Fibonacci Trading Rules

Drawing

Fibs are drawn from LOW to HIGH if Price is moving up.

Fibs are drawn from HIGH to LOW if price is moving down.

The way I got used to getting my fib drawings is that for up-moves. The 100% level marks the PIVOT LOW, as a price movement back to this level would imply that price has retraced 100% of the up-move.

The opposite is true for down-moves. The 100% level marks the PIVOT HIGH, as a price movement back to this high would imply a 100% retracement from the down-move.

What this means, is that extension levels are displayed with a negative value, because price is no longer retracing, it is extending. And what the Fibonacci Retracement measures is a….wait for it…..retracement. Therefore retracements must have a positive value (as that is what is being measured) and extensions should have a negative value (as they are the opposite of the retracement, the opposite of a positive value is a negative value).

I'm just clarifying because there might be other people who are used to drawing the fibs the other way around, where extensions are measured with positive values. That is perfectly valid, just change the negative values of the levels to positive values and add 100%. So if I talk about a -50% level, this would mean a 150% level if you draw extensions with a positive value.

Levels and their significance

These are the levels that are going to be used and what their significance is:

0%: Marks the pivot HIGH in up-moves and the pivot LOW in down-moves. The braking of this level will help determine when to draw a new Fib. This level can also be used as second target for multi-target trading.

23.6%: This level determines the target for trades. A limit order is to be placed right at this level, if you want to play it safe, you can front-run this level by 1 tick to ensure getting filled once this level is reached.

This level also aids in determining when to move/re-draw a Fib to a new High/Low. If price has exceeded the 0% level, (without having retraced to the 50% level) and then retraces to the 23.6% level, then you move the fib to the new pivot High. More on this later.

50%: This level determines the entry. Both WD Gann and Wyckoff talked about the importance on 50% retracements. A limit order is going to be placed 1 tick above this level if in an uptrend, or 1 tick below this level if in a downtrend; to ensure getting filled.

76.4%: This level will serve 2 purposes. The first one is that it will determine the stop placement. You will place a stop order at this level precisely. The second purpose is that it will tell us when a change in

direction has happened. When this level is surpassed by 1 tick, then you will draw the fibs in the opposite direction.

100%: This level represents the pivot LOW in uptrends and pivot HIGH in downtrends.

-23.6%: This level is used to determine if a new fib needs to be drawn following the same trend and direction as the previous fib.

-50%: This level is used to determine if a new fib needs to be drawn following the same trend and direction as the previous fib. This level is used to determine extended moves. If price, coming from a retracement, blows passed the -0.23% level and reaches the -50% level without ever retracing back to the 0% level, then the move is considered to be extended and a new type of fib needs to be drawn.

Implications on Money Management

The distance between the entry level (50%) and the target (23.6%) and stop (76.4%) levels is the same (50% - 23.6% = 26.4%; 50% - 76.4% = -26.4%). This would mean that under normal circumstances, the reward to risk ratio would be 1:1. However, since I use this to trade the ES, and I set the Fib tool to round the values to the nearest tick, sometimes the distance between them will vary due to the fact that the levels are being rounded to the nearest tick. So this means that the ratio will not always be 1:1.

One important reminder is that since the 50% level is being front-run by one tick, this means that you are decreasing the distance to your target price by 1 tick and increasing the distance to your stop level by 1 tick. So what you end up with is a stop that is usually 2 ticks greater than the target. This can sometimes increase to 3 ticks or decrease to 1 tick depending on how the levels are being rounded to the nearest tick. So now, the ratio is no longer 1:1 since you are risking more than your expected reward. So now in order to be profitable, you need a higher than 50% winning ratio.

I am letting you know beforehand so you can determine if this suits your style of trading or decide to paper trade first while you gather enough information to determine your own statistics for this system.

Trading Rules

Chart Timeframe: The timeframe to use is a 610 tick chart.

Trading Timeframe: Trades will only be taken between 9:30 EST and 12:00 pm EST. If you have a trade open at 12:00 pm EST, you can close it, tighten your stop, or manage it normally.

Contracts: ES (it can be used for other contracts or forex, just adjust parameters to the volatility. I use it to trade the ES).

Lot size: depends on your money management.

Entry: entry at 50% level on the **first** bounce. No trades are to be taken on any subsequent bounces at this level. The only time when you can take it on a subsequent bounce is if price has bounced off the

50% level during the overnight session (this does not apply to currencies as they are not traded lightly in the overnight session like most US indices are).

Exit: A limit order is placed at the 23.6% line (can be front-run by 1 tick if you want, but that diminishes the reward to risk ratio further). A stop order is placed at the 76.4% line.

Drawing Rules

The 1st rule is that the distance between pivot high and pivot low must be at least 16 ticks or 4 points in the ES. The maximum distance allowed between pivot high and pivot low is between 7 and 7.5 points (14-16 ticks). If the distance between the 50% and 76.4% line is 2 points (8 ticks) then no trade is taken. This way, you are not risking more than $100 per contract.

Drawing a new fib in the current trend

If price retraces to 50% or very close (75% of the distance between 23.6% and 50%) to it, and then continues the move and surpasses 0% line and gets at least halfway through the 0% to -23.6% price area before retracing, a new fib should be drawn. The 100% line will be around the original fib's 50% line or close to it), wherever price turned and made a pivot, and the 0% line will be at the new pivot made close to the -23.6% line. An example with pictures will be provided to clarify this. The new fib must comply with the 1st rule.

When to draw a fib in the opposite direction

If price breaks a regular fib's 76.4% level, then you draw a fib in the opposite direction if it meets the criteria specified in the 1st rule. If price breaks the 76.4% level on an extended price fib, then you don't change direction, you just draw a regular fib. This is explained in more detail below. However, if the regular fib exceeds the maximum distance allowed between pivots, then you can draw a fib in the opposite direction to the extended price fib.

Dealing with fibs where price does not retrace to 50% before surpassing the 0% line

If you have drawn a fib which retraces, but not quite to the 50% line and then goes passed the 0% line, then one of two things can happen. You either move the 0% to match the new pivot, or you draw an extended price fib.

Moving the 0% line

If price makes a pivot and retraces a bit, but doesn't get close to the 50% line and then breaks the 0% line. The following reasons would lead you to move the 0% line to the new pivot made:

1. Price breaks the 0% line, does not get to half the distance between 0% and -23.6% and then retraces back to the positive 23.6% retracement line. Then you leave the 100% line where it is and move the 0% line to the new pivot made passed the original 0% line.

2. Price breaks the 0% line, it does get passed half the distance between 0% and -23.6% and then retraces back to the 0% retracement line. Then you leave the 100% line where it is and move the 0% line to the new pivot made passed the original 0% line.

Extended Price Fib (EPF)

If you have a fib where the distance between pivots is 6 points or more; price retraces a bit, but doesn't get close to the 50% line and then breaks the 0% line, breaks the -23.6% line and gets to the -50% line without ever retracing back to the 0%, then you draw an extended price fib.

If you are in an up-move, you originally had a Pivot low (100% line) and a Pivot High (0% line) which was blown through. So you would go back in your chart and look for the pivot high made prior to the pivot low where you have your 100% line. By pivot high, I mean a high that has at least 5 candles/bars with lower highs to the left and 5 candles/bars with lower highs to the right. That pivot high would now be your 100% line and the new pivot high made passed the original -50% line would become the extended price fib's 0% line. So instead of drawing from a low to a high, you would draw from a previous high to a high.

If you are in a down-move, you originally had a Pivot low (0% line) and a Pivot High (100% line) which was blown through. So you would go back in your chart and look for the pivot low made prior to the pivot high where you have your 100% line. By pivot low, I mean a low that has at least 5 candles/bars with higher lows to the left and 5 candles/bars with higher lows to the right. That pivot low would now be your 100% line and the new pivot low made passed the original -50% line would become the extended price fib's 0% line. So instead of drawing from a high to a low, you would draw from a previous low to a low.

Extended Price Fib rules

Once you begin drawing an extended price fib, you would continue drawing from the same pivot marked by the 100% line and move the 0% to new pivot highs in up-moves and to new pivot lows in down-moves. The same rules on moving the 0% line for regular fibs apply to EPFs.

If price breaks the 76.4% line, you DON'T draw a fib in the opposite direction, but instead go back to drawing regular fibs. So for up-moves, you would go back to the pivot low where you had originally drawn the fib (before drawing the extended price fib) and draw from that low to the current pivot high. So you go back to drawing from low to high. For down-moves, you would go back to the pivot high where you had originally drawn the fib (before drawing the extended price fib) and draw from that high to the current pivot low. So you go back to drawing from high to low.