Stock Markets Guides

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How to Read Stock Charts for Beginners

The journey to becoming a successful day trader is anything but easy. Aside from understanding the stock market in general and the technical jargon used by traders, you also need to read stock charts by analyzing stock data, identifying patterns, and making decisions accordingly.

On most (if not all) trading platforms, the important data is presented in stock charts. Reading a stock chart is a crucial skill for any skilled trader. Analyzing a chart needs to become second nature because even split-second delays while trading can make the difference between a profitable and a loss-making trade.

In this post, you will find out what a stock chart is, what the different types of charts are, how you can read these charts, and get an idea of how to go about spotting potentially profitable trades.

What is a Stock Chart?

A stock chart is, quite simply, a chart that shows the trends in the stock price over a period of time.

As with all other charts, stock charts are a collection of points that can be represented in one way or another. For example, a 15-minutes line chart will indicate the stock price every 15 minutes; the daily stock price chart will indicate the stock price every day at the market closing, and so on.

Based on your trading timeline, you could be looking at different types of charts, ranging from 1-second charts, which show the prices as of every second, to weekly charts, which show prices as at market close on Friday every week.

Stock charts are a visual representation of data, and as they say, a picture speaks a thousand words. Therefore, stock charts can quickly get an idea of how the stock has been doing, what trends it has been following, and using all this information to try and predict how the stock will move.

Of course, this method isn't 100% accurate, but with practice, you will be able to use charts to identify trading opportunities in a way that you make a profit more often than not.

What You Need to be Able to Read a Stock Chart

The first thing that you need to do to read a basic stock chart is to study the different types of charts and choose the one that you are most comfortable with.

Most commonly, stock charts are available on public websites such as Trading View or Yahoo Finance; however, your stockbroker's platform will also have its own charting software that you can use.

Once you are comfortable reading a certain type of stock chart, you can choose that as your default stock type on whatever platform you choose.

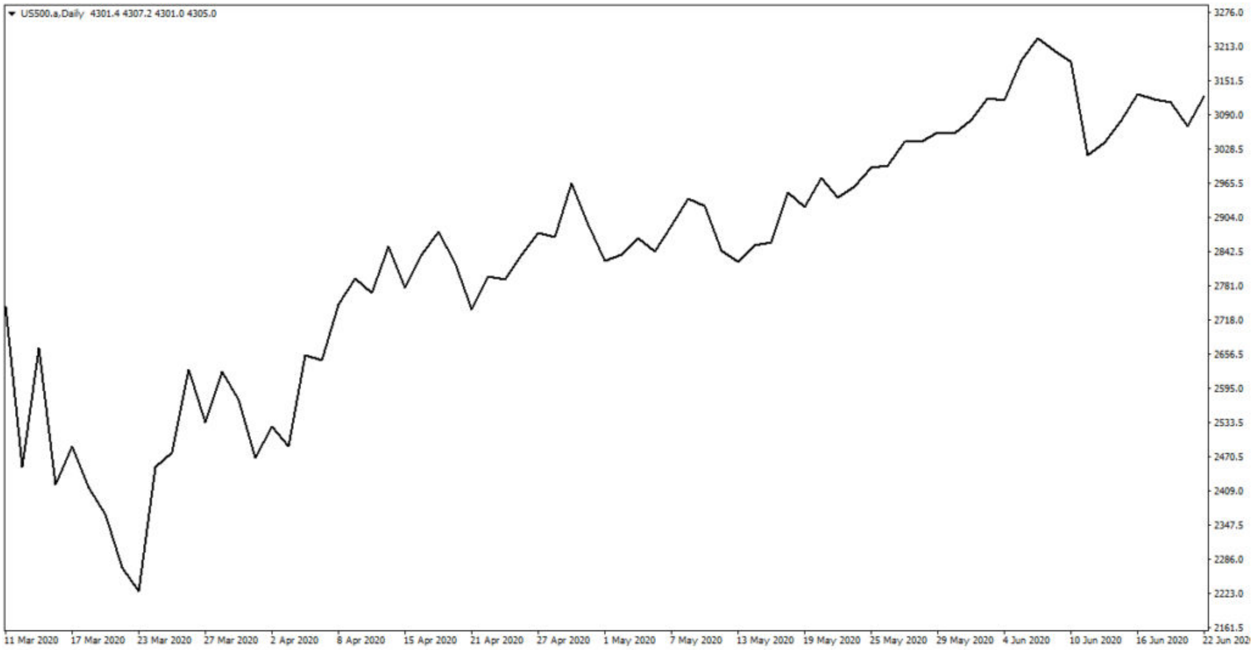
Below, three of the most commonly used stock chart types have been discussed. These are line charts, bar charts, and candlestick charts. Each chart has its own advantages and disadvantages and can be used for different purposes depending on your requirements.

Line Chart

The line chart is perhaps the most simple of all charts and is similar to normal charts used in other fields.

As the name indicates, a line chart is just a line that moves higher or lower according to the stock price. It provides the least amount of information since only prices can be seen in this chart, making it a little difficult to spot patterns. However, line charts are still used by some traders to identify trends in the overall price.

Since the line chart shows the price movement using only one variable, it is much easier to identify trends using a line chart. It can also be used to identify support and resistance levels (discussed below).



Bar Chart

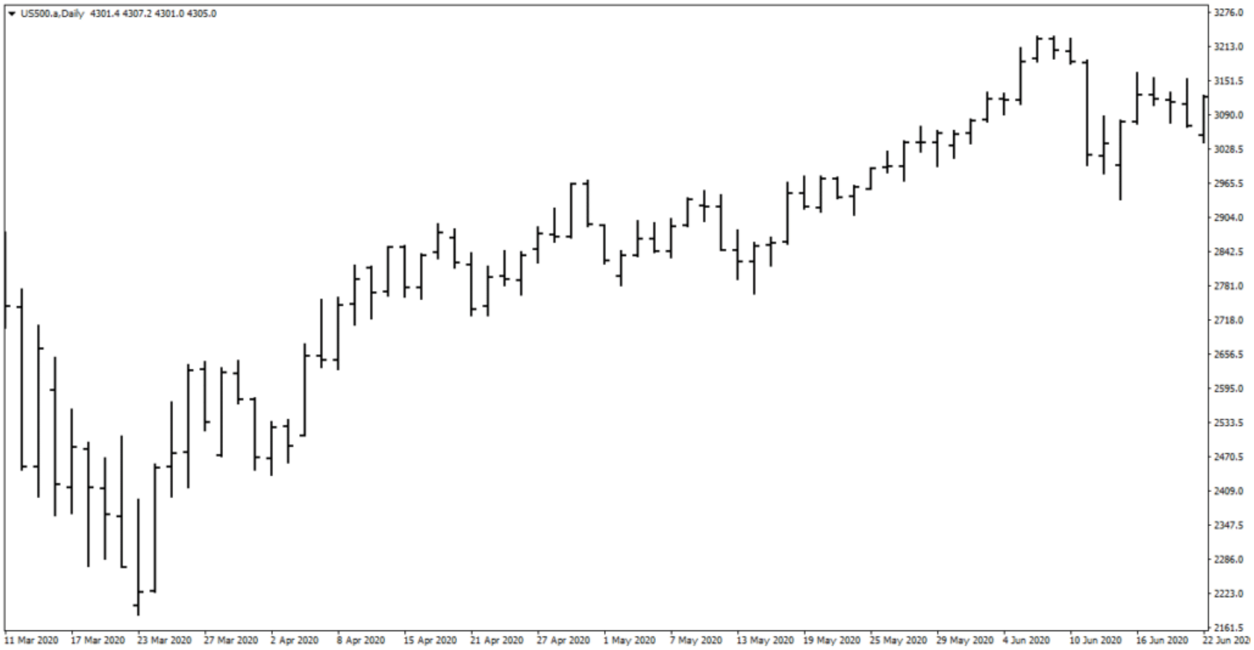
The bar chart is a tad more complex than the line chart since it displays not one but four variables about the stock price: the open price, close price, and the high and low for the particular period in time. For example, if you're looking at a daily chart and the open, close, high, and low prices for the day are $65, $66, $67, and $64, respectively, then the bar chart will be drawn as follows:

- A straight line will be drawn connecting the high and low points of the day, i.e., $67 and $64 in this case.
- A left tip or wing will be drawn to indicate the open price for the day, i.e., $65 in this case.
- A right tip or wing will be drawn to denote the day's close price, i.e., $66 in this case.

However, as you can probably see, bar charts are quite difficult to read because, for larger time frames, it might not always be easy to spot the left and right tips.

It's also difficult to see at a glance whether a particular day was bullish (the closing price was higher than the opening price) or bearish (the closing price was lower than the opening price).

These drawbacks are fixed by candlestick charts, which explains why they are the most commonly used stock charts.



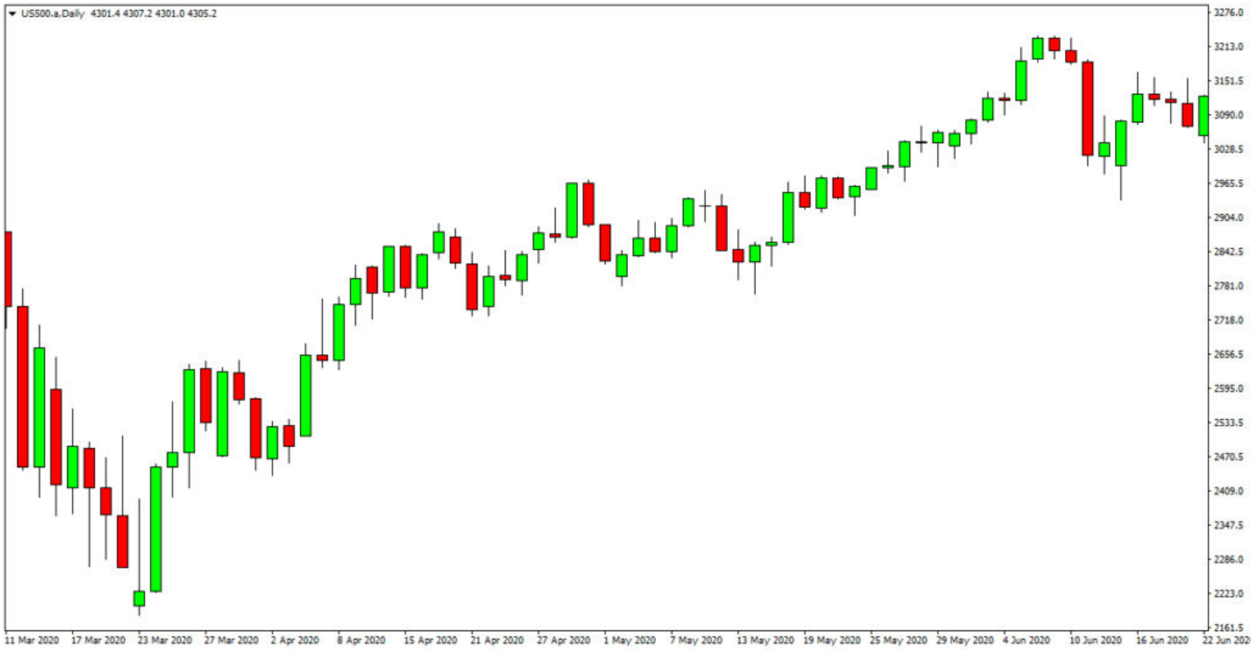
Candlestick Chart

A candlestick chart is quite similar to a bar chart in that it also denotes 4 variables: open, close, low, and high prices.

It does this using candles. Each candle has two parts, the body, and the wick. The body connects the open and close prices, whereas the wicks above and below connect the body to the high and low prices of the day, respectively. This makes candlestick charts much easier to see the open and close prices, which are the more important indicators for traders.

In addition to this, candlestick charts make it easier to spot whether a particular time period was bullish or bearish because the candle's body can be colored.

A red candle indicates a bearish trend, and a green candle indicates a bullish trend. This makes analysis a lot easier and quicker, thus explaining the popularity of candlestick charts in trading circles.



How to Read Stock Chart Patterns

Once you learn how to read charts quickly and accurately, the next step is to begin then analyzing the data in the charts to identify optimal trading opportunities.

This all comes down to understanding the psychology of the buyers and sellers in the market. Once you can do this, trading will become a lot easier and more profitable for you.

The major factors you need to look at while making a trade are the trends, support and resistance, and candle patterns.

Trend patterns

Over a given period of time, a stock moves in one particular direction: either up or down.

While there will definitely be corrections and pullbacks, identifying the one underlying trend can enable you to trade safely and profitably. Suppose you identify a stock that has been going up constantly with a few minor setbacks and corrections. You can buy the stock and gradually make a profit when the prices go up again. However, this is more of a long-term strategy and usually takes time to provide profits.

The small pullbacks when the stock price moves in the reverse direction of the trend for a while is an optimal time for you to enter the trade, as you will be able to maximize your profits by entering the stock at as low a price as possible.

Support and Resistance

These are some of the most common indicators that are used for trading. More often than not, the price moves up and down between a set range. Let’s say that this range is $50-$60 for a particular stock. This means that the bulls (buyers) start buying the stock at $50 and price up to $60 by increasing demand for the stock and overcoming the bears (sellers). However, at $60, buying pressure subsides, and bears come into power.

Those who bought their shares earlier now begin selling off their shares, creating excess supply in the market, thus causing the prices to fall to $50. Then, the bulls start to repurchase the stock, and the process repeats.

In this situation, the $50 level is the stock's support since the bulls take over from here and prevent the prices from falling any further. $60 is the resistance level since, at this price, the bears begin resisting any further buying pressures.

There are two ways to trade using support and resistance levels:

1. Trading can be done in the bounces between these two price levels. You can buy at $50 and sell at $60 to get a neat $10 profit per share multiple times in the above example.
2. Trading can also be done at breakouts. Sometimes, the stock breaks through the support or resistance barriers. When this happens, the bears or bulls have won the fight, and the stock usually continues moving in the same direction for quite a while. Therefore, trading on breakouts is also a strategy often used.

More Advanced Patterns

In addition to these indicators, traders also use other advanced candlestick patterns to spot trading opportunities. For the examples, daily charts will be considered to make analysis easier; however, the explanation can be applied to candlestick charts in any time frame.

Three major chart patterns have been discussed below, the Marobozu, the engulfing pattern, and the head and shoulders pattern. However, there are several candlestick patterns that you can study and read about.

The Marubozu

The Marobozu is perhaps the easiest candlestick to spot and is quite self-explanatory as an indicator. It is a single candlestick indicator and refers to a candle with no wicks and only a body.

A bullish Marobozu indicates that the bulls are willing to buy the stock at any given price and indicates a strong bullish trend.

Conversely, a bearish Marobozu indicates that the bears are willing to sell at any price and indicates a good time to sell shares since the prices will continue to fall in the foreseeable future.

The Engulfing Pattern

The engulfing pattern is a two-candlestick pattern that indicates a reversal in the trend. For this pattern to occur, there has to be one small candle, followed by a larger candle (that engulfs the smaller candle, so to speak) of the opposite color.

This indicates that the opposite side of the market has taken over and that the market trend has now reversed from whatever it was earlier.

The Head and Shoulders Pattern

This is a multiple-candlestick pattern and requires a keen and observant eye to spot. There is a clear support level in this pattern, and the price levels have three peaks, wherein the first and last peaks are at approximately the same levels, and the second peak is higher than both of them.

The outside peaks represent the shoulders of the body, and the second higher peak represents the head, thus giving rise to the name.

This pattern indicates a reversal of the trend and is one of the most reliable reversal trends followed by traders.

How to Read Stock Market Data

Reading stock market data, however, requires more than simply looking at candlestick patterns and trading.

There are several other indicators that traders use to understand stock market data better and double-check their trades. The main aids used by traders to read stock market data are volume information and external statistical tools.

Volume Indicators

The volume indicator basically shows how many shares of a particular company were bought and sold in a given time period.

A higher volume combined with an upwards trend indicates that the bulls are winning and that the stock can be expected to move further up in the future. The same goes for a downward trend coupled with a high volume, indicating a strong bearish sentiment. However, if the stock volume starts falling after a trend, this might indicate that the trend pushers are now losing momentum and power in the market and could be the warning of a reversal in the trends.

Looking at volume information is a crucial part of identifying trading opportunities.

Statistical Indicators

Several traders also use statistical indicators in conjunction with candlestick charts to re-confirm their trades.

A simple indicator is the moving average, the arithmetic average of the past X days of the stock's closing price. A simple strategy to identify bullish or bearish patterns is to use two moving averages together.

Usually, 5- and 100-day moving averages are plotted together. This indicates a bullish trend and a buying opportunity when the 5-day MA moves above the 100-day MA. When the 5-day MA falls below the 100-day MA, this is an indicator of a bearish trend, and traders sell off their positions in the stock.

Several other similar indicators that traders use, such as Bollinger Bands, Exponential Moving Averages, RSI numbers, etc.

How to Read Stock Charts for Day Trading

Finally, all that you have learned in this article has to be used to identify trading opportunities efficiently and effectively. How do you do this? The below steps are a good place to start and can offer a basic framework that will enable you to read and analyze stock charts for day trading:

1. Select a set of stocks that you want to trade on. Usually, these stocks are the most popular stocks on the stock exchange. For example, you can choose to trade the Dow Jones stocks or major stocks from the S&P 500.
2. Every day, go over these stock charts and see if there is a candlestick pattern forming. Since you will only be looking at the same stocks repeatedly, you will become better at spotting patterns in these stocks. Once you spot a candlestick pattern that you recognize, move to Step 3.
3. Identify the support and resistance levels for the particular stock. See if this matches with your analysis of the candlestick pattern. Is the price bouncing between the support and resistance levels? Or is it planning to breakout? If either of these conditions is satisfied, move to Step 4.
4. Use the volume indicators to confirm your hypothesis from Step 3 further. If you think there will be a breakout, is there a sudden spike in volume that supports this? If the volumes are shallow at the support or resistance levels, that might indicate that prices are going to bounce and not breakout, so it is important for you to look at volume indicators to see the direction of the trend.
5. Finally, if the volume indicator supports your hypothesis, use your statistical indicators as a final confirmation. While these indicators by themselves do not indicate a trading opportunity, they can be used to provide a secondary confirmation of your hypothesis.
6. If all the steps above result in favorable indicators, then you should go ahead and open the position accordingly.

While the above steps provide a useful framework for you to begin trading with, you will develop your own strategies to trade with over time.

You will become more reliable and comfortable with certain candlestick patterns. You will also find statistical indicators that you use more often.

Every trader needs to have their own system to trade on, depending on their timeline, risk appetite, level of experience, and own personal preferences.

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