

Strategies, analysis, and news for FX traders

CURRENCY TRADER

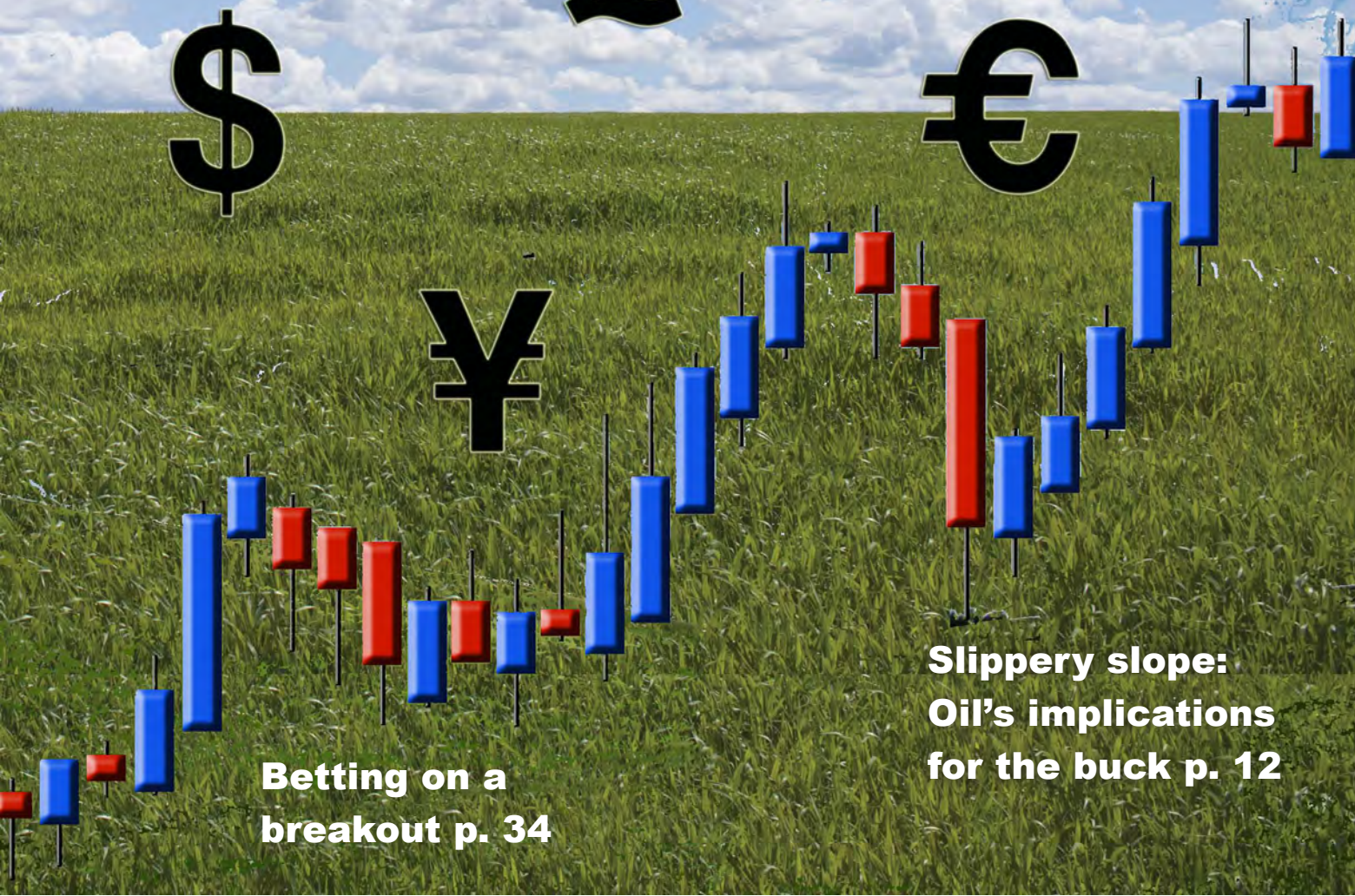
March 2011

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What's ahead for the Euro crosses

Removing the dollar from the FX equation highlights the unique dynamics of the European currencies and their potential moves in the coming months.

BY CURRENCY TRADER STAFF

Many forex traders focus primarily on U.S. dollar pairs such as dollar/yen, Euro/dollar, or Aussie/dollar, but trading opportunities still exist when the greenback is left out of the picture. The primary European crosses revolving around the Euro (EUR), British pound (GBP), and Swiss franc (CHF) are fertile ground for FX traders, and are driven by unique dynamics and fundamental factors.

The two major European crosses are the Euro/pound and Euro/Swiss. The pound/Swiss rate is an option for traders looking for a European play, but analysts warn this cross tends to be less liquid than the others. As with any other currency cross rate, traders need to analyze the growth and interest-rate differential pictures for the component economies.

The Eurozone continues to slog ahead economically, weighed down by several factors, including continuing sovereign-debt concerns, negative fiscal outlooks, and sluggish exports. Gross domestic product (GDP) growth has been tepid, at best, with 2011 looking to be less robust than last year.

"We expect growth to be around 1 percent in 2011 after expanding by 1.7 percent in 2010," says Enam Ahmed, senior European economist at Moody's Analytics in London. "Last year's performance was led by the strong recovery in Germany. We expect further improvements in the Eurozone's largest economy to be moderate after its GDP

rose by 3.6 percent in 2010."

Ahmed cites several obstacles in the path to Eurozone economic growth this year, including the highly indebted private and public sectors in many Eurozone countries.

"Correcting these balance sheets will take time, weighing on domestic demand and the outlook for several years,"

he says. "Linked to this are concerns over the sovereign-debt crisis which, if they re-ignite, have the potential to derail the recovery. Elevated unemployment will also limit the upside to growth."

Exports present another stumbling block.

"Most of the countries within the region trade among themselves," Ahmed says. "Even in

Germany, about 40 percent of exports go to the Eurozone, with another 20 to 30 percent going to others in the EU."

He does note, however, that Germany increased its exposure to emerging markets, especially Asia and China, in 2010, which is one reason it will continue to lead Eurozone growth this year.

Interest rates: Gauging the ECB

Forecasts for a European Central Bank (ECB) rate hike vary. According to Ahmed, although underlying inflationary pressures are subdued,

the Eurozone has not yet secured a "safe path towards self-sustaining growth," and it will start to feel the pinch of fiscal austerity in the middle of the year.



"We expect the ECB will start raising its key policy rate from the fourth quarter of 2011," he says. "Headline inflation is close to, but below, the 2-percent target, but core inflation, excluding food and energy, is hovering around 1 percent."

By the end of the year, Ahmed contends, "the worst of the sovereign-debt situation will likely have passed, and the ECB will be much more assured about the recovery."

Barclays Capital, however, sees the ECB holding rates steady at 1 percent throughout 2011, while Nomura anticipates a September 2011 hike. According to Nomura's Feb. 18 *Global Economics Weekly Economics Monitor* research note: "With growth close to trend and headline inflation hovering above the target in 2011, the ECB will likely become increasingly uncomfortable with a monetary policy stance that implies negative real interest rates. As the sovereign debt crisis gradually abates in 2011, we expect the ECB to continue its liquidity withdrawal policy and maintain a hawkish stance preparing the markets for its first rate hike by September 2011." Nomura forecasts the ECB rate to rise to 1.5 percent by the end of 2011.

UK fundamentals: Exports and austerity

The UK's economic outlook appears roughly in line with the lukewarm Eurozone forecast.

Moody's Analytics expects the UK to grow around 1.3 percent this year, following a 1.4-percent GDP gain in 2010 and a 4.9-percent decline in 2009.

"Domestic demand is weak in the UK," Ahmed says. "Elevated unemployment, surging inflation, and worries about the impact of fiscal austerity are dampening consumer confidence, which has fallen to nearly a two-year low."

There are some encouraging signs on the other side of the equation, but only to a degree. "The manufacturing sector continued to grow in the final quarter of 2010, thanks to demand from outside the country," Ahmed says. "With domestic demand expected to remain weak, the UK will remain reliant on trade to fuel growth this year."

But with most of its exports headed to the Eurozone, the upside on this front is likely limited, according to Ahmed. "Across the Eurozone, countries are shifting from fiscal stimulus to austerity in 2011," he says. "This will depress

domestic demand in the region."

Impact of belt-tightening

Austerity measures, which haven't yet impacted the UK economy across the board, will likely begin to do so later this year.

"We expect the cuts in government spending to really start to bite from the end of the second quarter," Ahmed says. However, he adds the jump in the UK's value-added tax (VAT) from 17.5 to 20 percent in January 2011 will have a more immediate impact on consumption and inflation in the coming months.

Danielle Haralambous, economist at 4cast in London, weighed in on the potential impact from the austerity

measures. "Thus far, an indirect effect has been to keep consumer confidence measures firmly below their long-run averages as the UK consumer faces reduced job security, cuts to welfare support, and a hike in the VAT to 20 percent," she says. "Positive sentiment will be key in ensuring that consumer behavior remains supportive of the recovery, but this could be difficult with the labor market set to deteriorate." According to Haralambous, the improvement in the employment situation that occurred 2010 will likely reverse in 2011 unless private-sector job creation can compensate for a contraction in the public sector.

"Positive sentiment will be key in ensuring that consumer behavior remains supportive of the recovery, but this could be difficult with the labor market set to deteriorate."

— Danielle Haralambous,
economist at 4cast in London

UK inflation

The Bank of England (BOE) has revised upward its forecast for 2011 inflation to 4.3 percent — well above the central bank's 2-percent target level. According to Ahmed, inflation is a big issue in the UK, and pricing pressures have complicated the BOE's decision-making process. Consumer price growth has reached 4 percent year-over-year and will likely rise more in the coming months because of increased food and energy prices.

"Core inflation also suggests underlying pricing pressures are high," Ahmed says. "Excluding energy and food prices, consumer price growth is 2.9 percent. If these expectations get embedded in wage demands and negotiations, pricing pressures will be stubbornly high for longer than currently expected by the Bank of England."

According to Nomura's Feb. 18 *Global Economics Weekly*

Economics Monitor report, "Inflation has been and should continue to be boosted by 'one-off' shocks such as changes to VAT and surging commodity prices. We expect these factors to force CPI inflation to a new peak of 4.5 percent y-o-y by February 2011 and look for it to remain above 3 percent until the end of 2011."

Expectations for the timing of a BOE rate hike are mixed, but Charmaine Buskas, chief strategist at 4cast Inc. in New York explains the bank is leaning toward raising rates. "The February MPC (*Monetary Policy Committee*) minutes showed a 6-3 split in favor of hiking rates," she says. "There are a growing number of hawks on the BOE MPC. There is a growing voice in the central bank that rates need to be higher, and sooner [rather than later]. The market is going to increasingly price in expectations over the next six weeks, and this could be the trade that really happens." Buskas sees the potential for the BOE to hike in May.

Moody's forecast was a bit more conservative. "The BOE will raise its key policy rate by 25 basis points by June 2011," Ahmed says. "It will hold off any further rate rises until the end of the year."

Citi economists also forecast rate hikes from the BOE soon — potentially from its March meeting. They expect

three rate hikes to end 2011 at 1.25 percent, with additional tightening to end 2012 at 2.25 percent, and further rate hikes to end 2013 at 3.25 percent.

Euro vs. UK

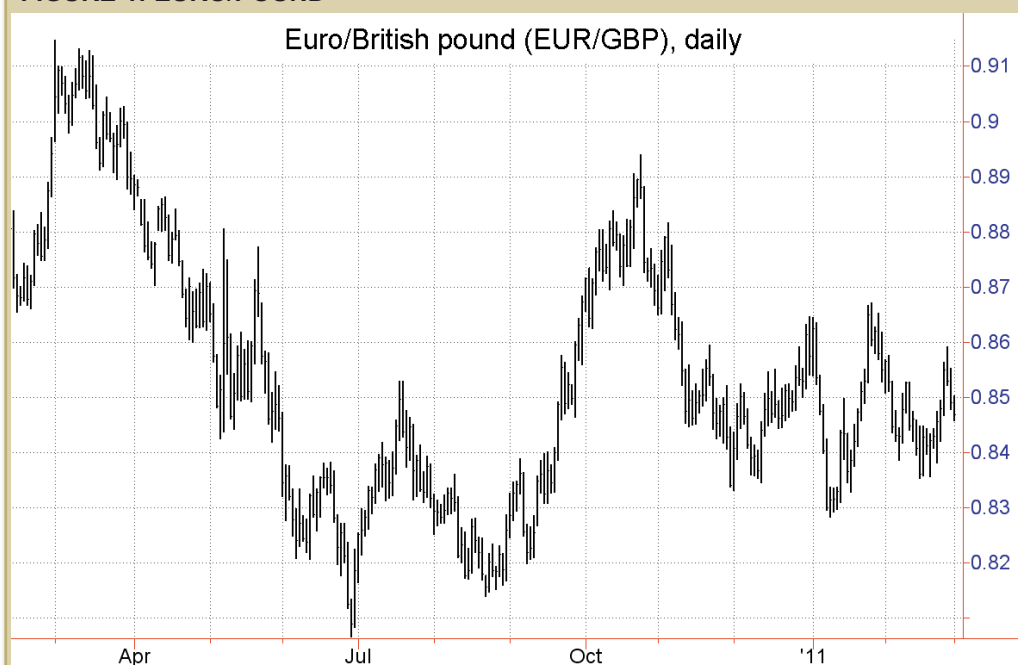
Differentiating between Britain and Eurozone growth prospects is difficult, according to Jay Bryson, global economist at Wells Fargo. "It's hard to distinguish between the Eurozone and the UK in the sense that in both you are looking at rebounds that are more or less similar," he says.

According to Bryson, during the recession UK GDP fell by more than 6.4 percent on a peak-to-trough basis. "That is quite steep," he notes. "Yes, there is an upturn. But they are still 4.3 percent below their previous peak."

The key takeaway, Bryson says, is the UK saw a "very deep recession. It is starting to climb out, but it is a sluggish recovery. There is [going to be] tight fiscal policy for the next several years, and we are looking at a relatively modest upturn."

Eurozone GDP fell 5.3 percent on a peak-to-trough basis at the same time. "Not quite as bad as the UK, but still a major recession," Bryson says. "It is still 3.2 percent below its previous peak. They are still in the hole."

FIGURE 1: EURO/POUND



In recent months the EUR/GBP has traded within a broad range, often rallying when there is more confidence in Europe's ability to address its various debt crises and falling when expectations of a UK rate hike increase.

Euro/pound price action

Since December 2010, the EUR/GBP pair has largely traded within a large intermediate-term neutral range between roughly .8500/.8600 on the upside and .8300/.8200 on the downside (Figure 1). Within that range the pair has tended to climb when there is confidence "Europeans will address the debt crisis or amid pound-negative news," says Brian Dolan, chief currency strategist at Forex.com. The pair has retreated toward the lower end of the range when there is a higher expectation the UK will raise interest rates because of inflation or when fear over the Eurozone debt situation

increases, he adds.

Since January, EUR/GBP has retreated from about .8670 to about .8350. Ahmed says the key driver behind that move was “the surge in inflation, which is leading to investor speculation about an earlier-than-expected interest rate rise by the bank of England.”

Many analysts appear to favor a push lower in the Euro/pound in the weeks and months ahead. “In terms of fundamentals, it looks promising to be short Euro/long pound,” Buskas says.

Dolan agrees. He sees potential for Euro/pound to break the .8320 area in March which could lead to a move down to the .8000 level.

“Look for levels to sell Euro/pound in the .8500/.8800 area,” he says.

Greg Anderson, foreign exchange strategist at CitiFx in New York says his firm expects the BOE to hike rates this year before the ECB does and a resulting down move in the EUR/GBP. “We are looking for a move to .8000 as a six-month target,” he says.

Barclays Capital forecasts a downside breakout from the recent trading range, with a late-March target in EUR/GBP of .8300, a late-May target of .8000, and an August target of .7800.

CitiFX analysts put out a sell recommendation for the Euro/pound early last month. “We are going short EUR/GBP spot at 0.8442 on the back of relative rate and credit outlook, which we expect to move further in favor of pound in coming weeks. We have a target of 0.8100, although we don’t have a buy order at that level. We are placing an initial stop loss at 0.8663, which is a firm order,” they wrote in their Feb. 3 CitiFX & LM Strategy research note.

“The key drivers for [Euro/pound] currency movements will be inflation, policy interest rates, developments over the sovereign debt crisis, and differences between the pace of their economic recoveries,” Ahmed says. “Concerns about surging inflation in the UK have raised the probability of a rate rise by the bank of England in the coming quarters. They could move as early as May. This will help boost the pound. On the sovereign debt crisis EU leaders

on 25 March will finalize plans to strengthen the EU rescue fund. If they fall short of market expectations, which we think they will, then that will weigh on the Euro.” He targets a move to around .8200 by mid-year.

Ahmed suggests pound traders keep an eye on inflation trends and BOE comments about pricing pressures. “This will provide some [idea of] when the central bank will raise rates, and by how much,” he explains. “Into the third quarter, traders will need to shift their focus towards growth, as that’s when the austerity measures will really start to bite.”

Swiss fundamentals

Turing to Switzerland, Nomura expects 2011 Swiss GDP growth of 2.2 percent, following a 2.7-percent reading last year. The Swiss economy contracted 1.9 percent in 2009.

Looking ahead to 2012, Nomura forecasts 2.3 percent GDP growth. Overall, Nomura targets 2011 consumer prices to grow at a modest 0.6 percent pace, and an overall unemployment rate of 3.7 percent.

That forecast compares with Moody’s 1.8 percent Swiss GDP growth forecast. “Switzerland’s recession was the mildest in Europe and the economy has been in recovery since the third quarter of 2009,” says Melanie Bowler, Moody’s Analytics economist in London. “The recovery has been broad-based, with both the domestic and external sectors driving growth.”

But that early strength might, ironically, set up Switzerland for some contraction. “Growth should moderate in coming quarters largely due to slowing exports,” Bowler says. “Swiss businesses are increasingly pessimistic.”

Bryson also notes Switzerland’s “upturn has been stronger than in the UK or Eurozone. They don’t have the same massive [fiscal] tightening as in the UK and the Eurozone.” He also notes the Swiss franc’s strength is a negative for the country’s export sector. “Since the fall of 2008 before Lehman, the Swiss franc has strengthened more than 20 percent vs. the Euro and about 25 percent vs. the U.S. dollar,” he notes.

Bowler voices similar concerns. “The strong Swiss franc

“The key drivers for [Euro/pound] currency movements will be inflation, policy interest rates, developments over the sovereign debt crisis, and differences between the pace of their economic recoveries.”

— Enam Ahmed, senior European economist at Moody’s Analytics in London



is the key downside risk to the outlook for Switzerland in 2011," she says. "Swiss National Bank Chairman, Philipp Hildebrand, is increasingly worried about the strong franc and recently noted the stability of the Euro region is an absolutely crucial factor to the franc and the Swiss economy overall. Also, although stress tests suggest Swiss banks would withstand a renewed global downturn and a deterioration in European public finances, they remain highly exposed to problems in Central and Eastern Europe and Eurozone economies with high deficits and debts."

Overall, exports are expected to be a drag on Swiss growth following a 0.7-percent quarter-over-quarter contraction in the fourth quarter of 2010. "Almost half of all Swiss exports are destined for the Eurozone, with around 20 percent specifically going to Germany, where GDP growth is expected to ease to around 1.6 percent in 2011 from 3.5 percent in 2010," Bowler notes. "The strong franc is further hitting the competitiveness of Swiss-made goods and weighing on the important tourism sector. Lingering high unemployment abroad will further weigh on tourist numbers in 2011."

However, Bowler adds that approximately a fifth of Switzerland's exports are destined for Asia, where growth is expected to remain relatively strong. "Switzerland is looking to further extend its trade ties eastward, which

will reduce its exposure to future slowdowns in Europe," she says.

Swiss monetary policy

The Swiss National Bank (SNB) has been active in the forex market. Starting in March 2009, the SNB began buying Euros and dollars in an attempt to stem the rising strength of its currency. That effort largely ended in June 2010 once the risk of deflation had largely disappeared, according to Bowler. However, given the intervention's general lack of success, she does not anticipate renewed SNB action in the near term.

"The bank never actually revealed when it intervened in the markets, but did explicitly note during monetary policy announcements that they would act to prevent any "excessive appreciation" of the Swiss franc," Bowler says. "Preventing the Swissie from appreciating had the added benefit of boosting demand for Swiss exports, an important driver of the Swiss recovery."

However, she notes, the policy was costly for the SNB. The bank reported a record loss in 2010 after the big downturn in the Euro eroded the value of the currency reserves it accumulated through its interventions. Meanwhile, the franc is 16 percent higher against the Euro than when interventions began in March 2009.

"While not completely ruling out a return to interventions, the bank will be reluctant to restart the policy unless deflation risks re-emerge," Bowler says.

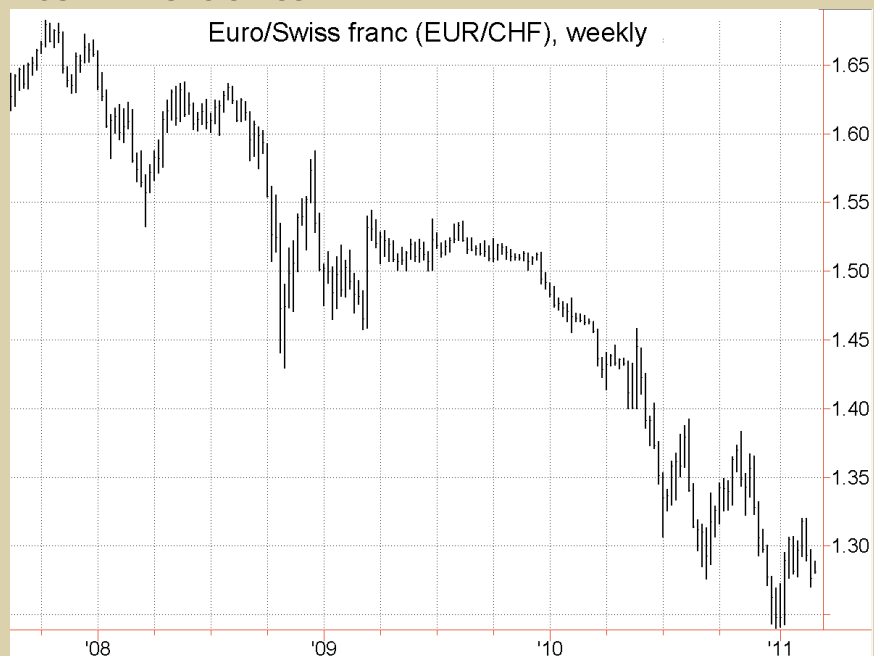
Barclays Capital forecasts the Swiss National Bank to hold its lending rate steady at 0.25 percent throughout 2011. Bowler agrees with that outlook. "Swiss interest rates will remain on hold until late 2011," she says. "Weak inflationary pressures will prevent any change in monetary policy."

Euro/Swiss

A monthly chart of the Euro/Swiss pair reveals massive gains in the Swiss franc vs. the Euro since the beginning of the global financial crisis (Figure 2). In October 2007, Euro/Swiss hit a high of 1.6800 before tumbling as low as 1.2400 in December 2010.

"Euro/Swiss fell out bed," Anderson says. "The global financial crisis started the appreciation of the Swiss franc. An awful lot of money got pulled out of

FIGURE 2: EURO/SWISS



The EUR/CHF pair has been in a long-term downtrend late 2007 as the Swiss franc benefited from safe-haven buying.

the Eurozone and into the Swiss franc amid safe-haven seeking."

CitiFX's six-month target for the Euro/Swiss is 1.3800. "If the sovereign crisis in the Eurozone stays on the back burner, Euro/Swiss will continue to grind slowly higher, in a recovery trade from the extreme move over the last couple of years," Anderson says.

Nomura International also anticipates strong appreciation in the Euro/Swiss pair throughout 2011, with a target at 1.4400, according to Takuma Ikeda, the firm's senior economist of European Economic Research.

Bowler, however, is more positive about the franc's relative strength vs. the Euro. "The Swiss franc should remain strong, at least in the near term, as the lingering sovereign-debt crisis continues to encourage investors to seek safe-haven assets," she says.

Barclays Capital forecasts a May target of 1.3200 in the Euro/Swiss, an August target of 1.3500, and an early 2012 target of 1.3800. In their Feb. 17 FX monthly report, Barclays Capital analysts wrote: "Despite growing Euro area concerns, the CHF's attractiveness as a hedge is likely to decline as investors look to diversify into other safe haven currencies."

The wave of demonstrations and uprisings in the Middle East also plays to the Swiss currency's strengths. Forex.com's Dolan notes that the Swiss Franc "has resumed its role as a safe-haven currency. When you see the global tensions heat up in the Middle East, the Swiss franc has strengthened vs. the Euro."

Buskas also stresses the near-term importance of the Middle East unrest and the Swiss franc's traditional status.

"The continued unrest in the Middle East suggests the Swiss franc could remain strong, especially vis-à-vis the Euro," she says. "I could see a profitable short Euro/long Swiss trade if troubles in the Middle East continue to unfold."

HSBC analyst Murray Gunn sees different trends for Euro/Swiss on different time frames. "The medium-term (*multi-week*) trend is down as long as 1.3231 holds as resistance," he notes, while "the long-term (*multi-month*) trend is higher as a five-wave-down (*Elliott Wave*) structure from the 2007 high comes to an end."

It all depends on how the pair handles

a certain resistance level, according to Gunn. "As long as 1.3231 holds as resistance, we expect EUR/CHF to be around 1.2500 by mid-year," he says. "The 1.3231 [level] is the key pivot. Below there the price structure is bearish but it switches to bullish above it."

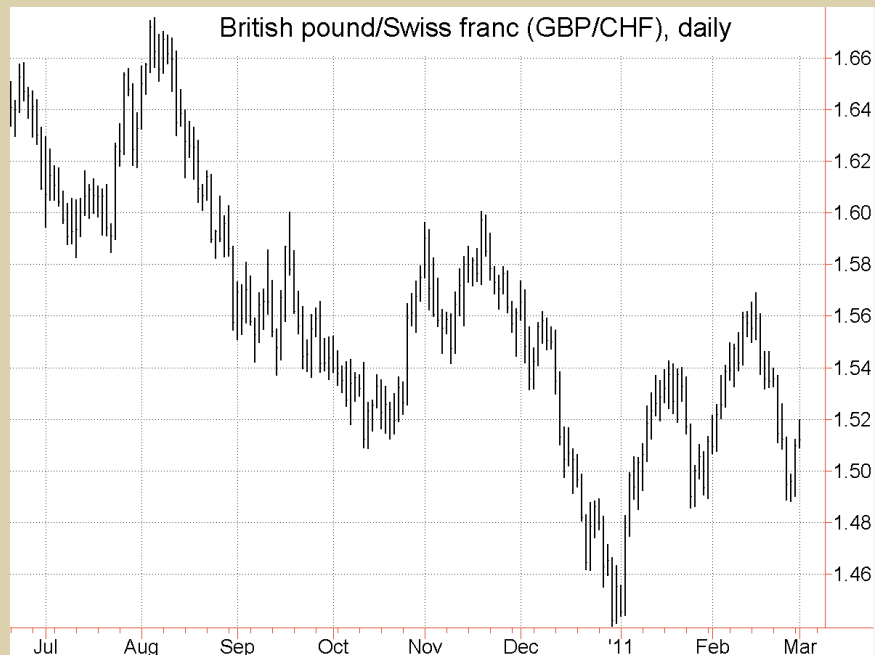
Pound/Swiss

Last, and justifiably least, is the pound/Swiss pair (Figure 3). Looking back on the pair from 2005 to 2008, CitiFX's Anderson says, "the pound [often had] higher interest rates, so there was carry in that cross. But now UK rates are at 50 basis points (.5 percent)." He also notes the low level of trade between the UK and Switzerland means there isn't much in the way of underlying natural flows between the currencies, and that means a less-liquid currency pair.

Increasing economic security and eventual growth may favor the pound, according to Ahmed.

"The Swiss franc is seen as a safe-haven currency, and it has been boosted in 2010 by tensions over the sovereign-debt crisis and the economic outlook," he says. "However, in 2011 the pound has regained some of its losses as these tensions have eased somewhat in the opening months of the year." ☒

FIGURE 3: POUND/SWISS



The GBP/CHF pair has rallied off its late-2010, early-2011 low, although it is still well below its August 2010 high.



Market failures and the future of the dollar

The “relationship” between the dollar and oil is widely misunderstood, but that doesn’t mean a correct reading of the situation will change the outlook for the dollar.

BY BARBARA ROCKEFELLER

Current thinking is that the dollar’s decline is understandable, and more dollar decline is inevitable because of developments in relative interest rates based on the new oil price shock. On closer examination, both of these ideas are built on flimsy assumptions and an incomplete understanding of how real economies work, but never mind — a falling dollar is indeed the likely outcome even after we get a better understanding of the facts. This dismal deduction is predicated on the likelihood that several markets will fail in ways we have seen before.

Popular uprisings in North Africa and the Middle East triggered a rise in oil prices to more than \$100 in late February and a fall in the dollar against the Swiss franc to March 2008 financial crisis levels. At the same time, the euro broke out of its downtrend and started retesting recent highs, despite no solution in sight for sovereign debt crises in Europe and the near-universal opinion that Greece will be forced to default. The euro got support from comments by a handful of European Monetary Union (EMU) officials asserting that rising inflation would force the European Central Bank (ECB) to raise rates at an accelerated pace, possibly as early as May. Sterling got support on the same basis; three of nine Monetary Policy Committee members at the February meeting wanted a rate hike.

The forex market is no stranger to prices that go to extremes on poorly founded assumptions and even false-

hoods. We tend to brush off panics as understandable and normal, to be exploited over the short run. But a school of thought throughout economic history is that financial markets are inherently unstable and prices trend toward extremes — quite a difference from the normal equilibrium of markets for regular goods and services. This is in part because price extremes themselves influence trading fundamentals and therefore set off another round of price extremes. George Soros made more than \$1 billion on his observation of this feedback effect from market prices to fundamentals and back to market prices.

Nowhere is the feedback effect more visible than in the relationship of oil panics and currency responses. In a nutshell, the reasoning is that an oil price shock will feed inflation that must be offset by swift and decisive central bank rate hikes. With the EMU reporting inflation over the central bank target of 2 percent for several months running, fear of inflation and talk of ECB rate hikes were already prevalent before the oil price crisis in late February. The Fed, meanwhile, had just announced that U.S. economic recovery, while more robust, was not enough to prevent QE2, which is at heart an easing measure. This line of reasoning has the dollar falling for two reasons — the dollar is inversely correlated with the price of oil, and the Fed doesn’t understand the inflationary effect of the oil price rise.

As for the dollar being inversely correlated with oil, see



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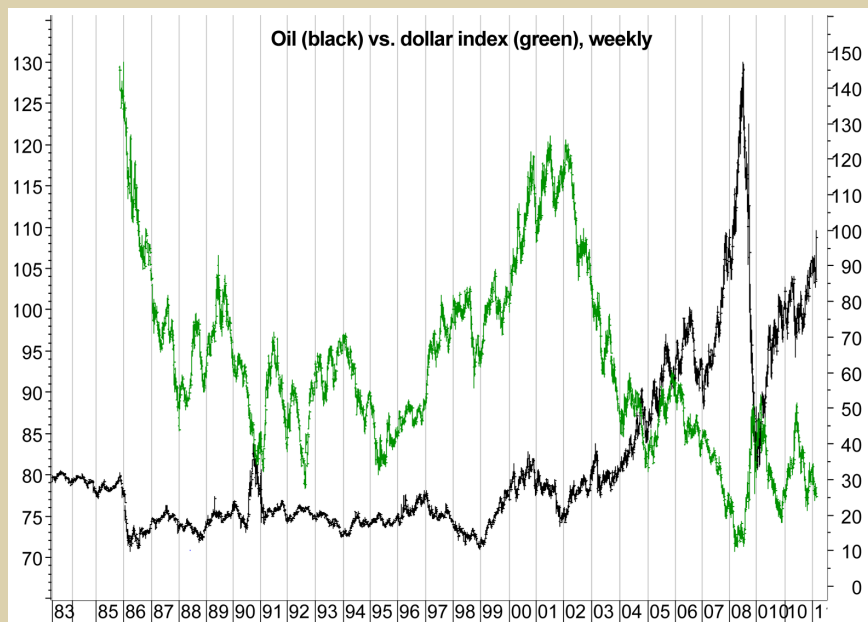
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Passion to Perform

Figures 1 and 2. Figure 1 indicates no long-term correlation of any sort. The shorter time frame of Figure 2 shows the relationship is more stable starting in 2005, or maybe 2007, when it became fashionable to “hedge” against a falling dollar by buying oil — a clear instance of a self-fulfilling

prophecy based on no sort of economic reality. The Fed not understanding inflation is a ridiculous charge against scholars who have devoted their entire working lives to the study of inflation. There must be something else — and there is.

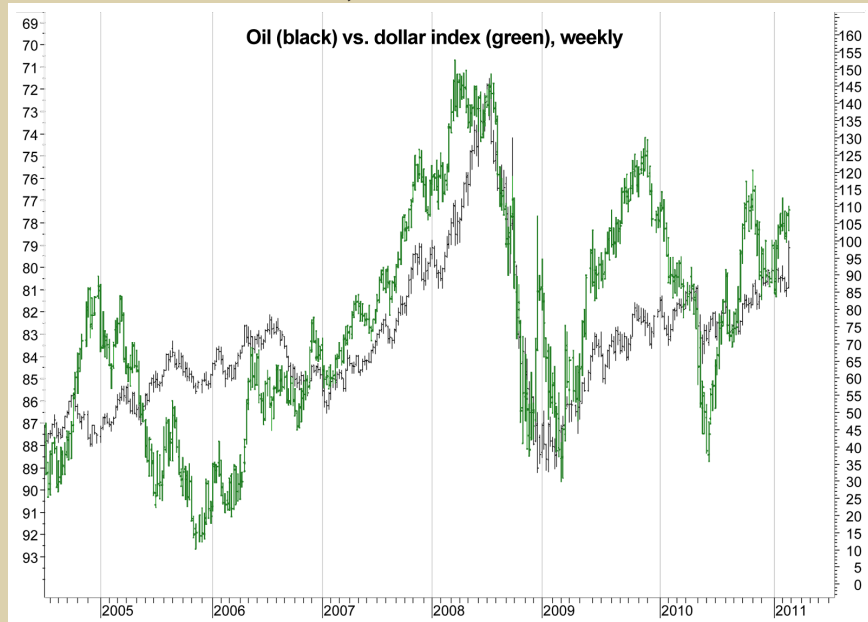
FIGURE 1: OIL AND DOLLAR, 1983-2011



No long-term relationship is apparent between the U.S. dollar and crude oil.

Source: Chart — Metastock; data — Reuters and eSignal

FIGURE 2: OIL VS. DOLLAR, 2004-2011



The oil-dollar relationship appears more stable beginning in 2005, or perhaps 2007 when some traders began “hedging” against a declining dollar by going long oil.

Don't bother me with the facts

The price of oil has tripled in two years — from \$32.70 in January 2009 to more than \$100 in February 2011. The CRB index, which includes oil, has risen 70 percent from the Feb. 10, 2009 low of 200.56 to 349.08 on Feb. 23. You can't open a newspaper without reading about first one commodity and then another rising to new multi-year highs, including copper, coffee, sugar, and wheat. Commodity price inflation is credited with inflation at about 5 percent in China, more than 4 percent in Great Britain and more than 2 percent in Europe. It has yet to hit the U.S., where headline inflation is 1.6 percent and core inflation is just 1 percent as of January.

The European view is that monetary policy alone suffices to fix inflation, whereas the UK and U.S. central banks are more inclined to consult the output gap and rate of growth of money supply and credit creation. The output gap is one of those awful concepts that bedevil first-year economics students. The idea is that when there's excess capacity, producers of goods and services don't raise output prices even if their input prices are rising, lest they choke off whatever demand they do see. Think of it as the restaurant owner refusing to raise his dinner prices when the place is half empty, even if the costs of bread and steak are up.

In other words, in a period of recession or slow growth, rising input prices are something to watch but not the decisive factor in changing monetary policy. In both the U.S. and Europe, money supply growth and lending are still at pre-recession levels, at around 4 percent (M2) in the U.S. and less than 2 percent in the EMU. Besides, other non-monetary factors have an important effect on prices. Former Fed Chairman Alan Greenspan never tired of reminding

us that the U.S. escaped inflation for many years by ever-rising labor market productivity that was not matched by wage increases.

And as monetarist Milton Friedman had us all parroting not that long ago, inflation is always and everywhere a monetary phenomenon. Urgency to raise interest rates on the oil price shock alone should not be strong and thus the expectation that the ECB will raise rates many months ahead of the Fed is not well-founded if we believe the ECB looks to money supply and credit creation.

Saudi Arabia vs. Goldman Sachs

No one denies that a tripling of oil prices in two years is a drag on just-recovering economies. Airlines have already raised fares four times this year and will raise them more; the price of gasoline heading back above \$3.50 a gallon would ruin U.S. travel and is a tax on the poor and working class. Experts say every one-penny rise in the price of gasoline takes more than \$1 billion out of U.S. discretionary consumer spending over a year.

But we have no hard evidence oil will stay up around \$100, let alone get back to the 2008 level (\$147). Forecasts of such high prices are coming from those with a vested

interest in that outcome, including Goldman Sachs, which is very long oil in various forms (producers, refiners, and inventory in storage). At the end of February, we don't even know how much Libyan oil supply has been reduced, although one in-country producer, Italian oil company ENI, said it is about 1 million barrels per day (bpd) of the country's total daily barrel production of 1.8 million.

Oil traders are in the mood to panic and drive up the price. Goldman may, in fact, be low-balling OPEC reserves to favor its own position. And traders are not heeding promises from the Saudis that OPEC has a reserve capability of 4-5 million bpd, or that Saudi Arabia alone, with most of that reserve, is able and willing to replace all of Libya's production in a matter of days. With the political situation in Libya deteriorating by the day, fear-mongers are free to suggest that Saudi Arabia is not immune from a populist revolution and thus a serious global oil supply shortage.

Realistically, that is extremely unlikely and even if there were to be a Saudi revolution, the probability is low that the winners would be the anti-West extreme Islamists who would embargo oil. After all, it is pro-democracy and pro-liberalization forces at work in the region today, although

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Iran taught us never to underestimate the possibility of the hijacking of a populist movement.

The more likely outcome is that oil producers, including Saudi Arabia, learned their lessons from the 1970s. The Saudi oil minister has said that OPEC wants oil priced around \$70-\$90 as a counter-weight initiative toward alternative energy sources. Oil producers know where their interest lies and it is not in oil priced over \$100. Self-interest doesn't always rule, of course — people do perverse things against it all the time — but if self-interest rules, oil producers are highly motivated to keep the price of oil under the level where serious work on alternative energy becomes the sane option. Coal, wind, solar, algae, and all the rest of it await — the silver lining of an oil shock.

A crisis doesn't happen in a single week. It would take many weeks of prices at \$100+ to have a true economic effect. But let's be realistic — now that it has happened, do we really think panic will come to a sudden end? Panic is profitable for some key players. And in the meanwhile, watch for the oil shock to cause growth estimates to be revised sharply downward and talk of double-dip recession to resume. This is the sense in which the oil market "fails" — it indulges in extreme pricing regardless of supply and demand facts, and has a lasting feedback effect in the real economy. To take just one thread, if U.S. consumers lose \$1 billion of discretionary purchasing power because of higher energy costs, the biggest effect is on Japanese and Chinese exporters. This is especially harmful if at the same time, the dollar falls and further reduces purchasing power, and if a double dip in housing prices reduces home-owner net worth and perception of the economic outlook.

The bigger effect

Sheer repetition of a premise — that commodity price shocks cause inflation and necessitate rate hikes — is like propaganda: say it enough times and everyone believes it. If this is what people believe, including forex traders, that's how we should position trades. George Soros is no doubt patting himself on the back — this is a perfect case of reflexivity, where the expectation of an event causes the very event forecast and an idea based on an assumption gets converted to reality. If you expect inflation because your central bank is insufficiently vigilant, inflation is what you get, even if it wasn't there to begin with.

Trends arise and persist because traders interpret prices as containing the embedded net sentiment of all the traders in the security. When sentiment is unfavorable — even when based on a questionable theory — the price will fall.

And since we all look at charts, a declining price is "proof" that the ruling assumption is at work, and who cares if it's "true"? It would be foolhardy to trade on facts when everyone else is trading on an assumption, false or not.

This is another kind of market failure, and it may arise from the absence of supply constraint. Demand for something can always be met at some price and right away, unlike the market for high-end cars, caviar, or socks, which take longer to ramp up supply. The price of regular goods and services ping-pong around in narrow ranges as higher prices elicit new supply and lower prices shove some producers out the door. In financial markets, most supply can be created out of thin air.

In May 2008, an impressive hedge-fund manager named Michael Masters testified at a Homeland Security hearing that there were more contracts for barrels of oil being traded on the New York Mercantile Exchange than there were in existence at the delivery depot in Cushing, Okla. Masters blamed the high ratio of speculators to actual oil companies that would want to take delivery at Cushing. Likewise, in the foreign exchange market, only a tiny fraction of all trades ever go to actual delivery in the checking accounts of the players.

The absence of a supply constraint in financial markets dooms prices to extremes when the right kind of catalyst comes along, in this case turmoil in North Africa and the Middle East.

Can it be halted? Maybe. The secret lies in flooding the new demand with so much supply that bulls take horrendous losses. Leaders in oil-producing countries can depart, as they did in Tunisia and Egypt. The Saudis can open the spigots wide. Hoarders can decide to make a one-time killing. Governments holding strategic oil reserves can decide to intervene, although nobody seems to have the stomach for intervening in forex, let alone oil. The least likely solution would be a sudden, unforeseen rate hike by the Fed that would shock speculators (and reduce demand through financing costs). The most likely outcome is an oil price rally to the point where economic growth stumbles and everyone wakes up to a new recession in which demand falls off the cliff to the point where oil bulls are getting hit over the head with it. Recognition of the 2008 recession is what caused oil to fall last time, and it was as much an overshoot as the earlier rise.

Until these corrective events take place, we're stuck with the new conventional wisdom that the dollar is toast. It's not right, but you can't trade against it. At the same time, keep your eyes peeled for a supply surprise. ☐

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Keltner Channel volatility breakouts

Keltner Channels provide an alternative basis for a volatility breakout system.

BY DANIEL FERNANDEZ

Volatility breakout systems are momentum strategies that go long or short when price makes a forceful move up or down, the idea being that the market is likely to continue for at least a while in the direction of the breakout. The techniques used to define such forceful momentum moves are varied. “FX Bollinger bandit” (*Currency Trader*, February 2011) explored a breakout technique based on [Bollinger Bands](#). The strategy’s overall success led to the idea of experimenting with related tools to develop similar strategies.

The following strategy uses a [Keltner Channel](#)-based breakout technique to determine if this indicator, which is similar to Bollinger Bands, is better or worse at capturing trends on the daily time frame.

Keltner Channels

Chester W. Keltner created the channels named after him in the late 1950s. The indicator originally consisted of a [simple moving average](#) (SMA) of each bar’s “typical price” ($\text{high} + \text{low} + \text{close} / 3$), with the upper and lower channel lines set at fixed distances above and below the SMA.

However, the indicator has been modified significantly over the past 40 years, with the most common application setting the channel lines a multiple of the [average true range](#) (ATR) above and below the central moving average. The indicator has several modifiable parameters: the central moving average length, moving average type (e.g., sometimes an [exponential moving average](#) is used instead of an SMA), ATR length, and the ATR multiple.

Keltner Channels have been typically used as a trend-following tool: a breakout of the upper or lower channel lines implies strong momentum in that direction. For example, if price pushes above the upper channel line that is two times the 14-day ATR above a 50-day SMA of the typical price, it means the market has moved at least twice the average daily volatility of the past 14 days above the “consensus” price of the past 50 days. The longer the moving average used for the central line, the longer the trend the Keltner Channels reflect. A smaller ATR multiple causes the channel to be broken more easily, since less movement is needed to push price outside the channel.

The following system enters trades using Keltner Channels in a “classic” trend-following fashion — using a very long-term indicator length — and adds a volatility adjusted stop-loss and alternate exit rule.

Keltner Channel breakout system

The strategy enters trades when price breaks out above or below the upper or lower channel lines, and exits when price penetrates (in the opposite direction) a separate 175-day SMA “exit” moving average.

The Keltner Channel settings are:

1. Central indicator line: 250-day SMA of the typical price.
2. ATR length: 10 days.
3. ATR multiple: 2.5.

TABLE 1: PERFORMANCE BREAKDOWN

	USD/CAD	GBP/USD	NZD/USD	EUR/USD	AUD/USD	USD/JPY	USD/CHF	Portfolio
Avg. yearly profit (AYP)	4.75%	4.40%	5.58%	5.13%	4.32%	0.83%	0.79%	30.49%
Max. drawdown	8.65%	9.91%	14.26%	13.39%	17.40%	11.58%	17.98%	46.06%
AYP/max drawdown ratio	0.55	0.44	0.39	0.38	0.25	0.07	0.04	0.66
Avg win/avg. loss	4.32	5.49	6.32	4.51	4.58	3.79	4.87	5.39
Win %	38%	26%	24%	32%	28%	24%	19%	26%
Profit factor	2.64	1.98	1.93	2.09	1.76	1.19	1.15	1.95
No. of trades	29	34	47	41	36	42	42	271
Ulcer Index	3.71	4.32	8.72	6.85	9.73	6.58	8.94	18.5
Trade cost (pips)	4	3.5	8	2	3.5	2.5	3.5	-

Currency pairs that produced extended trends, such as USD/CAD, GBP/USD, and NZD/USD performed best, while choppier pairs, such as USD/JPY and USD/CHF, performed worst.

The strategy trade rules are:

1. Go long if yesterday's close is above the upper Keltner Channel band and price is above the 175-day SMA.
2. Go short if yesterday's close is below the lower Keltner Channel band and price is below the 175-day SMA.
3. Exit long if yesterday's close is below the 175-day SMA.
4. Cover short if yesterday's close is above the 175-day SMA.
5. Place a stop-loss order two times the 14-day ATR below the entry price (for long trades) or above the entry price (for short trades).

Trade size is determined by the following equation:

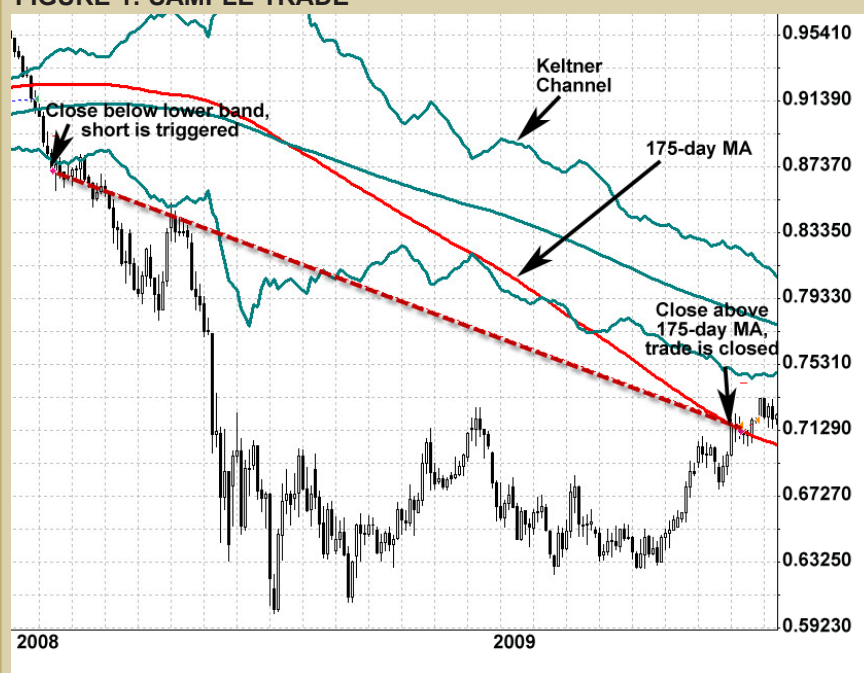
$$\text{Trade size} = (0.01 * \text{account balance in } \$\text{US}) / (\text{contract size} * 14\text{-ATR})$$

The same parameter values will be used for all currency pairs in the back-test.

Figure 1 shows a sample trade in the Australian dollar/U.S. dollar pair (AUD/USD). A short trade is entered when price breaks down below the lower Keltner Channel line and is exited more than six months later when price closes above the 175-day SMA. The posi-

tion was triggered at .8712 (when the 14-day ATR was 0.0104), with a stop-loss set at .8920 (.8712 - 2*0.0104). If the account size at the time of the trade was \$100,000 and the contract size per standard lot was \$100,000, the trade size would be 0.96 lots (\$96,000).

The strategy was tested on daily price data from June 6, 2000 to Jan. 1, 2011 (10.5 years) in the following seven currency pairs: Euro/U.S. dollar (EUR/USD), British pound/

FIGURE 1: SAMPLE TRADE


The system captures longer-term trends. A short trade was triggered when price pushed below the lower Keltner Channel line. The exit occurred six months later when price closed above the 175-day SMA.



U.S. dollar (GBP/USD), U.S. dollar/Japanese yen (USD/JPY), Australian dollar/U.S. dollar (AUD/USD), U.S. dollar/Canadian dollar (USD/CAD) and New Zealand dollar/U.S. dollar (NZD/USD). Trade costs were set in terms of the bid-ask spreads of the various pairs, and are shown at the end of Table 1. The strategy was tested on the MetaTrader 4 platform.

Test results

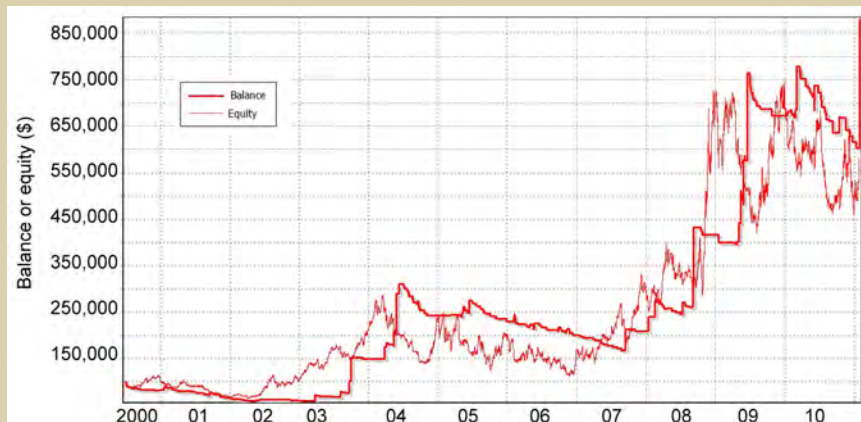
The system was net profitable on all the portfolio compo-

nents; Table 1 breaks down the performance statistics for each pair. The best-performing pairs (in terms of the ratio of average yearly profit to maximum drawdown, shown in the third row) were the USD/CAD, GBP/USD, and NZD/USD, while the EUR/USD — which is typically the best pair for this type of system — performed slightly worse. The strategy had its worst results on the USD/JPY and USD/CHF pairs, both of which were in drawdowns for a good portion of the past decade and recovered only in the last few months of the test. Figure 2 shows the system's equity growth for the entire portfolio.

Overall, the strategy was great at capturing the test period's very long-term trends, such as the one that unfolded in the AUD/USD pair in Figure 3. However, it failed in pairs that tend not to produce such clear and extended moves, such as the USD/JPY (Figure 4). Just as Figure 3 shows an ideal setup for the system, Figure 4 illustrates what happens when the system is confronted with choppy conditions and suffers repeated losses: It flounders when price is predominantly range-bound and tends to oscillate between the upper and lower bands.

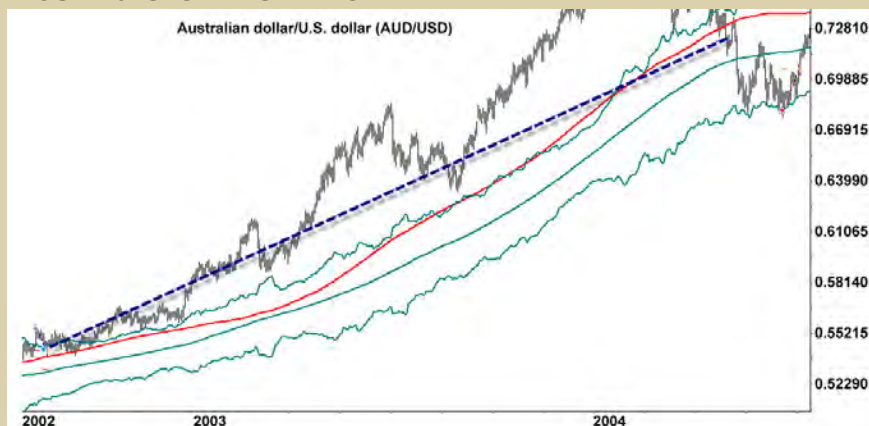
The Keltner Channel strategy is successful in that it exploits a broad market inefficiency that appears in these highly liquid currency pairs. The portfolio results indicate the system is characterized by very large, infrequent episodes of profit-taking (when successful trades are closed), which are explained by the fact that open-trade profits accumulate over long time periods. This is especially evident in Figure 5's distribution of monthly returns; dramatic profit-taking scenarios occur approximately every three to five years. Figure 2 shows the difference between account balance (reflecting closed-trade prof-

FIGURE 2: EQUITY GROWTH



The chart shows both open-trade equity ("equity," thinner line) and closed-trade profits ("balance," heavier line). Trade equity slowly accumulates, while the actual account balance increases sharply only when profitable trades are finally closed.

FIGURE 3: SYSTEM STRENGTH



The strategy effectively captured the long-term trends, such as this one in the AUD/USD pair.

its) and open-trade equity (which grows as open positions evolve): Trade equity slowly accumulates, while the actual account balance increases sharply only when profitable trades are finally closed.

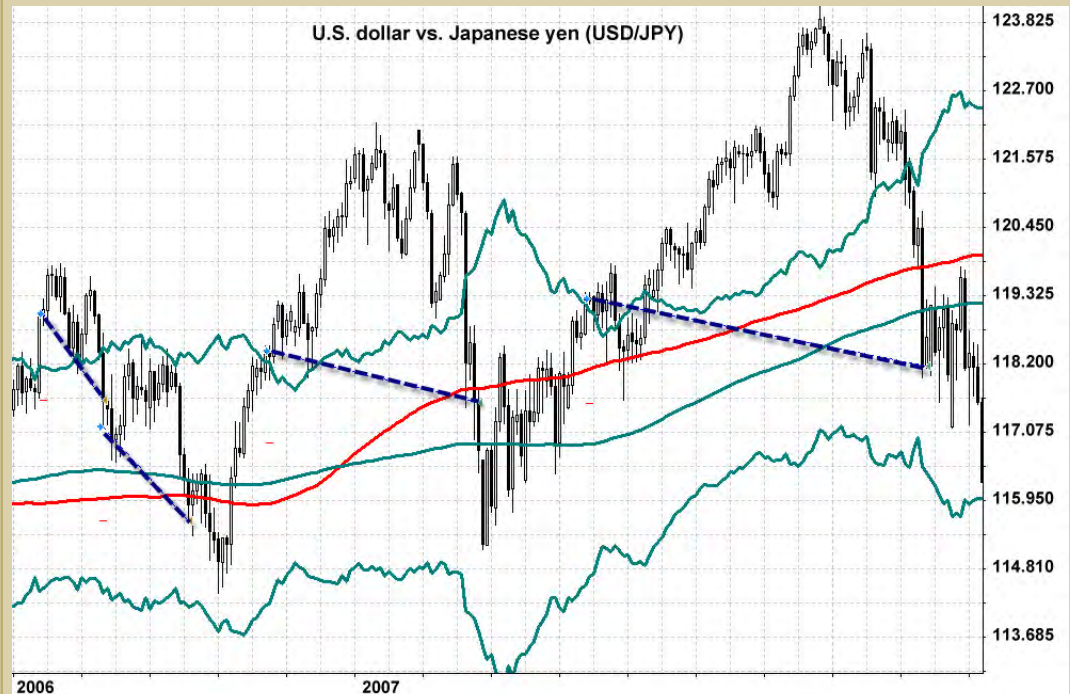
Balance and potential

Based on this test, this Keltner Channel strategy is a solid long-term trend-following approach that is likely applicable to a much larger basket of forex currency pairs, or even other markets. Developed with a single parameter set, the system is intrinsically robust.

Also, the Keltner strategy's performance results are more balanced than those of related strategies, such as the Bollinger Bandit, achieving comparable performance across the different pairs in the portfolio. Finally, certain aspects of the strategy, such as its performance during ranging market conditions, could undoubtedly be improved, and its profits might be augmented by the addition of pyramiding techniques. ☒

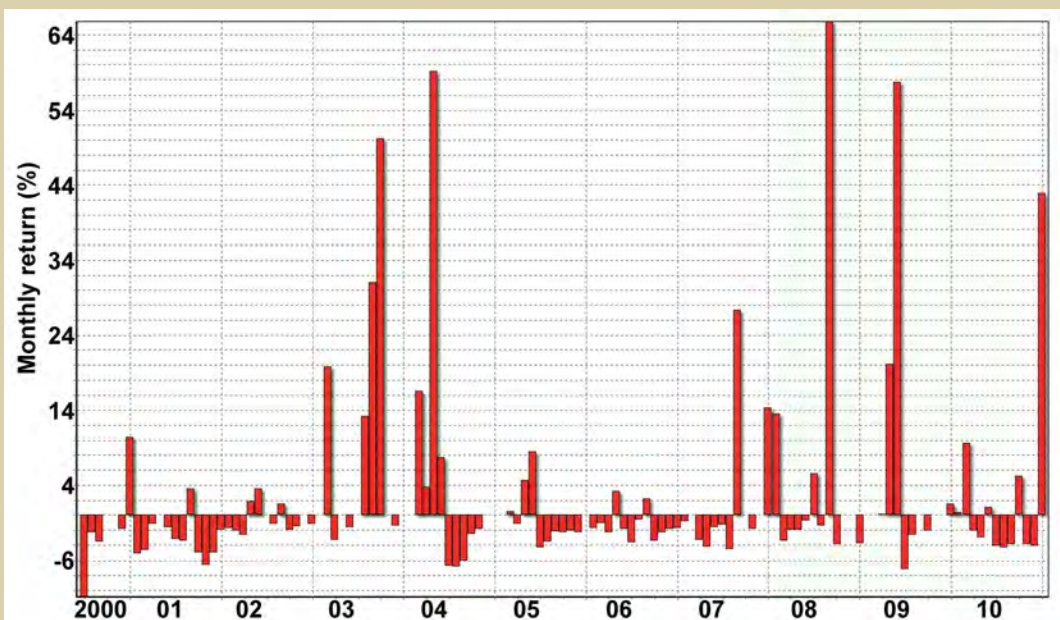
For information on the author, see p. 4.

FIGURE 4: SYSTEM WEAKNESS



The system underperformed in choppy, range-bound conditions when price tended to oscillate between the upper and lower bands.

FIGURE 5: MONTHLY RETURNS



The system offset the majority of small losing months with a minority of huge winning months.



Indonesian rupiah: River deep, bali high

The three-way case between Indonesia, Australia, and the U.S. is a perfect illustration of how countries that try to devalue their way to prosperity end up financing other countries via carry trades.

BY HOWARD L. SIMONS

Indonesia is at once fascinating and easily ignored. The archipelago has 17,000 islands — go ahead, name them — three of which (Borneo, New Guinea, and Sumatra) are among the 10 largest islands in the world. It is the world's fourth most populous country and the largest Muslim nation. The island arc, formed by the movement of the Indo-Australian plate northward into the Eurasian landmass, has produced some of the largest and deadliest volcanoes such as Krakatau, Tambora, and Toba; the latter's explosion nearly 75,000 years ago is thought by some to have reduced the humanoid population of the time to as few as 5,000-10,000 individuals. We all remember the catastrophic Sumatran earthquake and tsunami of 2004. It is a strange bargain with Mother Nature: The volcanic ash combines with Indonesia's tropical climate to allow for triple-cropping and the ability to support such a large population.

Indonesia is remembered for human catastrophes as well, such as the longtime strongman rule of President

Suharto and a culture of corruption that made Indonesia vulnerable to the 1997-1998 Asian financial crisis. The Indonesian rupiah (IDR) went from 2,432 against the dollar at the end of June 1997 to a low of 16,000 in January 1998. Just like earthquakes, financial shocks often have aftershocks for years. In the IDR case, the currency suffered significantly during the first half of 2001 and during the late 2008-early 2009 financial panic.

However, Indonesia managed to recover, clean up its politics (to a degree), and get on with its affairs. Let's take a look at how the IDR has fared not only against the dollar but against the currency of its neighbor and major trading partner, Australia (AUD).

Thinking about the thinkable

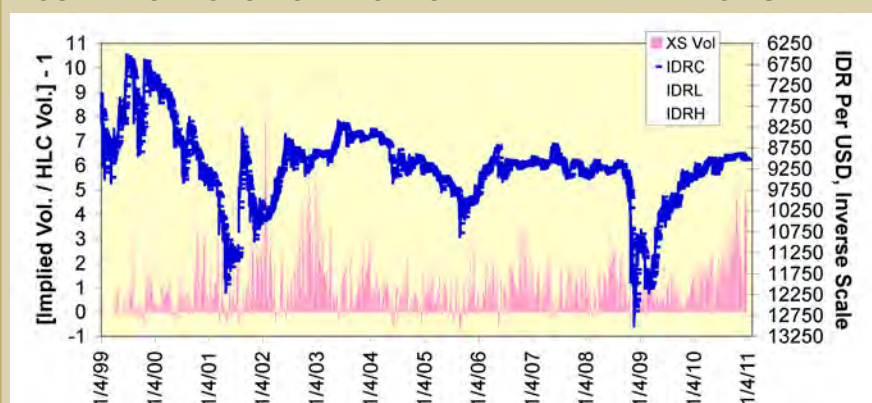
The various crises faced by the IDR since 1997 have led to the same asymmetry of risk seen in many emerging-market currencies. The underlying fear is the currency can weaken catastrophically without a balancing risk of

strengthening catastrophically; this asymmetric risk forces Indonesian interest rates to remain higher than they would be otherwise.

Mapping the IDR against its excess volatility (defined as the ratio of the implied volatility of three-month forwards to high-low-close volatility, minus 1.00) shows how the options market remains in a permanent state of "buying protection" against a declining rupiah (Figure 1). Indeed, excess volatility only declines toward or below zero when the rupiah is confirming traders' fears and falling. This is a case of mass neurosis as well as a currency market.

However, there is no comparable options market for IDR forwards for

FIGURE 1: OPTIONS MORE COMFORTABLE WITH FALLING RUPIAH



Comparing the rupiah to its excess volatility shows how the options market remains in a permanent state of buying protection against a declining IDR.

AUD holders. This is unfortunate, as the history of the cross-rate is substantially different. The IDR has been in a steady long-term downtrend against the AUD since mid-2002, punctuated by a massive retracement during the 2008-2009 financial crisis (Figure 2). We might expect far lower levels of excess volatility for these forwards, but we cannot say for sure this is the case.

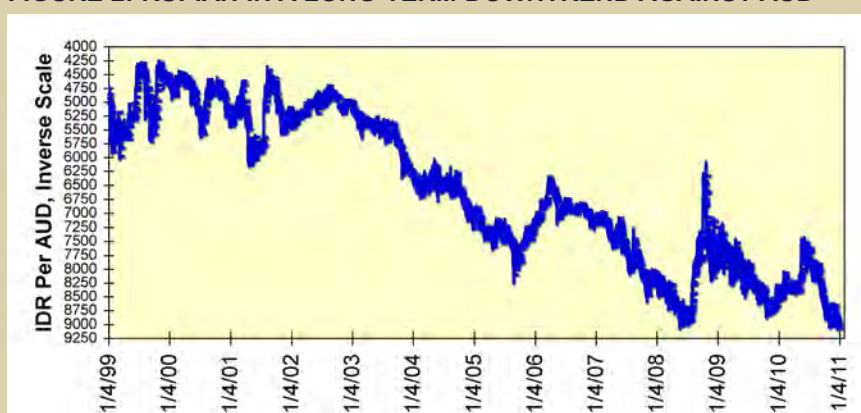
Interest-rate differentials

Another common attribute of minor currencies is they lack the raw materials for us to construct forward-rate ratios (FRRs) between six- and nine-month deposits. These FRRs, which are the rate at which we can lock in borrowing for three months starting six months from now divided by the nine-month rate itself, can be subtracted from one another to derive relative interest-rate expectations.

However, the exchange rate for minor currencies often follows, at least weakly, the contemporaneous spread between three-month deposits. This has been the case for the IDR's rate against the USD (Figure 3).

Interestingly, the cross-rate between the IDR and the AUD is not at all a function of their relative three-month interest rates (Figure 4). Indonesian rates have been consistently higher than Australian rates, but the trend, as noted above, has been for a steadily weaker IDR.

FIGURE 2: RUPIAH IN A LONG-TERM DOWNTREND AGAINST AUD



The rupiah has been in a steady downtrend vs. the AUD since mid-2002, punctuated by a huge retracement during the 2008-2009 financial crisis.

Deformations in the yield curve at note and bond horizons often provide us with clues as to whether a country is trying to bribe foreign investors into holding funds there via excessively high interest rates. This has not been the case at all for Indonesia, at least since the March 2009 global financial market low (Figure 5). The Indonesian government debt's yield curve had been stable to the point of being dull between March 2009 and hints of the restarting of [quantitative easing](#) in the U.S. in September 2010. That led to an abrupt steepening of the Indonesian yield curve, first bullishly and then bearishly. Its modestly positive slope stands as evidence Indonesia is not trying to pull funds into the country via high, and by definition unstable, short-term rates or yield curve inversions.

A tale of two carries

Currency rates often follow relative asset returns. As

emerging markets in general have outperformed (and by wide margins in many cases) so-called senior or developed markets for the past decade, we should expect the exchange rates to follow asset flows. This has been the case for the comparative total returns of the Indonesian and American stock markets. The relative performance of Indonesian stocks and the carry trade return for borrowing USD and lending IDR have been rising parallel to one another

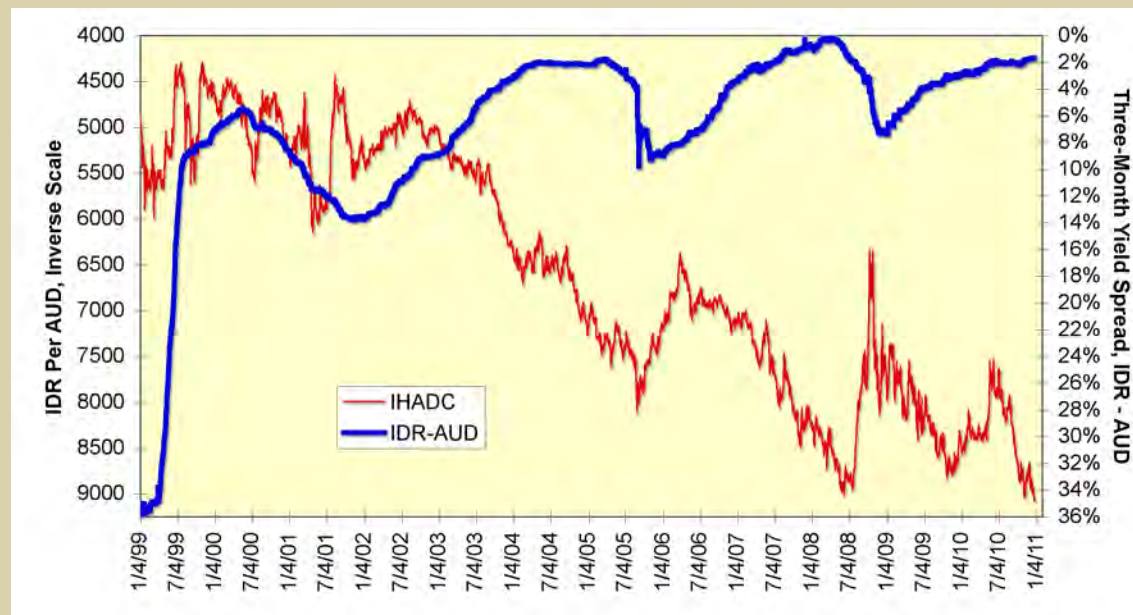
FIGURE 3: RUPIAH A WEAK FUNCTION OF SHORT-TERM RATE SPREAD TO USD



As is often the case with minor currencies, IDR's exchange rate against the USD follows the contemporaneous spread between three-month deposits.



FIGURE 4: RUPIAH NOT A FUNCTION OF SHORT-TERM RATE SPREAD TO AUD



Indonesian rates have been consistently higher than Australian rates, but the trend has been for a steadily weaker IDR.

(Figure 6). Global investors had been content to swap dollars into rupiah to invest in Indonesian equities through October 2010, at which point some of the enthusiasm started to wane as fears of an emerging-market bubble arose.

The case for Indonesia and Australia is a little differ-

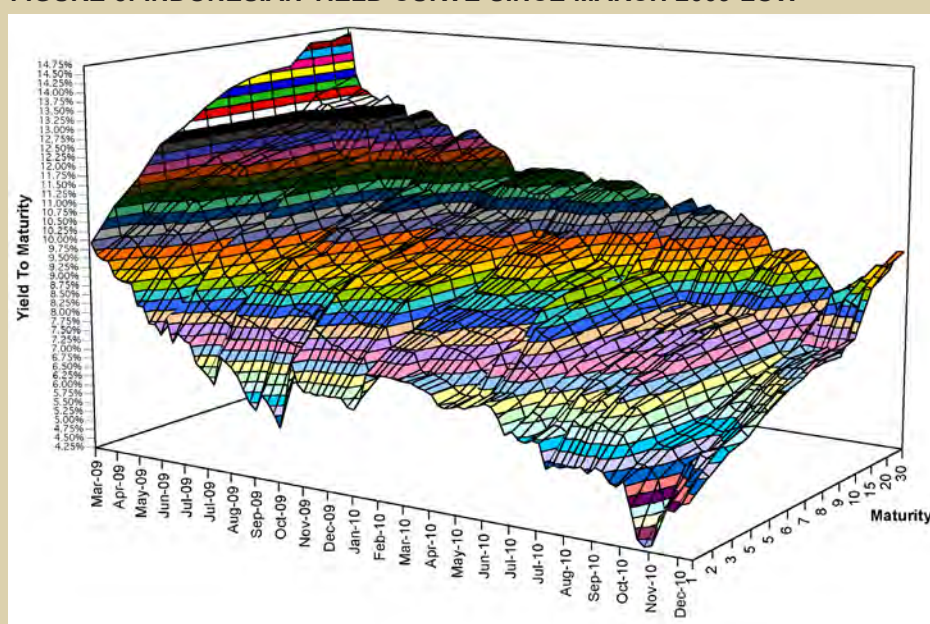
ent (Figure 7). The relative performance of the Indonesian market to the Australian market (both expressed in USD terms) has not been as strong because Australia has been one of the chief beneficiaries of the Asian economic boom and the China growth story. While the general trends

remain parallel over the long-term, they can and do oscillate in the short-term. Australian investors in Indonesian stocks have to endure the steady downtrend in the currency and require compensation from the interest-rate differential. When Indonesian rates rise sufficiently in relation to Australian rates, the carry trade re-opens and the two markets resume rising in parallel.

Previous articles including "Currencies and relative stock market performance" (*Currency Trader*, March 2008) and "No man is an island, but the UK is" (*Currency Trader*, August 2010) have described how countries such as Japan, the UK, and the U.S. that try to devalue their way to prosperity simply finance others well-being via carry trades.

The three-way case between Indonesia, Australia, and the

FIGURE 5: INDONESIA YIELD CURVE SINCE MARCH 2009 LOW



The yield curve's modestly positive slope is evidence Indonesia is not trying to pull funds into the country via artificially high (and thus unstable) short-term rates or yield-curve inversions.

FIGURE 6: CARRY INTO RUPIAH RISING PARALLEL TO RELATIVE STOCK PERFORMANCE



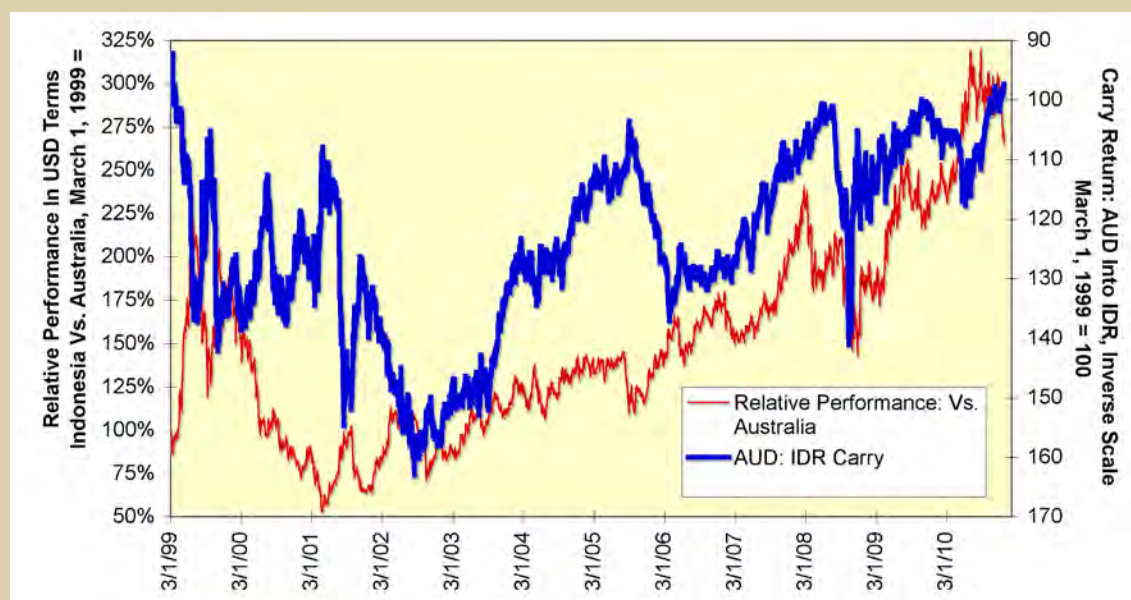
Indonesian stocks have been rising parallel to the carry trade return for borrowing USD and lending IDR. Investors had been content to swap dollars into rupiah to invest in Indonesian equities through October 2010, when some of the enthusiasm started to wane as fears increased of an emerging-market bubble.

U.S. illustrates this perfectly. If you want to chase emerging-market performance with the USD, you generally pay no penalty for borrowing it. If you want to chase emerging-market performance with the AUD, you pay a penalty. This open-ended

invitation to borrow and sell the U.S. dollar is not how the world's reserve currency should be managed. ☒

For information on the author, see p. 4.

FIGURE 7: AUD CARRY INTO RUPIAH AND RELATIVE STOCK PERFORMANCE



The relative performance of the Indonesian market to the Australian market has not been as strong as the Indonesia-U.S. relationship shown in Figure 6 because Australia has been one of the chief beneficiaries of the Asian economic boom. Australian investors in Indonesian stocks must endure the rupiah's steady downtrend and require compensation from the interest-rate differential.



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.

March 2011

27	28	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	31	1	2

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

March

1	U.S.: ISM manufacturing report Canada: Bank of Canada interest-rate announcement Germany: January employment report Japan: January employment report
2	U.S.: Fed beige book Australia: Q4 GDP Canada: January PPI
3	Brazil: Q4 GDP ECB: Governing council interest-rate announcement France: Q4 employment report
4	U.S.: February employment report Brazil: February CPI and PPI UK: February PPI LTD: March forex options; March U.S. dollar index options (ICE)
5	
6	
7	
8	
9	Mexico: February PPI and Feb. 28 CPI
10	U.S.: January trade balance Australia: February employment report Japan: February PPI UK: Bank of England interest-rate announcement
11	U.S.: February retail sales Canada: February employment report Germany: February CPI Hong Kong: Q4 PPI
12	
13	
14	India: February PPI LTD: March forex futures; March U.S. dollar index futures (ICE)
15	U.S.: FOMC interest-rate announcement France: February CPI Japan: Bank of Japan interest-rate announcement
16	U.S.: February PPI and housing starts UK: Q4 employment report FDD: March forex futures; March U.S. dollar index futures (ICE)
17	U.S.: February CPI and leading indicators Hong Kong: Dec.-Feb. employment report

18	Canada: February CPI Germany: February PPI
19	
20	
21	Hong Kong: Q4 GDP
22	Hong Kong: February CPI UK: February CPI
23	South Africa: February CPI
24	U.S.: February durable goods Brazil: February employment report Mexico: February employment report and March 15 CPI
25	U.S.: Q4 GDP (third estimate) France: Q4 GDP Japan: February CPI
26	
27	
28	U.S.: February personal income
29	Japan: February employment report UK: Q4 GDP
30	Canada: February PPI
31	France: February PPI Germany: February employment report India: February CPI South Africa: February PPI

April 2011

1	U.S.: March employment report and ISM manufacturing index
2	
3	
4	
5	
6	
7	Australia: March employment report Brazil: March CPI and PPI ECB: Governing council interest-rate announcement Japan: Bank of Japan interest-rate announcement Mexico: March PPI and March 31 CPI UK: Bank of England interest-rate announcement
8	Canada: March employment report UK: March PPI LTD: April forex options; April U.S. dollar index options

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Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	357.6	195.3	1.97% / 64%	1.41% / 39%	5.09% / 30%	.36 / 75%
JPY/USD	JY	CME	132.8	114.2	2.13% / 100%	0.48% / 19%	3.00% / 42%	.77 / 100%
GBP/USD	BP	CME	133.8	108.6	1.55% / 94%	2.55% / 45%	4.18% / 83%	.29 / 17%
AUD/USD	AD	CME	97.4	121.3	1.91% / 79%	2.91% / 88%	5.20% / 39%	.59 / 100%
CAD/USD	CD	CME	77.4	126.1	1.71% / 94%	3.05% / 100%	4.59% / 98%	.47 / 87%
CHF/USD	SF	CME	49.6	44.0	4.85% / 100%	1.40% / 36%	8.05% / 69%	.87 / 97%
MXN/USD	MP	CME	28.1	144.2	-0.51% / 64%	0.92% / 30%	2.36% / 43%	.30 / 72%
U.S. dollar index	DX	ICE	21.2	39.2	-2.28% / 93%	-1.21% / 35%	-3.13% / 25%	.37 / 78%
NZD/USD	NE	CME	7.5	27.3	-0.79% / 9%	-2.39% / 39%	0.37% / 5%	.41 / 62%
E-Mini EUR/USD	ZE	CME	6.5	5.5	1.97% / 64%	1.41% / 39%	5.09% / 30%	.36 / 75%

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.

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).

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: Top 10 currency traders managing more than \$10 million (as of Jan. 31 ranked by January 2010 return)

	Trading advisor	January return	2011 YTD return	\$ Under mgmt. (millions)
1.	First Quadrant (Managed Currency)	9.79%	9.79%	\$510.0
2.	Harmonic Capital (Gl. Currency)	4.32%	4.32%	N/A
3.	Metro Forex Inc	4.23%	4.23%	\$101.5
4.	24FX Management Ltd	3.90%	3.90%	\$50.4
5.	ACT Currency Partners (PAMFX)	2.98%	2.98%	\$15.6
6.	IKOS FX Fund	2.91%	2.91%	\$1,238.7
7.	Silva Capital Mgmt (Cap. Partners)	2.62%	2.62%	\$18.9
8.	Excalibur Absolute Return Fund	2.25%	2.25%	\$49.5
9.	ACT Currency Partner AG	1.93%	1.93%	\$20.0
10.	Bedford Investment Group (Currency)	1.78%	1.78%	\$39.0

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

1.	D2W Capital Mgmt (Radical Wealth)	20.60%	20.60%	\$1.8
2.	Iron Fortress FX Mgmt	3.24%	3.24%	\$1.2
3.	SuisseCap MA (Everest Strategy)	2.07%	2.07%	\$4.1
4.	Norman Conquests Trust	1.98%	1.98%	\$1.1
5.	Basu and Braun (Everest)	1.82%	1.82%	\$1.8
6.	ForexAtom	1.52%	1.52%	\$3.4
7.	Overlay Asset Mgmt. (Emerging Mkts)	1.28%	1.28%	\$8.0
8.	Aurapoint Asset Mgmt (QV)	0.61%	0.61%	\$2.3
9.	M2 Global Mgmt (2.5X)	0.06%	0.06%	\$2.4
10.	Marek D. Chelkowski (Forex)	0.05%	0.05%	\$1.8

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.

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CURRENCIES (vs. U.S. DOLLAR)

Rank	Currency	Feb. 25 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	Swiss franc	1.077545	3.06%	7.25%	11.79%	1.0786	0.8593	3
2	Swedish krona	0.15626	2.96%	8.78%	16.40%	0.1564	0.1236	7
3	Russian ruble	0.03443	2.78%	7.80%	6.07%	0.0345	0.0309	5
4	Australian Dollar	1.00619	1.47%	2.78%	13.70%	1.0227	0.8149	4
5	Great Britain pound	1.618805	1.34%	2.49%	4.95%	1.625	1.4334	17
6	Euro	1.37729	1.22%	3.01%	8.91%	1.418	1.1942	16
7	Indian rupee	0.02193	1.01%	0.64%	2.79%	0.0227	0.021	11
8	Canadian dollar	1.014465	0.90%	3.21%	7.46%	1.0188	0.9285	9
9	Japanese yen	0.012195	0.83%	1.54%	2.87%	0.0124	0.0106	8
10	Thai baht	0.032645	0.71%	-1.88%	2.98%	0.0338	0.0298	14
11	Singapore dollar	0.78251	0.39%	2.55%	6.55%	0.7858	0.7051	10
12	Brazilian real	0.59955	0.29%	3.54%	6.01%	0.6033	0.5257	6
13	Chinese yuan	0.15208	0.11%	1.19%	3.38%	0.1523	0.1461	13
14	Hong Kong dollar	0.128285	0.00%	-0.47%	-0.24%	0.129	0.1281	15
15	South African rand	0.140985	-0.63%	-0.02%	4.06%	0.1509	0.1257	1
16	New Zealand dollar	0.747035	-1.72%	-1.90%	6.11%	0.7951	0.6626	2
17	Taiwan dollar	0.03355	-2.51%	2.15%	7.64%	0.0347	0.0307	12



GLOBAL STOCK INDICES

	Country	Index	Feb. 25	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Canada	S&P/TSX composite	14,052.13	5.98%	8.55%	20.64%	14,160.70	11,065.50	8
2	U.S.	S&P 500	1,319.88	2.22%	10.97%	25.07%	1,344.07	1,010.91	3
3	Italy	FTSE MIB	22,349.71	1.87%	12.05%	14.82%	23,593.10	18,044.50	4
4	Germany	Xetra Dax	7,185.17	1.79%	4.44%	21.79%	7,441.82	5,518.27	6
5	UK	FTSE 100	6,001.20	1.41%	5.30%	17.45%	6,105.80	4,790.00	1
6	France	CAC 40	4,070.38	1.26%	8.24%	17.98%	4,169.87	3,287.57	2
7	South Africa	FTSE/JSE All Share	31,965.59	0.98%	2.13%	20.76%	33,094.06	26,019.71	5
8	Japan	Nikkei 225	10,526.76	0.60%	4.43%	19.01%	11,408.20	8,796.45	12
9	Australia	All ordinaries	4,924.90	0.32%	5.16%	13.04%	5,048.60	4,194.40	10
10	Switzerland	Swiss Market	6,537.20	-0.65%	0.54%	7.19%	6,990.70	5,935.00	11
11	Mexico	IPC	36,880.20	-1.58%	-0.24%	17.25%	36,880.20	30,074.10	9
12	Brazil	Bovespa	66,903.00	-2.63%	-3.55%	3.24%	73,103.00	57,634.00	14
13	Hong Kong	Hang Seng	23,012.37	-3.26%	-0.18%	11.52%	24,988.60	18,971.50	15
14	Singapore	Straits Times	3,025.16	-4.90%	-4.24%	3.37%	3,313.61	2,648.15	13
15	India	BSE 30	17,700.91	-6.69%	-8.37%	-2.63%	21,108.60	15,960.20	7

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	Feb. 25	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Aussie \$ / New Zeal \$	AUD/NZD	1.34686	3.24%	4.76%	7.15%	1.3498	1.2174	1
2	Franc / Yen	CHF/JPY	88.365	2.21%	5.61%	8.68%	89.06	77.2	3
3	Franc / Canada \$	CHF/CAD	1.06218	2.14%	3.91%	4.03%	1.0665	0.8972	2
4	Aussie \$ / Real	AUD/BRL	1.678245	1.17%	-0.74%	7.25%	1.7164	1.4528	6
5	Euro / Real	EUR/BRL	2.29721	0.92%	-0.51%	2.73%	2.4697	2.1366	16
6	Aussie \$ / Yen	AUD/JPY	82.51	0.63%	1.20%	10.52%	87.46	73.15	5
7	Canada \$ / Real	CAD/BRL	1.69205	0.61%	-0.32%	1.36%	1.7726	1.589	11
8	Aussie \$ / Canada \$	AUD/CAD	0.99184	0.56%	-0.42%	5.81%	1.0198	0.8636	4
9	Yen / Real	JPY/BRL	0.02034	0.54%	-1.93%	-2.96%	0.0211	0.0179	9
10	Pound / Yen	GBP/JPY	132.75	0.51%	0.92%	2.02%	145.35	126.1	17
11	Pound / Canada \$	GBP/CAD	1.59572	0.44%	-0.70%	-2.34%	1.6412	1.4885	15
12	Euro / Yen	EUR/JPY	112.94	0.38%	1.43%	5.86%	127.65	106.43	14
13	Euro / Canada \$	EUR/CAD	1.35765	0.31%	-0.20%	1.35%	1.4366	1.2493	13
14	Canada \$ / Yen	CAD/JPY	83.19	0.07%	1.63%	4.46%	94.13	78.75	8
15	Pound / Aussie \$	GBP/AUD	1.608845	-0.12%	-0.28%	-7.70%	1.8042	1.521	19
16	Euro / Pound	EUR/GBP	0.850815	-0.13%	0.51%	3.77%	0.9108	0.8098	7
17	Euro / Aussie \$	EUR/AUD	1.36883	-0.25%	-4.21%	-4.21%	1.524	1.2947	18
18	Aussie \$ / Franc	AUD/CHF	0.93378	-1.54%	-4.17%	1.71%	1.0073	0.8931	10
19	Pound / Franc	GBP/CHF	1.502305	-1.66%	-4.44%	-6.12%	1.6956	1.4498	21
20	Euro / Franc	EUR/CHF	1.27814	-1.79%	-3.95%	-2.58%	1.4634	1.2458	20
21	New Zeal \$ / Yen	NZD/JPY	61.265	-2.52%	-3.39%	3.16%	68.81	58.85	12

GLOBAL CENTRAL BANK LENDING RATES

Country	Interest Rate	Rate	Last change	Aug. 2010	Feb. 2010
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	2.75	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	Q4	2/28	1.7%	5.8%	5/30
EUROPE	France	Q3	11/30	0.4%	1.5%	3/25
	Germany	Q4	2/15	0.4%	4.3%	5/13
	UK	Q3	12/22	0.9%	5.2%	3/29
AFRICA	S. Africa	Q4	2/22	-3.8%	-15.9%	5/31
ASIA and S. PACIFIC	Australia	Q3	12/1	0.6%	2.8%	3/2
	Hong Kong	Q4	2/23	6.8%	8.1%	5/13
	India	Q4	2/28	13.8%	17.4%	5/31
	Japan	Q4	2/14	-0.6%	-2.5%	5/19
	Singapore	Q4	2/25	0.5%	12.0%	5/27

Unemployment		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS	Argentina	Q4	2/22	7.3%	-0.2%	-1.1%	5/20
	Brazil	Jan.	2/24	6.1%	0.8%	-1.1%	3/24
	Canada	Jan.	2/4	7.8%	0.2%	-0.5%	3/11
EUROPE	France	Q3	12/2	9.3%	0.0%	0.1%	3/3
	Germany	Jan.	3/1	6.5%	-0.1%	-0.8%	3/31
	UK	Oct.-Dec.	2/16	7.9%	-0.2%	0.1%	3/16
ASIA and S. PACIFIC	Australia	Jan.	2/10	5.1%	0.0%	-0.4%	3/10
	Hong Kong	Nov.-Jan	2/21	3.8%	-0.2%	-1.1%	3/17
	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	Jan.	2/11	0.7%	10.6%	3/15
	Brazil	Jan.	2/8	0.8%	6.0%	3/4
	Canada	Jan.	2/18	0.3%	2.3%	3/18
EUROPE	France	Jan.	2/23	-0.2%	1.8%	3/15
	Germany	Jan.	2/11	-0.4%	2.0%	3/11
	UK	Jan.	2/15	1.0%	4.8%	3/4
AFRICA	S. Africa	Jan.	2/16	0.4%	3.7%	3/23
ASIA and S. PACIFIC	Australia	Q4	1/25	0.4%	2.7%	4/27
	Hong Kong	Jan.	2/22	0.6%	3.6%	3/22
	India	Jan.	2/28	1.6%	9.3%	3/31
	Japan	Jan.	2/25	-0.2%	0.0%	3/25
	Singapore	Jan.	2/23	1.6%	5.5%	3/23

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Jan.	2/11	0.9%	14.1%	3/15
	Canada	Dec.	1/31	0.7%	2.9%	3/2
EUROPE	France	Jan.	2/28	0.9%	5.6%	3/31
	Germany	Jan.	2/18	1.2%	5.7%	3/18
	UK	Jan.	2/4	1.0%	4.8%	3/4
AFRICA	S. Africa	Jan.	2/24	1.1%	5.5%	3/31
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	Jan.	2/14	1.2%	8.3%	3/14
	Japan	Jan.	2/10	0.5%	1.6%	3/25
	Singapore	Jan.	2/28	1.7%	3.1%	3/29

As of March 1 LEGEND: Change: Change from previous report release. NLT: No later than. Rate: Unemployment rate.



Event: Introduction to Derivative Products

Date: March 18

Location: New York City

For more information: Go to www.soforum.com/training/introduction-to-derivative-products.800.htm

Event: Risk Management for Non-Quants

Date: March 22-23

Location: New York City

For more information: Go to www.fmwonline.com

Event: 12th Annual Technical Analysis Expo

Date: March 25-26

Location: Paris

For more information: Go to www.salonat.com

Event: London Traders Expo

Date: April 8-9

Location: Queen Elizabeth II Conference Centre

For more information: Go to www.tradersexpo.com

Event: Dallas Traders Expo

Date: June 15-18

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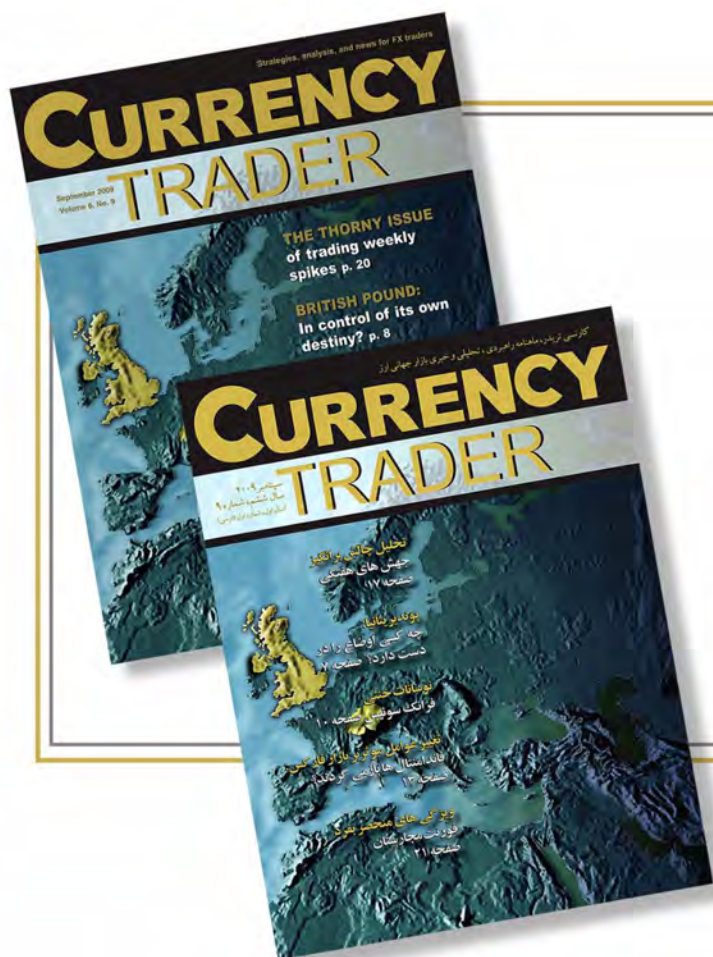
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Event: The World MoneyShow Vancouver 2011

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Longer-term congestion sets up breakout play.

TRADE

Date: Monday, Feb. 28.

Entry: Long the British pound/U.S. dollar (GBP/USD) at 1.6250.

Reason for trade/setup: The pound/dollar pair has approached the upper end of a progressively tightening congestion pattern on the weekly time frame right at the resistance of the late-2010 high (see chart inset). With renewed volatility on the horizon, the market is poised to test the 2009 highs just below 1.7000.

The pair made a strong up move early on March 28. We initially wanted to wait for an intraday pullback to the 1.6200-1.6220 range, but when the market failed to correct, pushing higher to around 1.6275, we raised the entry order to 1.6250.

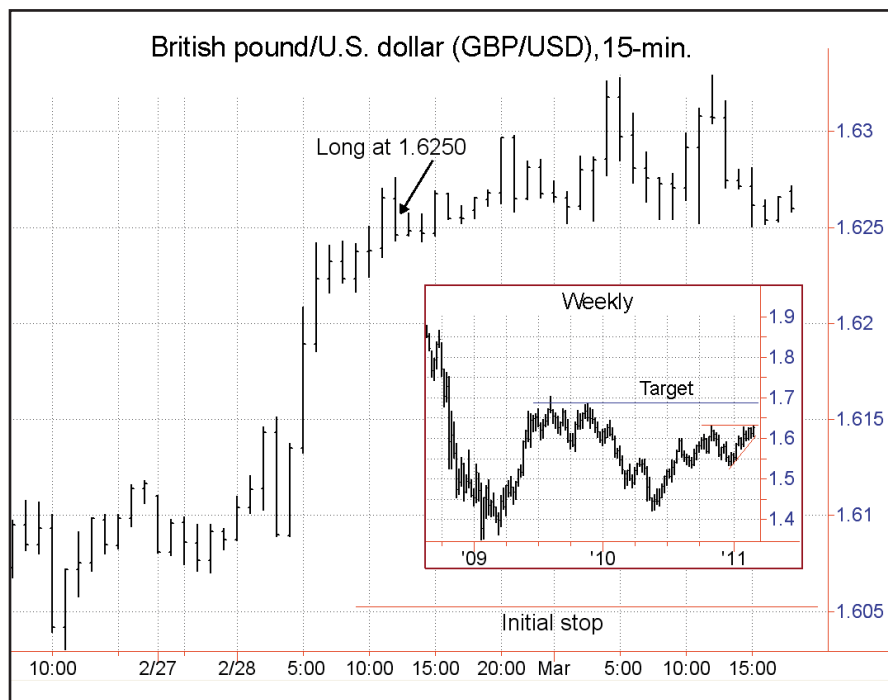
Initial stop: 1.6054, just below the low of the entry day.

Initial target: 1.6870.

RESULT

Exit: Trade still open.

Profit/loss: +0.0048, marked to market at 8:45 a.m. ET on March 2.



Source: TradeStation

Outcome: The trade's immediate gain (.0079) was wiped out when the U.S. equity market took a big hit on March 1, driving — as usual — buying in the dollar. After trading down to around 1.6210 (ironically, the middle of our initial buying zone) early on March 2, the pair rebounded somewhat. We will raise the stop to breakeven on a move above 1.6350. ☐

Go to www.currencytradermag.com after March 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	MTM	Date	P/L		LOP	LOL	Trade length
								point	%			
2/28/11	GBP/USD	1.6250	1.6207	1.687	14.42	1.6298	3/2/11	0.0048	0.30%	0.0079	-0.0036	2 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). . MTM: marked to market — the trade's open profit or loss at a given point in time.