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Risk Probability Calculator

The "Risk Probability Calculator" (RPC) was designed to work hand in hand with Fibonacci retracement levels. It is therefore important that you have some understanding of how basic Fibonacci works.

First Some History:

Leonardo Fibonacci da Pisa was born around 1170 the son of a city official and merchant. He became a prominent mathematician and is credited with the discovery of what we now call the Fibonacci series.

After a trip to Egypt he published his now famous Liber Abacci (Book of Calculation) in which amongst other things he comes up with the sequence of numbers.

1,1,2,3,5,8,13,21,34,55,89>>On to infinity

If you add one of the numbers in the sequence to the number before it - you get the next number in the sequence e.g. $3+5=8$ and so on.

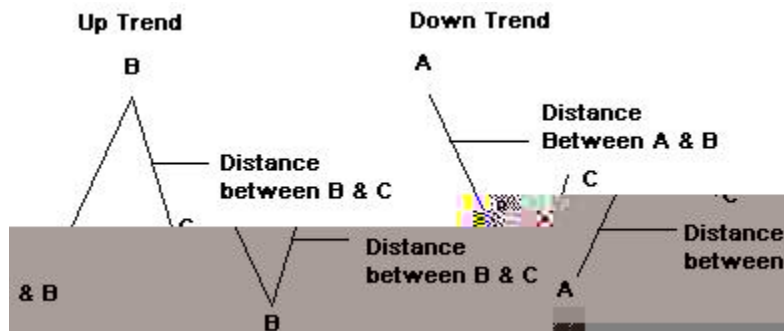
After the first few numbers in the sequence if you measure the ratio of any number to that of the next higher number you get .618 e.g. 34 divided by 55 equals 0.618. The further along the sequence you go the closer to phi you will get.

If you measure the ratio between alternative number you get .382 e.g. 34 divided by 89 = 0.382 and that's about as far into the explanation as I care to go in this lesson.

The most popular Fibonacci retracement ratios are .382, .500 and .618. We shall also touch on expansion ratios shortly.

How To Use Fibonacci In Your Trading:

In an uptrend measure the distance between point A and point B and in a downtrend measure the distance between point A and point B where point A will always be the lowest recent point in an uptrend and the highest recent point in a downtrend.



In the example below you can see a chart of the daily JPY/USD. Point A is 119.09 and Point B is 123.16. If you calculate the 38.2% retracement you get 121.61, the 50% retracement is 121.13 and the 61.8% retracement is 120.64. For example. The difference between 119.06 and 123.16 is 4.07. If you calculate 38.2% of 4.07 you get 1.55. If you then take 1.55 from 123.16 (Point B) you get the 38.2% retracement of 121.61. You can use the same principal for the other retracement levels.



In our next example of the 1-minute Dow Jones Point A is 7.916.08 and point B is 7.877.70. If you calculate the 38.2% retracement you get 7892.36, the 50% retracement is 7896.89 and the 61.8% retracement is 7901.42. For example. The difference between 7.916.08 and 7877.70 is 38.38, if you calculate 61.8% of that you get 23.72. If you then take 23.72 and add it to Point B of 7.877.70 you get 7901.42 the 61.8% retracement. The only difference between the downtrend and the uptrend is that you add your calculations to Point B and in the uptrend you subtract from Point B.



So how can we use all this information? Well, this is where the “Risk Probability Calculator” (RPC) comes in. The RPC calculates expansion ratios once Point A, Point B and Point C has been formed. These expansion ratios will give you likely targets, which you use to exit the trade.

Before we gone to the RPC calculator, it is important that you consider the purpose of the RPC. It is a tool to help you with money management. Essentially you can only make money trading if you make more than you lose.

You could have a method, which has an edge! Or you could have a method where your winners greatly outweigh your losers. The point of the RPC is to help you identify trades that have at least twice the potential gain to loss (sometimes called RRR - Risk Reward Ratio).

Risk Probability Calculator

4 Decimal Places

R
Risk Probability

Switch to 2
Decimal Places

Close

Clear

Calculate

Chart Points

Point A

Point B

Point C

Retracement Levels

0.382

0.618

Targets

Target 1

Target 2

Target 3

Potential Returns

	Risk	Reward	Ratio	Trade/No Trade
Target 1	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Target 2	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Target 3	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

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Once you have downloaded the RPC, it will look similar to the example above. Below you will find an explanation of its use.

Chart Points

Once you have identified a trend or you have determined that you wish to enter the market either long or short, your next job is to mark off the chart points just like the examples above. Point A will always be easy to find, as this will be the start of the downtrend or uptrend. Point B will be a recent "peak" in an uptrend or "valley" in a downtrend.

Once you have these two points you can enter them in the appropriate places in the RPC. This will automatically calculate everything else for you. Point C will be the point at which the pullback stops before the trend continues.

So far so good.

The only problem with this is that in real life you will not know where Point C has formed until after it has formed. By this time it may be too late.

To gain the advantage, you can use the 0.382 retracement level which was already calculated once you input the Point A and Point B levels. This is a temporary point C to allow you to enter a trade. Once the actual Point C had been formed you then enter that level. You may have to adjust your limit order after adjusting Point C if you entered the trade using "orders" e.g. once you have Point A and Point B you have enough information to set your entry order, stop loss order and limit order.

Retracement Levels

The RPC only uses two retracement levels. The .382 and the 61.8. These are automatically calculated when you enter Point A and Point B. The reason I only use these two levels is that the .50 level will be too close to the other two points on an intraday basis, which is where the vast majority of us trade.

Targets

You will find that the target levels will also act as resistance levels. These levels are automatically calculated once Points A,B and C have been entered. You should select a target according to market conditions and also the style of trader you are. You may fade out the position at each target.

Potential Return

This is where the little tool becomes really handy. With the information that has already been input, the RPC calculates if you have at least a 2-1 win ratio. This means that once the RPC has done its calculations it will only display "**Trade**" if you have at least twice the potential profit to risk ratio. If the calculation doesn't show that you have at least twice the potential gain then it will show "**No Trade**". This will keep you out of trades where you might find yourself taking a large risk for a small potential gain.

I hope you enjoy using the RPC and that it improves your trading results. If you have any question on the use of the RPC just drop me a line at info@surefire-forex-trading.com or you can go to www.surefire-forex-trading.com

Good Trading

Mark McRae

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