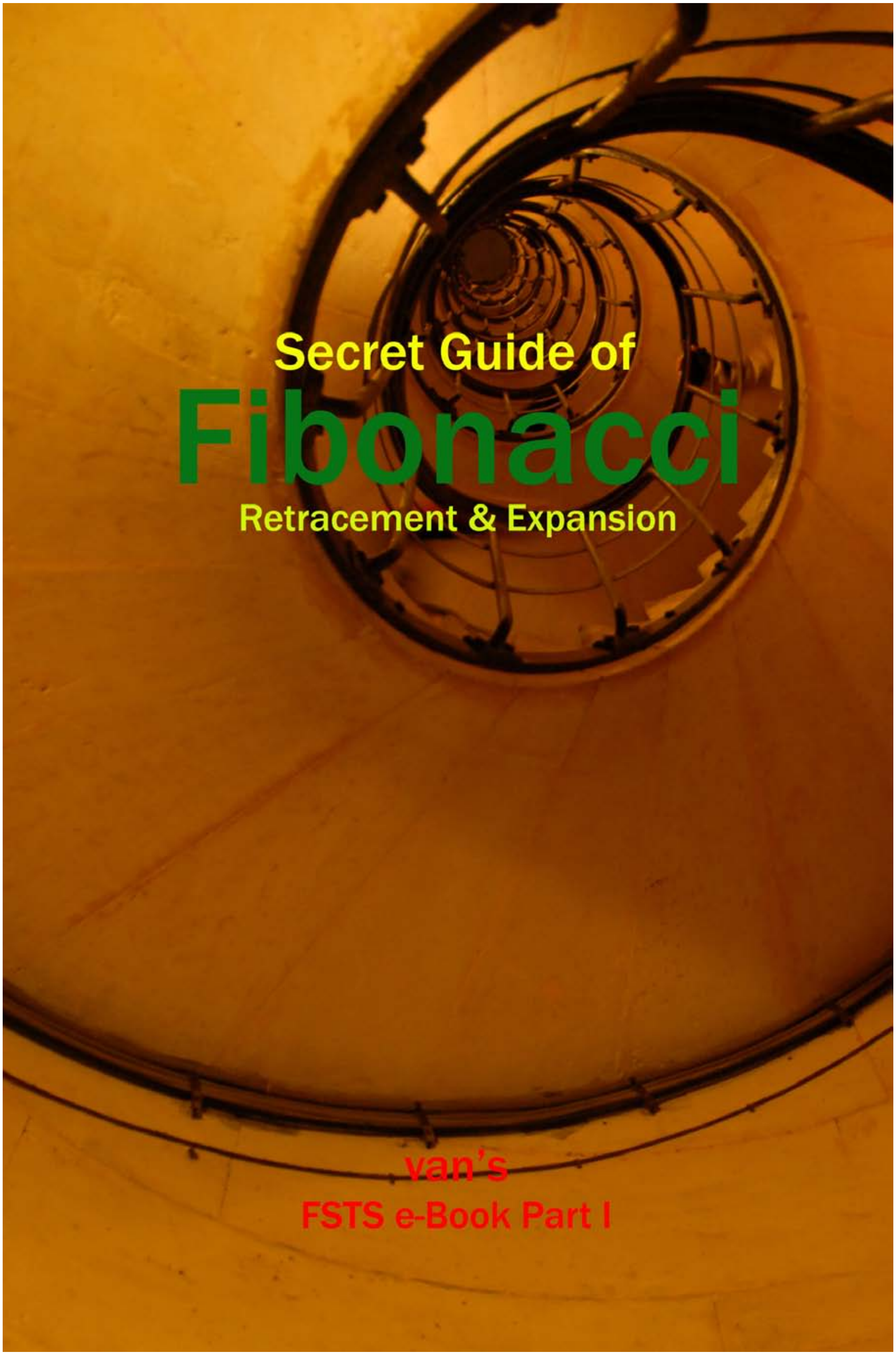
Secret Guide of
Fibonacci
Retracement & Expansion
van's
FSTS e-Book Part I

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Fibonacci Levels

The truth about Fibonacci levels is that they are useful (like all trading indicators). They do not work as a standalone system of trading and they are certainly not the "holy grail", but can be a very effective component of your trading strategy.

But who is Fibonacci and how can he help you with your trading?

Leonardo Fibonacci was a great Italian mathematician who lived in the thirteenth century who first observed certain ratios of a number series that are regarded as describing the natural proportions of things in the universe, including price data. The ratios arise from the following number series: 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144 ……

This series of numbers is derived by starting with 1 followed by 2 and then adding 1 + 2 to get 3, the third number. Then, adding 2 + 3 to get 5, the fourth number, and so on.

The ratios are derived by dividing any number in the series by the next higher number, after 3 the ratio is always 0.625. After 89, it is always 0.618. If you divide any Fibonacci number by the preceding number, after 2 the number is always 1.6 and after 144 the number is always 1.618. These ratios are referred to as the "golden mean." Additional ratios were then derived to create ratio sets as follows:

Price Retracement Levels
0.382, 0.500, 0.618

Price Extension Levels
0.382, 0.618

The first set of ratios is used as price retracement levels and is used in trading as possible support and resistance levels. The reason we have this expectation is that traders all over the world are watching these levels and placing buy and sell orders at these levels which becomes a self-fulfilling expectation.

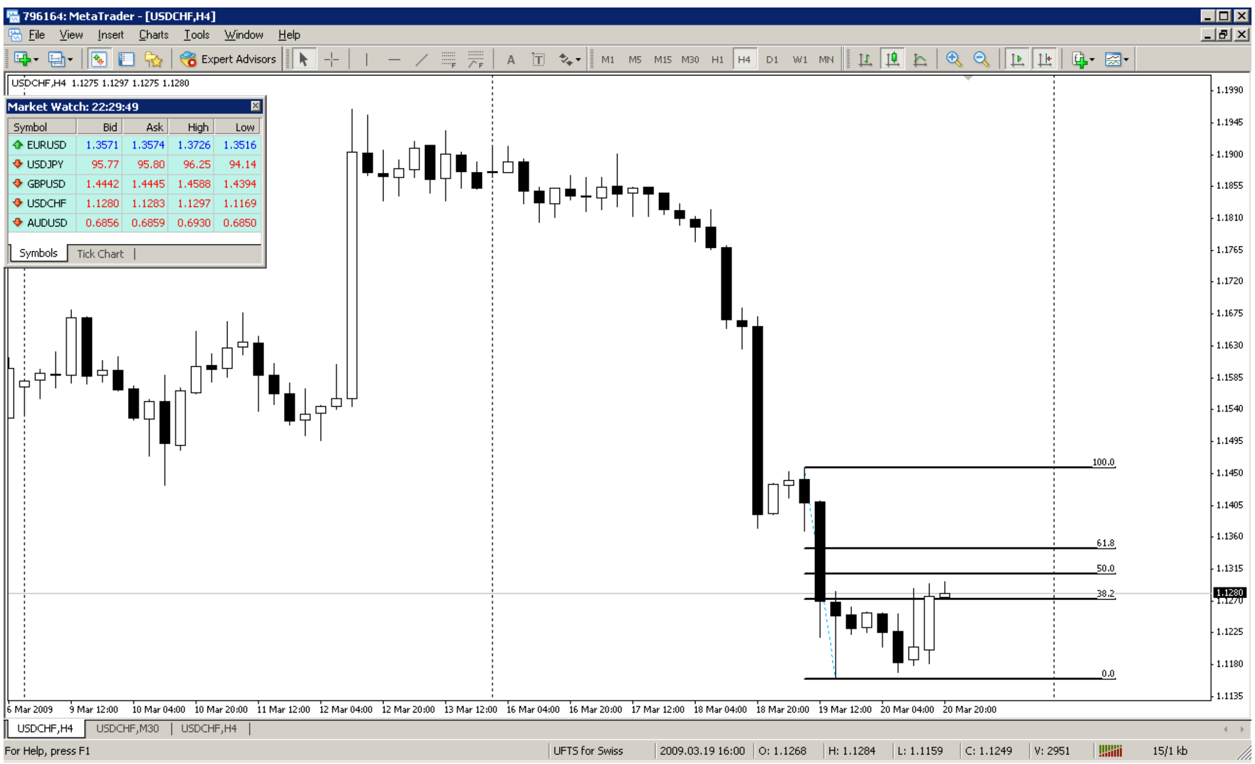
The second set is used as price Expansion levels and is used in trading as possible profit taking levels. Again, traders all over the world are watching these levels and placing buy and sell orders to take profits at these levels which becomes a self-fulfilling expectation.

Most good trading software packages include both Fibonacci Retracement Levels and Price Expansion Levels. In order to apply Fibonacci levels to price charts, it is necessary to identify Swing Highs and Swing Lows. A Swing High is a short term high bar with at least two lower highs on both the left and right of the high bar. A Swing Low is a short term low bar with at least two higher lows on both the left and right of the low bar.

Fibonacci Retracement Levels

In an uptrend, the general idea is to go long the market on a retracement to a Fibonacci support level. The price retracement levels can be applied to the price bar chart of any market by clicking on a significant Swing Low and dragging the cursor to the most recent potential Swing High and clicking there. This will display each of the Retracement Levels showing both the ratio and corresponding price level. Let's take a look at some examples of markets in an uptrend. The same points made by these examples are equally applicable to markets in a downtrend.

Example 1 : Here we plotted the Fibonacci Retracement Levels by clicking on the Swing High at about 1.1457 and dragging the cursor to the Swing Low at about 1.1159. You can see the resultant levels plotted by the software. Now the expectation is that if the market retraces from this low it will find support at one of the Fibonacci Levels, because traders will be placing sell orders at these levels as the market pulls back.



Example 1.1 : Now let's look at what actually happened after the Swing Low occurred. The market pulled back right through the 0.382 level to finding support. After a few days, the market resumed its downward move. Clearly sell at the 0.382 level would have been a good short term trade.

You can see from these examples that the market often finds at least temporary support at the Fibonacci Retracement Levels – not always, but often. It should be apparent that there are a few problems to deal with here.

First, there is no way of knowing which level will provide support. The 0.236 level seems to provide the weakest support, while the other levels provide support with approximately the same frequency.

Second, the market will not always resume its downtrend after finding temporary support, but instead continue to decline above the last Swing High.

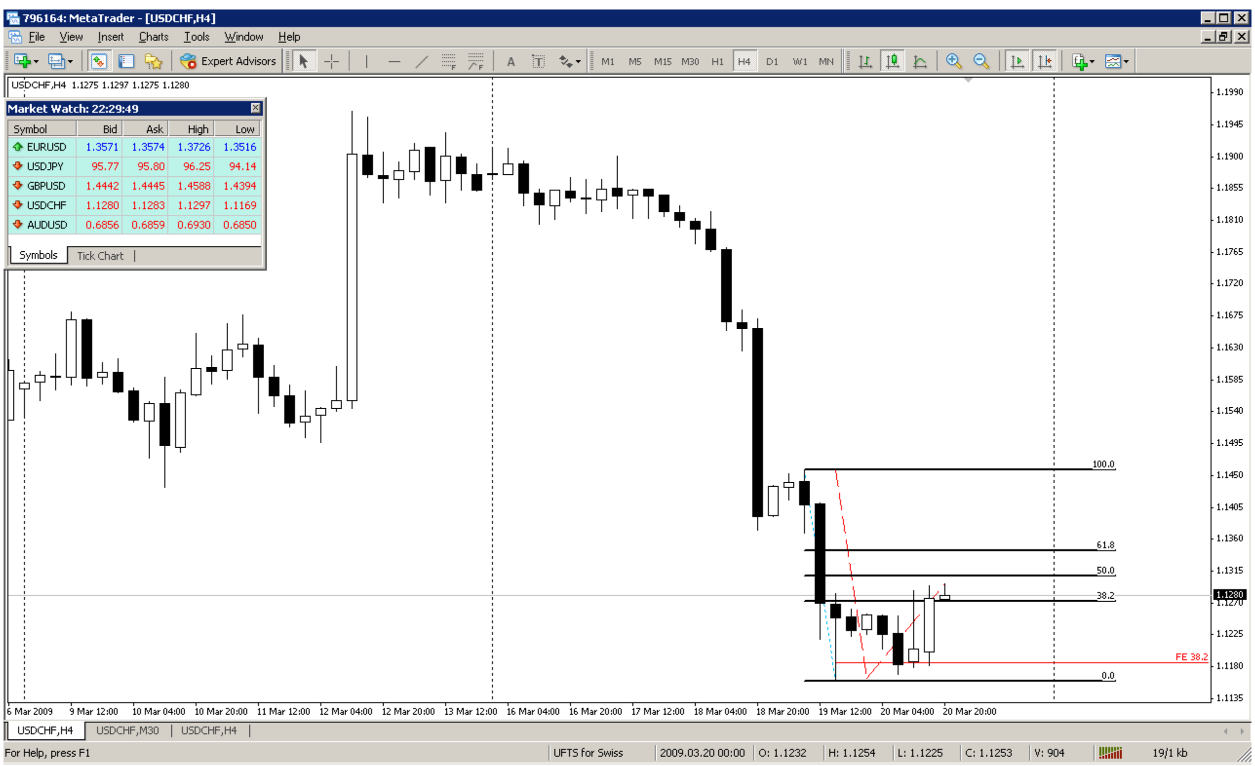
Thirdly, placement of stops is a challenge – it is probably best to place stops six points above the 0.618 level or you just can set 30 pips stop loss value.

Another problem is determining which Swing High to start from in creating the Fibonacci Retracement Levels. One way is from the last Swing High as we did in the examples. Another is from the high Swing High of the past 30 days. The point is, there is no one right way to do it, and consequently it becomes a guessing game.

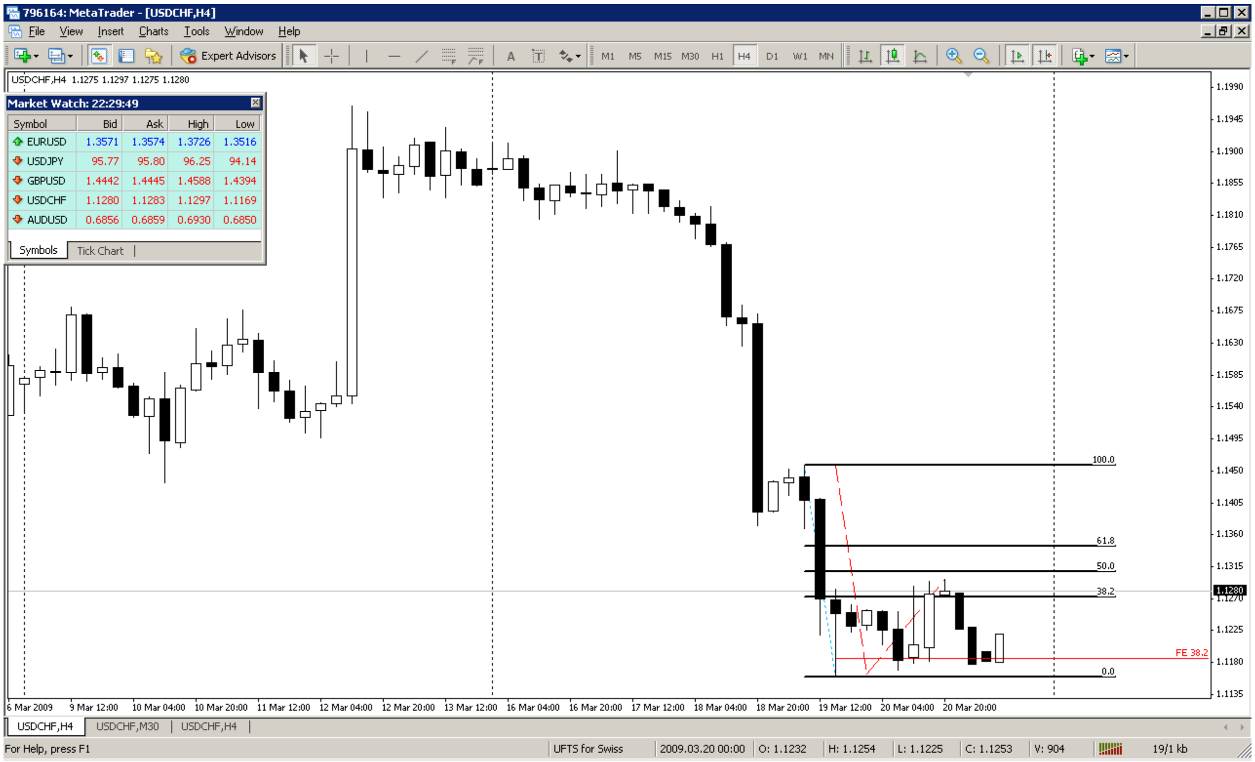
Fibonacci Expansion Levels

In an downtrend, the general idea is to take profits on a short trade at a Fibonacci Expansion Resistance Level. The Price Expansion Levels can be applied to the price bar chart of any market by clicking on a significant Swing High and dragging the cursor to the most recent Swing Low. Then by clicking on the Swing Low and back up to the retracement Swing High and clicking there. This will display each of the Expansion Levels showing both the ratio and corresponding price level. Let's take a look at some examples of markets in an downtrend. The same points made by these examples are equally applicable to markets in a uptrend.

Example 2 : Here we plotted the Fibonacci Expansion Levels by clicking on the Swing High at about 1.1457 and dragged the cursor to the Swing Low at about 1.1159 and then up to the retracement Swing High. You can see the resultant levels plotted by the software. Now the expectation is that if the market continues lower it will find resistance at one of the Fibonacci Levels, because traders will be placing buy orders at these levels to take profits on there short trades.



Example 2.1 : Now let's look at what actually happened after the retracement Swing High occurred. The market rallied making new lows pausing at the 0.382 level. Taking profits at the 0.382 level would have been premature, but taking profits at the 0.618 level would have made a nice trade.



You can see from these examples that the market often finds at least temporary resistance at the Fibonacci Expansion Levels - not always, but often. As in the examples of the Retracement Levels, it should be apparent that there are a few problems to deal with here as well.

First, there is no way of knowing which level will provide resistance. The 0.382 level was a good level to cover any trades, but taking profits at that level would be premature.

Another problem is determining which Swing High to start from in creating the Fibonacci Expansion Levels. One way is from the last Swing High as we did in the example; another is from the highest Swing High of the past 30 days. Again, the point is that there is no one right way to do it, and consequently it becomes a guessing game.

Alone, Fibonacci Levels will not make you rich. However, Fibonacci Levels are definitely useful as part of an effective trading method that includes other analysis and techniques. You see, the key to an effective trading system is to integrate a few indicators (not too many) that are applied in a way that is not obvious to most observers. All successful traders know it's how you use and integrate the indicators (including Fibonacci) that makes the difference. The lesson learned here is that Fibonacci Levels can be a useful tool, but never enter or exit a trade based on Fibonacci Levels alone.

Why We Choose Fibonacci Levels?

Prices never move in a straight line, it will often retrace a certain percentage of a previous move and find support / resistance at the main Fibonacci levels before continuing in its original direction. Not always. But very often, and reasonably close! This happens often enough that profitable trades can result.

Fibonacci retracement is used by traders to mainly calculate possible targets for entry and stop loss points, while Fibonacci expansion is used to determining potential levels of profit taking. The reason we have this expectation is that traders all over the world are watching these levels and placing buy and sell orders at these levels which becomes a self-fulfilling expectation.

The advantage of Fibonacci Levels :

1. Fibonacci numbers define Entry points.
   An entry point can be placed at the area which denotes important suport or resistance.

2. Fibonacci numbers define Stop Loss points.
   A stop loss can be placed above the area which denotes latest support.

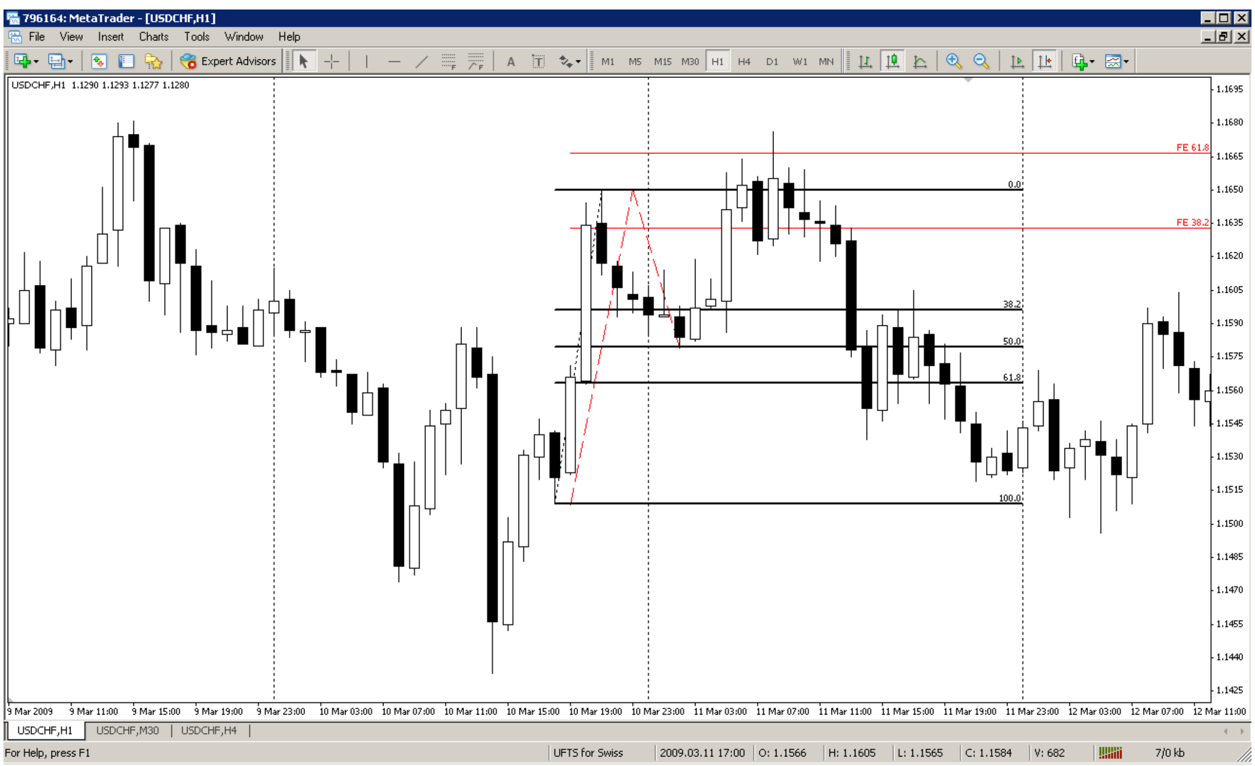
3. Fibonacci numbers define Profit Objectives.
   This clear view of where trades may go helps traders to lock in profits at set levels.

More Examples of Fibonacci Levels

Example 3 :

Example 4 :

Example 5 :



Example 6 :

Example 7 :

From now on, you should be able to identify and to draw both of Fibonacci Retracement or Fibonacci Expansion Levels. Keep practice and practice until you have mastered the Fibonacci before you go to our Fibonacci Sapper Trading System.

Happy learn…