Figure 2.20: **The resistance offered by the downtrending Kumo keeps the price rally in check**

What Kumo Tells Us About the Trend

- If the current price is above the Kumo, the trend is considered bullish.
- If the current price is below the Kumo, the trend will be considered bearish.
- If the current price is within the Kumo, the trend is said to be consolidating.

How Kumo Twist Anticipates a Trend Change

At some point during a trend, the demand-supply equation will change and price will reverse course. It will have to cross the Kumo to the other side and establish a new trend. Since the two components of the Kumo are plotted 26 periods in the future, the Ichimoku system gives a good idea of when investor sentiment is changing.

Remember that Senkou A is faster moving than Senkou B. If a stock is in an uptrend, Senkou A will be above Senkou B. When investor sentiment starts reversing, its repercussions will be seen in the future Kumo. In such a case, Senkou A will move below Senkou B. This crossover, referred to as a Kumo Twist, should alert the trader to a possible end of the current trend and, in some cases, a trend reversal.

Figure 2.21 shows Yes Bank in a strong uptrend till the end of February. Notice how the Kumo was rising during this period with Senkou A above Senkou B. However, at the end of February, the future Kumo had a bearish twist. This would have alerted traders that the current uptrend might be over and that it might be time to liquidate the entire position.

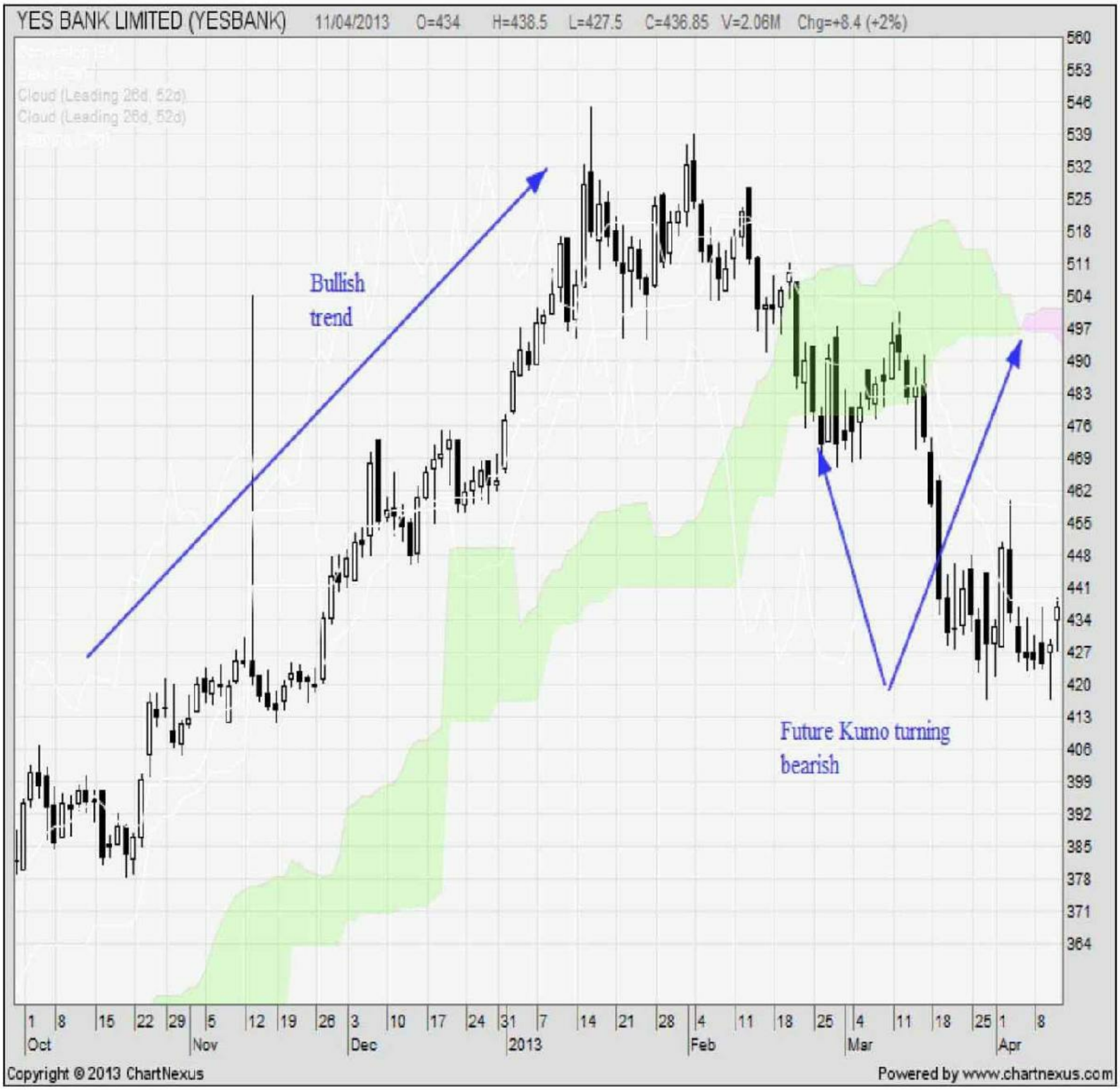

Figure 2.21: **Future Kumo forewarns of trend change**

Traders should also keep in mind that price will have relative ease in breaking through to the other side of the Kumo if the Kumo's width is thin.

A flat Senkou B can provide strong support / resistance to the price depending on the nature of approach.

A flat Senkou B means a steady equilibrium of prices.

A trending Senkou A and B, which I refer to as a Kumo in flux, has a lesser chance to halt the price.

Figure 2.22 shows Reliance Capital breaking to the Kumo upside in January 2012 as both Senkou A and Senkou B were trending down; Kumo was then in a flux. In April, as the price started coming down, it initially found support on the flat Senkou B. But notice that when it then ran out of this strong support, it broke the Kumo to the downside.

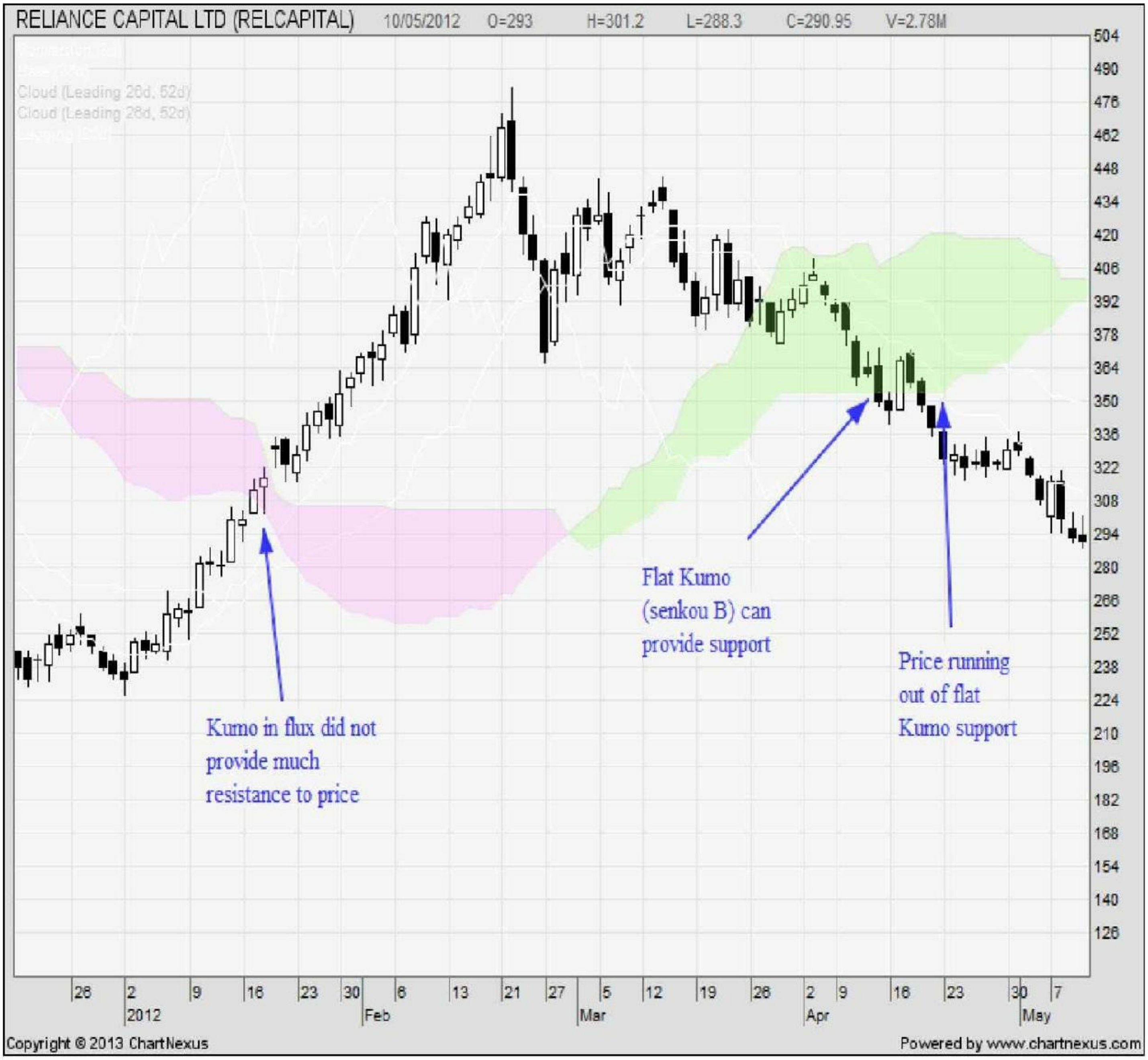

Figure 2.22: **Trend reversal in Reliance Capital**

Chikou

The Chikou is a simple yet powerful component of Ichimoku. It is the curret price shifted back 26 periods.

The Chikou is also the most misunderstood indicator of the Ichimoku system. Its simple nature masks its immense potential. Many traders disregard it on their charts either for a lack of understanding or because they think it to be too simple to be useful. Do not make this mistake. **Chikou provides powerful information to the trader** as you will witness. Here is how:

- **If Chikou is above the price of 26 days ago, then the chart is bullish.**
- **If Chikou is below the price of 26 days ago, it is considered bearish.**

Figure 2.23 shows a bearish chart.

Figure 2.23: **Chikou below the price of 26 days ago indicates bearish sentiment**

Figure 2.24 shows a bullish chart.

Figure 2.24: **Chikou above the price of 26 days ago indicates bullish sentiment**

The idea behind the Chikou is that the price level from 26 days ago will either act as resistance, or support, as the case may be. Markets have memory. Think about it for a moment. When you buy a stock and it goes down, what do you hope for? A breakeven! You want the stock to do nothing more than get back to the price you bought it for. At that point, you don't care about making even a single rupee. All you want is your hard earned money, your capital, back. This creates a supply zone / resistance zone for the stock. For example, for the stock to go any higher in Figure 2.25, demand will have to overcome the available supply.

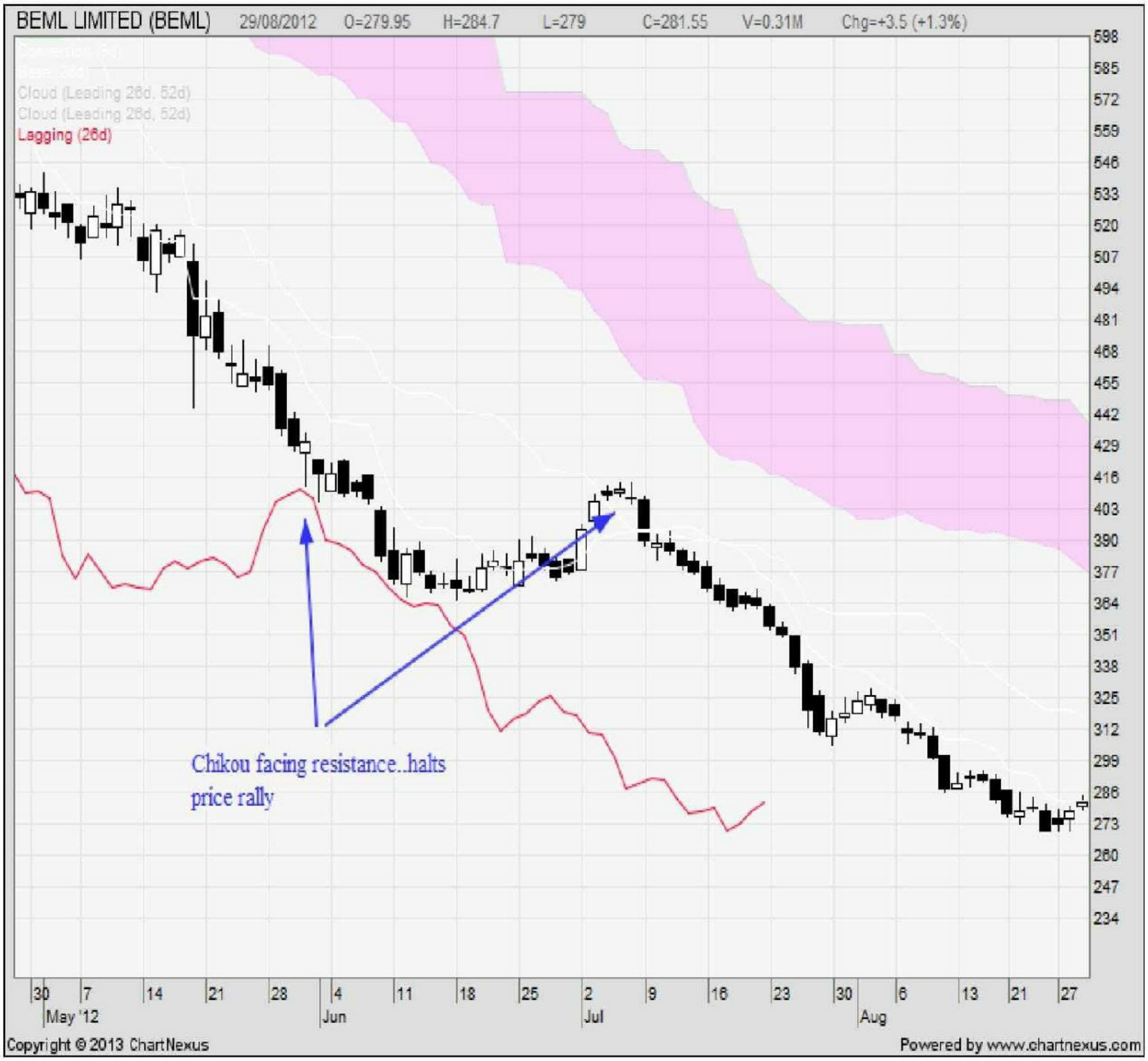

Figure 2.25: **Chikou facing resistance from 26 days prior candles**

A corresponding scenario holds true for the reverse side. If you either shorted a stock or missed buying it at a particular level, and the stock has now come back to the same level, wouldn't you want either to cover the short or jump into the stock at this point, as the case may be. Most likely you will. This creates a demand zone, or support zone, for the stock (*see* Figure 2.26). For the stock to go lower, this demand will have to be overwhelmed by the supply.

Figure 2.26: **Chikou finds support on candles from 26 days ago**

How Chikou Acts as a Momentum Indicator

The Chikou is a good indication of how the trend will proceed in the near future.

A trend has a good chance of running as long as the Chikou is free and does not run into previous prices. In this sense, the Chikou acts as a momentum indicator as illustrated in Figure 2.27.

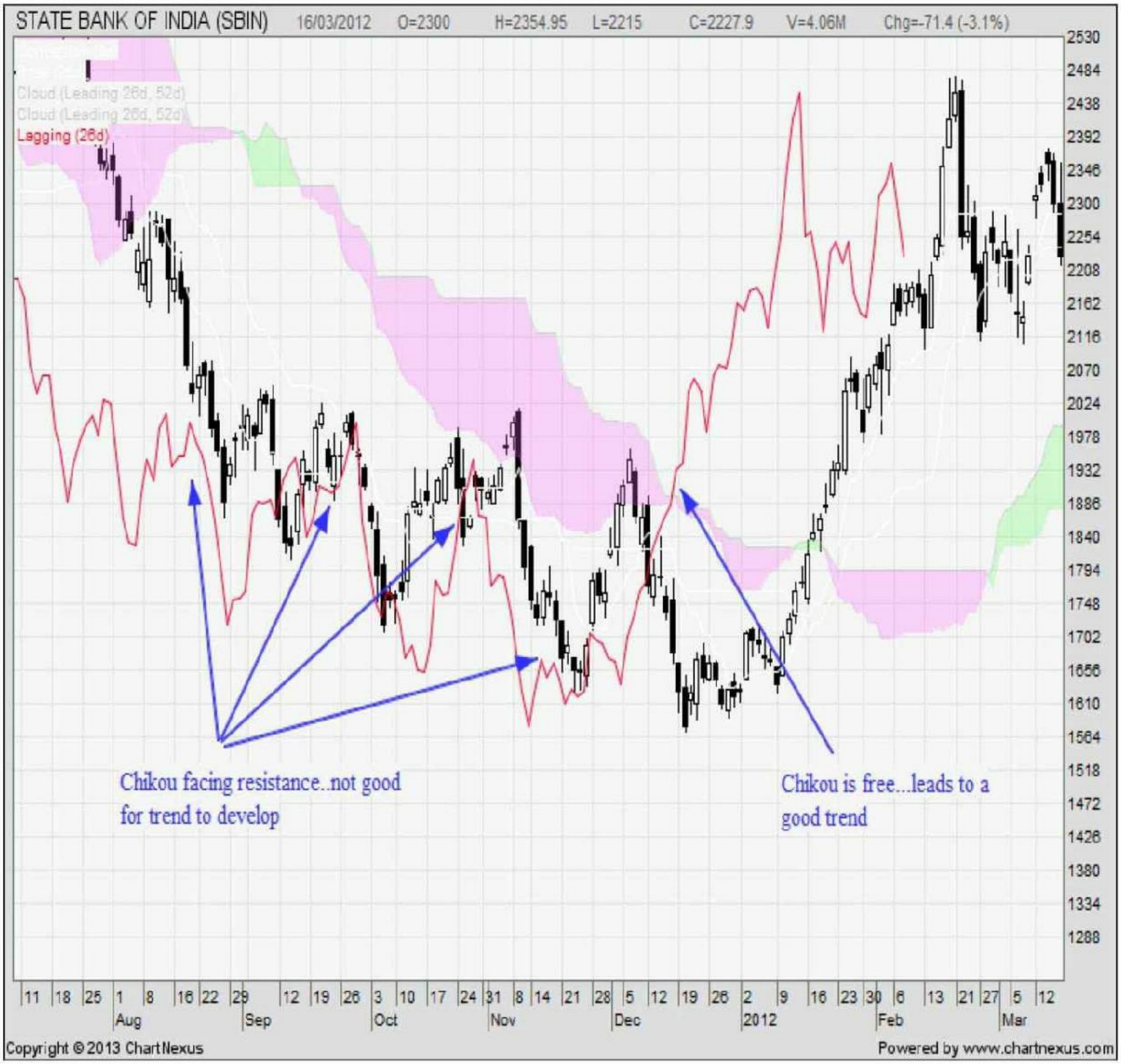

Figure 2.27: **How Chikou acts as a momentum indicator**

3

Ichimoku Trading System

Now that the reader is familiar with the five components of Ichimoku, it is time to integrate them all into a trading system. A system will ensure the trader that all aspects of Ichimoku are working in harmony with each other. A system can use any strategy, but should be rule-based in nature.

Individual traders have unique personalities and each one may find one strategy more suitable than the others. That is exactly how it should be in trading. One trader can make tens of million using one strategy. Another trader might fail miserably using that same strategy. The difference being their personality.

Here are the five commonly used Ichimoku trading strategies.

1. Tenkan / Kijun Cross.
2. Kumo Breakout.
3. Kijun Cross.
4. Chikou Breakout.
5. Kumo Twist.

In this chapter, we will look at the basics of each strategy. The first two strategies are then further discussed in depth, and with many, many examples in Chapters 4 and 5. They are my favorite strategies and work with an extremely high degree of success. If you wish to use the other three strategies, you can design rules similar to the ones described for the first two.

Alert

Keep in mind that no matter what underlying strategy one uses for entry into a position, all the Ichimoku components need to be looked at for their bearish or bullish indications. This can’t be emphasized enough.

Tenkan / Kijun Cross Strategy (T/K Cross)

Basic Principle

- Long positions are initiated when the Tenkan crosses the Kijun to the upside.
- Short positions are initiated when the Tenkan crosses the Kijun to the downside.

According to Ichimoku, the effectiveness of the T/K cross depends on its location with respect to the Kumo:

- If a bullish T/K cross occurs above the Kumo, it is considered a strong bullish signal.
- If a bullish T/K cross occurs below the Kumo, it is considered a weak bullish signal.
- If a bullish T/K cross occurs within the Kumo, it is considered a neutral bullish signal.

Correspondingly, on the bearish side:

- If a bearish T/K cross occurs above the Kumo, it is considered a weak bearish signal.
- If a bearish T/K cross occurs below the Kumo, it is considered a strong bearish signal.
- If a bearish T/K cross occurs within the Kumo, it is considered a neutral bearish signal.

Let us look at each example that follows to understand these points clearly.

Figure 3.1 shows a strong bullish T/K cross because it occurred above the Kumo.

Figure 3.1: **Strong bullish signal as the bullish T/K cross occurs above the Kumo cloud**

Figure 3.2 shows a weak bullish T/K cross because it occurred below the Kumo.

Figure 3.2: **Weak bullish signal as the T/K cross occurs below the Kumo**

Figure 3.3 shows a neutral T/K cross because it occurred within the Kumo. Keep in mind that when things are in the Kumo, they are consolidating.

Figure 3.3: **Neutral strength T/K cross as the bullish cross occurs within the Kumo**

Figure 3.4 shows a strongly bearish T/K cross because it occurred below the Kumo.

Figure 3.4: **Strong bearish T/K cross occurring below the Kumo**

Figure 3.5 shows a weak bearish T/K cross because it occurred above the Kumo.

Figure 3.5: **Weak bearish T/K cross**

Figure 3.6 shows a neutral bearish T/K cross as it occurred within the Kumo.

Figure 3.6: **Neutral T/K cross as the cross is within the Kumo**

Stop Setting

Initially the stop loss is set, with a small buffer, above or below the Kijun depending upon if the trade is bearish or bullish, respectively. As the position moves in the anticipated direction, it will continue to draw the Kijun with it. This enables the trader to trail one's stop out level with the Kijun.

Trade Exit

It is very important for the trader to take partial profits on an ongoing basis as the position moves in his or her favor. The final position can be exited in any of the following ways:

- Get stopped out as the price moves through the buffer area below the Kijun.
- Close out your position as price closes below the Kijun.
- Close out of a T/K cross occurs in the opposite direction.

Kumo Breakout Strategy

Basic Strategy

- Long positions are initiated when price breaks and closes above the Kumo.
- Short positions are initiated when prices break and close below the Kumo.

As mentioned earlier, the Kumo is central to Ichimoku. When prices are above the Kumo, the chart is considered bullish and when prices are below the Kumo, the chart is considered bearish. The chart in Figure 3.7 shows a long position entry as the price closes above the Kumo.

Figure 3.7 shows a bullish Kumo break. Traders can enter a long position on strength, meaning above the high of the signal candle.

Figure 3.7: **Bullish Kumo break as the price closes above the Kumo**

Figure 3.8 shows a short entry scenario as the price closes below the Kumo.

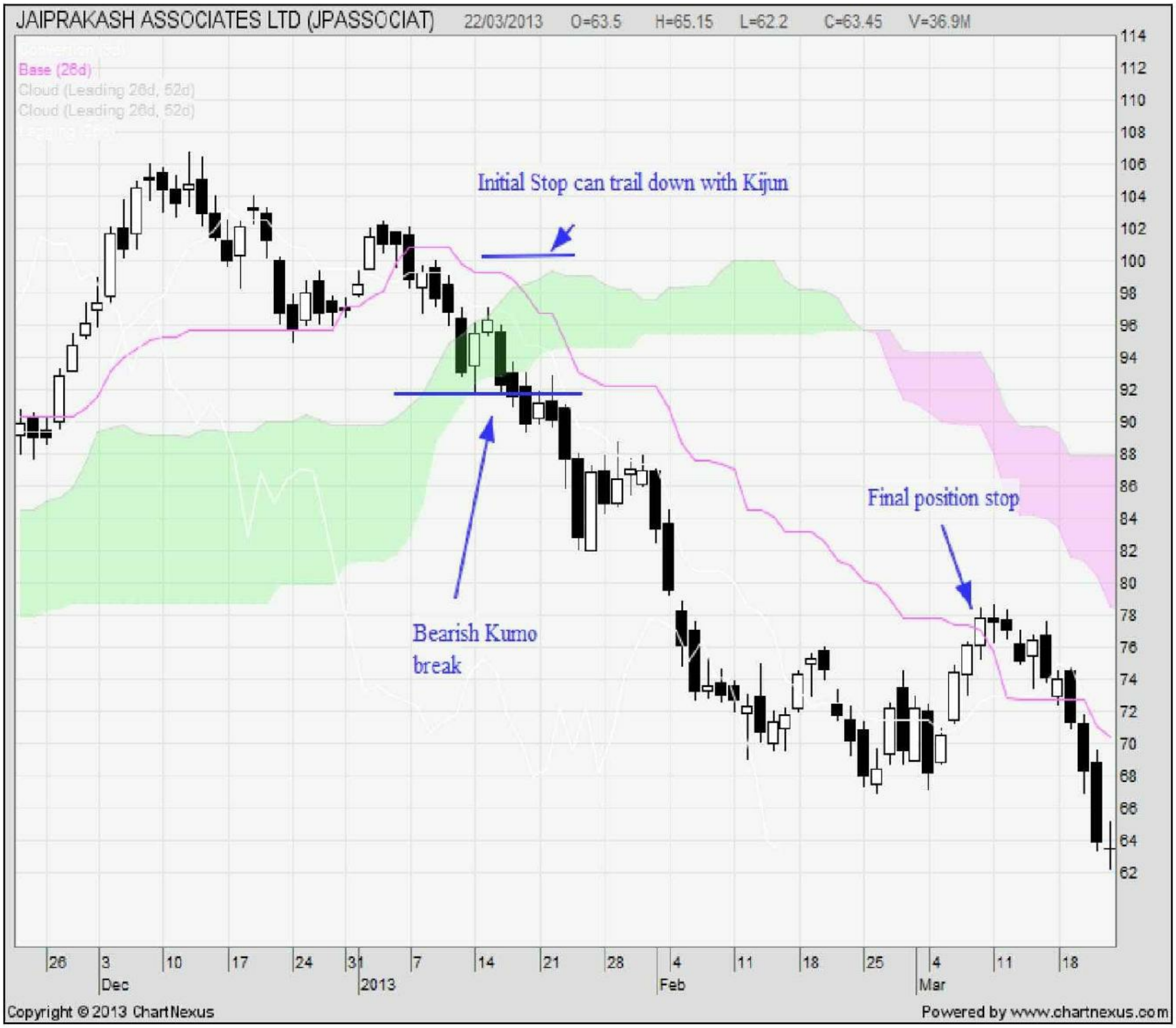

Figure 3.8: **Bearish Kumo break as the price closes below the Kumo**

Stop Setting

Initially the stop loss is set either above or below the Kijun with a small buffer depending upon if the trade is bearish or bullish, respectively. As the position moves in the anticipated direction, it will continue to draw the Kijun with it. This enables the trader to trail his or her stop out level with the Kijun.

Trade Exit

It is very important for the trader to take partial profits on an ongoing basis as the position moves in his favor. The final position can be exited in any of the following ways:

- Get stopped out as the price moves through the buffer area beyond the Kijun.
- Close out the position as price closes above / below the Kijun.

Kijun Cross

Basic Strategy

- Initiate long position when price closes above the Kijun.
- Initiate short position when price closes below the Kijun.

According to Ichimoku, the effectiveness of the Kijun cross depends on its location with respect to the Kumo.

- If price closes above the Kijun and this crossover is above the Kumo, it is considered a strong bullish signal.
- If price closes above the Kijun but the crossover is below the Kumo, it is considered a weak bullish signal.
- If the price closes above Kijun and it is within the Kumo, it is considered a neutral bullish signal.

Correspondingly, on the bearish side:

- If the price closes below the Kijun and it is below the Kumo, it is considered a strong bearish signal.
- If the price closes below Kijun and it is above the Kumo, it is considered a weak bearish signal.
- If the price closes below Kijun and it is within the Kumo, it is considered a neutral bearish signal.

Let's review the charts below for understanding these nuances.

Figure 3.9 shows Price / Kijun cross in the chart of Jaiprakash Power. Since the cross is above the Kumo, a strong bullish signal.

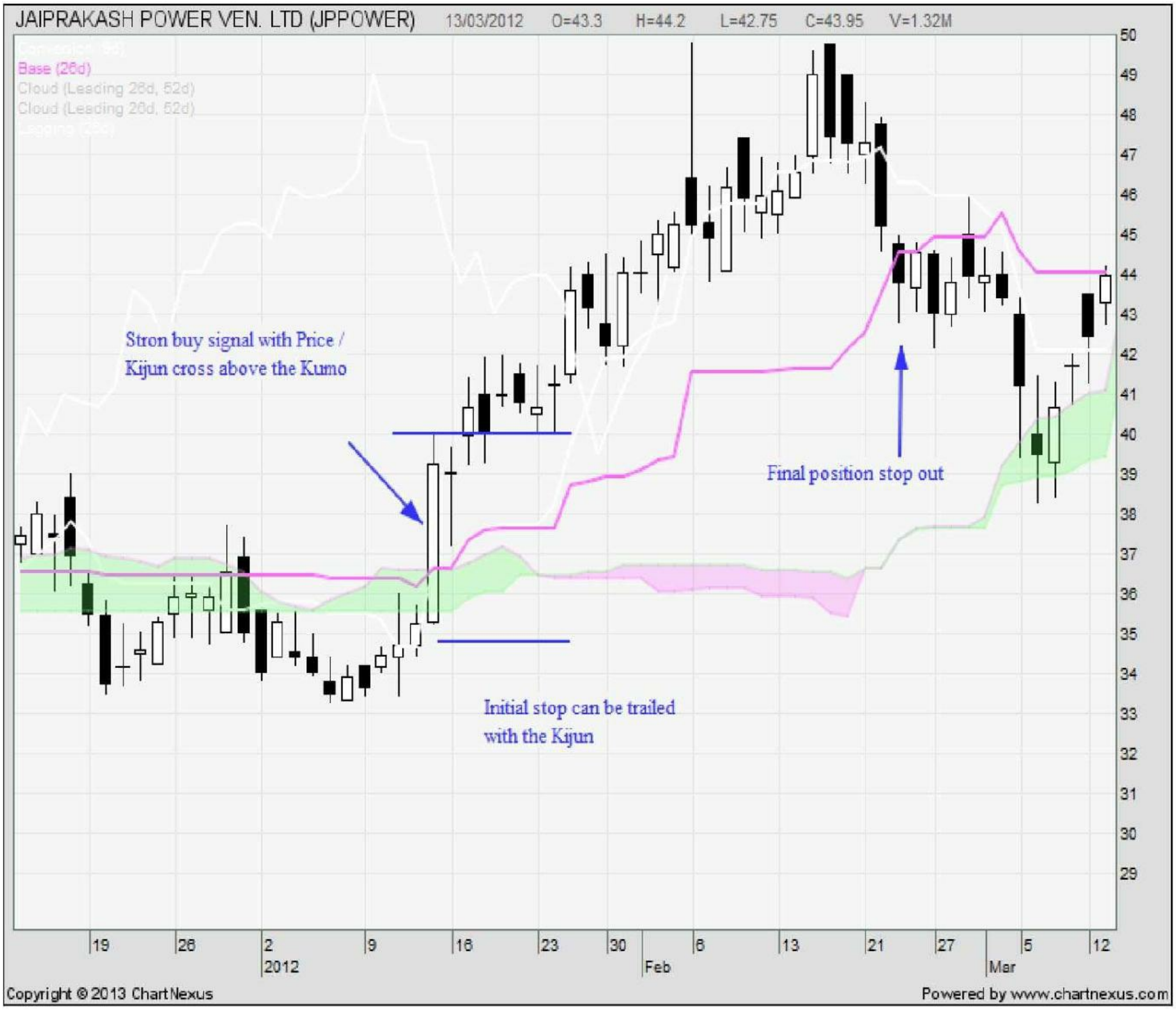

Figure 3.9: **Strong bullish signal as the price crossover of Kijun is above the Kumo**

Figure 3.10 shows Price / Kijun cross in the chart of Educomp Solutions. Since the cross is below the Kumo, it is a weak bullish signal.

Figure 3.10: **Weak bullish signal as the price crossover of Kijun is below the Kumo**

Figure 3.11 shows a neutral bullish price / Kijun cross in the chart of Infosys, as the cross occurs within the Kumo.

Figure 3.11: **Neutral bullish price Kijun crossover as it occurs within the Kumo**

Figure 3.12 shows a strong bearish price / Kijun cross in the chart of Wipro, with Kijun below the Kumo.

Figure 3.12: **Strong bearish price cross with Kijun below the Kumo**

Figure 3.13 shows a weak bearish price / Kijun cross, with the Kijun being above the Kumo in the chart of Gitanjali Gems.

Figure 3.13: **Weak bearish price cross with Kijun above the Kumo**

Figure 3.14 shows a neutral bearish price / Kijun cross in Sintex, as the Kijun is within the Kumo.

Figure 3.14: **Neutral bearish price cross as Kijun is within the Kumo**

Stop Loss Setting

For the Kijun cross strategy, the stop loss is initially set below the Kijun with a small buffer. As the position moves in the anticipated direction, it will continue to draw the Kijun with it. This enables the trader to trail his stop level with the Kijun.

Trade Exit

It is very important for the trader to take partial profits on an ongoing basis as the position moves in his favor. The final position can be exited in any of the following ways:

- Get stopped out as the price moves through the buffer area below the Kijun.
- Close out position when the price closes below the Kijun.

Chikou Breakout

Basic Strategy

- Initiate long position when Chikou crosses and closes above the price of 26 days ago.
- Initiate short position when Chikou crosses and closes below the price of 26 days ago.

As a trader you should visually ascertain if there will be any immediate resistance to the Chikou within the next few trading periods as the current price moves up or down. This is important because the Chikou needs to be free for the trend to continue.

According to Ichimoku, the effectiveness of the Chikou cross, or breakout, depends on the location of the current price with respect to the Kumo.

- If the Chikou closes above the price of 26 days ago, and the current price is above the Kumo, it is considered a strong bullish signal.
- If the Chikou closes above the price of 26 days ago, but the current price is below the Kumo, it is considered a weak bullish signal.
- If the Chikou closes above the price of 26 days ago, and the current price is within the Kumo, it is considered a neutral bullish signal.

Correspondingly, on the bearish side:

- If the Chikou closes below the price of 26 days ago, and the current price is below the Kumo, it is considered a strong bearish signal.
- If the Chikou closes below the price of 26 days ago, but the current price is above the Kumo, it is considered a weak bearish signal.
- If the Chikou closes below the price of 26 days ago and the current price is within the Kumo, it is considered a neutral bearish signal.

The examples that follow depict the different scenarios listed above.

Figure 3.15 shows the chart of Bombay Dyeing displaying a strong buy signal as the Chikou crosses above the price of 26 days ago, and the current price is above the Kumo.

Figure 3.15: **Strong bullish signal — the Chikou crosses above the price of 26 days ago, and the current price is above the Kumo**

The Andhra Bank chart in [Figure 3.16](#) shows a weak buy signal as the Chikou crosses above the price from 26 days ago but the current price is below the Kumo.