Fibonacci – The Theory

Leonardo Fibonacci is a thirteenth-century mathematician who discovered the Fibonacci sequence.

This series takes 0 and adds 1 as the first two numbers. Succeeding numbers in the series adds the previous two numbers and thus we have 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89 to infinity.

The Golden Ratio (1.618) is derived by dividing a Fibonacci number with another previous Fibonacci number in the series. As an example, 89 divided by 55 would result in 1.618.

0.618 is derived by dividing any Fibonacci number in the sequence by another Fibonacci number that immediately follows it. For example, 8 divided by 13 or 55 divided by 89

0.382 is derived by dividing any Fibonacci number in the sequence by another Fibonacci number that is found two places to the right in the sequence. For example, 34 divided by 89

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Most common Fib Levels

Common Fibonacci numbers in financial markets are

- 0.236
- 0.382
- 0.618
- 1.618
- 2.618
- 4.236

These ratios or percentages can be found by dividing certain numbers in the sequence by other numbers as previously mentioned.

While not officially Fibonacci numbers, many traders also use 0.5, 1.0, and 2.0.

Two common Fibonacci tools are retracements and extensions. Fibonacci retracements measure how far a pullback could go. Fibonacci extensions measure how far an impulse wave could go.

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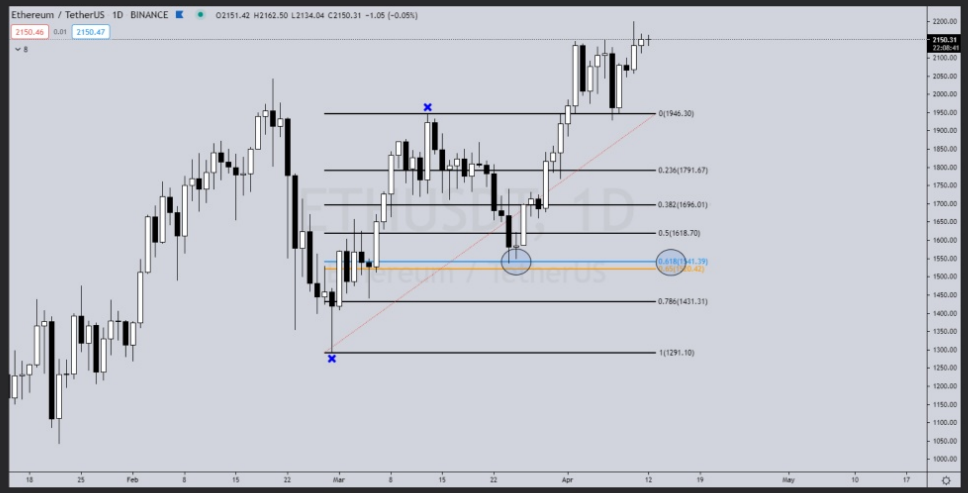
Rib Retracements

A Fibonacci retracement is a popular tool among technical traders and is based on the key numbers identified in the previous slides. Fibonacci's sequence of numbers is not as important as the mathematical relationships, expressed as ratios, between the numbers in the series.
In technical analysis, a Fibonacci retracement is created by taking two extreme points (usually a major peak and trough) on a chart and dividing the vertical distance by the key Fibonacci ratios of 23.6%, 38.2%, 50%, 61.8%, 78.6% and 100%. Once these levels are identified, horizontal lines are drawn and used to identify possible support and resistance levels.



In this fibonacci retrace example, we used the bottom price in the time frame of this chart as the bottom 100% fib. The highest price (or wick) of this chart as the 0% fib. And the in-betweens give us an idea of where exactly price could “retrace” as per the more frequently used fibonacci retrace levels. This helps us in identifying long or spot buy levels.

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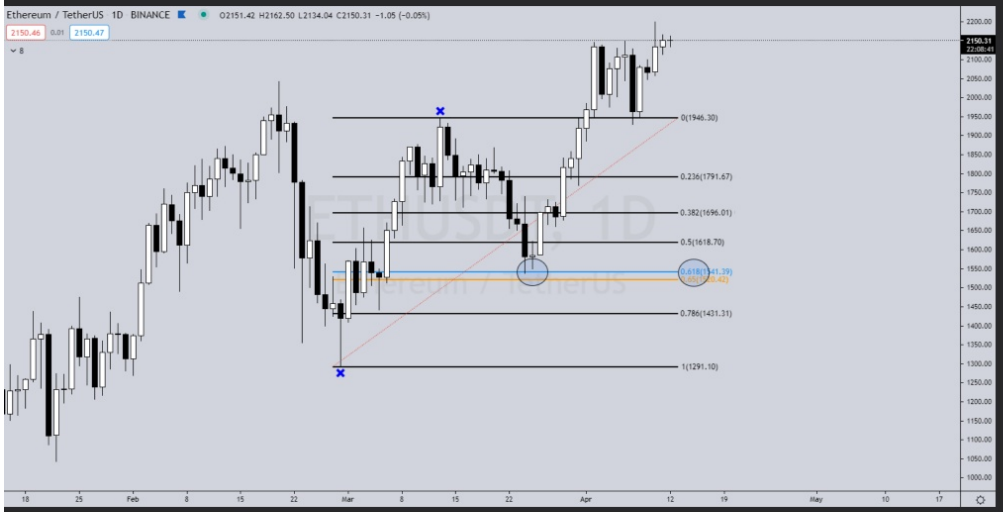

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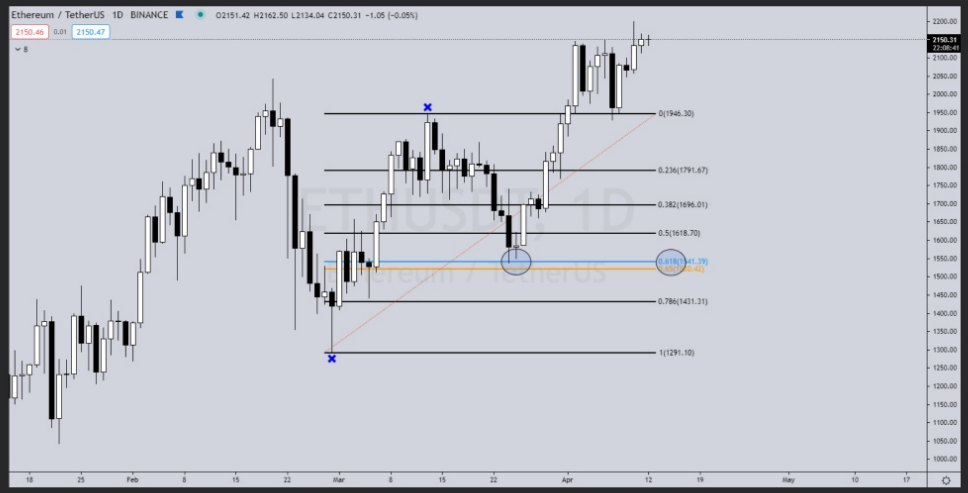

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Downtrend

In this example, we used the top price as the 100% (1) fib and the 0% (0) as the bottom price of this move. As you can see whenever price retreats it comes back to 382 fib and the 618 fibs. What we can deduce from this is that price is not strong enough to get past the 618 fib levels. This now gives us not only insight of the trend being overly bearish but also potential short opportunities at stated fibonacci levels.

Uptrend

In this uptrend example, we used the bottom price as the 100% (1) fib and the 0% (0)as the top price of this move. As you can see again whenever price retreats it comes back to 382 fib and the 618 fibs. Again price is not strong enough to get past the 618 fib levels.

The most common retracement levels are the .618 and .65 fib which is often referred to as "The Golden Pocket"

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Fib Extensions

While Fibonacci retracement provides traders with vital functional areas where a pullback might reach, the Fibonacci extension can help traders find profit targets for their trend continuation. The primary and frequently working Fibonacci extension levels include 161.8%, 261.8%, 361.8% 423.6% and 685%.

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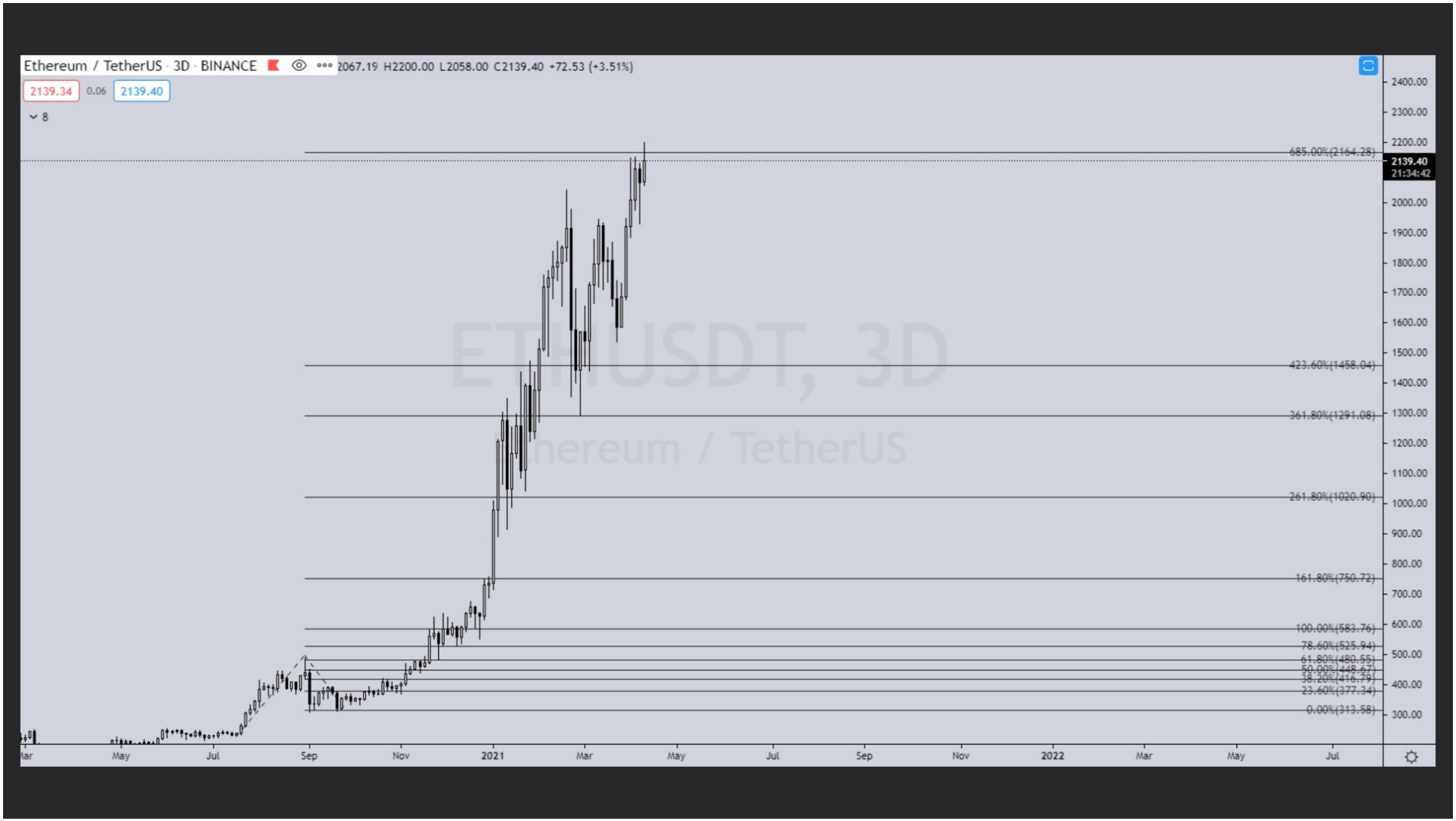

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