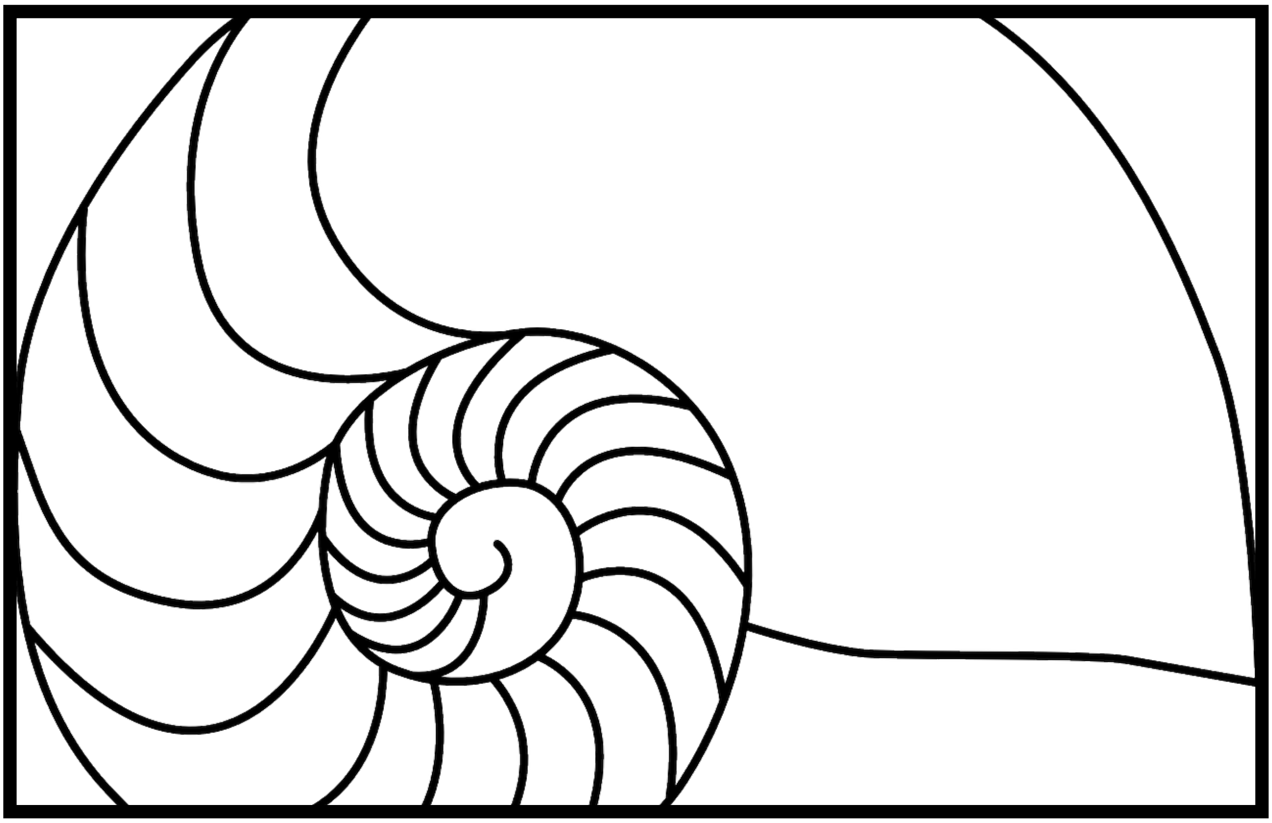
Fibonacci and Clouds

Advanced Technical Trading Strategy Using Fibonacci and Ichimoku Kinko Hyo for the Philippine Stock Market



Ichi Moku

1st Edition

To the Fallen Trolls of PSE,

Who risked their name and reputation

to help save others from getting burned by the hype.

Only to be ridiculed and kicked out of forums

And be branded as Bashers and Uneducated Trolls of some type.

*To those burned alive by the dreaded **Frank Candle**…*

That one candle that burns them all…

This book is dedicated to you.…HueHueHue.

To all my #FREnds…Pope, OOS, Kidlat, Slim, JW, Jhery, Hero, Frank, Washer.

Most importantly,

To my wife and kids,

For being there, no matter what.

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Introduction

My objective for this book is to allow you to open to just about any page in the book and find the trading strategy or idea that you can apply immediately, without having to go back and read from the start of the chapter. The goal of this text is to help you truly understand the risk and identify potential, as well as gaining a solid foundation on the use of Fibonacci and Ichimoku Kinko Hyo Trading System.

Most of the traders rely on the power of TA, or Technical Analysis, but there are those newbie traders who used a different type of TA, commonly known as *Tsismis/Tanong Analysis*, and failed to realise that they are becoming the milking cow of the guru that they follow. As you structure your portfolio and trading strategy, don't be afraid to come out of your comfort zone and look for alternative methods of gathering information and strategy.

Depending on your particular experience in trading stocks, you will have a preconceived notion about how useful the trading tools are to you. Even if you have been an extremely successful trader, keep your mind open to the trading strategy i am presenting, as this might help you improve your trades more by adding conviction to your analysis. The ideas, techniques, and strategy in this book are not the only solution available, but they have worked for me for many years and may make a good addition to your existing arsenal of trading tools. No one has the "holy grail" to technical analysis; you simply need a good action plan and a sound risk management system to succeed.

Although there is no perfect way to trade stocks, there are many wrong ways to do it. I learned a lot of valuable (and expensive) lessons along the way, and I hope to show you the system that i learned the hard way so that you can avoid the major pitfalls of *bad* trading.

Also realise that this book could not possibly contain every single thing you need to know about trading stocks, so if you have a question or if you don't feel completely comfortable with a concept or strategy, be sure to ask questions! I am available at www.iamichimoku.com, my Facebook page Ichi Moku, or Twitter @iamichimoku, if you need a helping hand or if you are looking for further depth on a subject.

This book was designed exclusively for trading the Philippine Stock Exchange (PSE), where short selling securities are not allowed as of this writing, and the only opportunity you will get a profit from a downtrend market is by catching the *Technical Bounce.* The concept of trading is the same if used in other financial market i.e. Forex, but the difference is that you won't see much of shorting example and trades in this book. I will update this book once the system used by PSE had been updated to cater for the requirement.

There are other good books about Fibonacci and Ichimoku Kinko Hyo, and there are training courses available as well, giving you all there is you need to know about their trading system. If someone would come to you, telling you that their system is fool proof and can give you guaranteed success, then be extremely cautious.

Always remember that there is only YOU and the MARKET, and nothing in between. A lot of traders have failed from trying to make a fortune out of stock trading, so you have to be very careful when you decide to trade and always respect the market. There are no magic solutions or shortcut to success in this field. This endeavour would involve a lot of hard work, dedication to learn and lots of practice, practice and practice. Always strive to learn the technique that would suit your personality. At the end of the day, it all boils down to profits.

I am fully convinced that Fibonacci and Clouds Trading System (FaCTS) will give you a good edge in trading. You have to get to know it, trust it and use them well to be successful.

May the odds be ever in your favour.

“***Ichi Moku***"
April 2016

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This book contains PSE charts and links to other resources on the internet. These are provided as aids to visualise what was being discussed and to help you identify other resources that may be of interest to you. The chart is owned by Amibroker (www.amibroker.com), and I am neither affiliated or associated with, nor am i endorsed by them.

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Chapter One:

Fibonacci Trading

This chapter will introduce the concept of Fibonacci trading in order for you to have a good and solid understanding of the different Fibonacci Tools used in doing my technical analysis, particularly the Fibonacci Retracement, Extension and Fan. By utilising the above mentioned tools, you will learn how to forecast the potential projection and derive a viable plan based on the scenario presented. This chapter will also discuss the different trading strategies involved in using the Fibonacci tools mentioned above, and integrate some of the indicators that complement it to increase your level of conviction.

If you know the enemy and know yourself, you need not fear the result of a hundred battles. If you know yourself but not the enemy, for every victory gained you will also suffer a defeat. If you know neither the enemy nor yourself, you will succumb in every battle.

—Sun Tzu

Part 1: Buy and Hold Strategy

You might be wondering why i included this on the first topic to discuss, and the reason is that i want to show you that the so called *Buy and Hold* or *Buy and Pray* strategy is not always the wise and smart thing to do. Many people still believe in this old concept of trading, and i've seen (and met) a lot of p caeople that are convinced that this is the only best way to make money in the stock market.

They'd be very easy to identify, as you'd here them say things like "*I want to be like **Warren Buffet**!*" or "*I am a long term investor!",* or "*Just average* down, *it'll come back eventually*" being repeated over and over again. They believe that by buying and holding shares of a good company for a certain number of years, they'll be able to beat short term traders, whom most of the time, are viewed as *gamblers*.

Just look at the sample chart of the PSEi below, from 1991 to 2003, to show why *Buy and Hold* or *Buy and Pray* isn't always a wise strategy to use.

Imagine you bought a stock on 1991 when the index was still around 940 level, and just held on to it. Based on the above chart 10 to 12 years later, your profit will still be close to zero. You might say my hindsight is 20/20 using this example, but the point of this is to prove that even if you've invested in shares in one of the biggest company in the Philippines, there is still no guarantee that you will make a profit in the long term. Imagine, 12 years of holding, and your profit is barely 1%! I wouldn't be happy if it was my money.

You could then say that had you held on to it further, you may be able to triple your money again. You could be right, but there is also the possibility that you could be wrong as well. If you have nothing to base your analysis other than hope, and Madam Auring's Crystal Ball and Tarot Cards, then the chances of success would be low. It's comparable to trying to find the survival rate of a person who doesn't know how to swim, and will be thrown out in the middle of the sea, with no floatation device or anything to cling on to.

Am I encouraging everyone to drop the notion of a buy and hold strategy? Yes, I am. Not only should you drop the idea, but you should also learn when to cash in your profits. The same thing should apply to cutting your losses. A doctor may decide to sever a limb if he finds it to be the only means to alleviate suffering and save the life of the patient. Cut loss is used to protect your portfolio from further damage. A loss of 5% is way better than 10%, 25,% 50% and 90%, isn't it? When choosing between two evils, i would choose the lesser one.

Furthermore, in my opinion, Buy and Hold strategy only applies during the Bull Market, where every stock has the highest probability of going up. The moment the market switches from sideways to down, the strategy is deemed to fail, with all your profits just going down the drain until you're left with nothing If you still choose to keep doing the Buy and Hold strategy, then this book is not meant for you.

Part 2: Why Fibonacci?

The main reason why Fibonacci is the tool i prefer the most is because this is a ***leading indicator****,* which means that you can identify the potential support and resistance of the price before it even happen. You can *forecast* the direction, identify critical support and resistance and project the price action before the price even move.

Compared to ***lagging indicators,*** i.e. MACD, Moving Average Crossover, etc., to name a few, the movement is based on the price from the past. What this means is that the price had already moved before you start seeing the *confirmation*. The disadvantage of using a *lagging indicator* is that a significant move may have already occurred before the indicator provided the signal, which could result to the trader entering a position too late, such as the example below.

The above daily chart of $BPI showed the comparison of the *leading* and *lagging* indicator side by side. The lagging indicator's buy signal is when 9MA crosses over 20MA. The leading indicator's buy signal is when 38.2% is broken as resistance. The trade goes as follows, with the numbers marked on the chart signifying below sequence:

1. When the price closed above the 38.2% point triggered a buy signal to a Fibonacci trader however, will not open a trade yet due to the low volume that do not support the breakout (we'll discuss this later). The buy conviction was confirmed two candles later

when the price managed to stay above the 38.2% Fibonacci ratio. There is still no sign of crossover from the MA to trigger a buy.

2. The trend was later confirmed to be strong when the candle broke out of the 61.8% Fibonacci resistance. The MA Crossover strategy confirmation to buy was only triggered after the closing of this candle.

3. On the selling side, the Fibonacci Trader already knew where the potential selling point would be and already planned the exit when the 113% resistance was not even reached, more so, a bearish candle formed. A break of 88.6% Fibonacci support would trigger the selling, booking profit from the trade. No sign of selling from the MA crossover was seen yet.

4. The MA crossover only triggered the sell signal after a couple of candles from the above selling point, ending up with losses due to delayed reaction.

Did you notice how the trader that uses MA Crossover entered too late, and sold too late as well. Compare that to the entry level of the Fibonacci trader, as well as the exit. A trader who used Fibonacci is able to get the most out of the move from the moment it breaks out, and in many occasions, exit almost exactly at the end of the move.

Based on the above example, we can see how a Fibonacci retracement can provide some of the information a trader would need, from the entry point up to the projected target price. Don’t worry if you don’t understand Fibonacci just yet, as the objective of this book is to get you up to speed.

Part 3: Fibonacci: Who, What, How?

Before we move on further to our discussion, i just thought we'd learn a little about the man behind the trading system that we will be using. Don't worry, this would be quick. I guarantee that after this short topic, we'd go straight to trading.

Leonardo Pisano Bigollo (or Leonardo of Pisa) was born in Pisa, Italy around 1170, and was the son of a customs officer in the present-day Algerian town of Béjaïa named Guglielmo Bonacci. He introduced the sequence in his book ***Liber Abacci,*** and he was more commonly known today by his name *Fibonacci,* which was short from the latin word *Filius Bonacci* (Son of Bonacci).

In Fibonacci's *Liber Abaci* book, he introduces the following problem (based in L.E. Sigler's translation[1]):

How Many Pairs of Rabbits Are Created by One Pair in One Year

A certain man had one pair of rabbits together in a certain enclosed place, and one wishes to know how many are created from the pair in one year when it is the nature of them in a single month to bear another pair, and in the second month those born to bear also.

Then, he goes on to explain the solution to the above problem:

Because the above written pair in the first month bore, you will double it; there will be two pairs in one month. One of these, namely the first, bears in the second month, and thus there are in the second month 3 pairs; of these in one month two are pregnant and in the third month 2 pairs of rabbits are born, and thus there are 5 pairs in the month;

…

there will be 144 pairs in this [the tenth] month; to these are added again the 89 pairs that are born in the eleventh month; there will be 233 pairs in this month.

To these are still added the 144 pairs that are born in the last month; there will be 377 pairs, and this many pairs are produced from the above written pair in the mentioned place at the end of the one year

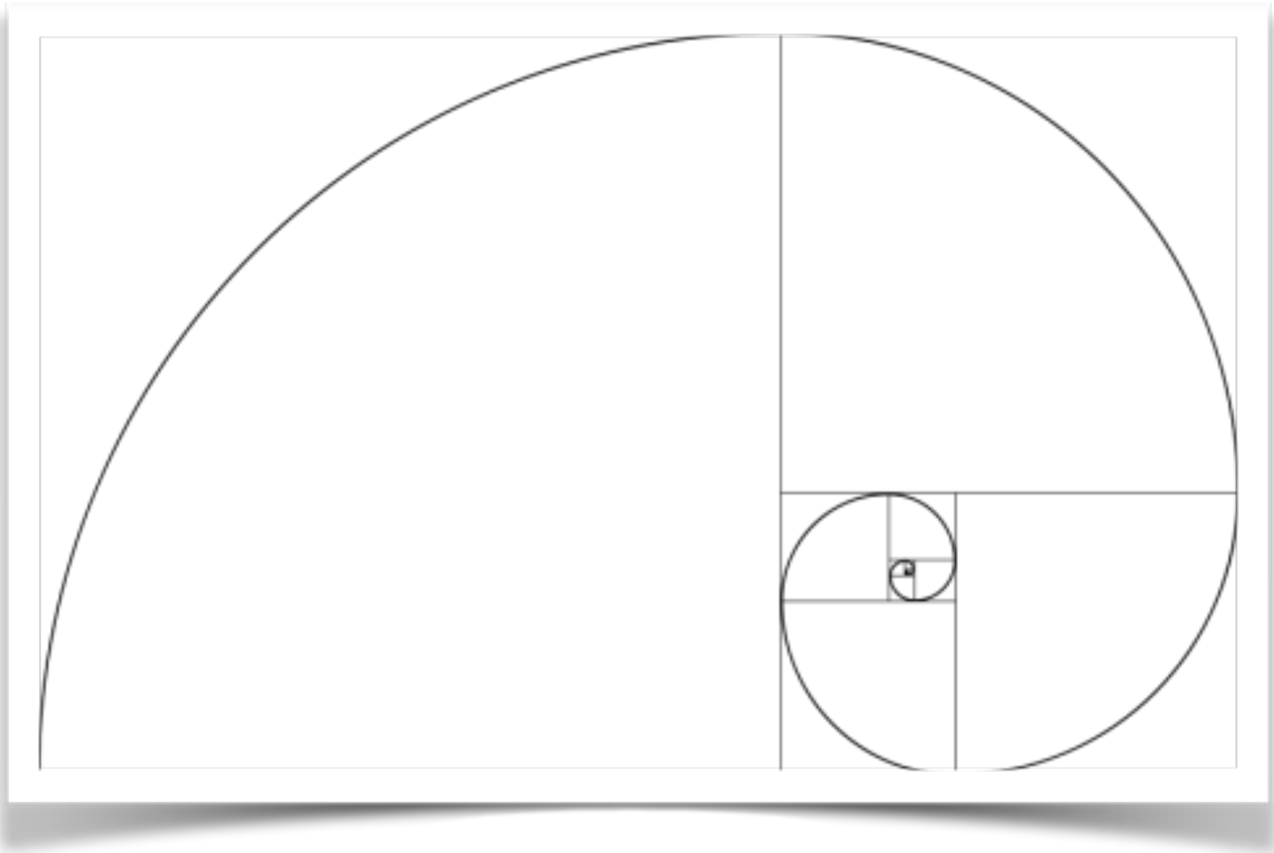
And from the above, we write the number sequence as below, which is what's known as the Fibonacci Sequence;

0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377…

[1] *Fibonacci's Liber Abaci: A Translation into Modern English of Leonardo Pisano's Book of Calculation by Laurence E. Sigler, New York:Springer, 2002*

The sequence was derived from the sum of two successive numbers from the left, to which we use the following examples: 5+8=13, 8+13=21, 13+21=34, 21+34=55, and so forth.

The sequence above is more than just numbers, because if you will delve deep into the world of science, art, architecture and mathematics, you'd be amazed on where you can find the Fibonacci sequence. The nautilus shell on the cover of this book is one representation of Fibonacci, wherein if you will put a block of square to corresponding to a number from the sequence and drew an arc along the middle of each box, you'll form what's known as the Fibonacci Spiral (see image below).



I'm sure you've seen this before, like the Eye of the Storm? The Milky Way Galaxy? The branches of a tree also uses Fibonacci, and even the solar system.

Moving forward, if the entire universe follows the natural order of things using the Fibonacci sequence, would it work in the world of stock market? The answer is yes, and it had been around since time immemorial. And you might be wondering how in the world could the Fibonacci sequence above work in the stock market, and the answer is by using what is known as *Fibonacci Ratio*.

How do we get the Fibonacci Ratio? By dividing the same two numbers that we added in the sequence, and vice versa. The result is what is known as *The Golden Ratio* or *The Golden Mean.*

5/8 = 0.62; 8/13 = 0.615; 13/21 = 0.619…233/377 = 0.618

No matter which successive pair I choose up to the millionth number, the result will *always* be the same…0.62 approximately, or equivalent to 61.8% Fibonacci Ratio.

Now, let's try the reverse, and this time, let's see what would be the result.

8/5 = 1.6; 13/8 = 1.625; 21/13 = 1.615 … 377/233 = 1.618

And just like the exercise we did earlier, it will be somewhere around 1.618, or equivalent to **161.8%** ratio.

The above-mentioned ratio is what we call *The Golden Ratio* or *The Golden Mean*, and because of this relevance directly to the Fibonacci sequence, you will see a lot of it while we go along this topic.

Fun Fact: Venus takes 225 earth days to revolve around the sun, while Earth travels around the same for 365 days. Can you guess their ratio?

There are other Fibonacci ratios that we will be using besides the *Golden Ratio,* and that's where were heading right now. I will only focus on the ratios which I very commonly used, however, you are free to research and use other ratios as well. Remember that my way is not the only way.

Using the same sequence, if we move two places forward and divide it, we will arrive on another Fibonacci ratio, and that is the 38.2% ratio.

5/13 = 0.384; 8/21 = 0.38; 13/34 = 0.382; 21/55 = 0.382; 34/89 = 0.382; 55/144 = 0.382

If you will go back to the above image of Fibonacci Spiral, assuming the entire length is equivalent to 1, the bigger half is 61.8% of the entire length, and the remaining half is 38.2%. This applies to all sections of the box.

And just like what we did on our earlier exercise, we will reverse the procedure and we will come up with another value that is generally a part of our list of ratios commonly used, the 261.8%.

13/5 = 2.6; 21/8 = 2.62; 34/13 = 2.61; 55/21 = 2.62; 89/34 = 2.62; 144/55 = 2.61

To summarise the above calculation, the Fibonacci Ratios that we will be using mostly based on the above calculations are **38.2%**, **61.8%**, **161.8%**, and **261.8%.** There are other ratios that we are going to use that doesn't have any relation or whatsoever with the sequence, however, these ratios had been proven thru time by a lot of Fibonacci traders to have significant effect with price, which we will discuss in the coming parts of this chapter.

The above mentioned ratios will be the basic set of ratios that we will be using, hence i suggest that you adjust your trading platform you use the same, i.e. ChartNexus, Amibroker, etc. If your broker platform do not have this feature to adjust the values, there is a free platform that i would highly recommend that has all the tools that we will discuss in our book. You can visit and register for free at www.investagrams.com. It's free to use and data is in real-time, with the only absence of intraday data.

Part 3: Getting Serious…

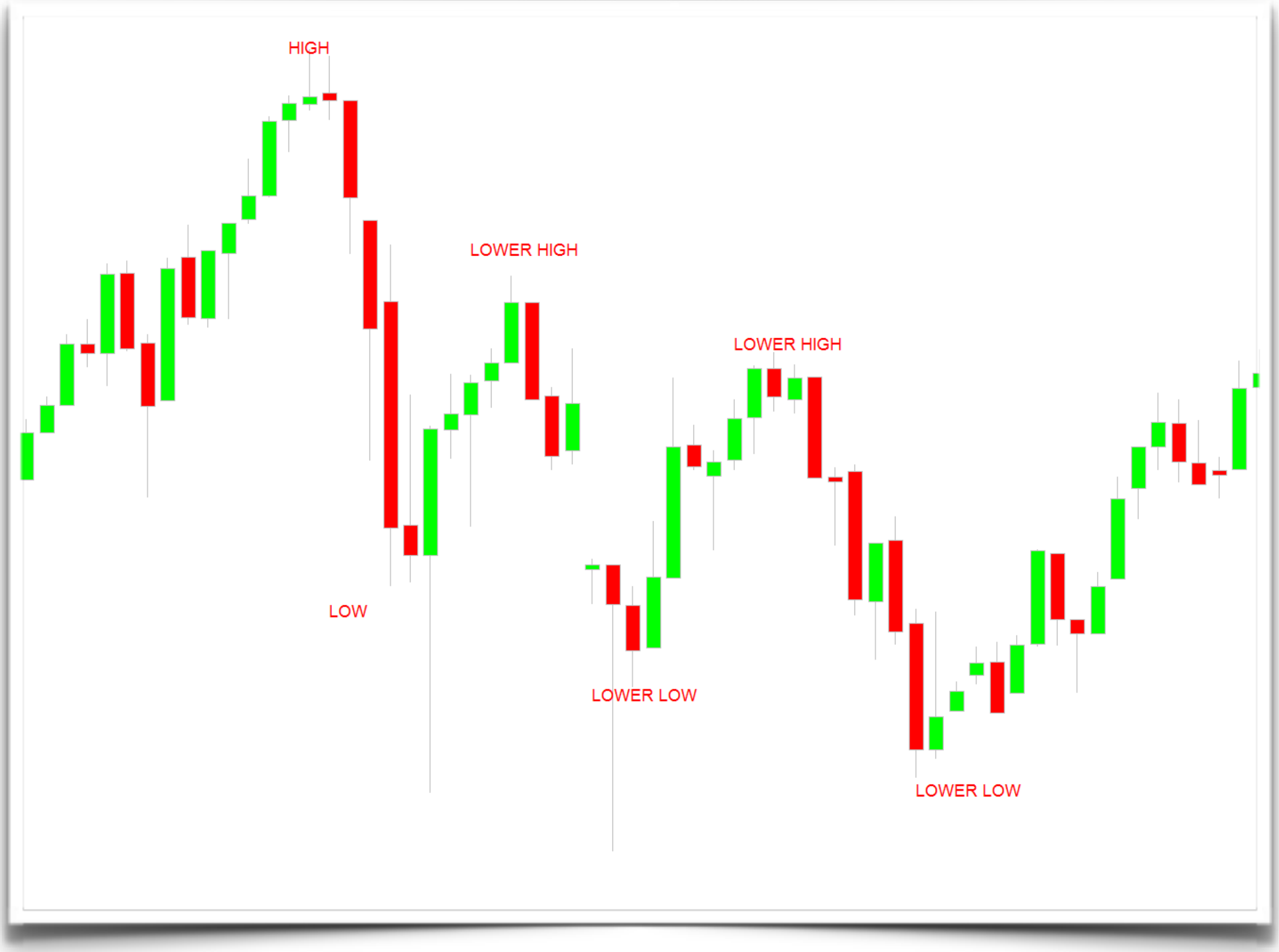
Before we get serious with Fibonacci retracement, we need to know the basics first. And what is the basic? Identification of price action. A lot of people tend to think that the price only moves in two directions, and that is either up or down. Many failed to realise that statistically, only 30% of the time does the price move in a trend, either on an uptrend or a downtrend, and the rest is just moving sideways. This usually happens when there is no strong trend present, the price will just move sideways.

Many people would say that there is no opportunity on a sideways market, and i would say it would depend on your trading style. If you're more of the investor type, then definitely this is not for you. Trading a range usually is for traders, particularly day traders (a.k.a. *Tsupitero)* or swing traders.

Since we mentioned that the trend doesn't just go in one direction, an uptrend will not be moving up most of the time, and vice versa. There will always come a time when the price needs to retrace, sort of like resting when climbing a mountain before proceeding to the final destination. If it moved forward and stopped at a higher level, this is a good indication that the trend is moving and strong, showing the "higher high" or "higher low".

You can see from the above chart the sign of an uptrend movement, with the highs moving higher, and so does the lows.

The same applies on the downtrend forming a lower high and a lower low, like the image below, it will give us a strong conviction that the prevailing downtrend is strong.



There are also some unusual cases when the price would suddenly go straight up or down, leaving a gap sometimes (such as the case of TAPET). This mostly happens when there is some good or bad news causing euphoria or panic to investors. Albeit the chart looking promising for a potential bounce, trading it is very hard because you have to be at the right place and at the right time before it happens. To make matters worst, shorting and stop loss is not available in our market, hence you have to be monitoring most of the time.

The examples above should give you a pretty good understanding of trend identification, as this gives us an idea of the direction of the trend, and from there, we adjust our trades according to what we see. If you were able to identify the highs and the lows, I am confident that you will be drawing fibonacci retracement like it was nothing new.

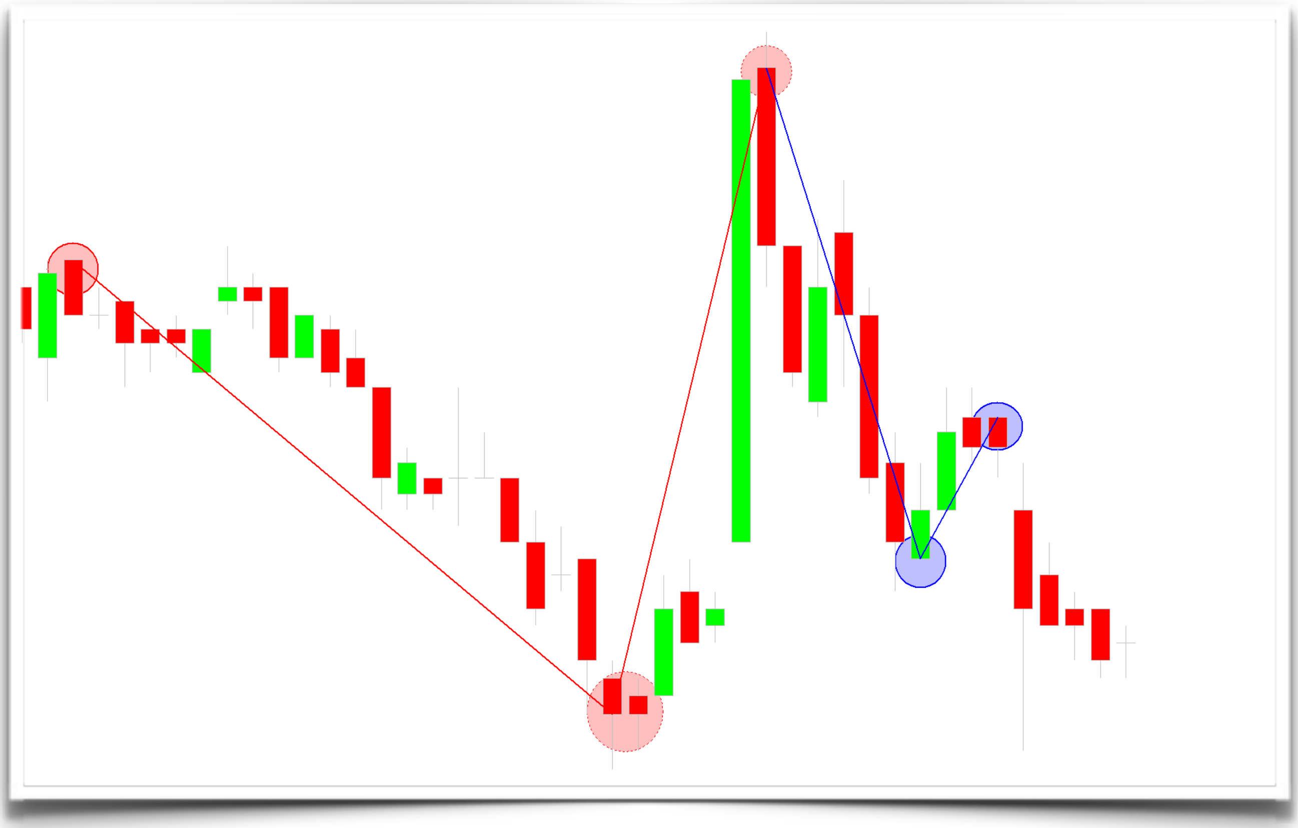
At first, Fibonacci Retracement may seem to be too complicated, but i will assure you that it's not. If you've watched my Youtube video about Fibonacci Retracement, then you surely have a pretty good understanding that i do it differently. I am hoping that you will be one of the few "different" people who will use this common tool differently.

Part 4: The Fibonacci Ratios

From the above topics that we discussed, we should now move to putting everything into perspective, and that is using the Fibonacci tool known as retracement. As we all know, price do not move on a straight line, but instead move like a zigzag pattern. Some traders call it wave, and that is because they are a practitioner of Elliott Wave Theory. Whether it is called wave, zigzag or whatever, only one thing is certain: we know for a fact that what goes up will go down eventually, and vice versa.

To draw the retracement, simply follow this steps and you'll be a pro in no time. I'm not exaggerating…it's how easy it is.

1. Identify the swing high and low reference to base the retracement. The chart below shows how easy it is to identify the swing high and low. To make it easier, i drew a line to connect the high and the low swing, and that will serve as my marker to do the next step. Although lines are not really required, i just use it for reference in identifying the swing. Size doesn't matter, but it will depend on the type of trader you are. Smaller swings will have more volatility compared to the bigger one, so if you're risk level matches it, then include that on your list.



2. Next step is to select the Fibonacci Retracement Tool from your trading platform and use the high and low as your start and end point. On the image below, i used the swing on the left side as my reference to show how it is done. Once you start dragging

the retracement tool, make sure you follow the direction of the identified leg to measure retracement, such as below chart showing a downward direction, hence we start from the high and ended with the low, as marked by the Start and End points. This retracement will measure how strong is the upside reversal of a stock, showing where the strong resistances are. You can try doing the reverse on an upward moving leg starting at the bottom.

One important thing to always keep in mind is NEVER plot a Fibonacci Retracement on an unfinished leg. ALWAYS wait for a confirmation of reversal i.e. a green candle following a downtrend, or a red candle at the end of an uptrend to mark the end of the swing and the start of the reversal. The reason is that the analysis you will derive from there has no basis because the swing is not complete yet. I've seen a lot of traders doing this, which leads to them getting hyped or bashed by their own analysis.

Always remember that the purpose of Fibonacci is for us to identify the nature of this move, and how deep or high the retracement will go. All we simply need to identify is the high and low of the swing, and we will be on our way. It's that easy. However easy it may sound, remember that there are a few points that we need to observe to maintain a consistent reading and prevent a costly mistake due to a biased analysis. These are as follows[2]:

[2] *Lee, R, 2015. Top 4 Fibonacci Retracement mistakes to avoid. Investopedia [online], Available at:<http://www.investopedia.com/articles/forex/11/fibonacci-rules.asp> [Accessed: 03 November 2015]*

1. Don't mix Fibonacci Reference points

This is probably the most important point that we need to follow consistently, as i've seen a lot of traders committing mistakes because of this. When we say *do not mix*, then don't mix. What this means is that when you start plotting your retracement and used the wick of the candle to start your retracement, all the wicks should be considered in all your analysis.

However, for me, i prefer to use only the candle body, which makes me unique with the rest of Fibonacci users. The reasoning behind it is that candle wicks do not show the actual support or resistance. The wicks are merely exaggeration of sentiment during a particular trading session which could be due to a bad earnings report, acquisition, etc. which caused the investors to either panic or become euphoric, hence i never considered it as basis for identifying resistance or support.

You will notice on our example chart of $FNI above how the price respected the strength of 38.2% and 61.8% resistance when none of the candles managed to close above it, which indicates consistency. Notice also the body of the candles almost closing on the

Fibonacci lines, this gives us a more solid conviction on the level of support and resistance because most of it are in line with the Fibonacci ratio. You are, however, free to use the wicks if that suits you the most, and all your analysis should include all the wicks. But you cannot mix, as that will signify a biased analysis and will not provide a consistent result.

2. Don't ignore long term trends

Most of the problem faced by newbie traders is that they ALWAYS get affected by the short term price action, which most of the time either gets them whipsawed or book profit early.

The chart of $PSEi below shows an example of the short term and long term scenario. A small Fibonacci was drawn around May 2013 to show the short term trend. If you'll notice, the chart broke all major support, suggesting that it is already in a downtrend. However, when you plot the long term trend starting October 2012, it had only broken one major support, and recovering after, which suggests that the uptrend is still strong.

By using Fibonacci on the longer timeframe, the trader is able to identify the direction of the trend and plan accordingly for the opportunity presented.

3. Don't rely on Fibonacci alone

Fibonacci will give you a lot of information, from strength of the trend to potential support/ resistance levels before it even happen. However, you need to match it with an indicator that would give you a confirmation to enter or exit a trade and increase your conviction on the likelihood of success of your trading setup. If you do not use any other indicator with your Fibonacci, there is a strong possibility that you may end up 'hoping' that the setup will work.

These indicators could be anything, as long as you know how to use it and it will not give you confusion more than conviction. The system we are using rely mostly on a specific indicator that had proven itself to complement the Fibonacci and Clouds Trading System, and we will have a topic exclusively on how to use it.

4. Don't use Fibonacci over short intervals

As mentioned above, the long term gives you more opportunity to identify the momentum and general direction of the trend. A short interval have lots of volatility, and in case you are new to it, it's not advisable to venture in this path. Reason is because if you will use Fibonacci on a short interval, there is a strong possibility that you will be stopped out early, only to be surprised by a rally after your cut loss level gets hit. You will have difficulty finding a good trade setup when all your supports and resistance gets skewed every now and then.

If you will look at the longer time frame, you will not bothered by the daily volatility because each weekly candle, for example, comprised of 5 daily candles already. You will see clearly where the price is heading, and the potential support or resistance. You can easily establish a good trade setup when you look at the bigger picture.

Fibonacci Retracement can be a pain to learn at first, but just like everything else that's new, i don't expect you to get a hold of it the first time. When you were given a bicycle when you were young, nobody expected that you'd be able to pedal your self without assistance in a day. Practice makes perfect, however, you need to make sure that what you're practicing is the proper way of doing it.

I highlighted above all the points that needs to be observed to properly and effectively use this tool. Take time to practice identifying the highs and lows and plot the retracement. Once you get the hang of it, the rest will be like a walk in the park. I encourage you to practice so that your eyes will get used to finding the setup and will be easier for you to spot a good or a bad trade once we get to the good stuff.

Fibonacci Levels

You then ask the million dollar question: What Fibonacci Levels Should I Use?

There are a lot of Fibonacci levels that we can use, however for the time being, we stick with the basics, as that is the most important. Once you get the hang of it, then you can start adding more that you think would complement your analysis. The basic levels that we will be using are the following: **38.2%, 50%, 61.8%** and **161.8%**. These alone should be enough for you to identify the strength of the trend, breakout and breakdown level. The other Fibonacci levels that we will be using in addition to the above are the **78.6%, 88.6%, 113%, 127%, 140%** and **161.8%.**

Of all the levels discussed above, the **38.2%**, **61.8%** and **161.8%** are the levels that we would be giving more of the emphasis. Don't worry about the rest, we will still have a special section that would include them, however, these levels are just too special that a

Fibonacci Trader must know. I will explain the concept behind the levels, and how you'd be able to interpret a Fibonacci Retracement to aid you in your trading decision.

The 38.2% Level

This level is probably the most important level that everyone should be watching because this decides whether a price will be strong or week during a reversal. There are characteristics that are not only specific to these levels, but to **61.8%** and **161.8%** as well, and these are as follows:

1. On an uptrend reversal, when a price breaches this level by closing above it, the usual reaction on the next trading day is to retest it as support. If the level managed to hold, then that is a sign that the trend is doing well and strong. Furthermore, this is only the time where i encourage you to look at the volume because if the price breached it with a volume lower than the previous trading days or just within the same level, the chances to hold as support is very low.

2. If the price did not retest the level as support, that is a sign of a strong reversal.

3. If the price failed to even close below 38.2% on a reversal, then expect the price to break out in the future because that is a sign of strength. This characteristic is only exclusive to 38.2%.

In the below example chart of $GMA7, we showed the three characteristics that we explained earlier.

- By looking at the small Fibonacci Retracement on the upper left, it showed the price wasn't able to reach 38.2% retracement, to which the result is as expected, a breakdown.

- The bigger Fibonacci on the right then showed the price successfully broke out of the 38.2% and managed to close above it with a good volume. What follows it should not surprise us: a retest of that level as support. It seemed to have managed to hold during the retest, however, if you notice the volume to be decreasing, this suggests that the trend is still weak as there are no buyers willing to protect it.

- When it broke as support, however, the same characteristic still applies. A break of 38.2% support will usually require a retest as resistance, and it succeed the next day. But then again, when you look at the volume and it is low, there is a very low chance that the support will hold on the next retest, to which was confirmed by the next candle.

- Lastly, on the far right, it managed to break out of the 38.2% resistance. If you noticed the absence of retest as support, this suggested the strength of the trend increasing. The volume is the validation, when it showed the volume increasing as the price move further up.

Below is a another chart, this time of $FNI, and by looking at this, it should be a no brainer already. Three times it failed to reach 38.2%, and three times it broke down, showing how the natural order of things work in the financial market.

The 61.8% and 161.8% Level

These level serves as the confirmation of the trend, meaning, it could either act as a breakout or a breakdown confirmation. If the 38.2% gets broken as resistance, a break of the 61.8% resistance will confirm the strength of the uptrend, or a breakout. The same goes when 38.2% gets broken as support, the 61.8% serves as the *line in sand,* or a breakdown. As mentioned above, the same characteristic of 38.2% applies to 61.8% and 161.8% as well, with the exception of the third characteristic that is only applicable to 38.2%.

In the example above of $FNI, the Fibonacci on the left showed the breakdown when it gapped down, breaching the 61.8% retracement. As mentioned above, this level usually requires a retest, and when the retest failed due to lack of volume, it then confirmed the signal provided by the 38.2%. The same applies to the Fibonacci on the right.

As for the 161.8% level, a break of this level either as support or resistance further increases the strength of the preceding trend. Notice above chart where the two Fibonacci on the right overlaps, the price was stopped out exactly by the Golden Ratio, which suggests that the preceding trend is still weak, which then usually resulted to a rapid decline of the price.

There are other examples that you can look up, i.e. PPC Daily Chart 02 July to 16 July leg and PSEi Monthly Chart May 2013 to July 2014, to name a few. On the PSEi chart you'll see the characteristic of 161.8% when broken as resistance, required a retest. When it failed to hold as support, a rapid decline followed. The chart of $FNI above showed the left Fibonacci with 161.8% being broken as support. Retest followed as resistance, and when it broke, a rapid incline of the price followed.

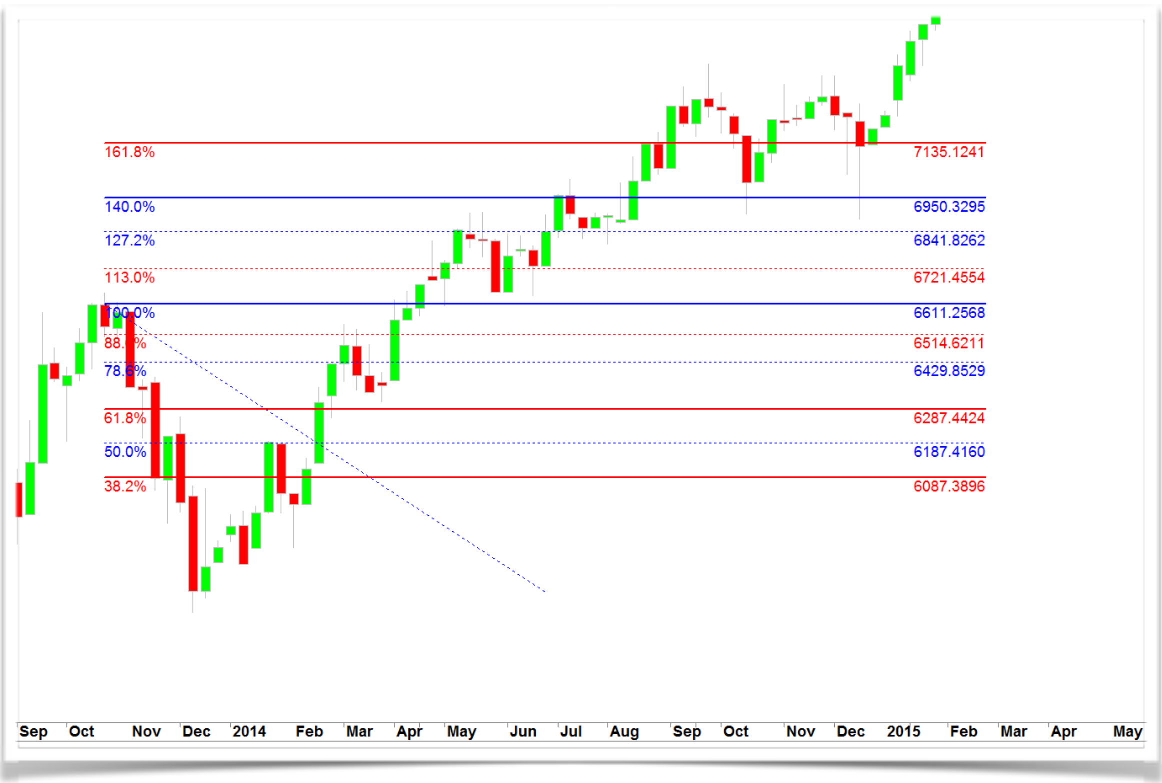
Based on the examples above, I have shown you how consistently the price moves based on our basic Fibonacci retracement, and how we interpret the price movement using it. I've seen a lot of people plotting the Fibonacci Retracement, however, most of them only see the value of it being a support or resistance tool. There's nothing wrong with how they use it, however, it's just that they are not utilising it to its fullest potential.

The Other Fibonacci Ratios

There are other ratios that we will be using that would act most of the time as support or resistance levels. They do not have the same characteristic as the basic set of ratios we discussed above, however, it is essential to know since most of the price action do respect these levels. As we go along this chapter, we will discuss about the AB=CD pattern developed by H.M. Gartley, where you will be seeing much of the other Fibonacci Ratios which are as follows: **50%, 78.6%, 88.6%, 113%, 127%, 140% and 161.8%.**

As i mentioned earlier, these levels merely act as support and resistance. However, there are two of those on the list that has a special connection to the basic Fibonacci Ratio which will give you a heads up of what's going to happen next, particularly after the **61.8%** level gets breached, either as support or resistance. These levels that i'm speaking of is none other than the **88.6%** and **113%.** These two levels act as the next strong support or resistance after the 61.8% level gets broken.

Of course, it would use 78.6% during the process, however, the 88.6% is usually the level where the price reverses the most, after 61.8%, followed by 113%. This means that you have to watch these levels closely, as there is the possibility that the price gets rejected by these levels, and push the price back.



The usual scenario once the price gets rejected by 88.6% is that it tends to go back to 61.8% and retest that level as support. If the price managed to stay above 78.6%, then there is the possibility of a continuation, to which 113% will be the next target. Should 113% reject the price from moving further, the support that we will consider is, of course, 88.6%, and a break of the latter could then push the price back to 61.8%. A successful breakout from 113% would then be met by 127%, then followed by 161.8%.

Above example of $PSEi Chart summarises all that we've discussed so far. The initial breakout of the 38.2% was met by a retest as support, to which it failed initially. The next attempt to breakout wasn't followed by a retest, suggesting the strength to be increasing. When it broke out of the 61.8%, a retest that followed confirmed the strength to be increasing when it managed to hold as support.

What usually followed the breakout of 61.8% is the 88.6% which is the next strong resistance to watch, and as seen on the chart, rejected the price from moving further. It moved back towards the 61.8%, but did not touch it, which shows the strength of the prevailing trend. After the breakout of 88.6%, then the 113% almost rejected it when a shooting star appeared, only to be invalidated by the next candle. Then the 127%, the 140% and 161.8% showed a bit of rejection. The chart also showed the characteristic of the 161.8% that acts like 38.2 and 61.8%, requiring a retest, and after it managed to hold as support the next time, only then it moved further away.

To summarise what we've discussed, the 38.2% level gives the signal of a possible strong reversal. The 61.8% level provides the confirmation of the signal provided by the 38.2%, while the 161.8% validates the strength of the trend. After this, try to look for any stock and see if the same characteristics that we mentioned is consistently being reflected by the price action.

For me, Fibonacci is more than just the basic support and resistance which most traders utilised it for. I've explained to you in detail the concept behind it, which would give you another perspective when using the tool.

Now that we've learn how to draw the retracement properly, the biggest question still lingers, and you're already too anxious to ask: When do we buy? Since everyone's risk profile is different, i'll give you different options on when to spot the opportunity to buy. It will be you who will decide which one would you choose to employ on your strategy.

If you're still struggling about plotting the retracement, i have a YouTube video that you can watch to aid with your studies. You can visit https://www.youtube.com/watch?v=116cWHyjDwU

Part 5: When to Buy and Set Stops

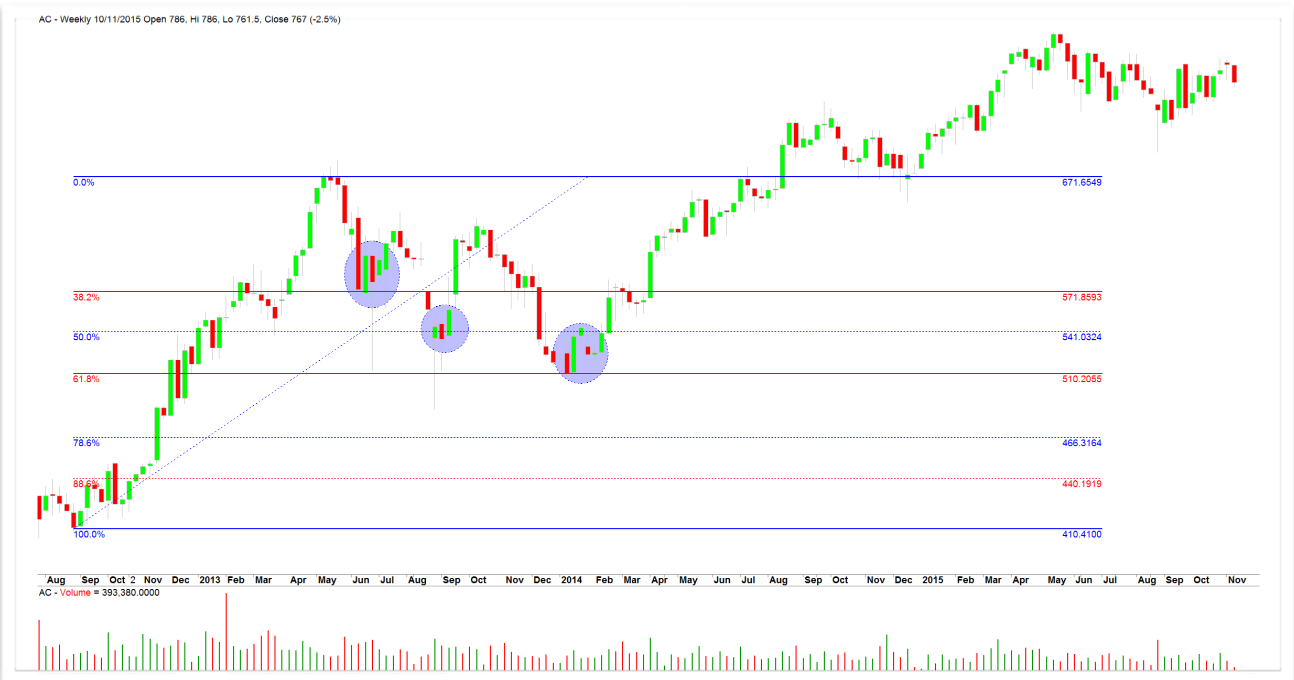
You might be wondering again why this topic is about Buy and Stops, and not Buy and Sell. The reason is simple: buying strategy is different from selling, hence i will provide a dedicated section for that matter. Another important thing to remember is to set stop loss, and you'll start to question why we need one. The reason is again simple: to protect your capital from further losses in case the trade went against you.

There are no guarantee in trading that your analysis will always materialise. If there is, then a lot of people may be rich already. As you are fully aware already, trading stocks, forex, etc involves a huge amount of risk, and with this warning, you should always consider using protection, and that is the Stop loss.

Now that you are familiar with drawing the retracement, you now have an opportunity to enter a trade on a much better price, which is always a good thing, isn't it? With that in mind, i'll give you three (3) options on when to buy, which are as follows:

1. High Risk Trading

This type is for the trader who wants to take big risks which in turn could possibly give a big return as well. If that is you, consider below setup: when the price almost touch the 38.2%, 50% or the 61.8% as support level (marked by the circles), you execute a Buy order. These levels, as we know, are strong supports, however, there is still no guarantee that this will be a bounce.



Having looked at the right side of the chart, you see how high the price went, however, there really is no guarantee when you're in that situation, should you choose this option.

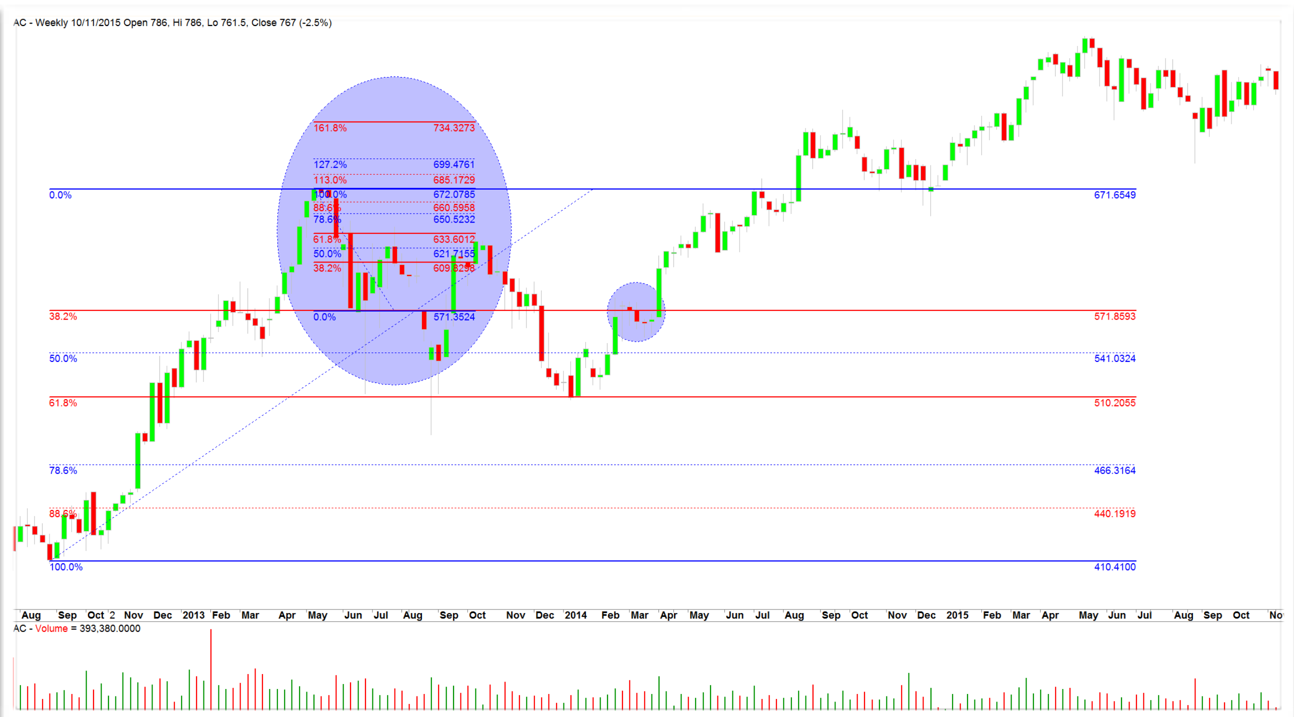
Take the 38.2% bounce, as an example. It made a good recovery from that level, only to be shortlived and a break down happened. The same thing happened on the 50%, it bounced, and again was shortlived and failed again. The last one, 61.8% managed to hold and retested 38.2% resistance many times, and after breaking it, then and only then it continued to move higher. In an actual trade, you really wouldn't know if any of these support levels will hold, or the breakout will be a false one. However, if you happen to be right, then the possible profit may be big as well.

2. Medium Risk Trading

This type is for the traders who would like to have confirmation from another fibonacci level or any oscillator being used before he/she starts buying one. From the same chart, a medium risk trader would not just buy when the 38.2%, 50% or 61.8% levels showed some bounce, but would rather wait for a confirmation instead.

Just like the first option, when the price managed to hold around the 38.2% retracement, the medium risk trader would plot another fibonacci retracement (large circle) to measure the strength of the bounce, and will only consider buying if, and only if, the price would breakout of the small 61.8% retracement, or a confirmation was given by another indicator. On the case below, since it failed to breakout of the 61.8%, no buy order was given and the trader was spared of some possible losses due to breakdown.

Even if the price managed to bounce from the 61.8%, this trader will still not buy unless a breakout from the 38.2% is registered (small circle). Confirmation is not always correct, however, your chances of failure is low. The ratio of risk vs possible reward would be good, because you considered a confirmation prior to executing an order to buy.



3. Low Risk Trading

The third and final option is designed for those who just want to play it safe. It's not because they're scared or anything, but rather their risk tolerance is lower than the rest. This type is for trader who would buy only when the previous high gets broken because there is a good chance that the move will continue. This type of trading is the safest one, however, because you came in late, expect the gain to be the smallest among the three options provided.

Personally, i trade using Options 2 and 3, depending on my capability to monitor the market due to my full time work. If i won't be able to monitor for a week, then i would choose the third option, and if i can monitor on a daily basis, then option 2 is the preferred choice. You don't have to follow my style. Remember that trading is personal, and what works for me may not work for your, and vice versa.

Now the question is, which option would be best suited for you? As i mentioned earlier, you will be the one to decide and select which one fits your personality because it would depend primarily on your trading skills and risk tolerance. Ask yourself how much risk you are willing to take, and if you have a good confirmation signal that you can really rely on and follow without hesitation.

As the saying goes, experience is the best teacher, and with that in mind, I would suggest you try all three options if you haven't decided yet the type that would fit your personality, and later on decide which one you like the most and can give you the most profit overall.

By using the simple techniques above, this opens your eyes to the different opportunities of buying and you won't just be buying blindly by asking in different forums, or asking different market technicians 'when' it's ok to buy. The above techniques will enable you to wait for a better entry price, which has been our objective. Furthermore, do not try to catch the bottom as that will be close to impossible and very hard to do.

If you identified the retracement and saw the opportunity based on the above-mentioned techniques, i would say you will be ahead of many other 'investors' because you will not be just asking when to buy, but rather you may have already bought when they started asking it in different forums.

When to stop/cut your losses?

Part of a good trading strategy is identifying not only the buying and selling point, but when to stop or cut your losses. The fibonacci retracement is a great tool when placing stop loss, so look no further. The same line that you drew to identify the potential entry will also give you the information you need to exit, should the trade go against your analysis.

Stop loss will also depend on your personality, however, you have to remember that a stop loss that is too tight from your entry point may get stopped early, only to be whipsawed to continue the movement based on your analysis. What i usually do, and would highly suggest, is to use the next fibonacci level below your entry point as your stop loss so that it gives the price more room to move and will only confirm the moment that level is broken. If you want it tight, then a break of the closest fibonacci level from your entry price can be used as well.

Another thing to consider is the time frame you used on your analysis. If you used the weekly chart to identify the trend, your cut loss level should be based on the closing of the daily. The reason is that the next candle for the weekly is still being formed by the daily, and a cut loss using the intraday may provide a false signal. You might lose some during the process, but at least it is confirmed that the trend is now against you. You can simply sell the next day at the open. If you used daily to identify the trend, then you should cut your losses on the intraday. I know it's easier said than done, and believe me, it's for your own protection.

There is another method of setting stop loss level, and that is by identifying the risk reward ratio. Do not go for a trade that would give you a 1:1 ratio, meaning, you risk to lose 1 peso for a 1 peso profit. Including commission, et.al., you will still be negative after you close that trade. A 1:2 profit is just about breaking even, barely a profit left after all the charges had been deducted. The best is to go with 1:3 risk reward ratio, at the minimum. When you use this ratio on your trading, you have to identify your profit objective the moment you draw your retracement (we'll do that in a bit). Once your target price is already identified, you simply divide that into 3, and whatever is the result, you simply subtract it from your entry price.

You can also do the reverse of identifying the level where you are comfortable at setting as cut loss level, and just multiply it by at least 3 to identify your target price. If that is close to the price projection, then you already have a basis. As i said, minimum is 3, you can use 5 if you want, but make sure it is feasible and based on your projection, and not just some random number taken out of thin air.

Using the same chart of AC above as our example, if the profit objective from your entry point of 510 (61.8% Fibonacci) is around 770 (you'll find out why later on), then that would give us a 260 difference (770-210=560). Simply divide 260 to 3 and that would give you roughly around 85. Subtract 85 from your entry price of 510, will give you around 425 as your cut loss level.

If you're aiming for a 1:5 RR Ratio instead, simply divide 260 by 5, and would give you a much tighter stop of around 50, moving your stop loss higher to 460. You might say that stop loss is too much, but believe me, if you're aiming for that much profit, the risk of losing 6% for a reward of 50% is justifiable.

As I always tell my students, never, ever press the buy button unless you have a solid plan in place. You should try not to be controlled by your emotions, as this most of the time causes a trader to fail. Simply plan your trade, and trade your plan. I'm not trying to make a robot out of you by removing your emotions into trading, but rather making you understand the risk and be prepared for any unforeseen outcome along the way.

As the saying goes, "Forewarned is Forearmed", and "Prevention is better that cure", do not attempt to go into battle without any plan of action, worst, not knowing how to defend yourself. If you'd say those who did these are nuts, then believe me, if the stock market is an actual battle, there are already a lot of casualties. Furthermore, don't think that your knowledge of Technical Analysis will serve as a bulletproof vest and will make you invincible. Your knowledge will only make you wiser, that is, knowing to wait for the perfect opportunity to make that kill.

Before we proceed further, i suggest you go straight to the chart and familiarise yourself of what we've discussed so far. Plotting the Fibonacci Retracement is one important tool that needs to be mastered, as this will decide the outcome of your trades from this day forth. If you're consistent in easily identifying the swing, then go ahead and move on to the next part. If you're still having some trouble, take your time. I would suggest you create a note of all your analysis, which for now will only identify the entry point and stop loss. As we go along the book, we'll start to add more details into it, and further strengthen you conviction.

Part 6: When do we make money?

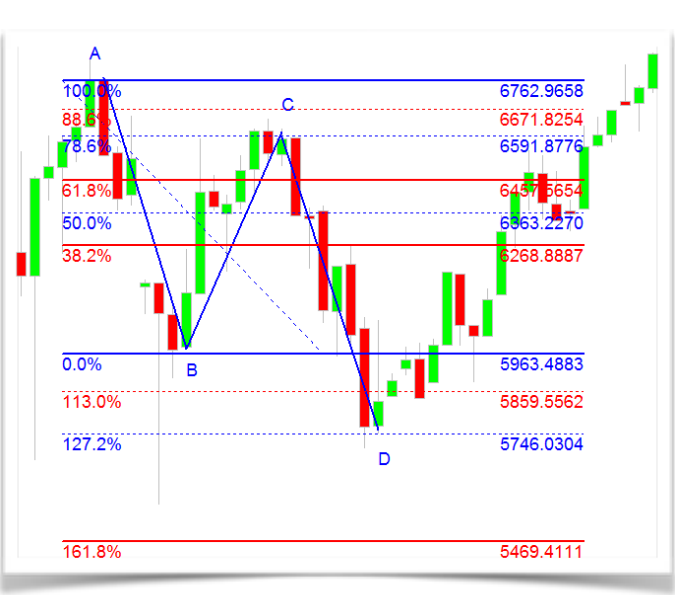
That is actually a very good question to ask: How do we make money from this system? I've seen a lot of cases when a trader opened a position at the perfect time, and already gaining profits from the position that he took. The problem is, as i mentioned earlier, Buying and Selling are two different strategy that needs to be mastered, and unfortunately, most of the trader's weakness is identifying the selling point. Because of the absence of a concrete basis to book their profits, they hesitated to close it, and some ended with some serious losses.

One important thing to remember is that you only earn money once the trade has been closed, and profits booked. Even if your position managed to increase 100% in 5 days time, that profit is merely paper gain, and that gain can be easily wiped out in a matter of days (since we have a floor price of 50% to consider). Price movement changes all the time, and until you secure that profit of yours, that, in a different turn of events, can become losses if not protected. In just a matter of minutes after a big news was disclosed, your profits could suddenly turn to losses, and there you are, hoping for a comeback, counting now the losses acquired instead of profits.

This is the reason why i keep reminding everyone to secure your profits whenever you're happy with it, because nobody knows what's going to happen next. And how do we identify the area where we should book our profits, the answer is called Fibonacci Projection.

Fibonacci projection is the process where we identify the retracement level, and derive the target price based on it. Fibonacci Projection is very helpful in solving this problem, and i'm sure you will enjoy using this. This is also commonly known as the ***AB=CD pattern.***

The history of the AB=CD pattern dates back to 1935 when a person by the name of H.M. Gartley decided to write a book and sell it for $1500 to investors titled "Profits in the Stock Market". In that book, he explained how the market would usually retrace after a rally, and the move is followed by a continuation that forms an up slopping channel. It was from that description that the AB=CD pattern got it's nickname as the '*lightning bolt'.*



This $PSEi chart is a classic example of the AB=CD pattern. You will notice from the chart on the right how the price behaved, that it will not go down on a straight line, but rather would create different waves. Retracement can be taken to identify how strong the reversal will be. Another user of this pattern is Scott M. Carney, the author and creator of Harmonics. He used the AB=CD as the basic foundation of harmonics, before going to the more complicated patterns.

The AB=CD Pattern

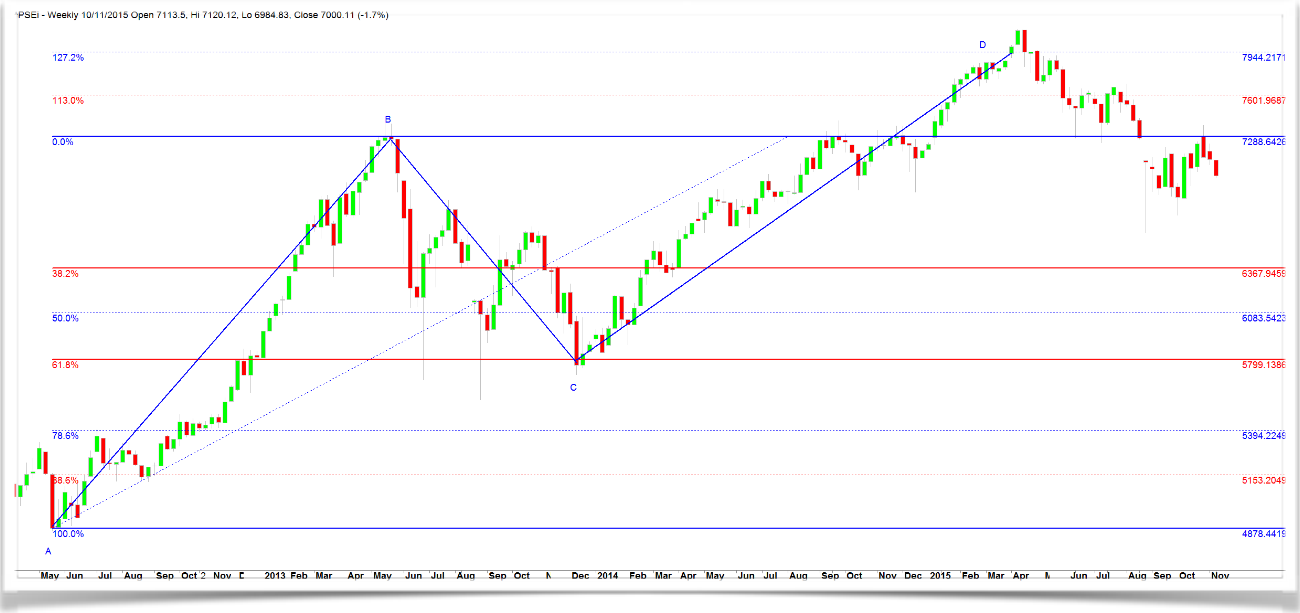
The AB=CD pattern is a four (4) point price structure, where the AB and CD points correspond to the swing points of the pattern. In theory, the AB leg should be equal to the CD leg, hence the name, and should be perfectly symmetrical both on the time and price. Meaning, if the AB leg is 20 candles up (or down), then the CD leg will also be 20 candles up (or down).

There are two types of AB=CD pattern, and these are the **Bearish** and **Bullish AB=CD** pattern. A *Bearish AB=CD* pattern means the price has the possibility to become bearish after it reached its projection level. In other words, the price may drop due to selling pressure, hence the term bearish. A *Bullish AB=CD* pattern, on the other hand, is just the reverse. The price may continue to drop and, upon reaching the projection level, has the possibility to become bullish due to increase in buying pressure. By utilising the above mentioned projection, we can maximise the profit by trading a Bearish Pattern and sell the moment the projected value is reached, and at the same time provide a good entry the moment a Bullish pattern's projected value is achieved.

The chart example above of $PSEi showed a classic Bullish AB=CD pattern, where time and price is equal. From point A, count the candles starting with the red long candle that denotes the start of the leg, which equates to 6 before a green candle emerged, marking the end of the swing or the B point. From the C point, do the same and count the candles starting from the long red candle that would mark the start of the leg all the way to the end of the swing or the B point. That will also equate to 6 candles.

However, that is not always the case, as most of the time, the CD leg extends further and may end up to be not completely symmetrical, and when that happens, the CD leg becomes an extension of the AB leg from anywhere around 127% to 161.8%. Below is an example of the AB=CD pattern being not symmetrical, as the AB leg is 52 candles while the CD leg is 68. You'll also notice the point where the price reversed, around 127%.

If we noticed an extended CD, how do we draw the pattern? It's as easy as writing ABCD (pun intended). By looking at the PSEi chart above, you'll notice the three (3) legs that form the pattern. The first leg is labeled as AB, second leg is BC, and the last leg as CD. The label corresponds to the swing high and low of the particular leg.

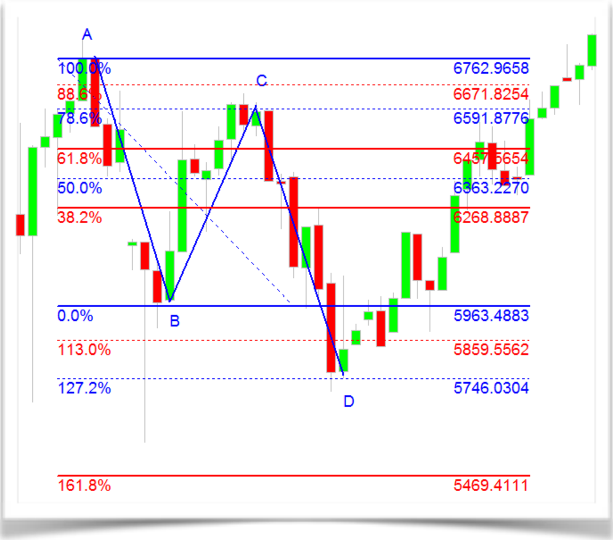


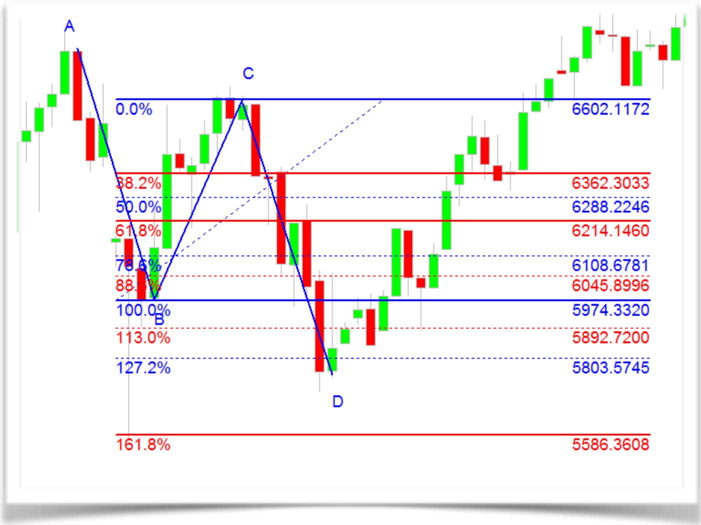
How we identify the C point is the same as how we plot fibonacci right from the start. Whatever retracement the C point falls and made the bounce will decide the projection of the D point to complete the pattern. Once we've identified the CD leg forming, we can project the the potential pattern that will be forming and generate a trading strategy based on the pattern. This is the point where we will *forecast* the potential target price based on the AB=CD pattern. How we identify the projection will require a little bit of memorisation, but i know you'll get it eventually.

Scott M. Carney wrote a very good guide, in his book *Harmonic Trading Volume One: Profiting from the Natural Order of the Financial Markets,* that we will be using as reference to identify the D point projection based on the C point retracement.

C point Retracement	BC Projection
38.2%	**224% or 261.8%**
50%	**200%**
61.8%	**161.8%**
70%	**140%**
78.6%	**127%**
88.6%	**113%**

Using below chart as examples, I will show you how we used the above-mentioned table. The chart on the left is showing the retracement to identify the C point, which in this case, is 78.6%. To identify the C point, we drew the fibonacci retracement of the AB leg. Once the C point is identified, we'll check on the table on the right to identify the corresponding projection, and in this case is 127% extension.





In order to identify the D point projection, we will draw a fibonacci line from B to C. Voila! Did you noticed that the price reversed around 127%, exactly where the projection is supposed to be? This is how powerful Fibonacci numbers are, that it is able to forecast the potential reversal using the natural order of things. I mentioned potential because there is still no guarantee, hence proper trade management has to be in place.

When studying this pattern, identifying the proper projection is as important as knowing what invalidates it. There is only one reason that would cause the pattern to be deemed invalid, and this is if the C point exceeds or is equal to 100%. When the C point exceeds 100%, a new pattern will materialise, but definitely not AB=CD. When C point is equal to 100%, this may become a double bottom/top pattern, and again, not AB=CD.

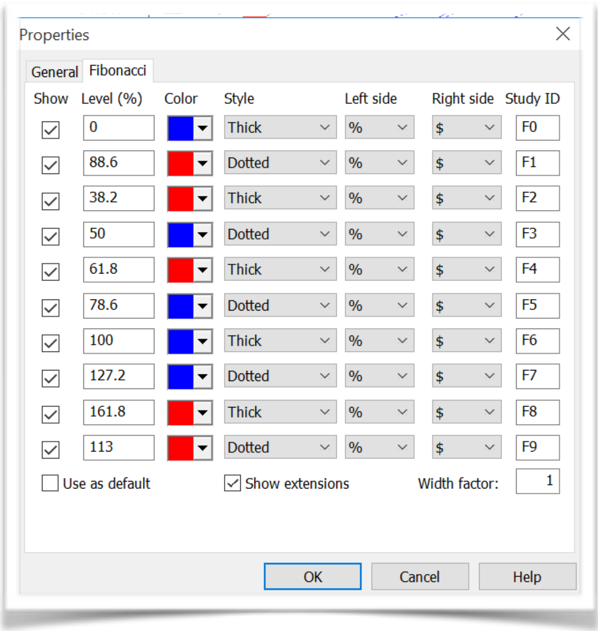
When trading this pattern, you should keep in mind that what we are identifying here are merely probabilities, or potential, and no certainty that the pattern will materialise. By using your sound understanding on the concept of Fibonacci that we discussed on the previous sections, we'll be able to interpret the price action and act upon a strategy that would suit our understanding of the situation. Without the understanding of the concept of Fibonacci, a trader trying to use this pattern is like jumping off the airplane without parachute, relying only on hope.

The Alt 1.27AB=CD and 1.618AB=CD Pattern

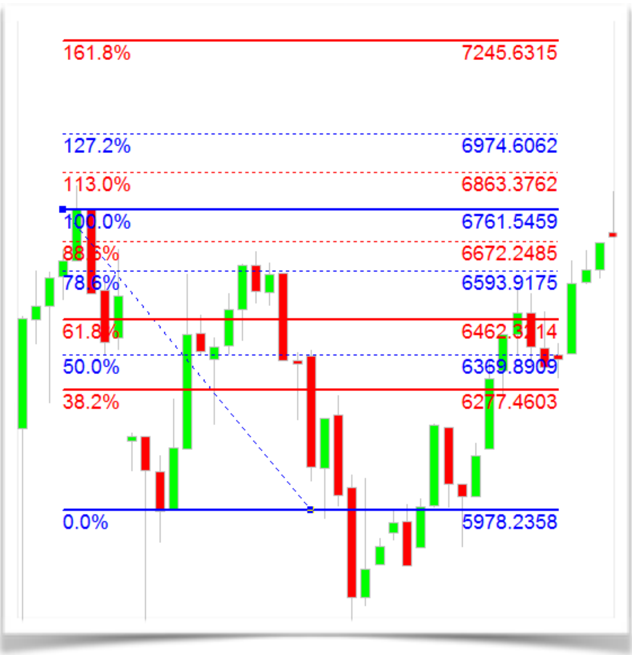
We mentioned earlier that the AB=CD do not always end up symmetrical all the time, and when this happens, the CD leg often becomes too extended that the BC leg projection do not apply anymore. This is where the *Alt 1.27AB=CD* and *1.618AB=CD* pattern comes into picture. The value of 1.27 and 1.618 is equivalent to 127% and 161.8% extension of AB to which the CD is bound to move. Depending on the trading tool that you use will decide the process.

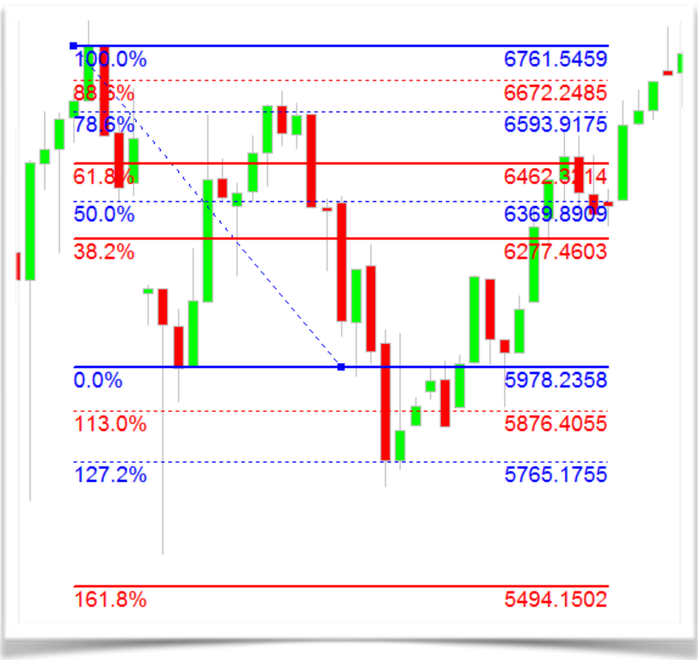
If you're using Amibroker, you plot the Fibonacci the same way as the usual, highlighting point A and B to identify the C point retracement. However, there's a shortcut that we will use after the retracement is drawn, which will give us the value with no need to plot again like how we do for the AB=CD pattern.

To do that, we need to double click on the retracement that we drew, and a new Properties window will appear just like the image on the right. Inside the window, you will see Fibonacci Tab and click on it. At the bottom of the window, you will see a tick box that says “**Show Extensions**” (refer to image). The moment you click the OK button, an extension will appear above or below the 0%, depending on the plot direction, showing the 113%, 127% and 161.8%.



Can you spot the difference on the 2 charts below? These are of the same chart, with the same swing points A to B. The left chart is the regular way of charting Fibonacci, wherein the extensions 113%, 127% and 161.8% appears **above** the 100%. However, the moment you did the procedure stated above, then the chart on the right will appear, with the





extensions of 113%, 127% and 161.8% Fibonacci showing up **below** the 0% line. The pattern on the right is now what we would call the Alt 1.27AB=CD pattern. If the price extends all the way to 161.8%, then that becomes Alt 161.8AB=CD.

To summarise, we provided the option about entry using fibonacci retracement in ***Part 5: When to Buy and Set Stops.*** We also discussed the requirement of a cut loss plan in case the analysed bounce did not go as plan to protect our capital. Depending on the level where the price bounced, we learned about the AB=CD pattern where it showed us the potential target price in reference to the bounce point.

The table we provided should be used as a guide to identify the projection based on the C point retracement. And as i mentioned, it will require a little bit of memorisation, but a few practice will get this locked in your memory for good.

The characteristics of the basic Fibonacci Retracement, and these are the 38.2%, 61.8% and 161.8% is a must that needs to be understood and kept in mind. The reason is before the pattern we've identified even materialised, these level will give us the conviction if there is a good chance that the pattern will complete. Always watch the 38.2% of the bounce, and use that as the initial profit point.

Any sign of weakness to break it as resistance should give us a trigger to sell as this is a sign of weakness and may eventually go lower, just like the many examples we showed. Furthermore, ,a close above it gives us more reason to hold, and if you're trend trading, should give you the signal to buy more on breakout. A break of the 61.8% will then give us the confirmation that the trend is getting stronger and also another reason to buy more, and a break of 161.8% tells us that the trend is your friend and just enjoy the ride from then.

So, how do we know that the uptrend is coming to an end? We'll use the same basic Fibonacci principle to identify if the reversal is getting stronger and we need to exit. Depending on your reference point, you can identify the short, medium and long term trend and apply the same strategy based on your risk tolerance. A break of 38.2% as support is a signal that the prevailing trend is strong, hence we partial sell on this part. The breakdown from the 61.8% will trigger us to sell all that is left, because this is the confirmation that the downtrend is indeed strong. Since no shorting is allowed, the only thing we can do is wait.

Case Study: D&L Industries, Inc (DNL)

We will try to summarise what we've learned so far and use the chart above. Let's assume that you bought this stock back in 2013 at around 2.5 pesos. Within 6 months time, the stock price surged up to 4.2. Then you notice that the momentum suddenly died and left you with the decision whether to sell or add more. Looking at the chart, we plotted the Fibonacci retracement to identify the strength of the reversal. When it breached the 38.2%, it gave us an indication that the reversal is strong. You can sell partially in this area to protect whatever profit was left.

You may lose some profits, but the important thing is that you get the confirmation that it is indeed a reversal. Our main objective here is to never let the profits become losses, hence we sell partially. Then we observe if the signal will be confirmed, and that is when it breaches the 61.8% retracement. A break of that 61.8% retracement should be our trigger point to sell all the remaining positions we have, as this is our confirmation that the trend is indeed reversing.

Moving forward, since the price did not breach the 61.8% support, it means we are still holding partial position with 2.5 average that we bought from way back January. If you will look at the chart, you will see that it is forming a potential AB=CD pattern, isn't it? Going back to our table earlier, the price is in between the 61.8% and 50% retracement, and when this happens, we consider whichever the price touched and closed, and that is the 50%, and if you use the wick, then the 61.8% will be used.

Should you decide to enter at these level, you should have your plan established already, which should have the most important information: Cut loss. If you're too tight, you can use the 61.8% as your cut loss level, or better yet, the 78.6%, to prevent getting whipsawed.

When doing a test buy, i recommend only using 30% of your planned acquisition cost. If you plan to buy a total of 100,000 pesos on a stock, your initial buy should be no more than 30,000 pesos. That way, if the trend moved in a different direction and hit your cut loss, you only have a small fraction of loss to worry. The value of a 10% loss of 30,000 is only 3,000, whereas 10% of 100,000 is 10,000. Go figure.

Can we assume that the pattern is going to move and follow the Bearish AB=CD pattern? We can, however, remember that this analysis is not cast in stone and should change based on the price action. What would give us further conviction that the pattern may materialise is when it manages to break out of the 38.2% resistance.

Since the reversal already started to show the completion of BC leg, we can now start plotting the projection to mark the areas where we will observe the most. The chart above showed that it was able to breakout of the 38.2%, and of course, you should already know what follows, right? A retest. Now that the retest succeed in holding as support, it

increases our conviction that the reversal is strong and at the same time will give us the trigger to buy another 30%. The break of the 61.8% is our confirmation of the strength of this reversal, and this is another level where you will start to buy again to top up on your earlier buy.

Should you go all in? Of course not! Your Test Buy is around 30%, the next 30% after breakout from 38.2% and another 30% would be after the breakout from 61.8%. You then ask, *Why only buy at these levels when i could've made some* **bodega** *when the price was low.* My response is simple: we didn't know what will happen, no one does, so you have to expect also the possibility of the price moving against your analysis.

The breakout from the above mentioned levels gives us the strong conviction that the price has the tendency to move based on our analysis, but still, no guarantee. Now that we are 90% invested from our planned acquisition, when do we place the remaining 10%? When the price breaks out of 88.6%. Why 88.6%, you might ask. The reason is that this level would be the last strong retracement, and the succeeding fibonacci extensions, from 113% to 161.8% are already potential reversal, where some traders would start cashing their profits the moment these level gets reached.

It then reached the projection level of 200%…what now? Should we sell? You can sell partially, like 30%, just to lock in your profits, and retain the 70%. This is now the best time to just sit back, relax and enjoy the ride. When the price starts to pull back, then plot a fibonacci retracement and see if it would reach 38.2%. If it haven't, it means the trend is still strong and you could add some more, if you like (a.k.a. Buying on Dips). If it does, consider selling half of your position because this is our early warning signal of the end of the trend, which should bring you back to the start of this case study…then repeat as required.

Did you notice how simple this strategy was? It is so darn simple, that all the information you need is already right in front of you, and the only thing that would prevent you is your emotion. That is the reason why traders are encouraged to create a trading plan, and execute without emotion.

You will also notice that by using the body only of the candle as reference points, you will see how it would make more sense when reading the chart. Just look at the 38.2, 61.8 and 161.8, and notice how the body of the candle reacts to it completely, like it was a solid wall placed to block the price from moving further, and respecting it more than any other level. That is how a resistance and support should look like, isn't it?

Now, try this exercise on some other stocks and note down your analysis on a log book, detailing your entry point, exit or cut loss point, test buy amount, initial top up, and so on.

One thing to note if, after breakout from 38.2%, 61.8% and 161.8%, the price would retest the aforementioned as support is to observe the next candle's ***opening*** *price. If the price opened higher than the previous close, the possibility of continuation is higher and no retest may happen. Of course, the price is still subjected to the next strong resistance, and a rejection from that would trigger the retest that we're expecting. If the price opened at the same level or lower, expect the above-mentioned supports to be retested at the earliest. It's not a rule to be followed, but worth considering.*

Part 7: Beyond ABC & D

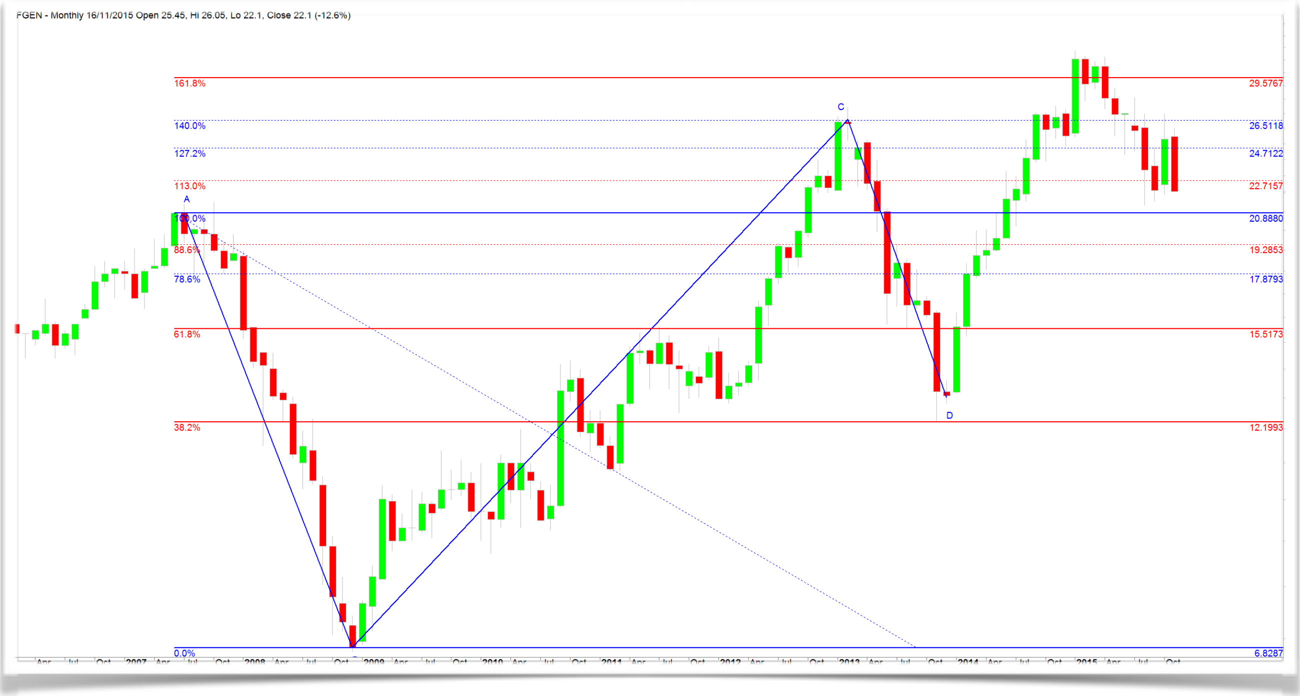
The AB=CD pattern provides a trader the ability to forecast a projection based on the Fibonacci retracement. This will only apply as long as the C point is not equal or did not exceed the B point. What would happen if the C point exceeded the A point? Then we will use another pattern known as ***Reciprocal AB=CD****.*

Reciprocal AB=CD, from the name itself, is the reciprocal of an AB=CD pattern that typically forms to mark a continuation of the trend. When you look at below table, and compare it to the table we used for AB=CD pattern, you will notice the resemblance. The C point retracement and BC projection values were swapped. In this case, if the C point exceeded the 100% retracement, then the AB=CD pattern becomes invalid. We then take the value of the Fibonacci extension (anything that exceeded 100% is called Fibonacci Extension, and lower than 100% is called Fibonacci Retracement) and plot the projection using retracement.

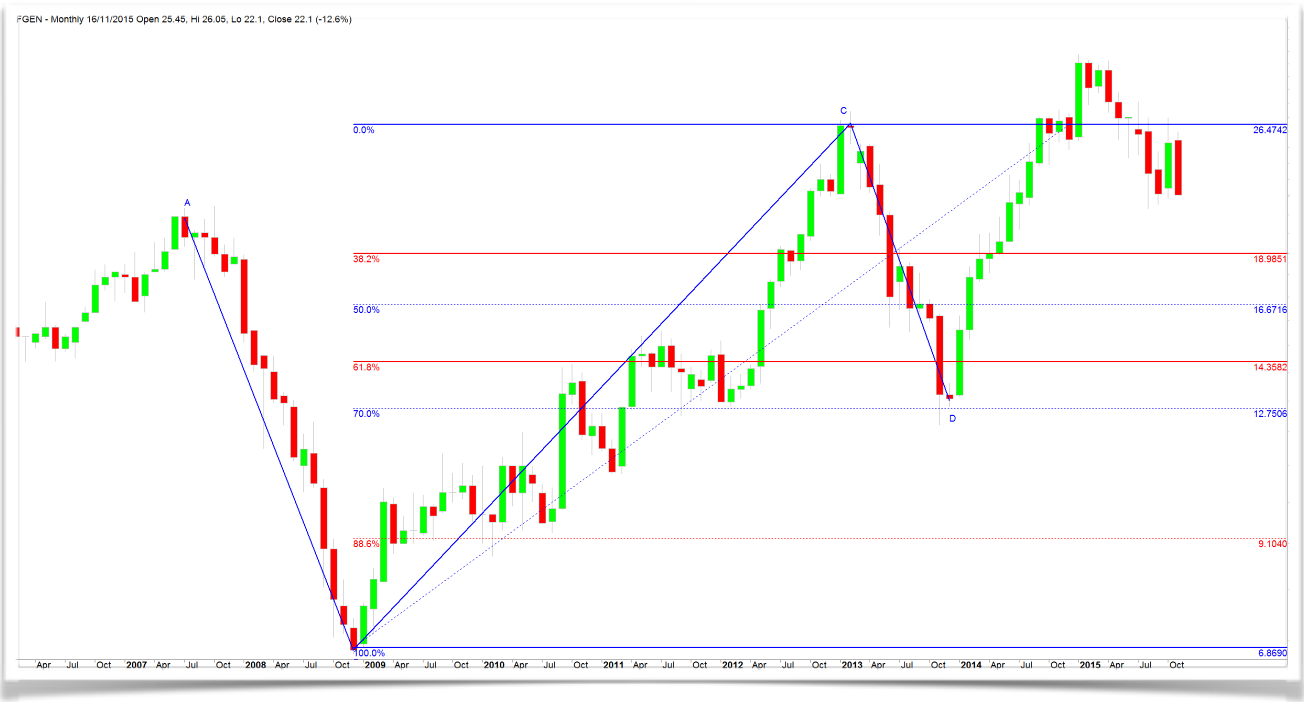
C point Extension	BC Projection
224% or 261.8%	38.2%
200%	50%
161.8%	61.8%
140%	70%
127%	78.6%
113%	88.6%

The way to trade a Reciprocal AB=CD will be the same as what we discussed earlier. We are just showing another opportunity to identify a potential bounce. Here is another case study that we will use to further explain the strategy. As i mentioned earlier, the moment the price breaks out of the 100% Fibonacci retracement, the next strong resistance is the 113%, and the rest of the Fibonacci Extension acts as reversal points due to this level being used by most traders to cash in their profits.

The chart below of FGEN is showing a sample of the Reciprocal AB=CD, with the initial sign of the C point to have exceeded the 100% retracement. When it hit a wall of resistance, we then identify what level was the reversal point to mark the C point by drawing the Fibonacci retracement and, using the table above, forecast the potential drop.

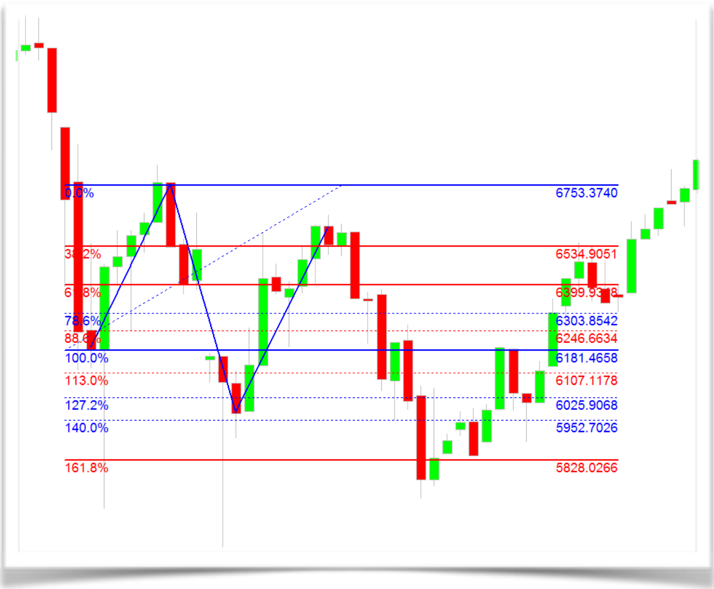


Looking at the table above, you will see that the corresponding projection of the 140% C Point extension is around 70% to form the D point and complete the CD leg. We'll then plot below to identify the projection of the drop based on the Fibonacci values.



The price respected the pattern by touching the 70% retracement level that we identified as the projected drop and reversal level, and formed the continuation of the primary trend. This also confirmed our analysis of the breakdown of 61.8%, where in most of the time required a retest.

Below is another sample of Reciprocal AB=CD pattern moving on a different direction, using the PSEi weekly chart.



The chart on the left showed the price dropping beyond the 100% ratio, and when we plotted the fibonacci retracement, it showed that it falls short of the 140%. Using the table above as reference, you can use the 127% or the 140%, since their projection is close with each other. Furthermore, don't expect the price to close exactly at the Fibonacci level, so it's best to give a little room.

The chart on the right shows the projection, where 127% is for 78.6% and 140% is for 70%, and notice that the price respected the 78.6%. From then on, it then continue the primary trend of moving downward.

A breakout from the projected level invalidates the pattern and may trigger the start of a new trend, however, the Fibonacci retracement could again tell us the direction. The Fibonacci ratio is more than just a tool to identify as support and resistance. It is one of the tool that is heavily used by a lot of trader, however, rarely understood. I hope by now you already have a different perspective when you see Fibonacci ratio being drawn. Feel free to explore and practice, as this is the only way it would enhance your ability to identify a potential trade.

In the succeeding part of this chapter, we will identify some other Fibonacci Tools that would complement our analysis, and further increase our conviction. We will also teach you about convergence in Fibonacci Ratio, a characteristic that is rarely used, which could give us further understanding as to why the price behaves in certain areas.

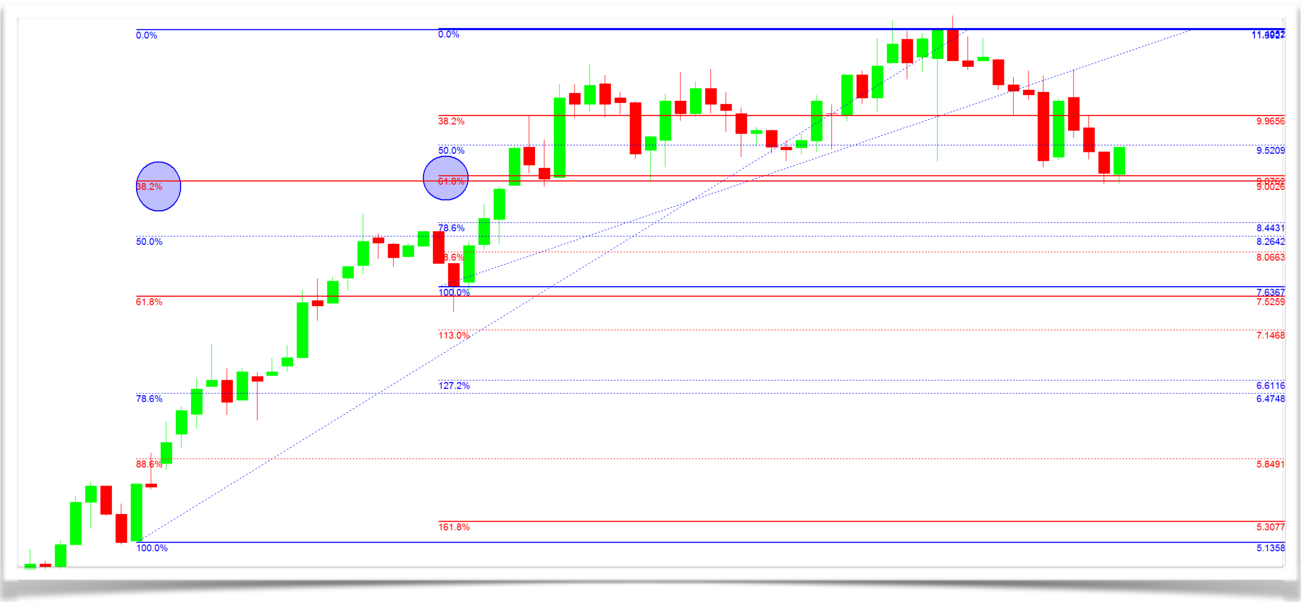
Part 8: Convergence and Confluence

There is another Fibonacci characteristic that could help a trader identify a strong level of support or resistance, and could aid in deciding and planning the trade. This is called *Fibonacci Convergence* and *Confluence.* These characteristics would be very useful, and the only requirement is that you are fully comfortable in identifying the price swing to use and plot the fibonacci retracement. If you're still not comfortable, don't worry. Simply go thru this chapter again, or you can visit my YouTube video about Introduction to Fibonacci via this link.

Fibonacci Convergence happens when you draw multiple fibonacci retracement lines on multiple swings where some levels ended up lying close to each other. Each of these level is an area of support and resistance in itself, and when coupled with another level measured from a different swing, the area of support or resistance where the level converged would increase in strength. Having this in mind, we could adjust our trade and provide further conviction that a bounce may materialise due to the support being able to hold, or a valid breakout after the resistance gets broken.

Below is an example of the convergence using the PSEi chart where i highlighted the convergence of 38.2% level of the longer swing and the 61.8% of the smaller swing. If you will notice how the index is having difficulty breaking out of the 7200 level is because of the presence of these two formidable resistance. Only one of these level is already a tough one to break, as it would require volume to confirm, what more if you add another level of resistance that also require the same?

Below is another example, using $DNL weekly chart. I have encircled the convergence of 38.2% and 61.8%, using two different swing points as reference. Notice how the strong support prevented the stock from moving down further. Convergence would add conviction to your analysis, to which, based on below, could suggest that we will anticipate the support to hold due to the presence of these two levels. Reason is because it would need twice the effort just to break it, if you remember the characteristics of this Fibonacci Retracement levels.

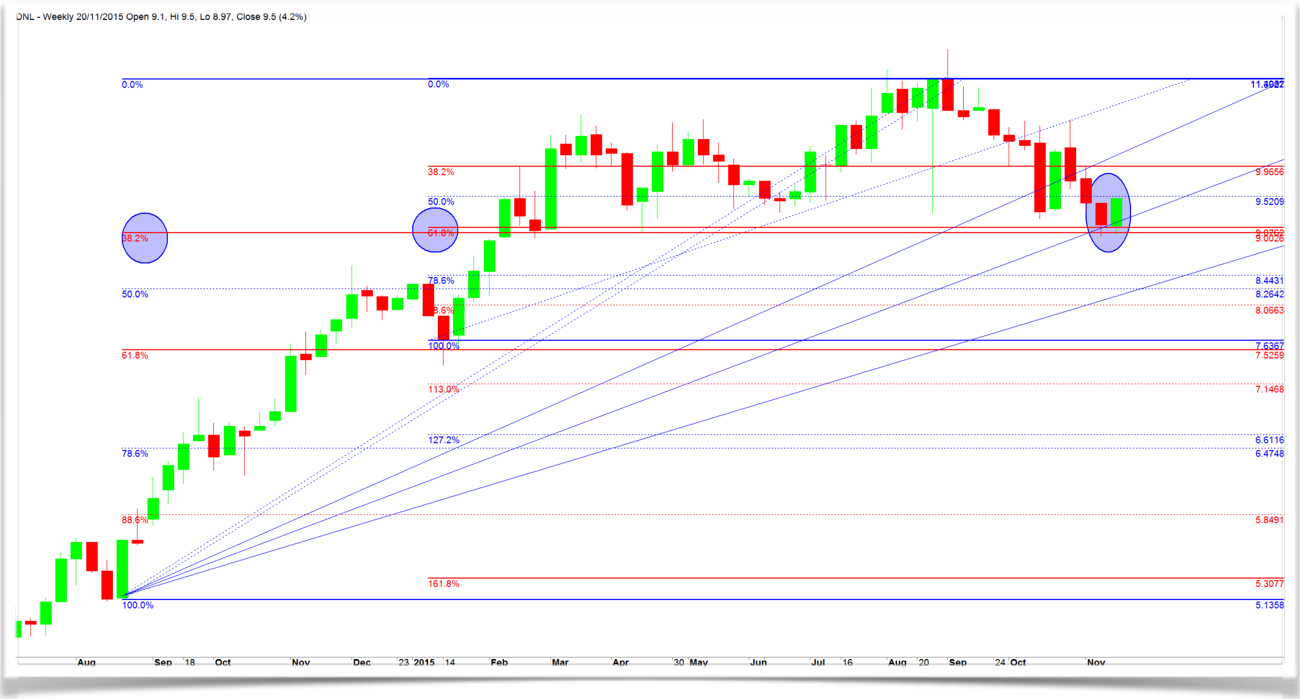


Remember the rule in drawing Fibonacci retracement: *Don't ignore long term trend.* I always have one plotted permanently, and just add a few small swings like the one above depending on the strategy i use. You can practice by identifying the major swing first, and then just add the small swings that you would identify, and see if it supports what i mentioned above.

Fibonacci Confluence, on the other hand, happens when multiple Fibonacci levels from different grid merged or crossed on a certain price level which could give a trader a likely area that would act as a strong support or resistance. In *convergence*, it uses the same Fibonacci tool, whereas in *confluence,* it uses another tool, i.e. Fibonacci Fan, Fibonacci Timezone, Fibonacci Arc, etc. For this topic, we will be using Fibonacci Fan, as this is another Fibonacci tool that i used more often. We will discuss Fibonacci fan later on, but to just demonstrate to you the concept of confluence, I will be using the same PSEi chart above and add the Fibonacci Fan to see where the confluence lies.

I encircled the point where the Fibonacci retracement levels crossed with the Fibonacci Fan line being respected by the price, adding further resistance to the already tough resistance to break. By having these information at hand, a trader can easily adjust his position if he knows that the possibility to move up is low, and vice versa.

The same also applies to $DNL chart above, where we will identify the confluence as shown below;



Fibonacci Fan

I use this tool to identify the trend and provide an additional tool to identify additional support and resistance that is using the time and price as its basis. Instead of drawing a trend line that could become biased due to the reference being used, i use this instead. The way to draw it is the same way we use fibonacci retracement, and that is by using the swing high and low, and vice versa.

Fibonacci Fans are best matched with Fibonacci Retracement because of the confluence characteristic. The Fibonacci retracement identify support or resistance by price, however, the problem is that time was never considered, which is where Fibonacci Fans come into the picture. By using the Fibonacci Fan, we are showing a dynamic type of support and resistance. What this means is that the support is not just a static location just like the retracement, but rather uses the time aspect which makes the support and resistance to vary by time. It acts the same way as the trend line, with the difference of using Fibonacci.

Fibonacci Fan uses the concept of a right triangle, as shown below, where the swing points act as the *hypotenuse*, and the legs forming a right angle at 90 degrees as shown by the blue coloured line.

A fibonacci retracement is then drawn just like normal, and wherever the vertical line crosses with the Fibonacci retracement (encircled points), that will form the fan lines. Don't worry, we're not doing this manually. There's a Fibonacci Fan on most technical analysis software, i.e. Amibroker, Chartnexus, Investagrams, etc.

By looking at the above chart, after the decline, Fibonacci fan lines were drawn to identify potential resistance or reversal areas. You will notice how the advance seem to be respecting the lines that acted as resistance, and a successful break of each line moves it to the next. These fan lines gives us the key levels to watch as the price moves. Failure to breach these trend line as resistance is a sign of weakness, and is bound to follow the direction of the trend.

Using the daily chart of $DNL and applying all that we've discussed so far, we can see from below chart the areas where the Fibonacci Fan line is in confluence with the small Fibonacci Retracement. When we interpret this, it means that if the price would decide to advance on 27 November as shown by the small circle, it will be met by a very strong resistance around 9.6. Should it succeed in breaking it, however, there's still no reason to celebrate because there is a confluence around 9.92, and convergence of 61.8% and 38.2% around 9.98 range

You will notice how forward looking Fibonacci is, which gives us more edge than those relying on lagging indicators to decide for them. As the saying goes, forewarned is forearmed. I would highly suggest you use the weekly chart to identify the trend, and any entry or exit decision should be done on a daily chart. If you notice a potential trade on a weekly, do the same analysis on a daily chart to tell you when is the best time to enter. The same applies when you exit, we use the daily to maximise any potential gain that is brought upon by the daily's volatility.

Part 9: Commodity Channel Index

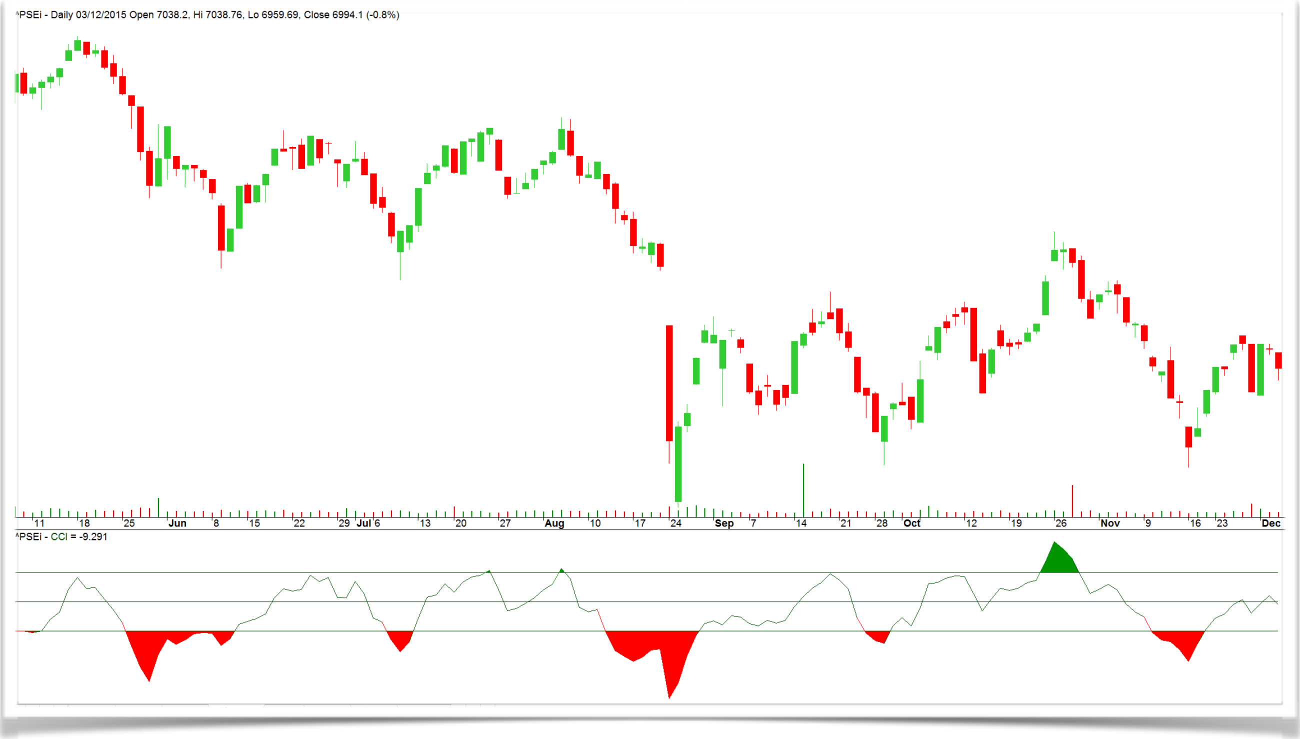
As part of the rule in trading using Fibonacci, we mentioned that we should not use Fibonacci alone. Reason being is that we need another indicator that would confirm our analysis and provide conviction for us to execute the trade. There are other indicators that can be used, depending on your liking, however, make sure that the indicators you will be using gives you conviction rather than confusion. '*Less is more*' is the suggestion i hear most often in different forums, however, you will see their charts showing 3 to 5 oscillators, not to mention the different indicators in their chart.

And then you hear them ask, '*Buy (or Sell) na po ba?'.* Because of the number of oscillators/indicators used, with different signals being presented leading to confusion, the trader was left to decide not based on technicals, but of their '*feel'* of the stock. Believe me, i've been there. Moving forward, i found what i would normally call the '*holy grail'* of oscillators, but, don't take my word for it. You will need to experience using it for you to know it, as some of my students fondly say '*Indicator pa lang, ulam na!'*.

Commodity Channel Index or **CCI,** for starters, was developed by Donald Lambert to identify cyclical turns of commodities, to include equities (i.e. stocks) and currencies. It is also considered as a momentum indicator which can be used to identify trends and warn of possible extreme conditions.

In technical terms, it uses only three levels; +100, 0 and -100, which measures the current price level relative to an average price level over a given period of time. It means that when it is trading above +100, the indicator tells us that the price is well above the average price, or overbought, and the reverse applies when it is below -100, or oversold.

The chart of PSEi on the previous page shows the CCI in action. The three horizontal lines denotes the +100 on top, 0 on the middle and -100 on the bottom. Since CCI based its calculation on the number of candles or bars, i would normally use the 20 value based on my trading style. You can tailor it to your liking, depending on the level of volatility you're willing to take, with 10 often used by short term traders.



There is an important note that you have to keep in mind when identifying an oversold or overbought condition, and that is *"There is no such thing as Overbought on a uptrend market, or Oversold on a downtrend market.* Not because it's overbought means we need to sell, and vice versa. When trading, it is always prudent to wait for confirmation, however, depending on your strategy and risk profile, you can enter early, but make sure that you have more than 100% conviction that the price movement will go based on your analysis.

To use this, simply we look for high positive reading which would indicate that the price is increasing in momentum which is a sign of strength, while low negative readings, on the other hand, indicates decreasing momentum which is obviously a sign of weakness. One of my favourite characteristic of CCI is the ability to detect early divergences to show the potential shift in momentum and anticipate trend reversal during the process. In other words, you can spot those doing the '*bodega'* and those doing the '*distribution'* even if there is no sudden breakdown of prices.

Having mentioned all that is you need to know about this awesome oscillator, we should now go down to business. Just like the Fibonacci retracement, i gave you options as to when to enter a trade, whether you are a low, medium or high risk trader. Of course, the indicator has to match that characteristic, hence i am also giving you different options. However, for this part, the medium and high risk traders are combined into a single option.

CCI Strategy for Low Risk Traders

If you are those type of traders who wants to play it safe, this is the strategy that would complement your risk level. Don't get me wrong, there is nothing wrong with being safe, and the main reason i am giving this option is because every trader is different. Even after you've learned the system which I am using, we will still differ on the way we execute because that is now dependent on the psychology the trader is at during the placing of the order.

Moving forward, the basic strategy for low risk trader is simple and straightforward: you buy when CCI move above 0, and sell when CCI move below 0. How difficult could that be? By using this technique, you are only encouraged to take the buy or sell signal when it happens, and repeat as intended. However, take note that this is not the only indicator that we will place our Buy or Sell signal, but rather use this only to increase your conviction of whether to Buy or Sell your position, instead of asking in different forums.

Using X as an example, below chart represents the way a low risk trader would analyse and trade using what we've learned so far.

We will start with the left fibonacci, notice when the price broke out of the 61.8% level, the CCI also crossed the 0 line. This, in turn, gave us additional conviction that the breakout of the strong fibonacci resistance has a strong momentum, thus possible of a continuation of the trend. As usual, we should not be surprised of the retest after it breaks out of 61.8%, but this time, we would watch the CCI closely as this will give us the conviction of whether the breakout would fail or not.

Since it didn't cross the 0 level going down, it gives us the added conviction that the trend could potentially continue moving up. And then it broke out of +100, further increasing the strength of momentum. This is a classic example of *"There's no such thing as overbought on an uptrend market",* as you may have noticed the CCI above the +100 for quite sometime.

Then it corrected right where we've expected it to be, at the golden ratio. As usual, every pullback, we measure with Fibonacci to see how strong the reversal might be. The break of +100 going down is a sign that the upward momentum is getting weaker, and with that, the downward momentum increasing. It breached the 0 line, triggering our sell signal. However, as i mentioned before, we don't use CCI as our basis for Buying and Selling, but rather to add only to the conviction. Fibonacci barely reached 38.2% on the pullback, which for us only means one thing: potential continuation. The continuation was confirmed after the CCI crosses the 0 line again, further increasing our conviction that the momentum has returned.

CCI Strategy for Medium/High Risk Traders

If you're more on this type of trader, there is another way of using CCI that would give you a decent advantage, however, poses you to greater risk. This setup is a bit more complicated than earlier discussed, however, this could give you a better position to start with. One of the things that a medium/high risk trader look at the CCI is the highest level it reached on +100 and -100 side. Reason being is that we will use that as a reference to identify the resistance and support.

For this part of CCI discussion, we will treat CCI like it is the price chart where we identify the support and resistance, as well as draw trend lines. This is the only time I am using the old way of drawing trendlines, and you'd find out why.

When a CCI level reached beyond the +200 or -200 values, this is what we would consider as the extreme. What this means is that like a pressure gauge, the possibility of reversal is imminent whenever a stock reached or breached these levels. Like a car reaching it's threshold and overheats, it will eventually stop. When that happens, we watch closely, as this may give us the signal to buy or sell, depending on the chart.

When the CCI breaches the -100 level as support and started to move back up, this would give us an indication that the selling pressure is decreasing, however, we still wouldn't touch it. The analogy is like when using a pressure cooker, after releasing the pressure knob and you hear the continuous hissing sound of the pressure, you wouldn't open it yet because you're on the risk of getting burned. We wait for the hissing noise to stop, to confirm that the pressure had indeed died down.

The way to confirm that the selling pressure had stopped is when the CCI manages to break out of the -100 CCI acting as resistance.

The chart of SSI is a classic example of the CCI breaching the -200 level, however, albeit the recovery on the CCI, still showed no sign that the pressure had died down and ready to be touched. The same confirms what we stated earlier, that there is no such thing as oversold on a downtrend market. Those who tried to catch the bottom because of the 'oversold' condition got burned after, much like the person who tried to open the pressure cooker while it's still hissing.

Using above strategy, by simply looking at the CCI, i gives us the impression that it is still far from reversing, and the reason is obvious: it failed to break out of the -100 CCI acting as resistance. The same applies to X on the previous page, where it tested the +100 acting as support and managed to hold, hence it continued to move up.

Bullish and Bearish Divergence

Aside from the above discussion, one of my favourite characteristics of CCI is the ability to identify bullish or bearish divergences. I noticed from browsing through different forums that the divergence is becoming a thing of the past for some traders, and never considered in their trades. I wouldn't say it's a must for a trader to learn about divergences, but putting it as part of your arsenal to analyse would be a good idea, as you will be warned beforehand of an impending reversal that might catch you off guard.

Divergences, for starters, provide a signal of an imminent reversal because the directional momentum indicator does not confirm the price action. What this means is that when a stock price creates a lower low, but CCI forms a higher low instead, it provides us the information that the downside momentum is becoming less. This is called **Bullish Divergence**. When a stock price, however, created a higher high, but CCI forms a lower high, it then informs us that the upside momentum is becoming less. This is called **Bearish Divergence**.

The chart of SMPH shows us the Bearish and Bullish divergences, and the resulting effect of it. The red trend line on the left showed the price moving higher, however, CCI forming a lower high instead, and the result of the Bearish Divergence is profits in 6 months wiped out. The blue trend line on the right showed the price forming a lower low, however, the CCI is forming a higher low which resulted to a Bullish Divergence, and the result is the 50% upside to date.

As always, confirmation is still required to identify divergence. While divergence reflect the possible change in momentum that could entail a potential reversal of the trend, we need a confirmation that would tell us that this is the end result of this divergence. One confirmation is the one we discussed above, wherein a break of the -100 as resistance or +100 as support, would give us an early warning signal of the impending reversal. The moment CCI break the 0 line on either direction, then that would serve as our final confirmation. This is the same as the 38.2% and 61.8% acting as signal and confirmation.

Using the same SMPH chart above, notice the multiple times it tried to breach the +100 as support, but since it still managed to stay above the 0 line, the divergence is still not confirmed. It just gave us an initial warning that there is an impending reversal about to come and we have to be ready. Of course, we match this with Fibonacci to have the bigger picture and strong conviction because if not, you may get whipsawed by the volatility of the indicator.

CCI Trendline Break

CCI also has another characteristic that is rarely used but very useful, and that is identifying breakouts from trend. By connecting the peaks and bottoms to form a trendline, we can identify which level it would breakout. The more peaks or bottoms that are touching the trendline, the stronger it will act as support or resistance, and a break of this level is more convincing.

The chart of PSEi above showed multiple trendlines formed using CCI, and how the price reacts to it when it gets broken. The first trendline on the left showed the CCI breaking out of it, and the price action that resulted after. The red trendline also showed how it acted as a strong support, and when it was finally broken, you can see how the price dropped. This is the only time that i am using the trendline because you can't go wrong with this setup, compared to using the trendline on the price where biases most of the time appear. All you have to do is locate the peak and connect, and that's it. How hard could that be?

Due to the limitation set on our market where you can only make money on a stock that moves up, and the first thing you need to look when scanning is the momentum. With that in mind, the first thing that we would be looking at is the CCI and see if there is increasing momentum, and how to identify it is discussed here. Once you've shortlisted the stocks that shows the probability of moving up, then we use our Fibonacci to identify the support/resistance and projection.

Case Study: D&L Industries, Inc (DNL)

Using the same case study we did earlier on page 39, this time, we will integrate all the tools that we learned from this chapter to summarise what we have discussed so far.

When we noticed that DNL managed to stay above 61.8% fibonacci level on page 39, we have an assumption that the bulls are still strong and won't let the price go lower. Furthermore, there is no sign for us to enter from the months of October to December because the CCI is not showing any sign of improvement.

When the CCI broke the -100 as support around December 2013, it gives us a stronger conviction that the downtrend is strong, however this time, we are just waiting for the right opportunity to enter. When it reversed and broke the -100 as resistance, it gave us the signal that the downward trend is getting weaker, and a change in cycle is imminent. The confirmation was given to us when CCI broke the 0 level as resistance.

For high risk traders, the break of -100 as resistance would trigger a buying opportunity. If you're more on the safe side, the break of the 0 as resistance would be the best choice, as this is the confirmation that we are looking for the change in cycle.

Looking at the fibonacci level, we notice how the 38.2% and 61.8% forced the price to respect them, and a check of the CCI showed the momentum to be ever increasing when it managed to stay above +100 line. You will notice that after the break of 61.8% resistance, the CCI started moving downwards while the price moves up. This is what we call Bearish Divergence, where in traders are starting to dump their shares gradually. Having this in mind, we can prepare ourselves of what might come, a possible end of the cycle.

The CCI broke the +100 support once after the price reached 161.8% ratio, a.k.a. The Golden Ratio, it gives us our conviction that the cycle may have started to change, however, yet to be confirmed. After reaching the golden ratio, the price didn't break down and CCI showed us that the trend is still strong because the 0 line is not even reached, which serves as our confirmation.

To conclude this topic, Commodity Channel Index is very useful in determining the potential buying and selling points, and add conviction to whether buy or sell. The CCI is best suited if used from a longer time frame to eliminate the noise caused by volatility of the shorter ones. Using it on the longer time frame also establishes the dominant trend, while the shorter time frame can be used to isolate pullbacks and generate trade signals. Add up the Fibonacci Retracement to know the story behind the price action and adjust your trades accordingly.

Chapter Two:

Trend Trading Using Ichimoku Kinko Hyo

This chapter will introduce the concept of trend trading using the Ichimoku Kinko Hyo Trading System, and how it could increase your chances of success in trading using this tool. We will also discuss the different trading strategies involving the use of the system, and integrate what we have learned from the previous chapter to complement our analysis.

Remember that when you use Technical Analysis in trading stocks, there is no certainty - only opportunity.

—Mangka Knorr

Part 1: A Quick Introduction

For the past 3 to 4 years or so, you may have noticed the increasing popularity of the "*clouds"* in the Philippine Stock Market*,* as you'd see a lot of traders using it to complement their analysis, but not all. Some uses it to make their chart look '*cool'* and '*professional looking',* but their analysis directly contradicts what the chart was actually saying. In general, it captured the curiosity of a lot of traders who have been using the traditional way of charting: some find it helpful, some find it not. The reason has nothing to do with the system, but the trading psychology we each have.

First and foremost, to those who only entered the market recently and don't know much about the history of the system, I did not create it. I am a fan of this system since i started using it, and fell in love with it since then. My #tsamba increased exponentially, and with it profit follows. I do not claim to be an expert, but rather a student of the craft, as i continue to study this system up until the time of writing this book.

Moving forward, the Ichimoku Kinko-Hyo trading system is a trend-trading system that had been used in nearly all tradable market, from equities, forex, to name a few. It is purpose-built and unique in many way, but it's strength comes by utilising multiple data points to give the trader a deeper and more comprehensive understanding of the price action. This view, since Ichimoku is a visual system, enables the trader to easily identify the low and high probability setup by merely 'glancing' at the chart. As i always tell my students, the objective is for you to be able to identify, in less than 30 seconds, the high and low probability setups.

Ichimoku will give the trader an unbiased view of the market, and information can be extracted by merely looking at it. If the probability is low, then why spend your time trying to form an analysis when you know you won't get anything from it? Makes sense, right? This tool will simply shift your energy into analysing a stock that has more chance of giving profit, than those that don't.

A brief history

The system that we will be studying was developed by Goichi Hosoda, a Japanese newspaper man, before the start of World War II. Since computers don't exist during his time, in order to achieve faster processing of his formulas and scenarios, he hired numerous students to test the system. After almost 30 years of back testing his system, he finally released it to the public in 1968, and with all these back testing and studies done before releasing it, i find no reason to change any of the setting that was recommended to be used.

One Glance

The name Ichimoku Kinko Hyo literally translates to One Glance Equilibrium Chart, where the name itself describes the system and how it is going to be used. That one glance is enough for you to identify the bias of a stock, and easily decide the way forward when opportunity showed itself.

The system uses five components (we'll deal with that later), and while it utilises these 5 lines, they are not to be used individually in isolation when making trading decisions. The components must be used together to form the complete picture of the price action, wherein a simple look at the chart would provide the Ichimoku practitioner an immediate understanding of the sentiment, strength and momentum of the trend.

Another feature of the system is that the price action is constantly measured based on the perspective of whether the price is in equilibrium or not. What this means is that a price that is in disequilibrium has the higher chance to correct, thus preventing us from putting a trade when we know the possibility of the price changing direction soon.

The creator of the system strongly believed that the market is the direct reflection of human behaviour, wherein there is a constant movement to bring back the balance or equilibrium. Each of the components of the Ichimoku Kinko Hyo system provides a reflection of its own balance or equilibrium, which gives us more detail when it comes to identifying support or resistance. It warns us of potentially buying at the top, and gives the opportunity to be able to buy almost at the start of the trend.

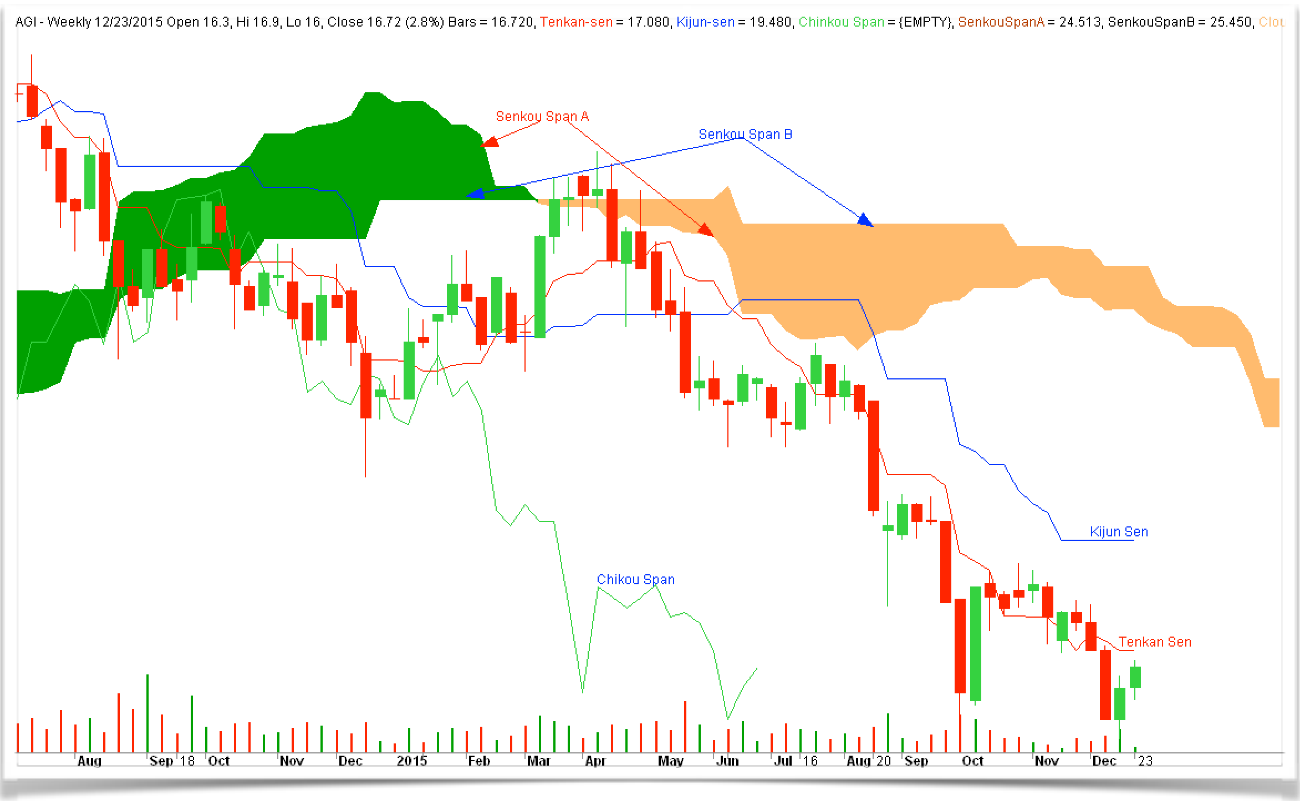
Part 2: The Components

The Ichimoku chart is comprised of five (5) separate indicators that work together to form the complete trading system. You will notice that there were key numbers used in the Ichimoku Kinko Hyo system, and these are the 9, 26 and 52. These set of numbers was the result of Goichi's years of back testing, finding the ideal setting that will provide the optimum result.

The number 9 represents a week and a half of the Japanese work week, which includes Saturdays. The number 26 corresponds to a month of work, and 52 is for 2 months. Using it on a weekly time frame, the number 26 would represent half of the year, and 52 for the entire year.

Many traders have argued that the setting needs to be tailor fitted to a certain situation, since the typical trading week in the Philippines is 5 days. Moreso, in the forex market, where trading is done 24x5, there were those who think that there might be an appropriate setting. The argument can be made, however, using the system other than the settings recommended by its creator could provide and invalid signal and throw the system out of balance. I agree with other Ichimoku traders who believed that the standard settings worked extremely well, and no altering is required.

Below is a visual representation of these components:



1. **Tenkan Sen**, or the **Turning Line**, is calculated as (Highest High + Lowest Low) / 2 using the 9 period average. While some may compare this to a 9 day Simple Moving Average (SMA), the difference is that the Tenkan Sen uses the high and the low compared to the SMA that uses only the closing price's average. Hosoda believed that by using the average of the extreme points over a certain period of time, he can measure the level of equilibrium rather than using the closing price alone.

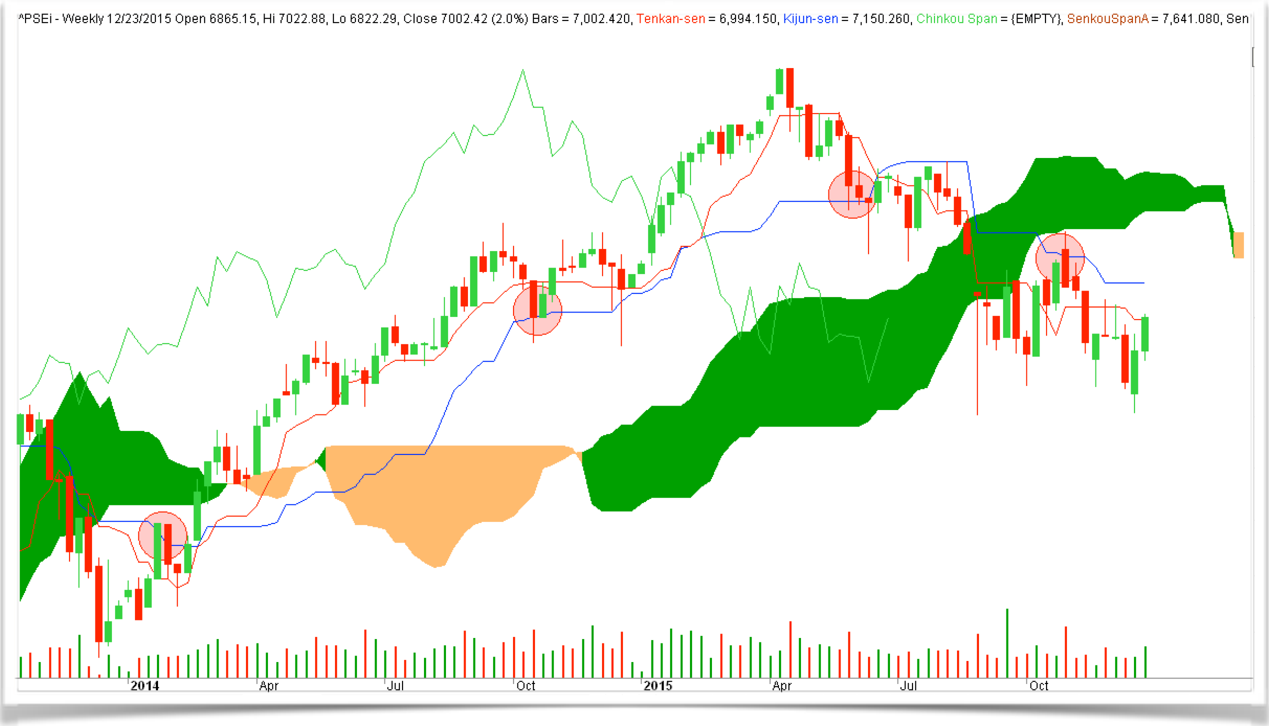
The Tenkan Sen also exhibits a flat aspect which would signify price ranging and trendless condition. On a bearish chart such as the above, the Tenkan Sen acts as a strong resistance. The reverse is true on a bullish chart, where the Tenkan Sen line acts as a strong support. The Tenkan Sen's angle also gives us an idea of the momentum of the price movement that happened during the last 9 periods, where a flat Tenkan Sen indicates low momentum, and an angled one indicates a strong momentum.

2. **Kijun Sen**, or the **Standard Line**, is calculated as (Highest High + Lowest Low) / 2 using the 26 period average. This is considered the more reliable indicator, compared to the Tenkan Sen, of short-term price sentiment, strength and equilibrium, due to the longer time frame it measures. It measures the same average as the Tenkan Sen, however, it does so in a longer time frame of 26 periods.

Price equilibrium is more accurately expressed in Kijun sen than in Tenkan Sen due to the longer period of time it considers. What this means is that price tends to move away and back to the Kijun Sen in a cyclical manner due to the strong expression of equilibrium. When a price moved rapidly up or down on a short period of time, given the momentum to be extreme during the process, a certain "rubber band" effect can be observed. It would attract the price back to the Kijun Sen line to bring back the balance or equilibrium lost.

An analogy could be made using the mother (Tenkan Sen), Father (Kijun Sen) and child (Price Action) while walking in the park. The child could run in any direction it chooses to, away from the parents, just as how the price tends to move in any direction it chooses. The mother (Tenkan Sen) would be the first one to react and follow the child. The father (Kijun Sen) would be trailing them, and if the mother and child moved further away, the father will follow their trail. Once he knew that the mother had the situation under control, he will stop following, and the child will eventually return to the father, with the mother trailing behind.

No matter how far the price had moved away from the Kijun Sen line, it will correct eventually, either by price or by time. If the correction is by price, there will be a sharp correction until it touches the Kijun Sen to bring back equilibrium. If correction by time, the price will move sideways for a certain period and the Kijun Sen will be the one to approach the price and bring back the balance. This particular characteristic is evident whenever the Kijun Sen is flat, or trendless, as can be seen in below image.

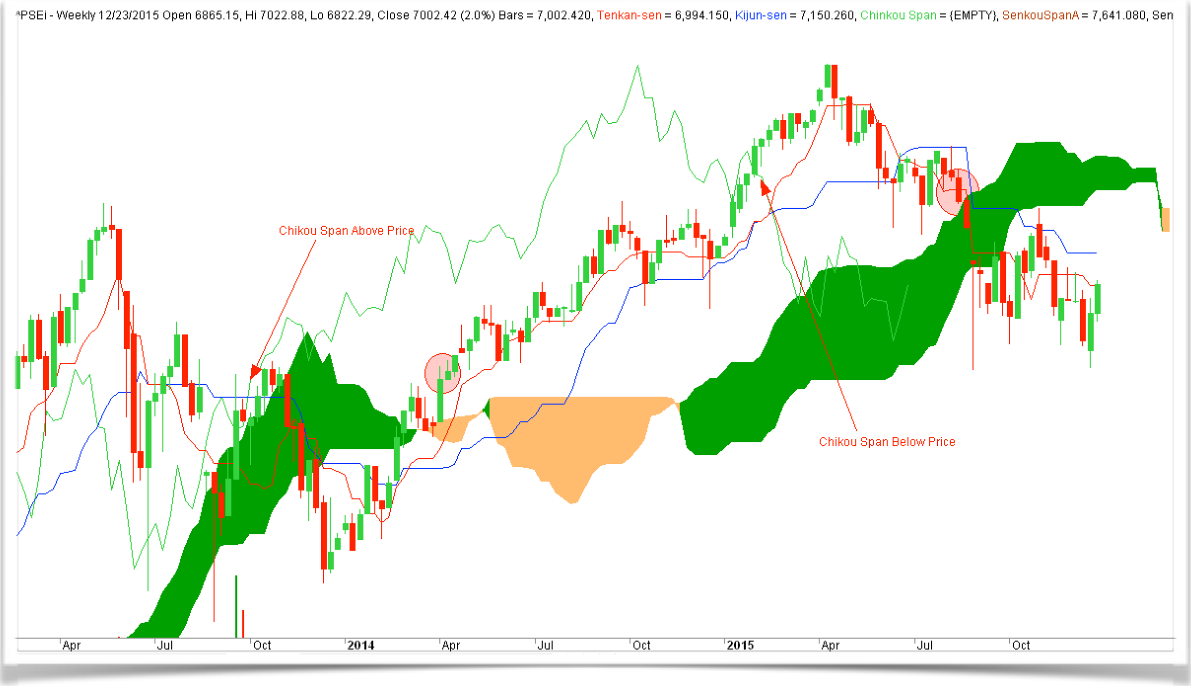


The Tenkan Sen and Kijun Sen measures short term trends, however, Tenkan Sen is the fastest since it measures trend over the past 9 periods compared to Kijun Sen that uses 26 periods, thus, making the Tenkan Sen less reliable compared to the other component. However, a break of the Tenkan Sen as support or resistance may give an early indication of the price moving towards the Kijun Sen to bring back equilibrium.

3. **Chikou Span**, or the **Lagging Line**, is nothing but the current closing price shifted backwards for 26 periods. This is one of the unique features of Ichimoku where it showed the trader a clearer perspective of the price action and help determine the direction of the trend.

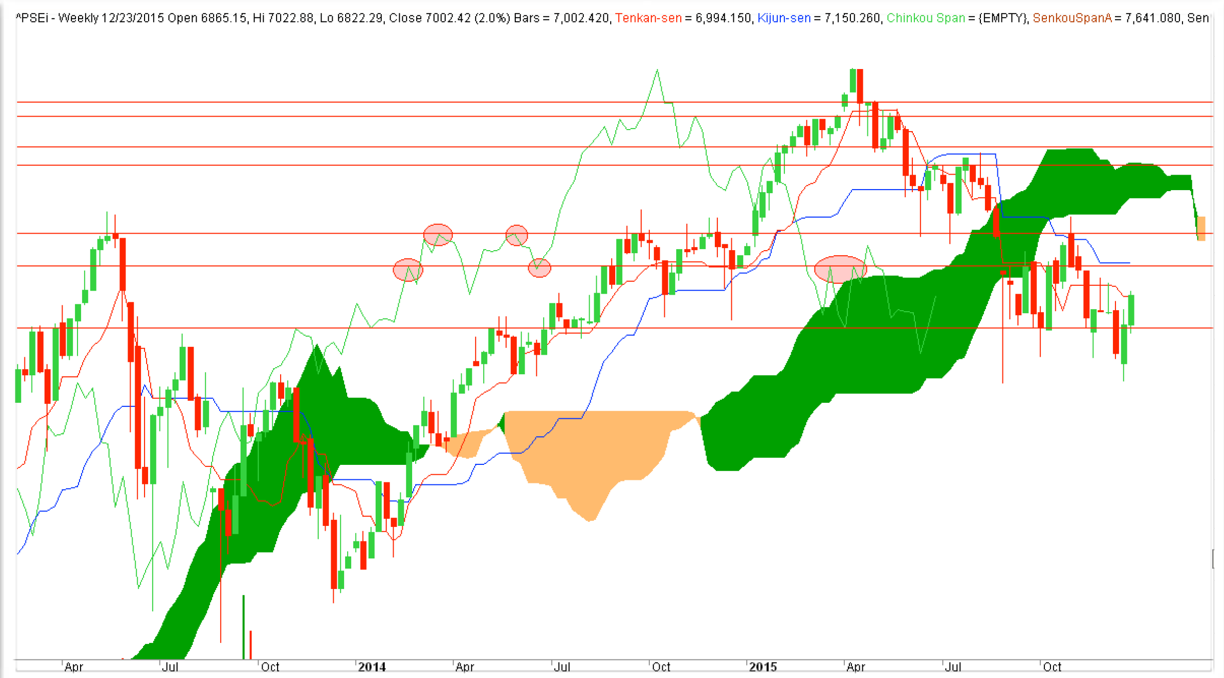
If the Chikou Span is **above** the price 26 periods ago, that is an indication of a bullish price action. If it is below, then that is an indication of a more bearish price action underway. By looking at the Chikou Span, you can also indicate the current trend, whether it is on the uptrend on the downtrend, and identify possible breakout of the preceding trend.

Below chart clearly summarised what we've mentioned about Chikou Span. The arrow mark points the Chikou Span in reference to the corresponding closing price, highlighted in red. Notice that when the Chikou span on the left broke out of the price action and stayed above it, the price action became bullish. The same is true on a bearish scenario when the Chikou Span on the right side broke the price action and stayed below it.



Another characteristic of the Chikou span is the ability to provide a clear level of support and resistance, since it represents previous closing prices. You can simply draw a horizontal line across the points created by Chikou Span to identify the key levels of resistance and support that could aid you in every analysis and trading decision. The more points touching the line, the stronger that level will be in terms of providing support or resistance.

Below chart gives us a visual representation of this characteristic.



4. **Senkou Span A**, or the **First Leading Line**, is calculated using (Tenkan Sen + Kijun Sen) / 2, shifted forward for 26 periods. This component, along with Senkou Span B line, is best known in forming the “kumo” or the “Ichimoku Cloud” which serves as the foundation of the Ichimoku Kinko Hyo System. It is another one of the time-shifted lines that is unique to Ichimoku, which in this case is shifted 26 days forward.

Since this component uses the average of Tenkan Sen and Kijun Sen, it is, on itself, already a measure of equilibrium. By shifting the Senkou Span 26 days forward, the trader is able to identify any critical support or resistance ahead of time. However, while it is possible to trade this on its own, the real power comes from the combination with Senkou Span B that forms the kumo.

To easily identify the Senko Span A, this line is the top part of the bullish kumo, and using our charts, the green cloud. On a bearish cloud, orange on our chart, it lies at the bottom.

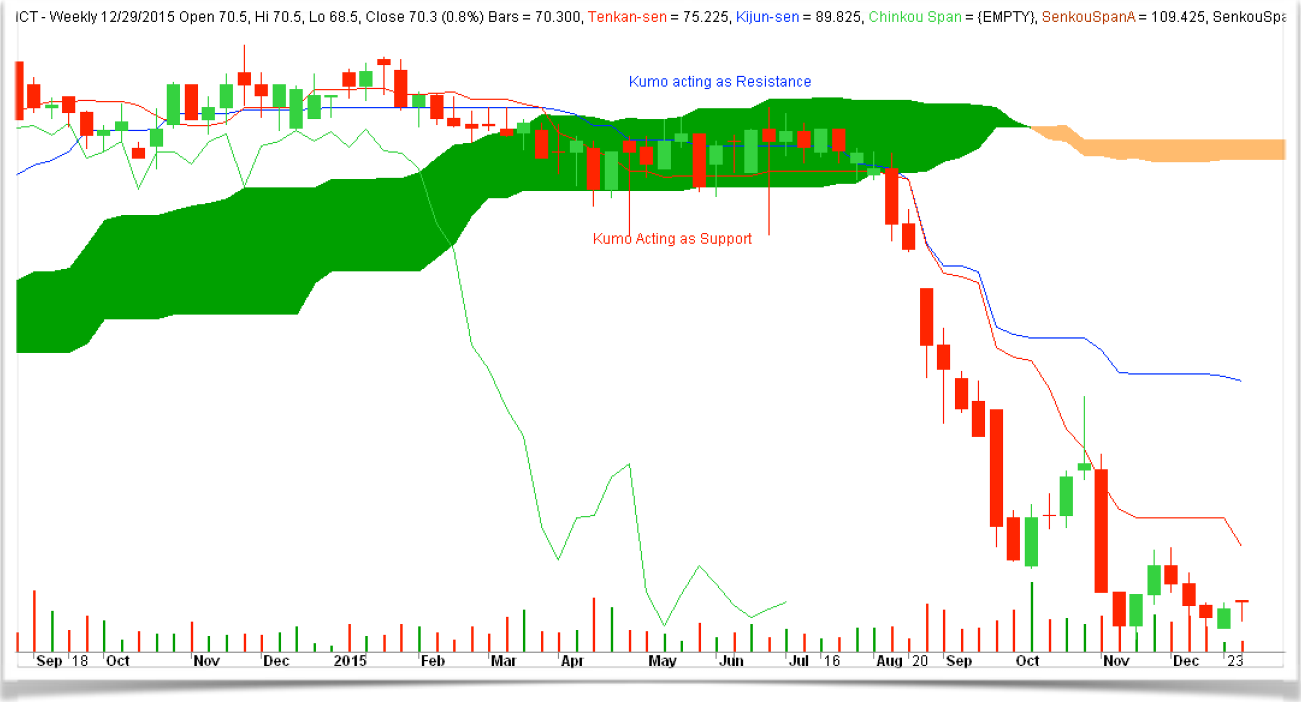
5. **Senkou Span B**, or the **Second Leading Line**, is calculated using the 52 period average of (Highest High + Lowest Low) / 2, shifted 26 days forward. Like the Senkou Span A, this component is best known in forming the kumo, which served as the foundation of the Ichimoku Kinko Hyo System. The Senkou Span B uses the average of the 52 periods, rather than the 26, in its calculation, to represent the longest term view of the equilibrium.

If used on a longer time frame, like the weekly, the Senkou Span B would represent the entire year. By having this information available 26 days ahead of time, the trader is able to make informed decisions based on the longer term measurement of equilibrium and adjust the trades accordingly.

The Kumo Basics

The kumo (“cloud” in Japanese), also commonly known as the Ichimoku Cloud, is probably the most visible component and the very heart and soul of the Ichimoku charting system. The kumo provides the trader the ability to distinguish the prevailing trend and the price’s relationship to that trend, and a multi-dimensional view of support and resistance that is different to the majority of the charting system available. This enables the trader to have a better view of how the market truly works, where the support and resistance is not merely a single straight line in the chart, but rather depend on market activity.

As mentioned previously, the kumo is comprised of the Senkou Span A and Senkou Span B, where each of the line is a measure of equilibrium and a representation of the longer term support and resistance. The void, or space, in between this two lines forms the kumo, an area that identifies the absence of trend. The equilibrium provided by the two Senkou Spans could make the price action very unpredictable and volatile, hence trading when the price is inside the kumo is not a recommended practice.



The chart above shows how the kumo acted as support and resistance, from the time the price initially enters the it around March 2015, all the way to the breakdown around August 2016. You will also observe the absence of trend when the price entered the kumo, and how the price respected the Senkou Spans acting as support and resistance on multiple occasions.

Price vs Kumo

The relationship of price to the kumo is pretty straightforward. When price is ABOVE it, then that is a bullish signal because the current price is trading above the perceived historical average. The same is true when the price is BELOW the kumo, then that is a sign of strong bearishness. If the price, however, is inside the kumo (just like our example chart above), then that is a sign of absence of a trend, or more commonly known as “consolidation”. This is the first thing that an Ichimoku trader would “glance” in a chart because you do not want to spend your time analysing a stock where you don’t see any potential profit. It’s just not worth the time, in my opinion.

An Ichimoku practitioner would, most of the time, wait for the price to break out or breakdown of the kumo before placing the trade. However, due to absence of shorting in PSE, the only way to make profit from a downward moving stock is by identifying a technical bounce, which we will discuss in the next chapter.

The Depth

If you noticed from many Ichimoku charts we posted above, the kumo varies with depth or thickness, and even colour. The depth is the representation of market volatility in the past, with the thicker ones indicating higher volatility, and the thinner ones indicating lower volatility. Since the kumo is comprised of the Senkou Span A and B, the Senkou Span A will travel along with the price, while the Senkou Span B will lag since it represents the average of the highest high and lowest low of the 52 periods. So when there is increase in volatility, where the price of stock changes direction dramatically over a short period of time, thicker kumos are created.

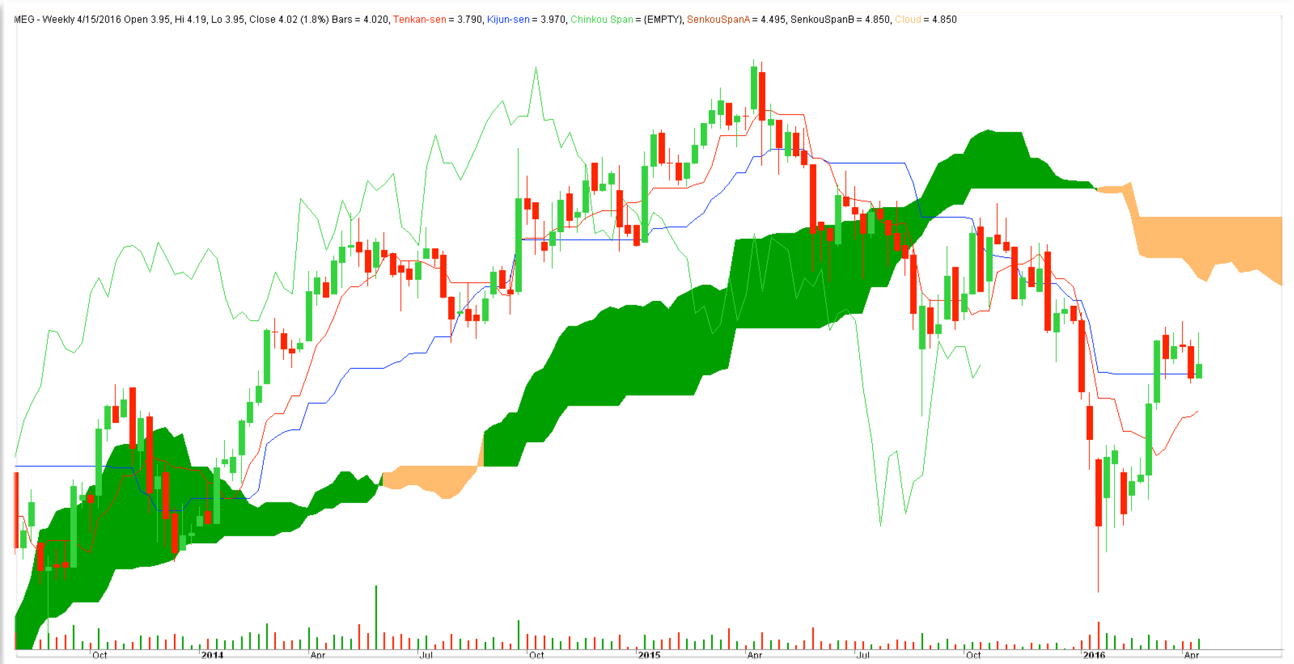
As shown in the image below, the thin peach kumo was the result of the sideways price movement, or low volatility, and the thick green kumo was the result of the increase in price volatility from the past.

The Ichimoku practitioner will use this information to identify their trading strategy, since they are aware that the thick kumo provides a great deal of support or resistance. An example is that they may consider buying a position if the breakout happened from a thin kumo, since they know that this doesn't count much as a resistance, compared to a thicker one. Another scenario is a breakout from the thick kumo, since the possibility of breaking back below it is relatively low.

Kumo Sentiment

Besides Kumo's relationship with the price, it is also being used to identify the bias, whether bullish or bearish. A bullish setup, with a bullish bias from the Kumo, adds to the conviction to buy. The same is true when a bearish setup is noticed, the bearish bias of the kumo adds to the bearishness.

The bullish sentiment happens when the Senkou Span A is above the Senkou Span B, and the bearish sentiment happens when you reverse the two. Below chart showed the Bullish Sentiment (Green Kumo) and the Bearish Sentiment (Peach Kumo). Notice how the price, after breaking out of the Kumo, continue to stay bullish because the kumo sentiment adds to the already bullish bias. The same thing happens after breaking down of the Kumo, the bearish sentiment of the kumo adds in to the bearishness, thus the price continued to go down.



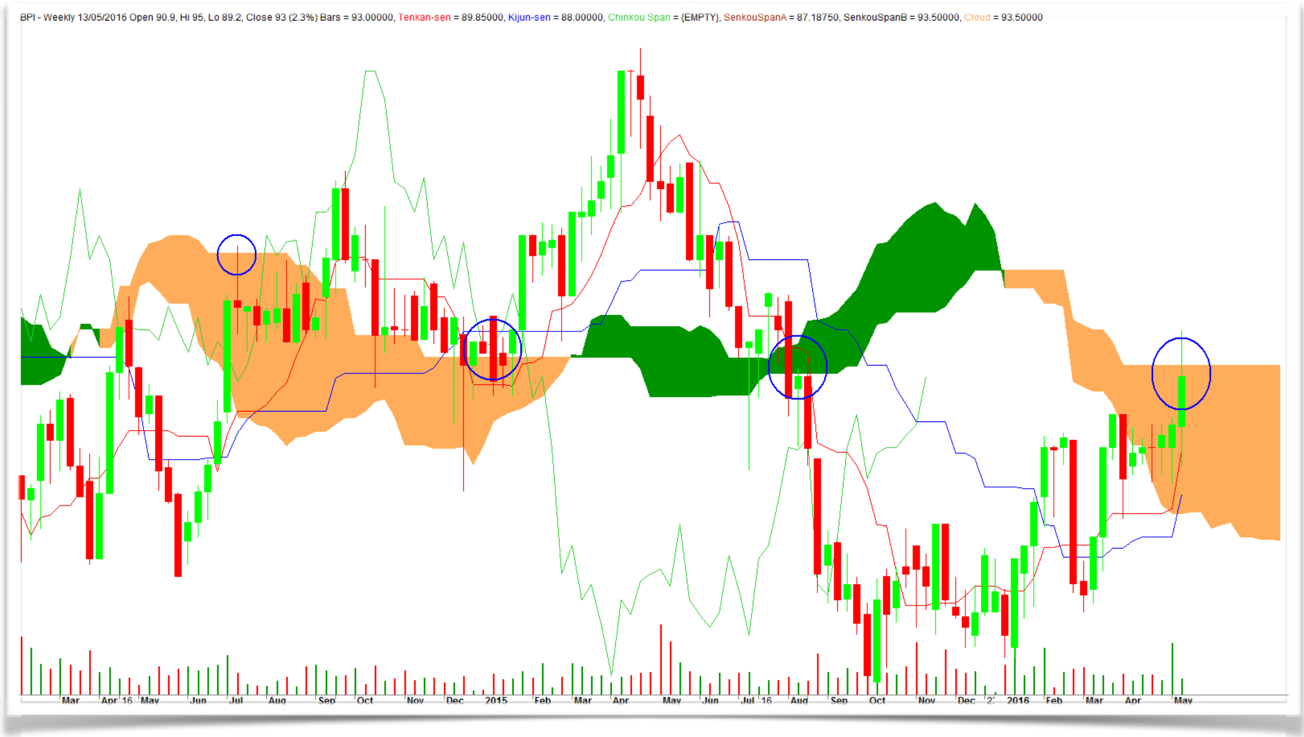
We should also keep an eye on the the leading kumo's sentiment to identify the current trend, and any potential change in sentiment. The same happens when the price broke down of the Bullish Kumo, the future kumo is showing bearish sentiment, thus further increasing the bearishness. Some traders uses the kumo twist (change from bullish to bearish kumo) as a strategy for trading, however, we will not be using that in our system since it doesn't provide an accurate trading signal based on my experience.

Flat Top and Bottom Kumo

The Flat Top/Bottom of the kumo plays a vital role in understanding the equilibrium concept of Ichimoku. The flat part of the kumo that we are referring to is the Senkou Span B, which acts the same way as the Kijun Sen line that attracts the price towards it that is within close proximity. It has the same rubber band effect on price, like that of the Kijun Sen. The reason behind this is because the Senkou Span B represents the midpoint of the 52 price period (if used on the weekly, this represents the whole year average), also known as the price equilibrium. Since price always seek to return to equilibrium, the Senkou Span B, like the Kijun Sen, becomes a very strong price magnet.

In reference to above chart of $AGF, in a bullish kumo (Green), the Senkou Span B will result in a flat bottom, and a bearish kumo (Peach) will manifest as a flat top. Using the flat top/bottom kumo to our advantage, a price that is above the flat top kumo has the strong possibility of it getting pulled by the strong price magnet it manifest (blue circle), and we can get out of the trade early. The same applies if the Flat Top or Bottom Kumo is above the price, we can set this level (arrow mark) as a target price. Just like the above chart, the gravitational pull of the flat top kumo will only materialise the moment the price breaks the bottom kumo acting as resistance.

Below is another example of the flat bottom and top kumo that should be self explanatory, based on above example. We can see how the flat top kumo was respected and act as our target price, and how the flat bottom kumo pulled the price. Having this information in advance would give us the advantage of what to expect, able to forecast a possible breakdown, and identify a potential target price.



TRADING STRATEGIES

Now to the good part…it's time to get our hands dirty.

While there are multiple strategies employed by the Ichimoku system, we will be only focusing on two, particularly the Kijun Sen and Kumo Breakout Strategy. The other strategies, in my opinion, is already integrated to the above-mentioned strategies, and we will only use them to provide additional confirmation to increase our level of conviction. I would focus on these two alone since these two are the strategies i used most of the time during my trade and provided good result.

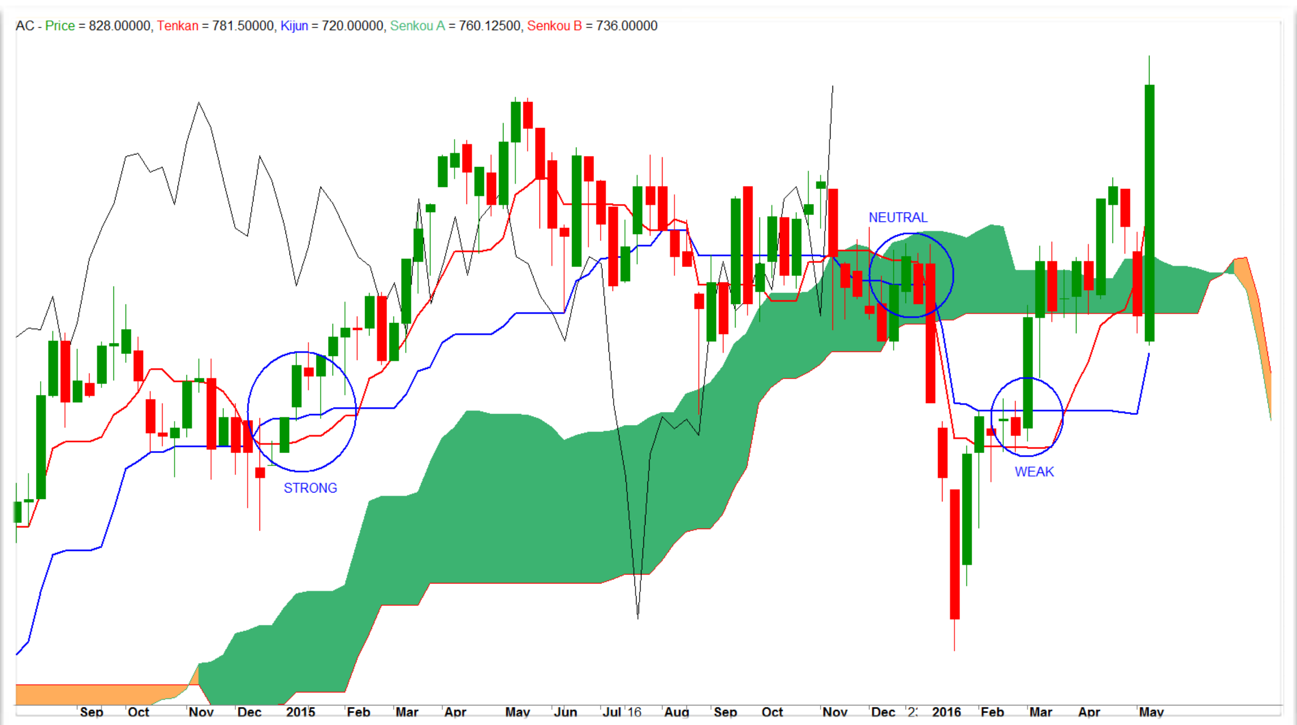
As i've been stating since the start of this chapter, the strategies that we will cover must use all the Ichimoku Kinko Hyo components, rather than in isolation. This means that while a given strategy may have transpired, the rest of the components must be checked to identify the probability of trade if it would be worth it. Other indicators can be used to add conviction to it, particularly the Commodity Channel Index (CCI), which worked very well with it. Mind you, the Ichimoku strategy we will be discussing below is very powerful and can give consistent result, if used properly.

KIJUN SEN BREAKOUT

The Kijun Sen Breakout (or Kijun Sen Cross), is, i would say, by far one of the most powerful and reliable trading strategy within the Ichimoku Kinko Hyo System. It can be used on almost all time frames having consistent result, however, less reliable if used on the lower (intraday) time frame due to high volatility. The strategy is simple: Whenever the price breaks out of the Kijun sen from the bottom up, then that is a Buy Signal, or simply called BULLISH CROSS. If it crosses from the top down, then that is a Sell signal, or BEARISH CROSS. Simple enough? You bet so. However, just like what i mentioned above, it needs to be evaluated against the overall Ichimoku Kinko Hyo system before committing any trade.

There are three general classifications of the Kijun Sen breakout strategy that all Ichimoku practitioners observe, and that is the STRONG, NEUTRAL and WEAK. These classification is what we referred to above when we say to evaluate with the overall Ichimoku system to verify the high and low probability trades (because the PSE have not approved the Short Selling facility yet, i will only focus on the Buying aspect of this strategy).

- **STRONG BUY** signal takes place when the **BULLISH CROSS** happens **ABOVE** the Kumo.
- **NEUTRAL BUY** signal takes place when the BULLISH CROSS happens **INSIDE** the Kumo.
- **WEAK BUY** signal takes place when the **BULLISH CROSS** happens **BELOW** the Kumo.



Besides the above condition, we must always consider the Chikou Span's location in relation to the historical price to give confirmation to the Kijun Sen Breakout signal. If the signal triggers a BUY, and the Chikou Span's location is above the price, then that would add an additional confirmation for us to buy. The same thing when the signal triggers a SELL, and the Chikou Span is below the price. If the Chikou span's location is the opposite of the Kijun Sen's breakout, then that weakens the signal. (This is one of the Ichimoku strategy, called Chikou Span Cross, which i mentioned above that will be integrated to the strategy we are using.)

ENTRY

The entry is as straightforward as it could be, that is you'd place an order in the direction of the cross. However, an Ichimoku trader must make sure that the cross has been solidified by a **close**, as this will provide us a confirmation that the resistance provided by the Kijun Sen has been broken and the trend is about to make a reversal. Furthermore, you should consider any significant levels of resistance near the cross, i.e. Fibonacci levels, Kumo, etc., and consider waiting for the price to breach those levels before pressing that BUY button.

For **High/Medium Risk** traders, you can place an order even if the sentiment is still Weak or Neutral, that is when the price breaks out of the Kijun Sen line even when it is still under or within the Kumo. The risk associated with this is that the ascend may be stopped by the resistances provided by the Kumo line. The reward, should it materialise, is a very low entry point which could provide more profit should the trend matures.

For **Low Risk** traders, you will only place an order when the sentiment is Strong, meaning, the cross only happens when the price is above the kumo. This way, there is not much of a resistance to consider, and the chance of the trend maturing will be high.

Always remember that most of the time, whenever a strong resistance gets broken, we observe the next opening candle to validate the strength of the reversal. Just like what we do in Fibonacci's 38.2%, 61.8% and 161.8%, the same also applies.

EXIT

There's only two reason that we would exit the trade, and that is if the cut/stop loss level was hit, or the price crossed the Kijun Sen in the opposite direction. Simple enough, however, we'll discuss further.

STOP / CUT LOSS

The good thing about the Kijun Sen Breakout strategy is that the stop/cut loss level is already managed by the Kijun Sen itself. If a Kijun Sen breakout happens, and the price then retraces back and breaks the Kijun Sen as support, that is an indication that the momentum to reverse is still low. The recommended stop loss level would be around 5 to

10 points below the Kijun Sen line, or depending on your risk tolerance, can further increase that and use the Fibonacci level instead.

Do not place your stop loss directly on the Kijun Sen level. The reason behind that is because, as you may have known already, Kijun Sen is the representation of price equilibrium, and after the breakout, there is a great chance that it would be retested as support. Placing your stop loss level at the Kijun Sen level itself has the greater chance of hitting it. What's worst is, after you sold your position because you followed your trading plan, the price moved according to your analysis. This is commonly known as "whipsawed", and we don't want that to happen to us.

While the price is moving along with Kijun Sen, we move our stop loss along with it, still maintaining the 5 to 10 point distance below it. Most trader ask whether to activate the stop loss the moment it got hit during the day, or wait till close, and the answer is depending on the time frame you used. If you used the Weekly Chart to identify your trade, then it is recommended to wait for the closing candle for the day, and cut your losses the next day if the stop loss level is hit. If you use the Daily time frame to identify your trade, then you don't have to wait for the closing price before you cut your losses as soon as it gets hit.

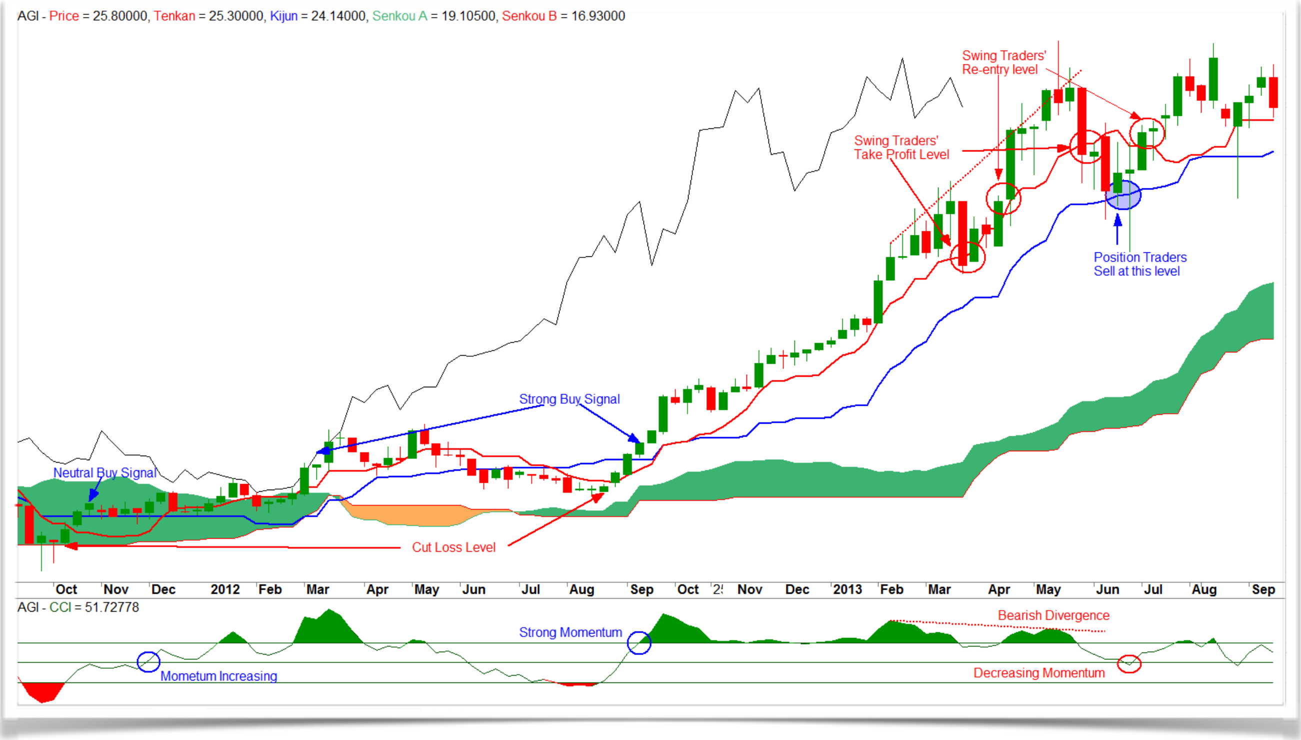
PROFIT TARGET

There are different method of taking profit from this strategy, and can be approached depending on your trading perspective. If you're a swing trader, you have two options: a)you can use Fibonacci levels to identify your target price, or use the Tenkan Sen break as support to trigger your selling. A break of the Tenkan Sen as support is an indication that the short term trend is about to end, thus triggering the breakdown from the short term support. The downside is that you may have to reenter again at a higher price if the trend reversal is not strong.

If you're a position trader, you do not set a specific target, but rather wait for the price to cross the Kijun Sen from the opposite direction. You will lose some profits while waiting for the Kijun Sen Cross to happen, however, at least you are certain that the trend is concluded and you're able to ride it all the way. If the price bounced off from it, then that is another opportunity for you to top up your position, or commonly known as "**Buy on dips**" or **BTFD** (*Buy The F*cking Dip*).

CASE STUDY: ALLIANCE GLOBAL GROUP, INC (AGI)

For our case study, we'll use $AGI. I'll explain each of the points of the strategy, and how an Ichimoku trader would ride the price action.



Looking at the above chart, we noticed a Neutral Kijun Sen Breakout back in October, and upon checking with our CCI, we noticed that it failed to break out of the Zero (0) line, thus making this not yet a candidate to ride, however momentum is increasing. Furthermore, the setup is still bearish, since the KS is still above TS, hence the more reason not to be tempted to buy just yet. If you're a high risk trader, then this is already a Buy signal for you, with the Cut Loss Level suggested to be below the TS or the Kumo.

The price managed to breakout of the Kumo around January, suggesting the strength of the trend increasing, but, when you look at the future Kumo, we are expecting a bit of bearishness (peach kumo), thus, anticipating that the breakout will just be shortlived (more on this on the next strategy). The price moved lower, as anticipated, and broke the KS as support. The high risk traders who bought earlier would've closed their position when the TS or KS was broken as support. CCI also validated our analysis of weak momentum when it failed to breakout of +100 on the next attempt, and continue to head down.

Since no shorting is available in our market, the only option we have is to wait again for another opportunity to enter this trade. This happened around September when the price broke out of the KS, with all the indicators suggesting this is a strong one. Chikou Span is above the price, further increasing our conviction, and the CCI broke out of the +100 line which indicates a Strong momentum ahead. An ichimoku trader would buy at the next candle, and use either the Tenkan Sen or the Lowest candle from the swing, as their cut loss level.

You will notice how the CCI managed to stay above +100 while the price continue to go up, which is an indication that there is still no reason to get out of this trade just yet. When the price broke the Tenkan Sen as support, a swing trader would be securing their profit at this level, and wait for another opportunity to re-enter the trade. The sign will be a break of the Tenkan Sen as resistance which tells us that the trend is still far from over. Position traders would take this opportunity to add more positions.

When the price broke the KS line, the position trader would be securing their profit, and wait for another opportunity to enter the trade again. The break of the +100 of CCI as support is a sign that the trend is losing momentum. Furthermore, we noticed the bearish divergence that was formed, which adds to our conviction that the bulls were already tired and would need that much needed rest.

You will notice how an Ichimoku trader was able to ride the entire duration of the trend, and has all the information he/she would need at a glance. You will not be asking anyone what will be their Target Price because you simply ride the trend.

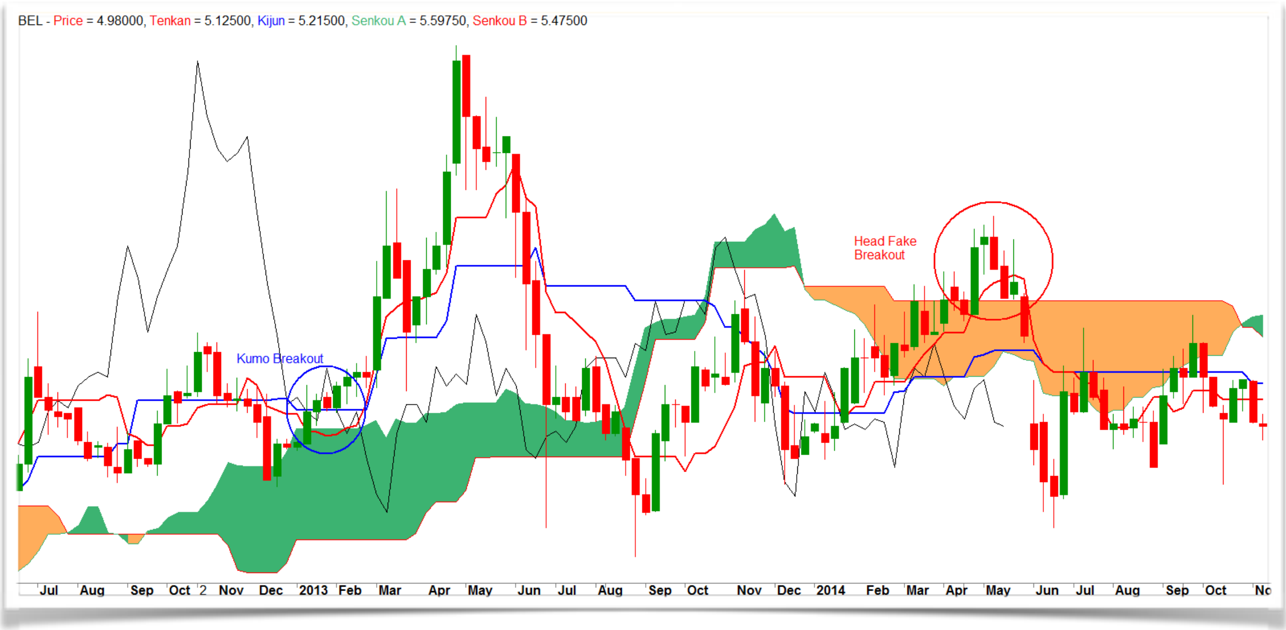
What if you're able to identify the trend halfway only? Is that still a safe way to trade? If this is the scenario you are at the moment, the first thing to do is to consider the effect of the Kijun Sen pulling the price, and once this start moving sideways, the price may get pulled, thus leaving you at the top. The best way is to wait for the pullback and enter whenever a) Tenkan Sen hold as support or b) Kijun Sen hold as support.

You will also notice that the chart i used is for the weekly. The reason is because there is a more defined trend and less noise than the daily. When you will enter into a trade, you will switch to the Daily chart and apply the same strategy of identifying the Kijun Sen Breakout.

Always make it a habit to identify the trend from the Weekly Chart, and plan your trade to buy or sell using the Daily chart.

KUMO BREAKOUT

The Kumo Breakout strategy, mostly used by position traders, can be used on multiple time frames, however, most widely used on the longer time frame i.e. Weekly, Monthly, etc. Just like the Kijun Sen Breakout Strategy, the trader will only look for a breakout of the price from the Kumo. This strategy is considered by most to be the purest form of trend trading because an Ichimoku trader will only be looking at the location of the price with respect to the Kumo.



ENTRY

The entry is relatively simple: You simply buy on the next candle after the price breaks out of the Kumo. Period. Simple enough, isn't it? However, there's a catch. You have to make sure that the breakout is really a breakout, and not a ***head fake***, and this can be easily identified when the breakout happened on a **flat top kumo**. In order to ensure that the flat kumo will not pull the price back, it is recommended to look at the Chikou Span resistance to see any potential resistance that could prevent the price from breaking out. Furthermore, if the Chikou Span is also inside the Kumo, the Senkou Span can also act as resistance to the Chikou Span which could prevent the price from breaking out further. This is called the *Kumo Shadow*.

Another thing to take note is the sentiment of the leading kumo after the breakout. If the price breaks out of the Kumo but the leading Kumo is a bearish one, then that would constitute a weak breakout, thus the Ichimoku trader is recommended to wait for the Kumo to agree with it before placing a trade to increase the odds of success.(*Again, another strategy that we integrated with the Kumo Breakout, known as the* ***Senkou Span Cross.****)*

EXIT

This is the easiest part of this strategy where an Ichimoku trader will only exit whenever the stop loss level gets hit, and that is when the price breaks the bottom Kumo as support. This will validate that the momentum to breakout and trigger a trend reversal is still too weak, and we have to get out of the trade to prevent further damage.

STOP / CUT LOSS

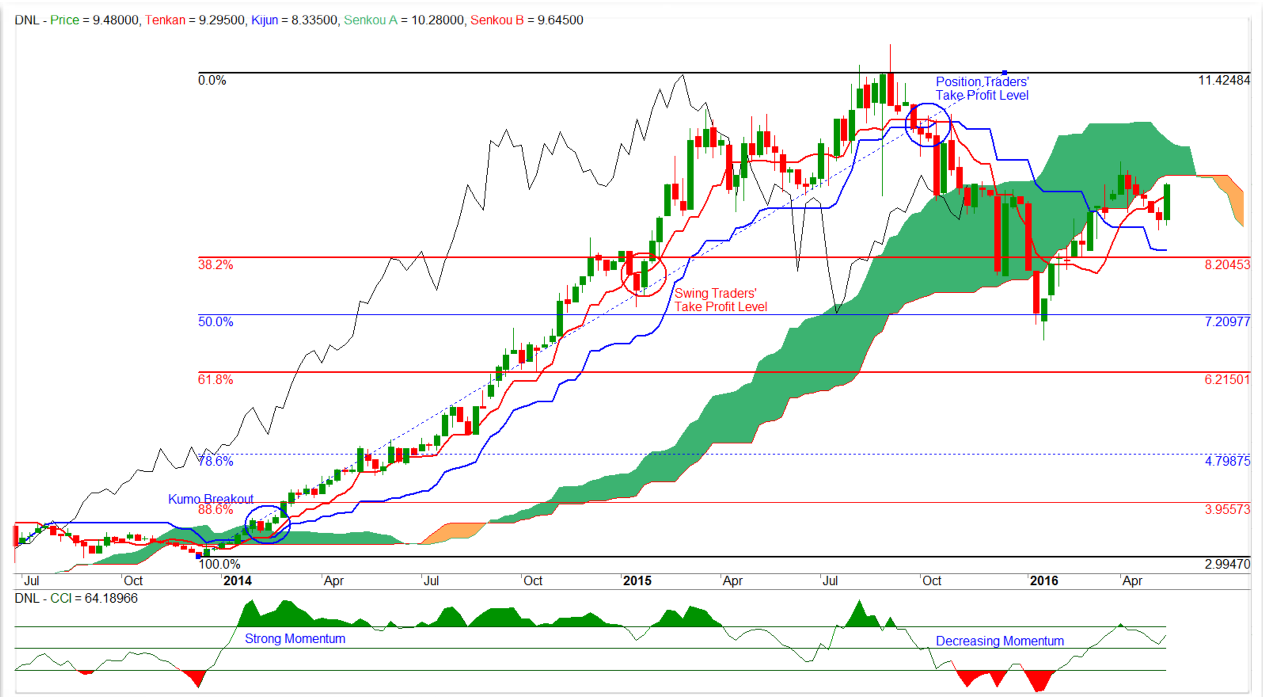
The stop / cut loss level that we will use will be the bottom kumo, wherein we place a 5 to 10 points of buffer to prevent us from getting hit whenever the price paid respect to it, especially when the bottom kumo is flat, to bring back the equilibrium. If the price managed to hit our stop loss level, we are assured that the downtrend is still too strong and no point in going against it.

PROFIT TARGET

Just like the Kijun Sen breakout strategy, the profit taking strategy can be approached either by being a swing or position trader. We can use Fibonacci as one way of taking partial profit, but because this is a trend trading system, i would recommend to use the Kijun Sen cross as our target to lock in profit. We can use a 10 point buffer after it breaks so that we can confirm that the trend is about to end. If you want to maximise your profit and ride the trend all throughout, use the bottom kumo break as your profit target, where in you'll wait for the price to break the bottom kumo as support. This will assure you that a major change in trend has already taken place.

CASE STUDY: D&L Industries, Inc (DNL)

The chart of DNL is one of the best example that we could use to show how this strategy works. We've also used DNL in our Fibonacci Case Study, so you can have an idea of how to perform the analyses given the two systems we used.



Fibonacci and Clouds Trading System

Looking at the above chart, notice that a Kumo Breakout around January, however, while looking at the Chikou Span, we noticed that it is still below the price which prevented it from moving further. Notice also how the price, albeit above the Kumo, waited for the Chikou Span to be freed from the resistance set by the price, and upon breakout, it just moved breaking all the previous highs. Notice also that prior to the Kumo Breakout, there is a Neutral Kijun Sen Breakout that happened, which makes the Kumo Breakout an additional indicator of a strong trend ahead.

The CCI also showed the strong momentum when it break out of the Zero (0) line after breaking out of the Kijun Sen. The momentum was further increase when the CCI stayed above the +100 line while the price broke out of the Kumo.

As a swing trader, you only would focus on where the price would break the Tenkan Sen as support, adding the CCI for conviction. The Swing Trader would've secured its profits after the TS was broken as support, matched with the CCI breaking the +100 as support, suggesting the momentum to be decreasing. They will re-enter again should it break out of the Tenkan Sen acting as resistance. The same strategy was employed by the Position Trader with the Kijun Sen Breakout, waiting only for the price to breach the KS as support before securing the profits.

If you're into trend following, and would really want a confirmation that the trend is over, you can plot a Fibonacci to see if it had broken a critical Fibonacci Support, and decide whether to stay or not. A break of the 38.2% and Lower Kumo would trigger the selling of those who are following the trend, however, knowing that the 38.2% is usually retested to confirm, the breakout of 38.2 as resistance would show that the trend is still, indeed, intact. This would give the trend follower an opportunity to buy back some more during the dip.

Chapter Three:

Trading the Technical Bounce

This chapter will introduce the concept of Technical Bounce play, how to identify the probability and make profit out of a downtrending stock. This applies to all market where Short Selling is not allowed. We will discuss how to utilise all the tools that was presented in this book to find the probability of finding a profitable trade.

Load the ship and set out. No one knows for certain whether the vessel will sink or reach the harbour. Cautious people say, "I'll do nothing until I can be sure." Merchants know better. If you do nothing, you lose. Don't be one of those merchants who won't risk the ocean.

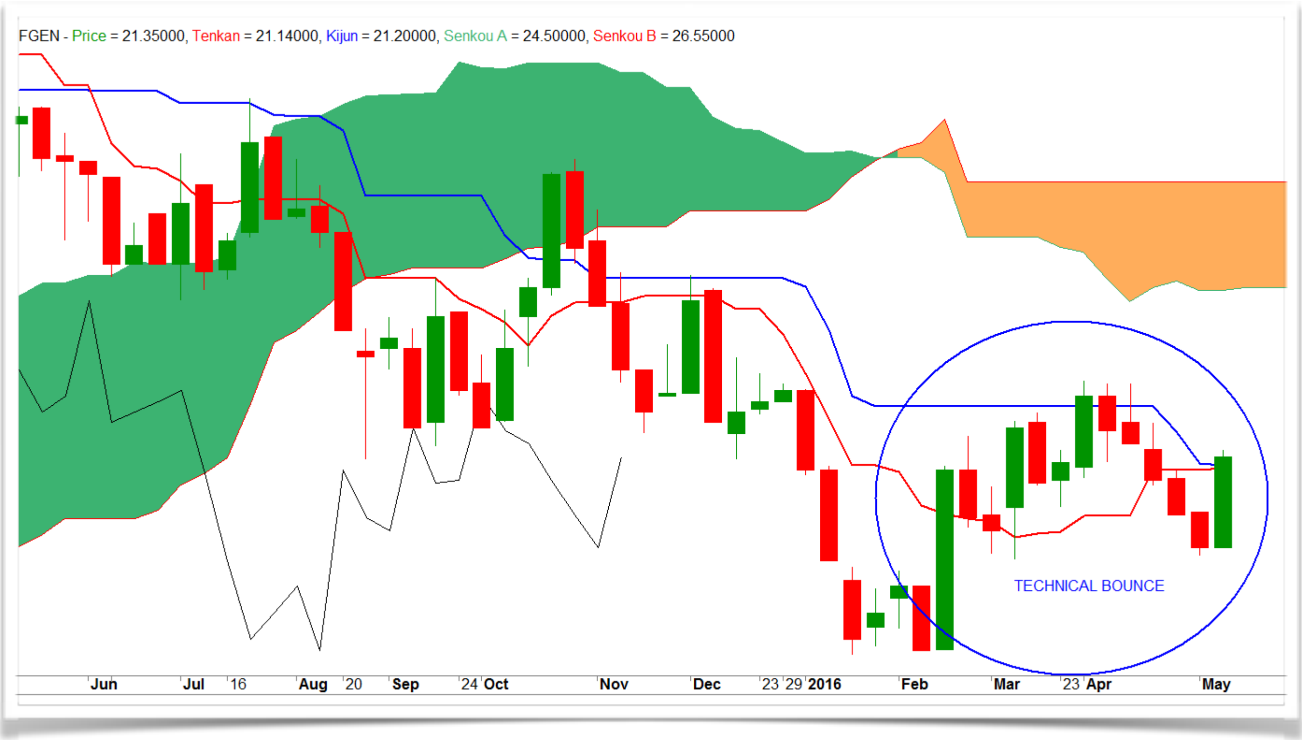
—Rumi

What is a Technical Bounce?

A "Technical Bounce", or more commonly known as "Dead Cat Bounce" or DCB, is a strategy which focuses on buying a given stock once the price started to fall, thereby bouncing off from an identified level of support. This support could either be a Fibonacci Retracement / Extension level (i.e. Harmonic Potential Reversal Zones) or Ichimoku Kinko Hyo.

The bounce is usually brief, and the upward movement of the stock price is based solely on charts and not on fundamental change in market direction. Depending on the timeframe we used to identify the potential technical bounce, the duration can be from one day, to even a couple of weeks. A bounce identified on the daily chart could last for a day or two, while on the weekly chart could last the whole week, and the monthly chart to a couple of weeks. We will provide multiple scenarios about each and every timeframe we used, and how we would trade it once identified.

Below is an example of a technical bounce in $FGEN.



What are the signs?

In order for us to identify which of those falling stocks is ripe for the picking, we have four (4) conditions that we will be looking at closely, and these are the following:

Bullish Divergence

We discussed in Chapter 1 the lone indicator that we are using along with our system, the Commodity Channel Index or CCI, and this is what we would refer most of the time to validate our analysis. A bullish divergence happens when the price is dropping, however the CCI is moving on a different direction. This means that while the price is continuously dropping, there are some accumulation going on in the background, albeit in small quantities.

Tenkan Sen and Kijun Sen

Besides the abovementioned conditions, these two played a major role in identifying the candidate that is potential to bounce. If you would recall from the previous chapter, the Kijun Sen has this special characteristic that we will utilise, and that is its “Rubber Band” effect, whereby pulling the price to bring back the equilibrium.

Everytime the Tenkan Sen or Kijun Sen remained flat, that is a sign of lack of trend, which some calls consolidation. Whenever the TS or KS goes flat, it will trigger the price to move towards the direction of the TS and KS to bring back the equilibrium lost due to the price movement. This movement of the price is called correction, where the price corrects to a healthy level before resuming to whichever trend the market chose. As it touches the Tenkan Sen line, the short term equilibrium is restored, and the Kijun Sen will bring back the medium term.

When used on a weekly chart, the Tenkan Sen represents the 9 week average, while the Kijun Sen represents the 26 week average.

Fibonacci Retracement / Extension

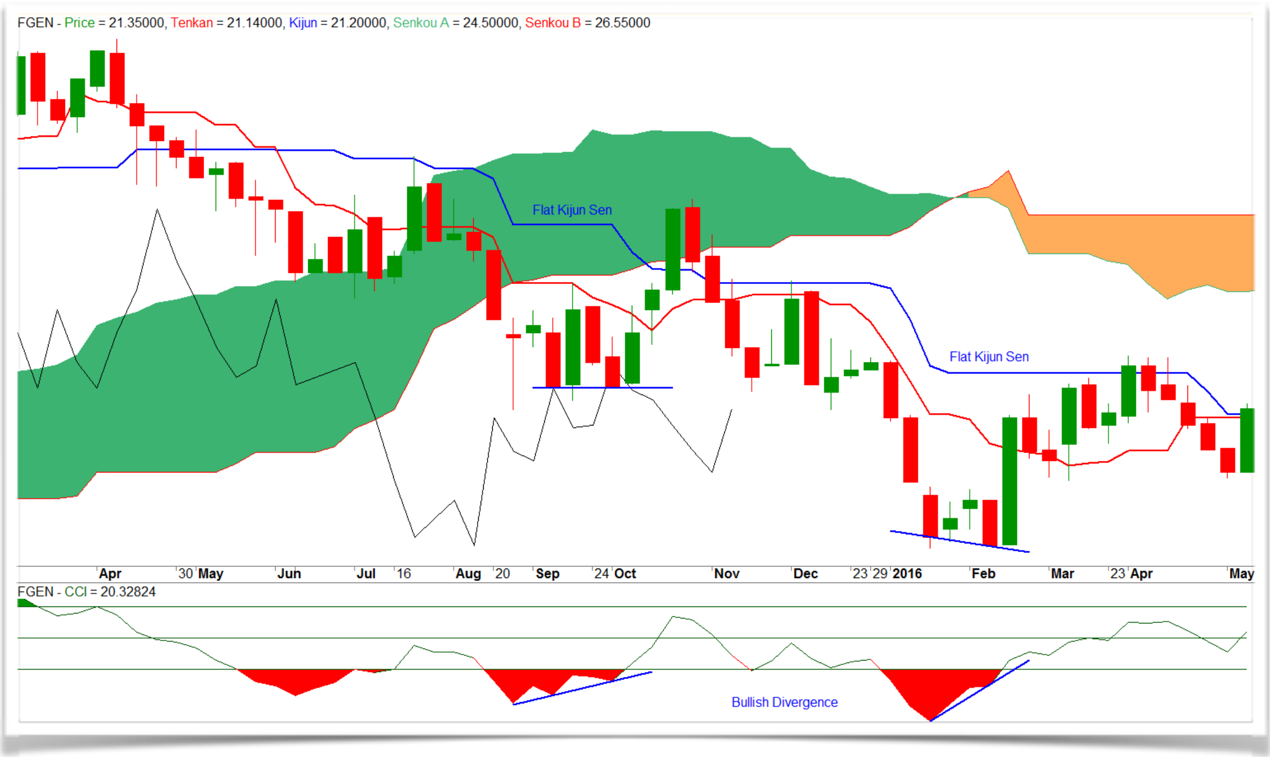
We’ve discussed in chapter one the Fibonacci levels that is commonly becoming the potential reversal zone, as well as those levels that usually acts as a strong support once tested. These levels can be used to identify the potential and add conviction for the bounce.

Volume

If the Volume is declining while the stock price is dropping, this suggests that the sellers may have already reached their threshold and getting too exhausted, which would give the opportunity for the buyers to take advantage. A dropping price with high volume suggests distribution going on, and you don’t want to be on the receiving end when this is happening. This is where the famous adage “Don’t try to catch a falling knife” falls into play.

In general, I only focus on the Bullish Divergence of CCI and the Tenkan Sen/Kijun Sen pair…the other indicators i.e. Volume and fibonacci are used mostly as confirmation. Technical Bounce could also be the start of a new trend reversal, so it's best to read all the signs so as not to sell early.

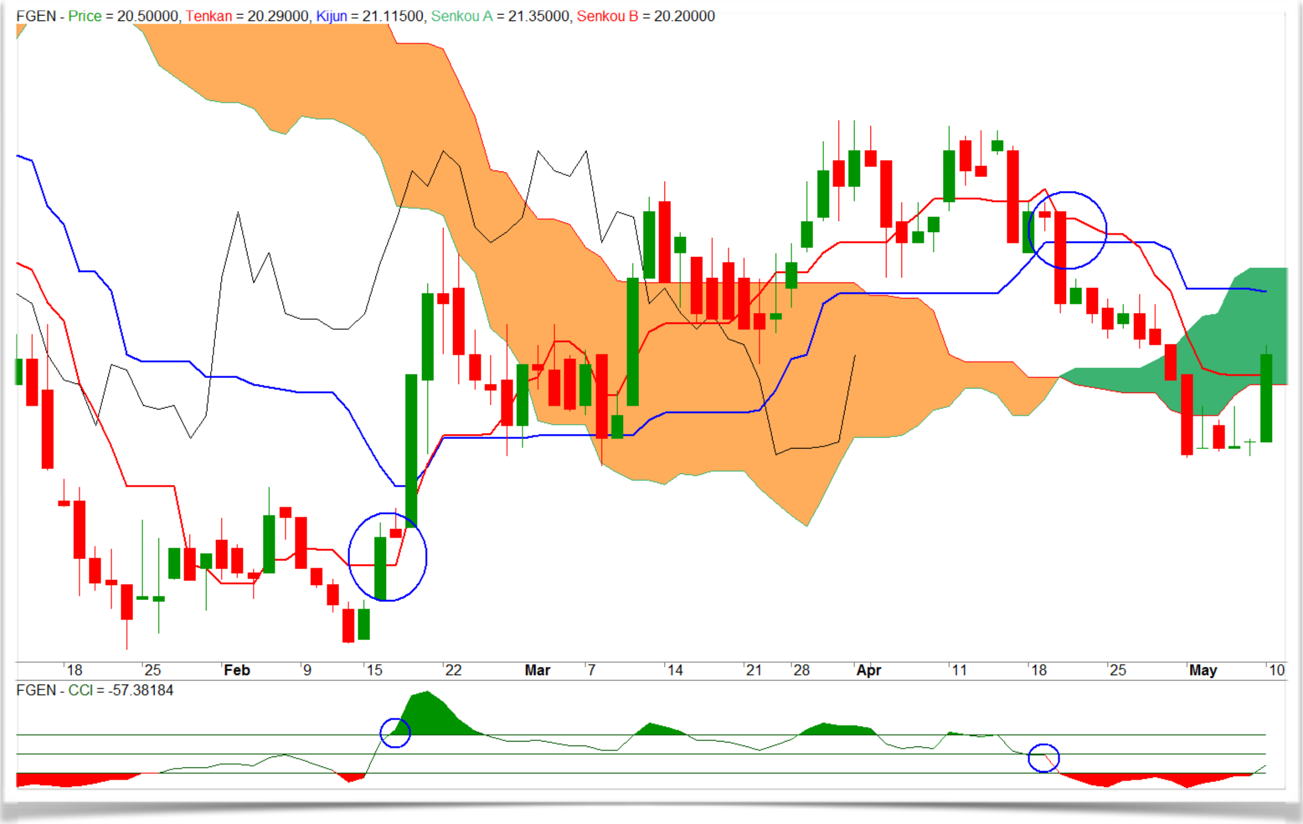
Below weekly chart of $FGEN will show the signs that would constitute a technical bounce.



When to trade a Technical Bounce?

Trading a bounce play is simple and straight forward. Once we've identified a candidate for technical bounce based on the above criteria, we will proceed with putting up the trade. It is recommended that weekly chart be used to attain a higher reward compared to the daily, but this should not stop you from using the same in a daily chart should the signal presents itself, and the reward is acceptable.

Assuming we'll take the January 2016 trade of $FGEN prior to the formation of the green candle, we notice the flat Kijun Sen that could trigger the price from being pulled to bring back the equilibrium. Also, the increasing bullish divergence brought about by the CCI by starting to create a higher low, while the price makes a lower low is an indication that the Kijun Sen may pull the price. From the current price, calculate the reward by setting the Kijun Sen level as the Target Price. If the upside is acceptable to your liking, then we proceed with planning our trade by moving to the Daily chart and identifying the possible entry.

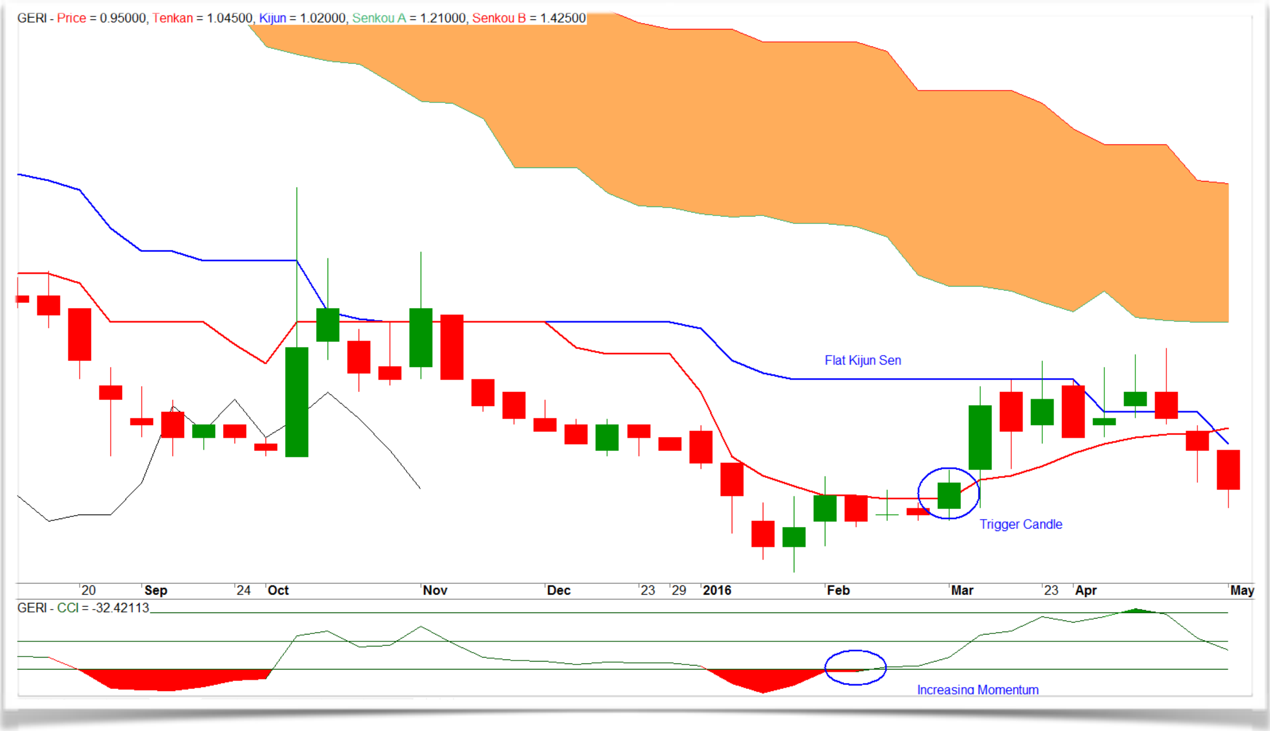


What gave us the reason to enter the trade is when the price on the Daily managed to breakout of the Tenkan Sen resistance, with the CCI breaching the +100, suggesting that the momentum is strong. By looking at the above chart, we are certain that it would take a lot of effort for the price to reach our TP due to a thick kumo that would prevent the price from moving further.

Notice that on the weekly chart, the Technical Bounce play that we've identified is now forming one of the Ichimoku strategy, particularly the Kijun Sen Breakout. This gives us the more conviction that the identified TP is bound to be respected, hence, albeit the drop after the price was rejected by the Kumo, we would still hang on to it because the Kijun Sen support is still intact and strong. We are also confident that if the price would breakout of the Kumo, it would be a fake one due to the presence of a flat top kumo.

After the price retested the Flat top kumo and managed to break out, the price then reached our identified target price, and because we know that there's a resistance that will be met on that level based on the weekly chart, it is now your prerogative to decide whether to take all the profit and call it a day, or watch and wait if it will breakout of it. My suggestion will be to sell half from the identified TP, and remaining half when the daily KS gets broken as support, suggesting that the trend is finished, and the technical bounce is completed.

Case Study: Global-Estate Resorts Inc (GERI)



GERI was a candidate for a Technical Bounce Play based on the above chart where it showed a Flat Kijun Sen line, followed by an increasing momentum from the CCI. However, notice how the Tenkan Sen rejected the price from reaching KS, thus the price started moving sideways from then on. In cases like these where there is a big gap between the Tenkan Sen and Kijun Sen line, and the Tenkan Sen trailing close to the price, it is best to wait for the price to break out of the Tenkan Sen resistance and use that move as our trigger.

When the price managed to break out of the Tenkan Sen, we then proceed to our Daily chart to see if any of the strategy could be used to complement the above move. What we noticed is the weak Kijun Sen Breakout on the 16th of February, however, with the CCI pointing downwards, there is no way that the bounce would be supported. As the price continued to move sideways using Tenkan Sen as resistance, we noticed an increase in momentum after it broke our of the TS line. What adds up to the conviction is the breakout of the Chikou Span from the price resistance.

If you noticed the multiple times the price breaks the KS as support, the CCI managed to stay above the +100 line, suggesting that the momentum is still strong. What followed it was a Kumo Breakout from a flat top kumo, to which we are anticipating a fake breakout. Since this level almost touched the Kijun Sen and within our TP, you can set a take profit on the next candle, or wait for it to fully touch the Kijun Sen if you set a GTC order.

And just like we mentioned earlier, you can sell half when the TP gets reached, and wait for any possible continuation. If the price on the daily broke the Kijun Sen as support, then that is the time to sell the remaining, since you could be sure that the Kijun Sen resistance on the weekly chart will not be broken due to weak momentum still.

Looking at the remaining candles from the above chart, you can see that there is a potential for a Technical bounce play to materialise…we would simply wait for the price to break out of the Tenkan Sen and Flat Bottom Kumo, and we know where it would be heading next…the rubber band effect of the Kijun Sen. CCI is also in agreement with our analysis, since there is increasing momentum, awaiting for it to break the -100 as resistance.

How to identify stocks with Ceiling/Bagger potential?

As you are fully aware, this is every traders' dream…to be able to catch the big one that could end up having 50% day change (ceiling) or 100% from it's original value (bagger). This type of movement is mostly prevalent on third liners, aka basura, because of the small market capitalisation, it would easily trigger the greed on most participants and push the price all the way to the ceiling.

Don't expect second liners and blue chip stocks to go for a ceiling play, however, there is the potential to even reach 100% in the long run. You simply need to follow the trend on these stocks. If you're up for some excitement, then you'll need to learn how to trade the third liner stocks.

The secret is simple: use the monthly chart.

We will apply the same concept for the technical bounce play. We'll identify the stock that is showing the potential for a "bounce" from the long term perspective. The same concept is used where the Kijun Sen would eventually pull the price to return back its equilibrium will be applied on the monthly time frame. The only difference with third liners is that because of the low market cap, the probability to move within a day or two is high.

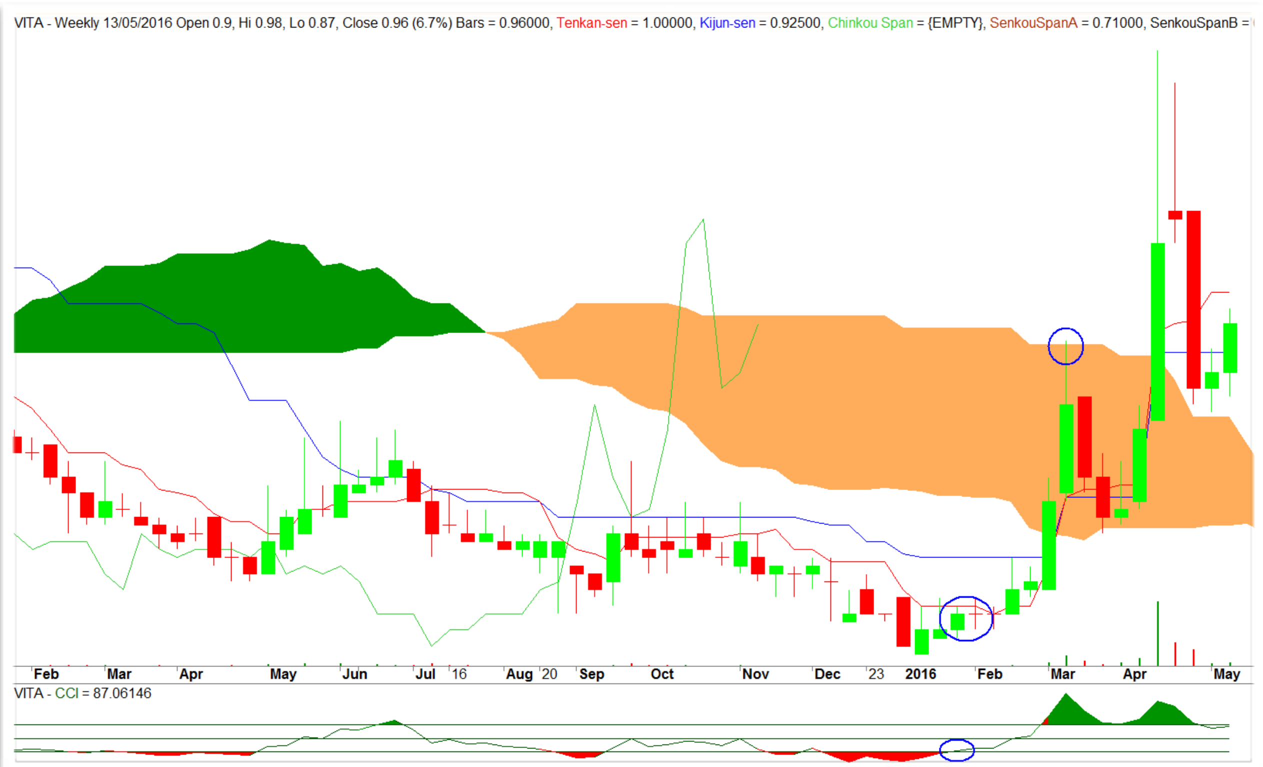
Once we've identified the candidate stock, we then proceed to the weekly chart to see if any of our entry strategy is agreeing with the monthly. We could use the Kijun Sen or Kumo Breakout strategy to see if the stock is getting bullish to be in agreement with the monthly chart. The same thing we will do on our daily chart to identify the entry level. Always keep in mind that the Monthly time frame controls the Weekly, and the Weekly controls the daily. If the weekly is moving down and the daily is moving up, you should be cautious, as this could end up badly. The same applies when the weekly is going up and the daily going down, this could be a candidate for entry.

CASE STUDY: VITARICH CORP (VITA)

We'll use $VITA as our case study to show how we were able to identify the potential for this stock to reach an initial 44% upside. We will go on step by step, from identification of the potential upside all the way to identifying when to enter the trade.

First step that every trader must do is to ALWAYS look at the bigger time frame so that you'll know the potential of any stock and you won't be selling early. Once you've identified the stock with a good reward, you then move one timeframe lower to see if it is in agreement with the identified trend. This will prevent us from getting in too early, ending up having a high average price. And lastly, if there are tell-tale signs that the lower time frame is moving based on the direction of the higher time frame, we move to the lowest time frame possible for our entry. For this case, we start with the monthly chart.

Looking at the above monthly chart, we have all the signs that tells us that there is the potential for this to bounce, namely, the CCI managed to hold above -100 line and pointing up that suggest momentum is slowly increasing. Having these information in advance would prepare us on how to properly position, and when to take profit initially.



We now mark the Kijun Sen level as our initial Target Price, followed by the Flat Top Kumo in case the Kijun Sen gets broken.

Moving one time frame lower, we noticed also the possibility on the price moving in agreement with the monthly. The highlighted candlestick marks the transition candles on the monthly from red to green, and the weekly showing also the potential for a technical bounce. We've identified the Kijun Sen on the weekly as the short term target, and a breakout from there could trigger the price to move based on the analysis on the monthly to touch the Kijun Sen. Note also the increasing momentum on the CCI that would validate the possibility of the price moving based on our analysis.

Furthermore, the flat top kumo that we highlighted on the weekly happens to be in confluence with the Kijun Sen line of the Monthly. Having this information in mind will enable us to anticipate a strong resistance along this level, and chance of breaking out of it is strong. We can safely set our TP to our original plan of the Kijun Sen because weekly is showing that the chances to breakout will be relatively small.

Looking at the Daily chart to identify our entry, we noticed that although the price managed to breakout of the Kijun Sen, the Chikou Span was held by the price acting as resistance. I have encircled the first possible entry when the price managed to stay above KS line, and the Chikou Span breaking out. The second entry, if you missed the first one, is the price breakout from the Kumo. The green forward kumo will give us the confirmation that the breakout from the kumo will be a vaild one, and having all the information we gathered from the Monthly and Weekly chart, we can see that they are moving in one direction, with the Monthly Kijun Sen acting as our TP.

Notice also how it reversed after reaching our identified TP, meaning that the long term equilibrium has been restored for this stock. I have also encircled another possible entry when the price breaks out of the Kijun Sen, where the Weekly CCI showing the momentum to be still strong when it managed to stay above +100, and the price breaking out of the Kijun Sen. The next level that we've identified on the monthly, should the KS gets broken, is the flat top Kumo.

The same applied to BRN, STI, SMC, PNX, PF, to name a few. There's a lot more that you'll see, but make sure to follow the steps and not be too hasty in entering. You can safely say that "it's all in the seating".

By applying all the topics we discussed, i am confident that this system would be a tool you'd benefit from if followed correctly. Most of the mistakes being done by a lot of traders, including myself, is trying to anticipate the movement of the price. Always remember that we are not here to try and catch the bottom…we need to have a solid and firm basis from our decision, and from there, we learn our mistakes and move on.

Before trading using your money, do a paper trade first. Put in a journal your trading plan, include why you bought the stock, what is the target price, what are the signals, cut loss level, etc. In every successful trade, replicate it. In every losing trade, learn from it. Always remember that no two trades will be the same…ever. Albeit the same stock, the condition during the trade would always be different.

May the odds be ever in your favour.