

How to Trade Using the Ichimoku Cloud

The Ichimoku Cloud is not easy to grasp at first glance and is honestly a bit intimidating. It's pretty ironic as Mr. Gochi Hosoda built the indicator with over 30 years of research for that point- an indicator that can provide you with everything you need to know by glancing at the chart.

As a trader, however, we all need an edge, and the great thing about the cloud is it's the one indicator which stands on its own.

But how do we figure out which setups work best with the indicator and which stocks?

Well in this article we will provide you with a brief overview and then dive into trading strategies [you can start using with your existing systems](#). We will then dive into the stocks that are not great candidates for the cloud and lastly where you can find additional resources to go deep with more advanced topics and strategies.

What is the Ichimoku Cloud?

The Ichimoku Cloud, also known as Ichimoku Kinko Hyo consists of five moving averages and a "cloud" formed by two of the averages.

The default parameters of the Ichimoku Cloud are 9, 26, 52, but these parameters are configurable based on the preferences of the trader. Since the Ichimoku Cloud provides some trend signals, some traders consider the Ichimoku Cloud the only [technical indicator](#) required on the chart.

The Ichimoku Cloud indicator on first glance can feel overwhelming to traders not familiar with the indicator.

Look at the image below:



LinkedIn Price Chart

This is a normal H1 chart showing the price action of LinkedIn during the month of September 2015. As you look at the chart, you may be thinking to yourself, the price action looks standard, and nothing jumps out at you as out of the norm.

Now we add the Ichimoku Cloud to our LinkedIn chart, and we get the following picture:



Ichimoku Cloud – LinkedIn

“What just happened,” is the initial reaction of traders not familiar with the Ichimoku Cloud. To the untrained eye, the indicator looks like chaos on the chart, with lines crossing each other without any clear purpose or trajectory. When

trading volatile stocks, the price action can resemble an EKG chart.

I can assure you that the Ichimoku Cloud is the furthest thing from chaos and is quite easy to understand after you become accustomed to the settings. To this point, in this article, we hope to improve your understanding of the indicator and provide a simple trading strategy you can apply to your trading toolkit.

Components of the Ichimoku Cloud

After panicking about the number of lines on your chart, let's take a closer look at the inputs to the Ichimoku Cloud. What do we see first? Five lines: one red, one blue, one green, two orange and a shaded area in-between.

Now, let's define each of these lines to further understand their purpose. Just to reiterate a point made earlier in the article, each line is a moving average. Therefore, you should look at the Ichimoku Cloud indicator as five moving averages and nothing more. If you are not familiar with moving averages, it is one of the easiest technical indicators to master, so no worries on that front. To further dive into the makeup of the Ichimoku Cloud, the below content outlines the moving averages and how the cloud is formed.

- **Tenkan Sen** (red line) – this line is a moving average, which displays the middle value of the highest and lowest points on the chart over the last nine periods.
- **Kijun Sen** (blue line) – it has the same function as the Tenkan Sen (red line), with the difference that the periods taken into consideration are 26. As you have probably noticed, the Kijun Sen (blue line) is slightly slower than the Tenkan Sen (red line) and the reason for that is the larger number of periods. Since the moving average takes more periods, it takes a longer period of

time to “react” in a meaningful way.

- **Chinoku Span** (green line) – this line represents the current price, but it is shifted to the left by 26 periods. If you look at the image above, you will realize that the green line is 100% identical with the price movement.
- **Senkou Span** or **“The Cloud”** (orange lines) – since people call this span “The Cloud,” we decided to color its inside with a clear white color, so it will look like a cloud. The cloud consists of two lines, which we have colored orange.
 1. The first line of the Senkou Span is the current average of the highs and the lows of the Tenkan Sen (red line) and Kijun Sen (blue line), displaced 26 periods to the right (leading).
 2. The second line displays the middle point between the highest point and the lowest point on the chart for 52 periods. This line is also displaced with 26 periods to the right, as the other line of the cloud.
 3. The cloud is the area on the chart, which is comprised of the interactions of the two aforementioned averages of the Senkou Span. The cloud also represents the furthest support/resistance level, where our trading position is recommended.

So, after explaining the components of the Ichimoku Cloud, we hope things are a little clearer for you the reader! Well, not really, but things have to be a little involved if it is the only indicator required on the chart.

How to use the Ichimoku Cloud

indicator when trading?

Today we are going to discuss an Ichimoku Cloud trading system, which does not require any additional indicators on the chart. This Ichimoku trading strategy is applicable for every trading instrument and timeframe.

Placing a trade when the price closes outside the cloud

This method could also be coined the Ichimoku Breakout Trading Strategy. This is because the trade trigger occurs at the point the price breaks through the cloud. First, you open your trade in the direction of the respective breakout and then hold the position until the security breaches the Kijun Sen (blue line) on a closing basis.

To illustrate the breakout strategy, we will review a real-market example of Intel from September and October 2015.



Ichimoku Cloud Breakout Strategy

As you can see, early on in 2015 the price action was in a [sideways channel](#). Furthermore, the cloud itself was flat to down during this same time period.

Sequence of Events

When analyzing the price action for potential trade entries, we walked through the following sequence of events:

First, the price of Intel goes through the Tenkan Sen (red) and Kijun Sen (blue) in a bullish fashion. Although these signals are bullish, we still need additional confirmation to take a long position.

Second, the price of Intel breaks through the cloud in a bullish fashion as well. We open a long position (first green circle) and hope for the best!

Third, Intel had a few unsuccessful attempts to break the Kijun Sen (blue), but lucky for us, the price never breaks on a closing basis, and the upward trend remains intact.

Fourth, the price breaks the Kijun Sen in a bearish direction and closes below the Kijun Sen. This price action means we need to exit our position and begin seeking other opportunities.

What Happens Next

In the next 4 hours, the price does another bullish break through the Tenkan Sen (red) and the Kijun Sen (blue). At the same time, Intel also breaks the cloud in a bullish direction once again. Opportunity after opportunity – great! We take another long position based on the bullish price action. On this run-up, Intel, unfortunately, broke the Kijun Sen (blue) on a closing basis; therefore, we exited our long position with a decent profit.

These are two trading examples of how this strategy could be successfully implemented. Note that in the second case, the signal to exit the position wasn't very strong, but should still be honored.

Although the market continues to move in our favor after we exited the position, there are many cases where the sell signal could lead to further losses. Therefore, the better alternative is to always follow your trading rules and exit your positions when required.

The results are the following:

- Two successful bullish positions
- 0 fails
- A total profit of 318 bullish pips

Now, let's try the same strategy on another trading instrument!

Below you will see an image displaying the M10 chart of Apple Inc.:



Ichimoku Cloud Apple Example

In this example, our Ichimoku Cloud breakout strategy fails twice but also succeeds twice.

Similar to our earlier Intel example, Apple starts with sideways movement. The price has been range bound and the cloud has been flat – presenting no opportunities to open a position.

Trade Setup

- We see the price breaking the Tenkan Sen (red), Kijun Sen (blue) and the cloud in a bullish fashion. We go long according to our Ichimoku Cloud breakout strategy. Unfortunately, shortly after the breakout, the price records a rapid bearish candle, which results in Apple closing below the Kijun Sen line (blue). We close our position with a loss equal to 19 pips.
- Fortunately, with the next two candles comes our second chance, as the price breaks through the cloud, Tenkan Sen (red) and Kijun Sen (blue) in a bullish fashion. So, we open our new long position. The market starts moving in our favor and we enjoy this nice and steady bullish movement. After a few hours, the price of Apple breaks the blue Kijun Sen line and closes below. We exit our position with a profit equal to 144 pips.
- After four hours, we take our third bullish position on [another breakout](#). After two hours of hesitation, Apple's price closes below the Kijun Sen (blue). We follow our exit strategy and are forced to close our position with a loss of 43 pips.
- Our fourth example is where the Ichimoku Cloud can really help you capture the big wins. As you can see, the bullish trend is really strong and has yet to break the Kijun Sen (blue). Therefore, our fourth position is still open and the result, for now, is a profit of 412 pips. Woohoo!

Results are In

Let's now revise the results of our second trading example:

- 4 bullish positions
- 2 successful
- 2 fails

- Loss = 62 pips
- Profit = 556 pips
- Balance = 556 – 62 = 494 pips profit

Not bad uh?

In the last chart example, we provided examples of unsuccessful traders on purpose. We did this because it is necessary to illustrate that the Ichimoku Cloud indicator is not perfect and there will be bumps in the road.

Anywho, when trading with the Ichimoku Cloud, you should be extremely careful not to ignore a signal and it is highly recommended to always monitor your open positions – do not walk away from the computer!

The reason is that you could miss an exit signal and a winner could just as easily turn into a losing trade. Remember, never give up on your trading strategy principles and never compromise any of your rules for profits.

Should Newbie Traders Use the Ichimoku Cloud?

As a new trader, I think the indicator will overwhelm you a bit. It's not that it doesn't work or that you can't figure it out in time, it's just that it's too much early on in your trading career to process.

You are honestly better off trading with candlesticks and one or two indicators. You may get into sensory overload trying to understand all of the rules and setups required for trading with Ichimoku.

As a new trader, you have to get to a point that you can understand market volatility and basic chart patterns.

Where You Would Likely Have Trouble

The Ichimoku will provide you clear signals but there are certain stocks that are not good fits. For those of you familiar with the [blog](#), this is where I go on my low float stock rant.

I have nothing personally against penny stocks, I just firmly believe the speed by which they move will render you the trader at some point paralyzed. The fallout from a simple mistake could prove disastrous even on a trade-by-trade basis.

Now throw the Ichimoku Cloud in the mix with all its glory and you now have a host of things you need to be aware of and look out for constantly.

In comes the low float mover and now you will need to not only have a handle on the stock you are trading but how each wild price swing will require you rethinking signals from the indicator.



Low Float Stocks – In the Cloud

You would think the stock would find support in the cloud but no shot. GBR cut through the cloud like butter. One point to call out is that you are looking at a 1-minute chart. The reason I'm calling this out is to show that even at this short of a time interval, things still move swiftly and with size.

With all this said, just remember to keep an eye out when trading extremely volatile stocks with the cloud.

Where To Find More Information on Ichimoku and Trading Strategies

So, this post provides you with the basics of how to trade with the Ichimoku cloud technical indicator but by no means covers every aspect of the indicator.

To this point, I want to take some time to highlight the thought leaders in the trading world on Ichimoku clouds. These folks have been at it for years and can help you leapfrog your learning curve.

[Here](#) you will find an awesome 32-page ebook detailing strategies and the history of the indicator.

This is a [link](#) to the book 'How to Make Money Trading the Ichimoku System'. The book provides great insight for how to use the indicator across multiple security types.

In Summary

- The Ichimoku Cloud is a trading indicator consisting of 5 moving averages and a "Cloud"
- The default Ichimoku settings are 2, 26, 52
- The names of the Ichimoku components are Tenkan Sen, Kijun Sen, Chinoku Span and Senkou Span (The Cloud)
- The Chinoku Span is displaced backward (26 periods) – it is lagging
- The Cloud is displaced forwards (26 periods) – it is leading
- The indicator can be used by itself for trading
- The Ichimoku Cloud is not as complicated as it looks
- The Ichimoku Cloud is fully customizable