



# Candlestick Charting and Trading Volume: Evidence from Bursa Malaysia

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## ABSTRACT

Technical analysis is deemed to be a futile practice among academicians who propose efficient market hypothesis, typically the weak form market efficiency which strongly protests the application of past prices and trading volume data for prediction of future market movement. As candlestick charting is one of the oldest technical indicators for short term investment, therefore this study examines the predictability of candlestick charting with combination to trading volume for Malaysian stock market within the period of 2000-2014. Skewness adjusted t-test is employed to test the statistical significance of candlestick returns. After taking into account the transaction costs and also out-of-sample test as robustness checking, the findings show that only bullish reversal patterns prior to trend are profitable for investors while most of the bearish reversal patterns have shown significant predictive power both before and after trend. The effective holding period for candlestick reversal patterns tend to accumulate around 10-15 day holding period.

**Keywords:** Efficient Market Hypothesis, Technical Analysis, Candlestick Charting, Reversal Patterns

**JEL Classifications:** G11, G12, G14

## 1. INTRODUCTION

The controversy between efficient market hypothesis and technical analysis still exists in today's finance world. All three forms of market efficiency signify the impossibility to obtain abnormal returns in an efficient market as all sorts of readily available information including the public and private information have been fully incorporated into the prices of financial assets (Fama, 1970). In particular, technical analysis is rejected by the weak form market efficiency which asserts the uselessness of historical information to forecast future market movement.

Technical analysis is believed to be originated from Dow theory since 1884. Technical analysis aims to trace market movement through numerical and charting analysis from past prices and trading volume data. The trading signals forecasted by technical indicators reflect investor sentiment that assist traders in market

timing (Murphy, 1999). If prices is the primary element in the securities market, then trading volume would be the secondary element to be considered. Trading volume reflects the liquidity of stock from daily transaction of shares in the market besides functioning as a basic fuel to control the movement of market prices. The combination of trading volume and stock prices could thus detect the true commitment of price movement easily (Dormeier, 2011). Brock et al. (1992), Lo et al. (2000), Shen (2003), and Neely et al. (2011) have even provide positive evidences which prove the effectiveness of technical analysis while recent findings from behavioral finance which validates the irrationality of investors in decision making has added value to the practice of technical analysis method (Marshall et al., 2006).

The Japanese candlestick charting which is time-tested since 1700s is one of the oldest trading rules among other technical indicators. In fact, candlestick charting technique acts as a leading indicator which