

Strategies, analysis, and news for FX traders

CURRENCY TRADER

November 2009

Volume 6, No. 11



JAPANESE
yen odyssey
p. 8

A FRESH LOOK
at the Canadian
buck p. 11

THE INFLATION
mirage p. 14

BETTER TRADING
THROUGH
adaptive money
management p. 26

INSIDE-DAY PATTERNS
in the yen p. 20

CURRENCY VOLATILITY,
liquidity, and
protectionism p. 30





Contributors 6

Global Markets

Japan's ongoing struggle 8

The dollar/yen pair is back where it was at the beginning of the year. Are we in store for more of the same?

By Currency Trader Staff

Canada: Dragged down by its neighbor .11

The Canadian currency has strengthened notably against the U.S. dollar in recent months, but it's approaching key levels.

By Currency Trader Staff

On the Money

Bucks, bonds and the new bully in town 14

The massive U.S. debt has many fearing the worst for the U.S. dollar. Perhaps the sentiment is overdone.

By Barbara Rockefeller

Trading Strategies

An inside look at a dollar/yen pattern 20

Getting down to the nitty gritty of inside days in the dollar/yen pair over the past 10 years.

By Currency Trader Staff

Adaptive FX money management 26

Historical tests illustrate the impact of a dynamic money-management regime on strategy performance.

By Daniel Fernandez

Events 29

Conferences, seminars, and other events.

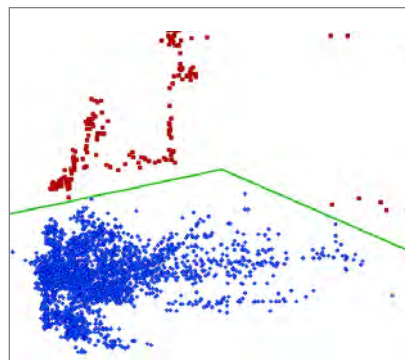
Advanced Strategies

The hidden cost of illiquidity 30

Evidence mounts that we actually failed to learn the lessons of the Great Depression.

By Howard L. Simons

continued on p. 4



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Currency Futures Snapshot35

International Markets36

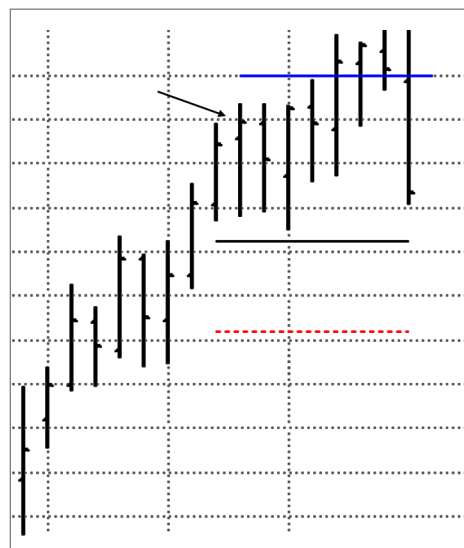
Numbers from the global forex, stock, and interest-rate markets.

Global Economic Calendar39

Important dates for currency traders.

New products & services40

Key concepts41



Forex Journal42

Attempting to catch up with a train that's already left the station.

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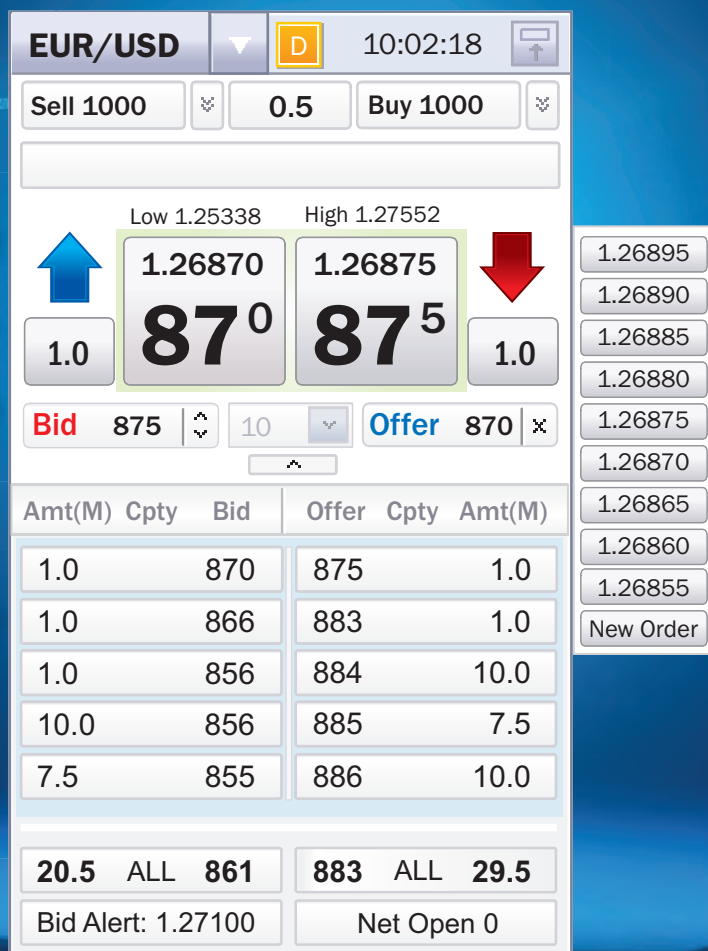
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A publication of Active Trader®

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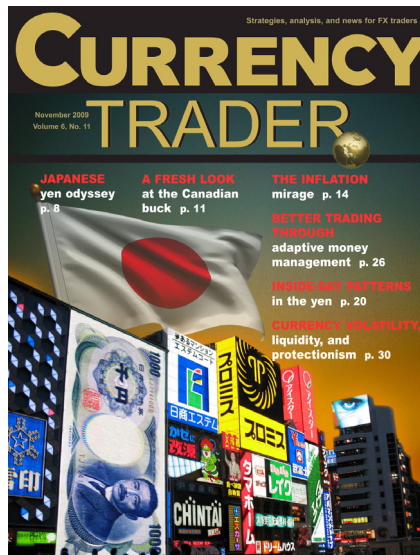
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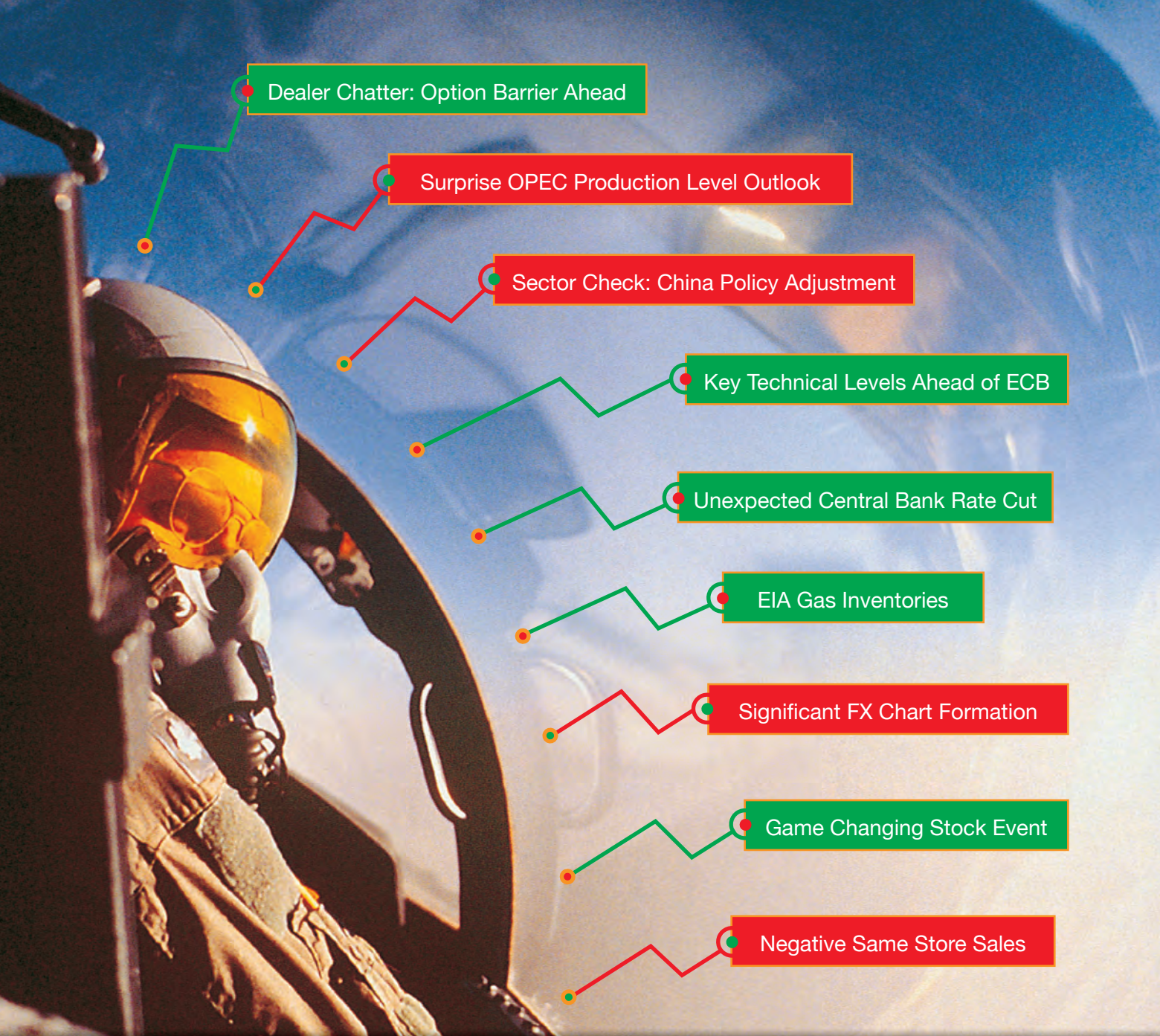


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Japan, yen struggle on

A new government doesn't necessarily mean Japan's economy or currency are on dramatically different paths.

BY CURRENCY TRADER STAFF

Despite the global upheaval over the past year, the U.S. dollar/Japanese yen (USD/JPY) rate has been remarkably stable. Entering January 2009 the pair was trading around 90.00, and in early November it was around 90-91.00 (Figure 1).

The Japanese economy continues to struggle, although economists say it is emerging from recession. But Japan is still battling deflation and has never really been able to shrug off the slow-growth, deflationary period that began as the "Lost Decade" in the 1990s; the country is now in search of a new moniker.

Nonetheless, after a brutal first quarter this year, Japan's economy has bounced back. First-quarter 2009 revealed a 12.4-percent plunge in Japanese growth domestic product (GDP) on a quarter-over-quarter annualized basis, but second quarter actually produced a +2.3-percent GDP reading. Credit Suisse forecasts a 6.4-percent Q3 figure and a 4.1-percent Q4 reading, putting the 2009 annual average at -5.2 percent. The firm also forecasts a 2.8-percent annual GDP reading for Japan in 2010.

Despite current improvement, however, challenges still lie ahead for Japan.

"You can say the recession is over, but don't expect [Japan] to come rocketing back," says Jay Bryson, global economist at Wells Fargo Securities.

A real economic hit

Japan was particularly hard hit by the collapse in global consumer demand

during the recent economic setback.

"Japan got clobbered," says Paul Sheard, global chief economist at Nomura. "It was exporting a lot of products that were hit in the global recession — high-end autos and electronics, and capital-goods components to China."

This drop in external demand for its goods, combined with the fact that Japan wasn't able to stimulate its own domestic demand, helped decimate industrial production by about 33 percent, Sheard notes.

"It was an ironic outcome," he says of Japan's recent economic malaise. "Japanese firms were not really exposed to sub-prime [financial] products, but they were hit through the real economy."

Another factor that has Japan limp-

ing out of its slump is that it never fully emerged from its Lost Decade deflationary spiral.

"Japan didn't come into this period with much ammunition," Sheard says. "Interest rates were only 0.50 basis points. Japanese monetary authorities weren't able to stimulate much."

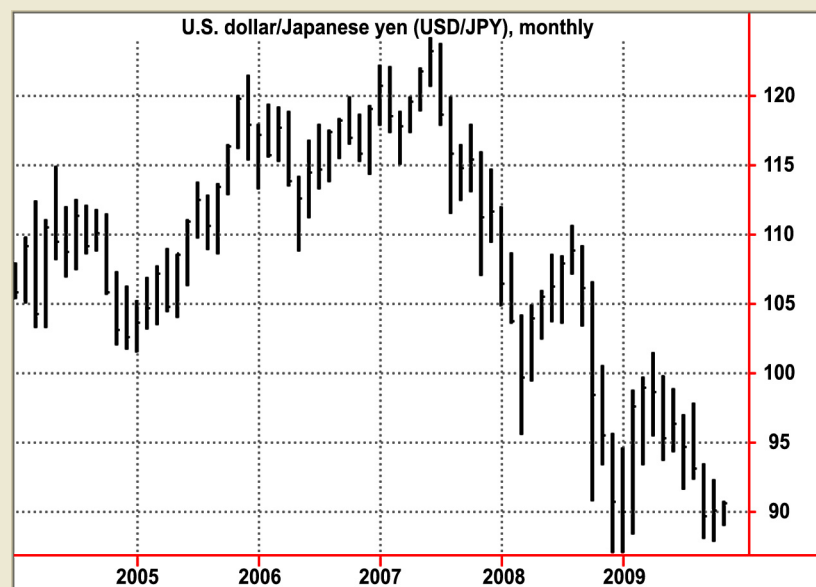
The Japanese economy continues to struggle with deflationary pressures. Credit Suisse forecasts a year-over-year inflation rate of -1.3 percent for 2009 and -1.1 percent for 2010.

"It's not the sign of a healthy economy," Sheard observes.

"All of the negatives are still there," says Steven Englander, Barclay's chief currency strategist. "[Japan] still has deflation. The fact that it is in Asia and doing poorly is a bad sign in economic terms. I don't think there is a

FIGURE 1 — MONTHLY DOLLAR/YEN

In early November, the dollar/yen pair was trading fairly close to where it was at the beginning of the year.



Source: TradeStation

macro-economic confidence story."

Sheard notes other central banks, including the U.S. Fed, the UK's Bank of England, and the European Central Bank, "have taken quite aggressive action to head off the threat of outright deflation. But Japan is actually *in* deflation and not responding as aggressively." He says unlike the U.S., the Bank of Japan has thus far resisted expanding its so-called balance sheet by purchasing financial assets to help strengthen the economy.

The debt issue

The Land of the Rising Sun has yet to figure out a way to escape the clouds that have been hanging over its economy for two decades.

U.S. DOLLAR/JAPANESE YEN AT A GLANCE

Daily range (past 40 days)	Median: 1.01		Average: 1.04	
Daily closing move (abs value, past 40 days)	Median: .28		Average: .45	
Weekly range (past 26 weeks)	Median: 2.31		Average: 2.55	
Wkly closing move (abs value, past 26 wks)	Median: .94		Average: 1.34	
% Gain/loss (close-to-close)	20-day	62-day	125-day	250-day
	0.65%	-5.09%	-7.57%	-7.77%
52-week high/low	101.84		87.08	
Central bank rate, change at last meeting	U.S.		Japan	
	0-0.25% -		.10% -	
Next central bank meeting	Dec. 15-16		Nov. 19-20	
Quarterly GDP (% , annualized rate)	Q3 2009*		Q2 2009	Q1 2009
	US	JPN	US	JPN
	3.5	6.4	-0.7	2.3
			US	JPN
			-6.4	-12.4

*Estimate All data as of Oct. 30

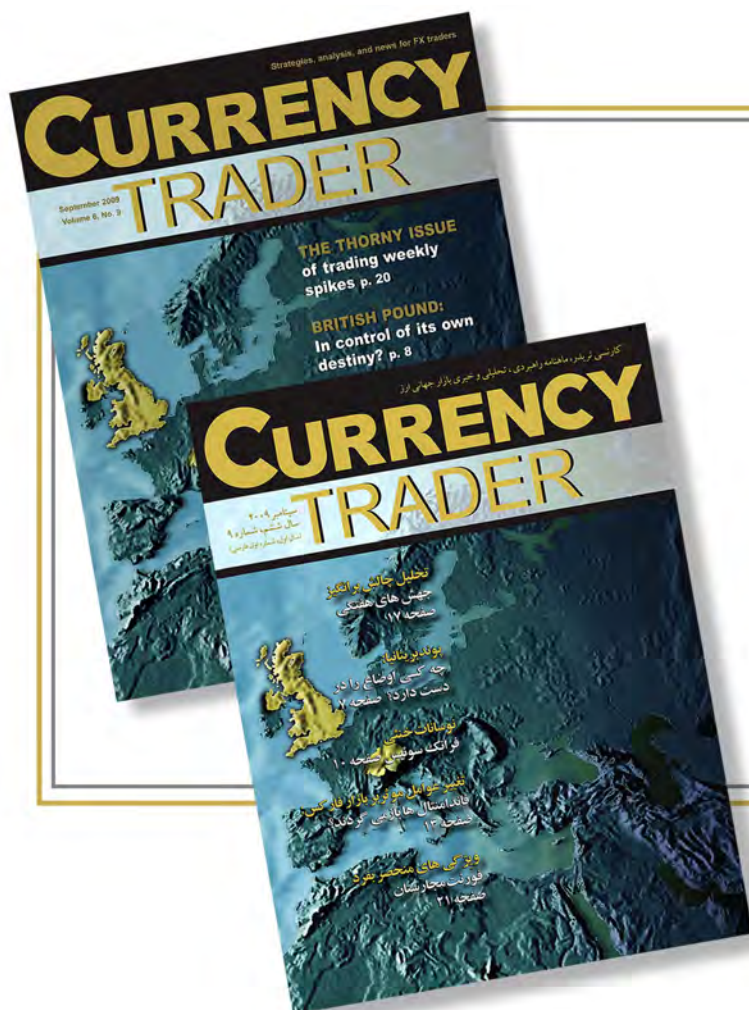
"[Japan's] bubble blew up 20 years ago and it's been trying to stimulate the economy in all sorts of ways. A problem is its debt could continue to go up," Bryson says.

Referring to the current Japanese government debt level of 180 percent of GDP, Bryson says "there are concerns about [Japan's] long-term fiscal solvency. Most estimates have its debt-

to-GDP ratio going over 200 percent sometime in the next two years. You could potentially be looking at a downgrade by the ratings agencies at some point in the future."

Interestingly, Japan's situation differs from the U.S. debt issue in that foreigners own more than 50 percent of outstanding U.S. debt, while in

continued on p. 10



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Japan most debt is held domestically, according to Bryson.

New government

This past summer Japanese politics shifted. The opposition party — the Democratic Party of Japan (DPJ) — scored a victory over the Liberal Democratic Party (LDP), which had ruled the government virtually unilaterally since World War II. The new party ran on a platform of major changes in government spending, social security, and bureaucracy.

"The new government is trying to get more money into consumer's hands," Bryson says. "The LDP over the last decade favored the big producers. The new party is trying to change the tax laws to favor households."

"The markets are watching what the new government does and if it has an impact on consumer spending," Sheard says.

In terms of impact on the Bank of Japan (BOJ), Moody's Economy.com associate economist Nikhilesh Bhattacharyya expects the DPJ government to stay out of the BOJ's way, more so than previous administrations.

"We don't think it will be particularly aggressive in intervening to drive the yen lower," Englander adds.

Low rates to remain

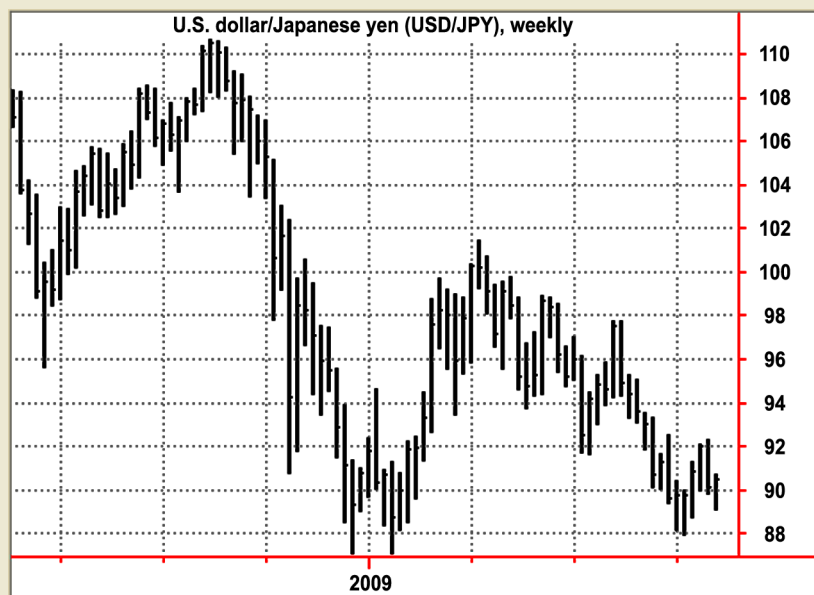
Japan's overnight lending rate remains at nearly zero — currently at 0.10 percent, with no changes anticipated in 2009 or 2010, according to analysts.

"I don't see any rate hikes or cuts to monthly government bond purchases until the first quarter of 2011," Bhattacharyya says.

The low interest rates leave the yen susceptible to the [carry trade](#), in which players borrow funds in a near-zero interest-rate currency such as the yen and buy higher-yielding assets. Since March 2009, risk appetite has returned to the global markets, and analysts say

FIGURE 2 — WEEKLY DOLLAR/YEN

The yen was one of the few currencies to gain ground vs. the dollar when funds poured into the greenback during the financial crisis.



Source: TradeStation

the yen has been used to fund carry trades not only vs. high-yield currencies such as the Aussie dollar, but also vs. equities and commodities.

"Japan will be in a slow growth world for a very long time, with no hope of raising interest rates any time soon," Bryson says.

Current account surplus: A yen floor?

In addition to the tug of war between low interest rates, a sluggish growth picture, and the opportunity to sell the yen to fund carry trades, there is also an underlying bullish factor that provides natural strength to the yen — Japan's current account surplus.

"[Japan] still runs a current account surplus of about 3 percent of GDP this year," Sheard says. "There is a surplus of dollars that needs to be sold. There is a natural upward pressure on the [yen] through the current account surplus."

He explains how this works: "If Toyota exports cars to the U.S., it receives dollars in return. It brings the dollars back to Japan and has to sell

the dollars and buy yen. [Currently,] these capital flows are staying in Japan."

This dynamic was evident in the forex market over the past year as the yen was virtually the only major currency to strengthen vs. the dollar when the global financial panic last fall drove funds into the U.S. currency (Figure 2).

The yen ahead

After trading near 87.00 in late 2008 and early 2009, the dollar/yen rebounded to 101.44 before retreating back below 90.00 in September. (The pair set its all-time low, around 81.00, in 1995.) Looking ahead to early 2010, Michael Woolfolk, managing director at BNY Mellon, says the U.S. dollar could begin to rally amid hints from the U.S. Fed that it will begin to normalize rates.

"The market has underappreciated the amount the Fed could raise rates in 2010 — maybe 200 or 300 basis points next year," he says. That could nudge the dollar/yen pair toward 96.00, he says.

Canada: Dragged down by its neighbor

Parity, and then what?

BY CURRENCY TRADER STAFF

Since March 2009, the U.S. dollar/Canadian dollar pair (USD/CAD) has tumbled, coming within pips of parity (1.00). The recent strength in the Canadian dollar vs. its southern cousin reflects some global confidence in Canada's fundamental situation, a return of risk appetite, and a rally in the "commodity currencies," a group that also includes the New Zealand and Australian dollars.

However, the Bank of Canada (BOC) has voiced concerns that the strength of the currency could actually derail the country's economic recovery, which has raised the possibility the central bank might engage in for-

eign exchange intervention to prevent further appreciation in the Canadian buck.

Canadian bulls back in action

Since peaking at \$1.3062 in March, dollar/Canada has pushed steadily lower to the mid-October low at \$1.0205, a 22-percent decline that brought the pair to its lowest level since August 2008, but still well off the record low of 0.9055 from November 2007 (Figure 1).

"In addition to the Aussie and New Zealand dollars, the Canadian dollar has been one of the strongest performers vs. the U.S. dollar," says Jimmy Jean, economist at Moody's

Economy.com. "The general theme is that countries that export a lot of commodities will be the first to emerge from recession."

However, while the Canadian dollar may have gotten swept up in a commodity currency momentum move, some analysts caution other factors — particularly who's trading with whom — foreshadow a different story for the future.

"There is a big difference in their major trading partners," notes Jonathan Basile, economist at Credit Suisse. "Australia is closely tied to China, while Canada is tied to the U.S. Who is performing better?"

Credit Suisse forecasts U.S. gross domestic product (GDP) in 2009 and 2010 at -2.5 percent and 3.2 percent, respectively. It expects China's GDP to post an 8.4 percent reading in 2009 and a 9.3-percent figure in 2010.

Joined at the hip

Some economists argue Canada was in a better structural position than the U.S. before the global recession, and likely has a leg up as the world struggles to sustain a global economic recovery. However, the two economies are inextricably linked.

"Canada has stabilized a little bit ahead of the U.S., but because it is so tied to the U.S. in terms of exports, their cycles are very closely related," Basile says.

Roughly 75 to 80 percent of Canada's exports go to the U.S., so the level of American demand for their manufactured goods and auto parts — as well as commodities such as natural gas, lumber, and base metals — plays

continued on p. 12

FIGURE 1 — WEEKLY DOLLAR/CANADA

The Canadian dollar has bounced back strongly vs. its U.S. counterpart since March, but it is still a distance from matching the November 2007 dollar/Canada low around 90.50.



Source: TradeStation



a key part in Canada's economic robustness.

"It bodes well when the U.S. economy is chugging along and U.S. demand is robust, but, there is a quick downturn [in Canada] when those two fall," says Charmaine Buskas, a Toronto-based market economist. "We are seeing the [Canadian] export sector remain very much under pressure."

Jean says Canadian exports plunged 30.4 percent in the first quarter of 2009, a rate that improved modestly in the second quarter to -19.3 percent.

"That was pretty harsh," Jean notes. "U.S. demand collapsed in the first part of the year."

The Canadian economy dipped into negative territory in Q4 2008 with a 3.7-percent GDP decline, which deepened to a 6.1-percent drop in Q1 2009. The second quarter saw a 3.4-percent decline.

Basile estimates a 2-percent GDP increase in Q3 2009 and a 2.7-percent growth rate in Q4. His 2010 quarter-by-quarter estimates forecast a 4.2-percent growth in the first quarter, a 4.2-percent second-quarter growth, and 3.2-percent growths in the third and fourth quarters. Jean forecasts an overall 2.7-percent GDP decline for 2009 and a 2-percent gain for 2010 after Canada's 0.4-percent overall decline in 2008.

Strong banks, available credit

On the plus side, the Canadian banking sector remains strong, having been largely untouched by the toxic subprime mortgage crisis.

"The Canadian banking system is viewed as one of the strongest in the world," Jean says. "They are tightly regulated and they didn't get into the type of excesses Wall Street did. Lending practices have been pretty

stable over the past couple of years — they didn't need any bailouts. That was one of the hallmarks of Canada during this crisis."

"The banking sector was heralded by a number of agencies around the world as the best and most stable," Buskas echoes.

In fact, Jean points to the stability of the financial sector as a factor helping Canada emerge from its recession ahead of the U.S.

"Credit is still widely available for credit-worthy individuals," he says. "That is a key support compared to the U.S."

Fiscal and monetary policy

Prior to the global financial crisis and recession Canada had boasted a string of 12 consecutive years with a fiscal surplus. This year, however, Canada is expected to show a deficit because of the government's stimulus efforts. Nonetheless, Jean says Canada's overall healthier fiscal situation has been supportive of the Canadian dollar rally in recent months.

"One of the reasons people were bullish has to do with Canada's fiscal outlook compared to the U.S.," he says. "Canada has one of the best fiscal positions in the G7. They have been pretty conservative in the past few years."

But that doesn't mean the skies are

entirely blue. Referring to his 2009 estimate of a \$56-billion Canadian government deficit, Jean concedes, "There is some concern about the deficit, especially for a country coming out of a stream of surpluses. There is quite a bit of concern about when and how it will get out of it."

Relatively speaking, though, Canada's position compares favorably to most industrialized nations.

"The Canadian deficit for 2009-2010 will be a little over \$50 billion," Buskas says. "This is certainly large by Canadian standards, but as a share of GDP it is only about 3 percent, so it is not a killer like in other countries where the deficit to GDP ratio is above 50 percent. By comparison, the U.S. federal deficit is on track to be about \$1.4 trillion or roughly 12 percent of GDP."

Most analysts praise the Bank of Canada's response to the global recession.

"The BOC was very timely [in cutting rates] and the results are [evident in] the domestic economy recovery," Jean says. "Its action has helped prevent a longer domestic recession."

The Canadian overnight lending rate currently stands at 0.25 percent, with the last move a 0.25-percent cut in April 2009. At its October meeting, the BOC reiterated its commitment to keep the overnight rate at the current

U.S. DOLLAR/CANADIAN DOLLAR AT A GLANCE

Daily range (past 40 days)	Median: .0137		Average: .0144	
Daily closing move (abs value, past 40 days)	Median: .0070		Average: .0200	
Weekly range (past 26 weeks)	Median: .0321		Average: .0333	
Wkly closing move (abs value, past 26 wks)	Median: .0165		Average: .0194	
% Gain/loss (close-to-close)	20-day	62-day	125-day	250-day
	1.32%	-0.47%	-7.07%	-10.47%
52-week high/low	1.3062		1.0205	
Central bank rate, change at last meeting	U.S.		Canada	
	0-0.25% -		0.25% -	
Next central bank meeting	Dec. 15-16		Dec. 8	
Quarterly GDP (% , annualized rate)	Q3 2009*		Q2 2009	Q1 2009
	US	CAN	US	CAN
	3.5	-0.6	-0.7	-3.4
			-6.4	-6.1

*Estimate All data as of Oct. 30

record-low level until the end of second quarter of 2010.

The challenges

However, the BOC has also been making noise about the recent gains in the Canadian currency, warning that it could derail the recovery. Analysts noted comments in the BOC statement that indicated it was concerned about an overheating Canadian currency: "The current strength in the [Canadian] dollar is expected over time to more than fully offset the favorable developments since July."

Canadian exports are not helped by an overly bullish currency.

"Strength in the Canadian dollar makes Canadian exports less competitive on the U.S. marketplace and that has had a negative impact," Jean says.

"There is concern that the Canadian dollar appreciating too quickly could dampen growth," Basile adds.

"Despite all the good structure in the Canadian economy, there are still issues that could derail it," Buskas says. "The currency remains a key variable over the next four to six months."

And because Canada is so intertwined with the U.S. growth prospects, there are some who foresee the potential for a "double dip."

"The U.S. economy is not yet on a sustained path," Basile says. "The U.S. keeps losing jobs. Consumers can't borrow like they used to. They can't use their houses like piggy banks anymore and paychecks are smaller. Until U.S. employment rebounds, Canada's outlook is still cloudy."

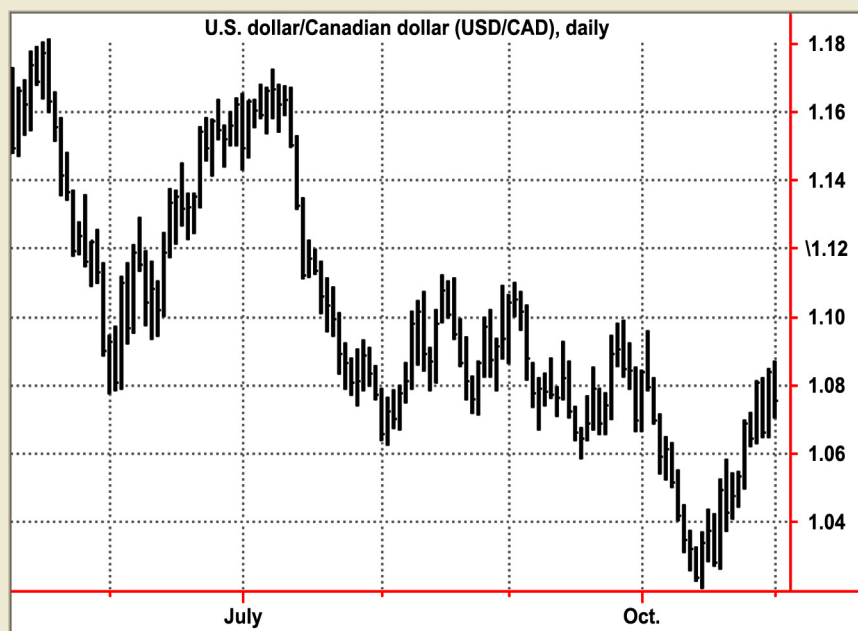
"If one of your biggest trading partners is still ailing, you aren't going to be completely convinced your economy can move forward without hitting potholes," he says.

Despite market chatter about possible BOC intervention to quell the rise of the Canadian dollar, most analysts downplay that scenario. Buskas calls forex intervention a "remote possibility."

Historically, when central banks

FIGURE 2 — DAILY DOLLAR/CANADA

After the mid-October bounce, some analysts see the dollar/Canada pair returning to 1.0000 in the relatively near future.



Source: TradeStation


have intervened in the foreign exchange markets, Buskas says the impact tends to be very short lived.

"It really doesn't accomplish anything because of the fundamental forces behind it," she says. "You can't get in front of a moving train. It would be an expensive waste of time."

1.00 in the crosshairs

With the dollar/Canada pair trading around 1.0700-1.0800 in early November, some analysts see parity as a reasonable near-term price objective (Figure 2). Longer term is a different story, though.

"Parity is certainly an easy target," Buskas says. "I think we will see it by year-end. [However], going much past parity for any extended period of time will be very serious for the Canadian economy."

Todd Elmer, currency strategist at Citi FX expects the Canadian dollar to appreciate over time. He expects dollar/Canada to "break beneath parity," adding, "there is no real incentive to do anything but sell into rallies." 

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Dollar doom-and-gloomers aren't seeing the entire picture.

BY BARBARA ROCKEFELLER

Critics say the dollar is on a never-ending down-trend because the U.S. is deliberately setting out to devalue it, and before long, reserve holders such as China will manage to replace the dollar as a reserve currency — whereupon it will fall even further out of favor. Furthermore, U.S. securities are junk because of the devaluing dollar. The U.S. has to “debase” its currency because it is issuing too much debt and it wants to let inflation allow for cheaper repayment down the road.

This idea is so widely accepted that almost nobody bothers to refute it anymore. But there is a giant, gaping hole in its logic. If the dollar is inevitably and inexorably devaluing because of over-issuance of debt, why is anyone buying the debt?

Over the past year (through September), the U.S. issued almost \$7 trillion in new and replacement government debt. With foreigners buying 35 to 45 percent of that paper, how can it get away with issuing that much debt if the dollar is such a bad bet? Why is the U.S. Treasury not sweating down to its socks over a failed auction, one where bids do not suffice to buy all the paper being offered?

The answer is that the whole thing is a work of fiction. The U.S. doesn't have inflation now, nor is inflation a threat. The U.S. doesn't have a policy of deliberate devaluation. Foreigners continue to buy U.S. government debt because the dollar is relatively cheap and therefore a bargain — and despite the low yields, U.S. debt is rated triple-A. The Treasury is not sweating about a failed auction because demand remains high.

Doom + gloom = juicy story

The dollar shot to the upside in the last week of October, while at the same time the U.S. Treasury was issuing massive amounts of new Treasury notes into rising yields, high bid-to-cover ratios, and really high institutional buying, including central bank purchases.

Wait a minute. If you listen to the doom-and-gloom crowd, foreigners are diversifying out of dollars. They shouldn't be eager to buy U.S. paper; they should be shun-

ning it. Swiss investment guru Marc Faber says the dollar will go to zero because of hyperinflation caused by the massive ballooning of the Fed's balance sheet. Doomster Nouriel Roubini says cheap dollars are fueling a speculative bubble in commodities and equities, especially emerging market equities (China, Brazil). The MSCI World Index of advanced-nation equities is up 65 percent from the March low, with the MSCI Emerging Markets Index up 96 percent. The CRB commodity index is up 33 percent. When these bubbles burst, the dollar will be worth zip. Commodities trader Jim Rogers has been forecasting endless dollar devaluation for several years now and moved to Hong Kong to get as far away from the dollar as possible.

Never mind that when bubbles burst and fear stalks the land, everyone rushes to the safe-haven of the dollar, as we saw last winter. Everybody and his brother thinks he is qualified to talk about the dollar. (Representative essay found on the internet: “Obama and Bernanke's Secret War on the Dollar.” Dollar stories have transcended financial news to the extent they even appear on YouTube.) You could argue the extreme doom-and-gloom scenario is just plain silly and should be dismissed as having a near-zero probability, but it has nonetheless bled into the mainstream. Newspapers, magazines, and TV talk show guests who know almost nothing about the dollar now feel qualified to pontificate. It's fun to watch — and it's also a sign the move has gone too far.

Refuting the doomsters

It's shockingly easy to rebut the dollar doomsters. Take the Fed balance sheet story. Assets increased from \$869 billion in June 2007 to \$2.144 trillion by the end of September 2009. As Federal Reserve Chairman Ben Bernanke carefully described in an early [October speech](#), the assets are: 12 percent in short-term lending to banks; 4 percent in commercial paper backstops and Term Asset-Backed Securities Loan Facility (TALF); 75 percent in marketable securities, including about \$300 billion in Treasuries in the program ending Oct. 31, 2009; and less than 5 percent in specific emergency

continued on p. 16

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**TABLE 1 — U.S. MONEY SUPPLY**

Excessive increases in money supply produce inflation, but Fed data indicates money supply has not been increasing abnormally.

Period	M1*	M2*
Three months from June 2009 to Sept. 2009	2.9%	-2.0%
Six months from Mar. 2009 to Sept. 2009	12.4%	0.2%
12 months from Sept. 2008 to Sept. 2009	14.3%	6.7%
*Percent change at seasonally adjusted annual rates		

M1: Currency in circulation plus demand deposits (checking accounts).

M2: M1 plus savings and time deposits.

Source: www.federalreserve.gov/releases/h6/Current/

TABLE 2 — COMMERCIAL BANK BALANCE SHEET DATA

Another inflationary trigger — too much credit — is not evident in the data.

Category	Sept. 2008*	Sept. 2009*
Bank credit	9191.6	9116.5
Loans and leases	7077.2	6740.6
Total assets	11,340	11,772.9
*Selected data, billions of dollars		

Source: www.federalreserve.gov/releases/h8/current/default.htm

loans (bank bailouts).

Quick — why is a bigger balance sheet inflationary or damaging to the private sector economy? Friedmanite money supply theorists — who have never been successfully refuted — argue an excessive increase in money supply causes inflation. But money supply has not been rising at an abnormal rate (Table 1). The increase in the Fed balance sheet fails to pass the “So what?” in terms of its supposed inflationary effects.

The wider money supply measure, M2, contracted from June to September, grew only 0.2 percent in the six months from March to September, and grew a modest 6.7 percent from September 2008 to September 2009.

Credit supply data paints a similar picture (Table 2). Loans and leases are down 5 percent year-over-year as of the end of September 2009. Total bank credit, which includes marketable securities, fell from 81 percent of total assets to 77.4 percent by September 2009. These are gross measures, but it's obvious an oversupply of credit — and thus inflationary pressure from credit on limited supplies of goods — is just not happening. In the Eurozone, private commercial bank lending fell 0.3 percent year-over-year in September, having just eked out a 0.1-percent gain in August.

Wait, it gets worse. The Bank for International Settlements caused a moment of stunned silence when it reported global credit contracted \$6 trillion since the start of

the financial crisis in October 2008. In the second quarter, cross-border lending fell 1.1 percent, or \$327 billion, to \$30.37 trillion. Lending to corporations rose \$48 billion, or 0.5 percent, while cross-border interbank lending declined \$375 billion, or 2 percent.

The final nail in the coffin of the fictional inflation threat is U.S. capacity utilization, which was down to 70.5 percent in September, a frightening 10.4-percent below its 1972-2008 average. Inflation is too much money chasing too few goods, but inflation expectations must be considered restrained when businesses have the excess capacity to produce any freshly demanded goods on short notice.

Therefore, inflation causing dollar “debasement” is a figment of the imagination of those with an ax to grind. What is that ax, exactly? It is the deep desire for what Bernanke calls “fiscal sustainability.” As noted, the treasury issued almost \$7 trillion in new and replacement debt in the year up to September. With U.S. government debt more than tripling to \$1.4 trillion in the upcoming fiscal year and gross government debt nearing 80-100 percent of GDP (depending on whose data you prefer), worrywarts think the U.S.'s triple-A rating could be cut.

Most people will agree U.S. indebtedness is getting excessive. In the Eurozone, the Stability Pact calls for gross government debt not to exceed 60 percent of GDP and each year's budget deficit not to exceed 3 percent of GDP, and these are reasonable levels — except, it can be argued, during the worst crisis since the Great Depression. As long as government acknowledges that such high debt increases must be reversed as soon as possible and not become a bad habit that (as some charge) turns the U.S. into a banana republic, there is no reason for hysteria and frenzied ranting.

Hysteria and frenzied ranting are a measure of the distrust of government, not a measured and reasonable assessment of the situation.

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The real bully

In economics and crime stories, we always want to know *cui bono*, or “Who benefits?” The single biggest beneficiary of the weaker dollar is China. With its currency pegged to the dollar and appreciating only very, very slowly, it benefits from an effective devaluation of the yuan virtually the same as the dollar drop. While observers note China's stimulus package was remarkably effective in keeping growth from falling too much immediately following the height of the crisis, the Chinese economy remains export-dependent.

The occasional Chinese anti-dollar outburst is good for China. It may temporarily drive down the value of China's

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reserves, but China continues to buy very large amounts of dollars anyway, getting them at a bargain price. This is probably not its main goal, which is an old-fashioned "beggar-thy-neighbor" trade strategy. This policy has not gone unnoticed by other countries in the region, notably South Korea, Thailand, Taiwan, Singapore, and Malaysia, all of which have their own export industries to worry about and many of which were forced to intervene in the forex market to prevent their currencies from appreciating too much. Brazil took the extraordinary step of taxing incoming portfolio flows seeking a high return in the Brazilian stock and bond markets, and the rising Brazilian real.

In the latest U.S. Treasury report on currency manipulation, the U.S. again declined to label China a currency manipulator, a charge that would have triggered further action, such as a complaint to the World Trade Organization and Congressional overview. Nobody knows whether the U.S. is a lily-livered coward or if there is a back-room deal to avoid calling China a manipulator in return for some foreign policy benefit we will never know about.

Ironically, the weak U.S. dollar is good for the U.S., too. The trade imbalance is gradually getting corrected and

exports are booming. In the longer run, to the limited extent that exports will lead growth in the U.S., China benefits from at least one swathe of the U.S. consuming public having the income to buy its goods. By engineering a dollar devaluation with all its talk of reserve diversification, the Chinese are cleverly getting their cake and eating it, too.

The old Robert Rubin mantra of "strong dollar, best interest" is meaningless. If you want a stronger currency, you have to raise the real return to investors or otherwise change conditions. The Fed views the dollar as a secondary consideration in contemplating monetary policy. Yes, inflation is mechanically pushed higher when import prices rise because of the currency effect, but this is minor given the low percentage of GDP that trade represents, and other economic forces are more important to the Fed.

Like all central banks, what the Fed *does* care about is appearances and confidence. A loss of confidence in the prime government economic and financial agency is never good for a country, or the Establishment in office at the time. In a remarkable speech at the San Francisco Fed in October, Bernanke spoke out about the dollar, a rare occur-

continued on p. 18



rence. He noted the U.S. financial system was “overwhelmed” by the inflow of capital arising from the global trade imbalance and said, “We must avoid ever-increasing and unsustainable imbalances in trade and capital flows.” The imbalance is improving now but more than doubled from under \$400 billion in 2000 to more than \$800 billion in 2006. The trade deficit used to be less than 2 percent of GDP in the 1990s but is now above 5 percent.

In a miracle of fancy wording, Bernanke managed to avoid talking about the dollar directly. He also avoided singling out China, but did say, “Trade surpluses achieved through policies that artificially enhance incentives for domestic saving and the production of export goods distort the mix of domestic industries and the allocation of resources” and yield “an economy that is less able to meet the needs of its own citizens in the longer term.”

The Fed chief also stated smaller U.S. budget deficits would preserve confidence in the dollar and help rebalance global growth by pushing America toward more saving.

“The most effective way to accomplish this goal is by establishing a sustainable fiscal trajectory, anchored by a clear commitment to substantially reduce federal deficits over time,” he said.

So there — the U.S. does not deliberately seek a weaker dollar. The top spokesman in the country for economic policy says he wants a lower U.S. deficit level specifically to help the dollar, and he wants others, namely China, to stop manipulating the dollar lower for their own ends.

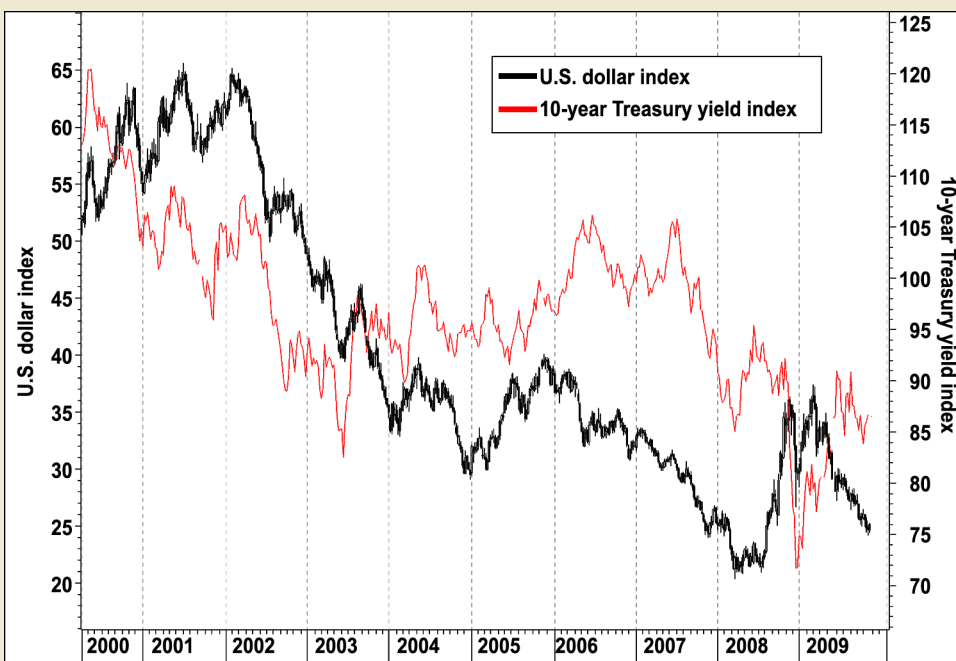
There has never been such a clear statement of U.S. dollar policy — and strangely, it went almost unnoticed. Technically, matters pertaining to the dollar are the Treasury’s turf, but Bernanke and Treasury Secretary Timothy Geithner are reportedly in complete agreement about these matters, including the dollar. This sounds just wonderful — and exactly what would quiet the doomsters — except the Fed has no ability to make either fiscal policy or trade policy. The only thing the Fed can do is threaten Congress that it will raise rates if fiscal sustainability is not forthcoming; other central bankers have made this threat, although it would be a first in the U.S.

On notice

It is probably safe to assume a few words from Bernanke

FIGURE 1 — U.S. DOLLAR INDEX VS. 10-YEAR TREASURY YIELD INDEX, WEEKLY

The Treasury yield-dollar correlation might not be as strong as theory would have it, but there is a connection nonetheless.



Source: Chart — Metastock; data — Reuters and eSignal

will not move the Chinese one inch. But they are on notice that change is needed from them, and we have figured out their game.

The incentive for the U.S. to hasten the pace of global rebalancing is to reacquire lost confidence. But the U.S. also has incentives to let things stay the same, mostly in the form of the less-expensive debt service costs created by low interest rates. One analyst estimates the cost savings are probably about \$61 billion over the past year alone, with more to come as expensive older notes are replaced with cheaper new ones.

The correlation between the 10-year Treasury yield index and the dollar is not as strong as theory would have it, mostly because other factors color the interpretation of yield (such as taxes and inflation expectations), but Figure 1 shows they are certainly connected. With the weak dollar benefiting U.S. exporters and low interest rates costing the government less in debt service costs, U.S. self-interest doesn’t call for strident cries about China’s beggar-thy-neighbor trade policy and dollar manipulation. Still, it’s inherently unhealthy, and it’s costing the U.S. jobs and damaging its image.

Bernanke apparently plans to speak out again on these matters in the Fed’s endless quest for “transparency.” We may get some innovations or initiatives, too. Stay tuned.

Something is cooking on the back burner and when the market gets a whiff, the dollar could move up in a big way. ☺

For information on the author see p. 6.

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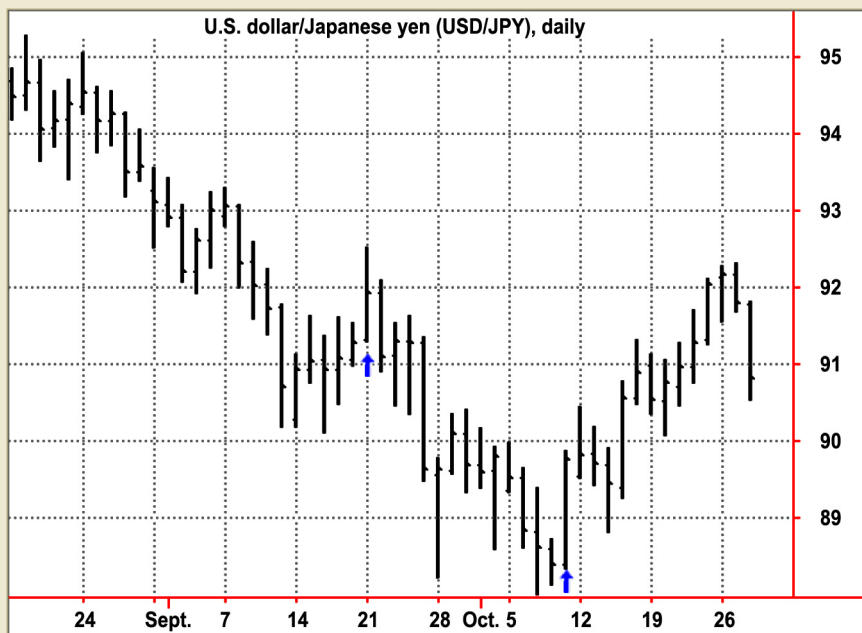
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An inside look at a dollar/yen pattern

FIGURE 1 — INSIDE DAYS FOLLOWING DOWN MOVES

A long trade signal tied to the Sept. 22 bar was followed by selling, while a subsequent setup after the Oct. 8 bar was followed by a rally.



Source: TradeStation

A pattern-based trade setup begins to take on a different appearance with detailed analysis of its components.

BY CURRENCY TRADER STAFF

What if you're not really trading what you think you are?

One of the triggers for a long U.S. dollar/yen trade detailed in the *Forex Journal* in the October issue of *Currency Trader* was a pattern consisting of an inside day that occurred after a sell-off. The *Journal* notes "analysis of similar patterns showed the potential for a several-day mild rally after an initial bounce and pullback."

This trade (signaled on Sept. 22) happened to get stopped out with a 1.34-point loss three days later (Figure 1). Although one trade result doesn't indicate anything, other factors led to a discussion of whether the pattern analysis that triggered this trade was really telling us what we thought it was.

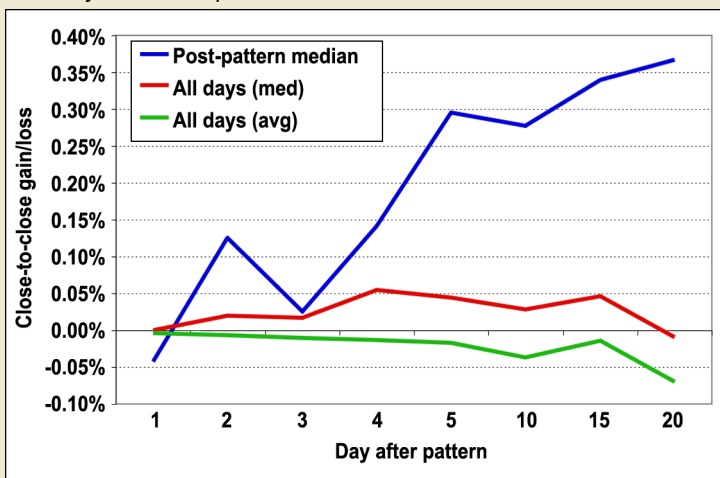
Sound confusing? The numbers themselves weren't. The pattern in question was based on the recent price history leading up to Sept. 21, one day after an inside day. It signaled a long entry when price closed higher after forming an inside day that was preceded by a down move over (roughly) the preceding three weeks:

1. Yesterday was an inside day.
2. The lowest low of the four days preceding the inside day was below the lowest low of the 13 days before that.
3. Today's close is above the two preceding closes.

continued on p. 22

FIGURE 2 — INSIDE-DAY PATTERN PERFORMANCE

The price action after the inside day pattern was mostly bullish, in stark contrast to the dollar/yen's typical performance during the 10-year review period.



Automated Trading Systems: Are they really as easy as they sound?

By Betsy Waters, global head of dbFX.com, the retail currency trading platform of Deutsche Bank

Sophisticated traders are increasingly looking for new ways to invest in the global forex market, the largest investment market in the world. A growing trend within the retail forex market over recent years has been the use of automated trading systems as an alternative to self directed trading.

In 2009, dbFX, Deutsche Bank's online margin forex trading platform for individuals and small institutions, has seen a dramatic rise in the number of clients trading through automated trading systems. Since the start of the year the percentage of volumes contributed by such systems has risen from 1% to approximately 20%. dbFX seamlessly integrates with systems such as MetaTrader 4 enabling traders to use their preferred system at the same time as accessing Deutsche Bank's quality pricing and trade execution.

A key advantage of automated trading systems is that they enable traders to manage their forex portfolios according to a set of pre-determined rules. They therefore tend to be less time intensive than self-directed trading because trades are executed automatically and emotion is removed from the equation. However, Forex traders considering using one of these systems should do comprehensive research to make sure they choose a system which meets their investment objectives as well as the current market conditions. A system that works well when carry trades are popular might not be suitable at a time when market movements are being created mostly by trading trending currency pairs - and vice versa. It is therefore important to continually evaluate your system to satisfy yourself that its strategy meets your objectives within the current market conditions.

There are many online specialist forex trading forums and reviews in industry publications to help you understand the different systems available but beware that some system websites sometimes make big claims about the returns their systems will deliver (if it sounds too good to be true it probably is). Instead you should carefully review the trading logic of the system, and how it works and be able to follow the trades that the system is generating at all times.

It is also important to consider whether the system matches your trading style in regards to leverage and risk. For example, if you are the type of trader who likes to carefully plan trades using a stop loss order on every position, you should pick a system that has a similar risk management methodology. When evaluating a system, it is essential that you ask the system developer detailed questions on how the system actually works, to fully understand the trading, risk and leverage parameters. You should also consider the cost benefit of implementing such a system. Depending on the logic and strategy it implements, the system may increase the frequency of trades that you are used to, and consequently

increase the cost, whilst potentially not producing the profitability of your strategy.

Look for reviews and feedback on your system developer and the product on trading community forums. As with any purchase it is important to look for a system that has received consistent feedback from a number of different sources.

Automated trading systems are rapidly gaining popularity and the very name makes them sound like an easy solution to trading, however, as with any other investment you still need to do thorough analysis before choosing a system and to keep on top of its progress to ensure it is the right solution for your needs. ■



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Dollar/yen weekly low setup update

A weekly time frame buy setup described in “Dollar/yen weekly low pattern” (*Currency Trader*, October 2008) has triggered three signals since the article’s publication. The first of these signals occurred on July 20 at 94.24, the second on Sept. 21 at 91.30, and the third on Oct. 5 at 89.35. The first and third signals were fairly well positioned, but the dollar/yen declined 3.31 (3.7 percent) before rebounding (Figure A). These were the first signals since July 21, 2008. The pattern has issued 28 signals since March 2000.

The entry pattern consists of a series specific lower weekly lows over the past four weeks, combined with a strong close in the current week.

As formulas, these rules are:

1. $\text{High}[1] < \text{high}[2]$ and $\text{low}[1] > \text{low}[2]$
2. $\text{Min}(\text{low}[6]:\text{low}[3]) < \text{Min}(\text{low}[20]:\text{low}[7])$
3. $\text{Close}[0] > \text{Max}(\text{close}[1], \text{close}[2])$

Where: 0, 1, 2, 3, etc., refer to today, yesterday, two days ago, three days ago, etc.

This setup formed 47 times in the 10 years between Sept. 21, 1999 and Sept. 21, 2009. Figure 2 shows what happened afterward. The chart compares the median dollar/yen performance one to 20 days after the pattern instances to all one- to five-day periods in the 10-year review period. Overall, the dollar/yen lacked any notable trend over the different snapshot lengths: The overall median moves were slightly positive (at least until day 15), while the average moves were slightly negative. By contrast, the price action after the inside day pattern is clearly bullish (after the slightly negative performance on day 1) and is still climbing at day 20.

So what’s wrong with this picture, if anything? Let’s start with the inside-day component, which was one of the primary reasons the trade idea was originally researched.

Starting at the beginning

Peruse any trading literature and you will find inside days (those with a lower high and higher low than the preceding day) typically described as harbingers of increased volatility as a market transitions from the inside day’s supposed indecision or sleepiness to a new phase of directional movement. In other words, low volatility is typically followed by higher volatility — a common enough claim.

FIGURE A — YEN WEEKLY LOW PATTERN

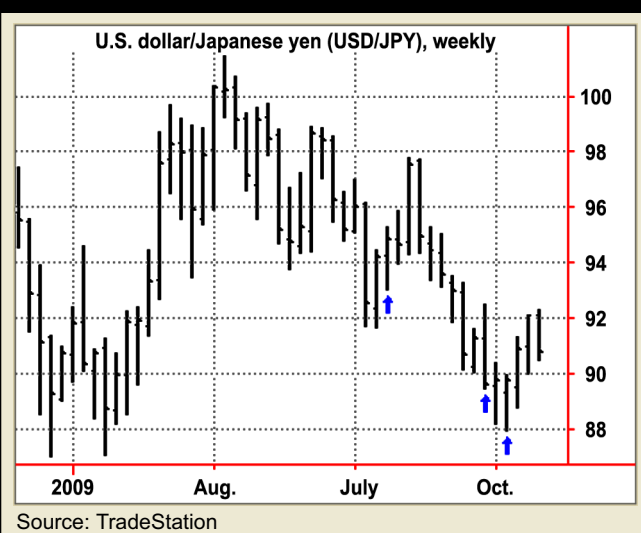


FIGURE 3 — USD/JPY VOLATILITY AFTER INSIDE DAYS

In the first five days after inside days, volatility tended to be higher, but not dramatically higher.

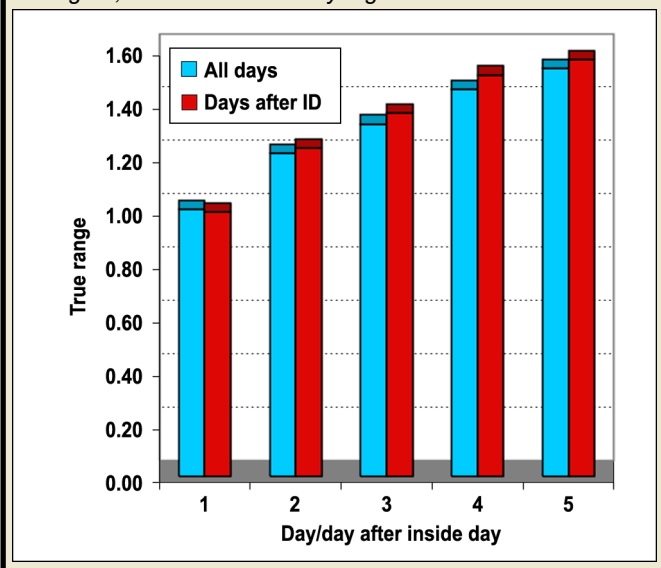
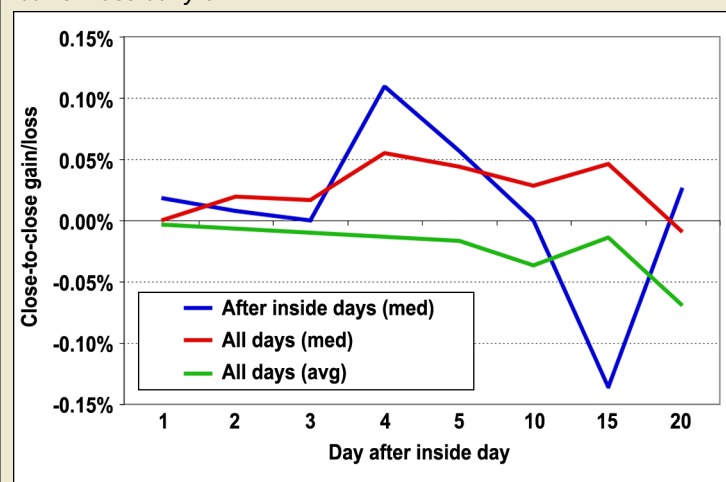


FIGURE 4 — AFTER ALL INSIDE DAYS

Overall, price action after inside days was a more volatile reflection of the dollar/yen’s typical performance, with some minor bullishness early on.



Various patterns and trade setups have appeared over the years that enter when price pushes above or below the range of an inside day (often after an initial false move in the opposite direction), to take advantage of the market's first thrust on renewed volatility.

In this case, we might want to check whether that general principle holds water, and then drill down to more specific situations involving inside days. Let's start by analyzing all the inside days in the dollar/yen pair in the September 1999-September 2009 period. There were 417 inside days during this period (not counting Sept. 18, 2009, the day that triggered the aforementioned trade) — plenty of examples to analyze.

First, let's address the issue of whether volatility increases after inside days. Figure 3 compares the volatility one to five days after the 417 inside days to all one- to five-day periods in the 10-year analysis period. Volatility is represented by the median **true range**. The results might be surprising: Volatility was, in fact, higher after inside days in four of the five instances, but not dramatically; it was actually a hair lower for day 1. Overall, traders looking for a significant pop in the dollar/yen right after an inside day are likely to be disappointed. (However, one important factor this analysis doesn't take into consideration is whether a particular inside day actually represents a meaningful volatility contraction. For example, if yesterday had the largest range of the past 100 days and today is an inside day that is only marginally smaller than yesterday, is it logical to claim today represents the same phenomenon as an inside day that was a third the size of the preceding day, which in turn had a range slightly smaller than the average range of the preceding 20 bars?)

Next, let's analyze the direction price took after these inside days. Figure 4 compares the median close-to-close gains one to 20 days after inside days to the dollar/yen's average and median performance. The moves after inside days were simply a more volatile reflection of this lack of direction: A gain at day 4 was a loss by day 15, and by day 20 the results were back in line with the market's typical performance — fitting, given the unlikelihood a moderate one-day event such as an inside day would have a notable effect a month later.

These results represent inside days in the dollar/yen in their rawest form, though. What we need to do is bring additional price information

continued on p. 24

FIGURE 5 — HIGHER-CLOSING INSIDE DAYS

Inside days that close higher than the previous day were followed by a more bearish version of the price action shown in Figure 4.

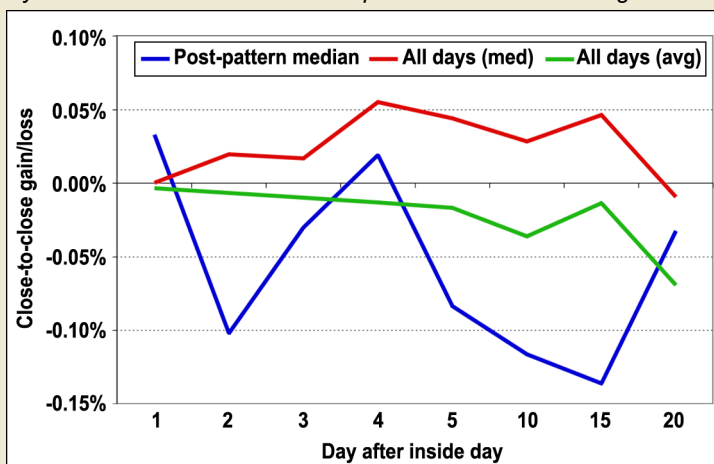


FIGURE 6 — HIGHER CLOSE, VERSION 2

Higher-closing inside days that also closed above the open showed similar results to those in Figure 5. (Ninety-five percent of inside days that closed higher on the day also closed above the open.)

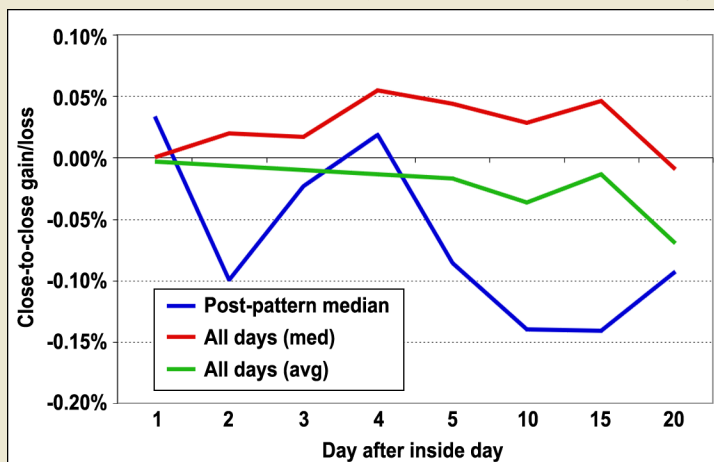
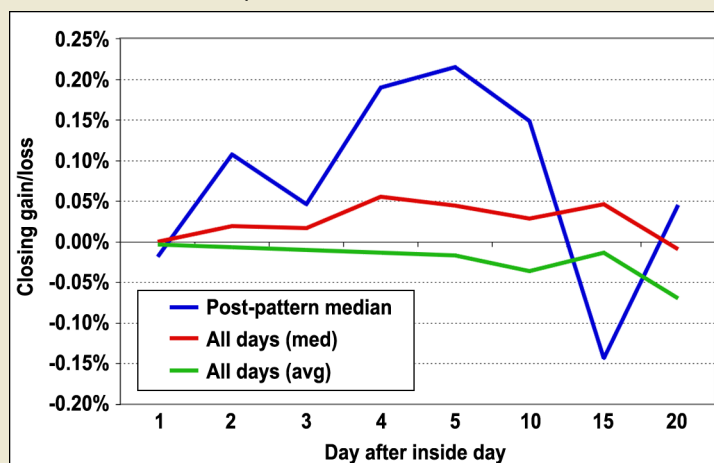


FIGURE 7 — LOWER-CLOSING INSIDE DAYS

The dollar/yen tended to rally in the first five days after inside days that closed below the previous close.





into the picture to see if various kinds of inside days — or those occurring in different situations — produce notably different results.

Up- and down-closing inside days

One way to segregate inside days is by their closing prices: Did they close higher or lower than the previous day? Did they close above or below the opening price? Perhaps the short-term momentum suggested by these closes might signal a directional bias.

Figure 5 shows the results for inside days that closed higher than the previous day (203 instances). In a way, the post-pattern performance is a negatively skewed version of the performance shown in Figure 4: an initial down move, followed by an up swing (peaking at day 4), then a down swing and, finally, by day 20, a move back in line with the market's typical price action.

Figure 6 shows the performance after inside days that close above both the previous close and the inside day's opening price (192 instances). The results are very similar to those in Figure 5.

Figures 7 and 8 show the opposite patterns: Inside days that closed below the previous day's close, and those that also closed below the inside day's open (212 and 198 instances, respectively). The results (through day 5) are basically reversed from Figures 5 and 6 — price tends to rally before, in the longer term, reverting back toward the market's typical performance. In all cases, however, the moves following the inside days are relatively small.

Figures 9 and 10 provide yet another short-term perspective: the performance after the day immediately after the inside day closes higher or lower. In the case of Figure 9, higher closes the day after upside days (212 instances) were followed by bullish price action through day 5, after which performance turned negative. Figure 10, which shows the performance after inside days followed by lower closes (204 instances), is particularly interesting: after some weakness through day 3, the dollar/yen was still pushing higher (albeit moderately) through day 20.

With the exception of this final tendency, however, the various inside-day variations (Figures 4 through 10) show little evidence of providing the more prominent bullish tendency from Figure 2.

Next month's issue will look at the missing piece of this analysis puzzle.

FIGURE 8 — LOWER CLOSE, VERSION 2

More than 93-percent of inside days that closed below the previous close also closed below the open.

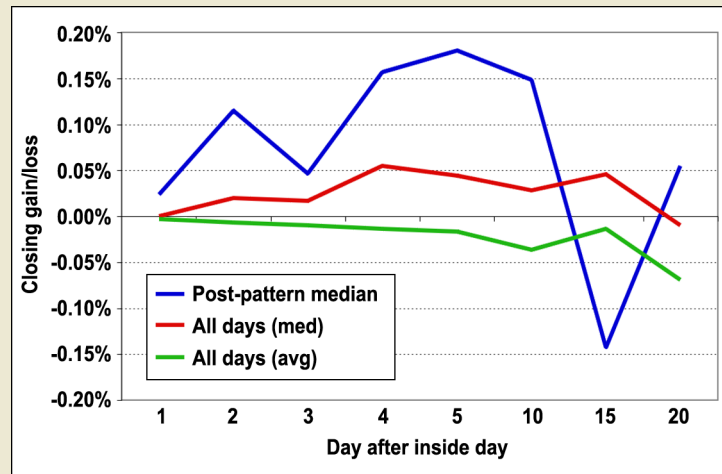


FIGURE 9 — CLOSING ABOVE THE INSIDE DAY'S CLOSE

When the dollar/yen closed higher the day after an inside day, price was bullish through day 5.

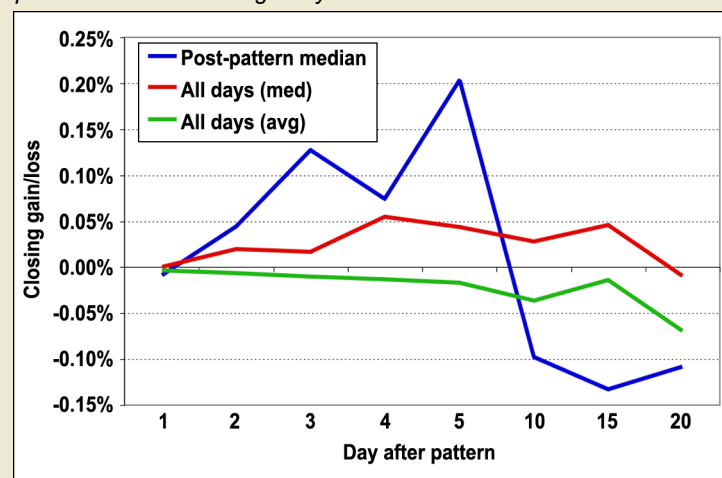
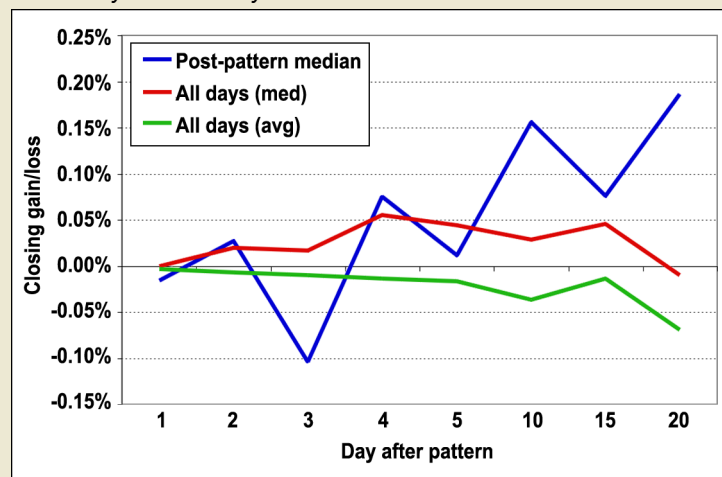


FIGURE 10 — CLOSING BELOW THE INSIDE DAY'S CLOSE

After bottoming at day 3, the dollar/yen tended to push higher after inside days followed by lower closes.



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Adaptive FX money management

Your choice of money-management rules will dramatically affect the long-term profitability of your trading system.

BY DANIEL FERNANDEZ

Almost all forex trading literature focuses on finding better entries rather than developing sound exit and money-management strategies. This article shows how a money-management system that adjusts trade size based on market volatility can transform an unprofitable forex trading strategy into a profitable approach.

Given that we want to emphasize the role of money management, we will use a very basic trading approach — a simple moving average crossover system. Then we will apply different risk-control and money-management schemes to the system to see how they impact performance.

The system goes long when a 15-period moving average (MA) crosses above a 250-period MA and goes short when

the 15-period MA crosses below the 250-period MA. Figure 1 shows trade examples on a one-hour British pound/U.S. dollar (GBP/USD) chart. Positions are closed when these moving averages cross in the opposite direction, or when a 15-period moving average crosses below (for a long trade) or above (for a short trade) a 25-period moving average.

Also, the tests will incorporate a stop-loss and a profit target, the nature of which will change depending on the specific money-management approach used.

Historical testing

To provide a good picture of the strategy's performance in different market conditions, the system was tested on intraday data from Jan. 1, 2000 to Jan. 1, 2009. Two currency pairs were tested on different time frames: one-hour GBP/USD data and five-minute Euro/U.S. dollar (EUR/USD) data.

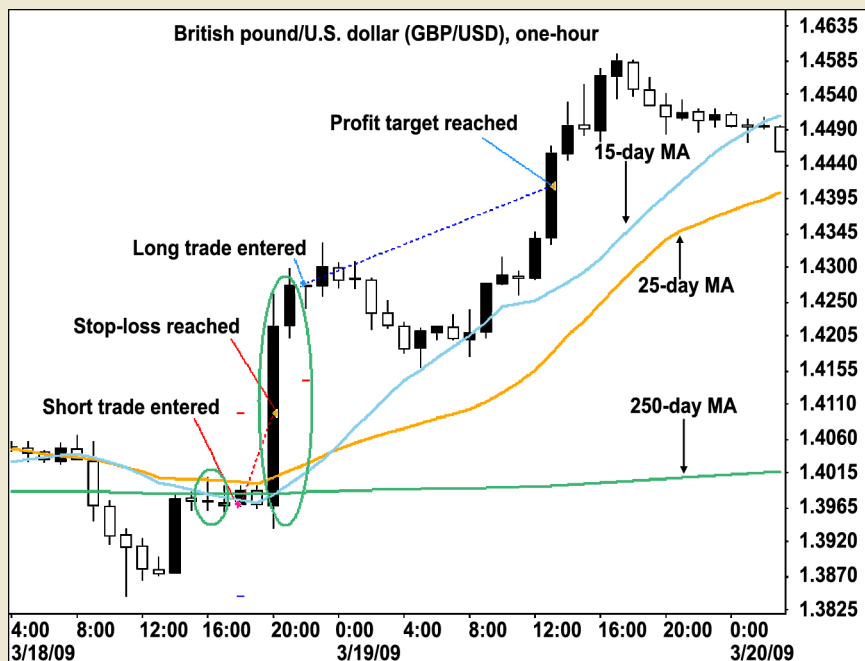
All positions took into account only information of closed price bars. This ensures the strategy is evaluated as accurately as possible, a fact that was confirmed by the almost perfect match between demo trading and historical testing of the strategy from September to October 2009. The initial account equity in testing was \$100,000. A 3-pip spread cost was factored into all GBP/USD trades, and a 2-pip spread was assessed for EUR/USD trades.

Money management

To compare non-adaptive and adaptive money management, three approaches were applied to the trading system. The first used fixed profit-target and stop-loss amounts of 50 pips (.0050 in the pound/dollar and Euro/dollar pairs) and a position size of 1 percent of account equity.

FIGURE 1 — MOVING AVERAGE CROSSOVER SYSTEM

The different money-management routines were applied to an intraday moving average crossover system.



Source: MetaTrader, © 2001-2009 MetaQuotes Software Corp.

FIGURE 2 — FIXED MONEY MANAGEMENT (GBP/USD)

Using fixed stop-loss and profit-target amounts results in an overall loss for the system, although it traded profitably for part of the test period.



Source: MetaTrader, © 2001-2009 MetaQuotes Software Corp.

FIGURE 3 — 1% EQUITY STOP-LOSS (GBP/USD)

Modifying the stop-loss so it always represented 1 percent of account equity didn't change the system's overall negative performance.



Source: MetaTrader, © 2001-2009 MetaQuotes Software Corp.

The second approach used the same profit target and position size, but the stop-loss was changed to make the per-trade risk equal to 1 percent of account equity. For example, with a \$100,000 account balance, a losing trade would be exited when the loss reached \$1,000.

The third, dynamic, approach used stop-loss, profit-target, and position-size values that were adjusted using the 14-day **average true range** (ATR). The formula for the stop-loss (SL) and profit target (PT) is:

$$SL = TP = 0.5 \times 14\text{-day ATR}$$

This formula sets the SL and PT as 50-percent of the 14-day ATR. For example, if the 14-day ATR is 0.0120, the stop-loss and profit target would be 0.0060 (60 pips). In this case, 50 percent was used because it generated approximately the same average profit/loss as the first two money-management systems.

The dynamic position size formula is:

$$\text{Position size} = \frac{0.01 \times \text{AccountBalance}}{(\text{ContractSize} \times 14\text{-day ATR})}$$

This formula is designed to achieve the same profit (relative to account balance) regardless of market volatility: higher volatility (a higher ATR) will reduce trade size while lower volatility will increase trade size. But position size is also determined by account balance: more equity is risked when the account balance increases, and less when it decreases. (Some may have connected this money-management approach with the popular "Turtle" trading system developed by trader Richard Dennis in the 1970s and 80s, which used a similar technique for determining trade size and stop-loss amounts.)

The contract size variable is included because the formula was first designed to be traded on different instruments;

continued on p. 28

**FIGURE 4 — ATR-ADJUSTED MONEY MANAGEMENT (GBP/USD)**

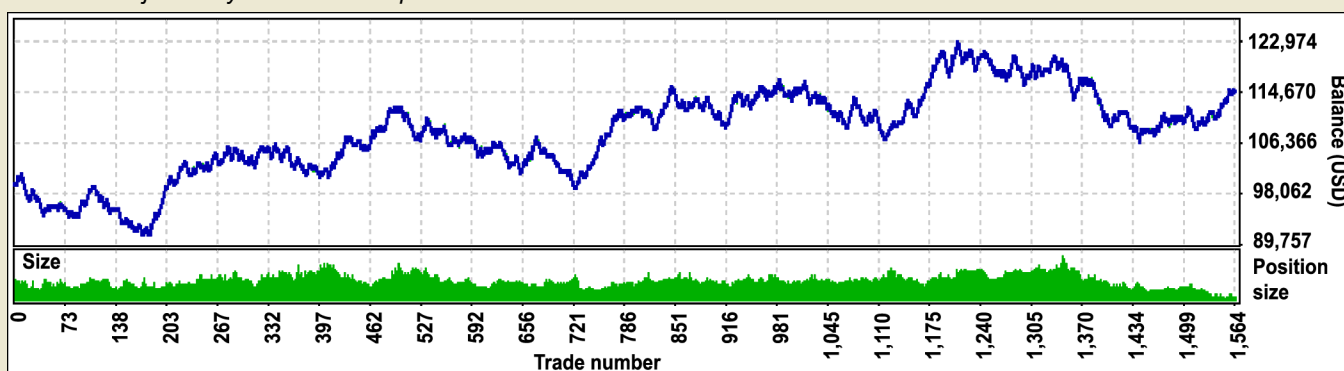
Making the system dynamic through the addition of ATR-adjusted stop-loss, profit target, and position-size values resulted in net profitability and a reduced maximum drawdown.



Source: MetaTrader, © 2001-2009 MetaQuotes Software Corp.

FIGURE 5 — ATR-ADJUSTED MONEY MANAGEMENT (EUR/USD)

The ATR-adjusted system was also profitable on five-minute Euro/dollar data.



Source: MetaTrader, © 2001-2009 MetaQuotes Software Corp.

to achieve the same results across a portfolio, the positions needed to be adjusted to contract size. In forex trading the “contract size” is \$100,000 for standard accounts and \$10,000 for micro accounts. The value of 0.01 in the formula represents the risk factor, which is the percentage of equity risked per trade. For an initial account balance of \$100,000 for a standard spot forex account, and an ATR value of 0.0120, the trade size would be 0.83 “contracts,” or \$83,000.

The ATR gives the third money-management approach an adaptive element because it changes the SL, PT, and position size traded according to changes in market volatility. Theoretically, this should give it an advantage over the other two money-management systems, which ignore market conditions and are influenced only by changes in equity.

Test results

It is important to evaluate strategies for long time periods because short time frames can be deceptive. That is, you can have a money-management system that is unprofitable in

the long-term show profitable results during shorter periods.

The tests show the system was unprofitable using the first two money-management schemes, although both had profitable sub-periods. Figure 2 shows the equity curve for the first (fixed) money-management approach for the GBP/USD pair. After moving sideways for roughly the first third of the test period, the equity curve made a new high around trade 394 before sliding into a long drawdown that lasted the remainder of the test. Performance on the five-minute EUR/USD pair (not shown) was similar.

Some traders might think the introduction of the dynamic stop-loss in the second money-management approach would correct the problem, but instead it simply changed the periods of profitability and produced almost no changes in the overall results (Figure 3). The trading system remained unprofitable, a condition that appeared to be independent of the currency pair and the time frame, as the five-minute EUR/USD results were again similar to the one-hour GBP/USD performance.

The third, adaptive money-management system pro-

TABLE 1 — MONEY-MANAGEMENT COMPARISON

The first two money-management approaches had negative average annual profits. The ATR-adjusted money-management approach produced a positive average annual return, dramatically reduced the drawdown, and cut the number of trades significantly.

	Max. drawdown	Avg. annual profit	Win %	Max. consec. wins	Max. consec. losses	No. of trades
1. Fixed	35%	-0.7%	49%	7	11	724
2. 1% equity SL	52%	-3.5%	46%	6	10	529
3. Adaptive	7%	1.5%	50%	7	8	491
4. Adaptive*10	57%	24.8%	50%	7	8	491

Source: MetaTrader, © 2001-2009 MetaQuotes Software Corp.


duced very different results. Figures 4 and 5 (GBP/USD and EUR/USD, respectively) show the inclusion of the ATR-adjusted stop-loss, profit target, and position size translated into uptrending equity curves for both currency pairs (also, the most significant drawdown period for this strategy, approximately 2003-2004, was decisively reduced). These adaptations make the system trade for almost the same profit or loss regardless of the market conditions, while retaining flexibility in both the stop-loss and profit target (although they remain comparable in size to

the fixed amount used in the first two money-management systems).

In an additional test, which increased risk by a factor of 10 (0.1 vs. 0.01), the system did a great job of protecting equity: The resulting maximum drawdown was proportionally smaller than the geometrical increase in risked equity (a 57-percent maximum drawdown vs. the expected 78-percent). Equity is protected by the position-sizing function when the account balance starts to decrease.

Table 1 shows some of the key performance statistics in the GBP/USD pair for different money-management approaches.

Equity, risk, market

A sound money-management technique must always take into account three things: equity, risk, and the market. The transformation here of an unprofitable trading system into a profitable one argues for the importance of money management in general, and a dynamic money-management approach specifically. 

For information on the author [see p. 6](#).



EVENTS

Event: Lawrence G. McMillan's Intensive Options Seminar

Date: Nov. 9

Location: New York City, Marriott Marquis

For more information: Go to www.optionstrategist.com and click on "Seminars"

Event: The Fifth Middle East Forex Trading Expo and Conference 2009

Date: Nov. 17-18

Location: Jumeirah Emirates Towers Hotel, Dubai

For more information: www.meforexexpo.com

Event: International Traders Expo

Date: Nov. 18-21

Location: Mandalay Bay Resort & Casino, Las Vegas

For more information: www.tradersexpo.com

Event: International Traders Expo

Date: Feb. 13-16

Location: Marriott Marquis Hotel, New York, N.Y.

For more information: www.tradersexpo.com

Event: TradeStation Futures Symposium

Date: Dec. 10-12

Location: Naples, Fla.

For more information: Visit www.tradestation.com/strategy

Event: 26th Annual Risk Management Conference

Date: March 7-9

Location: The Ritz-Carlton Golf Resort, Naples, Fla.

For more information: Visit www.cboe.com/rmc

Event: The World MoneyShow Vancouver 2010

Date: April 6-8

Location: Hyatt Regency Vancouver

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The hidden cost of illiquidity

Analyzing currency volatility and interbank liquidity suggests we may have found a way to create a protectionist environment without resorting to tariffs.

BY HOWARD L. SIMONS

If you want to thin out a crowded restaurant or bar, hijack the sound system and start talking about liquidity in the London interbank markets. Fleeing patrons might pay you to take their table just for the privilege of leaving.

This inattention to detail can be costly. One of the lessons we thought we learned from the Great Depression was protectionism was a lose-lose game for all involved. That lesson was learned primarily in the context of high tariffs, such as the American Smoot-Hawley tariff of 1930, and it is easy to understand why. Tariffs are visible, they are a direct cost on imports, and the exporter penalized by them is aware of the penalty. Consumers of goods with high tariffs should be outraged at this tax on their goods purchased, but as tariffs are imposed indirectly, this never seems to be the case.

The post-World War II order created a mechanism — the General Agreement on Tariffs and Trade (GATT) — to countermand the general political impulse toward trade barriers. GATT went through several rounds of negotiations over the decades (the likes of which make a wiring diagram look simple), and was eventually succeeded by the World Trade Organization (WTO).

Trade barriers are like the heads of the mythical Hydra — cut one and others grow to take its place. Each barrier comes replete with predictable if unintended consequences. For example, the U.S. imposed quotas on the importation of Japanese cars starting in the 1970s; we should not have to ask how American firms such as General Motors and Chrysler fared vis-à-vis Japanese firms such as Toyota and Honda over the past 35 years. The Japanese sold fewer cars to meet the quota, but predictably upgraded their mix to include luxury names such as Lexus.

Other non-tariff barriers include health and safety regulations, licens- es, and restrictions on distribution

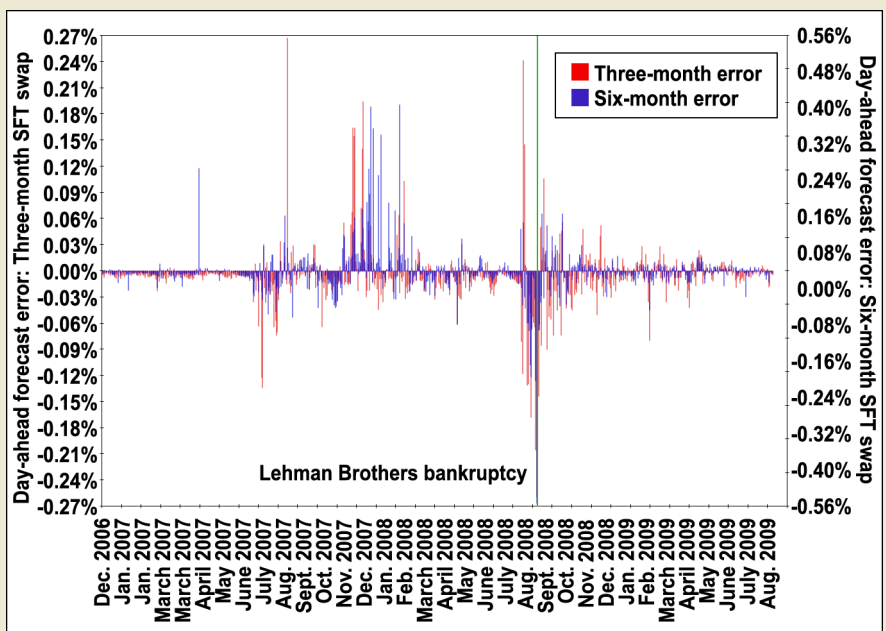
networks and logistical systems. But the biggest one of all has been the deliberate manipulation of currencies by governments. This has been a tawdry tale in international trade ever since the collapse of the Bretton Woods system of fixed exchange rates between 1971 and 1973. The actual impact on trade flows of these currency manipulations has been far less than intended (see “Currencies and Federal Reserve trade weights” and “Minor currencies and Federal Reserve trade weights,” *Currency Trader*, June and July 2007), but protectionists everywhere are convinced they can devalue their way to prosperity.

Currency volatility

A more subtle way of stumbling into a protectionist morass is to increase the cost of currency trading, intentionally or otherwise. Because options are a form of insurance, and

FIGURE 1 — FORECAST ERROR FOR USD LIBOR SET-FOR-TOMORROW SWAPS

Comparing the difference between the actual rate and the forecasted rate for both three- and six-month LIBOR from December 2006 onward highlights three unusual periods, the last of which occurred in the weeks following the Lehman Brothers bankruptcy.



because higher volatility increases the cost of options, it must follow higher currency volatility imposes a cost on all currency transactions and therefore on the underlying physical trade.

Volatility in any market can rise either as a function of prices and events or simply as a function of wider bid-ask spreads or lower market liquidity. Such appears to have been the case with the London interbank market starting in 2008. Because currency trades are executed primarily through the borrowing and lending of deposits in this market, anything that lowers

The actual impact on trade flows of currency manipulation has been far less than intended, but protectionists everywhere are convinced they can devalue their way to prosperity.

liquidity and raises spreads will raise currency volatility and, therefore, hedging costs.

The key event in eroding interbank liquidity and its effect on the currency market was not, surprisingly, the April 2008 disclosure (by *The Wall Street Journal*) that British Bankers Association member banks were, um, fudging their rates lower in the daily London Interbank Offered Rate (LIBOR) fixing. (This disclosure did lead to a greater reliance by American borrowers on the overnight index swap [OIS], which is a strip of federal funds over a given interval, such as 30, 60, or 90 days. It also led to a rather pronounced decrease in the open interest of the CME Group's flagship Eurodollar futures contract, which is based on three-month LIBOR.) No, the key event in 2008 for currency traders was the mid-September bankrupt-

cy of Lehman Brothers.

We can illustrate this most clearly in the British pound trade against the U.S. dollar. First, let's take a look at how the LIBOR market manages its own day-ahead risk. The LIBOR rate is fixed in the morning, much to the frustration of newbies in this market who kept looking for real-time

continued on p. 32

FIGURE 2 — TED SPREAD DISLOCATION AFFECTED USD VOLATILITY FOR GBP HOLDERS

The three-month TED spread blew out during the crisis as banks both fled each other's credit in favor of the U.S. Treasury's.

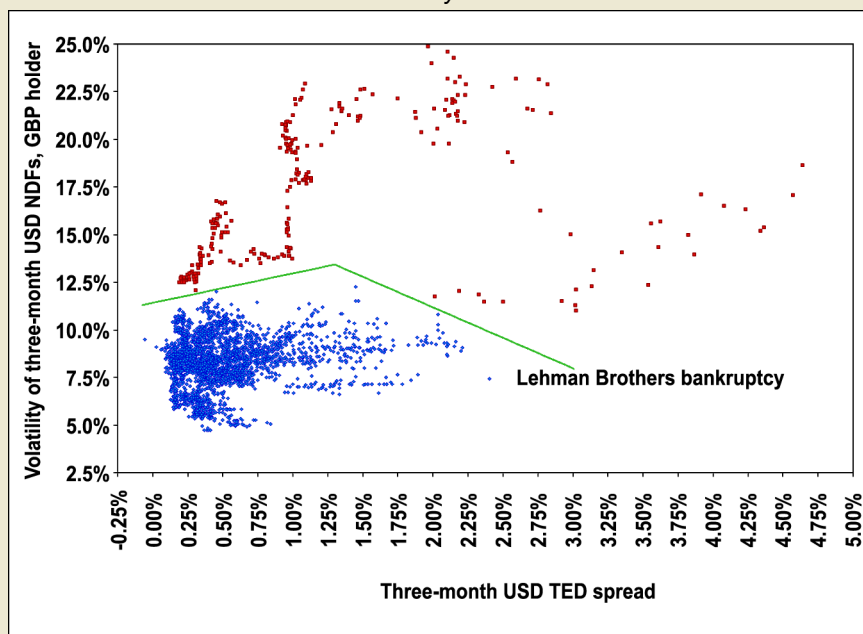
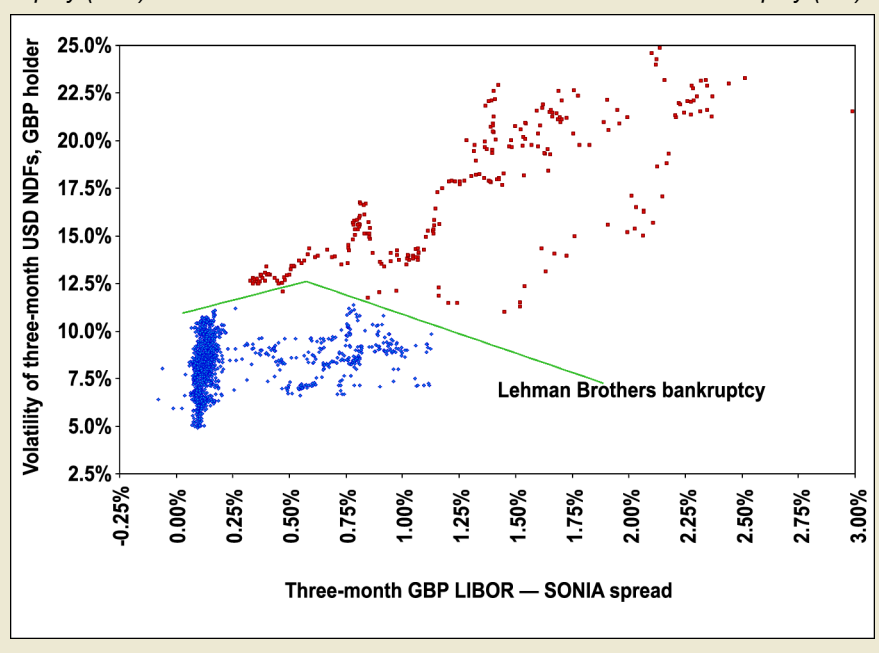


FIGURE 3 — LIBOR-SONIA SPREAD DISLOCATION AFFECTED USD VOLATILITY FOR GBP HOLDERS

As was the case in Figure 2, all observations prior to the Lehman Brothers bankruptcy (blue) are distinct from those after the Lehman Brothers bankruptcy (red).





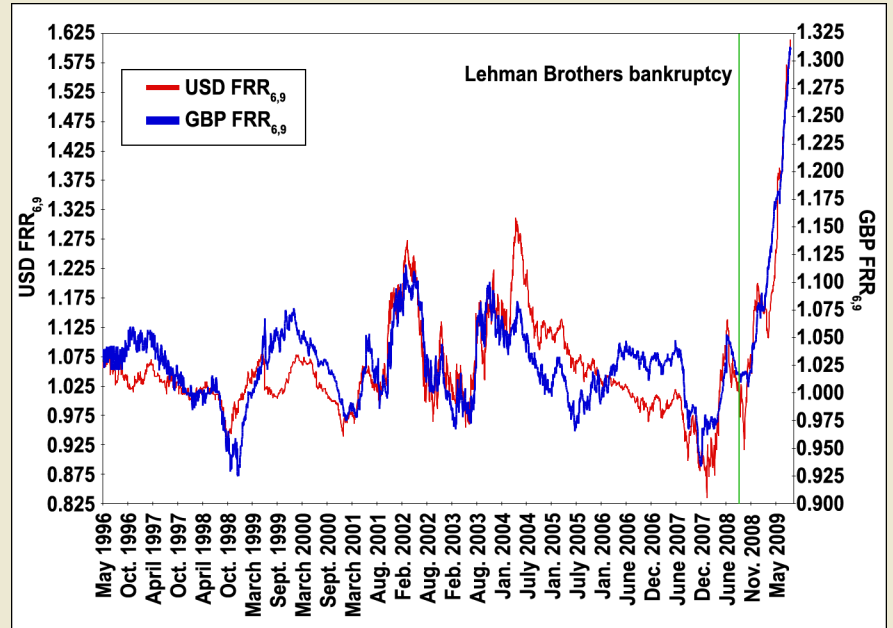
updates during the depths of the credit crunch in October 2008. There is a one-day-ahead swap market that began in December 2006, known as the set-for-tomorrow (SFT) swap, that essentially represents a bet where the next morning's LIBOR fix will be.

If we map the forecast errors (the difference between the actual rate and the forecasted rate) for both three- and six-month LIBOR from December 2006 onward, three periods stand out as deviations (Figure 1). The first was a period of systemically low bias in July-August 2007. The second was a much more persistent and more powerful period of systemically high bias between November 2007 and March 2008. This was the first period the Federal Reserve began its attempts to push LIBOR lower even though it had no tools for doing so directly.

The third and final period, highlighted with a green vertical line in Figure 1, is a period of persistently low bias during the weeks following the Lehman Brothers bankruptcy. The degree of shock here was so great we can be confident at

FIGURE 4 — COMPARATIVE LIBOR YIELD CURVES

Mapping the two forward-rate ratios over time indicates the period surrounding the Lehman Brothers bankruptcy was nothing unusual.



66.33-percent and 78.64-percent levels the three- and six-month SFT forecast errors were different during the period between the Lehman Brothers bankruptcy and a renormal-

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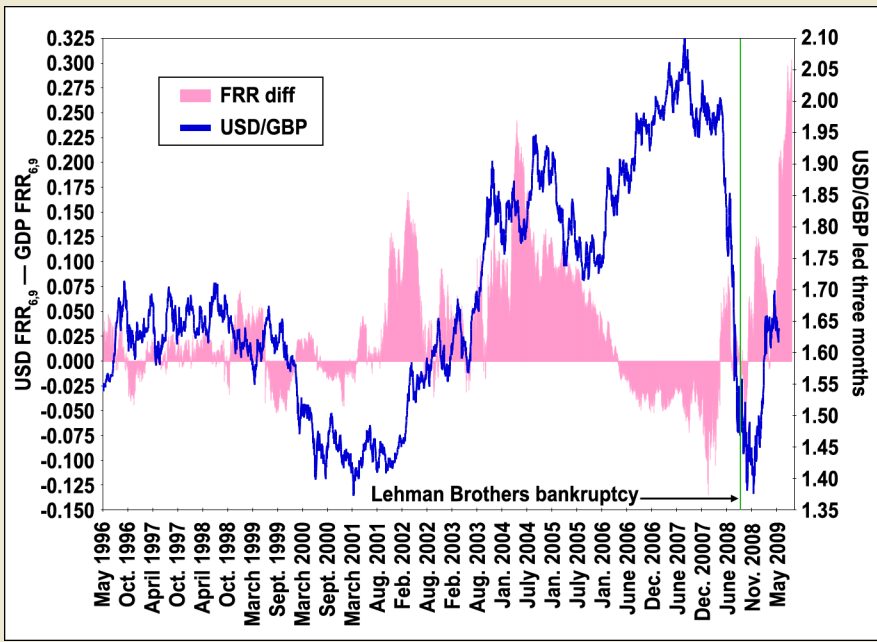
ization of LIBOR in late May 2009 than they were previously.

How did the volatility of three-month U.S. dollar (USD) forwards for a British pound (GBP) holder change around this date? Here we can look at two other spreads related to the liquidity of the interbank market. The first is the three-month TED spread, or difference between LIBOR and the Treasury rate. This spread blew out during the crisis as banks both fled each other's credit in favor of the U.S. Treasury's (Figure 2). The second is the spread between three-month GBP LIBOR and SONIA, the Sterling overnight index average rate (Figure 3).

In both cases, the answer is stunningly clear. All observations prior to the Lehman Brothers bankruptcy, marked in blue, can be separated from all those after the Lehman Brothers bankruptcy, marked in red.

FIGURE 5 — RELATIVE INTEREST RATE EXPECTATIONS IN THE DOLLAR-POUND MARKET

Does the chart represent a functional market or simply prices imposed by various central bank facilities and machinations?



A different metric

One important aspect of this analysis is how it highlights significant liquidity changes in a market, in this case the

interbank fixing, whose bid-ask spreads and volume are not available in the conventional sense.

continued on p. 34

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We can illustrate this in the negative by our standard interest-rate expectation analysis, the difference between the USD and GBP forward-rate ratios between six and nine months ($FRR_{6,9}$). These are the rates at which we can lock in borrowing for three months starting six months from now divided by the nine-month rate itself. The more this ratio exceeds 1.00, the steeper the yield curve and the greater the expectation for rising rates in the future.

If we map the two forward-rate ratios over time, we see the period surrounding the Lehman Brothers bankruptcy was nothing unusual (Figure 4). Yes, both $FRR_{6,9}$ s steepened rapidly, but they had done that before, and the divergence between the rising GBP $FRR_{6,9}$ and the falling USD $FRR_{6,9}$ had occurred previously in mid-1999 and mid-2006.

The course of the exchange rate conformed to the $FRR_{6,9}$ differential before and after the Lehman Brothers bankruptcy — the positive value indicated U.S. rates were expected

to rise faster than UK rates — but we have no idea of whether either the USD or GBP six- and nine-month LIBOR readings represented a fully liquid market or not. Anecdotal evidence is negative here. We could look at Figure 5 and have no idea whether it represented a functional market or simply prices imposed by various central bank facilities and machinations.

What the volatility link shows us is how the world may have stumbled into a protectionist environment produced by rising currency volatility and declining interbank liquidity. That sort of thing in the midst of a global recession should have been avoided, but was not. This is one more unfortunate piece of evidence that what we thought we learned in the Great Depression we actually did not. What will future generations learn from our foibles? 

For information on the author [see p. 6](#).

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Market	Symbol	Exchange	Volume	OI	10-day move/% rank	20-day move/% rank	60-day move/% rank	Volatility ratio/rank
Eurocurrency	EC	CME	238.6	166.3	-1.15% / 86%	0.95% / 24%	2.67% / 16%	.33 / 78%
British pound	BP	CME	130.0	99.1	0.56% / 8%	3.32% / 93%	-1.98% / 57%	.49 / 68%
Japanese yen	JY	CME	95.7	118.2	0.95% / 38%	-0.45% / 19%	6.03% / 91%	.29 / 30%
Australian dollar	AD	CME	82.6	111.1	-1.70% / 100%	4.27% / 59%	7.31% / 18%	.24 / 65%
Canadian dollar	CD	CME	70.9	90.7	-3.87% / 83%	0.29% / 8%	-0.11% / 0%	.48 / 92%
Swiss franc	SF	CME	48.1	51.0	-0.71% / 67%	0.90% / 23%	3.96% / 28%	.31 / 67%
Mexican peso	MP	CME	21.0	66.3	-0.69% / 43%	3.62% / 64%	-1.44% / 62%	.54 / 60%
U.S. dollar index	DX	ICE	10.7	32.1	0.93% / 83%	-0.96% / 25%	-3.32% / 19%	.29 / 88%
New Zealand dollar	NE	CME	5.5	24.2	-2.78% / 100%	0.42% / 2%	7.12% / 5%	.34 / 100%
E-Mini eurocurrency	ZE	CME	3.6	2.5	-1.15% / 86%	0.95% / 24%	3.91% / 24%	.33 / 80%

Note: Average volume and open interest data includes both pit and side-by-side electronic contracts (where applicable). Price activity is based on pit-traded contracts.

LEGEND:

Volume: 30-day average daily volume, in thousands.

OI: 30-day open interest, in thousands.

10-day move: The percentage price move from the close 10 days ago to today's close.

20-day move: The percentage price move from the close 20 days ago to today's close.

60-day move: The percentage price move from the close 60 days ago to today's close.

The **"% rank" fields** for each time window (10-day moves, 20-day moves, etc.) show the percentile rank of the most recent move to a certain number of the previous moves of the same size and in the same direction. For example, the % rank for 10-day move shows how the most recent 10-day move compares to the past twenty 10-day moves; for the 20-day move, the % rank field shows how the most recent 20-day move compares to the past sixty 20-day moves; for the 60-day move, the % rank field shows how the most recent 60-day move compares to the past one-hundred-twenty 60-day moves. A reading of 100% means the current reading is larger than all the past readings, while a reading of 0% means the current reading is lower than the previous readings.

Volatility ratio/% rank: The ratio is the short-term volatility (10-day standard deviation of prices) divided by the long-term volatility (100-day standard deviation of prices). The % rank is the percentile rank of the volatility ratio over the past 60 days.

Managed money: Barclay Trading Group's currency trader rankings for September 2009

Top 10 currency traders managing more than \$10 million as of Sept. 30, ranked by September 2009 return.

Rank	Trading advisor	Sept. return	2009 YTD return	\$ Under mgmt. (millions)
1.	Friedberg Comm. Mgmt. (Curr.)	14.11%	-37.20%	48.1
2.	QFS Asset Mgmt (QFS Currency)	8.20%	12.22%	608.0
3.	Richmond Group (Gl. Currency)	7.55%	-3.75%	41.0
4.	Harmonic Capital (Gl. Currency)	4.66%	8.19%	N/A
5.	Metro Forex Inc (Tri Gl FX)	4.26%	12.76%	111.7
6.	Metro Forex (Cable Forex Fund)	4.26%	13.51%	20.0
7.	Fortis Investment Mgmt. (Curr EUR)	4.17%	-0.98%	36.5
8.	Goldman Sachs (Fund. Currency)	3.89%	-4.20%	334.5
9.	Quantica Capl (Diversified FX)	3.86%	4.41%	24.5
10.	Auriel Currency 2X Fund	3.86%	-3.80%	220.7




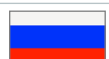













Top 10 currency traders managing less than \$10 million and more than \$1 million as of Sept. 30, ranked by September 2009 return.

1.	Putnam Currency Alpha Fund	10.22%	13.43%	2.3
2.	EMC Capital Mgmt (Currency)	4.80%	-5.42%	2.4
3.	Armytage AAM (Trading 1)	4.12%	11.22%	3.9
4.	Wooster Asset Mgmt (Portage Fund)	3.58%	0.77%	9.0
5.	Stonebrook Capital Mgmt. (Currency)	3.43%	2.68%	7.0
6.	Drury Capital (Currency)	1.93%	2.72%	3.7
7.	Wallwood Consultants (Abs. Return)	1.51%	33.51%	1.4
8.	Aurora Futures Corp (FX)	1.34%	-2.81%	2.1
9.	Old Mutual Asset Mgrs (Curr GBP)	1.14%	-9.64%	9.9
10.	Rove Capital (Dresden)	1.09%	13.06%	2.2

Source: BarclayHedge (www.barclyhedge.com). Based on estimates of the composite of all accounts or the fully funded subset method. Does not reflect the performance of any single account. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE.



CURRENCIES (vs. U.S. DOLLAR)

Rank*	Country	Currency	Current price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous rank
1		Australian dollar	0.9221	6.23%	12.82%	27.49%	0.9327	0.6005	4
2		Brazilian real	0.5832	5.07%	10.60%	28.33%	0.5874	0.3751	9
3		New Zealand dollar	0.7525	4.67%	14.72%	31.46%	0.7635	0.4892	2
4		Russian ruble	0.034555	4.10%	6.95%	15.16%	0.03769	0.02695	3
5		Indian rupee	0.02138	3.46%	5.76%	6.95%	0.03974	0.01853	14
6		Canadian dollar	0.94705	3.32%	2.92%	14.55%	0.9795	0.7653	13
7		British pound	1.6311	2.25%	-0.73%	11.12%	1.7042	1.3501	17
8		Euro	1.49905	2.05%	5.54%	13.20%	1.5063	1.2329	7
9		Swedish krona	0.1469	1.98%	9.63%	18.85%	0.148	0.1068	8
10		Swiss franc	0.99045	1.77%	6.16%	12.82%	0.9966	0.813	6
11		Singapore dollar	0.717	1.54%	3.25%	6.88%	0.7216	0.6	10
12		Thai baht	0.02993	0.47%	1.70%	5.87%	0.02999	0.0262	12
13		Chinese yuan	0.14645	0.00%	0.07%	-0.03%	0.1465	0.1448	15
14		Hong Kong dollar	0.129	-0.04%	-0.04%	-0.04%	0.1291	0.1288	16
15		Taiwanese dollar	0.03087	-0.08%	1.33%	4.03%	0.03119	0.02835	11
16		South African rand	0.1333	-1.19%	3.29%	16.17%	0.1383	0.08776	1
17		Japanese yen	0.010875	-2.51%	3.13%	5.63%	0.01148	0.00986	5

As of Oct. 27 *based on one-month gain/loss

ACCOUNT BALANCE

Rank	Country	2007	Ratio*	2006	2008*	Rank	Country	2007	Ratio*	2006	2008*
1	Singapore	39.209	23.486	35.383	26.983	13	Mexico	-8.171	-0.797	-4.375	-15.527
2	Hong Kong	25.529	12.332	22.936	30.621	14	India	-11.285	-1.024	-9.299	-33.33
3	China	371.833	10.993	253.268	440.011	15	France	-26.915	-1.038	-12.835	-45.327
4	Switzerland	43.109	10.094	56.382	44.847	16	UK	-80.722	-2.879	-82.975	-45.392
5	Sweden	39.099	8.615	33.804	40.429	17	U.S.	-731.214	-5.296	-788.115	-673.266
6	Taiwan	32.975	8.57	26.3	25.024	18	Australia	-57.129	-6.28	-40.384	-42.833
7	Germany	250.263	7.536	178.837	235.257	19	South Africa	-20.707	-7.307	-16.284	-20.53
8	Netherlands	47.376	6.095	55.874	38.339	20	Spain	-145.141	-10.079	-110.14	-154.036
9	Russia	76.241	5.89	94.34	102.331	Totals in billions of U.S. dollars *Account balance in percent of GDP +Estimate Source: International Monetary Fund, World Economic Outlook Database, October 2009.					
10	Japan	210.967	4.812	170.437	157.079						
11	Canada	12.726	0.886	17.838	9.652						
12	Brazil	1.551	0.116	13.643	-28.3						

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	Oct. 27	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Aussie \$ / Yen	AUD/JPY	84.795	8.93%	9.43%	20.66%	85.314	46.508	9
2	New Zeal \$ / Yen	NZD/JPY	69.195	7.30%	11.27%	24.42%	69.5573	45.12	4
3	Canada \$ / Yen	CAD/JPY	87.09	5.97%	-0.17%	8.42%	90.3149	70.6656	18
4	Pound / Yen	GBP/JPY	149.995	4.85%	-3.71%	5.16%	164.966	118.782	20
5	Euro / Yen	EUR/JPY	137.845	4.66%	2.37%	7.13%	139.2	112.045	12
6	Aussie \$ / Franc	AUD/CHF	0.931	4.39%	6.27%	13.00%	0.9371	0.712	8
7	Franc / Yen	CHF/JPY	91.085	4.37%	3.00%	6.78%	91.549	74.698	11
8	Aussie \$ / Canada \$	AUD/CAD	0.97365	2.81%	9.63%	11.29%	0.9739	0.7812	3
9	Aussie \$ / New Zeal \$	AUD/NZD	1.22535	1.52%	-1.66%	-3.03%	1.2939	1.0976	14
10	Aussie \$ / Real	AUD/BRL	1.58115	1.11%	2.01%	-0.69%	1.721	1.3603	7
11	Pound / Franc	GBP/CHF	1.64685	0.47%	-6.49%	-1.52%	1.8968	1.512	19
12	Euro / Franc	EUR/CHF	1.51345	0.27%	-0.59%	0.33%	1.5882	1.4297	13
13	Euro / Pound	EUR/GBP	0.919	-0.20%	6.26%	1.87%	0.9804	0.7806	1
14	Pound / Canada \$	GBP/CAD	1.72225	-1.04%	-3.55%	-3.00%	2.0344	1.6344	17
15	Euro / Canada \$	EUR/CAD	1.58285	-1.23%	2.55%	-1.18%	1.7263	1.496	6
16	Franc / Canada \$	CHF/CAD	1.04585	-1.50%	3.16%	-1.51%	1.1583	0.9924	5
17	Canada \$ / Real	CAD/BRL	1.62395	-1.67%	-6.95%	-10.75%	2.091	1.63	16
18	Euro / Real	EUR/BRL	2.5705	-2.87%	-4.58%	-11.81%	3.415	2.5468	10
19	Pound / Aussie \$	GBP/AUD	1.7689	-3.75%	-12.01%	-12.84%	2.5611	1.7438	21
20	Euro / Aussie \$	EUR/AUD	1.6257	-3.93%	-6.45%	-11.21%	2.1025	1.6073	15
21	Yen / Real	JPY/BRL	0.01865	-7.19%	-6.77%	-17.66%	0.02862	0.01868	2

GLOBAL STOCK INDICES

Rank	Country	Index	Oct. 27	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Hong Kong	Hang Seng	22,169.59	7.68%	9.47%	49.39%	22,620.01	10,676.29	8
2	South Africa	FTSE/JSE All Share	26,518.70	6.10%	10.81%	30.76%	26,937.86	17,770.97	15
3	Brazil	Bovespa	63,161.00	3.01%	15.79%	37.85%	67,529.90	29,435.11	4
4	Singapore	Straits Times	2,694.50	2.48%	4.57%	48.16%	2,739.55	1,455.47	10
5	Japan	Nikkei 225	10,212.46	2.03%	1.23%	17.03%	10,767.00	6,994.90	14
6	Australia	All ordinaries	4,755.00	1.67%	14.64%	28.86%	4,897.50	3,090.80	2
7	Switzerland	Swiss Market	6,368.00	1.25%	10.27%	23.03%	6,473.65	4,296.47	13
8	UK	FTSE 100	5,201.00	0.68%	13.41%	24.81%	5,299.57	3,460.71	5
9	U.S.	S&P 500	1,063.41	0.04%	8.27%	24.01%	1101.36	666.79	9
10	Mexico	IPC	29,312.84	-0.30%	9.31%	34.30%	31,216.45	16,756.65	11
11	Germany	Xetra Dax	5,635.02	-1.77%	7.30%	20.05%	5,888.21	3,588.89	12
12	France	CAC 40	3,743.95	-2.12%	11.02%	20.68%	3,913.81	2,510.24	6
13	Canada	S&P/TSX composite	11,053.54	-2.52%	2.75%	17.66%	11,648.55	7,479.96	3
14	Italy	FTSEMIB	22,829.52	-2.76%	12.21%	21.29%	24,558	12,332	7
15	India	BSE 30	16,353.40	-2.96%	6.36%	43.81%	17,457.26	7,697.39	1

GLOBAL SHORT-TERM INTEREST RATES

Country	Interest rate	Rate (%)	Last change	April 09	Oct. 08
U.S.	Fed funds rate	0-0.25	0.5 (Dec. 08)	0-0.25	1
Japan	Overnight call rate	0.1	0.2 (Dec. 08)	0.1	0.3
Eurozone	Refi rate	1	0.25 (May 09)	1.25	3.75
UK	Repo rate	0.5	0.5 (March 09)	0.5	4.5
Canada	Overnight funding rate	0.25	0.25 (April 09)	0.25	2.25
Switzerland	3-month Swiss Libor	0.25	0.25 (March 09)	0.25	2.5
Australia	Cash rate	3.25	0.25 (Oct. 09)	3	6
New Zealand	Cash rate	2.5	0.50 (April 09)	2.5	6.5
Brazil	Selic rate	8.75	0.5 (July 09)	10.25	13.75
Korea	Overnight call rate	2	0.5 (Feb. 09)	2	4.25
Taiwan	Discount rate	1.25	0.25 (Feb. 09)	1.25	3
India	Repo rate	4.75	0.25 (April 09)	4.75	8
South Africa	Repurchase rate	7	0.5 (Aug. 09)	8.5	12

GLOBAL BOND RATES

Rank	Country	Rate	Oct. 27	1-month	3-month	6-month	High	Low	Previous
1	Germany	BUND	121.52	0.03%	1.01%	-1.03%	126.53	115.88	1
2	UK	Short sterling	99.44	-0.04%	0.31%	0.77%	99.52	95.59	4
3	U.S.	10-year T-note	117.92	-0.05%	1.61%	-3.58%	119.73	114.78	2
4	Australia	10-year bonds	94.28	-0.43%	-0.07%	-1.31%	96.16	94.14	5
5	Japan	Government Bond	137.7	-0.98%	-0.43%	0.73%	140.50	135.45	3

**Gross Domestic Product***

	Period	Release date	Change	1-year change	Next release		Period	Release date	Change	1-year change	Next release
AMERICAS						AFRICA					
Argentina	Q2	9/18	10.1%	-80.0%	12/18	S. Africa	Q2	8/25	12.4%	-5.5%	11/24
Brazil	Q2	9/11	10.5%	3.6%	12/10						
Canada	Q2	8/31	-0.6%	-6.5%	11/30	ASIA AND SOUTH PACIFIC					
EUROPE						Australia	Q2	9/2	-2.2%	-0.5%	12/16
France	Q2	8/13	0.3%	-1.5%	11/13	Hong Kong	Q2	8/14	3.3%	-2.2%	11/13
Germany	Q2	8/13	0.6%	-5.9%	11/13	India	Q2	8/31	8.0%	2.4%	11/30
UK	Q2	9/29	-0.6%	-4.5%	12/22	Japan	Q2	8/17	2.8%	-6.4%	NLT 11/17
						Singapore	Q2	8/21	5.4%	-3.5%	NLT 11/26

* Final estimates, at current prices, seasonally adjusted

Unemployment

	Period	Release date	Rate	Change	1-year change	Next release		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS							ASIA AND SOUTH PACIFIC						
Argentina	Q2	9/14	8.8%	0.4%	0.8%	12/14	Australia	Sept.	10/8	5.7%	-0.1%	1.4%	11/12
Brazil	Sept.	10/22	7.7%	-0.4%	0.0%	11/26	Hong Kong	July-Sept.	10/19	5.3%	-0.1%	1.9%	11/17
Canada	Sept.	10/9	8.4%	-0.3%	2.2%	11/6	Japan	Sept.	10/30	5.3%	-0.2%	1.3%	11/27
EUROPE							Singapore	Q3	10/30	3.4%	0.1%	1.1%	1/29
France	Q2	9/3	9.1%	0.6%	1.8%	12/10							
Germany	Sept.	10/29	7.6%	0.0%	0.5%	12/1							
UK	June-Aug.	10/14	7.9%	0.3%	2.1%	11/11							

CPI

	Period	Release date	Change	1-year change	Next release		Period	Release date	Change	1-year change	Next release
AMERICAS						AFRICA					
Argentina	Sept.	10/14	0.7%	6.2%	11/12	S. Africa	Sept.	10/28	0.4%	6.1%	11/25
Brazil	Sept.	10/8	0.2%	4.3%	11/11						
Canada	Sept.	10/16	0.0%	-0.9%	11/18	ASIA AND SOUTH PACIFIC					
EUROPE						Australia	Q3	10/28	1.0%	1.3%	1/27
France	Sept.	10/13	-0.2%	-0.4%	11/13	Hong Kong	Sept.	10/22	0.7%	0.5%	11/20
Germany	Sept.	10/20	-0.4%	-0.3%	11/10	India	Sept.	10/30	0.1%	11.6%	11/30
UK	Sept.	10/13	0.0%	1.1%	11/17	Japan	Sept.	10/30	0.0%	-2.2%	11/27
						Singapore	Sept.	10/14	-0.2%	-0.4%	11/23

PPI

	Period	Release date	Change	1-year change	Next release		Period	Release date	Change	1-year change	Next release
AMERICAS						AFRICA					
Argentina	Sept.	10/14	1.1%	6.6%	11/12	S. Africa	Sept.	10/29	-3.2%	-3.7%	11/26
Brazil	Sept.	10/7	0.3%	-3.4%	11/6						
Canada	Sept.	10/29	-0.5%	-6.1%	11/30	ASIA AND SOUTH PACIFIC					
EUROPE						Australia	Q3	10/26	0.1%	0.2%	1/25
France	Sept.	10/30	1.4%	-13.9%	11/30	Hong Kong	Q3	10/22	0.7%	0.5%	12/14
Germany	Sept.	10/20	-0.5%	-7.6%	11/20	India	Sept.	10/10	0.1%	0.5%	11/13
UK	Sept.	10/9	0.5%	0.4%	11/6	Japan	Sept.	10/14	0.1%	-7.9%	11/12
						Singapore	Sept.	10/29	-2.2%	-15.7%	11/26

LEGEND:**Change:** Change from previous report release. **NLT:** No later than. **Rate:** Unemployment rate.

As of Oct. 30.

**Legend****CPI:** Consumer price index**ECB:** European Central Bank**FDD (first delivery day):** The first day on which delivery of a commodity in fulfillment of a futures contract can take place.**FND (first notice day):** Also known as first intent day, this is the first day on which a clearinghouse can give notice to a buyer of a futures contract that it intends to deliver a commodity in fulfillment of a futures contract. The clearinghouse also informs the seller.**FOMC:** Federal Open Market Committee**GDP:** Gross domestic product**ISM:** Institute for supply management**LTD (last trading day):** The final day trading can take place in a futures or options contract.**PMI:** Purchasing managers index**PPI:** Producer price index

Economic release (U.S.)	Release time (ET)
GDP	8:30 a.m.
CPI	8:30 a.m.
ECI	8:30 a.m.
PPI	8:30 a.m.
ISM	10:00 a.m.
Unemployment	8:30 a.m.
Personal income	8:30 a.m.
Durable goods	8:30 a.m.
Retail sales	8:30 a.m.
Trade balance	8:30 a.m.
Leading indicators	10:00 a.m.

NOVEMBER 2009

1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	1	2	3	4	5

DECEMBER 2009

29	30	1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	1	2	3

The information on this page is subject to change. Currency Trader is not responsible for the accuracy of calendar dates beyond press time.

November**1****2 U.S.:** October ISM report**3****4 U.S.:** FOMC interest-rate announcement

5 ECB: Governing council interest-rate announcement
UK: Bank of England interest-rate announcement

6 U.S.: October employment report
Brazil: October PPI
Canada: October employment report
UK: October PPI

7**8****9 Mexico:** Oct. 31 CPI; October PPI**10 Germany:** October CPI

11 Brazil: October CPI
UK: September employment report

12 Australia: October employment report
Japan: October PPI

13 U.S.: September trade balance
France: Q3 GDP; October CPI
Germany: Q3 GDP
India: October PPI

14**15****16 U.S.:** October retail sales

17 U.S.: October PP
Hong Kong: August-October employment report
Japan: Q3 GDP
UK: October CPI

18 U.S.: October CPI and housing start
Canada: October CPI

19 U.S.: October leading indicators

20 Germany: October PPI
Hong Kong: October CPI
Japan: Bank of Japan interest-rate announcement

21**22****23**

24 U.S.: Q3 GDP (prelim); October durable goods
Mexico: October employment report; November CPI
South Africa: Q3 GDP

25 U.S.: October personal income
Mexico: Q3 GDP
South Africa: October CPI

26 Brazil: October employment report
South Africa: October PPI

27 Japan: October employment report and CPI**28****29**

30 Canada: Q3 GDP; October PPI
France: October PPI
India: u

December

1 U.S.: November ISM report
Germany: October employment report

2 U.S.: Fed beige book

3 U.S.: Q4 employment cost index
France: Q3 employment report
UK: Bank of England interest-rate announcement

4 U.S.: November employment report
LTD: December forex options

5



▼ **CQG** (www.cqg.com) has released CQG Integrated Client 8.1, which includes access to CQG Spreader, a server-side solution for creating, trading, and managing multi-legged, intermarket, and intramarket spreads across accounts and across asset classes. CQG provides hosted direct market access, and CQG Integrated Client 8.1 offers improved-performance electronic trade routing through CQG's network of hosted exchange gateways. This version also provides new algorithmic order-building capability, improved order-routing options, enhancements to CQG's Market Profile and Market Scan, and several new decision-making tools. The new Algorithmic Order Builder empowers traders to create their own order types with familiar programming technologies. Custom order types can be created to reflect personal trading strategies and can then be automatically executed within CQG Integrated Client based on trader priorities. Other enhancements include expanded functionality in Market Profile and Market Scan, visual display improvements in DOMTrader and Order Ticket, the addition of a summary tab to the orders and positions window, the addition of a Volume Profile Study, and the inclusion of trade volume on Spread Matrix and Spread Pyramid.

▼ **Integral Development Corporation** has launched TrueFX, providing retail brokers with direct access to the interbank foreign exchange market. TrueFX is built upon FX Grid, Integral's global inter-institutional connectivity and trading network, linking market making banks to forex market participants. At TrueFX.com, Integral publishes tick-by-tick historical and real-time market data free of charge to all market participants. Users have access to clean, aggregated, dealable bid and offer prices direct from leading market makers.

▼ **TradeStation Securities**, an electronic brokerage firm for active, professional, and certain buy-side institutional traders, has launched its new TradeStation Prime Services division. TradeStation Prime Services seeks to fill the growing need of start-up to mid-sized hedge funds, registered investment advisers, professional traders and asset managers for prime brokerage services which are no longer being provided by the larger firms that traditionally served this market segment. The new division intends to provide a valuable combination of industry-leading execution platforms, including the award-winning TradeStation, reliable clearance and settlement of trades, and first-class service and support, including start-up assistance, outsourced/direct access trading, real-time risk management, portfolio reporting, securities lending, and capital introductions for its clients. TradeStation Prime Services plans to serve traders of equities, equity and index options, futures, non-U.S. equities, and forex, making it a powerful solution

for institutional traders who seek to trade those asset classes. Also, as the new division grows, TradeStation plans to enhance its TradeStation trading platform.

▼ Trader and former *Active Trader* contributor John Saleeby has launched a Web site called **TradeWithJohn.com** providing traders of all levels the information and tools needed to trade successfully. TradeWithJohn.com features the Market Rev-Up, a free daily video broadcast of key market indicators and news. Saleeby started his trading career more than 15 years ago at McDonald Group in Chicago, where he was promoted to partner within three months. In 2000 he founded Gargantuan Financial to become the largest independent trader in Nasdaq futures and equities, trading more than \$100 million in equity and derivatives daily.

▼ **MB Trading**, a technology-driven, low-commission brokerage specializing in order routing in forex, equities, futures, and options through various global exchanges and electronic networks, has integrated the popular MetaTrader 4 (MT4) platform into its ECN execution technology. The platform provides customers with a wide variety of trade entry options and reflects all customer limit orders in the public order book. The integration includes immediate and anonymous posting of all limit orders directly into the quotes for anyone else to see and execute against; no limitation on proximity of limit and stop orders; direct routing of market orders through proprietary algorithms to obtain best-price execution against banks, customers, and other dark pools of liquidity; and no restrictions against scalping. The company has also launched MetaTrader Webinars in MBT University covering a range of topics from basic charting to custom indicator trading. Future courses will explain the differences between deal desk and ECN MetaTrader systems.

▼ Stock software and data services provider **Worden Brothers** has launched its latest version of www.FreeStockCharts.com. This new site includes free, real time streaming charts for stocks, exchange-traded funds (ETFs), indices, and currencies. Also, the site now automatically tracks live positions for TD Ameritrade customers in real time. The free real-time stock data is provided by the BATS exchange, forex data is provided by CMS Forex, and fundamental data is provided by Morningstar.

▼ **TradingScreen**, a global leader in execution management systems, has released TradeSmart X, the next generation version of its multi-broker, multi-asset class flagship front-end. TradeSmart X has been designed to provide a more intuitive and richer user experience, integrating major functionality enhancements for liquidity access, execution

management, cross-asset class trading, and reporting delivered with a new look and feel. TradeSmart is a customizable interface that enables buy-side clients to trade a broad portfolio of financial instruments, around the clock, on any market and with a wide range of counterparties. TradeSmart is unique in its ability to aggregate multiple-dealers and multiple asset classes onto a single screen format for electronic order routing. Its application service provider model enables rapid deployment and activation and incorporates the most comprehensive and intuitive access to the proprietary algorithmic trading strategies offered by the leading global brokers. TradeSmart connects to all of the leading portfolio and order management systems to ensure complete integration into the workflow of the buy-side institution.

▼ All of Zero's **TraxStocks** is free for iPhone and iPod touch users, available now in the iTunes App Store. TraxStocks provides market data in an elegant, intuitive interface specifically designed to efficiently visualize trends over time. TraxStocks displays only necessary data. Visual trends are depicted by "sparklines," a graphing function designed specifically for ease of comprehension. A user can quickly see current values, highs, lows, and relative stock and index performance for all items over the selected time period. The iPhone makes interaction with market data incredibly simple. Touch any sparkline to get the value for that point. Rotate the device clockwise to see a trend comparison of price, percent change, and volume for selected stocks. Rotate counterclockwise and a single graph compares price, percent change, or volume over time on the full screen. Choose to display indices, funds, commodities, and anything else on Yahoo finance. A full feature list is available at www.allofzero.com/traxstocks.

▼ The new Web site **TheThreeBlindMice.com** (T3BM), created by investment professionals with more than 70 years of cumulative trading experience, provides daily market commentary on stocks and futures, price targets, projected trends, model portfolios, sector rotation updates, and more. The site is kept current with morning, mid-day, and closing comments. T3BM generates actionable daily trading ideas as well as longer-term strategies covering anything that trades on Wall Street. For more information, visit www.tbmlc.com.

▼ **Trade MONSTER** (www.trademonster.com), an online broker designed by professional traders for self-directed investors, has introduced "Exit Plan," a tool for setting profit and loss parameters upon making a trade. Exit Plan uses plain English and easy-to-understand icons to replace confusing trader jargon such as "trailing stops," "contingent orders," "trigger orders," and others previously required to place such trades. In setting an Exit Plan, trade MONSTER shows the real-time probability of those targets being hit, making it easy for investors to fine-tune each trade's maximum profit and loss levels. This news follows the recent introduction of two additional tools that give professional grade tools to retail investors: "adjustTRADE," which enables customers to adjust positions on current stock or options holdings with just a few clicks; and "Portfolio Analysis" which allows customers to benchmark their portfolio against other indices and stress-test portfolios against various risk metrics.

Note: New Products and Services is a forum for industry businesses to announce new products and upgrades. Listings are adapted from press releases and are not endorsements or recommendations from the Active Trader Magazine Group. E-mail press releases to editorial@currencytradermag.com. Publication is not guaranteed.



KEY CONCEPTS

Carry trades involve buying (or lending) a currency with a high interest rate and selling (or borrowing) a currency with a low interest rate. Traders looking to "earn carry" will buy a high-yielding currency while simultaneously selling a low-yielding currency.

London Interbank Offered Rate (LIBOR): A benchmark short-term interest rate established daily by the British Bankers' Association. It represents the rate at which banks can borrow funds in the London interbank market.

True range (TR): A measure of price movement that accounts for the gaps that occur between price bars. This

calculation provides a more accurate reflection of the size of a price move over a given period than the standard range calculation, which is simply the high of a price bar minus the low of a price bar. The true range calculation was developed by Welles Wilder and discussed in his book *New Concepts in Technical Trading Systems* (Trend Research, 1978).

True range can be calculated on any time frame or price bar — five-minute, hourly, daily, weekly, etc. The following discussion uses daily price bars for simplicity. True range is the greatest (absolute) distance of the following:

1. Today's high and today's low.
2. Today's high and yesterday's close.
3. Today's low and yesterday's close.



Waiting patiently for the market sometimes means waiting forever. But that's okay.

TRADE

Date: N/A.

Entry: See "Outcome" below.

Reason for trade/setup: A long trade was signaled by the Euro momentum system (see "Short-term momentum signals in the Euro," *Currency Trader*, May 2008) at 1.4583 on Sept. 30 with a profit target around 1.5000. The system went long when the five-day momentum indicator dropped below -0.80 (on a scale from -1.00 to +1.00) while the 30-day momentum indicator remained above +0.60. Historical trade results suggested this trade had an approximately 63 percent of hitting 1.5000, and this round-number price will be a big, fat target for the market in general. (The analysis also showed odds improve when a trade isn't quickly stopped out.)

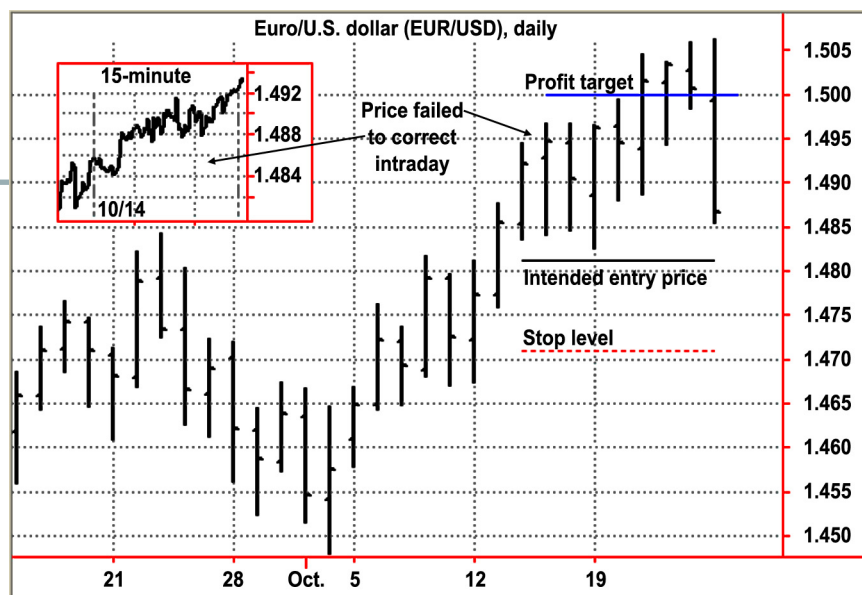
On Oct. 13 price pushed above the Sept. 23 high (reaching 1.4876) after consolidating for a couple of days. Believing the market will pull back before testing and surpassing 1.5000, we entered a limit buy order a little above 1.4811 on Oct. 14.

Initial stop: 1.4721.

Initial target: 1.5011.

RESULT

Exit: N/A



Source: TradeStation

Profit/loss: N/A

Outcome: The good news is the Euro momentum signal fulfilled its objective. Unfortunately, the "piggy-back" trade at 1.4811 never occurred because the expected correction never arrived. (The Trade Summary box shows the results that would have occurred had the market reached the limit price on Oct. 14.) The pair dropped as low as 1.4827 on Oct. 19, but that was the extent of its "decline" before it hit 1.5000 on Oct. 21, rallying as high as 1.5059 by Oct. 23. However, not chasing the market has to be considered a positive — and the wise choice given a position was already live in the market. ☺

Note: Initial trade targets are typically based on things such as the historical performance of a price pattern or a trading system signal. However, because individual trades are dictated by immediate circumstances, price targets are flexible and are often used as points at which to liquidate a portion of a trade to reduce exposure. As a result, initial (pre-trade) reward-risk ratios are conjectural by nature.

TRADE SUMMARY (hypothetical — entry not executed)

Date	Currency pair	Entry price	Initial stop	Initial target	IRR	Exit	Date	P/L		LOP	LOL	Trade length
								Point	%			
10/14/09	EUR/USD	1.4811	1.4721	1.5011	2.22	1.5011	10/21/09	.0200	1.35%	.0248	—	7 days

Legend: IRR: initial reward/risk ratio (initial target amount/initial stop amount). LOP: largest open profit (maximum available profit during lifetime of trade). LOL: largest open loss (maximum potential loss during life of trade).



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