

Fibonacci Trading Basics

By Bobokus

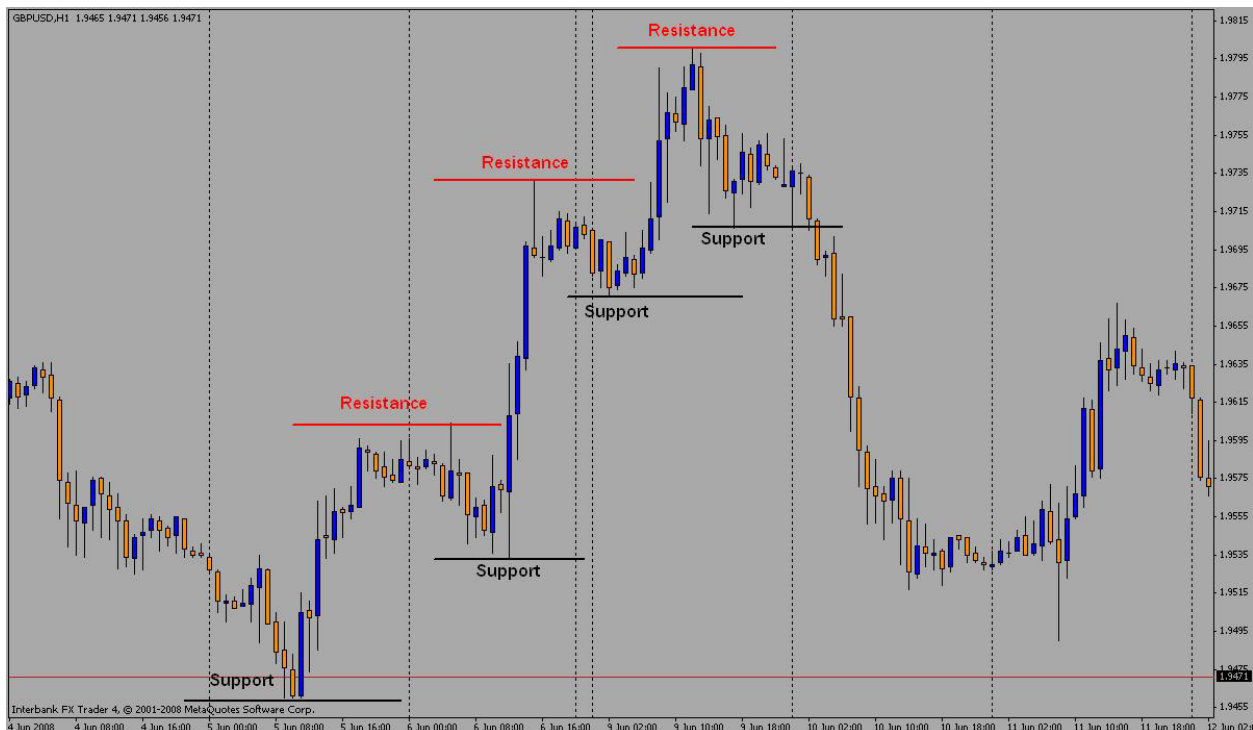
This guide is meant to help you understand the basics of the fib tool and represent how they are placed on the chart. First there is nothing magical or no secret set of numbers as to the reasons that fibs are used in trading. It is simply a measuring tool, if you need magic or psychic help trading you need to call one of those psychic 1-900 numbers to get the next direction of the markets, or better yet just flip a coin.

Two points that you need to understand:

1. The market moves from economic conditions and is displayed in economic indicators that you see reported as the news. This sets the market in its motion. Not always will you see a currency pair going in the direction it should from day to day news announcements for the simple fact that something may be trumping it or may not be significant enough to change the current market sentiment.

2. Indicators, fib tools, candlestick formations do not move the market they are merely showing you entry and exit points. Most of the time new traders have so many indicators from so many different systems or methods that they have a confused situation; it's evident in the questions you see asked on the forums here at ForexFactory.com.

Me personally I trade based off Support and Resistance. If you don't know what Support and Resistance is, it's the areas on the chart you see price reversing its direction. Support is what forms below price; Resistance is what forms above price (see chart below).



I use Fibonacci as a guide to trade Support and Resistance. The fib tool is drawn from a resistance point to a support point. I have renamed the levels of the fib tool to suit the job I want the tool to accomplish. The fib tool is a representation of Support and Resistance as viewed from a horizontal plane, perfect for my style of trading. The point of renaming the levels is that no matter if you draw the tool by starting at the top and pulling to the bottom or the bottom and pulling to the top the levels will be in the same place and by renaming the levels of the tool you can always draw from the high point (Resistance) to the low point (Support).

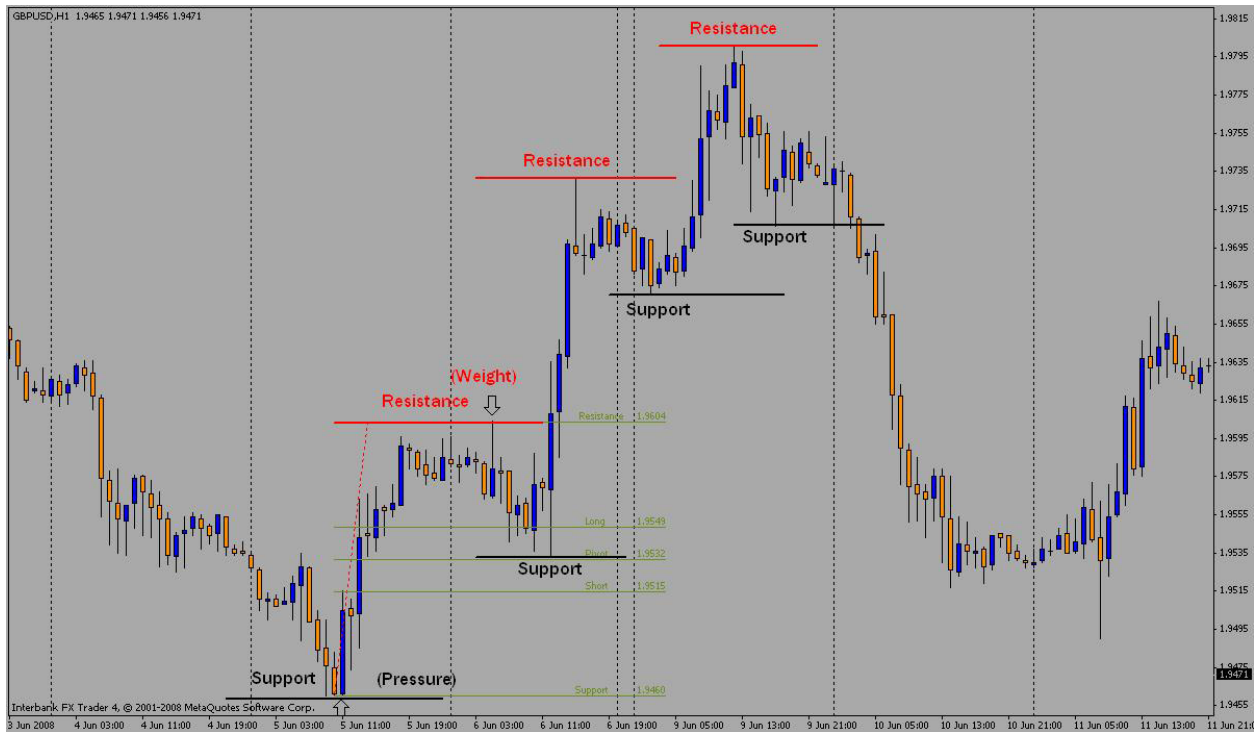
The normal levels of the fib tool are not actually Fibonacci numbers but derivatives of the Fibonacci numbers, there are the most common numbers used 0, 23.6, 38.2, 50, 61.8, 76.4, and 100. Then there are the extensions 138.2, 161.8. There's nothing magical about them other than the fact that these levels have been used for over a long time and still are. Me personally I do not use all the numbers since they serve no purpose for what I use them for. I don't use the 23.6 or the 76.4. Also leaving the description in the form of a number can be confusing if you are always pulling from high to low because leaving the numbers and pulling from low to high the numbers will be backwards. Renaming them to represent what I want the tool to show me long and short solves this as well.

A better way to describe the fib tool is more of a balance measurement between a long and a short condition. I've used this analogy before and its if you imagine the playground seesaw and how it works by when more weight is applied to one side it tends to tip into the direction with the more weight on it, now applying pressure from the other side it will try and tip to the other side and if enough pressure is applied it will tip over to the other side and reverse.

The fib tool is just a representation of this simple concept in the sense that if more bullish pressure is applied the pair will tend to tip into a bullish condition, if enough bearish weight can be applied in the opposite direction to the bullish pressure it will attempt to tip in the bearish direction from the weight overcoming the pressure.

The balance point always being the 50 fib level (renamed Pivot). If you remember once a seesaw was almost in balance or almost tipped to the other side it always required that extra oomph to push it on over to the other side, without the extra oomph it fell back to the direction it was in. That extra oomph is what the Long and Short levels represents once it gets past the oomph part it would reverse and go to the other side.

Now with this fresh in your mind we will apply this concept to the Support and Resistance chart posted earlier. The chart below shows that we placed the fib tool by starting at the Resistance point and pulled down to the Support point, so we can see the balance points between Long and Short (the inner Fib levels are Long/Buy, Pivot, Short/Sell). This is the optimum place we want price to go after each movement it makes. Ideal conditions are a movement then a retracement, a movement then a retracement (see chart below).

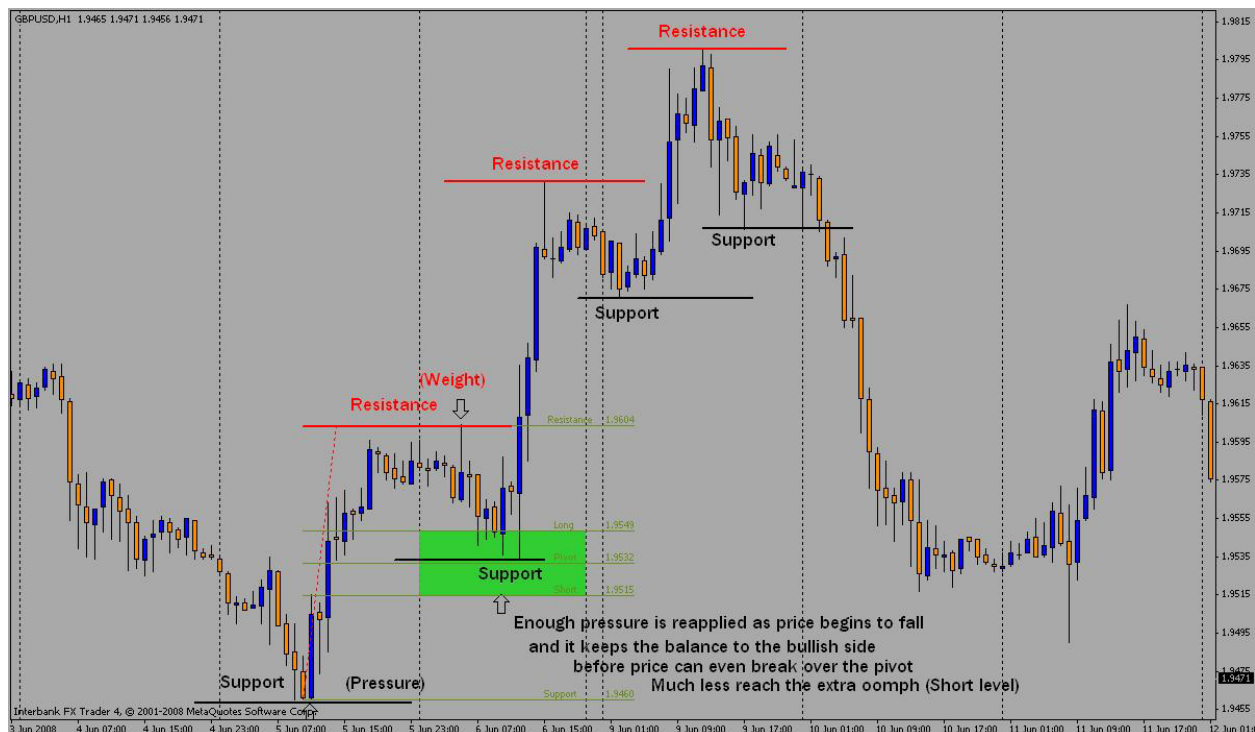


The highlighted area (see chart below) is where we want price to go in an ideal condition. The chart below shows the inner fib levels where we want to make our order entries from.



Remember what happens in this instance is the ideal condition (see chart above), price visits the inner levels. We have an indication of a bullish/buy move from the price we are

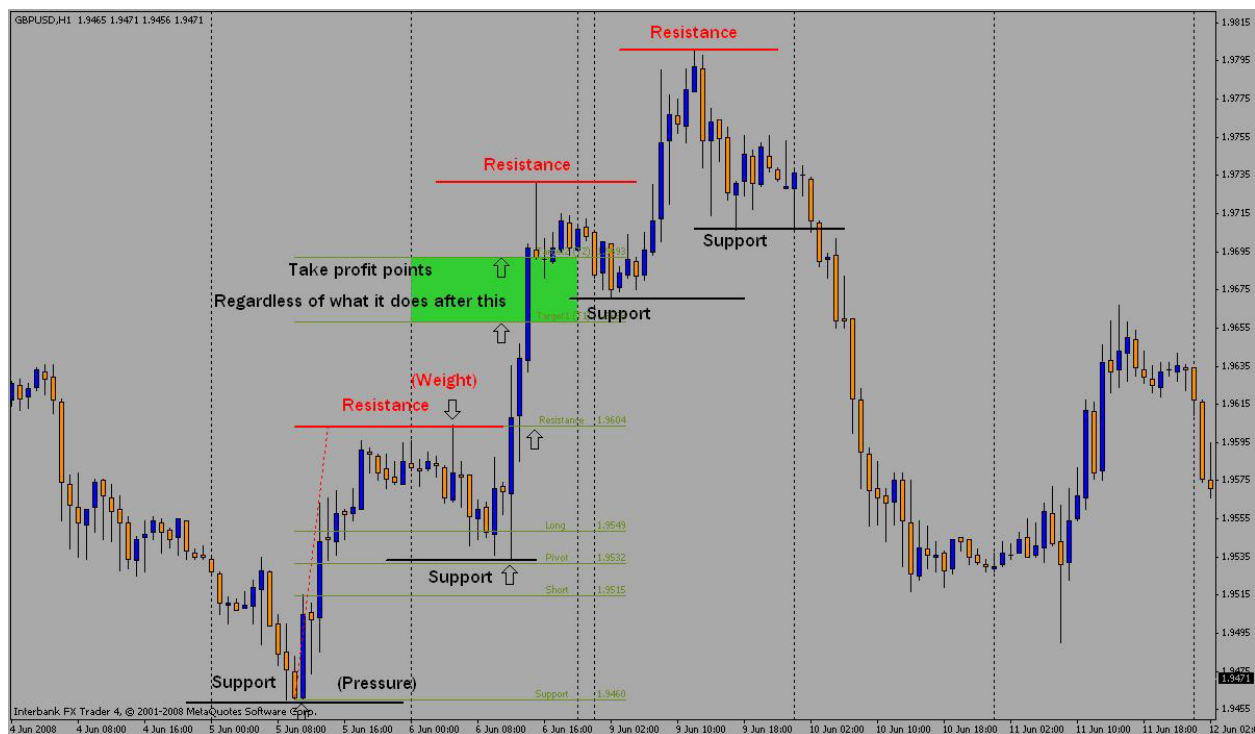
measuring so we would be expecting price to bounce. A bounce is when price is above the inner levels then falls to them and bounces off like a ball...hence bounce. A bounce is not when price is below the levels then goes up to penetrate them and then falls back again, that's a rejection...just like when a center in a basketball game rejects an opponent from dunking in the basket, he rejects the opponents shot. But we want to look at this in Weight and Pressure, Weight makes it go down...Pressure makes it go up. In the example chart below Weight was applied from Resistance (shorts/sellers/bears), but once we reached the balance/Pivot Point enough pressure from Support (longs/buyers/bulls) is reapplied and it overcomes the Resistance/Weight again and we get the bounce up/Long. This becomes your buying entry once you get use to recognizing such setups.



But there is no certain way or method to enter here you just simply need experience trading the market and over time it will become natural because there are so many things that affect its movement fundamentally you have to be aware of. It's called learning the market you're trading. I get a lot of what if this or this or this happens. There is no way to answer this because there are too many reasons why to enter and why not to enter that we could go on and on for days on end trying to describe all the conditions you will face as a trader.

The safest entry in my opinion is a break or a candle opening past a fib level but even this is not perfect and you have to be able to read what's going on to decide your entry...once again experience as a trader and knowing the market your trading. I can't teach you to trade, I can only show you the tools I use and how I use them.

Now that enough pressure has been applied (see chart below) and it overcomes the weight, price will resume in the up direction it was originally in.



Again there's nothing magical about the extensions and to understand the concept, think of being in a retail business. You want to buy at a wholesale price then sell at a retail price. To apply that to this fib tool the inner levels of the tool 38.2, 50, 61.8 are where price becomes a bargain into the trending price. The extensions 138.2 and 161.8 are the point where price meets the retail value, but in the trillion dollar a day trading world of Forex the above concept works in both directions.

For more information/help go to: <http://www.forexfactory.com/showthread.php?t=50767>

Note:

Trade this method on a demo account until you fully and surely understand how to work the fib tool through experience, while also learning how to properly read the market flow. If you can't first be consistently successful trading on a demo account, don't even think that will change in a real account with real losses.

For more Fibonacci strategies go to:

<http://www.forexfactory.com/showthread.php?t=60272>

<http://www.forexfactory.com/showthread.php?t=69499>

<http://www.forexfactory.com/showthread.php?t=75922>