How to Use Fibonacci Retracement to Enter a Forex Trade

The first thing you should know about the Fibonacci tool is that it works best when the forex market is trending.

The idea is to go long (or buy) on a retracement at a Fibonacci support level when the market is trending up, and to go short (or sell) on a retracement at a Fibonacci resistance level when the market is trending down.

Finding Fibonacci Retracement Levels

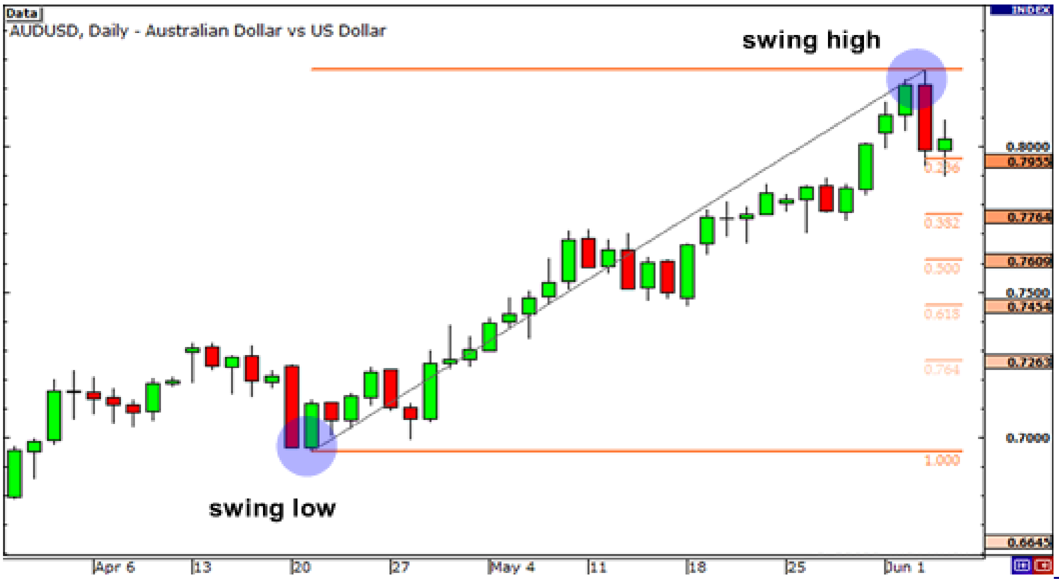
In order to find these Fibonacci retracement levels, you have to find the recent significant Swing Highs and Swings Lows. Then, for downtrends, click on the Swing High and drag the cursor to the most recent Swing Low.

For uptrends, do the opposite. Click on the Swing Low and drag the cursor to the most recent Swing High.

Got that? Now, let's take a look at some examples on how to apply Fibonacci retracements levels to the currency markets.

Uptrend

This is a daily chart of AUD/USD.



Here we plotted the Fibonacci retracement levels by clicking on the Swing Low at .6955 on April 20 and dragging the cursor to the Swing High at .8264 on June 3. Tada! The software magically shows you the retracement levels.

As you can see from the chart, the Fibonacci retracement levels were .7955 (23.6%), .7764 (38.2%), .7609 (50.0%), .7454 (61.8%), and .7263 (76.4%).

Now, the expectation is that if AUD/USD retraces from the recent high, it will find support at one of those Fibonacci retracement levels because traders will be placing buy orders at these levels as price pulls back.

Now, let's look at what happened after the Swing High occurred.

Price pulled back right through the 23.6% level and continued to shoot down over the next couple of weeks. It even tested the 38.2% level but was unable to close below it.

Later on, around July 14, the market resumed its upward move and eventually broke through the swing high. Clearly, buying at the 38.2% Fibonacci level would have been a profitable long term trade!

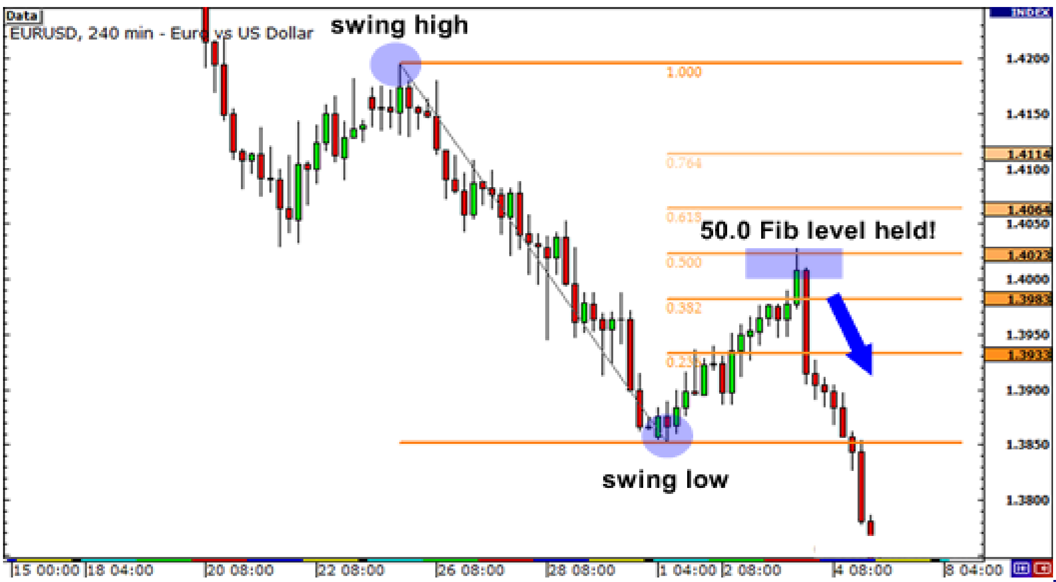
Downtrend

Now, let's see how we would use the Fibonacci retracement tool during a downtrend. Below is a 4-hour chart of EUR/USD.

As you can see, we found our Swing High at 1.4195 on January 25 and our Swing Low at 1.3854 a few days later on February 1. The retracement levels are 1.3933 (23.6%), 1.3983 (38.2%), 1.4023 (50.0%), 1.4064 (61.8%) and 1.4114 (76.4%).

The expectation for a downtrend is that if price retraces from this low, it could possibly encounter resistance at one of the Fibonacci levels because traders who want to play the downtrend at better prices may be ready with sell orders there.

Let's take a look at what happened next.



Yowza, isn't that a thing of beauty?!

The market did try to rally, stalled below the 38.2% level for a bit before testing the 50.0% level. If you had some orders either at the 38.2% or 50.0% levels, you would've made some mad pips on that trade.

In these two examples, we see that price *found* some temporary forex support or resistance at Fibonacci retracement levels. Because of all the people who use the Fibonacci tool, those levels become self-fulfilling support and resistance levels.

One thing you should take note of is that price won't always bounce from these levels. They should be looked at as *areas of interest*, or as Cyclopip likes to call them, "**KILL ZONES!**" We'll teach you more about that later on.

For now, there's something you should always remember about using the Fibonacci tool and it's that they are not always simple to use! If they were that simple, traders would always place their orders at Fibonacci retracement levels and the markets would trend forever.