TRADING WITH ICHIMOKU KINKO HYO

Whatever the chosen asset, an index, a stock, a currency pair or a commodity, the market is the place of exchange between buyers and sellers. The confrontation of these two opposing parties is represented by the price which variation is the result of the adjustment between supply and demand at a definite time. The market life is made of rises, falls or stagnations according to stakeholders' activities which charts are the visual translation.

The best representation of prices both in analysis or trading is one that uses Japanese candlesticks. For a given time frame, the candle gives us the open, the extreme variation and close of the price. It is thus easy to see who the main actors are, either sellers or buyers.

However, this description is incomplete because it basically shows us only the inflection points of the market trend. In case of a reversal signal, it is not possible to accurately assess what will be the magnitude of the movement, or whether it is a correction or a trend reversal. The only information given is that the current trend changes.

It is to overcome this "defect" that Goishi Hosada created the Ichimoku Kinko Hyo, published in 1968, an "indicator" that allows to understand the actual market situation, its points of balance and the likely price movements targets.

I do not like the term indicator, preferring “reading system” as it is considered a set of tools which used together forms a complete system of chart analysis.

Although each component of the system can be interpreted separately, it is their interactions that give all its strength and power, to identify trends and Support / Resistance levels, establish trading strategies and generate input signals in the market with the greatest likelihood of success.

The setting used is the original as defined by the designer and invariant whatever the time frame (TF): 9-26-52. With "9" representing a week and a half of trading sessions, "26" is the number of trading sessions days in the Japanese months (in 1968) and "52"is twice "26".

While this tool was developed after the Second World War and without computers, based on daily prices of rice, these parameters are still relevant today, on all time frames, from monthly to the minute. They are those used by professional traders in trading rooms and strategists analysts worldwide. This is what makes Ichimoku so fascinating: although it was designed from price daily close, the accuracy and informations given on other time frames are sometimes amazing especially over very short TF. This makes it a formidable system for short term trading.

It is also quite useless to "adapt" this setting on current Western trading days criteria. Do not forget that the individual trader is but dust in the financial market and that it is highly recommended to observe the same charts as professionals, that is," big hands". To do differently is to be exposed to misinformation, false signals and ultimately to losses.
This reading system is thus composed of five lines, two of which are synchronous with the current price; two others represent the projection of the equilibrium of this market in the future; and the last line is the projection of the current price in the past, it is the memory of the market.

- **The TENKAN-SEN** is constructed by adding the highest price and the lowest price in the last 9 periods then divided by 2 to get the midpoint. Extreme materialized by the shadows of the candles are considered because those are prices that have been traded by the market, in which buyers and sellers were active. So we should not ignore them.

- **The KIJUN-SEN** is calculated in the same way but taking into account 26 periods.

  These two lines are drawn as the same time prices are changing. The Tenkan, due to its short period of calculation, is closest to prices and so represents the strength and momentum of the trend by its slope. But because of its proximity to prices, it can be often crossed by them when volatility is high.

  Therefore, the Kijun associated with it, is farther and serves as the last support or resistance following a break of the Tenkan by prices.
The Kijun gives us two main informations:

- The market makes a simple correction in an established trend: the Kijun will then act as support / resistance and stop prices, sending them back in the direction of the original trend;

- The market reverses: prices will break the Kijun on close. This is THE signal that we will look for to enter the market.

- The SENKOU SPAN A (SSA) is the representation of the average between the Tenkan and Kijun shifted 26 periods forward;
• The **SENKOU SPAN B** (SSB) is calculated in the same way as the Kijun but taking into account 52 periods and shifted 26 periods forward.

The area between these two lines is called **the Cloud**, the original aspect of the Ichimoku.

The first information given is that of the trend: if prices are above the cloud then the trend is bullish, and vice versa when prices are below.

The second information is its thickness given by the evolution of the SSA: a thick cloud will be more difficult to cross for prices and thus to reverse a trend.

The cloud is the heart of the Ichimoku because it allows you to view the current trend of the asset at a glance and it embodies the fundamental concept of market equilibrium.

As the cloud is built from projections of midpoints calculated in the present time, it displays the supports / resistances that prices will encounter when they will reach this new time zone. The study of the future cloud therefore has no relevance to judge the state of the market in the present time.

• The **LAGGING SPAN** (LS) also known as Chikou Span, is the price line shifted 26 periods backwards. No calculation is made: it is the simple representation of current prices on close.
This line is the market memory and will therefore interact with the other lines of the system in the same way as the prices will do.

Due to the special calculation of these 4 lines (midpoints instead of moving averages) and their different positions in the space-time (delayed or advanced by 26 periods), the temporal vision of market changes is very wide and allows a more accurate appreciation of the current trend potential.

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**Ichimoku all in one**

This reading system has the main advantage of being instantaneous and invariable in its parameters, allowing to quickly assess the behavior of a market by easily switching from one time frame to another.

In a trading situation, the ideal reading covers three different time frames:

- A long TF for a thoroughly analysis: identification of key levels (support/resistance) and potential targets;
- An intermediate TF to establish a strategy defining the Target Price, Stop-Loss and the size of the position according to one's money management.
- A short TF to enter/exit the market and to make sure the trade goes as planned and expected.

Here are a few concrete examples, three ways of trading with the Ichimoku, from the simplest to the more technical reading, the last being better suited to very short term trading.

**A) SIMPLE EXAMPLE: INTRADAY**

Here is a trade that can take place over several hours without having to watch the screen permanently.

The first screen of analysis is the Daily indicating a bearish interesting opportunity (chart 2.1):
After a double bullish signal given by the break of the Kijun, prices rise to the cloud which acts as resistance. At the same time the Lagging Span refuses to break its own Kijun. Then prices fall back and give a sell signal with a bearish break of the Kijun. The Lagging Span confirms this information by crossing its prices and the Tenkan. It is free to fall.

However, the rising trend line connecting recent lows remains on the way and could act as support.

The trading idea is to sell with this support as target. The break of the Kijun having been tested by the shadow of the candle in progress, the price decline is inevitable at least to this level.

The second intermediate screen is used to define a strategy more precisely. Here we choose the 240 minutes time frame (chart 2.2).

The downward trend is very clear and is validated by the Lagging Span which crossed its Kijun and SSB (green ellipse). Prices crossed the thin cloud and thus confirmed the downtrend. Note that the
Lagging Span entered its cloud by breaking the SSB. As it is well known in technical analysis, a break has to be tested in order to be confirmed. Here, this test occurs with the blue candle in progress.

The strategy is then to enter a short position on the level of the SSB (blue dashed lines) with the trend line as target and a stop-loss placed above the SSB.

The last screen is the 60 minutes time frame (chart 2.3) which is used to manage the trade: the entry is triggered on the second correction candle which makes a lower high point, confirming the downward price determination. On this time frame, the Stop-Loss is set above the Tenkan.

![Chart 2.3 - 60 minutes (H1)](image)

If it were placed from a strictly Ichimoku technical point of view, it should be set above the Kijun because it is the break of this line which would invalidate the fall. But the risk reward ratio becomes insufficient. In addition, you may notice that the Tenkan plays perfectly its role of resistance. Thus this line is preferred for a possible invalidation because it is a "short term" trade.

Let’s see this position on the strategy screen H4 (chart 2.4): the Stop-loss appears to be well above the SSB, which is perfect. The limit (take profit) is the trend line which is in the continuation of the cloud bottom and the Kijun on the left. The market will inevitably stop on this level.
Finally, the trade which lasted three hours was closed a few points from the support on close of the third red candle. As correction is expected, it is best to get out and take the profits. (Chart 2.5).

Moreover, the Lagging Span almost reached the bottom of the cloud H4 (chart 2.6) with the shadow of the candle concerned. It will always be very wise to place limit orders leaving some points to the market.

Notice that the second blue candle, on which the entry position was made, ended as a red candle (chart 2.2 & 2.6). The downward validation was perfect.
This type of trading is also valid on a longer time frame such as weekly, daily and H4 for swing trading.

But it is also possible to have this kind of simple reading to manage trades on shorter time. We will then choose the H4, H1 and 15 minutes time frame or even faster with H1, 15 minutes and 5 minutes charts.

In the latter case, while keeping the basic reading simplicity, I prefer to use a slightly more thorough system that provides a more detailed reading of the market and enables faster thinking, better related to the unit of time over which the trade is executed.

**B) ADVANCED EXAMPLE:** below 60 minutes.

Even though one is a short-term trader, it is highly recommended to look at the asset on a daily time frame in order to get an overview of the market and especially to identify possible key levels that could be decisive in strategizing.

Looking at chart 3.1, we notice that prices have given a new bullish signal by breaking the Kijun. But the cloud acts as resistance, keeping prices within, a sign of indecision regarding the continuation of the movement.
Here, two key levels can be observed:

- The Kijun which was broken on the upside and tested now acts as support and prices will remain bullish as long as they remain above this line.

- The SSB in the continuation of the Kijun (left) is resistance as prices are within the cloud.

The trend will therefore be given by the crossing of one of these two levels.

By looking at H4 screen (chart 3.2), the indecision is clearly expressed by the Lagging Span which remains inside its cloud and by prices staying below the Tenkan which has to be broken in order to resume the uptrend started by the break of the Kijun.
On the 60 minutes chart (3.3), prices got out of the cloud but the Lagging Span is hampered by candles. No confirmation of the bullish trend on this time frame.

Now, if we project the cloud and Kijun H4 on this H1 chart, we have a different vision of price movements. (Chart 3.4)

At a glance, we immediately appreciate why the double bearish breakout of H4 Kijun (green) and H1 Kijun (blue overlapped) was a weak signal (red rectangle). Indeed, prices quickly find themselves on a double support with the Daily Kijun (dotted line) on the same level as the H4 SSB. And although they managed to cross this support, the thickness of the H4 cloud combined with the H1 cloud immediately below, was not an indication for a further decline.
Similarly, looking at candles from a shorter time frame (here H1) on a longer time frame (here H4), we better understand what the market tells us: candles with small bodies and a single bearish candle countered immediately behind mean sellers are not present. (violet rectangle)

Then prices rise after a new bullish signal is given by the break of H4 Kijun + H1 SSB gradually along H1 cloud. These latter acts as support until the horizontal break of the Kijun H1 and the exit of the cloud.

By looking at a shorter time frame (15 minutes), we can see the steady increase in prices observed on H1, with the Kijun in support identical to the cloud and the Tenkan on H1. (chart 3.5)

![Chart 3.5 - 15 minutes](image)

Then by projecting the H1 time frame over this 15 minutes chart, it is interesting to see the Lagging Span 15 minutes (blue dotted line) stopped by the H1 Kijun (green line): prices are kept in the H1 cloud with the 15 minutes Kijun as support. (Chart 3.6)
Thus, the fact of combining two different time frames on the same chart gives a better understanding of the active resistances on different time frames.

Now, (chart 3.7) if we add the H1 Lagging Span (dashed red line at the far left of the chart), we get another useful information: this line is going to meet the 15 minutes Kijun as resistance (ellipse a).

And you can see that even if prices break their Kijun (right side of the chart), this level is too low for the H1 Lagging Span (a) to confirm the break while the 15 minutes LS will validate the rise (b).

This "double" validation is especially necessary when the movement of the asset is uncertain.

On this last chart (3.8), the two Lagging Span confirm the upside movement of the prices which have broken their Kijun.
This projection system that may appear complicated to appreciate at first, is a major asset for very short term trading.

For example, on this 5 minutes chart (3.9):

The Lagging Span is breaking its Kijun, thus giving a buying signal but prices are neutral (in the cloud) or bearish (below their Kijun).

But if we look at the same chart (3.10) with a projection of the 15 minutes time frame, we see that the 15 minutes Kijun acts as support for prices therefore they cannot fall.
Chart 3.10 - 15 minutes projected on 5 minutes

It's then necessary to look at a shorter time frame: 1 minute chart (3.11)

Chart 3.11 - 1 minute

Here the situation appears more clearly with prices still below their Kijun and their cloud and the Lagging Span is below its cloud. This is an horizontal range without buying or selling signal.

By projecting the 5 minutes time frame on this 1 minute chart (3.12):
We can observe that prices reached the Kijun 1 minute with the Kijun 5 minutes as reinforcement above. And the Lagging Span 1 minute is stopped by the Kijun 5 minutes.

A projection of the 15 minutes time frame on this same chart 1 minute (3.13) gives another view:

We better understand why prices fail to drop to the bottom of the cloud 5 minutes seen above (3.12): the Kijun 15 minutes acts as strong support.

Naturally, we can also observe these configurations on different screens on each time frame. Projecting one time frame over each other allows faster reading of movements and especially instant analysis of the active different supports and resistances and how prices interact with them. We thus get a better “feeling” of the market because it shows short term candles acting with longer term supports and resistances.
C) ADVANCED TECHNICS ON SHORT TIME FRAME

While trading on very short term basis, it is also possible to add traditional indicators. But be careful: too many could distort the analysis and slow the reasoning / decision process.

In my trading, I use the RSI 5 rated at 38 and 62 as confirmation of buy or sell area. I do not have the traditional reading of overbought / oversold that could be easily read with the movements and body of the candles.

I sometimes project Fibonacci extensions (chart 4.1), especially after a correction, to find out the potential movement relative to an apparent Ichimoku level.

On the 1 minute chart with the 5 minutes projection (4.1 & following charts), prices are trying to cross the thin 1 minute cloud. On the left side, the Lagging Span tries to break both Kijun 1 minute and 5 minutes.

A first upward movement occurred from the low point validated by the break of two Kijun by prices. Then a corrective / consolidation happened on the Kijun 5 minutes which acted as support, confirming the bullish momentum.

So I positioned a Fibonacci extension in order to determine which Ichimoku levels should be considered as a target as soon as prices would be out of their cloud.

The first interesting level is the 50% that corresponds at the bottom of cloud 1 minute (SSB) in the continuation of two Kijun (left side) and on the right side, this level is also the bottom of the cloud 5 minutes. Prices are very likely to stop on this level.

The second level is the classic level of 0.618.
I do not take immediately into account the other ratios because prices must first penetrate the 5 minutes cloud before considering these ratios as potential targets.

Moreover the Lagging Span must cross the two Kijun (chart 4.2): the 5 minutes Kijun (green) has already been broken.

Chart 4.2

The break of the 1 minute Kijun should follow. This will be the signal to buy.

The Lagging Span validates prices upside movement (chart 4.3)

Chart 4.3

The entry is made on the candle which gets out of the cloud following a rebound on the Tenkan by a bullish engulfing candle.
The Stop-Loss is set below the Kijun 5 minutes and SSB 1 minute on the same level as the lowest point of the shadow of the doji which resumed the bullish momentum.

The limit order is set a few points below the 5 minutes SSB.

Usually, on very short term trades a limit order is not needed as one is supposed to follow the trade in front of its screen.

Finally, on this chart, we note the presence of a twist that the Lagging Span needs to cross in order to reach the target expected. This is what we will closely watch during the progress of the trade.

Chart 4.4

The Lagging Span stops on its twist at the same time prices reach the bottom of the 5 minutes cloud (resistance).
After three bullish candles and the RSI reversing on the level of its previous highest point, the trade exit is planned on close of the 1 minute candle. This trade resulted in a gain of 19 points.

The upward movement is complete: prices could not enter the 5 minutes cloud on a second try and reverse sharply by breaking the 1 minute Kijun and fall towards the Kijun which is then broken. A sell signal is given. But as we can observe, there is a double support (5 minutes Kijun + 1 minute SSB) close by. So we don’t enter a short trade as the risk reward ratio is not worth it.
On this screen which shows the end of the movement, we can see that prices were hampered on the Fibonacci level of 0.618 before correcting to the 5 minutes Kijun which held as support. After a long consolidation on the 1 minute Kijun, a new bullish impulse occurred. The target of the initial limit order has been achieved and exceeded up to the level of Fibonacci 1.272 which implied a coming correction.

Through these examples, I wanted to show that this kind of market analysis and reading system is complete regardless of the time frame on which one operates. However, on very short time frame, it may sometimes be wise to complete one's vision by projecting another time frame or by looking at another indicator. But it is useless to "put too much" other indicators except to blur the essential information given clearly by the Ichimoku.

This tool could be useful both for the novice trader because it requires little knowledge in technical analysis as well as for the more experienced trader who will find a great field of possibilities.

However, as powerful as this technical tool is, it will not enable one to become a successful trader without a great discipline in the application of strict rules in accordance with a well defined trading plan and a consistent money management.