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How do candles work?

Anatomy of a candle

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Understanding Candlestick Charts

Candlestick charts are the foundation of technical analysis. They compress price action into a visual language that reveals market sentiment, trader psychology, and potential turning points. This lesson breaks down how to read the anatomy of a candle and what each component tells you about the market.

What you'll learn here

Candlestick charts have remained the dominant form of price visualization for centuries because they encode market information efficiently. Understanding what each part means transforms raw price data into actionable insights.

- How to read the four price points in each candle
- What the body and wicks reveal about market sentiment
- How to interpret color coding and visual structure
- Why candle patterns matter for trading decisions

History and Origins

Long before stock exchange traders began using candlestick charts, a Japanese rice merchant named Munehisa Homma (1724-1803) revolutionized the way markets were analyzed. Homma came from a wealthy rice trading family in Sakata, Japan, and actively traded on the Dojima rice exchange in Osaka, the world's first futures market.

In the 18th century, rice was not simply food. It was the foundation of Japan's economy. The rice market was volatile, and traders desperately needed ways to predict price movements. Homma meticulously recorded price fluctuations and noticed that prices were determined not only by supply and demand, but also by trader psychology. Emotions such as fear and greed played a decisive role in price movement.

In 1755, Homma published "The Fountain of Gold: A Three-Monkey Record of Money," the first book on market psychology. In it, he argued that understanding trader emotions was the key to successful trading. He famously observed: "When everyone is bearish, there is reason for prices to rise" - a principle that remains fundamental to contrarian trading today.

Homma developed a system of visual patterns to track price movements and market sentiment, which became known as the Sakata Rules. His ideas were so powerful that some historical accounts claim he made 100 consecutive profitable trades. Valued in modern dollars, his trading fortune is estimated at approximately 10 billion dollars.

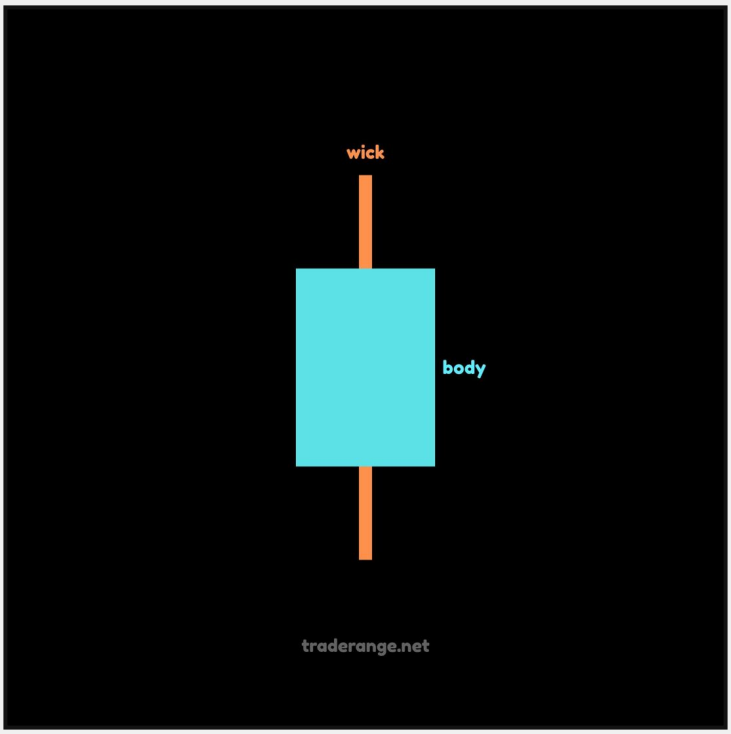
For centuries, candlestick charts remained largely unknown outside of Japan. This changed in the 1980s, when American technical analyst Steve Nison introduced candlestick charts to Western financial markets. Nison researched, translated, and refined Japanese candlestick methods, publishing his major book "Japanese Candlestick Charting Techniques" in 1991. Today, candlestick charts are used by traders worldwide to analyze stocks, forex, commodities, and cryptocurrencies.

Candle Structure: Reading the Body and Wick

Each candle tells a story about what happened in the market during a specific time period, whether it be one minute, one hour, one day, or one week. To read this story, you need to understand four key data points and how they are visually represented.

Each candle displays four prices:

- Open - the first price traded during the period.
- High - the highest price reached during the period.
- Low - the lowest price reached during the period.
- Close - the last price traded during the period.

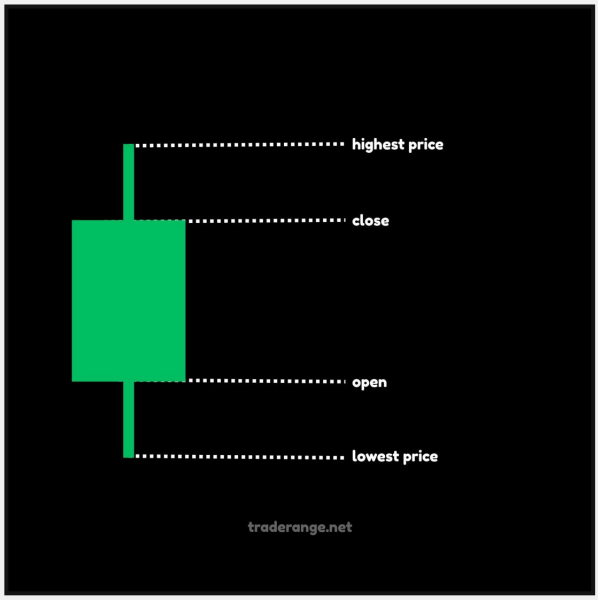


Candle Structure

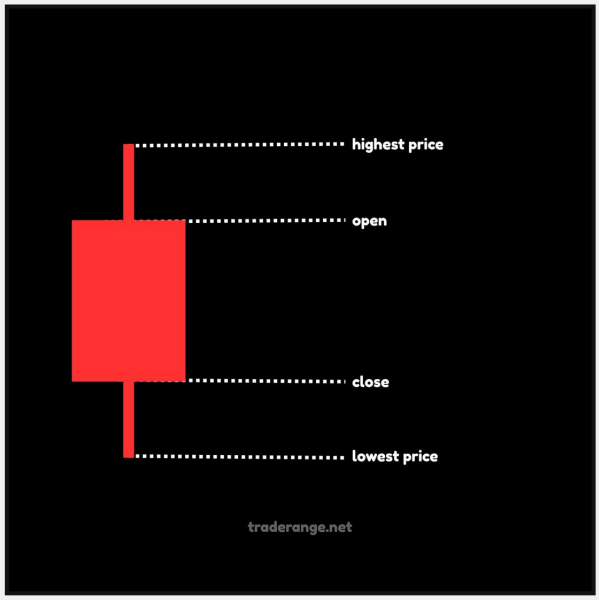
The body (or "real body") is the thick rectangular part of the candle. It represents the range between the opening and closing prices. In a positive (bullish) candle, the closing price is higher than the opening price. The bottom of the body marks the opening, the top marks the close. In a negative (bearish) candle, the closing price is lower than the opening price. The top of the body marks the opening, the bottom marks the close.

Color coding varies depending on the platform, but the most common convention is:

- Green or white = bullish (price increased)
- Red or black = bearish (price decreased)



Positive Candle



Negative Candle

The thin lines extending above and below the body are called wicks, shadows, or tails. The upper wick extends from the top of the body to the highest price reached during the period. The lower wick extends from the bottom of the body to the lowest price reached during the period.

These wicks show where the price traveled during the period, but where it ultimately did not close.

Each candle is a snapshot of the battle between buyers and sellers. The body shows who won the battle (bulls or bears), the length of the body shows how decisive the victory was, and the wicks show where the opposing side fought back. By reading these visual signals, traders can gauge market sentiment and anticipate potential trend reversals or continuations. The color of the body shows whether buyers (green) or sellers (red) controlled the period. The length of the body shows conviction strength: long means strong, short means weak or indecisive. The upper wick shows the highest price and where selling pressure appeared. The lower wick shows the lowest price and where buying pressure appeared.

Key Takeaways

KEY TAKEAWAYS

- ✔ Each candle represents four price points: open, high, low, and close.
- ✔ The body shows the range between open and close, with color indicating direction.
- ✔ Wicks reveal where price traveled but ultimately failed to sustain.
- ✔ Long bodies indicate strong conviction, short bodies indicate indecision.
- ✔ Candlestick patterns emerge from reading sequences of candles together.
- ✔ Understanding candle structure is foundational to all technical analysis.

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