

8 Day Intensive Course

Lesson 3

A) What are Fibonacci Retracements?

Fibonacci Retracements

What are Fibonacci retracements?

- Levels at which the market is expected to retrace to after a strong trend.

Based on mathematical numbers that repeat themselves in all walks of life, Fibonacci retracements attempt to measure the likely points that a currency pair will retrace, or pull back to within a range. The key numbers in FX trading are 38.2%, 50%, and 61.8%.

Consider the following example to see how Fibonacci retracements work:

Suppose an asset is on an uptrend, going from 0 and 1000. After the asset reaches 1,000, how far will it retrace – meaning how far will it fall – before resuming its initial uptrend? We can do this by using the Fibonacci retracement numbers to gauge how deep of a pullback we could expect after the top “boundary” is reached.

So, mathematically, it works like this:

- **The 38.2% line.** Calculate 38.2% of the size of the significant price move. The size of the significant price move in this case is (1,000) minus the lower boundary (0). In this case, the size of the significant price move is 1,000 pips. $.382 \times 1000 = 382$ pips. It is expected that the asset will retrace 382 points from its peak. Assuming the asset is going up from 0 to 1,000, it would retrace 382 pips from 1,000. $1,000 - 382 = 618$. Accordingly, this is a key level to look out for; you may want to buy here (at 618), as it is expected the upward trend will resume after reaching this retracement level.
- **The 50.0% line.** Same situation; 50% of the significant price move (1,000 pips) is 500. Take that off from top (1,000) since it is on the upward trend. $1,000 - 500 = 500$. Look for the upward trend to resume at that point.
- **The 61.8% line.** 61.8% of the significant price move is 618. $1,000 - 618 = 382$. If the asset retraces to this point, it is viewed as an opportunity to buy.

If the asset were trending lower – meaning it had gone from 1,000 to 0 – then you would use the Fibonacci numbers to calculate the retracement regarding how far the price may rise before resuming the downtrend again. You would calculate the Fibonacci retracements in the same manner, except you would draw from the high point of the

significant price move to the low point of the move.

Parameters: 38.2%, 50.0%, and 61.8% are the most common Fibonacci Levels. The 38.2% level is considered the least significant of the three major Fibonacci levels. The larger the percentage line (i.e. 61.8%) the greater the likelihood that the price will find support.

Please keep in mind that other retracement levels exist in Fibonacci Studies that are not widely watched by the market. These levels include 21.4% and 78.6% as well as 127.2% and 161.8% extensions. Most charting packages do not even reference these levels and most traders would argue that if the market retraces 100% of a previous move, the original trend is no longer valid. Other Fibonacci studies called fans and arcs are quite mathematically complicated and are similarly ignored by most traders.

Key Concept: Look for Confirmation

· Traders should enter when confirmation - for example key candlestick patterns – emerge at Fibonacci levels. Traders can also seek confirmation from a variety of other indicators, as we will see as the course continues.

Attached Images

B) How to Draw Fibonacci Lines

Fibonacci Retracements: How to Draw Them

Drawing Fibonacci lines is easy. It can be broken down into three easy steps:

1. Identify the bottom and top of the overall trend. The bottom is referred to as support, and the top is referred to as resistance. While they are subjective, support and resistance levels can easily be determined simply by looking at a chart.



2. Using a [charting package](#) you are comfortable with, draw Fibonacci lines from the support level to the resistance level. The three lines should appear: one at 38.2% of the difference from the top and the bottom; one at 50%; and another at 61.8%. These are the key Fibonacci levels around which you should look for potential opportunities to enter trades.



3. After that, simply look for price action to confirm an opportunity to enter a trade.



C) Fibonacci Retracements: Historical Trades

Fibonacci Retracements: Historical Trades

Below are two examples of how Fibonacci retracements, when used in conjunction with candlestick patterns, can be useful indicators for suggesting when a trend will reverse itself. Note how Fibonacci retracements work in both bullish (upwards trending) and bearish (downwards trending) markets.



In the chart below, see that price comes very close to touching the fib level (by 13 pips) but does not quite break it. While many traders may take that as a positive sign (they may rationalize that the level was so strong that traders did not wait for it to touch the fib level), you ideally want to see the level being breached. The reason for it is because breakout traders may come into the market, thinking that price will go lower, maybe even down to a lower fib level. When the market reverses and starts to go back into the trend, these short traders will now have to eventually cover their trades at a loss. Short traders who need to cover their positions will add to the buying pressure, thereby increasing the probability of your trade going in your favor.



D) Assignment

ASSIGNMENT: Using a charting application of your choice, draw Fibonacci retracement lines on charts for the various currency pairs accessible through the trading station. Then, upon analyzing the charts, look for trading opportunities based on Fibonacci retracements. Reply to this thread telling us what trade you placed and why you placed it. In this case, the trade could be an entry order that is waiting for the price to retrace to a given Fib level. Feel free to upload an image of the chart you were looking at as well. If possible, try to focus on a longer time frame, such as a daily chart. You may use current or past situations.

E) Question of the Day

Question of the Day

Many traders feel that Fibonacci levels are significant only because the levels are highly publicized and other traders are aware of them. This self-fulfilling prophecy has the effect of making these levels significant because so many traders regard them as important levels.

If this is true, what is the danger of using Fib. retracement levels for a small move that occurs on an hourly chart or an even shorter time frame?

F) Quiz

Quiz: Fibonacci

Please test yourself on your knowledge learned from this lesson.

Go to the Quiz Center and take the Fibonacci Quiz.

The Quiz Center is located at the following link.

<http://www.learncurrencytrading.com/main>

G) Using Moving Averages

Using Moving Averages

What is a moving average?

Moving averages simply measure the average price or exchange rate of a currency pair over a specified time frame. For example, if we take the closing prices of the last 10 days, add them together and divide the result by 10, we have created a 10-day simple moving average (SMA).

There are also exponential moving averages (EMAs). They work the same as a simple moving average, except they place greater weight on the more recent closing prices. The mathematics of an exponential moving average are complex, but fortunately most charting packages calculate them automatically and instantaneously.

Parameters. The most commonly used time frames for moving averages are 10, 20, 50, and 200 periods on a daily chart. As always, the longer the time frame, the more reliable the study. However shorter term moving averages will react more quickly to the market's movements and will provide earlier trading signals.



How to Use Moving Averages in Trading

- Enter when a strong trend pulls back to a moving average line
- Enter on a moving average crossover

Gauge overall trend. Moving averages display a smoothed out line of the overall trend. The longer the term of the moving average, the smoother the line will be. In order to gauge the strength of a trend in a market, plot the 10, 20, 50 and 200 day SMA's. In an uptrend, the shorter term averages should be above the longer term ones, and the current price should be above the 10 day SMA. A trader's bias in this case should be to the upside, looking for opportunities to buy when the price moves lower rather than taking a short position.

Confirmation of price action. As always, traders should look at candlestick patterns and other indicators to see what is really going on in the market at the time. The chart above points out the Bullish Engulfing pattern that occurs just as the pair bounces off the 20 day EMA. Hitting the 20 day EMA, in conjunction with the candlestick pattern, suggests a bullish trend. Traders should enter once the Bullish Engulfing candle is cleared.

Crossovers. When a shorter moving average crosses a longer one (i.e. if the 20 day EMA crossed below the 200 day EMA), that is viewed by many as an indication that the pair will move in the direction of the shorter MA (so, in the aforementioned example, it would move down). Historically, moving average crossovers have not been accurate trade indicators, but they do offer insight into the market's psychology. Accordingly, should the pair move in the opposite direction of the shorter EMA and thus cross it, this should be viewed as an opportunity to enter a position.

H) Moving Averages: Historical

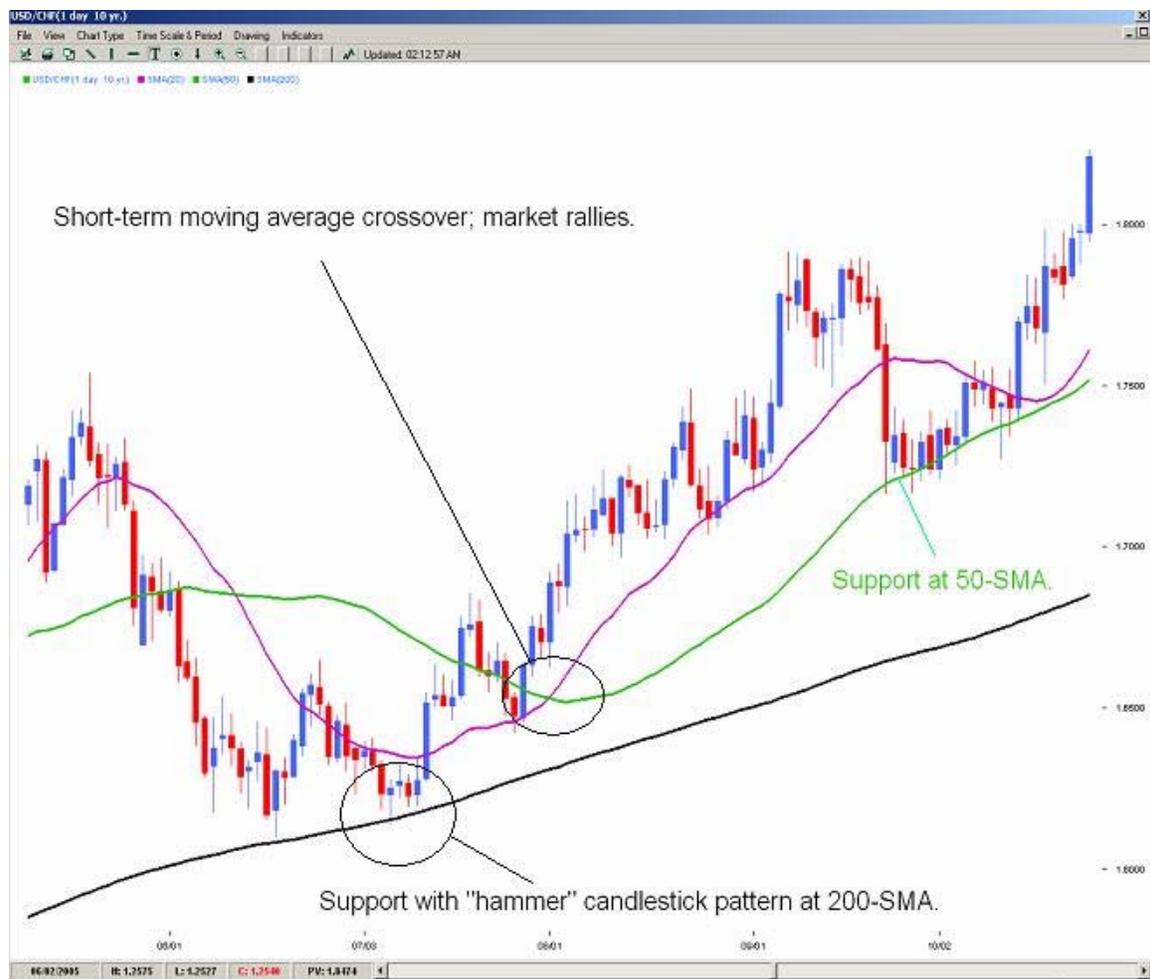
Moving Averages: Historical Trades

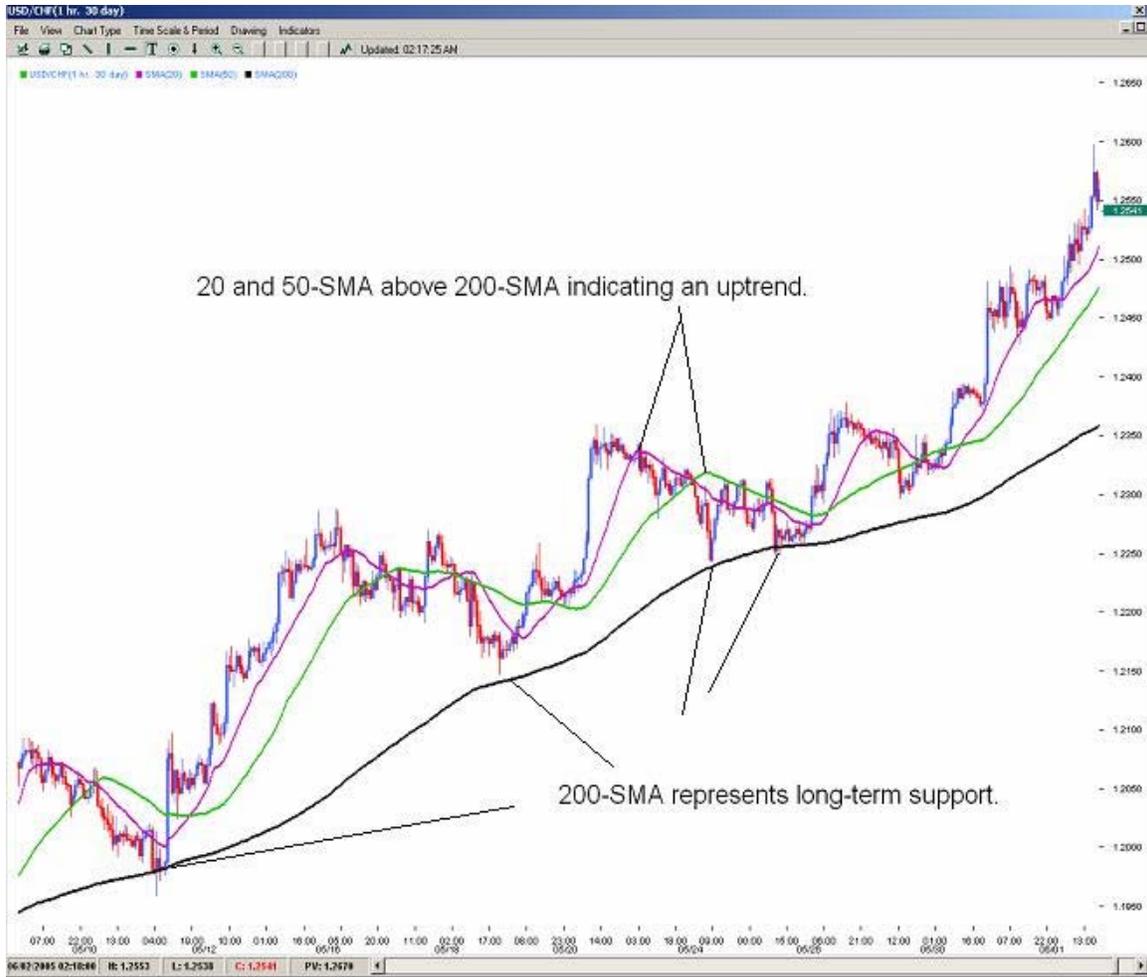
The charts (top) below show examples of how moving averages, when confirmed by price action, can signal trading opportunities.

In second chart we see moving averages applied to the USD/CHF currency pair. Notice the Hammer candlestick pattern that penetrates the 200 moving average (Black Line). This reversal pattern and the fact that it bounces off of the 200 moving average shows that the downside momentum is lost, and signals that a rally may follow.

Here we see a classic candlestick pattern, as only the long wicks breach below the long-term moving average (200-SMA). As it pierces the 200-day SMA on this daily chart for the USD/CHF, we see a subsequent rally of the pair.

Attached Images





I) Assignment-Place a Trade

ASSIGNMENT: Create moving averages on chart of a currency pair and place a trade based on the moving averages. Reply to this thread telling us what trade you placed and why you placed it. Feel free to upload an image of the chart to this thread. If possible, try to focus on a longer time frame, such as a daily chart. You may use current or past situations.

J) Question of the Day

Question of the Day

Yesterday we presented the concept that Fibonacci retracement levels are valuable only because a large number of traders are aware of them, and they become a self-fulfilling prophecy.

The same concept can be raised for Moving Averages. Generally the 200, 100, 50, 20, and 10 day moving averages are the most commonly used, but that does not necessarily mean that other moving averages are not valid. In fact, some indicators

that we will discuss in future lessons are created from moving averages. You can also plot moving averages on shorter term charts.

In your opinion--and there is no right answer for this one--do you think a moving average has value as an indicator if it is not one of the common ones? For an example using a completely random number, do you think the 15 day MA could be useful.

K) Animated Lesson:

The following link(s) illustrate how the various indicators can be used to identify the best times to initiate a position, keep losses relatively small, and take advantage of trading situations that may occur over the course of a trading day. Please feel free to pause each animation or replay it as many times as you wish. In addition, please turn your speakers on to listen to the audio segment as well.

<http://www.learncurrencytrading.com...hFibonacciM.swf>

<http://www.learncurrencytrading.com...averagesIIM.swf>