The Truth About Fibonacci Trading

The truth about Fibonacci levels is that they are useful (like all trading indicators). They do not work as a standalone system of trading and they are certainly not the holy grail, but can be a very effective component of your trading strategy. But who is Fibonacci and how can he help you with your trading? Leonardo Fibonacci was a great Italian mathematician who lived in the thirteenth century who first observed certain ratios of a number series that are regarded as describing the natural proportions of things in the universe, including price data. The ratios arise from the following number series: 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144 This series of numbers is derived by 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 ratios are derived by dividing any number in the series by the next higher number, after 3 the ratio is always 0.625. After 89, it is always 0.618. If you divide any Fibonacci number by the preceding number, after 2 the number is always 1.6 and after 144 the number is always 1.618. These ratios are referred to as the golden mean. Additional ratios were then derived to create ratio sets as follows: The first set of ratios is used as price retracement levels and is used in trading as possible support and resistance levels. The reason we have this expectation is that traders all over the world are watching these levels and placing buy and sell orders at these levels which becomes a self-fulfilling expectation. The second set is used as price extension levels and is used in trading as possible profit taking levels. Again, traders all over the world are watching these levels and placing buy and sell orders to take profits at these levels which becomes a self-fulfilling expectation. Most good trading software packages include both Fibonacci Retracement Levels and Price Extension Levels. In order to apply Fibonacci levels to price charts, it is necessary to identify Swing Highs and Swing Lows. A Swing High is a short term high bar with at least two lower highs on both the left and right of the high bar. A Swing Low is a short term low bar with at least two higher lows on both the left and right of the low bar.

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