Lan Turner's Fibonacci Elliott Wave Trading Strategy Cheat Sheet

One of my favorite trading strategies and tools is known as the Fibonacci Extension & Retracement Tool. But, before I get into describing this pattern in detail, we must have a small amount of background information under our belt before we can fully understand how to take advantage of this unique trading methodology.

Background Info Step 1: Understanding Elliott Wave.

This section is in no way meant to be a full undertaking of the Elliott Wave, but to only impart to you, what I feel to be the most important basics of the Elliott Wave pattern.

First and foremost, I see it all the time, when I say Elliott Wave, people's eyes glaze over and begin to roll back into their head, and tears begin to slip from their eyes.

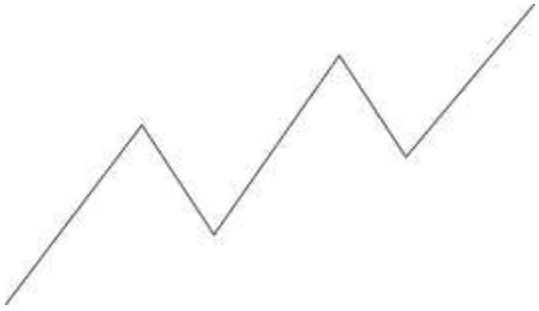
Elliott Wave does not have to be a tear jerking technique or strategy, and you don't need an 800 page tomb to understand it. Basically, Elliott Wave is nothing more than one more recurring price pattern.

We're all familiar with 1-2-3 Tops and Bottoms, Wedges, Triangles, Flags and Pennant formations. If you're not familiar with these trading formations, please write to me at lhturner@geckosoftware.com and request my "Recurring Price Pattern Cheat Sheet." (Even if you are familiar with them, feel free to write and request this cheat sheet, it's awesome, and I would be happy to give it to you.)

Anyway, back to the subject at hand...Elliott Wave is nothing more than one of these recurring price patterns and it is not difficult, in fact it's the easiest of them all to understand, because we have a basic innate understanding of this theory.

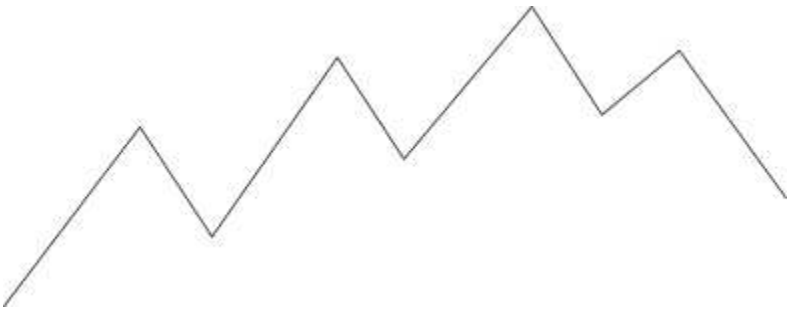
First, markets move in waves, two steps forward, one step back, two steps forward, then one step back again. This is what gives us a trend, higher highs, and higher lows, an uptrend; lower highs, lower lows make a down trend.

If we were to draw a picture of this, it would look something like this:



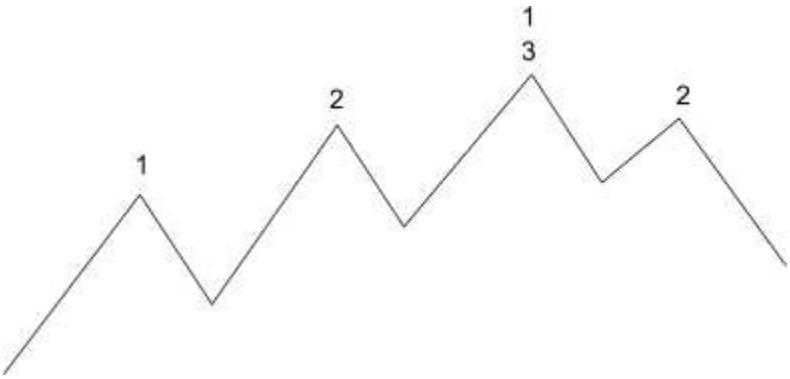
Pretty simple I think, right?

Well, markets don't always go up, they sometimes go down, so in the process of making that change over, we get something that looks like this:

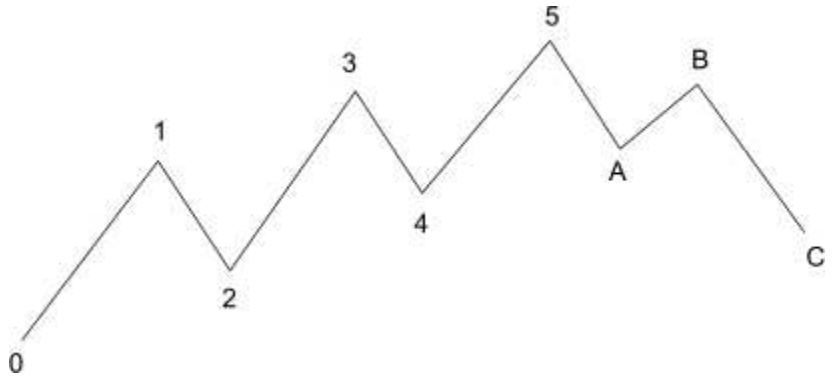


And, voilà, we have ourselves an Elliott Wave. Wow, it's that simple?
Okay, now here are some simple rules for following Elliott Wave.

The "perfect" Elliott Wave has three advancing peaks, and two retracing peaks. (The third advancing peak is also the first retracing peak.) So we would count it like this:



But, when you talk like an "Elliottician" (A fancy name for someone who studies and trades Elliott Waves, feel free to start referring to yourself as an Elliottician after reading this document.) That's not how we actually count Elliott Waves, we count like this:



Which is much more difficult as you can see, (I'm being facetious.) I hope you realize this is pretty simple stuff. Elliott Waves don't have to be complicated, people like to make you think it's complicated, so that it makes them look smart, which is why I call this a cheat sheet, my goal is to show you how really simple these "complex" subjects can really be.

Now, the next thing you need to know about Elliott Waves, before you can start calling yourself an Elliottician, is that statistically speaking, the market's move in waves, again, two steps forward, one step back, and then two steps forward once again, forming the above mentioned Elliott Wave. Now, Ralph asserted (Ralph is Elliott's first name), Ralph asserted that markets move in these wave formations, and that markets generally, more often than not, go through a series of higher highs, and higher lows up to the fifth wave, then they turn around and rebound back down through the A-B-C retracement wave pattern.

Now this does not mean that markets cannot go to the 6th, 7th, 8th or higher wave points, they certainly can, and often times do, and it also does not mean that markets can't stop at the third wave, which they also very often do.

Ralph's assertion is that markets go to the fifth wave more often than any other point. (Now in my opinion, I think that's a bit of an overstatement, simply because to get to the fifth wave, you have to also go through the 3rd wave, and if the market stops at the third wave sometimes, then it is statistically correct to say that the market would actually go to the 3rd wave more often than the fifth wave, but of course I believe Ralph would discount the 3rd wave if the market actually did continue on to the 5th wave. Okay, enough rambling, let's get on with the analysis.

Now, before you can consider yourself an Elliottician, you should know two more simple rules:

Rule 1, the peak of wave three must be higher than the peak of wave one; obvious, right?

Okay, here's Rule 2, the peak of wave five must be higher than the peak of wave two, another obvious rule.

Now, here's where the rules get tricky, Rule 3, wave two cannot drop below wave zero, and Rule 4, wave 4 should not drop before wave 2, but sometimes it's allowed. (I know, I know, weird rule, but that's what Ralph allowed for, seems to be the one rule that breaks all the rules.)

So there you have it, that's not everything there is to know about Elliott Wave, but it's enough that I think you now know enough to consider yourself an Elliottician, congratulations!

Let's move onto the next level of understanding, that of the Fibonacci sequence with Projections & Retracements! Sounds complicated doesn't it? Well, it's not. Let me show you.

Fibonacci is nothing more than a measuring tool, like a ruler. If you think of it like a ruler, then you have 90% of Fibonacci already figured out. Why do we call it Fibonacci then? Why give it such a hugely difficult and weird name? Well, very simple, just like Elliott Waves are named after Ralph Nelson Elliott, since he's the one that first published his work on this subject, and he named them after himself, Fibonacci was the last name of the guy who came up with the Fibonacci sequence; his full name is Leonardo Fibonacci.

What's the Fibonacci sequence? Very simple, it's just simple addition that looks like this:

0+1=1 1+1=2 1+2=3 2+3=5 3+5=8 5+8=13 and so on, and so on, and so on...

Wow, see the pattern there? Very simple, right?

Well, we arithmeticians like to take things like this and do what is known as "applied math!" Pretty big name for something as simple as "use what we just learned in a real world application."

Okay, let's take a look at how we apply Fibonacci.

Now again, this is not, by any stretch of the imagination, a full discovery of all the uses of Fibonacci, or is it meant to be a full disclosure of the myriad of ways that we manipulate or recalculate this series of numbers into all kinds of different configurations, purposes and uses.

What's most important, and what I want to cover here, is how we use it in our trading, or in other words, how we can use it to make money. That's why we're here anyway, right?

Okay, back to the beginning, Fibonacci, as we use it in trading, is nothing more than a fancy ruler that we use to measure Elliott Waves with.

Ya, they go hand-in-hand, like hamburgers and French fries, or Tweedledee and Tweedledum, you never hear anyone say, hey Tweedledee, without following up with Tweedledum, and every time you go to the burger stand, they always say, “would you like fries with that?” Same same, here in trading, when you trade using Elliott, you should always ask yourself, “Would you like Fibonacci with that?”

What we do is we measure each advancing leg as well as the pull back of the Elliott Wave. You see, markets move in waves, right? Two steps forward, and one step back, well...one step back from two steps forward is 50%, (Of course 50% is a Fibonacci ratio.) very simple. That’s what the Fibonacci ruler does, it measures those Elliott Wave pull backs, and then projects out into the future a price and time calculation of where, and when the market is going to create the next Elliott Wave, out in time, and in the future...that my friend, is the magic of why Fibonacci is so, so cool!

One more thing we need to know and understand about Fibonacci, is that the most popular Fibonacci Ratio is 61.8, which is also known as the golden ratio, or the golden mean; you may have heard of it, and not even realized that’s what it was, that it’s actually a Fibonacci calculation.

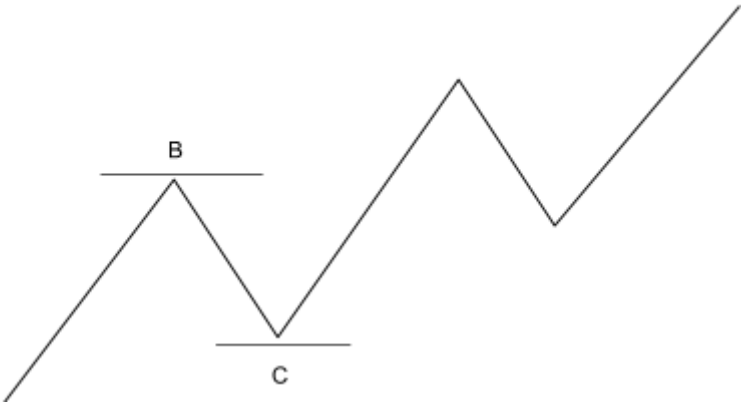
The reason this number is important, is because what we find in trading the financial markets, is that those Elliott Wave pull backs, they don’t just come back to 50%, but more often than any other number, they pull back to 61.8% of the previous move, and that pull back happens on every scale of the market, short term trades, mid-term trades, and long-term trades, (We call that fractal, another fancy word that just means different time frames.) Let’s look at a couple of examples.

Now again, just as mentioned before, just because the market pulls back to 61.8% more often than any other ratio, it does not mean it can’t come back further than 61.8, it often times does, and it also does not mean it can’t stop short of 61.8%, because that too is very common, it’s just that more often than any other ratio, the market has a tendency to hit that 61.8% ratio more than any other number.

So, knowing that, we use it as our primary guideline; what we’re doing is trying to put as many of the odds in our favor as possible, in an attempt to be right more often than we’re wrong, and the more we know about market psychology the better traders we’re going to be.

First, let’s look at how we measure a Fibonacci pull back.

Here’s an example: Remember this drawing from before? This should look familiar to you; it’s the first leg of an Elliott Wave. So, let’s measure it using Fibonacci. Here’s what that would look like.



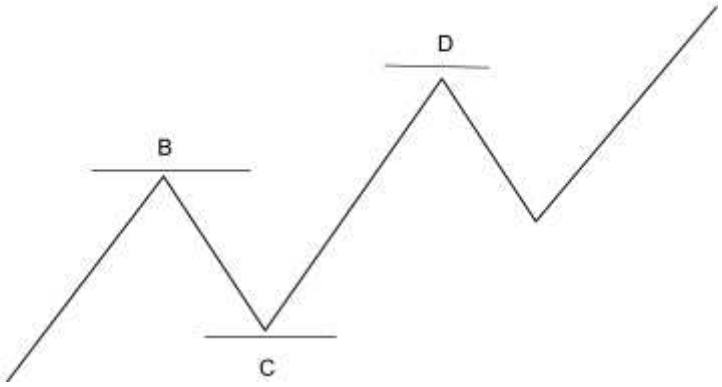
We measure from (A) to (B), which is 100%, and then C= our pull back or retracement level. Just by looking at it, you can see that this level (C) is about 50% pull back between A & B. Pretty simple stuff, right? Now, our in depth studies have proven to us that markets like to pull back to approximately 61.8%, our Fibonacci golden mean, more than any other pull back level.

Now, how can that help us? Well, in this industry, we have little mantra's, or rhymes that we like to tell ourselves to help us remember specific trading strategies. One such mantra is, "Buy the Valley's and Sell the Rallies." So, to do that, we need to know where the valley is, and where the rally is...right? Well, that's exactly what Fibonacci and Elliott Wave, teamed up, can help us do. (Side bar here: I also like to use Slow Stochastics to help me identify rally points, but that a topic for later discussion.)

Hopefully, by now, the lights are starting to come on, and you're seeing how this is beneficial. According to our mantra, we would be buyers at the (C) pull back area of the 61.8% level of the first leg of the Elliott Wave...right?

Now, the next part of our mantra says, "Sell The Rallies." So, let's sell the rally. How do we know where that is? Well, once again, Fibonacci comes to the rescue.

Again, we look at a Fibonacci scale, and we project out into the future where we anticipate the next rise in price, or leg of the Elliott Wave. So we want to calculate the distance between the pull back (C) and calculate out into the future using our Fibonacci price and time scale to help us identify that rally point, or point (D).



Now, within Fibonacci, there are more numbers than just 50% and 61.8% ratios that are important to us. In fact, there are lots of Fibonacci ratios, but for our purposes, the only ones we really care about, or I guess I should clarify, the only ones I personally really care about, are the following:

0% - 23.6% - 38.2% - 50% - 61.8% - 76.4% - 100% - 161.8%

Now, it will become clearer later on why each of these numbers are important to me, but let's start off with the easy one's:

0% = Starting place, on our diagram above, that's our (A) point.

100% = that's our first high point on the Elliott Wave scale (B) point.

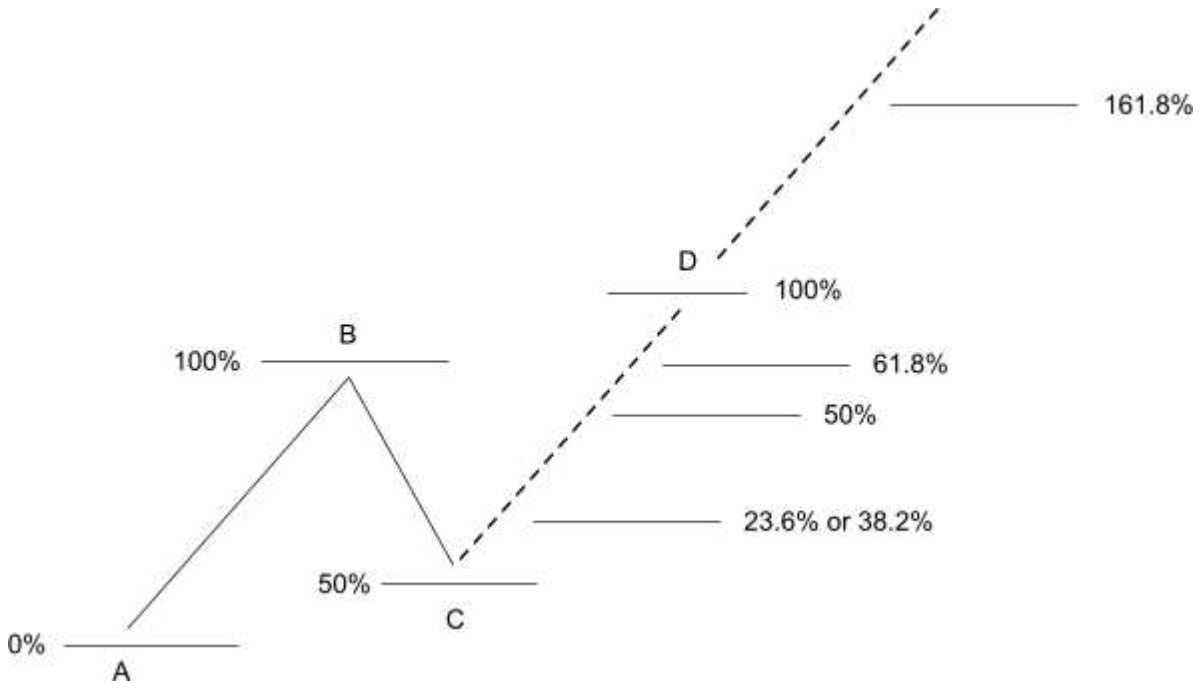
38.2%, 50%, 61.8% = This is the range in which a market pulls back to, somewhere between 38.2, and 61.8%. (C) Point.

76.4% = Two fold, this is a less likely pull back, less often does the market pull back all the way to the 76.4% range, as well, this is a projection level where the market can project out to, out from the (C) point.

100%, 161.8 = Projection levels, where we look for markets to shoot up to. (D) point.

Okay, let's now take a look at my favorite part of Fibonacci, its ability to project price and time.

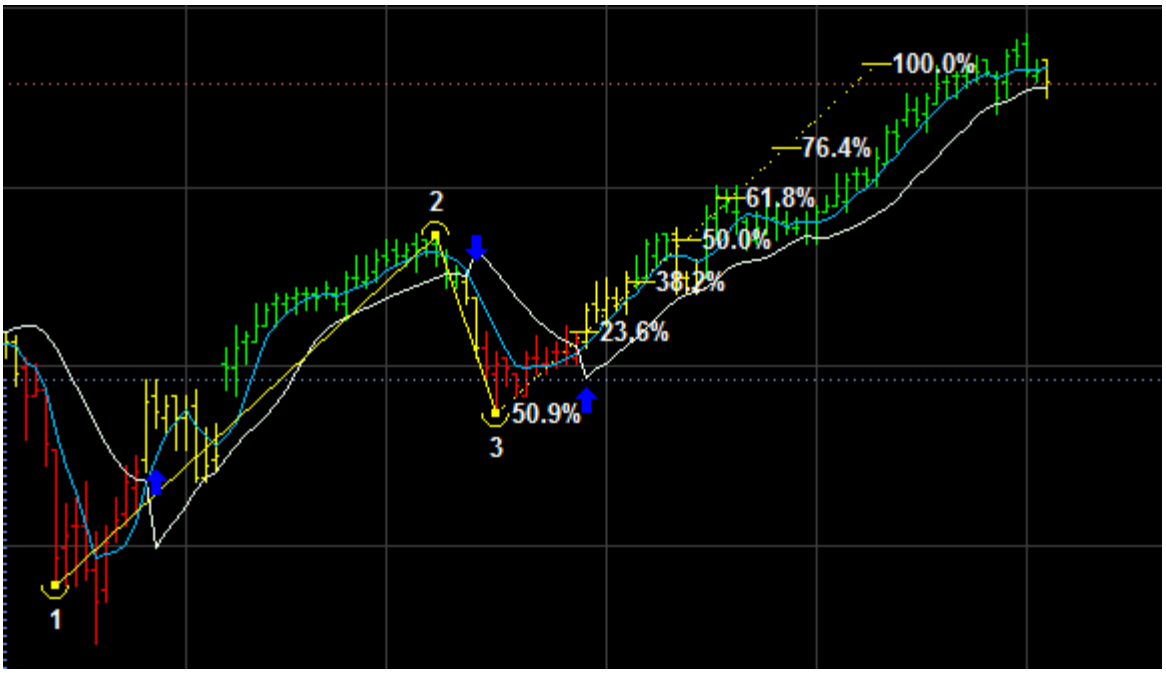
It's really very simple...what we do is we count and measure the Elliott Waves, we then project, using Fibonacci, where we think the next leg is going to rise to, which it's done like this:



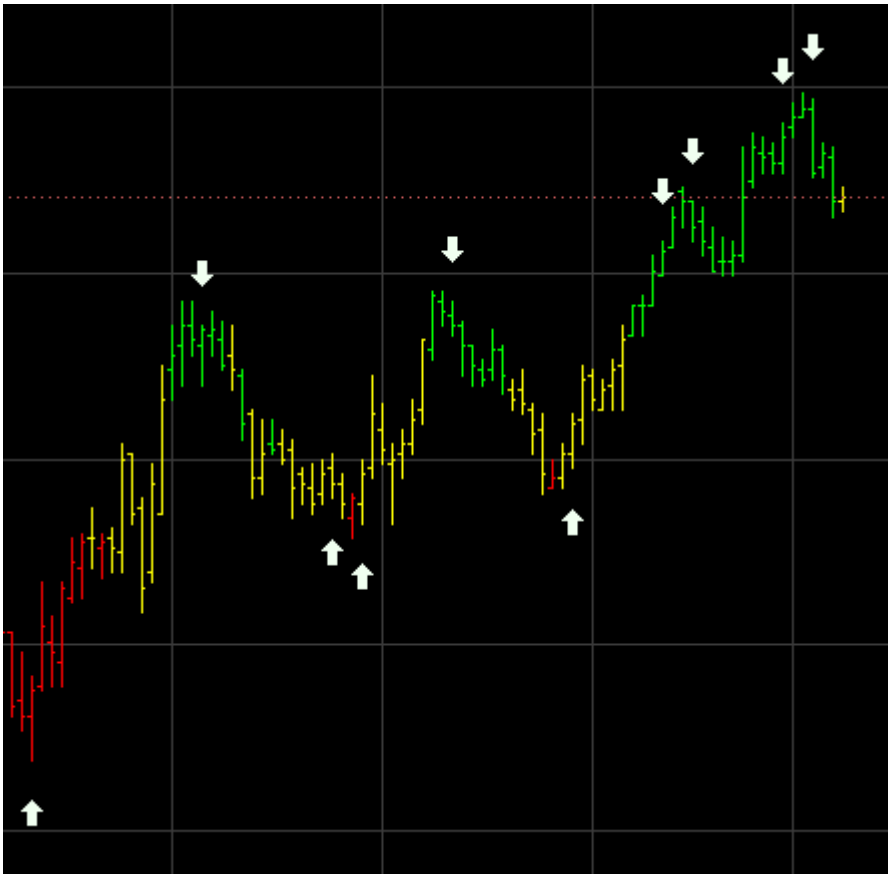
Here's my super-secret Fibonacci trading strategy:

1. Wait for the market to pull back to level C.
2. Place a stop ENTRY order at 23.6%, or 38.2% projection level.
3. Once stop entry order is filled, place stop loss order behind (C) Point. (This is your risk vs. reward ratio, or in other words, the amount of money you would lose if you got stopped out from where you entered.)
4. Place limit orders to exit and take profits at: 50%, 61.8%, 100%, 161.8%
5. Trail the market with multiple stop loss orders behind areas of support and resistance, Bulls 'n Bears Blue Light System, and/or PSAR/ATR Stop systems.

NOTE: You'll notice, if you look close at the next few actual chart examples, that the Bulls 'n Bears indicator is turned on too (Red, Yellow, Green bars). Look close, shhh, secret insight to the Bulls 'n Bears. Its technology is based on this same concept of Fibonacci/Elliott Wave counting, measuring and projecting, which is what makes the Bulls 'n Bears so powerful, we do all this crazy math and calculations for you, and then turn the price bars the color of the Fibonacci level...Bullish, Bearish, or Neutral.

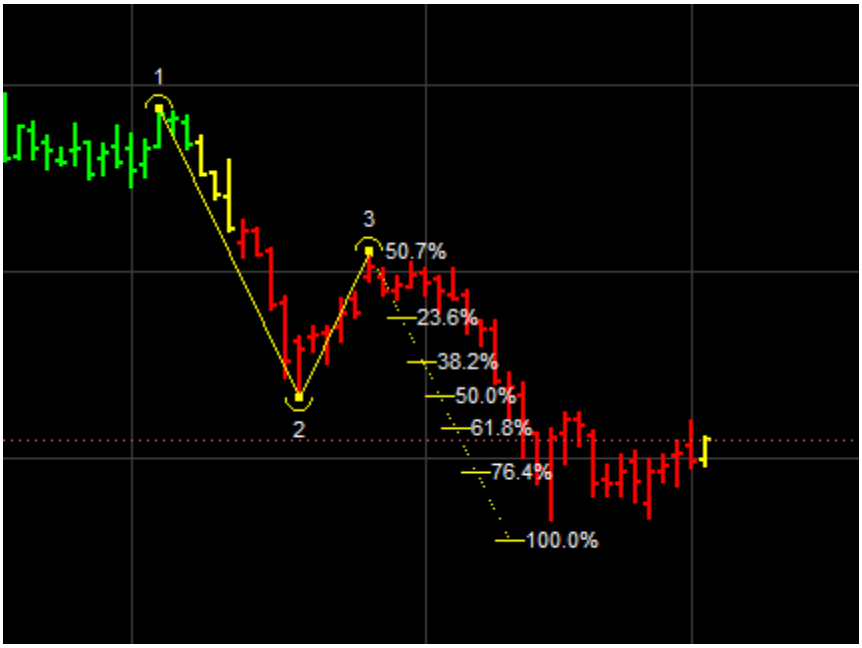


Tips & Tricks #1: Often times a market will be in a situation where you could project long, or short off of the Elliott Wave points, and the question becomes, “Am I Bullish or Bearish? Should I project up, or down?” I’ve seen very popular guru traders, in public demonstrations of Fibonacci struggle with these questions, which is, in my opinion, very simple to answer. Ask the Bulls ‘n Bears Indicator. Is the market currently Bullish according to Bulls ‘n Bears, or is Bearish according to Bulls ‘n Bears? AND, more importantly, where are we in our Elliott Wave count? Are we at the fifth (5) wave of the Elliott Wave? If so, let’s not project Bullish, let’s Project Bearish. (Many Fibonacci Gurus have yet to put 2 and 2 together, and have not yet figured out that Fibonacci is just a ruler to measure Elliott Waves. They have still left Elliott Wave out of their calculations and considerations.



Tips & Tricks #2: I mentioned earlier that I like to use Stochastics to help me find the rally points on the Elliott Wave, I'll mention that here once again in the Tips & Tricks section. Stochastics is one of the very best tools, that I've found, to help us identify the tops of rising Elliott Wave points. Try it sometime; you'll be amazed at how accurately it can help us identify the rally points. Using it in conjunction with the Fibonacci projection tool within Track 'n Trade is truly a 1-2-3 knockout punch!

Tips & Tricks #3: For those of you who like that sort of thing, just turn everything I just showed you upside down, and you can now use this same exact strategy for going short the market as well.



The tools that make it possible to trade this strategy are all created for you within Gecko Software's Track 'n Trade trading platforms, Stocks, Futures & Forex. Even the little projection tool has been created to help facilitate doing my super-secret Fibonacci trading strategy. Take a free trial online at: www.TracknTrade.com

Video's: Here's two video lessons to go along with this trading strategy. (I posted these videos here at the time I wrote this article, if you're reading this document, and these links are dead, write to me at lhturner@geckosoftware.com to get the updated links:

Video Lesson #1:
www.tradementors.com/lesson4-fibonacci.htm

Video Lesson #2:
www.tradementors.com/lesson5-fib-abc.htm

Mr. Lan H. Turner, is the President and CEO of Gecko Software, Inc., creator of the popular line of trading platforms known throughout the financial industry as Track 'n Trade.

Mr. Turner is also the Editor In Chief of PitNews Magazine, and founder of The Experts Trading Academy, found on the web at: www.TradeMentors.com, he's an accomplished author, publisher, and public speaker, having taught live trading seminars across the US, as well as internationally.

Mr. Turner has been working in the financial industry for over 18 years, and has taught his Stocks, Futures & Forex trading ideas and concepts to clients, professional traders, and brokers around the world.

Mr. Turner has also been invited to present at the Chicago Board of Trade and the Chicago Mercantile Exchange Education Centers on multiple occasions.

Mr. Turner is also the President of PitNews Press, and Editor in Chief of PitNews Magazine; he's an accomplished author, publisher, and public speaker, having taught live trading seminars across the US, as well as internationally.

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