1.6 - Fibonacci & retracement zones

Understanding Fibonacci

The Fibonacci sequence — 0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89… — is a series where each number is found by adding the two before it. Identified in the 13th century by Leonardo Fibonacci, though the sequence was known and used hundreds of years before (even in Egyptian architecture).

The Golden Ratio

The golden ratio **0.618** (or its inverse 1.618) is derived from the Fibonacci sequence and appears throughout nature — from atoms to galaxies, honeybee populations (female/male ratio = 1.618), sunflower spiral rotations, and even human body proportions (shoulder to fingertips ÷ elbow to fingertips ≈ 1.618). It's been used for centuries in art (Mona Lisa), architecture (pyramids), and design (Twitter logo).

The Fibonacci Levels

Dividing a number by the next in the sequence gives the key ratios:

- 21 ÷ 34 = **0.618** (61.8%)
- 21 ÷ 55 = **0.382** (38.2%)

The key retracement levels: **0%, 23.6%, 38.2%, 50%, 61.8%, 78.6%, 100%**

Note: The 50% level is NOT actually a Fibonacci number. It's included because of Dow and Gann theory — and human psychology. If you see a "50% off" sale, you automatically gravitate towards it. Financial markets work the same — when something is half price, people perceive it as a bargain.

Fibonacci Retracement Strength — The "Discount" Framework

Each Fib level tells you something about the strength of the underlying trend. Think of it as a sale:

Fib Level	Discount	Trend Strength	Meaning
23.6%	~24% off	Very strong	Buyers jumping in at a tiny discount — massive demand
38.2%	~38% off	Strong	Buyers stepping in at a modest discount — still strong demand
50.0%	50% off	Normal	Human psychology — half price attracts buyers naturally
61.8%	~62% off	Weak	Buyers waiting for a big discount before stepping in
78.6%	~79% off	Very weak	Needs to be nearly 80% off before anyone's interested
Below 100%	Full retrace	Reversal	No discount is enough — trend is over

The key insight: If successive retracements go deeper and deeper (38.2 → 50 → 61.8 → break), the trend is weakening. Each time, buyers need a bigger discount before stepping in. When even an 80% sale won't attract buyers, the trend is done. This is how you can use Fibonacci to see a trend weakening before it fully reverses.

Example: Bitcoin showed successive retracements getting deeper — 382, then 500, then 618, then broke entirely. The trend was weakening with each leg, and Fibonacci showed it clearly.

How to Draw Fibonacci Retracement

In TradingView: Left toolbar → 2nd group down → arrow → **Fib Retracement** (or Alt+F shortcut).

In an Uptrend (Looking for Support)

1. Identify market structure is bullish (HH/HL)
2. Find the **major swing low** and **major swing high**
3. Click from the **low (100%)** to the **high (0%)** — wick to wick
4. The levels show where you can expect support on the pullback (23.6, 38.2, 50, 61.8, 78.6)

In a Downtrend (Looking for Resistance / Profit Targets)

1. Identify market structure is bearish (LL/LH)
2. Find the **major swing high** and **major swing low**
3. Click from the **high** to the **low**
4. The levels show where you can expect resistance on the bounce (where to take profit)

Critical Rule: Draw Wick to Wick

Always draw from the wick of the low to the wick of the high (or vice versa). Not candle bodies.

The Golden Pocket — The Zag Zone

The **382-618 zone** is called the "golden pocket" or the "zag zone." This ties directly back to Dow Theory: the secondary action is a 1/3 to 2/3 retracement of the primary move. The Fibonacci 382-618 range IS that 1/3-2/3 zone.

Nine times out of ten, the zag will come down to the golden pocket.

Every zag (correction) in a trend should retrace back to somewhere in the 382-618 zone. This is where you look for:

- Support in an uptrend (buying opportunity)
- Resistance in a downtrend (profit-taking / exit point)

Using the Zag Zone for Profit Taking

The zag zone isn't just for entries — it's essential for exits. In a downtrend, when price bounces, expect the bounce to reach the 382-618 zone of the prior down move. That's where you take profit or look for weakness, because the bounce may just be a zag before more downside.

Only two things can happen at the zag zone:

1. It's just a zag (correction) and the prior trend resumes → price rejects at 382-618
2. It's the beginning of a new trend → price pushes through the 618 on increasing volume

If price gets above the 618 on strong volume, it becomes more likely the bottom is in and a new bull market is starting. Until then, treat every move into the zag zone as potentially just a correction.

The Forecasting Process

1. **Identify your zone** — draw Fib from the move, mark the 382-618 zag zone
2. **Watch for weakness** when price reaches the zone — bearish divergence on RSI and OBV, declining volume, reversal candlestick patterns
3. **Wait for confirmation** — change of market structure (reversal pattern) at the zone
4. **React** — take profit, exit, or enter based on the confirmed setup

If price retests the zag zone, drops out, then retests the bottom of the zone again — that's usually a sign the price will continue to fall away.

The Bread and Butter Setup — Combining Everything

ASX Trader's process for entries:

1. Price moves into a Fibonacci support level (382, 500, or 618)
2. The move into the level happens on **lowering volume**
3. **Bullish divergence** appears on OBV
4. **Bullish divergence** appears on RSI
5. A **change of market structure** confirms the reversal (double bottom, failure swing, or non-failure swing)

That's the complete setup — Fibonacci level + weakening volume + OBV divergence + RSI divergence + reversal confirmation. Don't just buy because it's on a Fib level. Combine everything from the prior five weeks.

How Markets Move: Zigs, Zags & Three Steps Forward

The Zig-Zag Pattern

Markets never move in straight lines. They **zig** (move in the trend direction) and **zag** (retrace). The zag comes back to the golden pocket (382-618) before the next zig.

Apple example: From the tech bubble bottom in 2003, every single correction came down to the golden pocket zone — 618, 500, 618, 618, 382, 618 — and bounced. Knowing the golden pocket for a strong fundamental company like Apple, Microsoft, Google means knowing where to look for buys.

Three Steps Forward, Two Steps Back (Simplified Elliott Wave)

The market moves in a rhythm: **one, two, three forward — then one, two back.**

Each forward move consists of:

- Zig 1 → Zag 1 (golden pocket) → Zig 2 → Zag 2 (golden pocket) → Zig 3

That gives you three zigs with two zags between them. After the third zig:

- The market doesn't just correct the last zig — it **corrects the entire three-zig move**
- The correction comes back to the golden pocket of the WHOLE move (typically to the bottom of the "wave 4" area — the bottom third of the final zig)

Connecting to Dow Theory Phases

The three zigs ARE the three phases:

- **Zig 1 = Accumulation** (breakout from the base)
- **Zig 2 = Public Participation** (the big trending move)
- **Zig 3 = Excess** (the blow-off top)
- **Then the whole-move correction** = Distribution/Bear market (corrects back 1/3-2/3 of the entire move from accumulation bottom to excess top)

This pattern repeats fractally: three small zigs make one medium zig, three medium zigs make one large zig, and so on. The major correction events (tech bubble, GFC, COVID) are the "two steps back" from the bigger three-step pattern.

Fibonacci Clusters (Advanced Confluency)

A Fibonacci cluster is when multiple Fibonacci levels from different timeframes or different moves overlap at the same price area. This creates a much stronger support/resistance zone than any single Fib level.

How to Find Clusters

1. Draw Fib retracement on the **recent move** (e.g. daily timeframe, COVID bottom to top)
2. Zoom out and draw another Fib retracement on the **larger move** (e.g. monthly timeframe, entire trend)

3. Look for where levels from both overlap — e.g. the 618 from the recent move aligning with the 382 from the whole move
4. Draw a rectangle box around the cluster zone — that's your high-probability support/resistance area

Microsoft Example

The 618 retracement from the COVID bottom overlapped with the 382 from the entire move. This created a cluster zone. Microsoft (a trillion-dollar company) bounced off this cluster zone — two independent Fib levels both pointing to the same area of support.

Cluster zones are stronger than single Fib levels because you have multiple independent mathematical reasons to expect support/resistance at that price.

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