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Understanding Market Psychology Through Candlestick Patterns: A Qualitative Analysis Of Investor Behavior In Stock Trading

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Abstract

Stock trading is influenced not only by companies' fundamentals and market price movements, but also by investors' perceptions, expectations, and psychological behavior. One technical-analysis tool commonly used to read price movements is the candlestick chart. Candlestick patterns are often interpreted as representations of the contest between buying and selling pressure and may help investors understand market sentiment. However, the same pattern does not always lead to the same decision because investors differ in experience, knowledge, risk tolerance, and emotional state. This study aims to understand how investors interpret candlestick patterns when reading market psychology, how emotions affect trading decisions, and which factors shape investors' interpretations. The study is designed as descriptive qualitative research, using in-depth interviews, price-chart documentation, and observation of investors' analytical processes. Data are analyzed through data condensation, data display, and conclusion drawing and verification. The analytical framework draws on Kahneman and Tversky's Prospect Theory and behavioral-finance literature, while considering empirical studies of candlestick-strategy effectiveness. The study is expected to explain candlesticks as an aid to market interpretation and to explore the role of perception and emotion in decision-making. Empirical conclusions will be established on the basis of the field data collected.

Keywords: candlestick, market psychology, investor behavior, behavioral finance, technical analysis.

INTRODUCTION

The capital market is an important part of the financial system, connecting parties that need funding with those who have funds to invest. Through stock trading, investors

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have opportunities to earn returns from price changes and dividend distributions. Nevertheless, stock investment involves risk because prices can change in response to many factors, including company performance, economic conditions, market information, interest rate changes, and market participants' behavior. In stock trading, investors use various approaches to make investment decisions. Some focus on fundamental analysis by assessing financial conditions, business prospects, and a company's ability to generate profits. Investors who use technical analysis, meanwhile, pay greater attention to price movements, trading volume, trends, and chart patterns. These approaches have different emphases but can complement each other in the decision-making process.(Jakpar et al. 2018)

One technical-analysis tool widely known among investors is the candlestick chart. It presents the opening price, highest price, lowest price, and closing price for a particular period. The candlestick body and wicks help investors observe the price range and the closing price relative to the opening price. Stockbit's educational articles explain that patterns such as Doji, Hammer, Shooting Star, and Engulfing are often used to interpret possible buying pressure, selling pressure, market indecision, or a potential trend change. The appeal of candlesticks lies not only in their visual form but also in the meanings investors assign to price movements. When a stock price declines and forms a particular pattern, some investors may interpret it as a sign that selling pressure is weakening. Others may regard the decline as a sign that risk remains high. These different interpretations show that price charts do not operate independently of human thought. Trading decisions also involve each investor's knowledge, experience, expectations, risk tolerance, and objectives.(Leippold, Wang, and Yang 2024)

Market psychology is therefore important to understand. It refers to patterns of perception, emotion, expectations, and behavior among market participants that may be reflected in trading activity and price changes. When optimism increases, investors may be more willing to buy shares in the expectation that prices will rise. Conversely, when fear and uncertainty increase, some may sell shares or postpone investment decisions. Price changes, however, cannot be explained by emotion alone, because fundamentals, liquidity, new information, and economic conditions also affect market activity.(Liu, Liu, and Son 2026a) Candlesticks are often used to interpret these dynamics through price shapes and sequences. For example, a Doji forms when the opening and closing prices are relatively close. It is often interpreted as indecision or a temporary balance between buying and selling pressure. A Doji does not automatically indicate that prices will reverse; its meaning depends on the preceding trend, where it appears, trading volume, and subsequent price movements.(Norasaed and Siriborvornratanakul 2024)

Another example is the Hammer, a pattern with a relatively small body and a long lower wick. In a downtrend, it is often interpreted as indicating that the price was pushed

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lower but recovered before the period ended. This interpretation may suggest rejection of lower prices. Nevertheless, a Hammer indicates a possible scenario rather than guaranteeing that buying pressure will continue.(Meher et al. 2025) Stockbit also emphasizes the importance of trend context when reading a Hammer. The issue becomes more interesting when investors interpret the same pattern differently. Experienced investors may wait for confirmation before taking a position, whereas less experienced investors may buy immediately after seeing what they consider a bullish pattern. Conversely, investors who have experienced substantial losses may become more cautious, even when technical analysis suggests a possible price increase. Candlestick interpretation therefore involves not only technical knowledge but also prior experience and the way investors assess risk.(Loubaris 2026)

This phenomenon can be examined through behavioral finance, which studies how psychological factors and limits to rationality affect financial decisions. In fully rational financial models, decision-makers are assumed to evaluate information and alternatives consistently. In practice, however, investors may be influenced by fear of loss, expectations of profit, selective attention to information, and the tendency to follow other people's actions. Investor decisions therefore do not always correspond fully to the objective information available.(Price et al. 2024)

A relevant theoretical foundation is Prospect Theory, developed by Daniel Kahneman and Amos Tversky in The theory explains that people evaluate outcomes in terms of perceived gains and losses rather than final wealth alone. People may respond differently to gains and losses and may avoid risk in some situations while taking greater risks in others. In stock trading, the theory may help explain why investors experiencing losses sometimes refuse to sell, while investors who have made a profit sell too quickly because they fear that the profit will disappear.(Fortin and Hlouskova 2024b) This theory must nevertheless be applied carefully in candlestick research. Prospect Theory does not directly explain candlestick shapes; rather, it helps analyze how investors interpret price information and assess risk when making decisions.(Lakatos and Botos 2024)

Empirical research on candlesticks also cautions against treating chart patterns as tools that always generate profits. Marshall, Young, and Rose, in "Candlestick Technical Trading Strategies: Can They Create Value for Investors?", tested candlestick trading strategies on stocks in the Dow Jones Industrial Average. They found that the tested strategies did not add value for investors in the sample and under the methods used.(Marshall, Ben R. 2006) This finding distinguishes two issues: investors may use candlesticks to understand and interpret prices, but that interpretive usefulness does not automatically prove that a pattern can generate consistent profits. The distinction between interpretation and strategy effectiveness is an important foundation for this study. If the aim is to test whether a pattern generates returns, a quantitative approach

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using historical data and statistical testing would be more appropriate. By contrast, if the aim is to understand why investors trust a pattern, how they interpret signals, and how emotions and experience affect decisions, a qualitative approach can provide deeper insight.(Tharavanij and Siraprapasiri 2017)

A qualitative approach allows researchers to explore investors' explanations based on their own experiences. Through in-depth interviews, a researcher can examine why one person sees a Hammer as a buying opportunity, why another chooses to wait, and how investors combine candlesticks with additional information. The study can also explore whether decisions are based on consistent rules, previous experience, community influence, or emotional responses to price changes. Although candlestick analysis and behavioral-finance research have developed, there remains room to investigate investors' interpretive processes in depth, particularly how investors explain the relationship between price patterns, perceived market sentiment, emotional conditions, and trading decisions in the Indonesian stock market. This gap should be understood as a focus to be examined through literature review and field data, not as a claim that no similar research exists.(Tantri and Atikah 2025)

Based on this discussion, the study entitled "Understanding Market Psychology through Candlestick Patterns: A Qualitative Analysis of Investor Behavior in Stock Trading" examines candlesticks as an interpretive tool used by investors under market uncertainty. It does not assume that chart shapes can reveal the psychological state of all market participants with certainty. Instead, it seeks to explain how investors construct meaning from price patterns, connect them with market sentiment, and consider psychological factors when deciding to buy, sell, or hold shares.

THEORETICAL FRAMEWORK

Candlestick Analysis

A candlestick is a form of price visualization used in technical analysis. Each candlestick depicts price movements over a particular period, such as one minute, one hour, one day, or one week. It displays four main components: the opening price, highest price, lowest price, and closing price. The candlestick body shows the difference between the opening and closing prices. The upper and lower wicks indicate the highest and lowest prices reached during the period. When the closing price is higher than the opening price, the candle is generally called bullish. When the closing price is lower than the opening price, it is called bearish.(Huang, Wang, and Wang 2024)

Candlestick analysis provides a visual way to read price movements and can be combined with other analytical techniques. Candlestick shapes should, however, be interpreted in context rather than memorized as automatic buy or sell signals. In this study, candlesticks are treated as objects of investor interpretation. The focus is not to

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prove that a particular pattern always generates profits, but to understand how investors read chart shapes and assign meaning to them.(Li et al. 2024)

Market Psychology

Market psychology concerns how market participants form expectations, respond to information, assess risk, and make decisions. Stock prices result from the interaction of many trading decisions. However, prices cannot directly measure the emotions of all investors, because transactions may be motivated by different objectives and information.(Safitri 2025)

Baker and Wurgler explain that investor sentiment can influence assessments of investment prospects and risk and is associated with stock-price movements. They also discuss how individual psychological biases, such as overconfidence and assigning excessive weight to particular information, may help explain investors' responses to market conditions.(Pham et al. 2025) Based on this perspective, this study examines market psychology through three dimensions:

Cognitive dimension: how investors understand chart patterns, assess information, and form expectations.

Emotional dimension: how fear, optimism, anxiety, or greed is experienced when prices change.

Behavioral dimension: how interpretations and emotions are considered when investors buy, sell, hold, or refrain from taking a position.

These three dimensions guide the development of interview questions and the organization of research data.

Prospect Theory by Kahneman and Tversky

Prospect Theory is a theory of decision-making under risk developed by Kahneman and Tversky It indicates that people do not always evaluate choices solely through objective calculations of final gains. They may compare outcomes with a reference point, such as a stock's purchase price, an expected profit, or a current loss. An important idea in the theory is that losses and gains can have different psychological effects. A perceived loss may lead a person to avoid certain risks, but in other circumstances it may encourage greater risk-taking in an attempt to recover the loss.(Fortin and Hlouskova 2024b)

In stock trading, this theory can help explain several situations.

First, investors may use the price at which they purchased a stock as a reference point. When the price falls, they may see the situation as a loss that should be limited immediately. Other investors may continue holding the stock because they expect the price to return to the purchase level.

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Second, investors who have made a profit may sell earlier than planned because they fear that the gain will disappear. Others may hold the stock longer in the hope of further increases.

Third, candlestick interpretation may be influenced by an investor's existing position. A bullish pattern may seem more convincing to someone who already owns the stock than to someone who has not taken a position. This possibility must be investigated through interviews rather than assumed to apply to all investors. Prospect Theory therefore helps this study examine how reference points, perceptions of gains and losses, and risk assessments shape candlestick-based decisions.

Behavioral Finance and Investor Biases

Behavioral finance examines how psychological and behavioral factors influence financial decisions. This approach is relevant because investors may lack complete information, sufficient time, or the ability to evaluate every alternative objectively. (Sharma 2025) in a systematic literature review of behavioral biases in investor decision-making, discuss the relevance of psychological biases to investment decisions. Their article can provide an additional reference for developing analytical categories concerning the influence of bias on investors' judgments and actions.

This study uses four behavioral concepts as initial analytical categories:

a. Loss aversion

   The tendency to give losses greater psychological weight than comparable gains. In candlestick analysis, this concept can help explore why investors respond differently when a bearish pattern appears while they are experiencing a loss.

b. Confirmation bias

   The tendency to seek or pay greater attention to information that supports an existing belief. For example, an investor who already expects prices to rise may focus on bullish patterns and ignore contradictory signals.

c. Overconfidence

   Excessive confidence in one's knowledge or ability to predict the market. Investors who are overly confident in their candlestick interpretations may make decisions without adequately considering uncertainty or the possibility of error.

d. Herd behavior

   The tendency to follow other people's decisions or actions. In stock trading, this may occur when investors follow community recommendations or other people's trades without evaluating the reasoning independently.

These four concepts are preliminary analytical categories. The researcher must seek evidence in interview data before concluding that an informant exhibits a particular bias.

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Candlestick Interpretation as Price Action

Price action refers to the observation of price movements, including trend direction, price structure, trading range, and patterns that develop over time. Candlesticks are one way of presenting price-action information. The relationship between price action and market psychology must be interpreted carefully. A candlestick may show that the price moved in one direction and then closed in another, allowing investors to infer possible changes in buying and selling pressure. However, candlesticks do not directly reveal the identities of traders, their reasons for trading, or the emotions they experienced.(Rink 2025)

This study therefore distinguishes between two things:

Chart information: price data that can be observed directly.

Psychological interpretation: the meaning investors assign to that data.

This distinction is important so that technical interpretations are not treated as proven facts about psychological states.

RESEARCH METHOD

This study uses a descriptive qualitative approach because its purpose is to understand investors' experiences and interpretations when using candlestick patterns in stock trading. It is not designed to calculate pattern accuracy or statistically test the relationship between candlestick patterns and investment returns.(Clear 2025)

The qualitative approach allows the researcher to understand the reasons behind investors' decisions, including how they read charts, consider risk, respond to price changes, and manage emotions. The accounts obtained from informants are then compared with chart documentation and theories of behavioral finance. Data analysis follows Miles, Huberman, and Saldaña, who emphasize data condensation, data display, and conclusion drawing and verification.(Matthew B. Miles, A. Michael Huberman 2019)

FINDINGS AND ANALYSIS OF CANDLESTICK PATTERNS

The Doji Pattern and Interpretations of Market Indecision

A candlestick is a type of stock-chart pattern that resembles a candle. A Doji is a candlestick pattern in which the opening and closing prices are equal or very close to one another. Doji patterns generally have a very thin body and visible wicks. Because the body is small, traders may find it difficult to determine the next trading opportunity from the pattern alone. Several Doji forms are commonly discussed in stock trading, including the Doji Star, Long-Legged Doji, Gravestone Doji, Four-Price Doji, and Dragonfly Doji.(Piasecki 2020)

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1. Doji Star Pattern



Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

This formation includes a small horizontal body, indicating that the opening and closing prices were nearly equal. The upper and lower wicks represent the range through which prices moved during the period. The pattern is often interpreted as market indecision, in which neither buyers nor sellers clearly dominate. This interpretation describes the price action; it does not prove that every market participant was equally uncertain.

2. *Gravestone Doji*

Another Doji pattern frequently discussed in stock markets is the Gravestone Doji. It is characterized by a relatively long upper wick and an opening and closing price near the low of the period.



Gravestone Doji

Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

Although the opening and closing prices are at approximately the same level, that level is below the highest price reached during the trading period. The Gravestone Doji is often interpreted as a possible price-trend reversal, particularly from a bullish to a bearish direction. However, it should not be treated as a definitive reversal signal; the preceding trend and subsequent price action remain important.

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3. Dragonfly Doji

A Dragonfly Doji is a Doji pattern in which the opening and closing prices are approximately equal and located near the high of the period, while the price has moved substantially lower during the period.(Mersal 2025)



Dragonfly Doji

Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

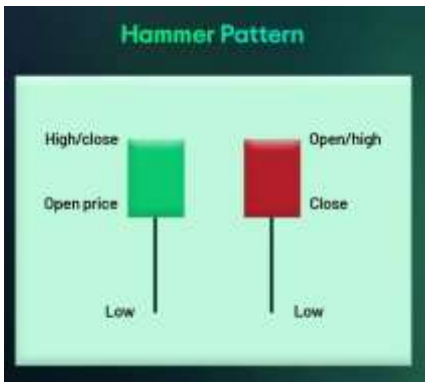
The Dragonfly Doji generally resembles a capital letter T. It is often interpreted as a possible shift from a bearish to a bullish trend, although confirmation from subsequent price movements is still needed.

The Hammer Pattern and Perceptions of a Trend Reversal

A Hammer has a relatively small body and a long lower wick. It is commonly observed after a downtrend because it may indicate that the price fell substantially during the period but recovered before closing. In technical interpretation, the Hammer is associated with the possibility of a reversal from a downtrend to an uptrend. Its appearance alone, however, does not confirm that a reversal will occur. Confirmation from subsequent price movements and the broader market context remains important. From a psychological perspective, the pattern may prompt investors to reconsider whether selling pressure is weakening. Some may interpret the recovery from the low as evidence of buying interest, while others may wait for confirmation because they regard a single candle as insufficient evidence. The pattern therefore provides an opportunity to explore how investors assess uncertainty rather than a guarantee of future price increases. Overconfidence is relevant if the data show that an investor is excessively certain about an interpretation and makes a decision without considering the possibility of error. The researcher should also consider alternative explanations, such as a pre-established trading plan or confirmation from other indicators.(Loubaris 2026)

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Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

The Shooting Star Pattern and Perceived Downside Risk



Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

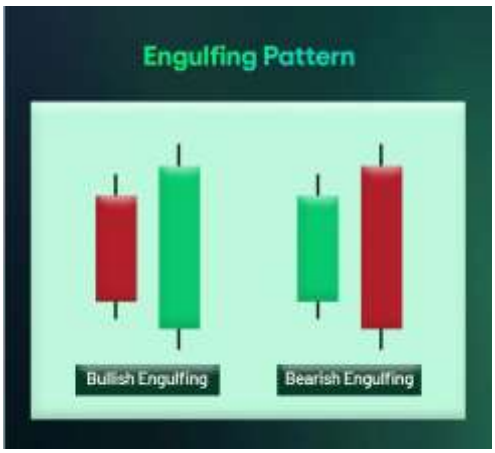
A Shooting Star has a relatively small body and a long upper wick. It is often interpreted as showing that the price rose during the period but then fell back toward the opening price or candle body. When it appears after an uptrend, it may indicate weakening buying pressure or increasing selling pressure. This interpretation remains probabilistic and should take subsequent price movements into account.

In market-psychology terms, this pattern may prompt investors to reassess their expectations of further price increases. Investors who already hold shares at a profit may consider realizing their gains, while those who do not own the stock may postpone buying. Prospect Theory can help examine how an investor's position influences the response. Investors with unrealized gains may be more sensitive to the possibility of losing those gains, while others may rely on predefined trading rules. A decision to sell should not automatically be interpreted as fear; it may reflect a planned risk-management strategy.

The Bullish Engulfing Pattern and Changing Sentiment Perceptions

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Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

Bullish Engulfing is a two-candlestick pattern in which a bearish candle is followed by a bullish candle whose body is larger and covers the body of the preceding candle. It is often observed after a downtrend because it may indicate a change in the relative pressure of buyers and sellers. Investors may interpret it as a sign that buyers are gaining strength. However, the pattern does not directly identify who is trading or why, and it does not guarantee that the price will continue to rise.(Ibrahim and Susanto 2025)

From a market-psychology perspective, research can explore whether the appearance of a Bullish Engulfing pattern increases investor confidence, changes risk perception, or leads investors to reconsider earlier decisions. Confirmation bias may be relevant if informants focus on bullish patterns that support their prior beliefs while ignoring contradictory information. Conversely, investors who compare the pattern with the trend, volume, and other information may be using a more contextual decision process.

The Bearish Engulfing Pattern and Investor Responses to Negative Sentiment

Bearish Engulfing is a two-candlestick pattern in which a bullish candle is followed by a bearish candle whose body is larger and covers the body of the preceding candle. It is often interpreted as a possible increase in selling pressure, especially after an uptrend. From a market-psychology perspective, the pattern provides a context for examining how investors respond when expectations change. Previously optimistic investors may reconsider their positions, but selling does not necessarily mean that they are afraid; it may also follow a predetermined risk-management rule. Loss aversion is relevant if the data show that fear of losses affects how informants respond to bearish patterns. The researcher should distinguish decisions based on planned risk management from those driven primarily by emotional reactions.(Mobasheer 2025)

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Source: Stockbit Snips, "How to Read Stock Candlestick Charts: The Basics of Reading Candlesticks

DISCUSSION

Candlesticks as Price Information, Not a Direct Measure of Market Psychology

Candlesticks are practically useful because they present price information visually. Investors can observe changes between opening and closing prices, the trading range, and the sequence of patterns within a trend. However, the relationship between chart shapes and market psychology must be explained carefully. For example, a Doji is often interpreted as a sign of indecision. This is a reasonable way to describe uncertainty in price action during a particular period, but it does not mean that every market participant is uncertain. Some investors may trade according to short-term strategies, while others may respond to fundamental information or liquidity needs.(Liu, Liu, and Son 2026)

Market sentiment concerns the expectations and beliefs of market participants more broadly, whereas candlestick interpretation is one way an investor understands price information. The contribution of this study is therefore to understand how investors use chart patterns to form judgments about the market, rather than treating each pattern as a direct measurement of the psychological state of all market participants.

The Influence of Risk Perception on Trading Decisions

Risk perception is an important aspect of trading decisions. Investors who encounter the same pattern may take different actions because they have different goals, positions, experiences, and risk tolerances. Prospect Theory provides a framework for understanding how reference points and perceptions of loss influence choices. Investors may use their purchase price as a reference point when evaluating an investment. When the price falls, their decisions may be influenced by a desire to limit losses, hope for a recovery, or reluctance to acknowledge a loss.(Ballestra, Guizzardi, and Mazzucchelli 2024) In this study, the theory can help interpret informants' experiences when they see bearish or bullish patterns in stocks they own. The analysis must nevertheless consider each informant's full explanation. Holding a stock, for example, does not necessarily indicate an unwillingness to accept a loss; it may be based on fundamental analysis or a long-term investment strategy.(Fortin and Hlouskova 2024)

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The Role of Behavioral Biases in Candlestick Interpretation

Behavioral biases can influence how investors seek, evaluate, and use information. In candlestick analysis, these biases become relevant when investors conclude too quickly that a pattern supports their expected price direction. Confirmation bias may occur when investors pay greater attention to signals consistent with their views. Overconfidence may be evident when investors believe their interpretations are almost always correct and disregard the possibility of error. Loss aversion may help explain responses to potential losses if the informants' accounts support that interpretation. Systematic review provides a basis for discussing behavioral biases in investment decisions. However, because that study is a literature review, its findings cannot be used to conclude directly that the participants in this study exhibit a particular bias.(Dewasiri and Munasinghe 2025)

Investor Sentiment and Herd Behavior

Investors do not always make decisions independently. Stock communities, social media, news, and discussions with other investors can provide information that shapes chart interpretation. Baker and Wurgler (2007) demonstrate the importance of investor sentiment in stock-market research. This concept can be explored at the individual level by examining how investors interpret sentiment and connect it with candlestick patterns. The researcher can ask whether informants analyze charts independently, follow other people's recommendations, or combine both approaches. If an informant buys a stock because many community members interpret a pattern as bullish, the researcher should explore whether the decision is based on personal evaluation, trust in the community, or fear of missing a price increase.(Yang, Lin, and Cheng 2025)

CONCLUSION

Candlesticks are price-visualization tools that help investors observe price movements and form interpretations about market dynamics. Patterns such as Doji, Hammer, Shooting Star, Bullish Engulfing, and Bearish Engulfing are commonly used to interpret possible changes in buying and selling pressure. However, these patterns do not directly prove the psychological state of all market participants and do not guarantee the next price direction.

Prospect Theory and behavioral finance provide frameworks for understanding how risk perception, reference points, emotions, and behavioral biases may influence investor interpretations and decisions. Previous studies of candlestick patterns also indicate that strategy effectiveness may vary according to context and testing methods.

Through a qualitative approach, this study seeks to explain how investors interpret patterns, connect them with market sentiment, and consider these interpretations when

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making decisions. Empirical conclusions about investors' experiences must be established after interview data and documentation have been analyzed.

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