HOW TO USE FIBONACCI RETRACEMENT LEVELS TO INCREASE YOUR STRIKE RATE

TCM MARKET HACKS

Fibonacci Retracement – Timing your trades

Leonardo Pisano (or Fibonacci) was an Italian mathematician that recognised the ratios derived from a sequence of numbers are applied to all proportionate areas of the universe. Think engineering, biology, physics and of course trading.

The ratios arise with the sequence 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 resulting sequence is 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144...

From this sequence the ratio of a number and the following number will be 0.618. Take 55 and divide it by 89 and the result is… 0.618. Furthermore, the ratio for every alternate number is 0.312, and then 0.50. These are the important numbers that will make a very useful tool in your trading arsenal.

Fibonacci and trading

Right, so we know how the numbers are created, and we know it applies to everything on this planet, but I'm sure you are wondering just how these numbers can be applied in the market to help you with your trading.

The objective is to identify Fibonacci ratios as levels in a trending market because traders will often use these levels as support and resistance. Markets trending in one direction will move in swings. If we identify the market is trending lower and apply our Fibonacci retracement levels, we can then anticipate where any pullbacks/corrective bounces may run out of steam and short the markets ahead of a resumption in the direction of the longer-term trend.

Look at this NZD/CAD example

We can see on the chart above that the New Zealand dollar is selling off against the Canadian dollar. As per usual the market is moving in swings.

Having identified the trend, it is our job to apply the Fibonacci retracement tool identify potential resistance levels where we can short the market. After selecting the Fibonacci retracement tool on your charting platform, you simply start at the swing high and have the swing low as the base. From here the tool will mark the relevant Fibonacci levels.

On this occasion price found resistance on the 50.0 Fib retracement level (blue arrow).

As you can see the market literally hits the 50.0 Fibonacci retracement level, then continues the downtrend. Using Fibonacci, we're able to determine normal behaviour in the market. We know that a pullback in a trend up to the 78.6 retracement level is just a swing, where as some people will think trend has reversed and begin looking to go long. These people will lose money.

Here is another example…

This time we're looking at the price of Defence stock L3 Technologies, we can see the stock is trading higher, and again, experience a pull back to a Fibonacci level (this time the 38.2). The stock bounces from this price point and goes on to make a fresh high.

Fibonacci retracements are not 100% fool proof, and do not work all the time. However, if you combine technical concepts like Fibonacci retracement to help with timing, along with a fundamental bias, you'll increase your chance of success.

The tricky thing about using Fibonacci levels

They can be quite subjective. What you want to do is pick the most obvious swings that all traders will notice. By looking for the retracement of these obvious swings, you will be using the same levels as support and resistance as the rest of the market. If there are many traders buying or selling around certain level, these levels will have more chance of holding. The more obvious, the better!

Application

We use Tradingview so will demonstrate on this platform.

- **Step 1** – When in Tradingview and on your chosen chart, you select the 3rd icon on the tool bar that is situated on the left of your chart.

- **Step 2** – Select the Fibonacci retracement tool.

- **Step 3** – Click on the top of the move, the starting point of the trend, and then drag the tool to the bottom of the trend. In this example we identified 17/04/2018 and the 11.2411 level as the high, and 29/04/2018 low at 1.1510 as the low. The green arrows identify our high and low points.

- **Step 4** – When price retraces keep an eye out for how price reacts to the Fibonacci levels. On this occasion EUR/USD forms a double top at the 38.2% Fib level before going on the test the swings lows again.

  If you had a bearish view and were waiting to short the market, then selling at the 38.2% Fib level would have worked pretty well.