit: $6 (received) - $3 (paid) = $3 per share (your maximum profit).

Maximum Loss: The difference between strike prices ($105 - $100 = $5) minus the net credit received ($3), so $2 per share.

This strategy is profitable as long as the stock price stays below $100 at expiration. The maximum profit is achieved if both options expire worthless (stock price < $100).

Psychology of Risk Management in Spread Strategies

Spread strategies like bull put spreads and bear call spreads are appealing because they offer a balanced approach to risk and reward. Here's how they align with risk management psychology:

- **Defined Risk:** Both strategies have a predetermined maximum loss, helping traders manage their risk exposure effectively.
- **Capital Efficiency:** Using spreads can be more capital efficient than outright stock or option positions, allowing for diversified strategies.
- **Strategic Flexibility:** These spreads can be adjusted based on changing market views or risk tolerance, providing a psychological comfort of adaptability.
- **Risk-Reward Optimization:** The ability to fine-tune strike prices and expiration dates allows traders to optimize the risk-reward profile according to their market outlook and risk appetite.