

Strategies, analysis, and news for FX traders

CURRENCY TRADER



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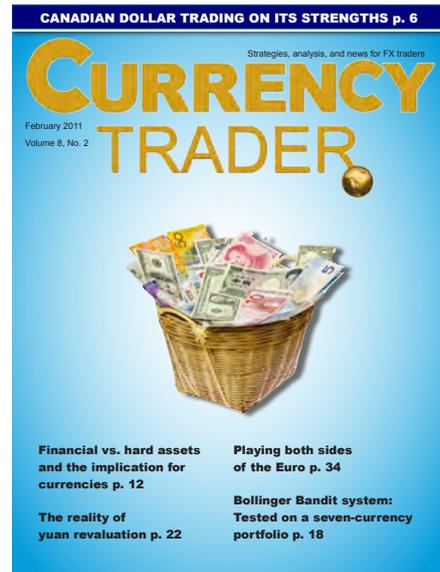
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Canada makes most of positioning

Those looking to play Canadian strength may want to look toward Europe instead of the U.S.

BY CURRENCY TRADER STAFF

During the ongoing global recovery, Canada has been a star among industrialized nations, bolstered by robust commodity exports, a sound banking sector prior to the 2008 global crisis, and relatively debt-free consumers who have helped spend the economy into recovery and growth.

Canada first hiked rates during the current monetary policy tightening cycle in June 2010, and it now boasts a bullish interest-rate differential vs. the U.S., the UK, and the Eurozone. Additional central bank rate hikes are forecast for later in the year, which should continue to underpin the attractiveness of the Canadian dollar (CAD).

Canada has pushed through its recovery phase and is now, in fact, the only G-7 nation in an expansion phase.

"The [current] level of GDP is back to where it was pre-recession," says Charles St.-Arnaud, FX strategist and Canadian economist at Nomura. "That is not insignificant, especially compared to other industrialized nations."

However, with Canadian fiscal stimulus set to wind down and consumers with recently acquired debt, the expansion is facing a slowdown. Exports are responsible for roughly one-third of Canadian GDP growth, and the U.S., the country's largest trading partner (absorbing about 75 percent of these exports), remains a key lynchpin to sustained growth. As a result, the pace of the U.S. recovery in 2011 will be a key factor in determining how much this sector can pick up in Canada.

"The problem is the expansion will be a lot harder than the recovery," St.-Arnaud says.

Let's take a look at the economics behind the current 2011 forecasts, the challenges Canada faces, and how the

dollar/Canada (USD/CAD) and the CAD crosses are likely to react to shifting global dynamics.

Faster recovery

Canada emerged from the global recession more quickly than other industrialized nations because of better positioning prior to the crisis.

"Canada's financial sector was superior to that of U.S. and Europe," notes Mark Hopkins, senior economist at Moody's Analytics. "Their banks tend to be much more conservative. They operate in an old-school, clubby manner, which helped them because there wasn't a race to profitability."

Richard Thies, associate international economist at Northern Trust Company, agrees Canada's strong banking sector helped the Canadian economy rebound.

"It was supported by the banking sector, which did not see ruin," he notes. "The credit [market] environment did not dry up."

According to economists at Wells Fargo Securities, during the recession Canadian GDP fell 3.3 percent from peak to trough, compared to a 5.3-percent decline in Eurozone GDP and a 6.5-percent plunge in the UK.

Another supporting factor is the aforementioned commodity export strength. Canada exports a wide range of commodities, including wheat, base metals, oil, electricity, and potash. Rising commodity prices in 2010 were a bullish bonus for the Canadian economy.

"It was selling the same amount [of commodities], but getting more money for them," Hopkins explains.

Also, unlike their U.S. counterparts, Canadian consumers were not debt laden heading into the global recession, which allowed them to take advantage of low interest rates and bolster recent economic growth numbers. Final 2010 Canadian GDP is estimated a 2.9-percent rate.

Slowdown

That cycle, however, is coming full course. A Canadian central bank governor recently voiced concerns over the current high levels of Canadian household debt, which could be a drag on growth going forward as consumers begin to pay down debt in a rising interest-rate environment.

A Dec. 22, 2010 research release from Wells Fargo Securities noted: "Over the last few years, American consumers have been actively reducing their debt while Canadian households have taken on more leverage. As a percent of GDP, total household debt in Canada has risen from 77 percent in 2008 to over 90 percent through the third quarter of [2010]. In the same time period, U.S. households have gone from more than 92 percent to 85 percent."

Most economists are forecasting a mild Canadian GDP slowdown in 2011. Wells Fargo sees a 2.7-percent pace this year, while Moody's Analytics forecasts a 2-percent rate and Northern Trust estimates 2.5 percent.

Close economic ties to the U.S. is a big piece of the slowdown puzzle.

"Canada isn't going anywhere without the U.S.," Thies says.

Canada manufactures and exports a wide range of auto-related parts, equipment, and heavy machinery. As the U.S. recovery sputtered in 2010, demand for Canadian exports failed to pick up strongly.

"The usual linkages with the U.S. have hurt the economy, which has impacted the broader manufacturing sector," says Charmaine Buskas, chief strategist at 4Cast. "We've seen deterioration in manufacturing numbers lately."

According to Buskas, manufacturing sales shipments fell 0.8 percent in November. "It gave back half the 1.5

percent gain in October," she notes. "It's been pretty spotty lately."

Additional drags on Canadian growth include the end of the country's fiscal spending program, which totaled C\$62 billion during 2009-2010.

"The government is withdrawing fiscal stimulus," Hopkins says. "Both fiscal and monetary policy makers want to dial it back."

However, the Bank of Canada (BOC) is caught in something of a Catch-22 when it comes to interest rates.

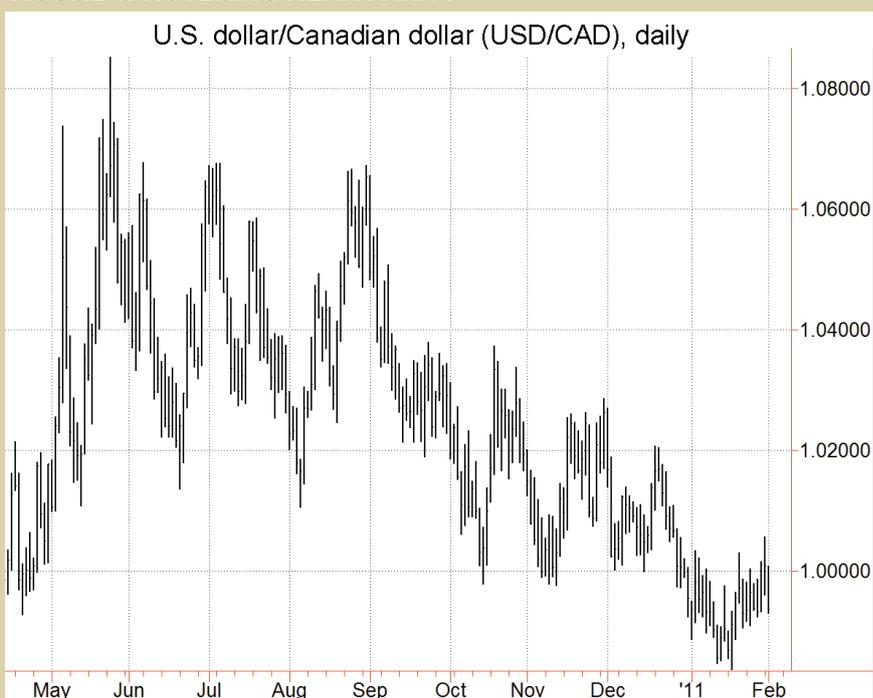
"It is hamstrung by the Fed," Hopkins explains. "It can't raise rates significantly unless the Fed does."

Why? Monetary policy hikes would only add to the attractiveness of the Canadian currency, and according to the BOC's official commentary, the currency is just too strong right now, which hurts the export sector.

Buskas actually estimates a "more realistic value of the currency, which, according to fair-value purchasing price parity, is around 1.1500-1.2000." As of early February, dollar/CAD was trading around .9980 (Figure 1).

"[The \$1.00 area is] a temporary extreme level that still

FIGURE 1: HOVERING NEAR PARITY



In January the USD/CAD pair fell below 1.0000, dropping to its lowest level in more than two years.



poses a lot of risks for the economy," she says. "The strong currency will remain an Achilles heel for the economy. Either we get to a more sustainable level for the CAD, and that smoothes out hurdles for the export sector, or we see the U.S. dollar slide and the export sector will be hamstrung for quite some time. The Bank of Canada will be watching the currency very closely."

BOC hikes

Nonetheless, most economists expect the BOC to hike interest rates again later this year. Currently, the overnight central bank lending rate stands at 1.00 percent. 4Cast Inc. estimates the first move of the year (a 0.25-percent hike) will come in July, with additional hikes bringing the rate to 1.75 percent by the end of the year. Hopkins estimates a hike could come even earlier, at the BOC's April meeting. Nomura forecasts four 0.25 basis point hikes throughout the year, pulling the overnight rate up to 2.00 percent by year-end.

Unlike the U.S. Federal Reserve, which walks a tightrope with its infamous dual mandate (high employment and low inflation), the BOC has a much more specific mandate to keep inflation between 1 and 3 percent, with the target at the 2-percent core, according to Hopkins. He expects tightening earlier rather than later in the year because of the danger of inflation.

"With the tax deal and the strong shopping numbers in December, we now expect the U.S. economy to pick up," he says. "Then it's a good guess exports will pick up in Canada. The surge in demand means there's potential for inflation to pick up."

Risk dynamics

A new factor for currency traders to consider is the Canadian dollar's new role in the global FX marketplace as a so-called "risk asset," which means its starting to trade more like the Brazilian real (BRZ) or Australian dollar (AUD) — two currencies that attract money flows when traders are willing to take riskier bets on potentially higher-yielding markets.

"It has become even more of a risk asset over the past year," Thies says. "It means the CAD's value is becoming more affected by the global risk outlook and less by local fundamentals. The correlation between the Canadian dol-

lar and commodity indices has tightened, which suggests opinions about global recovery are central to any forecast for the Canadian dollar."

Additional European sovereign-debt concerns might also impact CAD traders.

"People equate problems in Europe with weakness in the global economy and that could act as downside pressure on the Canadian dollar," Thies says, although he adds that what happens in Europe *shouldn't* really impact CAD action because they aren't that closely connected on a trade basis.

CAD outlook

Although Canada and its currency are currently on fairly stable ground, there are a few issues that will weigh on sustained CAD strength.

"Over the long-term, the CAD picture is basically good," says Steve Englander, head of G-10 strategy at Citi. "Canadian monetary policymakers are conducting normal, orthodox monetary policy. The Fed is not at that stage yet." He adds that Canada's commodity strength "makes it attractive in a world with low interest rates."

But Englander also notes currency traders are a little torn because it's clear the BOC would prefer a weaker currency. Also playing into current CAD dynamics are questions about whether the "concerns we're seeing now about asset markets and are going to persist. Will commodity markets continue to come off? If so, CAD will be hurt, and it will go above parity. If you think this is a relatively brief episode of jitters, CAD will firm up," he says.

Ultimately, Englander sees a market biased toward a stronger CAD, with a three- to six-month target below .9500.

"We don't think the global economic picture has changed that much," he says.

Other analysts believe overall downside potential for the USD/CAD pair is limited, with the modest dips below parity the most likely scenario.

Andrew Chaveriat, technical analyst at BNP Paribas, who sees several long-term support zones below the market from .9710 to .9820, says: "that is still a very strong support zone."

Murray Gunn, head of technical analysis at HSBC, explains his view from a long-term chart perspective:

“USD/CAD is nearing the end of a long-term bear cycle from the 2009 high,” he says. “It appears to be tracing out an ending diagonal from December 2010. This may result in one more marginal new low in the next few weeks toward 0.98 but the next significant move should be higher toward 1.10 and above on a multi-month basis.”

Gunn identified intermediate USD/CAD support between .9712 and .9800 and resistance at 1.0209 and 1.0670 (Figure 2). Over several months, Gunn sees a USD/CAD objective at the 1.1600 level.

Sideways movement

In the nearer future, the USD/CAD pair may be dominated by sideways action.

“We expect a narrow-range trade in USD/CAD to continue for the next few weeks, and target USD/CAD at 1.0200 by end the end of first quarter,” says Shaun Osborne, chief FX strategist at TD Securities in Toronto. “We look for broader USD strength through the second quarter to drive USD/CAD up to 1.09 before the CAD strengthens again modestly in the second half the year.”

He’s not the only one anticipating more relative strength in the U.S. currency.

“The U.S. recovery is going to pick up steam and the dollar is going to do well,” says Brian Dolan, chief currency strategist at Forex.com. That, he says, implies a sideways dollar/CAD rate, and may make CAD crossrates preferable to the USD/CAD pair.

However, these markets have their own challenges.

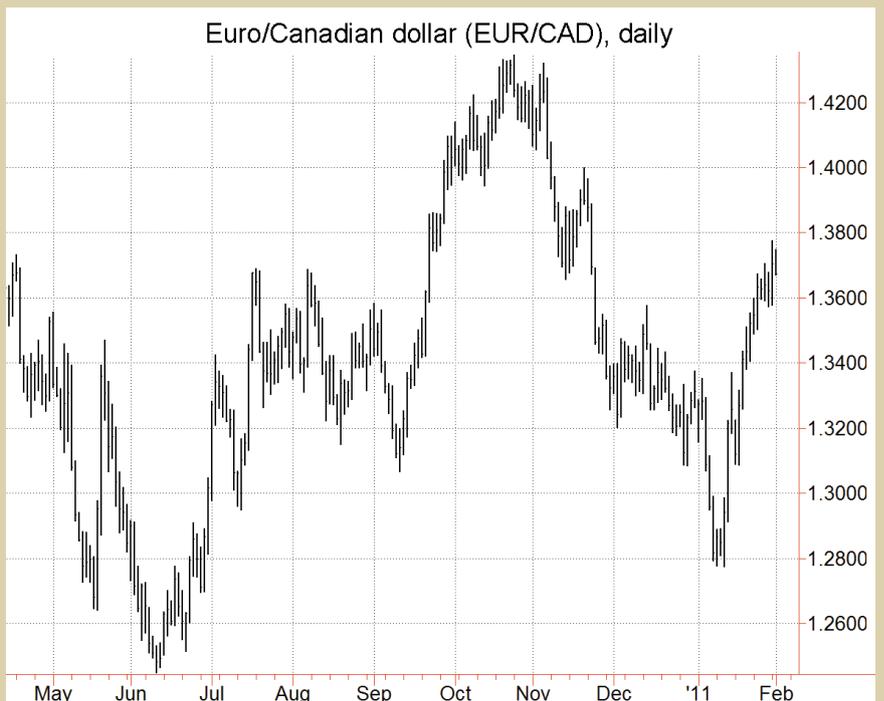
“The CAD crosses remain quite

FIGURE 2: BIG PICTURE CAD



Most analysts see fairly limited downside action in the USD/CAD pair, with many forecasting a move later this year to 1.1000-1.2000 after a period of mostly sideways action.

FIGURE 3: EURO/CANADA



The Canadian dollar may have more trading opportunities vs. Europe than the U.S. in the coming months. The EUR/CAD pair has already retraced 62 percent of its October-January downswing.

active but are volatile," Osborne says. "There's potential for the CAD to outperform over the year overall. The economy is sound and the Bank of Canada will likely resume its monetary policy tightening in the second half of the year. We think buying CAD/JPY dips and/or selling EUR/CAD rallies makes sense from a longer-term point of view on the crosses."

Dolan sees potential in going long the CAD vs. Europe. "Whereas the U.S. is still implementing additional stimulus measures, the Eurozone is doing the opposite," he says. "They are raising taxes and cutting spending. It is going to be a difficult road for the UK and Europe."

In the EUR/CAD pair, Dolan says traders could look to use strength to the 1.3650-1.3900 zone as selling levels, with targets at the 1.2800/1.2500 region into mid-2011 (Figure 3). In the pound/Canada pair (GBP/CAD), he says 1.5800/1.6100 could be used as selling spots, with a target in the low 1.50s.

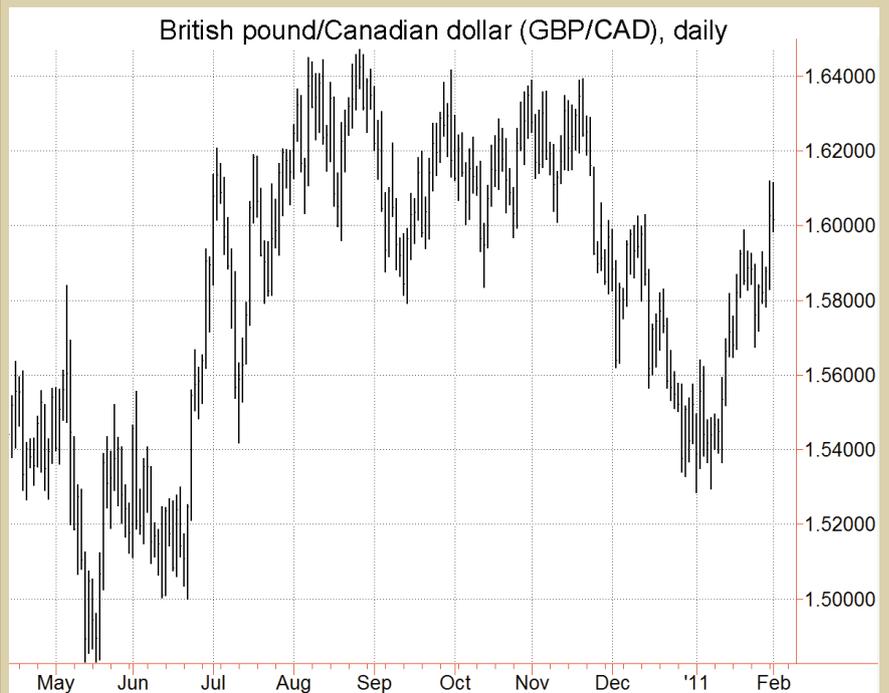
Dolan doesn't specifically see current opportunities in Aussie/CAD because "they will both benefit as commodity currencies."

"The surest bet is weakness in the UK and Europe," he says.

Gunn's viewpoint in the sterling/CAD revolves around a large-scale Elliott Wave perspective: "GBP/CAD has traced out a five-wave up, three-wave down cycle from the outside month of May 2010, in what looks like the first two waves of a bigger uptrend coming off the 30-year support zone," he says. "As long as 1.5293 holds as support the medium- to long-term wave cycle looks positive."

Gunn looks for the 1.8000 level to be a target for GBP/CAD (Figure 4).

FIGURE 4: POUND/CANADA



The GBP/CAD pair faces resistance around 1.6400, with some analysts predicting a move toward 1.8000.

Englander also sees potential on the CAD crosses. "If the U.S. economy improves and the dollar rallies, the U.S. and CAD will rally vs. the European currencies," he says.

Specifically, Englander highlighted a long view on the CAD/Swiss cross, amid potential vulnerability for the Swiss franc. "If the Euro strengthens, the strength comes out of Swissy," he explains.

Near term, Englander warns of the potential for a positioning move in the FX markets. "Investors have bought commodity currencies," he explains. "If CAD goes above parity, the real villain could be position cutting" as traders square up positions to book profits and limit losses.

Englander sees the potential for a bump up toward 1.0200 on a shorter-term liquidation type of move, followed by a return to CAD bullishness.

"Once the liquidation is over, traders will go back to buying CAD," he says. ☒

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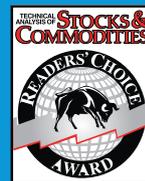
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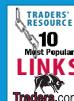
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Nearing a tipping point between hard and financial assets

Watch out — gold may not be a one-way street in the coming year.

BY BARBARA ROCKEFELLER

The real rate of return is the key determinant in international asset allocation. Gold has glamor and allure, but no inherent return — in fact, a negative return when you factor in storage and insurance. Commodity prices are continuing a decade-long secular bull run, but are terribly hard for the average Joe to trade, hence the wild success of exchange-traded funds (ETFs). Still, when interest rates

hit bottom and start going up, financial assets bearing a real return start looking better than hard assets with only a speculative return.

Commodities may arrive at that tipping point later in 2011, and a pullback in commodities in general, and gold in particular, will almost certainly have implications for the dollar.

The Chicago Mercantile Exchange raised margin requirements for gold (and silver) futures contracts effective Jan. 21 for the second time in two months. A few days earlier, China reported sustained high inflation (above 5 percent year-over-year) and growth (above 10 percent), triggering a 3-percent drop in the Shanghai stock index on worries interest rates would be raised and further credit tightening would follow.

Meanwhile, the Eurozone reported a December 2010 Consumer Price Index (CPI) number of 2.2 percent — above the 2-percent inflation cap — triggering talk of the European Central Bank (ECB) raising rates soon. Given the ECB's iron will on inflation, the idea is credible, if premature.

What do gold margins and looming interest rate hikes have to do with one another? Exchanges raise margin requirements when prices rise so high the margin is too small to reflect the risk of speculation. Rising margins accompany bull markets.

FIGURE 1: GOLD CONTINUOUS FUTURES (WEEKLY)



Gold has shot far above the trend implied by a linear regression of prices from 1999 through 2008.

Source: Chart — Metastock; data — Reuters and eSignal

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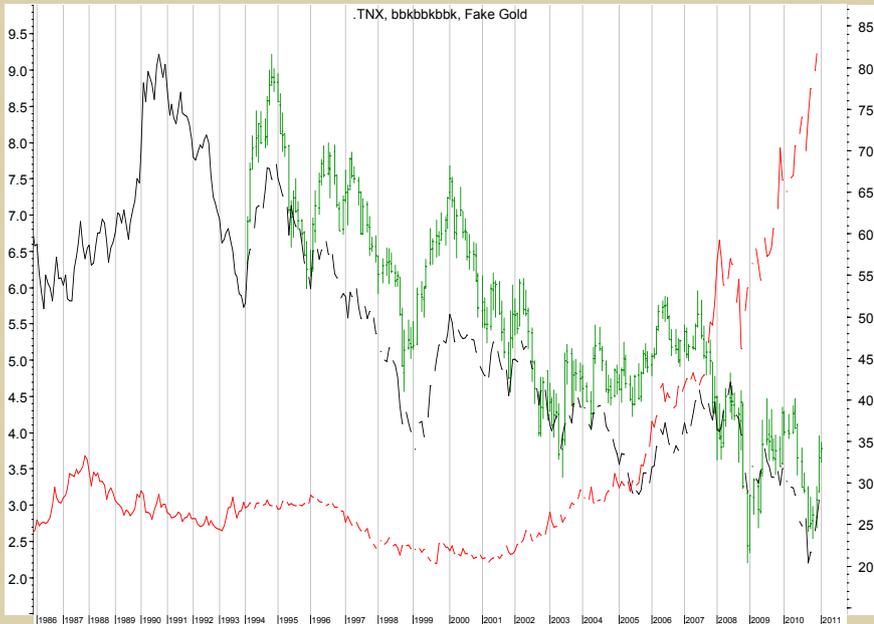
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FIGURE 2: GERMAN 10-YEAR BUND YIELD (BLACK) AND 10-YEAR U.S. T-NOTE YIELD (GREEN) VS. GOLD (RED)



Gold took off in 2006 and 2007 as both U.S. and European interest rates were falling.

Gold mania?

You could also say rising margins accompany a speculative mania, and there is plenty of evidence gold is in the grip of a mania. Figure 1 uses the trick of drawing a **linear regression line** from the beginning of 1999 to the end of 2008. A linear regression is a “pure” trendline in the sense that it minimizes the distance between itself and every data point it encompasses, and “scientific” in the sense that everyone will get the same line using the same starting and ending points. Let’s say a 10-year linear regression line is representative of the market’s trend, and project it into the future as a dotted line, forming a hypothesis of where the price should go if it maintains the same trend. The bubble over the hypothetical line represents just that — a bubble.

Extending the linear regression is a sanity check, not a forecast. If we thought it was a good way to forecast, we’d say “Gold should return to \$1,050 by the end of 2012.” This is not what we are saying. In fact, a lesser pullback may currently be forming, but it’s likely temporary. However, it’s important to look at some of the factors behind the gold rally to avoid getting creamed and also to avoid confusing analysis of the FX market with false notions about the gold rally.

Gold really took off in 2006 and 2007 as both U.S. and European interest rates were falling (Figure 2). In fact, before then U.S. rates were rising faster than European rates (from a one-month Libor spread over Euribor of 0.828 percent in April 2005 to 2.048 percent by November), and both gold and the dollar were rising at the same time — violating the conventional inverse correlation idea (Figure 3).

FIGURE 3: GOLD VS. DOLLAR INDEX (GREEN)



The dollar has traditionally been inversely correlated to gold, a notable exception occurring in 2005 when they both rallied at the same time.

Finding a relationship with equities is harder (Figure 4). After all, equities have an inherent rate of return, too — the dividend yield. Gold rose only modestly in 2001 and 2002 after the 2000 crash, and picked up steam at about the same pace as equities in 2003-2007. By the time the stock market crashed in 2008, gold was well on its way to bubble territory.

A different way to display the equity-gold relationship is to calculate a ratio of the two. In Figure 5, the preference for gold over equities can't be missed, and the dividing line falls at 2005. What happened that year? China conducted a one-time revaluation of the yuan in July and the Homeland Investment Act cut corporate tax rates on repatriated earnings from 35 percent to 5.25 percent and inspired a \$600 billion inflow to dollars. Probably more important, ETFs started to hit the scene in a big way. The first gold ETF was from Canada and listed on

FIGURE 4: GOLD (RED) VS. S&P 500 (MONTHLY)



After the 2000 crash, gold rose only modestly in 2001 and 2002 before keeping pace with equities in 2003-2007. By the 2008 stock-market crash, gold was on its way to bubble territory.

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the American Stock Exchange in 1986; the next one was in Australia in 2003. The iShares Gold Trust (IAU) launched in January 2005 and is listed on the New York and Toronto Stock Exchanges. As of July 2010, the fund held 90.88 tons of physical gold.

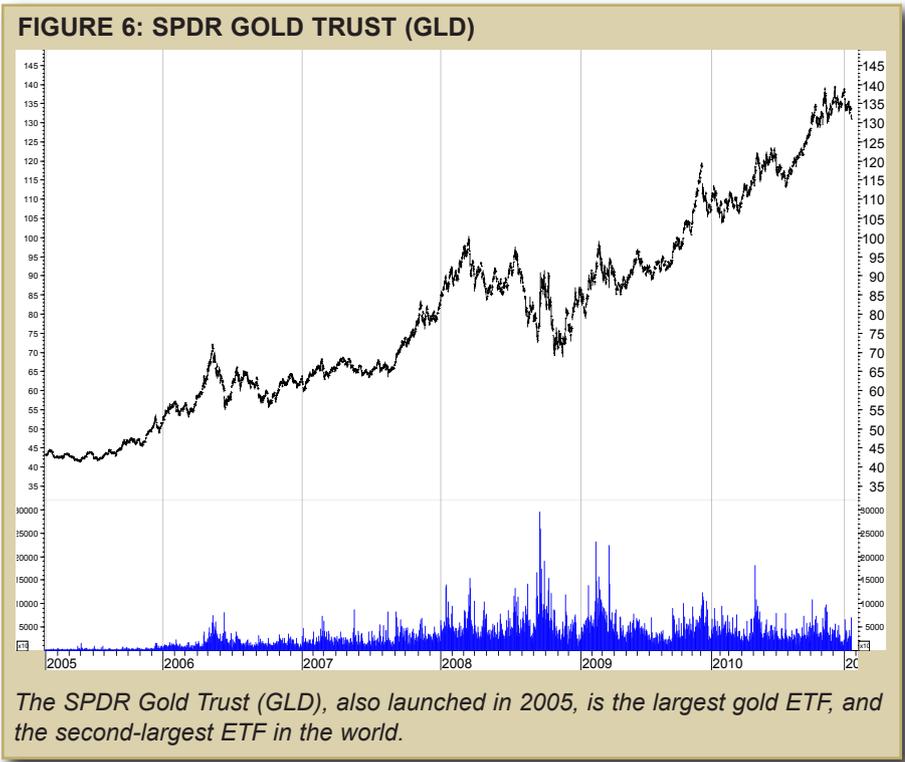
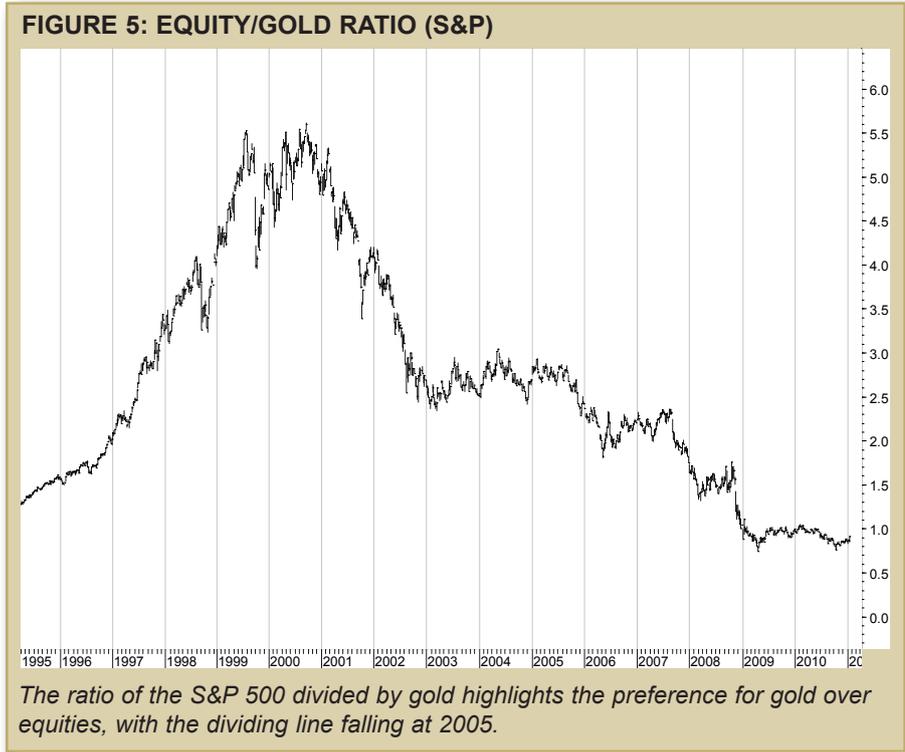
The biggest gold ETF, State Street's SPDR Gold Trust (GLD), also launched in 2005 and is the second-largest ETF

in the world (Figure 6). It is listed in the U.S., Japan, Hong Kong, and Singapore. Some ETFs hold physical gold and some hold derivative contracts, but either way, they have been a solid and unrelenting source of demand for gold. According to the *Wall Street Journal*, the stock-market capitalization of all gold ETFs is about \$80 billion, roughly that of McDonald's Corp. As of June 2010, the physical-backed

ETF's held 2,062.6 tons of gold. In just five short years the gold ETF space expanded to include the Market Vector Gold Miners ETF (GDX), a gold volatility index (the CBOE's GVZ), a security to short the gold ETFs, and other double-leverage and shorting options too complicated to think about.

Sophisticated analysts look at the put/call ratio (and note that in January 2011, put options were more expensive than call options, a usually reliable sign traders expect a drop in prices). To cap it all off, those speculators who like to trade Comex gold futures directly were long 244,054 contract as of the Jan. 21 Commitments of Traders (COT) report. Since each contract is for 100 troy ounces and gold closed on Jan. 21 at \$1,340.00, the amount being traded by speculators alone is \$3.27 billion. This is a juggernaut and probably unstoppable, even if gold is a bubble, is perceived as overbought, and undergoes the usual pullback.

We say "pullback" instead of "crash" because gold offers something a portfolio of stocks does not. First, it has a certain magic — it is beautiful, rare, almost indestructible, and useful in many applications. Second, gold has been touted as the best store of value of any substance over centuries and maybe millennia. This is probably not true and certainly not useful, since individuals do not live for centuries, let alone millennia, but nevermind — in a financial world comprised of electrons, a tangible store of value is nearly unique. A third virtue is that it is independent of governments, which issue money and these days, do not reference money to gold. Gold stands alone, above governments. In fact, some governments, including China, India, Saudi Arabia, Russia, Sri Lanka, Bangladesh, and the Philippines appreciate this point and have been increasing gold stockpiles.



But most of all, at least some proponents of holding the metal assert gold is a hedge against inflation. It's not. Figure 7 shows gold has failed to keep up with inflation from 1983 to today — nearly three decades. Many analysts have noted if gold had kept up with inflation, it should be priced at about \$2000 already, or maybe \$3,000 (www.inflationdata.com has some nifty charts). Some point out if China were to triple its gold holdings, it would take all of the \$200 billion per year of new gold production in one fell swoop.

But if gold is not really a good inflation hedge, at least it is a good crisis hedge — gold always rises when the world gets more frightening. Gold futures closed at \$271.60 on Sept. 10, 2011 and jumped 10 percent to \$289.80 the next trading day (Sept. 17).

Gold and the dollar

Of all the intermarket correlations, the strongest is the inverse relationship of gold and the dollar. The hypothesis is that inflation in the U.S. debases the dollar and prudent investors should have some portfolio allocation to gold as a safe haven. Since the U.S. is still battling deflation and the CPI was up at year-end 2010 by less than 2 percent year-over-year, gold should not be rising for this reason. And it's not — it's rising because it has already risen and because it's magic, despite the negative real return.

But let's not forget that one year, or rather that part of one year (April to November 2005), when U.S. rates were rising while European rates were flat, the Chinese revalued, and U.S. tax policy favored earnings repatriation. The implication is that as rates rise globally, those willing to pay for the sense of security embedded in gold will start to feel the siren call of a real rate of return. Rates do not have to rise in the U.S. itself for gold to lose its luster — and rates are already on the rise in Australia, Canada, Norway, and China. Assuming the Great Recession really is over, it's only a matter of time before the U.S. and Europe follow suit.

Where is the breakeven rate, or the rate of return in Europe and the U.S. that will draw money from gold to money market accounts, CDs, and Treasuries? In 2005, it was 10-year rates falling below approximately 3.5 to 4 percent (plus the advent of the ETFs) that set off the gold rally still in place today. Presumably rates have to be higher this time to draw funds from gold — let's say a full 1 to 2 percent, which would put the 10-year note yield at 4.5 to 5.5 percent (compared to 3.4 percent near the end of January). Because the Fed's [quantitative easing](#) program specifically aims to keep rates on the low side and doesn't end until June, this is a scenario for later in the year. Ironically, the Fed might close down QE2 early if inflation rises more

FIGURE 7: GOLD VS. CPI (RED) MONTHLY FROM 1968



Despite its popular reputation, gold has failed to keep up with inflation for nearly three decades.

than it likes — but rising U.S. inflation would only feed demand for gold, so one factor can leapfrog the other and take some months to stabilize.

For gold to lose power against the dollar, though, it's possible we need the other two conditions from 2005 — China revaluing and a tax incentive to repatriate inflows. And these two may come to pass in 2011. China has promised a more flexible exchange rate, although the pace of revaluation has been glacial so far, and there is talk in Washington of another Homeland Investment Act. Watch out — gold may not be a one-way street in the coming year.

A final peevish word: Gold is not “money.” Money is defined as a medium of exchange, a unit of accounting, and a store of value — all at once. You cannot pay your mortgage with gold coins, and the utility company and grocer insist on “legal tender.” Gold is not a medium of exchange. It is also not an accounting unit. If you submit your tax return denominated in ounces of gold, the Internal Revenue Service will come down on you for fraud, misrepresentation, and probably 10 other offenses. The one thing we may claim for gold is that it is a store of value, even though it has failed to rise keep pace with inflation over many decades.

There are many reasons for this failure, including the opportunity cost of holding it and the cost of storing and insuring it, plus the acknowledgment that gold is not actually “money.” The 20th century editor of UK newspaper *The Guardian*, Charles Prestwich Scott, stated his top principle of journalism as “Comment is free, but the facts are sacred.” When you hear that gold is the only true money, run for the hills. This is an opinion, not a fact. ☒

For information on the author, see p. 4.



FX Bollinger Bandit

A channel-breakout forex strategy.

BY DANIEL FERNANDEZ

In their book *Building Winning Trading Systems with TradeStation*, George Pruitt and John R. Hill describe several interesting trading systems designed to trade the futures market on a portfolio basis. One of the strategies, the “Bollinger Bandit,” applied a volatility channel breakout approach (with an adaptive exit) on the daily time frame. The following strategy modifies this system to trade a basket of seven currency pairs on the forex market.

The original futures strategy

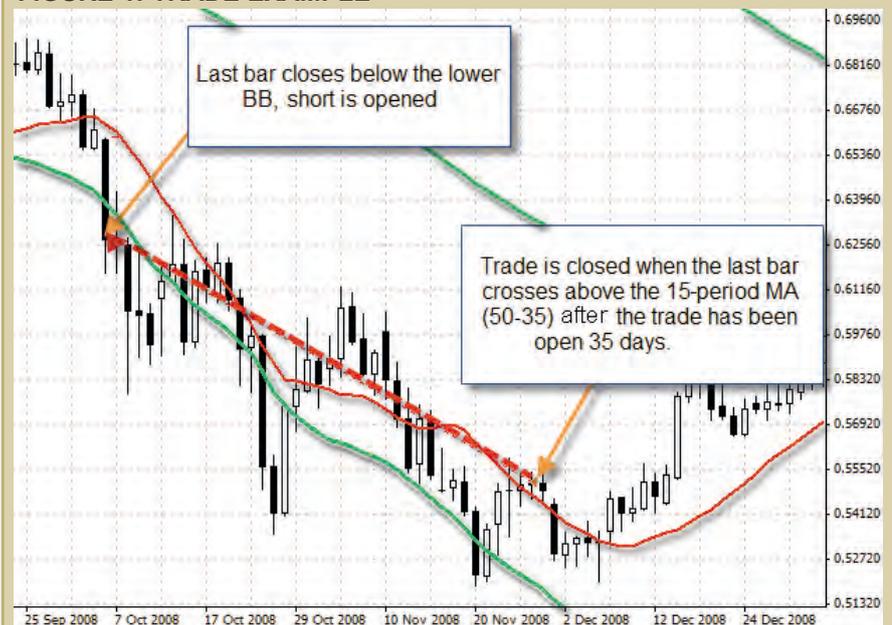
The Bollinger Bandit strategy uses **Bollinger Bands** based on a 50-period simple moving average (SMA) with the bands placed one **standard deviation** above and below the SMA. The strategy enters when price breaks out above or below the bands and exits when price crosses below a separate SMA.

However, an important feature of the strategy is the look-back period of this “exit SMA,” which is reduced by one day for each trading day a position remains open (starting at 50 to a minimum of 10), helping close out trades before they give back a significant portion of their profits. For example, if a long position is entered on Monday, it would be closed on a move below the 50-period SMA value on this day, a move below the 49-day SMA on Tuesday, a move below the 48-day SMA on Wednesday, and so on until the minimum look-back period of 10 is reached. The look-back period would then be reset to exit new positions.

Adapting the strategy for forex

There’s a problem with this strategy, however. Because positions are entered whenever price moves above or below the Bollinger Bands, traders who do not have access to system automation through their broker need to constantly monitor the market. A way to

FIGURE 1: TRADE EXAMPLE



Trades are entered when price pushes above or below the bands. Exits occur when price penetrates a moving average, the length of which shortens each day the position is open.

simplify the strategy is to base all entry and exit triggers on the values of previously closed bars so trade decisions can be made by looking at the screen once each day. This approach also simplifies testing, since no intraday data is needed for accurate evaluation.

Another way to tailor the strategy to the forex market is to increase the Bollinger Bands' moving average length and standard deviation multiple. The original parameters (a 50-day SMA and bands of one standard deviation) are too tight and highly likely to result in excessive whipsawing. Finally, to clearly define maximum risk, the modified strategy incorporates adaptive stop-loss and position-sizing rules.

Trade rules

The forex-modified Bollinger Bandit strategy uses an 80-period SMA and bands placed two standard deviations above and below the average; the initial exit-SMA length remains 50. Figure 1 shows a trade example. The entry and exit rules are:

- 1. Long entry:** If yesterday the currency pair opened below and closed above the upper Bollinger Band, enter long and place a stop-loss two times the 14-day **average true range** (ATR) below the entry price.
- 2. Short entry:** If yesterday the currency pair opened above and closed below the lower Bollinger Band, enter short and place a stop-loss two times the 14-day ATR above the entry price.
3. For each day a position is open, shorten the exit-SMA's length by one day.
- 4. Long exit:** If yesterday the currency pair closed below the exit SMA, close the position.
- 5. Short exit:** If yesterday closed above the exit SMA, close the position.

Regarding the stop-loss: For example, if the Euro/U.S. dollar pair's (EUR/USD) 14-day ATR is 150 pips (0.0150) and a short trade is triggered at 1.5050, a stop-loss order would be placed at 1.5350 ($1.5050 + (0.0150 \times 2)$).

Trade size is determined with the following formula:

$$\text{Trade size} = 0.01 \times \frac{\text{Account Balance}}{\text{Contract Size per}}$$

Standard Lot *
14-day ATR)

This equation should result in a maximum risk per position of approximately 2 percent. Using a \$100,000 trading account (with a 100,000 standard forex lot size), the trade size would be:

$$(0.01 \times 100,000) / (100,000 \times 0.0150) = 0.67, \text{ or } \$67,000$$

The system will be tested using daily data on the Metatrader 4 platform from June 1, 2000 to June 1, 2010 in the following currency pairs: Euro/U.S. dollar (EUR/USD), British pound/U.S. dollar (GBP/USD), U.S. dollar/Swiss franc (USD/CHF), Australian dollar/U.S. dollar (AUD/USD), New Zealand dollar/U.S. dollar (NZD/USD), U.S. dollar/Canadian dollar (USD/CAD) and U.S. dollar/Japanese yen (USD/JPY). The trading costs (in terms of each pair's spread) are shown in Table 1.

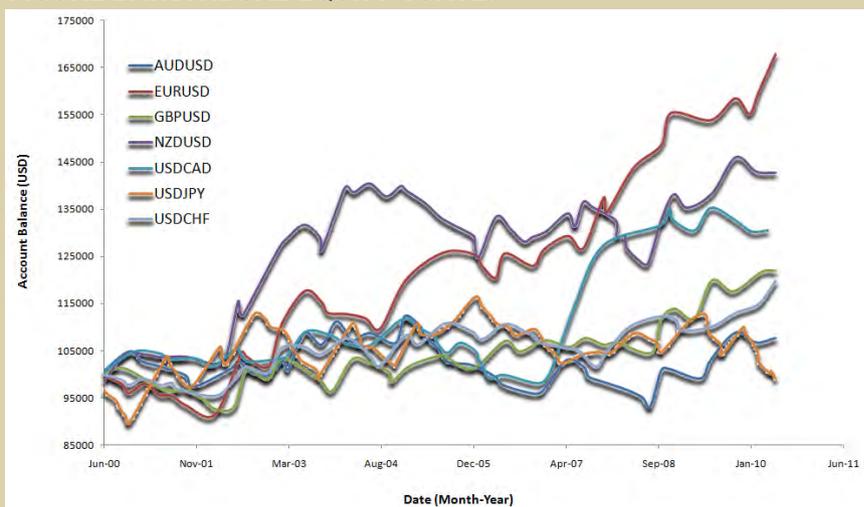
System results

Figure 2 shows the trading strategy produced net profits in all seven currency pairs, which suggests the strategy

TABLE 1: TRADE COSTS

Currency pair	Spread (pips)
EUR/USD	2
GBP/USD	3.5
USD/CHF	3.5
USD/JPY	2.5
AUD/USD	3.5
NZD/USD	8
USD/CAD	4

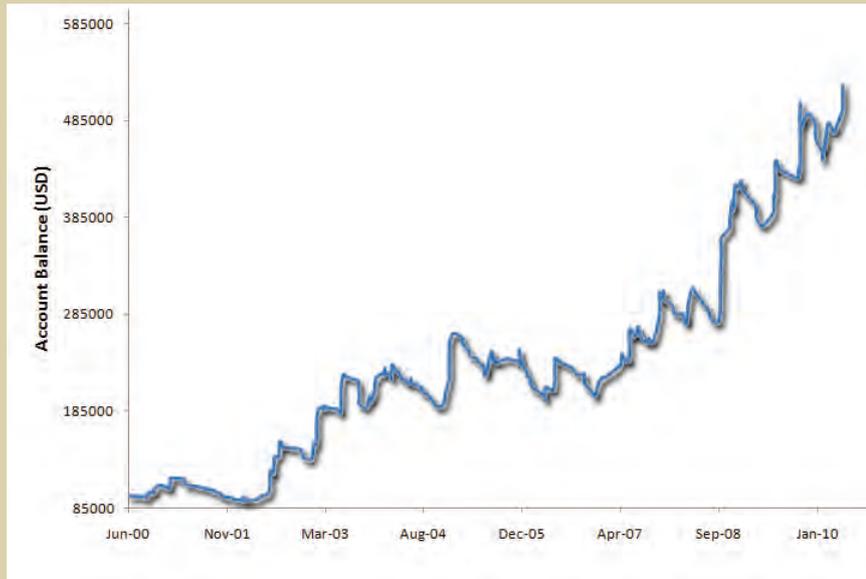
FIGURE 2: INDIVIDUAL EQUITY CURVES



The system was profitable on all seven currency pairs, using identical parameters.



FIGURE 3: PORTFOLIO EQUITY CURVE



The system's performance at the portfolio level was better than the sum of the component currency pairs. Equity growth was especially strong from 2007 forward.

ysis period, compared to the prolonged periods of range-bound trading seen in the USD/JPY and USD/CAD pairs. In fact, most of the strategy's losses result from these range phases, during which price tends to reverse off the bands instead of trading through them. As a result, the strategy is not well suited to currencies that move in an indecisive manner or range more than they trend.

Nonetheless, the results of some pairs, such as the USD/CAD, show the strategy can generate profits from pairs that have been in extended draw-downs. The system is quite good at preserving capital because of its exit mechanism, while it tends to capture

is robust and capturing a broad market inefficiency. It is important to emphasize the same parameters and logic were used on all currency pairs, without optimization — a fact that highlights the significance of the results.

However, analyzing the individual pairs in Table 2 shows the most profitable results occurred in the EUR/USD and NZD/USD, while other pairs, such as the USD/JPY, produced much less favorable results. This is a result of the EUR/USD having trended strongly during the anal-

relatively large trend-following opportunities when they arise.

At the portfolio level the system behaved very well, producing an average compounded yearly return of 18.8 percent, along with a maximum drawdown of 26.1 percent (Figure 3). In this respect, the portfolio's results are more than the sum of its parts, as the portfolio's profit-to-drawdown was better than that of any of the individual currency pairs.

TABLE 2: TEST RESULTS

	EUR/USD	USD/CHF	USD/JPY	GBP/USD	AUD/USD	NZD/USD	USD/CAD	Portfolio
Avg. compound annual profit	5.0%	1.7%	0.7%	1.8%	0.9%	3.5%	2.8%	18.8%
Max. drawdown	8.5%	8.2%	14.4%	8.6%	17.1%	12.1%	8.2%	26.1%
No. of trades	38	42	40	38	42	51	39	290
Win %	42%	40%	37%	45%	36%	43%	41%	40%
Profit factor	2.7	1.6	1.1	1.6	1.2	1.7	1.9	1.7
Reward/risk ratio	3.7	2.4	1.9	2.0	2.1	2.3	2.7	2.4

Pairs with stronger trends (EUR/USD) fared better than those prone to choppy trading or extended ranges (USD/JPY, USD/CAD).

However, the overall portfolio results exhibit a weakness common to most trend-following strategies: extended drawdown periods that can last several years. The maximum drawdown was 850 days, which means a great deal of patience and confidence would be required to trade this strategy successfully.

The portfolio's monthly returns (Figure 4) show how most months (57 percent) were losers, but the rarer profitable months were very profitable. It is also worth mentioning the portfolio took only 290 trades in the 10-year test period (2.4 trades per month), which makes it a low-frequency (and thus, lower-cost) strategy.

Pluses and minuses

Although the forex-adapted Bollinger Bandit strategy was not extremely profitable, it is robust. It was able to produce positive results across a basket of seven currency pairs without any optimization, along with a significant 1 to 1.4 average annual profit to maximum drawdown ratio. Although it suffers from the common trend-following "curse" of long drawdowns, the strategy practices the basic principle of limiting individual trade losses while allowing winners to run to their full potential. Performance could conceivably be improved through portfolio optimizations, pyramiding techniques, or the addition of more currency pairs. ☒

For information on the author, see p. 4.

Related reading

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Edge-ratio analysis of "classic" indicator entry rules

Currency Trader, January 2011

The value of classic technical indicator signals is evaluated across four major forex currency pairs.

Daily pivot breakouts

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When attempting to trade mechanically defined intraday support and resistance levels, don't forget the time element.

Multiple average trend-following

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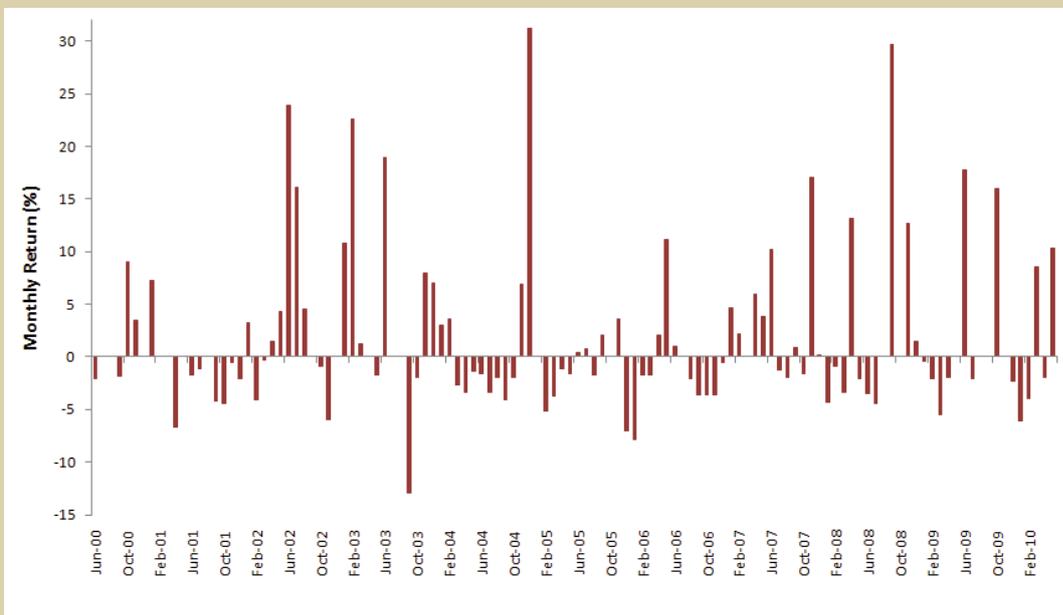
A "double-doji" breakout strategy gets a boost from a tick-volume filter.

Taking advantage of the Asian trading session

Currency Trader, June 2010

Breaking down the range characteristics of the Asian forex session produces some surprisingly reliable trading statistics.

FIGURE 4: MONTHLY RETURNS



The system had more losing months than winning months, but the winners were generally much larger than the losers.



Viewing the yuan from the grassy knoll

Conspiracy theorists take note: China has the means, opportunity, and motive to keep financing the U.S. and keep the yuan undervalued. This will continue to work until the minute it stops working.

BY HOWARD L. SIMONS

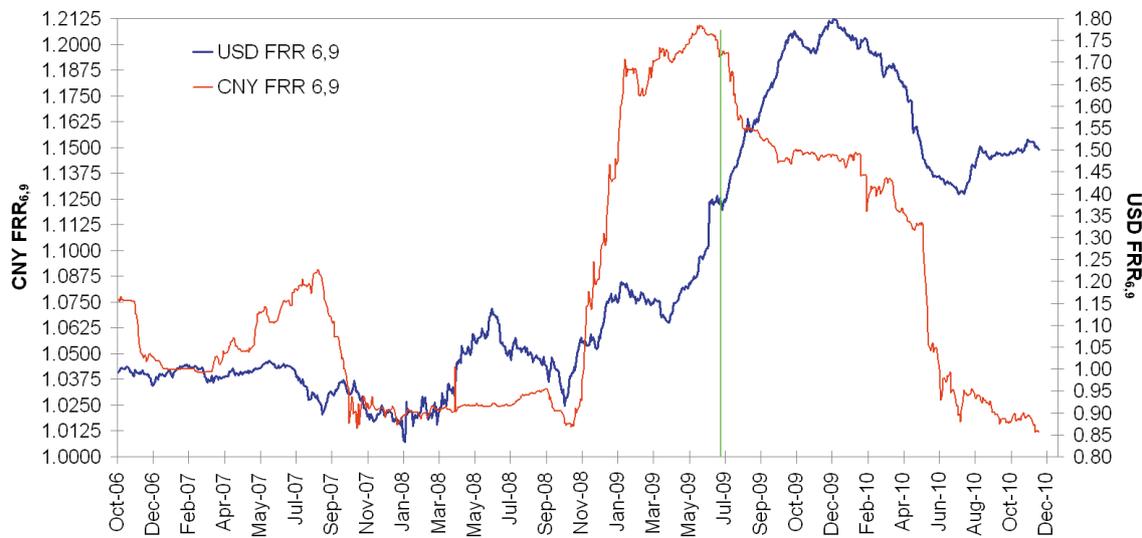
Conspiracy theories of all stripes generally collapse at the first whiff of reality or objective investigation. However, they are part of the human experience and always will be, if for no other reason than they give exercise to our imagination. Sometimes they are embedded deeply in a culture; a long-ago Egyptian colleague once explained how any of his countrymen who treated an official explanation of anything as truthful was regarded immediately as a fool or, worse, "one of them."

One of the great perpetrators of conspiracy theories is the government itself. Nothing along the lines of an alien landing at Roswell, New Mexico, or Area 51 in southern Nevada could exist in the popular culture, if an immediate and credible explanation were offered. People who act as if

they are covering something up create suspicion, as every White House press secretary learns the hard way sooner or later. More Americans today regard the Warren Commission as part of a conspiracy than was the case shortly after its release in 1964.

Moreover, technology is eroding what we consider to be true or not; think of how many believable "photo-shopped" pictures or CGI-generated videos you have seen. Can any visual image be regarded as proof-positive anymore? As an aside, think of how different world religious and cultural history would have been had such technology been available at the time. Moses parted the Sea of Reeds? Let's put in on YouTube!

FIGURE 1: A TALE OF TWO YIELD CURVES



Two countries with closely tied currencies had completely opposite money market yield curves. This normally would be resolved by the steeper yield curve witnessing a stronger currency, but this relationship was inverted in 2009 when a state of "perma-expectations" arose across a wide range of currencies.

Scene of the crime: Part I

One government that makes it exceptionally easy to believe the worst about itself and its intentions is China. The yuan (renminbi) remained resolutely pegged to the U.S. dollar until July 20, 2005, at which point it was allowed to begin a very limited float. Beijing had calculated it could afford to do so and that it had to placate Washington protectionists such as Senators Charles Schumer and Lindsey Graham. Even though the U.S. runs a massive trade deficit vs. China, the overall impact of a stronger yuan on U.S. price indices has been negligible (see "The yuan and U.S. inflation," *Currency Trader*, December 2007). The impact of the yuan on U.S. and European financial markets as the result of the yuan's peg to the dollar were discussed in "Robin Hood carry: The yuan as a funding currency," *Currency Trader*, July 2010).

China re-pegged the yuan in July 2008 during the very same weekend the Paulson Treasury backstopped U.S. mortgage giants Fannie Mae and Freddie Mac. The Chinese had bought a massive quantity of these agencies' securities under the mistaken assumption they were backed by the full faith and credit of the U.S. government. They were shocked to learn otherwise (*Memo to Beijing: No one here reads the Prospectus, either*), and apparently demanded a currency deal to keep financing their largest customer. Unlike the July 2005 decision to allow revaluation, not even a quiet announcement was made in July 2008.

The re-pegging looked like a win-win-win situ-

ation at first: The U.S. maintained a creditor who at that point should have been running quickly in the other direction; China re-established its beloved undervaluation, and the implicit support for the dollar pleased Europeans who were worried about the Euro becoming too strong.

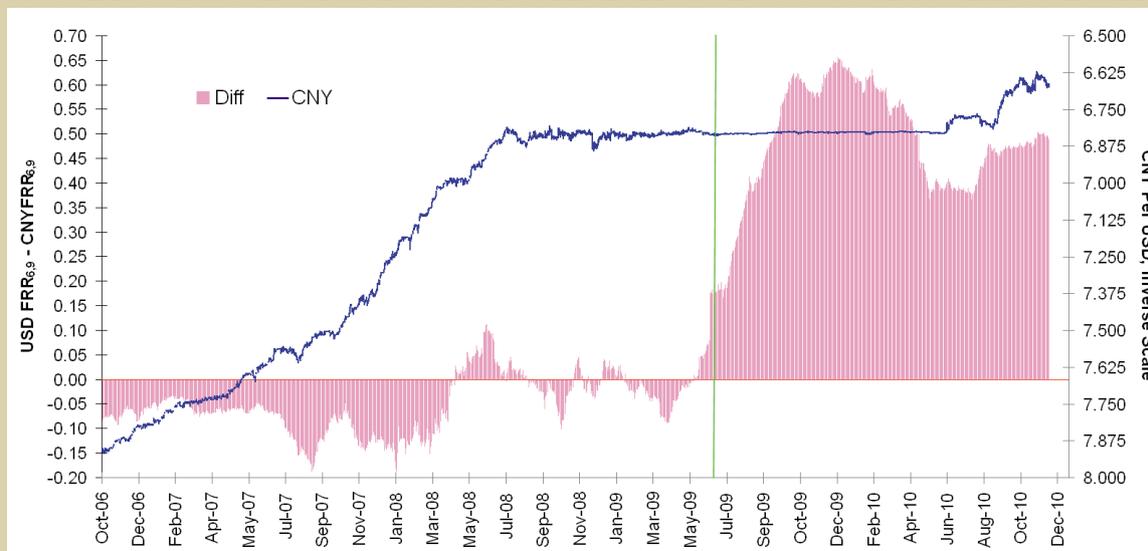
It was all a smashing success until the world almost ended in September 2008. Eventually, China relented to another timorous round of revaluation beginning on June 18, 2010.

Scene of the crime: Part II

Just over a year ago, China joined a few intrepid countries in raising short-term interest rates and tightening credit conditions. Their stated reason was to quell rising inflation and speculation in property markets. As the move came just two weeks after Federal Reserve chairman Ben Bernanke's statement (at the American Economics Association's annual meeting) that low interest rates had nothing to do with the U.S. real estate bubble, the timing bordered on a mix of horrifying and hilarious.

The Chinese move triggered suspicions just as a makeover of Dealey Plaza in Dallas would trigger suspicions. Even though the impact of large short-term moves in interest rates on currency rates are never as direct as we might assume them to be (see "Stock shocks and the dollar," October 2007), as a general rule, making your currency more expensive to borrow is a move used by officials who wish to strengthen, not weaken or maintain,

FIGURE 2: USD MONEY MARKET CURVE STEEPENED AFTER U.S. 10-YEAR YIELDS PEAKED



The huge gap between the two yield curves did not impact the yuan. Money was being drained out of the Chinese banking system (flattening CNY FRR_{6,9}), while money coming into the U.S. or into dollar-denominated instruments worldwide (steepening the USD FRR_{6,9}). China was buying U.S. assets to keep the CNY in line with the USD.



their currencies. How, then, can the Chinese move be reconciled? And, while we're at it, we can address another perplexity: how U.S. Treasury yields remained low and auctions well-bid while Uncle Sam was borrowing record quantities of cash.

Onward, Sherlock

If a country is tightening credit, its money market yield curve should flatten. That would be visible in a lower forward rate ratio between six and nine months ($FRR_{6,9}$). This is the rate at which we can lock in three-month borrowing beginning six months from now divided by the nine-month rate itself. The more this ratio exceeds 1.00, the steeper the yield curve.

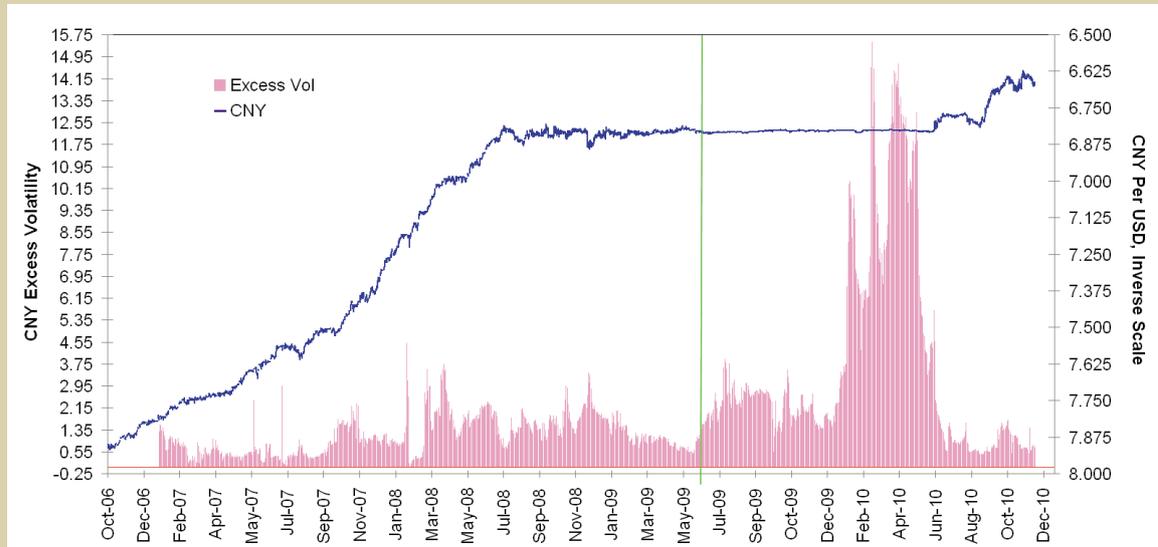
Incredibly, the Shanghai interbank market's yield curve had been flattening since June 11, 2009. Does this date ring a bell? Probably not, but it's the same day U.S. Treasury yields hit a local maximum and proceeded to spend the rest of the year declining or remaining confined in a tight trading range. The June 2009 date is marked with a green line on all subsequent charts.

Of course, while the CNY $FRR_{6,9}$ was flattening, the USD $FRR_{6,9}$ was steepening into January 2010 (Figure 1). It then flattened into the August 2010 move toward a second round of **quantitative easing**, whereupon it steepened once again. Two countries whose currencies were tied together had completely opposite money market yield curves.

This normally would be resolved by the steeper yield curve witnessing a stronger currency; during 2009, a state of "perma-expectations" arose across a wide range of currencies where the relationship inverted and the flatter yield curve produced the stronger currency (see "No man is an island, but the UK is," August 2010). Regardless, the last outcome to be expected in this situation is for the yuan to remain in a quasi-peg against the dollar.

Now the first piece of the puzzle falls into place. The huge gap between the two yield curves did not produce a ripple in the yuan — nor could it, given the peg. The one logical explanation for how this was possible was a capital flow from China to the U.S. Money being drained out of the Chinese banking system explained the flattening CNY $FRR_{6,9}$, and money coming into the U.S. or into dollar-denominated instruments worldwide explained the steeping USD $FRR_{6,9}$. We need to remember some very strange things were happening in the U.S. short-term money market during the fourth quarter of 2009, such as record-low three-month USD LIBOR and three-month Treasury bill rates near zero percent. These cannot happen in a stabilized, non-critical economy unless someone in addition to the Federal Reserve was jamming vast quantities of cash into that currency. That "usual suspect" to be rounded up was China, which was buying U.S. assets to keep the CNY in line with the USD.

FIGURE 3: YUAN EXCESS VOLATILITY



Shortly after June 11, 2009, yuan excess volatility jumped as the CNY $FRR_{6,9}$ flattened, then excess volatility stopped rising until speculation began (in January 2010) the peg would be loosened, perhaps as early as March 2010.

In good hands

One of the tools we have used frequently is excess volatility, or the ratio of implied volatility to high-low-close volatility minus 1.00. The implied volatility used is that for three-month CNY forwards. Shortly after June 11, 2009, the excess volatility on the yuan jumped as the CNY FRR_{6,9} flattened (Figure 3). Then excess volatility stopped rising until speculation began in January 2010 the peg would be loosened, perhaps as early as March 2010.

We should note, cynically, options traders in illiquid markets often trade as if they have an information advantage, perhaps linked to official contacts. In addition to the rise into the June 2010 loosening of the peg, please note how quickly excess volatility fell thereafter: Those with the information understood the revaluation to be permitted would be a tepid one. A second piece of the puzzle is joined.

Treasure it always

We can now add the third piece of the puzzle, and that is the behavior of U.S. Treasury rates as the CNY FRR_{6,9} flattened. If money was flowing out of China and bidding up the price of USD-denominated assets, we should see U.S. yields decline as soon as the Chinese money market curve changed direction. This twice took place exactly as predicted, first in the third quarter of 2009 and a second time in the second quarter of

2010 (Figure 4).

This entire inference can be drawn without having to trace fund flows around the world through official channels, direct and indirect bidders at U.S. Treasury auctions, or through offshore-domiciled accounts. Let's assume someone with \$2.65 trillion to throw around, an interest in keeping it quiet, and a police state apparatus at its disposal knows more tricks for hiding money than you know for sleuthing it out.

We now come to the very straightforward "conspiracy theory" conclusion: China has the means, opportunity, and motive to keep financing the U.S., to keep its yuan undervalued while it tightens domestic credit, and to keep the dollar from collapsing against the Euro during those periods when the 16-nation European Monetary Union is not forming a circular firing squad to resolve their various sovereign credit issues.

This, too, will work until the minute it stops working. No flow of this size can be maintained forever; ultimately the U.S. credit rating will fall to the point where it cannot afford to buy even financed goods out of China.

China cannot afford to lose its largest customer. This unholy game will not end happily for either side, even though we can explain it to the proverbial Man From Mars. ☒

For information on the author, see p. 4.





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.

February 2011

30	31	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	1	2	3	4	5

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

February

1	U.S.: January ISM manufacturing report Germany: December employment report
2	U.S.: January employment report and Fed beige book
3	ECB: Governing council interest-rate announcement
4	Canada: January employment report LTD: February U.S. dollar index options
5	
6	
7	
8	Brazil: January CPI and PPI
9	Mexico: Jan. 31 CPI and January PPI
10	Australia: January employment report Japan: January PPI UK: Bank of England interest-rate announcement
11	U.S.: December trade balance Germany: January CPI
12	
13	
14	India: January PPI Japan: Q4 GDP
15	U.S.: January retail sales and FOMC interest-rate announcement Germany: Q4 GDP Japan: Bank of Japan interest-rate announcement
16	U.S.: January PPI and housing starts South Africa: January CPI
17	U.S.: January CPI and leading indicators
18	Canada: January CPI
19	
20	

21	Hong Kong: Nov.-Jan. employment report
22	Hong Kong: January CPI South Africa: Q4 GDP
23	France: January CPI Hong Kong: Q4 GDP
24	U.S.: January durable goods report Brazil: January employment report Mexico: Feb. 15 CPI South Africa: January PPI
25	U.S.: Q4 GDP (second) Japan: January CPI Mexico: Q4 GDP and January employment report
26	
27	
28	U.S.: January personal income Canada: Q4 GDP France: January PPI India: Q4 GDP and January CPI
March 2011	
1	U.S.: February ISM manufacturing index Canada: Bank of Canada interest-rate announcement Germany: January employment report Japan: January employment report
2	Australia: Q4 GDP Canada: January PPI
3	Brazil: Q4 GDP France: Q4 employment report ECB: Governing council interest-rate announcement
4	U.S.: February employment report Brazil: February CPI and PPI LTD: March U.S. dollar index options

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The information does NOT constitute trade signals. It is intended only to provide a brief synopsis of each market's liquidity, direction, and levels of momentum and volatility. See the legend for explanations of the different fields. Note: Average volume and open interest data includes both pit and side-by-side electronic contracts (where applicable).

Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	307.3	175.3	1.99% / 57%	2.46% / 61%	-2.99% / 37%	.34 / 63%
JPY/USD	JY	CME	108.7	107.2	0.65% / 46%	-0.84% / 22%	-1.82% / 68%	.27 / 40%
GBP/USD	BP	CME	102.7	85.0	0.17% / 0%	2.96% / 81%	-0.97% / 24%	.30 / 10%
AUD/USD	AD	CME	81.7	116.4	-0.20% / 15%	-1.81% / 57%	-0.57% / 100%	.18 / 25%
CAD/USD	CD	CME	64.6	112.2	-1.06% / 100%	0.01% / 0%	0.89% / 9%	.23 / 22%
CHF/USD	SF	CME	38.6	43.6	2.25% / 44%	-0.72% / 16%	3.97% / 31%	.50 / 88%
MXN/USD	MP	CME	21.6	127.5	-0.34% / 100%	1.81% / 55%	0.83% / 4%	.23 / 40%
U.S. dollar index	DX	ICE	19.5	30.3	-1.37% / 23%	-1.27% / 30%	3.00% / 81%	.35 / 70%
NZD/USD	NE	CME	6.0	26.3	0.76% / 33%	0.43% / 3%	0.22% / 1%	.34 / 48%
E-Mini EUR/USD	ZE	CME	5.6	5.3	1.92% / 46%	1.83% / 50%	-3.47% / 42%	.38 / 70%

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 the 10-day move shows how the most recent 10-day move compares to the past twenty 10-day moves; for the 20-day move, it shows how the most recent 20-day move compares to the past sixty 20-day moves; for the 60-day move, it 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 smaller 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.

BarclayHedge Rankings

(as of Dec. 31 ranked by December 2010 return)

Top 10 currency traders managing more than \$10 million

	Trading Advisor	December Return	2010 YTD Return	\$ Under Mgmt. (Millions)
1.	QFS Asset Mgmt (QFS Currency)	9.80%	30.43%	787.0
2.	Ortus Capital Mgmt. (Currency)	6.73%	27.87%	1940.0
3.	Sunrise Cap'l Partners (Currency Fund)	5.58%	-0.17%	18.0
4.	Auriel Currency 2X Fund	4.99%	6.32%	54.0
5.	Henderson Global Currency	3.80%	-10.87%	50.0
6.	JCH Capital Mgmt (Global Currency)	3.65%	-9.31%	30.0
7.	Greenwave Capital Mgmt (GDS Beta)	3.33%	7.45%	15.0
8.	MIGFX Inc (Retail)	3.05%	37.25%	13.0
9.	Silva Capital Mgmt (Cap. Partners)	2.81%	12.71%	18.4
10.	Gables Capital Mgmt (Global FX)	2.66%	13.09%	33.0

Top 10 currency traders managing less than \$10M & more than \$1M

1.	D2W Capital Mgmt (Radical Wealth)	35.00%	38.55%	1.5
2.	Bluenose FX	9.52%	114.50%	2.2
3.	Quantica Cap'l (Diversified FX)	3.40%	9.86%	2.0
4.	Rove Capital (Dresden)	3.33%	21.91%	2.2
5.	CenturionFx Ltd (6X)	1.62%	68.75%	4.5
6.	Armytage AAM (Asian Currency)	1.50%	-12.25%	3.1
7.	M2 Global Mgmt (2.5X)	1.38%	0.14%	2.4
8.	Drury Capital (Currency)	1.13%	0.09%	3.4
9.	BEAM (FX Prop)	0.98%	8.88%	2.0
10.	Aurapoint Asset Mgmt (QV)	0.58%	19.38%	2.3

Based on estimates of the composite of all accounts or the fully funded subset method.

Does not reflect the performance of any single account.

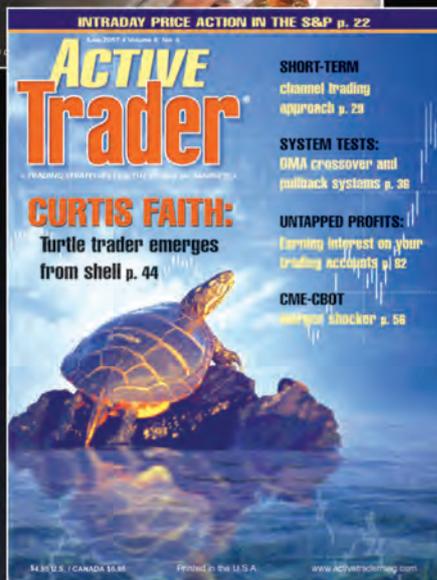
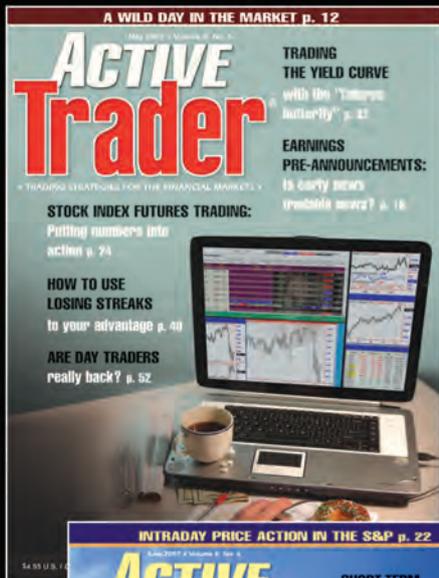
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CURRENCIES (vs. U.S. DOLLAR)

Rank	Currency	Jan. 26 price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Swedish krona	0.152675	4.57%	0.24%	11.55%	0.1542	0.1227	7
2	Euro	1.36421	3.96%	-2.66%	5.72%	1.4282	1.1891	16
3	Great Britain pound	1.58923	2.94%	0.96%	3.05%	1.6299	1.4235	17
4	Russian ruble	0.03358	2.39%	1.65%	1.83%	0.03459	0.03077	5
5	New Zealand dollar	0.76469	2.10%	1.46%	5.15%	0.7975	0.6561	2
6	Taiwanese dollar	0.034455	2.03%	5.46%	10.57%	0.03448	0.03074	12
7	Swiss franc	1.055925	1.54%	2.47%	11.37%	1.075	0.853	3
8	Singapore dollar	0.78062	1.44%	0.87%	6.97%	0.7819	0.702	10
9	Canadian dollar	1.004655	1.31%	2.39%	4.08%	1.0163	0.9217	9
10	Brazilian real	0.598465	1.19%	2.02%	6.17%	0.6075	0.5076	6
11	Chinese yuan	0.15192	0.99%	1.14%	3.02%	0.15200	0.1461	13
12	Japanese yen	0.01213	0.54%	-2.10%	6.12%	0.01246	0.01053	8
13	Hong Kong dollar	0.128315	-0.15%	-0.43%	-0.33%	0.129	0.1281	15
14	Australian dollar	0.9945	-1.02%	0.05%	11.04%	1.033	0.8069	4
15	Indian rupee	0.021715	-1.07%	-3.68%	2.67%	0.02274	0.02089	11
16	Thai baht	0.03224	-2.72%	-3.86%	3.90%	0.03386	0.02938	14
17	South African rand	0.14216	-4.23%	-1.86%	5.68%	0.1518	0.1233	1



GLOBAL STOCK INDICES

	Country	Index	Jan. 26	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Italy	FTSE MIB	22,007.00	7.28%	3.82%	5.70%	23,593.10	18,044.50	4
2	France	CAC 40	4,049.07	4.84%	5.10%	11.36%	4,086.00	3,287.57	2
3	Hong Kong	Hang Seng	23,843.24	4.42%	1.03%	14.41%	24,988.60	18,971.50	15
4	U.S.	S&P 500	1,296.63	3.11%	9.36%	16.29%	1,299.74	1,022.50	3
5	Germany	Xetra Dax	7,127.35	2.25%	7.76%	15.06%	7,165.00	5,433.02	6
6	Singapore	Straits Times	3,220.78	1.94%	1.84%	8.55%	3,313.61	2,648.15	13
7	Brazil	Bovespa	68,709.00	1.34%	-2.87%	3.41%	73,103.00	57,634.00	14
8	Australia	All ordinaries	4,907.00	0.73%	3.06%	8.94%	5,048.60	4,194.40	10
9	Japan	Nikkei 225	10,401.90	0.44%	10.93%	9.45%	11,408.20	8,796.45	12
10	Switzerland	Swiss Market	6,593.00	0.38%	1.80%	6.35%	6,990.70	5,935.00	11
11	Canada	S&P/TSX composite	13,465.75	0.12%	6.16%	14.64%	13,572.30	10,990.40	8
12	South Africa	FTSE/JSE All Share	31,965.24	-0.15%	6.08%	12.16%	32,661.06	25,793.06	5
13	UK	FTSE 100	5,969.20	-0.45%	4.59%	11.55%	6,090.50	4,790.00	1
14	Mexico	IPC	37,585.40	-1.44%	6.25%	14.04%	38,876.80	29,926.10	9
15	India	BSE 30	18,684.43	-6.71%	-7.60%	3.69%	21,108.60	15,652.00	7

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	Jan. 26	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Euro / Aussie \$	EUR/AUD	1.371725	5.03%	-2.71%	-4.78%	1.5953	1.2917	18
2	Pound / Aussie \$	GBP/AUD	1.598015	4.00%	0.91%	-7.20%	1.814	1.5217	19
3	Euro / Yen	EUR/JPY	112.43	3.36%	-0.59%	-0.43%	128.354	105.404	14
4	Euro / Real	EUR/BRL	2.27951	2.73%	-4.59%	-0.46%	2.6379	2.1772	16
5	Euro / Canada \$	EUR/CAD	1.357885	2.62%	-4.93%	1.54%	1.4968	1.2502	13
6	Euro / Franc	EUR/CHF	1.291965	2.39%	-5.01%	-5.10%	1.4848	1.24	20
7	Pound / Yen	GBP/JPY	130.98	2.36%	3.08%	-2.88%	147.286	125.49	17
8	Pound / Canada \$	GBP/CAD	1.581865	1.61%	-1.40%	-0.99%	1.7208	1.4894	15
9	New Zeal \$ / Yen	NZD/JPY	63.025	1.52%	3.63%	-0.94%	68.8751	58.9096	12
10	Pound / Franc	GBP/CHF	1.505075	1.40%	-1.47%	-7.49%	1.7112	1.4397	21
11	Euro / Pound	EUR/GBP	0.85845	0.98%	-3.58%	2.56%	0.9147	0.8065	7
12	Franc / Yen	CHF/JPY	87.025	0.94%	4.66%	4.92%	89.982	76.36	3
13	Canada \$ / Yen	CAD/JPY	82.8	0.73%	4.57%	-1.94%	94.1955	78.9222	8
14	Franc / Canada \$	CHF/CAD	1.05103	0.23%	0.08%	7.00%	1.0687	0.8989	2
15	Canada \$ / Real	CAD/BRL	1.67872	0.11%	0.36%	-1.97%	1.8244	1.6399	11
16	Yen / Real	JPY/BRL	0.020275	-0.61%	-4.02%	-0.02%	0.02127	0.01838	9
17	Aussie \$ / Yen	AUD/JPY	81.96	-1.58%	2.16%	4.63%	88.048	72.0981	5
18	Aussie \$ / Canada \$	AUD/CAD	0.98989	-2.29%	-2.28%	6.69%	1.0218	0.8643	4
19	Aussie \$ / Franc	AUD/CHF	0.94183	-2.52%	-2.36%	-0.29%	1.0079	0.8949	10
20	Aussie \$ / New Zeal \$	AUD/NZD	1.30059	-3.13%	-1.39%	-1.12%	1.3506	1.2088	1
21	Aussie \$ / Real	AUD/BRL	1.6175	-4.79%	-4.54%	1.81%	1.7459	1.4954	6

GLOBAL CENTRAL BANK LENDING RATES

Country	Interest Rate	Rate	Last change	July-10	Jan. 10
United States	Fed funds rate	0-0.25	0.5 (Dec. 08)	0-0.25	0-0.25
Japan	Overnight call rate	0-0.1	0.1 (Oct. 10)	0.1	0.1
Eurozone	Refi rate	1	0.25 (May 09)	1	1
England	Repo rate	0.5	0.5 (March 09)	0.5	0.5
Canada	Overnight funding rate	1	0.25 (Sept 10)	0.75	0.25
Switzerland	3-month Swiss Libor	0.25	0.25 (March 09)	0.25	0.25
Australia	Cash rate	4.75	0.25 (Nov 10)	4.5	3.75
New Zealand	Cash rate	3	0.25 (July 10)	3	2.5
Brazil	Selic rate	11.25	0.5 (Jan. 11)	10.75	8.75
Korea	Korea base rate	2.5	0.25 (Jan. 11)	2.25	2
Taiwan	Discount rate	1.25	0.25 (Feb. 09)	1.375	1.25
India	Repo rate	6.5	0.25 (Jan. 11)	5.75	4.75
South Africa	Repurchase rate	6	0.5 (Sept.10)	7	7

GDP		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Q3	12/17	-2.8%	15.5%	3/18
	Brazil	Q3	12/9	0.5%	5.6%	3/3
	Canada	Q3	12/23	0.7%	6.3%	2/28
EUROPE	France	Q3	11/30	0.4%	1.5%	2/15
	Germany	Q3	11/12	0.7%	4.2%	2/15
	UK	Q3	12/22	0.9%	5.2%	3/29
AFRICA	S. Africa	Q3	11/30	0.6%	9.7%	2/22
ASIA and S. PACIFIC	Australia	Q3	12/1	0.6%	2.8%	3/2
	Hong Kong	Q3	11/12	7.8%	6.8%	2/23
	India	Q3	11/30	18.7%	21.7%	2/28
	Japan	Q3	11/15	0.9%	3.9%	2/14
	Singapore	Q3	11/26	1.6%	12.5%	NLT 2/25

Unemployment		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS	Argentina	Q3	11/22	7.5%	-0.4%	1.6%	2/22
	Brazil	Dec.	1/27	5.3%	-0.4%	-1.5%	2/24
	Canada	Dec.	1/7	7.6%	0.0%	-0.9%	2/4
EUROPE	France	Q3	12/2	9.3%	0.0%	0.1%	3/3
	Germany	Nov.	1/4	6.7%	0.0%	-0.8%	2/1
	UK	Sep.-Nov.	1/19	7.9%	0.2%	0.1%	2/16
ASIA and S. PACIFIC	Australia	Dec.	1/13	5.1%	0.0%	-0.4%	2/10
	Hong Kong	Nov.-Jan.	1/18	4.0%	-0.1%	-1.1%	2/21
	Japan	Dec.	1/28	4.9%	-0.2%	-0.3%	3/1
	Singapore	Q4	1/31	2.2%	0.1%	-0.1%	4/29

CPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Dec.	1/14	0.8%	10.9%	2/11
	Brazil	Dec.	1/6	0.6%	5.9%	2/8
	Canada	Dec.	1/25	0.0%	2.4%	2/18
EUROPE	France	Dec.	1/13	0.5%	1.8%	2/23
	Germany	Dec.	1/14	1.0%	1.7%	2/11
	UK	Dec.	1/18	1.0%	3.7%	2/15
AFRICA	S. Africa	Dec.	1/19	0.2%	3.5%	2/16
ASIA and S. PACIFIC	Australia	Q4	1/25	0.4%	2.7%	4/27
	Hong Kong	Dec.	1/20	0.5%	3.1%	2/22
	India	Dec.	12/31	0.6%	7.7%	2/28
	Japan	Dec.	1/28	-0.3%	0.0%	2/25
	Singapore	Dec.	1/24	0.1%	4.6%	2/23

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Dec.	1/14	0.9%	14.6%	2/11
	Canada	Dec.	1/31	0.7%	2.9%	3/2
EUROPE	France	Dec.	1/14	-0.2%	-0.3%	2/28
	Germany	Dec.	1/20	0.7%	5.3%	2/18
	UK	Dec.	1/14	0.5%	4.2%	2/4
AFRICA	S. Africa	Dec.	1/20	0.3%	5.8%	2/24
ASIA and S. PACIFIC	Australia	Q4	1/24	0.1%	2.7%	4/21
	Hong Kong	Q4	12/13	6.5%	0.6%	3/11
	India	Dec.	1/14	1.3%	8.4%	2/14
	Japan	Dec.	1/14	0.4%	1.2%	2/10
	Singapore	Dec.	1/28	2.7%	2.7%	2/28

As of Jan. 30, 2011 LEGEND: Change: Change from previous report release. NLT: No later than. Rate: Unemployment rate.



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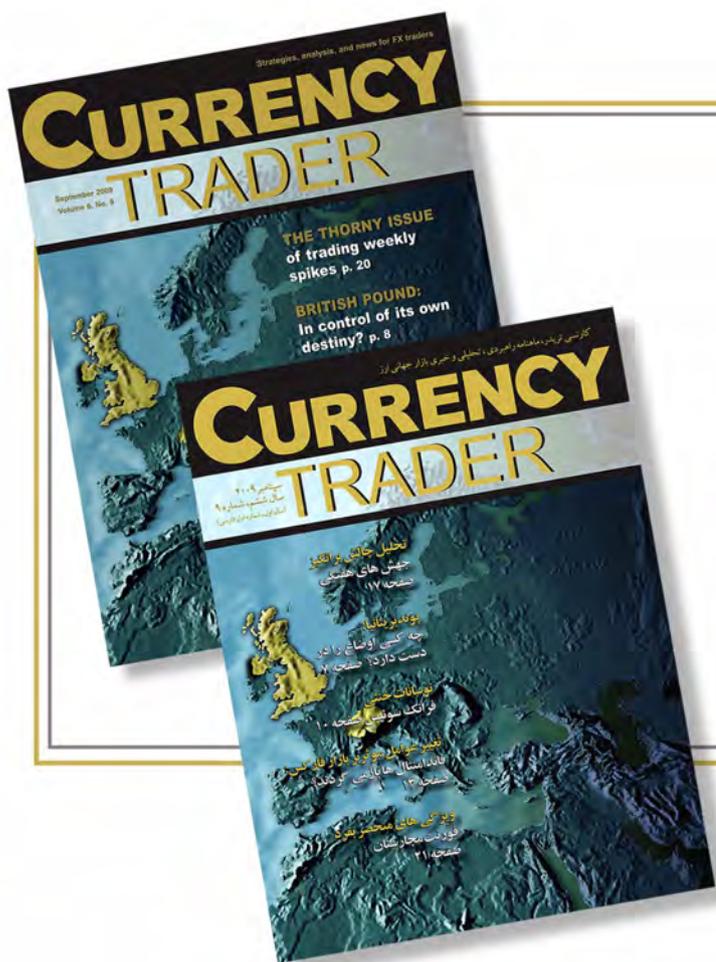
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Switching sides near a market extreme.

TRADE

Date: Thursday, Jan. 27.

Entry: Short the Euro/U.S. dollar pair (EUR/USD) at 1.3715.

Reason for trade/setup: This paper trade was actually intended to be an intermediary position in an attempt to profit from the expected extension of the EUR/USD's rally in late January.

After dropping to a more than three-month low on Jan. 10, the pair roared back to gain nearly 7 percent in a little more than two weeks, making a two-month high and approaching resistance around the Nov. 22 high of 1.3785. The idea (on Jan. 25) was to go long on a pull-back in anticipation of a challenge to the early November peak around 1.4280 (which was a nearly 10-month high). A buy order was entered at 1.3411, a little below the implied support of the Jan. 4 and 14 highs. After two more days of price strength, however, the idea to go short was activated, with the goal of taking profits at the intended buy level, and entering a tight stop to control risk in the event of another upside burst.

Initial stop: 1.3777, which is .0020 above the high of the entry day.

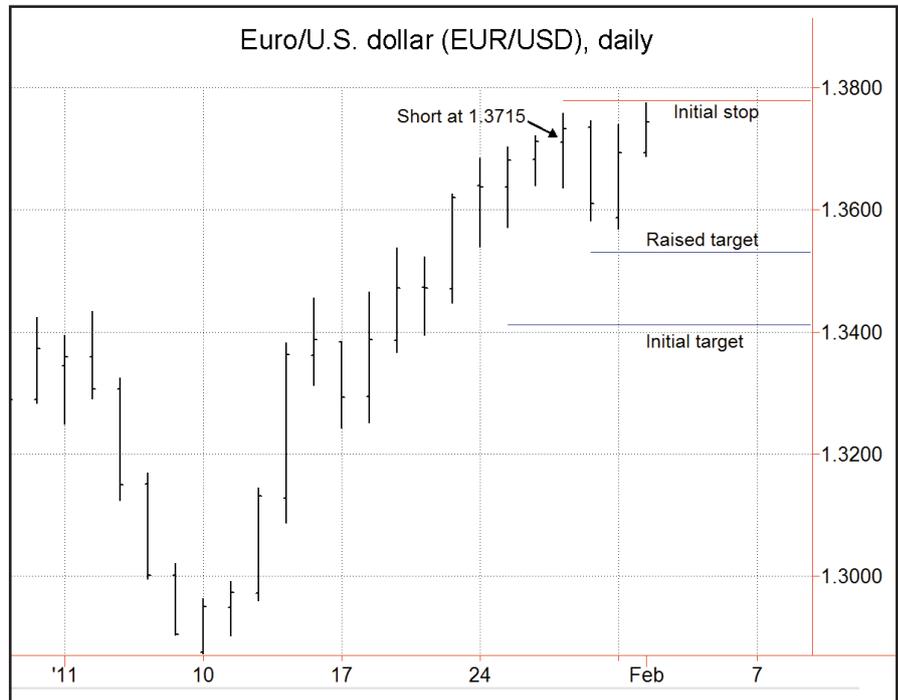
Initial target: 1.3411.

RESULT

Exit: Trade still open.

Profit/loss: -.0032, marked to market around 10 a.m. ET on Feb 1.

Outcome: The basic premise turned out to have some value, but the chosen exit level appeared (as of early on



Source: TradeStation

Feb. 1, anyway) to be too optimistic.

On the trade-entry day, the pair closed a little above the entry price, but dropped sharply the next day, falling more than 1 percent intraday and closing at 1.3609. The trade seemed to be on its way. One day later (Jan. 31), however, the market almost completely reversed that move, rallying back above the entry price and closing around 1.3700. We raised the exit/reversal level to around the Jan. 24 low of 1.3539, but this seemed to be too little, too late. As of 9 a.m. ET on Feb. 1, the pair had traded to within two pips of the stop price, and a loss on this trade appeared to be a foregone conclusion. In retrospect, taking a quicker profit on a smaller down move would have been the wise choice, given the market's upside momentum and our longer-term bullish bias. ☒

Go to www.currencytradermag.com after Feb. 7 for the result of this trade.

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

Date	Currency pair	Entry price	Initial stop	Initial target	IRR	Exit	Date	P/L		LOP	LOL	Trade length
								point	%			
1/27/11	EUR/USD	1.3715	1.3777	1.3411	4.90	1.3747	2/1/11	-.0032	-0.23%	0.0145	-0.0060	3 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).