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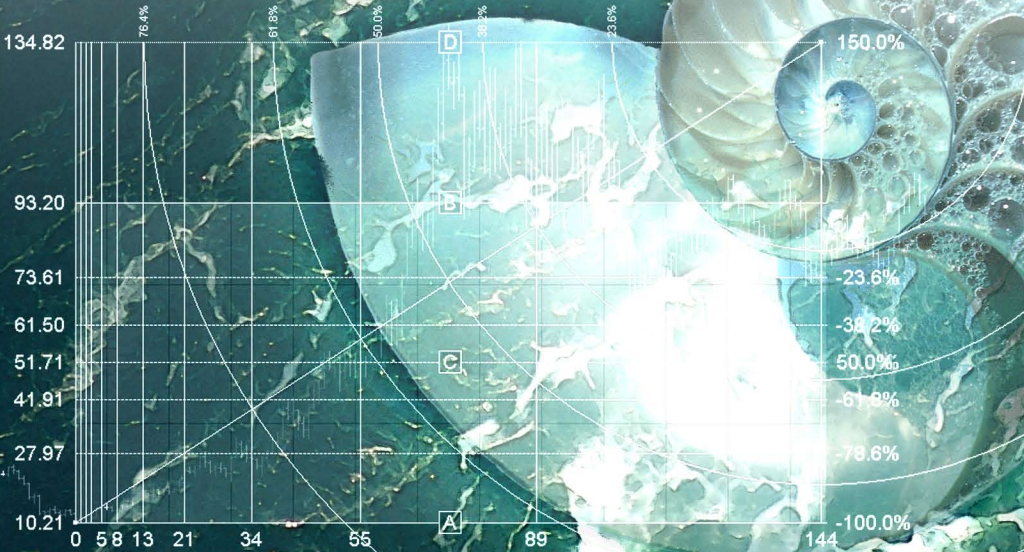
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*Magazine*

## Fibonacci and the Fan Principle

by: Lan H. Turner



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# Mid-Month REVIEW



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# *Fibonacci* and the Fan Principle by: Lan H. Turner

**A**ny serious market technical analyst should be able to give you a complete run-down on the history and uses of the infamous Fibonacci Ruler. Basically, we all know that the Fibonacci sequence was discovered by Leonardo Pisa, a medieval mathematician who lived between 1170 and 1250. Of course, the Fibonacci ratio starts with a simple math formula where a series of numbers are added one to the other, giving us the now famous Fibonacci sequence: 0,1,1,2,3,5,8,13,21,34,55,89,144...etc, where in the preceding two numbers are added together to get the third number, i.e.  $0+1=1$ ,  $1+1=2$ ,  $1+2=3$ ,  $2+3=5$  and so on and so on.

This famous mathematical formula is also known as the golden ratio, or as the Greek letter Phi.

So you may be asking, "What does all this have to do with me and how can it be used to make more money in the financial markets?" Mathematicians have long studied the usefulness of the Fibonacci sequence and numbers, and have found that one of its many uses is to bring order to chaos. In that regard,

many market analysts will tell you that the financial markets and their price fluctuations are a perfect example of chaos, having no structure or reason, but driven by immeasurable market forces

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***Mathematicians have long studied the usefulness of the Fibonacci sequence and numbers, and have found that one of its many uses is to bring order to chaos.***

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or human emotion and intervention. This is where the use of chaos theory, our Fibonacci sequence, or Golden Ratio comes into play. We use Fibonacci to help bring sense to chaos.

Take a look at the following chart...





To make use of Fibonacci mathematics in trading, we first apply the formula to a simple ruler. Notice that we lay the further most left point of our Fibonacci ruler in line with the bottom of the new rising trend. The correct placement is key to the accuracy of this tool. We then stretch the tool to the utmost top of the prevailing trend. These two points are identified on the ruler by the horizontal parallel lines A & B. We then see the market price reflected along the left column of the Fibonacci Ruler, and the corresponding Fibonacci ratios along the right column.

In this example, you can see that our price of gold completed the initial advancing forward wave at 669, where prices began to break down, giving back to the market some of its earlier gains.

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***One such retracement level that we as technical analysts watch for, more than any other level, is the 61.8% level.***

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One of the most useful methods for trading the financial markets is through the identification of reoccurring price patterns, and using the Fibonacci ruler is the simplest way of identifying one of our most powerful reoccurring price patterns, known as the Fibonacci retracement.

One of the highest degrees of commonalities that we find in the financial markets is through the use of and measurement of the Fibonacci ruler across multiple price levels established by the natural ebb and flow of the markets wave action. We have found that markets have a tendency to use these Fibonacci levels as areas of support and resistance. One such retracement level that

we as technical analysts watch for, more than any other level, is the 61.8% level. Here we find a much higher likelihood that a

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***Because we find that markets have a tendency to use the same levels of support and resistance time and time again, we are then able to make sense of what seems to be mere market noise and chaos...***

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market will retrace back to this level before continuing on in a forward price advance. Note that in our gold chart, this market

The combination of these two tools, which have been specifically designed to help us measure market dynamics, gives us one very powerful forward looking tool, allowing us to see "into the future" of the markets potential price and time.

made a perfect retracement back to the 61.8% level before advancing forward once again.

Being able to project out into the future and making estimates as to where we might anticipate the markets to go – and when in time they might arrive at those projected prices – has long been a strong point of interest to traders. Through the use of the Fibonacci ruler, and the corresponding speed fan principle of support and resistance, we can combine and make use of these two tools to give us a forward-looking projection of where



Charts courtesy of Track 'n Trade Pro. Visit [www.TracknTrade.com](http://www.TracknTrade.com) for a FREE Trial!

prices might be headed.

The traditional speed fan principle would have us lay our fan tool over the top of the corresponding market in much the same way we started our Fibonacci Ruler; the initial starting point

**To properly establish a forward-looking Fibonacci fan, follow these five simple steps:**

1. Place the Fibonacci ruler over the chart as indicated in the above example; locate and establish the lowest/highest point of a new trend then place the horizontal A line at the corresponding price level.
2. Watch for and establish the first peak of the initial market wave, which is where we place the corresponding horizontal line, labeled B, of the Fibonacci ruler.
3. As the market retraces back down the Fibonacci scale, you will need to continually move the vertical right edge of the ruler to match the right most price bar.
4. Once the retracement level has been established, optimally the 61.8% level, line up the right most column of the Fibonacci ruler with the lowest retracing price bar. A 61.8% level is optimal, but other Fibonacci retracement levels are acceptable and have been found to be very effective as well.
5. Draw in the Speed Fan tool over the top of the Fibonacci ruler, starting the speed fan at the same point as the Fibonacci ruler A point. Drag each speed fan trend line across the vertical Fibonacci axis of the ruler, extending the trend fan lines out into future levels of price and time.

being that of the lowest point in price and time of the newly established trend. We then extend the necessary fan extensions up through and beyond the price levels as dictated by the market. As it makes its way through price and time, we realize that the market has a tendency to use previous levels of support and resistance as new levels of support and resistance. Because we find that markets have a tendency to use the same levels of support and resistance time and time again, we are then able to make sense of what seems to be mere market noise and chaos; this is done through the use of tools specifically designed to count and measure the markets' dynamic price structures as they are being built.

In the following three examples, you can see we've placed the Fibonacci ruler over the top of the corresponding market. We've established a full retracement back to the 61.8% level, where we now anticipate a continuation of the overall market trend. It is at this point that we combine these two fascinating tools together to establish future price and time projections. By intersecting the speed fan lines with the horizontal and vertical crossover axis of the Fibonacci ruler, we create a Fibonacci Fan, which basically gives us a roadmap or guide as to where we can anticipate forward looking price projections.

*Lan Turner is the president of Gecko Software, Inc. – creators of Track 'n Trade Pro and Track 'n Trade High Finance, which are two software applications dedicated to helping people not only trade the financial markets, but learn the techniques necessary to profit from them.*

*Mr. Turner is also the Editor in Chief of PitNews Magazine, owner of Chartbook.com and StockAnnual.com, plus he's an author, trainer, public speaker, columnist, and publisher of numerous educational videos, books and multimedia CD-ROM's that teach traders how to navigate the financial markets.*

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# Example 1: Gold



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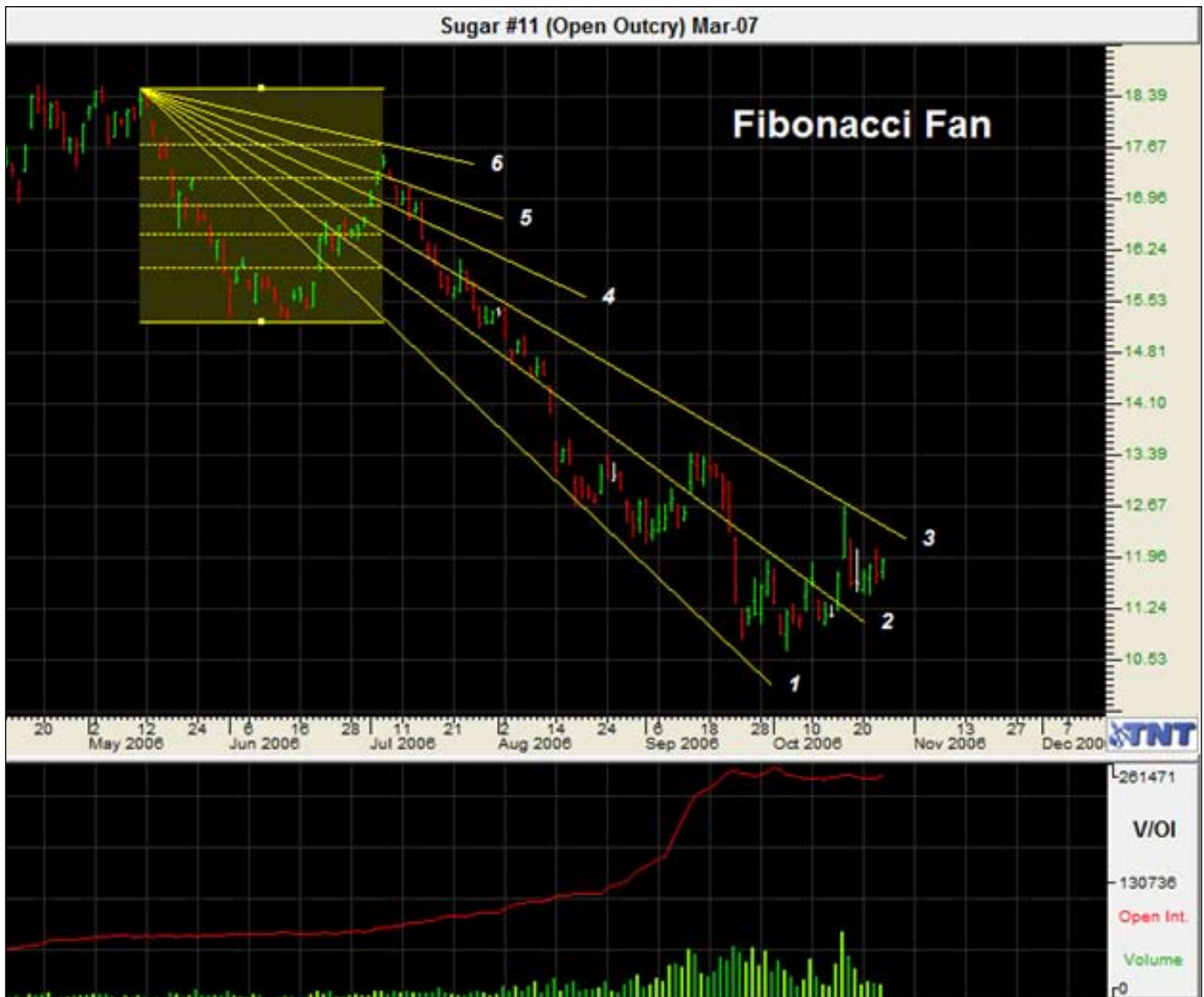


# Example 2: Silver



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# Example 3: Sugar



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March 2007

# COMMODITY TRADER'S ALMANAC

## Mid-Month Update

By: Scott Barrie



In the last Commodity Trader's Almanac we discussed the prospects for Coffee, Sugar and Cocoa. All of these markets tend to be under pressure this time of the year. Coffee prices are pressured by harvest and slowing Northern Hemisphere demand, while Sugar prices tend to be pressured by harvest and increasing available supplies. However, the market that is typically hit the hardest by harvest pressures is Cocoa.

### Cocoa Overview

The Cocoa tree thrives in the lower growth of the evergreen rainforest where the climate meets the following conditions: average temperature between 66 F to 92 F, average monthly rainfalls in excess of 1500mm, a high degree of humidity, and shade. These conditions only exist along the equator, as illustrated in the following table:

Top 5 Cocoa Producers		
Rank	Country	% of Total
1)	Ivory Coast	38.0%
2)	Ghana	19.0%
3)	Indonesia	13.0%
4)	Nigeria	5.0%
5)	Brazil	5.0%
World Production in Thousand Tonnes		3504
Source: <a href="http://www.commodityalmanac.com">www.commodityalmanac.com</a>		

The largest Cocoa producing nation is the Ivory Coast, or Cote d'Ivoire, which produces over a third of the world's Cocoa. In total, Africa produces over half



## Major Cocoa Growing Areas



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the world's Cocoa, despite the fact that it originated in South America.

The Cocoa tree typically produces two crops each year. In Africa, the main Cocoa harvest runs from October to March, which is roughly five to six months after the wet season. The mid-crop harvest runs from May through August. The main crop accounts for roughly 75 to 80% of the total Cocoa produced, while the mid-crop accounts for the remaining 15 to 20%. The influx of supply at harvest tends to pressure prices in most years.

Price pressure on Cocoa futures can readily be seen by the fact that May '07 Cocoa futures have declined in 13 of the last 15 years from 12th trading day of March (03/16) through to the 11th to last trading day of April (04/17).

## Technical Outlook

However, this year may be somewhat of an anomaly, as Cocoa prices are rallying as harvest has progressed, instead of breaking

### HYPOTHETICAL PERFORMANCE RESULTS May Cocoa Futures Changes in \$/Ton Enter Approximately March 16th / Exit Roughly April 17th

Entry Date	Entry Price	Exit Date	Exit Price	Closed P&L (pts)	Closed P&L (\$)	High Price	Low Price
3/16/06	1511	4/13/06	1418	93	\$930.00	1523	1410
3/16/05	1829	4/15/05	1495	334	\$3,340.00	1850	1483
3/16/04	1474	4/16/04	1336	138	\$1,380.00	1562	1330
3/18/03	2054	4/15/03	1866	188	\$1,880.00	2070	1843
3/18/02	1543	4/16/02	1518	25	\$250.00	1578	1447
3/16/01	1028	4/16/01	970	58	\$580.00	1088	949
3/16/00	935	4/13/00	815	120	\$1,200.00	947	783
3/16/99	1232	4/16/99	1054	178	\$1,780.00	1237	1051
3/17/98	1626	4/16/98	1572	54	\$540.00	1689	1540
3/18/97	1459	4/16/97	1400	59	\$590.00	1532	1370
3/18/96	1223	4/16/96	1327	-104	(\$1,040.00)	1362	1209
3/16/95	1346	4/13/95	1303	43	\$430.00	1375	1281
3/16/94	1243	4/14/94	1132	111	\$1,110.00	1250	1101
3/16/93	903	4/16/93	907	-4	(\$40.00)	953	874
3/17/92	1057	4/15/92	917	140	\$1,400.00	1088	914

			In points	In \$'s		In points	In \$'s
# Trades	15	Total P&L	1433	\$14,330.00	Max Draw	-139	(\$1,390.00)
# Win	13	Avg. P&L	96	\$955.33	Avg. Draw	-43	(\$427.33)
# Loss	2	Avg. Win	119	\$1,185.38	Min. Draw on Win		
% Win	87.5%	Avg. Loss	-54	(\$540.00)		-88	(\$880.00)

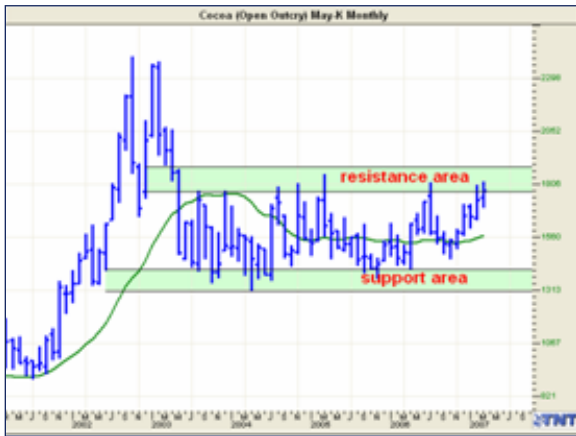
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as they normally do. The mixed nature of the market can be seen in the daily and monthly charts.

### Daily



### Monthly



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The daily Cocoa chart (CC2007K) is showing a mixed trend, with higher highs and lower lows. Though prices have been slowly moving higher, indicators such as slow stochastics (SSTO) have been trending lower, forming a potential divergence. Typically in a healthy uptrend, stochastics will make corresponding highs to prices. When they don't, it can be a sign of market weakness.

This short-term sign of weakness is occurring as long-term prices are in a major resistance area. For the last 3 ½ years, Cocoa futures have been in a major sideways channel. Prices have oscillated between \$1300 and \$1870/ton. The current supply/demand situation is not radically different from previous years, hence the recent trading range in Cocoa may well continue.

It is against the backdrop of a weakening technical picture of short-term and long-term resistance that traders may wish to view the current seasonal situation in Cocoa. Traders might consider establishing short Cocoa futures positions in line with the seasonal tendency for lower prices this time of the year if prices show signs of weakness – such as a violation of 1750 to the downside.

*Scott Barrie is a former floor Chicago floor trader who currently publishes the Commodity Almanac's Seasonal Strategies Newsletter. He is also a well respected author of several books: 2007 Commodity Trader's Almanac, the Complete Idiot's Guide to Options and Futures and The Complete Idiot's Guide to Market Timing. His firm, Commodity Futures/Forex and Equity Analytics (CFEA) does research for major brokerage firms, clearing firms and proprietary traders. For more information, visit [www.CommoditySeasonals.com](http://www.CommoditySeasonals.com)*



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