

Fibonacci trading in Forex

To draw Fibonacci, we need to select a swing move. Additionally, we have to try to do that in the right direction. That is why it is crucial to understand price behaviour, trends, swings.

Let's start from a tricky question and basics of price behaviour. In which direction, can price move? You probably would answer: up and down. That is the correct answer, only that there is one "but". What if there is no main trend? If there is no strong trend, price will probably move sideways. Statistics says that price is about 30% of time in a trend and rest of this time it's moving in range. Why moving in a range is such a bad thing? Because there is no clear direction and the price moves up and down so it is very hard to make money in that kind of movement. Just look at chart below, is it something you would like to trade?



Sideway move example

I don't think so. What we want to trade is a trending market. Going into trend direction increases your chances of success. Look at this beautiful trend below. Isn't it something you would like to trade? On the short-side of course!



Downtrend example

We want to use Fibonacci technique in that kind of market. Before I go further and explain more about this, there is another important thing you must learn..

How to recognize trend?

You should be able to easily recognize if there is a trend in place or not. Sometimes it is hard because of the “noise”, but there are some tips you can use.

Look for higher highs and higher lows, if you are looking for uptrend. I have probably showed you this chart before, but this is important. On chart below you can see an example of uptrend. You can see that every high is higher than the previous one, and every low is higher than previous low.



Higher high sequence

When you can find these elements on a chart, then you have identified an uptrend.

In a downtrend, you should look for lower lows and lower highs. Each low is lower than the previous one, and each high is lower than previous high. Just like on chart below:



Lower low sequence

If you are able to identify lower lows sequence, than you have found a downtrend and you can plan to enter short position.

In range market there is no sequence, therefore there is no trend.

You can also use simpler tools to define trend. Most popular moving average is a good choice. Let's say you are using 200 simple moving average. When moving average is rising and price is above that line, then there is a strong chance that trend is up. If trend is down, price will be under 200 SMA. Of course, this method does not make you 100% sure, but the chances are good.



So, what really is Fibonacci trading?

Now, when you know what kind of trends there are and how to recognize the current trend, we can move to answer the question from the title. What is Fibonacci trading about?

Fibonacci trading is a technique, where you are using tools based on Fibonacci numbers to predict possible turning points.

There are many tools which you can use for trading with Fibonacci. Each of them do a different job. Some are more important, some less. Let's review them quickly.

How to trade with Fibonacci?

Now you know what Fibonacci trading means, and what kinds of Fibonacci tools we have (plenty of them!). There is one more important question to answer. How should you trade with these tools?

Notice that all these tools give you a potential level of support/resistance or potential exit points. This is very valuable information! But how to use it for your benefit? Of course, I am not able to answer you in a few words, but I can give you some advice on what you should do.

You should build a trading plan. The main core of your trading plan will be Fibonacci tools. As I wrote before, first include Fibonacci retracement and extension to your plan. Next, you need some signals which help you to enter and exit positions. The logic here is that when price is in an uptrend and correction occurs, you draw retracement levels. When price is near one of them, you do not know which one will be a support. That is ok, because you define your own signal and when price returns to move up from correction, you get your signal. It might be something simple like moving averages crossover or a signal from some oscillator.

Same with closing a position. You should define on which signal you will exit your position. It will be probably near one of the expansion levels, so you will be ready to act.

The last, very important part of your trading plan is money management. You should keep your losses small. It is very important to trade smart and not to risk too much.

Some of this information is not very specific, but the whole topic about trading with Fibonacci is very wide. In the end, it is about practice, practice, practice. You should be testing new ideas and getting experience. Trading with Fibonacci is great, because you have possible support and resistance levels and even exit points. Of course, they are only possible levels, but on many time frames they work excellent. You need to build your whole trading plan around these levels, so around Fibonacci tools. Add to this entry and exit signals and proper money management system and you are on great way to success in trading.

ABCD and Fibonacci trading

There are more advanced techniques to trade with Fibonacci, but you should start with ABCD. This is a simple yet powerful approach. In short, we look for a swing. Based on that swing we draw our Fibonacci lines (A and B). Next, we wait for a correction to retracement – C. After that we open a trade and wait for continuation move towards D (which is an extension line).

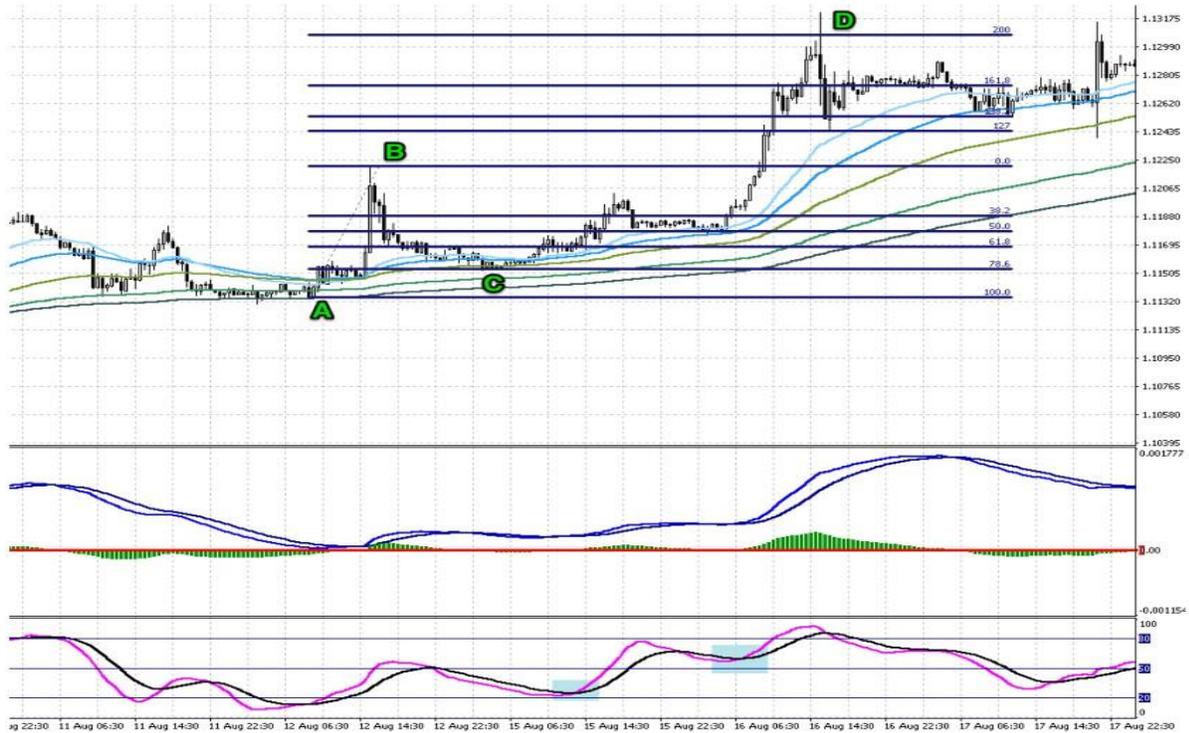
Look at some examples below, it should be clear.

Fibonacci trade examples - GBP/JPY 1 hour chart



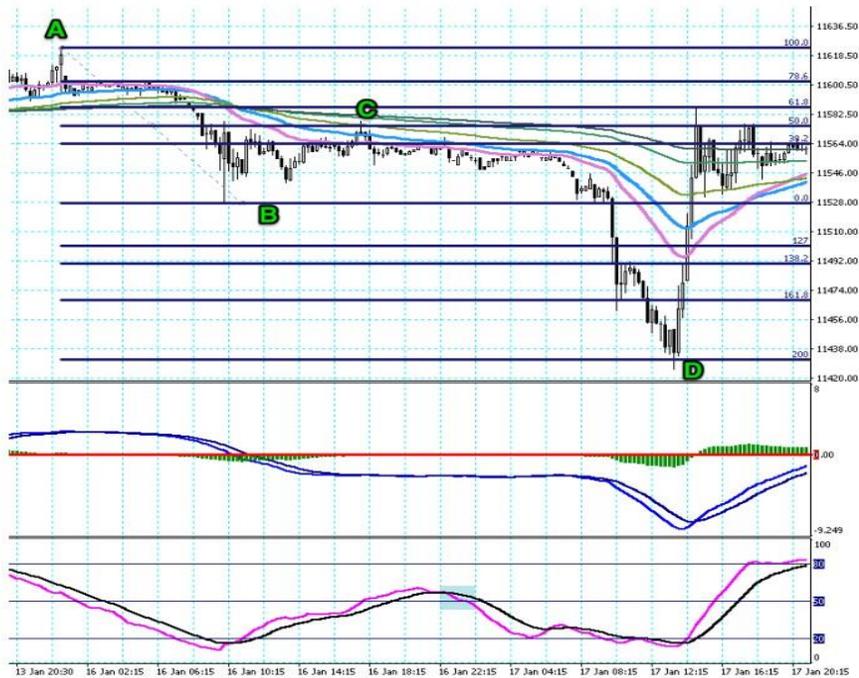
Here we have example of GBP/JPY. We can see that after strong move down (from A to B) there was a correction up. This was a good moment to draw Fibonacci lines and wait for signal to go short. Correction ended at 78.6% and after that there were signals from MACD and Stochastic. This short trade worked well. Move ended at 138.2 Fibonacci extension and it was our D point.

50 EUR/USD 30m



In this EUR/USD example, the time frame is 30m. We are in an uptrend and after a strong move to the B there was a correction. It was rather deep, down to the 78.6 retracement line (our C point). Next EUR/USD returned to the uptrend. We saw some signals to go long. This was a strong move up, with short stop at 161.8% extension line. Eventually move ended at 200% extension line, this was our D point.

DAX 15m



Above is 15m chart of DAX. It is a good example, because it shows how universal Fibonacci tools are. They work with currency, with commodities, stocks, indices...

On the chart, we can't see the left side – there was an uptrend move before. It ended, price went down below averages. There was a correction to the C (50% retracement). From there some move in the range and strong move down to the 200% extension line (D).