

Strategies, analysis, and news for FX traders

CURRENCY TRADER



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China's slowing down, but it's all relative

China's super-hot economy is poised to cool off a bit, but don't look for dramatic shifts on the currency front.

BY CURRENCY TRADER STAFF

The economic powerhouse of the global economy — China — is slowing down, with a potential real estate bubble, inflation, and interest rate hikes hanging over its head. And yet by most countries' standards, China's moderating GDP growth — expected to be in the high single digits this year after 10.3 percent in 2010 — remains supercharged. And Asia ex-Japan is forecasted to be the strongest region in the world in 2011, as its ongoing modernization and development continue to power ahead.

What this means for the region and global currency market long-term has yet to play out, but for now the country remains a force to be reckoned with.

On a purchasing power parity basis, China accounted for nearly one-third of overall global growth in 2010, according to Paul Sheard, global chief economist at Nomura. That represents roughly two-and-a-half times as much as the U.S., Western Europe, and Japan combined. Chinese real GDP has grown at an average annual rate of 10.1 percent over the past 30 years.

China is the strongest country in the strongest region. Nomura forecasts non-Japan Asia to grow at an 8.1 percent pace this year, vs. a 1.8 percent pace for the Eurozone, a 4.1 percent pace for Latin America, and a 2.8 percent pace for the U.S.

Tightening conditions

One of the factors contributing to the lower growth forecasts in China is the monetary policy tightening cycle the central bank began in October 2010 to combat rising inflation.

"They have raised interest rates and clamped down on lending," says Jay Bryson, global economist at Wells Fargo. However, he adds, with China all things are relative. "Loans are still growing at a 15- to 20-percent pace year-over-year, but it's not 30 percent like it was in late 2009," he says.

The People's Bank of China (PBOC) began tinkering with its monetary policy last fall, and they have hiked lenders reserve requirements six times since November 2010. The latest move in late March increased the required reserve ratio for the country's biggest banks to a record 20 percent.

James Pressler, associate international economist at Northern Trust, explains that increasing the reserve ratio "effectively takes money out of the economy, but it doesn't change the cost of borrowing." While China has three benchmark lending rates, he says the one-year lending rate is the most important because increases in that rate raise the cost of actual borrowing. The PBOC first hiked the one-year rate in October 2010. Pressler notes that the one-

"History shows that it is often very difficult to engineer a soft landing after a rapid expansion fuels inflation. "

— Sean Callow, senior currency strategist at Westpac Institutional Bank

year lending rate “bottomed out” at 5.31 percent at the end of 2008. The PBOC kept it at that level until October 2010, when it announced a .25 basis point (bp) hike. Since then, two more hikes boosted the rate to 6.06 percent as of February.

With recent inflation numbers hovering around the 5-percent mark, economists widely expect the central bank to continue a fairly aggressive tightening policy throughout 2011.

“We believe China is in the initial stages of a prolonged monetary policy tightening cycle as inflation pressures are likely to persist ... We expect further 75 bp rate hikes and 100 bp reserve requirement ratio (RRR) hikes through to end 2011,” wrote Tomo Kinoshita in the March 18 *Global Weekly Economic Monitor* research note from Nomura.

Rising prices, along with perceptions of a possible real estate bubble, are driving the Chinese central bank to tighten monetary policy. On a year-over-year average basis, Credit Suisse economists note China’s consumer price index (CPI) fell 0.7 percent in 2009, but the final 2010 figure is estimated at 3.3 percent and the 2011 estimate is 5.3 percent.

“Inflation is a genuine problem in many economies, damaging consumer confidence, undermining export competitiveness and forcing central banks such as India’s, China’s, and Korea’s to play catch-up, after monetary policy was left loose for too long after the global crisis,” says Sean Callow, senior currency strategist at Westpac Institutional Bank. “It was telling that even as the world was focused on Japan’s damaged nuclear reactors, India raised its repo rate and China lifted its RRR for large banks to a stunning 20 percent.”

One of the major symptoms of increased inflation has been a sharp surge in food prices. Bryson notes that in February the overall CPI rate stood at 4.9 percent, while

the food component of the index was up 11 percent. Nonetheless, “the concern for Chinese policy markets is that they tighten too aggressively,” says Bryson, noting that China’s governing system makes it much easier for them to “turn their economy on a dime,” compared to the Fed. “In China monetary policy works very quickly amid the direct controls and mandates from the government,” he says

However, Callow notes: “History shows that it is often very difficult to engineer a soft landing after a rapid expansion fuels inflation. The surge in oil prices is almost as troublesome as food prices, given the high use of oil per unit of GDP in emerging markets. Korea and India are particularly vulnerable in this regard. Long-standing subsidies used to depress gasoline prices make matters worse for example, in India, Thailand and Indonesia.”

Signs of a real estate bubble

Another potential cloud on China’s horizon has been its massive residential development in recent years. Actual statistics are not readily available from the government, but anecdotal evidence suggests overbuilding has resulted in vast numbers of unoccupied residences, with reports of entire “empty cities” built on speculation.

Pressler describes the situation as one filled with incentives to build amid a low interest-rate environment. “Housing, condos, and office buildings are being built at breakneck speed, beyond what could be economically justified,” Pressler says. “It has started taking on a speculative nature.”

Unlike in the U.S., Pressler explains, “there are no real estate taxes — no carry costs” to owning real estate in China. “It is a very dangerous inflating factor,” he notes. “You can build something and wait. You are hearing stories of high-end luxury condos going for \$45 million.”

Much of this likely sounds depressingly familiar to those who have suffered in the U.S. real estate implosion.

“There is a lot of anecdotal evidence that people are buying real estate as an alternative form of savings, under the dangerous if not deadly assumption that prices will continue to go up,” Pressler says. “If there is no tax hit and the bank is only paying 3 percent in a savings account, why would I not do that? There is no disincentive.”

Pressler cites accounts of Chinese investors buying second and third properties. “It suggests there is money churning in that economy at a dramatic pace,” he says.

China has been quietly implementing some controls in an attempt to slow down the speculation, including raising the down-payment requirements for second and third mortgages. Also, a couple of cities have instituted pilot programs for residential real estate property taxes. “They know if real estate prices start to decline, what is really declining is the savings of the middle class,” Pressler says.

Why the odd numbers?

When it comes to Chinese monetary policy, even the math is steeped in a rich history of Eastern tradition. The one-year lending rate, currently at 6.06 percent, is expected to rise to 6.81 percent by year’s end. Northern Trust’s James Pressler notes the odd increments have a very logical origin.

“China used to raise and lower its rates by .27 basis points,” he says. “As Chinese markets developed, they were notorious for using abacuses. It’s a one-finger motion to click off 9 basis points. They did that for a long time. In October 2010, China announced it was ‘westernizing,’ and for the first time it increased by 0.25 basis points. It was a big breach of tradition.”



"They want to avoid a possible run on the [real estate] market as people want to go back to cash—that becomes a very scary moment."

Reading between the lines

Pressler notes the PBOC has suggested that 2011 and 2012 GDP growth will shrink to the 7 to 8 percent range.

"That for China analysts leaves an uncomfortable silence in the air," Pressler says. "That is a little scary when it was at 10.3 percent in 2010." He interprets the downsized fore-

cast to mean "they are making adjustments that are really going to affect things. It is suggesting they are going to put some things into play knowing it will slow growth. It also suggests they are taking on something risky to address this asset bubble issue."

The key question is what, exactly, is the Chinese government doing to slow the real estate bubble? "As we learned here in the U.S., you don't want to go into recession when you get this type of situation," Pressler warns. "How do they deflate the bubble without bursting it? Historically, that does not go well."

The currency

The Chinese renminbi (yuan) essentially remains on a semi-fixed peg to the U.S. dollar, despite nominal moves by the government to allow the currency to appreciate. China put any appreciation on hold during the global recession, but the renminbi began gaining some ground again in June 2010 (Figure 1). The renminbi has since appreciated by 3.7 percent, although Pressler estimates it is still roughly 15 percent undervalued.

"Beijing managed to go another year without the U.S. calling them a currency manipulator," he says.

With the currency trading around 6.56 in late March, Nomura analysts forecast additional appreciation to the 6.22 level by year-end.

"Movement on spot dollar/renminbi has been extremely slow, despite the potential support for CNY in, for example, the Obama-Hu meetings in January and rising imported inflation," Callow says. "If these haven't stoked faster yuan gains, then conservatism clearly still rules at the top policy levels in China."

Trading China

Individual traders are unable to directly trade the Chinese currency, but other proxy plays might be an option. "Many investors use the Australian dollar (AUD) as a proxy for Chinese growth," Callow says. "But the Malaysian ringgit (MYR, Figure 2) is probably the best Asian currency proxy, along with the Singapore dollar (SGD). Both have lower volatility than the South Korean won (KRW), but have ever-tighter trade links. Malaysia runs large current account surpluses, which insulates the ringgit to a degree

FIGURE 1: DOLLAR/RENMINBI (YUAN)



After being on hold during the financial crisis, the renminbi (yuan) began gaining some ground vs. the dollar again in June 2010.

FIGURE 2: MALAYSIAN RINGGIT



Some analysts consider the Malaysian ringgit the best Asian currency proxy for China, along with the Singapore dollar (SGD).



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from bouts of risk aversion."

Brian Dolan, chief currency strategist at Forex.com, agrees the Australian dollar and also the Singapore dollar are potential plays on emerging Asia. Dolan notes that the USD/SGD has been strengthening over the past several months, trading around \$1.28 recently (Figure 3). Wells Fargo analysts wrote in their March 2011 Monthly FX Express: "The risks remain clearly tilted to a stronger

Singapore dollar. Economic activity is rebounding, while inflation has accelerated sharply. Singapore's central bank will at the very least continue and possibly accelerate its policy of exchange rate appreciation at its April monetary policy announcement. Look for Singapore's currency to continue strengthening against the greenback in 2011."

Callow was also upbeat on the Singapore dollar: "SGD is appealing in its own right, with the Singapore economy growing quickly, straining spare capacity and seeing tighter policy in 2010. Those confident that China's growth will suffer no serious setback in coming months should look to long AUD, MYR and SGD positions vs. USD."

Looking at other options, Dolan did note that traders can access the Hong Kong dollar on his firm's platform, but adds that it is a "managed float. You don't see a lot of price changes in terms of trading opportunities there. It has traded in a half of a percent range year-to-date," he says.

Shifting to the "commodity currency" angle, Dolan sees the Australian dollar and also Canadian dollar as potential plays China growth views. "Chinese growth is seen to be resilient and solid and commodity currencies stand to benefit from that," he explains. "While China continues to take measures to slow its growth rate, I'd be looking to buy pullbacks in the Canadian dollar and Australian dollar. If we get more events that spark risk aversion, you may get the opportunity to buy Aussie in the 95.00-97.00 region and sell dollar/Canada in the 1.0200-1.0500 area (Figure 4). The idea being the global recovery does continue and commodity demand and Asian regional outperformance should resume after a period of moderation," he says.

However, as with any market there are always uncertainties, and according to Pressler, this year the China uncertainty revolves around real estate.

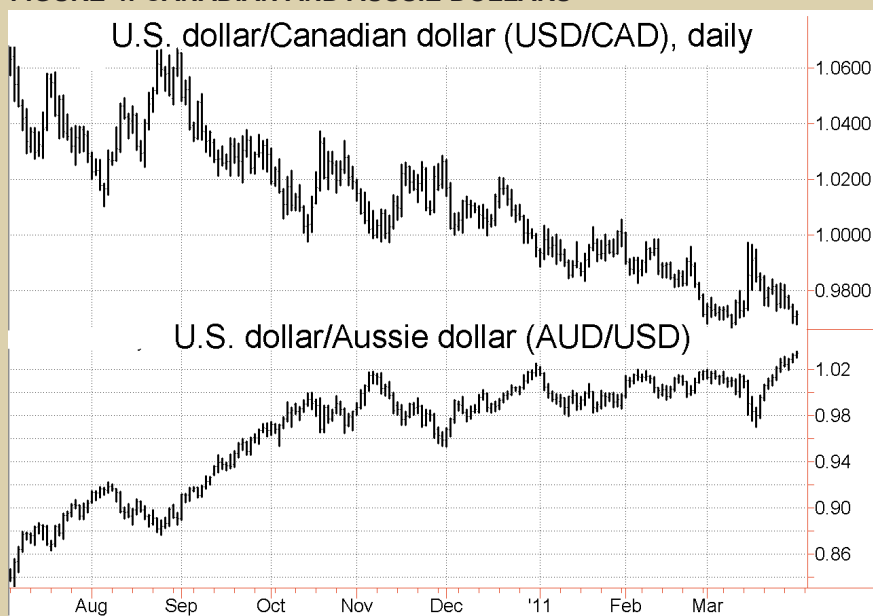
"Their economy is going to moderate for a reason," he says. "There is probably a higher element of risk involved than in years past because of the real estate market, the reforms to correct it, and what happens if it bursts." ☒

FIGURE 3: SINGAPORE DOLLAR



The USD/SGD rate has been strengthening over the past several months.

FIGURE 4: CANADIAN AND AUSSIE DOLLARS



Asian outperformance can also be played by trading pullbacks in the Canadian (top) and Aussie (bottom) dollars.

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The strange story of intervention

The big intervention on behalf of the yen isn't as unique as many market players think.

BY BARBARA ROCKEFELLER

The G7 intervention in the forex market last month was inspired by the yen's huge rise in response to the triple tragedy in Japan the week before — the earthquake and tsunami followed by the failure at the Fukushima nuclear power plant.

Intervention in the FX market is a massive but intermittent worry for traders in the major currencies. The decision

to intervene is a political one, making coordination among G7 countries a real surprise, since the G7 is unable to agree on much, let alone implement action. In fact, the March intervention was the first G7 intervention since September 2000 in support of the euro.

The FX market is unique in possessing this form of political risk, since with only a few exceptions (Japan, Hong

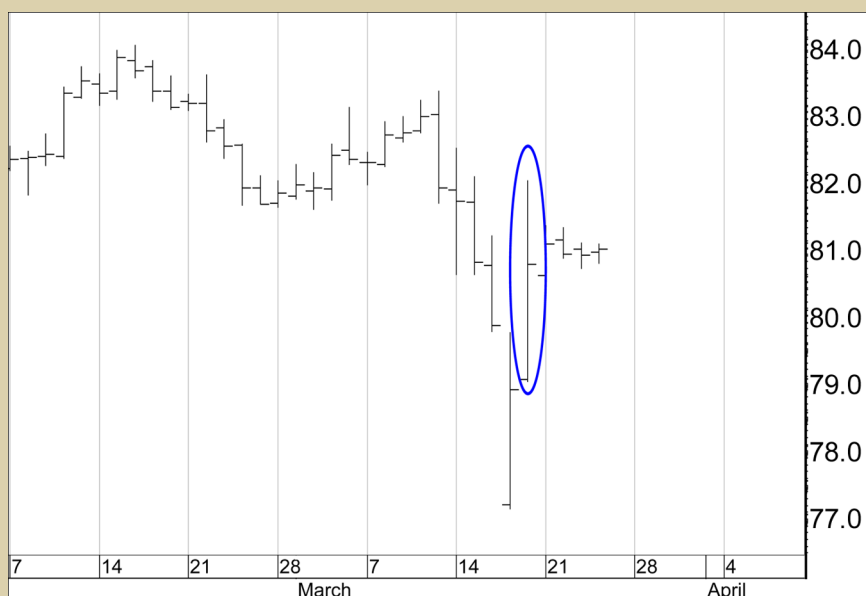
Kong), governments tend not to intervene in equity and other markets. The immediate question is whether this intervention will be followed by others. We also want to know whether it will work — i.e., end the long-standing yen appreciation — and if so, what will become of the yen [carry trade](#)?

On March 18 the G7 intervened in the FX market to the tune of about ¥2 trillion, or \$25 billion, to halt the trend of the strengthening yen. The yen had moved from 83.30 on the day of the earthquake, tsunami and Fukushima nuclear power plant crisis, to a low of 76.43 by March 17 (Figure 1). The intervention shifted the yen back to 81.99, not quite to the pre-crisis level but enough to remove panic and also instill fear of further intervention.

Intervention is not rare

People tend to think government intervention in the FX market is an exceptional event, but in practice, it has a very long history and is more common than we might think. Intervention by big coun-

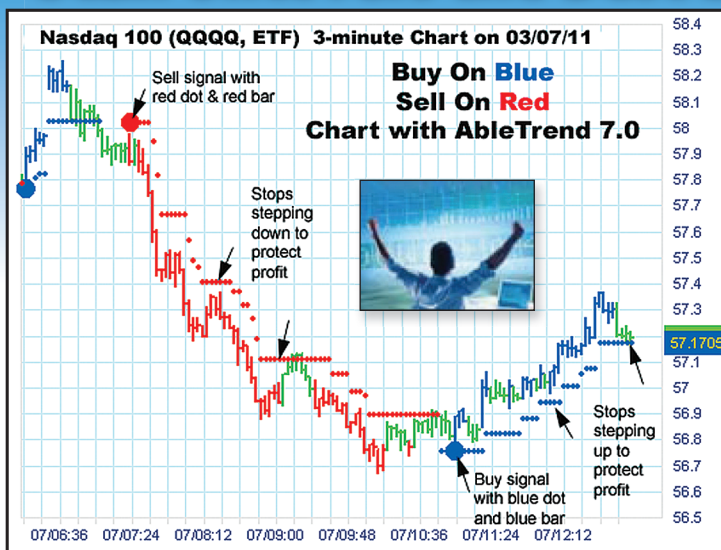
FIGURE 1: YEN INTERVENTION



The March 18 intervention consisted of approximately ¥2 trillion, or \$25 billion, pumped into the market to halt the yen's strengthening trend. The move pushed the dollar/yen back to 81.99, not quite to the pre-crisis level but enough to remove panic and also instill fear of further intervention.

Source: Chart — Metastock; data — Reuters and eSignal

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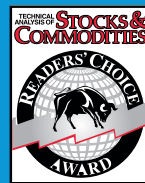
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tries may be fairly rare, but many smaller nations intervene every year — Mexico, Australia, Canada, and South Korea are just a few examples. Switzerland intervened in December 2009 and again in April and May 2010.

In the days of fixed exchange rates before the dollar began floating in 1974, intervention took the form of one-off revaluations, usually to the downside. The UK pound was devalued in 1967. The French and Belgian francs were devalued numerous times during the 1960s and 1970s. In 1978-79, the U.S. intervened to support the dollar. In 1985, the G7 intervened to weaken the dollar and in 1987 it moved to strengthen it.

Until a policy change in Japan in 2002, intervention amounts were a big secret. The Plaza Accord (1985) and later the Louvre Accord (1987) involved undisclosed sums in G7 intervention, with most of the shift in rates achieved through the “announcement effect.” In his 1992 book *Changing Fortunes*, former Fed Chairman Paul Volcker revealed the 1985 intervention was about \$10 billion, of which \$4.8 billion was done by the German Bundesbank (at first unilaterally) and \$600 million by the U.S. Federal Reserve.

In 1992, the UK was forced to leave the European Rate Mechanism, in part because of the assault by speculators (including George Soros) who judged the level of the British pound against the Deutsche mark was economically unsustainable. The Bank of England intervention ahead of leaving the ERM cost £3.3 billion, but this information was not revealed until 1997. Also, after the European Monetary Union was formed and issued the first Euro in January 1999, the G7 intervened in 2000 to halt its slide from \$1.1746 at the launch to \$0.8444 around Sept. 20 of that year. The amount of the intervention was reported at the time at about €3 billion by the European Central Bank and \$1.5 billion by the U.S.

Cold hard cash vs. jawboning, and the “announcement effect”

Aside from the Bank of Japan’s (BOJ) massive intervention in 2003-2004, which cost about \$300 billion, most intervention amounts are actually pretty small (usually \$3 to \$10 billion) compared to the trillions traded each day in the FX market. Most central banks, including the BOJ and Fed, have a policy of reporting intervention, albeit not right away. Many researchers enjoy rooting around in the official statistics of bank reserves and short-term capital flows to deduce intervention amounts; in practice, they often find flows that might derive from intervention, even when not labeled as such. The Eurosystem is accused of hav-

ing many such entries, especially around the time of the September 2000 intervention.

Because of the absence of hard data, we can’t add up the cash cost of the combined G7 interventions over the years. It is probably about \$500 billion since the dollar was floated in 1974, excluding emerging markets. It can be argued the exact amounts don’t matter, anyway, because what matters is that professionals get an electric jolt of fear that inspires them to pull in their horns. The announcement of the intention to intervene changes trader behavior. They gear down or exit. The Japanese have honed their warnings about the possibility of intervention, also known as jawboning, to a fine art. They say the Ministry of Finance is “watching the FX market carefully,” which can get ratcheted up to “the Ministry of Finance will act if FX market conditions become disorderly.” Another code word is “excessive volatility.”

Japan is not alone. In the late 1970s the Fed made many “moral suasion” phone calls to bank treasurers, and we have no reason to suppose central banks today do not continue to twist arms behind the scenes.

Intervention doesn’t work and wastes reserves

Traders don’t spend much time contemplating the value of intervention. It is a fact of life, like lightning storms and public transportation strikes. Central bankers and academics, however, spend a great deal of time thinking about intervention. On the whole, the basic premise is that advanced economies with well-functioning financial markets should let the market establish exchange rates. Intervention is a dirty business.

Conventional wisdom has it that intervention in financial markets is a waste of taxpayer money because it hardly ever has a lasting effect in the absence of a change in interest rates — and sometimes not even then. This was the conclusion of a G7 report on intervention demanded by French President Francois Mitterrand at the June 1982 summit in Versailles, which was published in April 1983. The committee was chaired by French Ministry of Finance official Philippe Jurgensen and named for him, with the key chapter written by the Fed’s international economist Ted Truman.

Truman wrote: “Exchange market intervention has definite limits as a policy instrument. Its effectiveness is uncertain and imprecise ... Intervention is not a separate instrument of policy that can be used regardless of the stance of other economic and financial policies; it is not effective in achieving discrete adjustments in exchange rates, moving

them from one level to another and holding them there ... It is dangerous to prescribe the use of intervention except in extreme situations, and it is certainly not recommended for everyday use" (www.petersoninstitute.org/publications/chapters_preview/360/12ie3519.pdf).

The Jurgensen report subsequently has been augmented, but its conclusions have not changed since 1983, including a report by the Bank for International Settlements in December 2004 that was published as a set of essays by BIS economists and several central banks (www.bis.org/publ/bppdf/bispap24.htm). Since then, academics have built on intervention literature with studies of interventions by Mexico, Argentina, South Korea, Thailand, Indonesia — and, of course, China.

Is it correct to lump together intervention in fixed or managed-float currencies with intervention in floating currencies? Yes, because the motivation is the same: to obtain or restore a competitive advantage without changing the monetary and fiscal policies that contributed to the currency crisis in the first place.

In addition, intervention is triggered by perception of disorderly or disruptive FX market conditions that contaminate other markets, especially stock markets. The Hong Kong Monetary Authority's stock-market intervention during the 1997-98 Asian crisis was designed specifically to fight speculative pressure against the Hong Kong dollar, which is fixed against the U.S. dollar. It's even fair to say a key motivation in many instances of FX intervention is to prevent stock market slides, since currency devaluation tends to drive away foreign equity market investors. In the case of Japan, everything is upside down — it's a rise in the yen that harms the stock index, since stocks are dominated by exporters.

A great deal of the academic debate focuses on whether intervention proceeds are "sterilized." When a central bank creates money with which to intervene, that money immediately increases the money supply, thus increasing bank reserves and lending capacity. An increase in the money supply generally drives interest rates down and gooses economic activity, which may not be consistent with the policy stance of the central bank. The process of sterilization removes the excess reserves by offering a non-cash asset, usually a Treasury bill, thus leaving monetary policy the same.

The U.S. has a policy of sterilization. A policy of non-

FIGURE 2: LINE IN THE SAND



In September 2010 Japan intervened when the dollar/yen was nearing the 80.00 "line in the sand," a move that appeared to hold the currency at that level for more than four months.

sterilization is considered inherently inflationary — normally a bad thing, except in Japan. Japan tends not to sterilize, since interest rates are already near zero and intervention is a handy way to fight deflation.

In fact, most of what we know about FX market intervention comes from our experience with the Japanese, who have intervened more often and in larger amounts than any other country. In fact, before this year's G7 intervention, Japan had intervened in September 2010 — and was heavily criticized by the rest of the G20, which was meeting in Seoul at the time. In that instance, Japan meekly stopped. On other occasions, the Japanese Ministry of Finance has intervened heavily, repeatedly, at vast expense, and without regard for others' disapproval. Japan intervened from September 2001 to March 2004, spending ¥40.76 trillion.

Intervention does work

The March 18 intervention has worked so far. Note that the previous September, Japan intervened when the dollar/yen was nearing a "line in the sand" at ¥80 (Figure 2). Japan's intervention worked to hold the level comfortably over ¥80 for over four months.

Given the long time frame of Japanese policy making, the Japanese intervention from fall 2001 to the early spring 2004 should probably be seen as a success, too. It certainly sent a message to traders, even if sometimes they chose to defy official wishes and buy yen anyway. The message was

continued on p. 37



The Euro and yen vs. stocks and commodities

The relationships between these markets will probably surprise you.

BY MARC CHANDLER

It looks so easy: Risk on and risk off. When market players are putting on risk trades, stocks and commodities prices, such as gold and oil, rise. The Euro appreciates and the yen sells off. When risk trades come off, the opposite occurs.

This scenario is based on several assumptions, one of which is that the **correlations** between currencies, equities, and commodities are fairly stable. The following analysis tests this hypothesis and leads to some surprising conclusions. Contrary to expectations, there has recently been a sharp decline in the correlations between the Euro and yen on one hand, and equities, gold, and oil on the other.

A word about methodology: The correlations are based on percent change, which is more robust than running the correlations on the actual price levels. A 60-day rolling correlation was used to capture the middle ground between the noisy short-term time frame and the long-term horizon

that may remove too much detail.

Euro-stock correlation

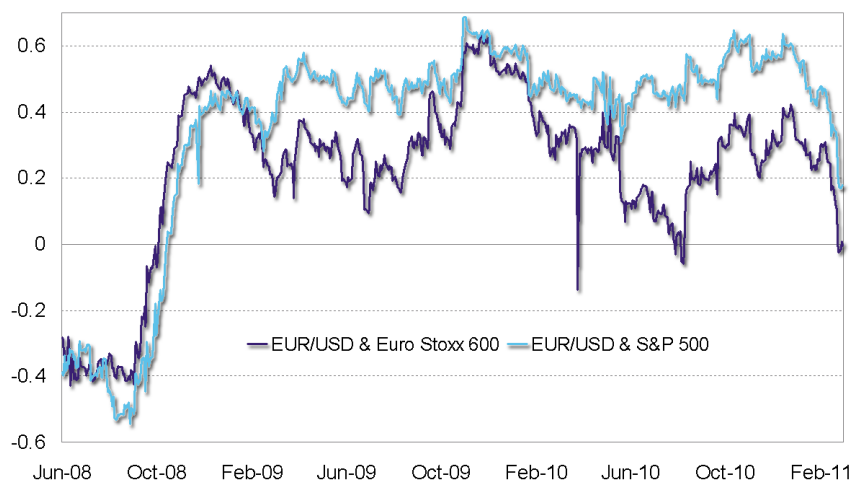
Figure 1 shows the 60-day rolling correlation of the euro to the S&P 500 and the Dow Jones Stoxx 600 (the S&P's approximate European equivalent) since the start of 2008. On the most general level, it's apparent the correlations are not stable. During the period leading up to the Lehman crisis in 2008, the Euro was inversely correlated to the S&P 500 and the DJ 600. Another general characteristic is that the Euro tended to be more correlated to the S&P 500 than the DJ 600.

The Euro-S&P 500 correlation was generally confined to the 0.40 to 0.60 range for the past two years, except for the height of the European debt crisis in the second quarter of 2010. Ironically, as more observers seem to talk about it, the correlation, as measured here, has been trending lower this year. It now sits at a multi-year low, even though it is not inverted.

An intensification of the European debt crisis might lead the correlation to further break down. This could potentially occur on disappointment after the March 24-25 summit, if leaders cannot provide the markets with substantial closure. Officials disappointed and Greek and Portuguese debt were further downgraded.

In Figure 2, which shows the 60-day rolling correlation over a longer period, the Euro-S&P 500 correlation was mostly inverted between 1994 and 2003. Although it is tempting to think of correlation as a mean-reverting process, this longer-term chart suggests that if this hypothesis is true, the mean might be near zero (i.e., no correlation).

FIGURE 1: EURO 60-DAY ROLLING CORRELATION TO EQUITIES



The correlations are not particularly stable, but the Euro tends to be more correlated to the S&P 500 than the DJ STOXX 600.

Yen-stock correlation

Figure 3 illustrates the yen (the yen/dollar rate, not the dollar/yen rate) has been inversely correlated to the S&P 500 since 2007. Although the correlation has generally been negative, it was positive during the previous three years. In recent years this correlation has been considerably more volatile than the Euro's correlation to stocks.

The yen-stock inverse correlation progressively weakened in the second half of last year, and it turned positive for a brief period at the end of 2010. Since the start of the year the correlation turned again, and the yen and stocks have been increasingly inversely correlated. Ironically, in early March the yen was as inversely correlated to the S&P as the Euro was positively correlated (approximately 0.2). If the "Jasmine Revolution" in the Middle East and North Africa continues to extend and/or European leaders disappoint, the yen's inverse correlation will likely increase.

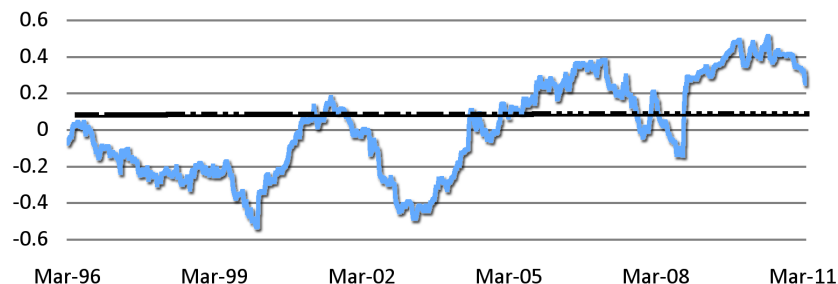
Unlike the Euro, the yen tends to be more correlated to its domestic equity market (the Nikkei was used here) than the S&P 500. It has been fairly stable in the -0.1 to -0.3 range, and is currently at the upper end of that zone — perhaps a reflection of strong foreign purchases of Japanese stocks this year (approximately \$18.7 billion thus far in 2011, according to Japanese Ministry of Finance weekly data).

The Euro vs. gold and oil

Correlation may not be readily evident by eye-balling two time series. The rolling 60-day correlations of the Euro to oil and gold have fallen near zero from around 0.4 at the end of last year (Figure 4).

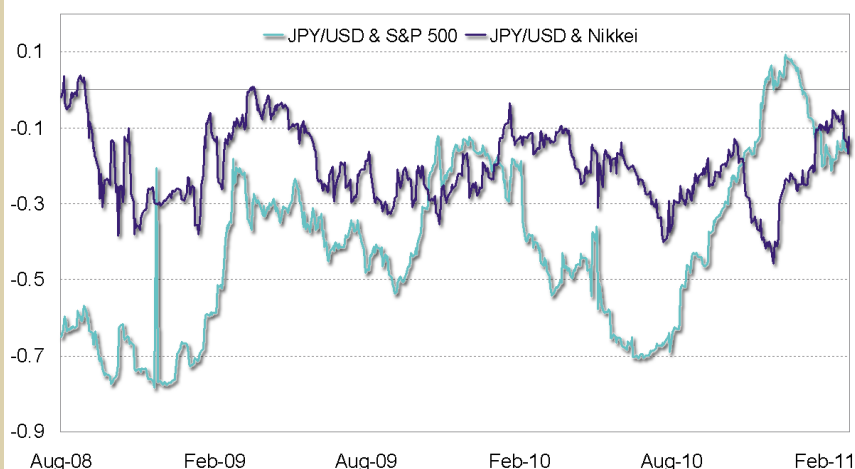
The vast majority of the time, the Euro was positively correlated to gold. The notable recent exception was May-September 2010. It then returned to where it was before the European debt crisis became acute (around 0.5 by mid-December). It has trended lower this year and is now flirting with inverse correlation territory. It could become more inversely correlated if

FIGURE 2: LONG-TERM EURO-S&P 500 60-DAY CORRELATION



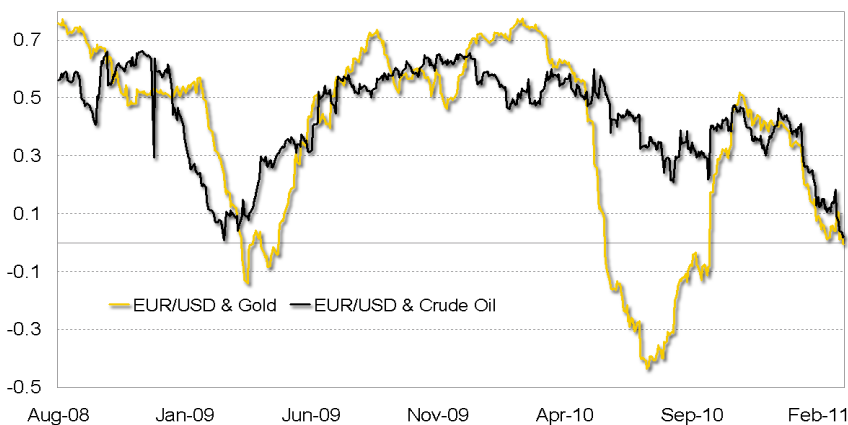
The longer-term chart of the Euro-S&P relationship suggests the markets might have little correlation.

FIGURE 3: YEN 60-DAY CORRELATION TO EQUITIES



In recent years the yen-stocks correlation has been considerably more volatile than the Euro-stocks correlation.

FIGURE 4: EURO 60-DAY CORRELATION TO COMMODITIES



Most of the time the Euro has been positively correlated to gold. The currency's correlation to oil has been less volatile, but it has been trending lower this year. With only brief exceptions, the Euro has been positively correlated with oil prices since 2003.

the European debt crisis is not resolved shortly.

The Euro's correlation with oil has been somewhat less volatile, but it, too, has been trending lower this year and is nearing zero. With only brief exceptions the Euro has been positively correlated to oil prices since 2003, but as Figure 5's longer-term chart shows, the currency (using a "synthetic" Euro prior to 1999) was inversely correlated to oil during the preceding 10-plus years.

One possible explanation for this shift is that it reflects more active management and diversification of petrodollars. Another potential explanation could be divergences in policy responses, as we have seen in recently; the European Central Bank (ECB) seems intent on preventing a second-round impact of higher oil prices, which it acknowledges may be a temporary spike.

The ECB's headline inflation (it eschews core-rate focus) is 2.3 percent, while U.S. headline CPI is around 1.6 per-

cent. (Admittedly, these measures reflect different baskets of goods and services, but that's for another article.) The Federal Reserve is more likely to look past a suspected temporary rise in headline inflation as long as the core rate remains subdued and inflation expectations are anchored. The Fed remains committed to easing policy, even in unconventional ways, given the overnight rate is close to zero.

The yen vs. gold and oil

Since mid-January the yen has swung from negative to positive correlation with oil (Figure 6). While this correlation appears volatile, it is at the high end of a long-term range of 0.25 to 0.30. Since 1992, there have been only four periods when the yen's correlation to oil was above 0.35.

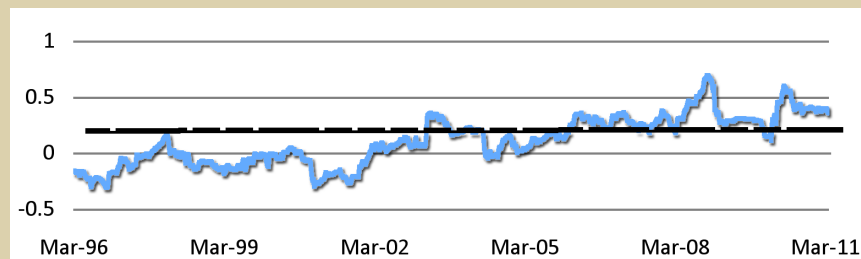
One takeaway from this data is that even though Japan imports nearly all its oil, higher oil prices have not meant

a weaker yen, as the positive correlation now and in mid-2008 illustrate. Similarly, low oil prices haven't meant a strong yen. This also supports the earlier point about the general instability of these correlations.

The yen has spent the bulk of the past 20 years positively correlated to gold. This correlation became negative once a year, on average, but not for more than for a couple of months at a time. July-August 2010 was one of those periods; the correlation then spent most of the fourth quarter and the early part of this year increasingly positively, reaching a high near 0.60 in late January. The correlation has been higher only five other times over the past two decades.

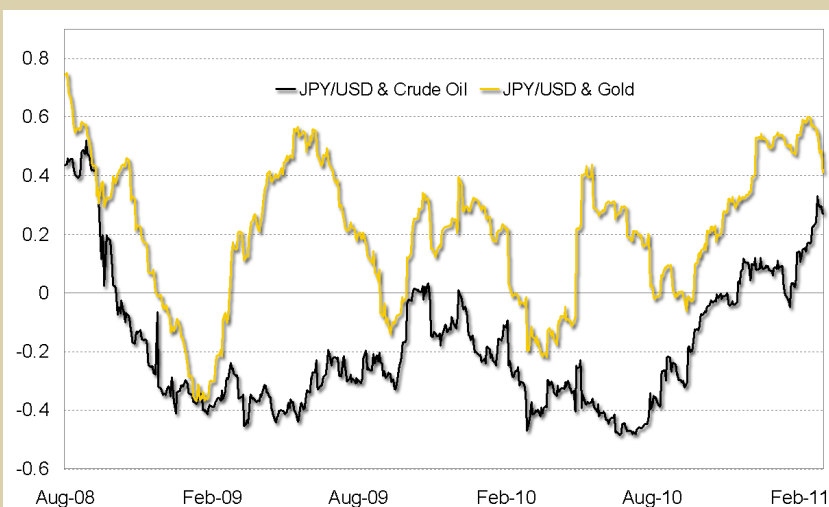
More recently it has fallen, but at around 0.40, it remains substantially higher than the Euro's near-zero correlation to gold, which seems to garner much more attention. It is ironic that the yen, the currency of a country that no longer enjoys a triple-A credit rating and has a gross debt nearly 200 percent of its GDP, enjoys even this degree of correlation to gold, since the yellow metal is often proposed as an alternative to the debase-ment of paper money and the ultimate safe haven. ☒

FIGURE 5: LONG-TERM EURO-CRUDE OIL 60-DAY CORRELATION



The Euro was negatively correlated to oil prices before 2003.

FIGURE 6: YEN 60-DAY CORRELATION TO COMMODITIES



The yen-oil correlation is near the high end of a long-term range of 0.25-0.30.

For information on the author, see p. 4.



Dollar/yen

Central bank action creates spike low in mid-March. How has the currency performed in similar situations?

BY CURRENCY TRADER STAFF

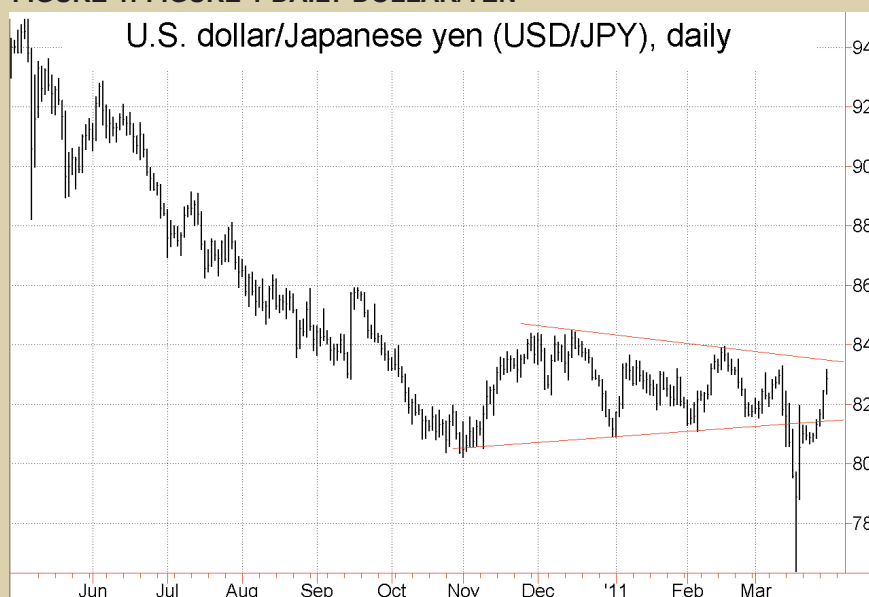
At the end of March the Japanese yen (JPY) had backed away from a record high vs. the U.S. earlier in the month, when the tsunami-earthquake disaster hit the unfortunate nation and jolted world financial markets.

The already strong yen — which had been the only major currency to gain ground vs. the dollar during the 2008-2009 financial crisis — punched to a record high in the aftermath of the tsunami-earthquake disaster. The dollar/yen pair (USD/JPY) dropped more than 4 percent low-to-low from March 16 to March 17, losing more than 6 percent from the previous week's low, before rallying to close near the high of week's range on March 18 forming a huge spike low (Figures 1 and 2). The USD/JPY rate dropped to 76.38 intraday — falling well below the long-standing 1995 low and the October-November 2010 lows (Figure 3).

The initial catalyst for the upside reversal was [the Bank of Japan's \(BOJ\) decision](#) (supported by the G7) to pump massive amounts of yen into the financial system to stem runaway buy-

ing in the yen triggered by expected repatriation of funds as the country battles the crisis and begins to rebuild. After the immediate rebound, the USD/JPY pair consolidated for several days, until speculation the U.S. was ready to

FIGURE 1: FIGURE 1 DAILY DOLLAR/YEN



The BOJ intervened to cool off a surging yen, reversing the dollar/yen's sharp decline on March 16-17. The pair made a higher low on March 18, which is one of the components of the spike-low pattern discussed later in the article.

dial back its currency-weakening stimulus programs gave the move another boost in late March.

The move was quite extraordinary — low-to-low daily drops of 4 percent or more have occurred only six previ-

ous times since 1998, and 6-percent weekly low-to-low drops have only occurred seven times since 1975. The difficulty of finding comparable moves makes modeling the current scenario challenging, and one school of thought

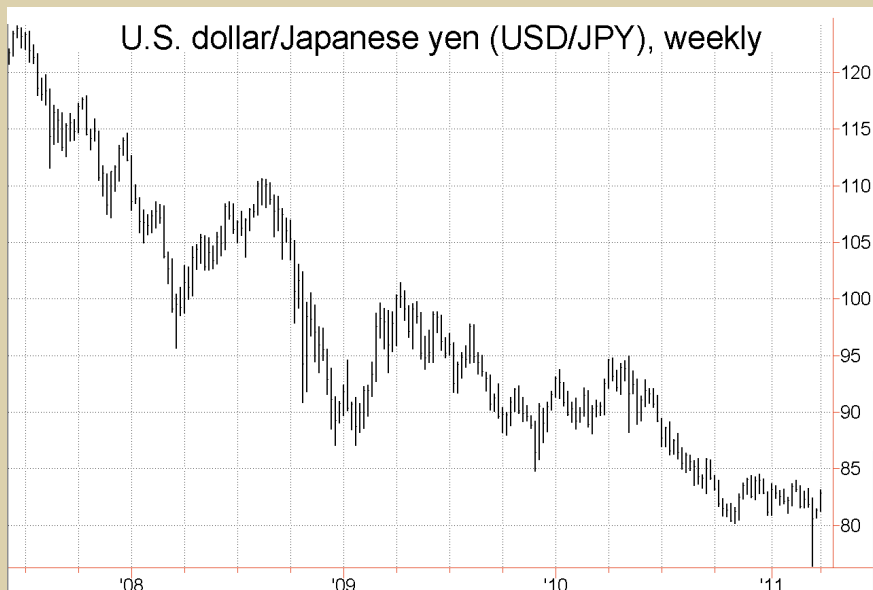
is that it is incorrect to try. Figure 1 shows by the end of March the USD/JPY rate had pushed back toward the upper end of an extended, progressively narrow consolidation that the mid-March shock briefly interrupted, and faces resistance in the form of the November 2010-February highs a little above 84.00.

Most patterns that could be compared to the mid-March spike are much smaller in scale, but even then examples are difficult to come by. The dollar/yen's long-term history is one of decline; large down moves more often than not have been followed by further selling.

One condition that made some comparisons possible was a large drop followed by a lower low. A daily time frame pattern that resembles the recent pattern (but which has only just 12 examples since 1998) consists of consecutive low-to-low drops of 1 percent or more followed by a higher low. This was the market's condition on March 18. Figure 4 shows the dollar/yen's average and median close-to-close price moves for the 20 days after the completion of the previous pattern examples. The pair tended to gain ground until 10 to 13 days after the completion of the pattern, after which a pullback occurred. Nonetheless, even the moderate gains at the end of the 20-day review window are in stark contrast to the pair's long-term downside bias.

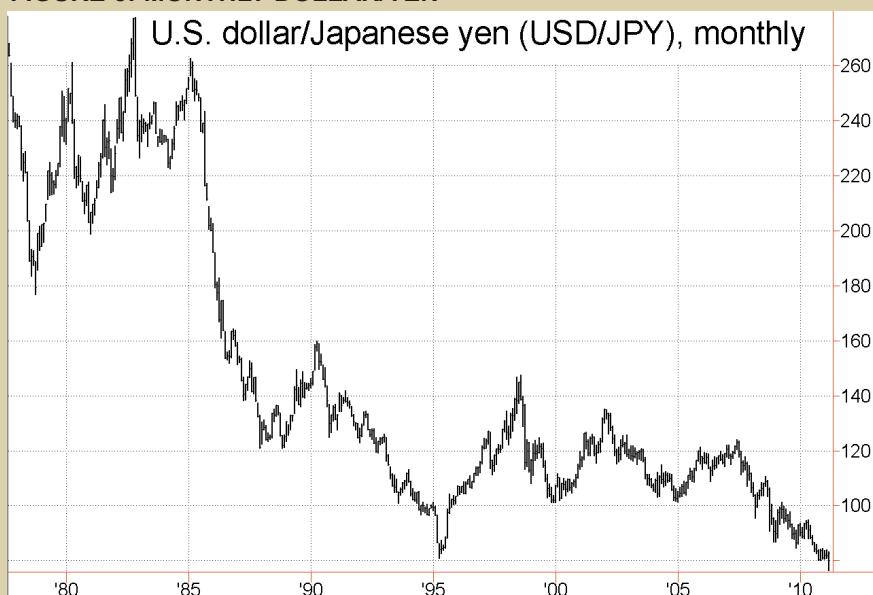
Analysis also showed that relaxing the pattern criteria (i.e., allowing examples with smaller declines) to increase the number of samples resulted in much less bullish post-pattern performance. In this case, the analyti-

FIGURE 2: WEEKLY DOLLAR/YEN



The dollar/yen continued to decline in the 2008-2009 financial crisis, which means the yen continued to strengthen against the dollar.

FIGURE 3: MONTHLY DOLLAR/YEN

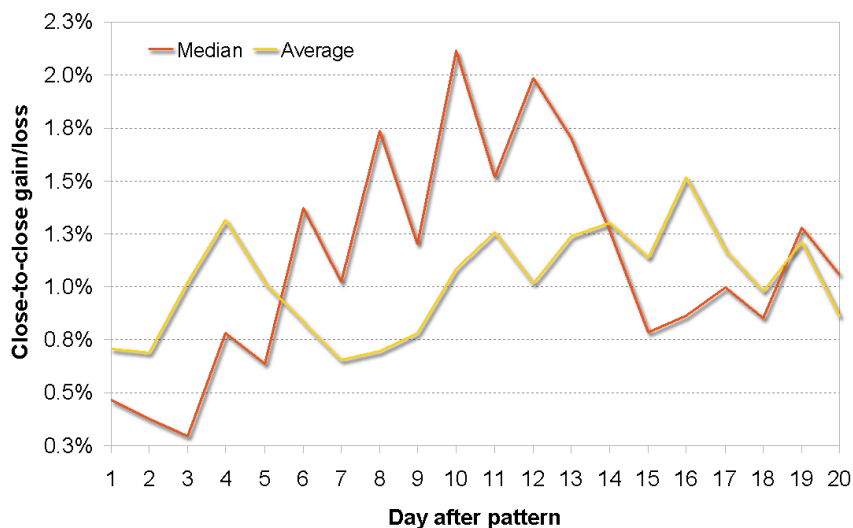


The dollar/yen has been in a long-term downtrend. The March sell-off set a new record low for the past 35 years.

cal trade-off is studying past examples that do not necessarily reflect the severity of the pattern being modeled, or using a very small sample of more-correlated patterns as a guide.

Monday, April 4 corresponds to the 12th day after the pattern, which means the dollar/yen was nearing the peak of the rebound shown in Figure 4 at this juncture. Although it would be foolish to assume the market would rigidly follow such a profile, this does coincide with the pair reaching the previously described chart resistance. Whether the market is likely to sustain the move beyond this level cannot be extracted from this limited analysis window, and will ultimately be determined by the fundamental factors driving the pair. ☐

FIGURE 4: POST-PATTERN PERFORMANCE



The extreme nature of the recent spike low made finding historical equivalents difficult. Performance after 12 examples (since 1998) of a scaled-down version of the spike-low pattern was bullish, but the height of the rebound occurred a little more than two weeks after the pattern.

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Edge-ratio strategy design

Adding unoptimized exit and risk-control rules to an entry signal with favorable odds increases the likelihood of creating a robust trading system. This MACD-based system illustrates the approach.

BY DANIEL FERNANDEZ

Analysis often suggests seemingly worthwhile trading ideas, but without the ability to turn those ideas into tradable realities, the best-looking setup has no practical value.

“Edge-ratio analysis of ‘classic’ indicator entry rules” (*Currency Trader*, January 2011) detailed a specific edge ratio analysis of different traditional indicator signals on four major forex currency pairs. The analysis uncovered several exploitable entry signals with the potential to provide the basis of successful trading strategies.

However, the article did not discuss how to actually create a system in practice out of this information. Here, we’ll

use some of this information to create a [moving-average convergence-divergence \(MACD\)](#)-based strategy for the Euro/U.S. dollar pair (EUR/USD) that we will test over a 10.5-year period. We will walk through the process of analyzing what *could* be created, how to determine appropriate exit rules, and how to avoid pitfalls such as curve-fitting in the design process.

Using edge-ratio tables

Edge-ratio analysis compares the ratio of favorable price movement to unfavorable price movement following a particular trade signal. (The basic approach is outlined in “[The edge-ratio technique](#).”) Table 1 is an example of edge-ratio table; it highlights entries that yielded an edge ratio above and below 1.00.

When attempting to create a system from an edge-ratio table, you should always take into account the type of system you want to create. For example, if you want to create a trend-following system that enters trades after momentum established itself, you should first find an entry signal that triggers after specific behavior in favor of the trend has happened — for example, a resistance or support breakout, or an inverted oscillator signal. Then look for a currency pair with an edge-ratio table showing several consecutive rows with values above 1.00.

Suppose we want to create a strategy

	GBP/USD		USD/JPY		USD/CHF		EUR/USD	
Period	Long	Short	Long	Short	Long	Short	Long	Short
1								
2								
5								
10								
20								
30								
40								
50								
60								
70								
80								
90								
100								

Legend: Above 1 edge ratio for both long and short. Below 1 edge ratio for both long and short (above 1 for the opposite rule). Below 1 edge ratio. Above 1 edge ratio.

that enters trends in the direction of increasing momentum. The MACD signal described in the January article is an example of this idea:

- Go long when the 12-26-9 MACD histogram crosses above zero; go short when the MACD histogram crosses below zero.

Table 1 shows the edge-ratio analysis for this signal. The performance in the EUR/USD has a clear edge in several consecutive short-term periods (as well as the longest periods), which suggests the MACD signal is a good choice for creating a trend-following system on the daily time frame for this pair.

After deciding upon the pair and entry you want to work with, you can move on to the key considerations of trade size and exit criteria that will ultimately determine whether or not the system is successful.

Adding exit rules

Great care is needed here to avoid over-optimization, or “curve fitting” (cherry picking the most profitable system parameters from a historical test) that would harm the strategy’s real-time performance. To sidestep this problem, exits should be created without any optimization. This will result in a more robust trading system.

There are two easy ways to create an exit mechanism for a strategy like this. The first is to establish an inverse-

entry criterion, which means the system would exit a trade whenever a signal opposite to an entry signal occurs. The second is to create stop-loss and profit-taking criteria, which presents the challenge of assigning their values without succumbing to curve fitting. Here, we’ll use the inverse-entry approach because of its greater simplicity, but add the following unoptimized stop-loss rule to ensure a fixed risk per trade: All trades will be closed when price moves against the position by two times the 14-day **average true range (ATR)** from the entry price. For example, if the EUR/USD pair’s 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 ($1.5050 + (0.0150 \times 2)$).

The system is stop-and-reverse: It covers shorts and goes long whenever the 12-26-9 MACD histogram crosses above the zero line, and exits longs and goes short when the MACD histogram crosses below the zero line.

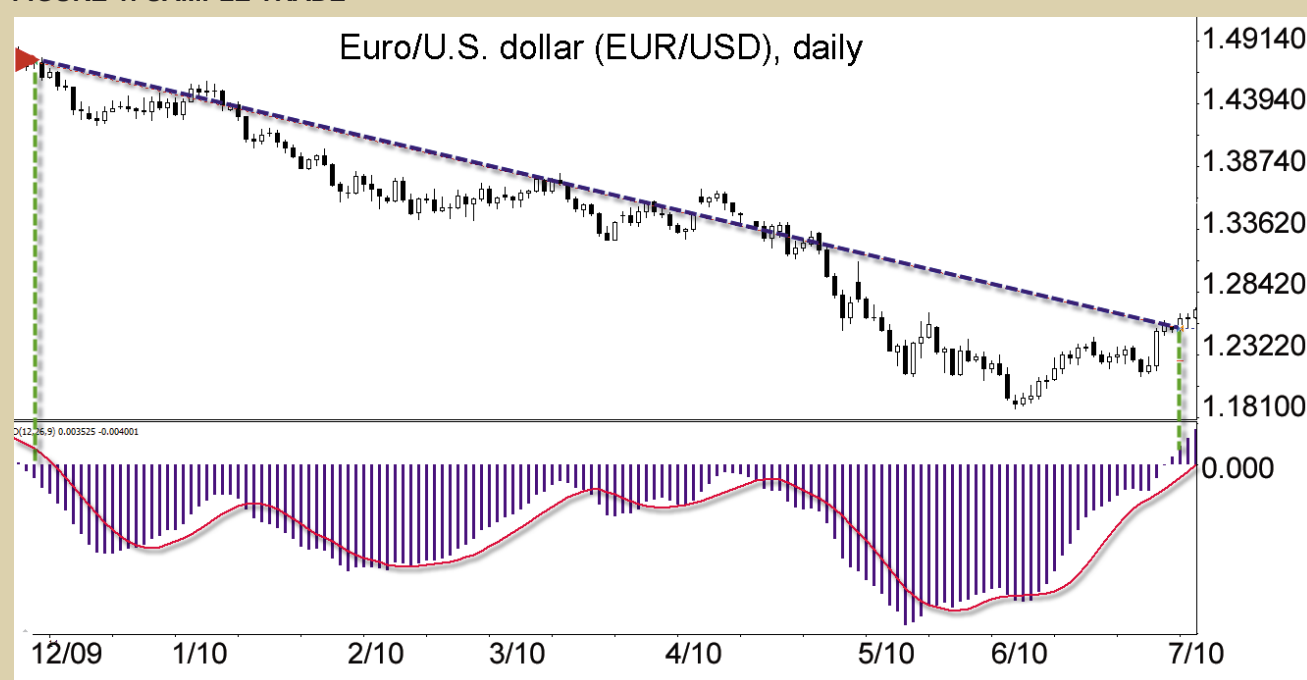
Trade size

There are many ways to determine an appropriate position size, but using volatility-adjusted criteria usually gives the best results. The formula risks 2 percent of account equity per trade, as adjusted by the 14-day ATR:

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

Figure 1 shows a sample trade from 2010 that profited

FIGURE 1: SAMPLE TRADE



The system captured an extended downtrend in 2010 by entering short when the MACD histogram dropped below its zero line.



The edge-ratio technique

Edge-ratio analysis is a way to evaluate the potential of a given entry signal in the absence of a full trading strategy (i.e., without position sizing or exits). It measures the amount the market moves for or against the position as a percentage of a volatility-adjusted benchmark over a certain holding period after trade entry.

The first step in the process is to choose a volatility benchmark (e.g., the 14-day average true range, ATR) and a fixed holding period (e.g., 20 days). Then, for each entry signal we calculate the maximum move in favor of the trade (the maximum favorable excursion, MFE) and the maximum move against it (the maximum adverse excursion, MAE) as a percentage of the 14-day ATR. A signal's edge ratio is simply the ratio of the MFE to the MAE.

For example, suppose a long entry occurs in the EUR/USD pair at 1.3560 and we want to analyze its performance in the first 20 days after the signal. If the highest high after entry was 1.3580, the lowest low after entry was 1.3520, and the 14-day ATR was 0.0080, the MFE is:

$$(1.3580 - 1.3560) / 0.0080 = .25, \text{ or } 25 \text{ percent of the ATR.}$$

The MAE is:

$$(1.3560 - 1.3520) / 0.0080 = .50, \text{ or } 50 \text{ percent of the ATR.}$$

The edge ratio in this case is $.25 / .50 = 0.50$. A "good" entry — that is, one followed by more favorable price action than adverse price action — will have an edge ratio greater than 1.00.

This type of analysis is very similar to the benchmark analysis shown in many *Currency Trader* and *Active Trader* magazine articles, in which post-signal price performance is compared to overall market performance in various ways using the largest up move (LUM) and largest down move (LDM) calculations.

from a long-term downtrend in the EUR/USD pair. A short trade triggered at 1.4739 when the 14-day ATR was 0.0142, and a stop-loss was entered at 1.5023 ($1.4739 + (2 \times 0.0142)$). Assuming an account balance of \$100,000 and the contract size of 100,000 (standard forex trading lot), the position size was:

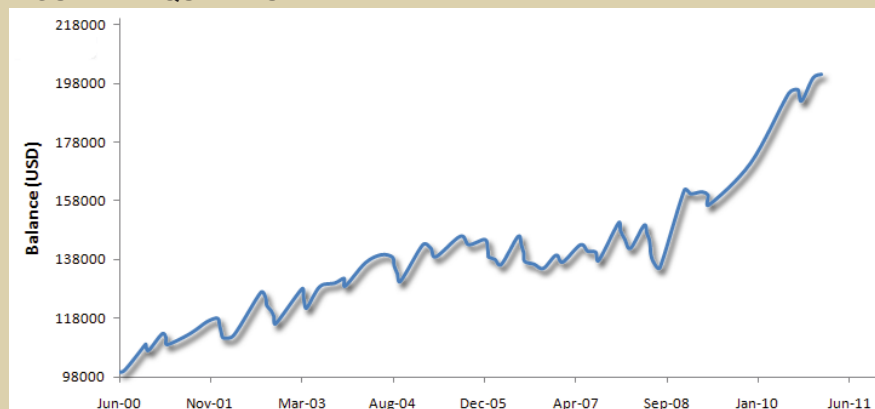
$$0.01 \times 100,000 / (100,000 \times 0.0142) = 0.7, \text{ or } \$70,000$$

Testing the system

The strategy was tested on EUR/USD daily data from June 1, 2000 to Jan. 1, 2011, deducting trading costs of 2 pips per trade.

The test results indicate the initial edge-ratio analysis correctly identified an approach that was able to adequately predict medium-term trends in the EUR/USD beyond random chance. Figures 2 and 3 show that, despite its simplicity, the strategy produced positive returns in all years except 2006, which posted a 5-percent loss. The net profit over the test period was 101 percent, or 6.72 percent annually. The maximum drawdown was very modest at 10.14 percent. The other performance statistics in Table 2 reflect what we would expect from an intermediate- to longer-trend-following strategy: a low winning percentage (35 percent) compensated by a very high reward-to-risk ratio and a

FIGURE 2: EQUITY CURVE



The system's upward progress was modest but upward until a sharp surge in 2008.

low number of trades.

Edge-ratio analysis and simplicity

An important factor to consider is the system development process and a strategy's end characteristics. The fact that this strategy's parameters are unoptimized and no profit-taking rule is used — which “lets profits run” — increases the odds it is robust, even though it has been applied to only the currency pair for which the edge-ratio analysis showed the best potential.

Keeping things simple, avoiding curve-fitting, and properly interpreting edge-ratio analysis will allow you to design systems with the potential to be successful over time, and on a portfolio basis. ☒

For information on the author, see p. 4.

TABLE 2: PERFORMANCE STATISTICS

Avg. compound annual profit	6.72%
Net profit	101%
Maximum drawdown	10.14%
No. trades	79
Winning percentage	35%
Reward:risk ratio	3.53
Ulcer Index	4.39

The system posted solid trend-following results using simple, unoptimized rules.

Related reading

By Daniel Fernandez:

Keltner Channel volatility breakouts

Currency Trader, March 2011

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

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

Currency Trader, December 2010

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

Multiple average trend-following

Currency Trader, November 2010

Translating a multi-moving average technique into a mechanical forex-trading system highlights the benefits of simplicity and diversification.

Validating candlestick patterns with tick volume

Currency Trader, October 2010

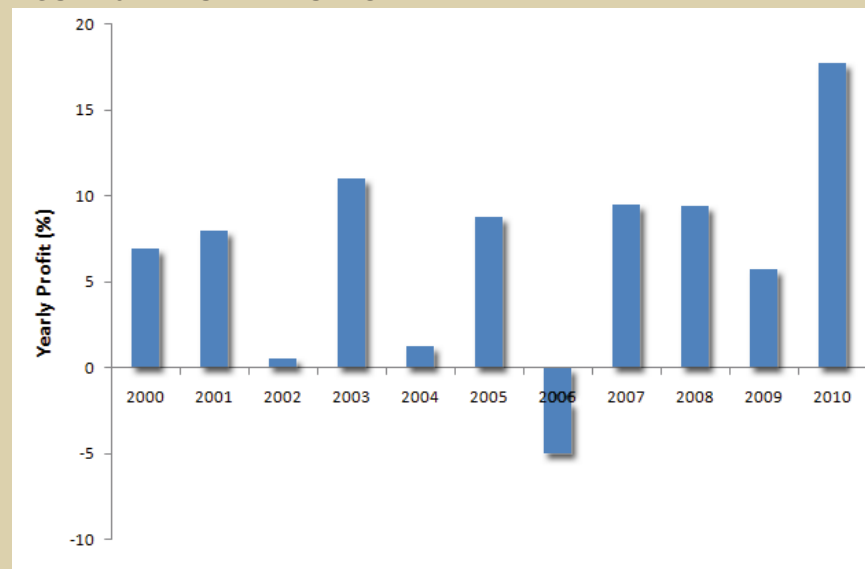
A “double-doji” breakout strategy gets a boost from a tick-volume filter.

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 3: ANNUAL RETURNS

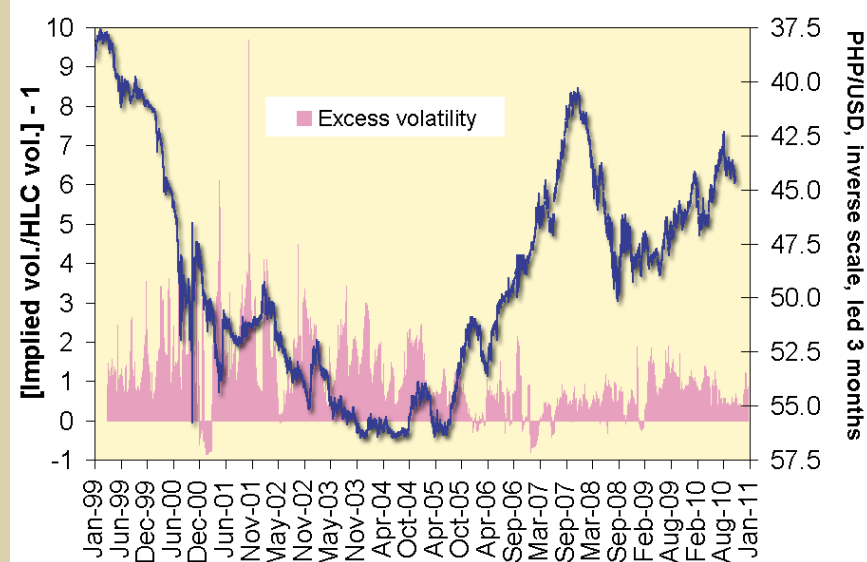


The system was profitable in all years but one.



No whacks at the Philippines

FIGURE 1: OPTIONS MARKET LEADS PESO WEAKLY



Analyzing the excess volatility shows the options market remains in a permanent state of “buying protection” against a declining PHP, regardless of the currency’s course.

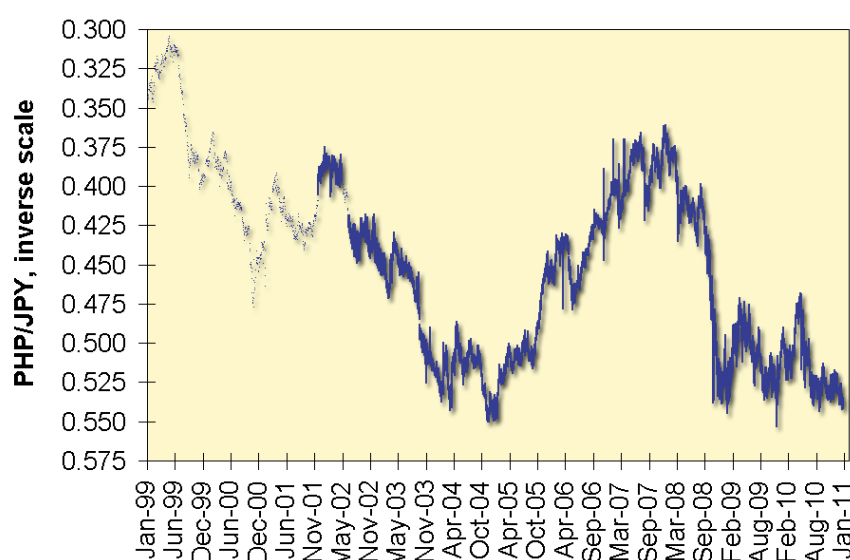
The Philippine peso lives in an economic and forex universe all its own.

BY HOWARD L. SIMONS

A laugh-line from the Cold War was that the Soviet Union was the only country in the world surrounded by hostile communist powers. Had the wholly artificial borders in Eastern Europe been drawn a little bit differently and managed somehow to make Bulgaria abut the Soviet republic of Moldova, this statement would have been false. Bulgaria, despite its alliance with Germany against Russia during both World Wars, always had a cultural soft spot for Russia because of the Tsars’ efforts in driving the Ottomans out of their homeland. In addition, there are the ties of the Cyrillic alphabet and Eastern Orthodox Christianity.

The relationship between the Philippines and the U.S. is somewhat similar. The islands became a colony of Spain in 1521 — the Portuguese explorer Ferdinand Magellan sailed under a Spanish flag and was killed there, which makes his status as the first known circumnavigator of the world a tad suspect — and were perfunctorily kept as an American colony after the Spanish-American War and

FIGURE 2: PESO REBOUNING AGAINST YEN



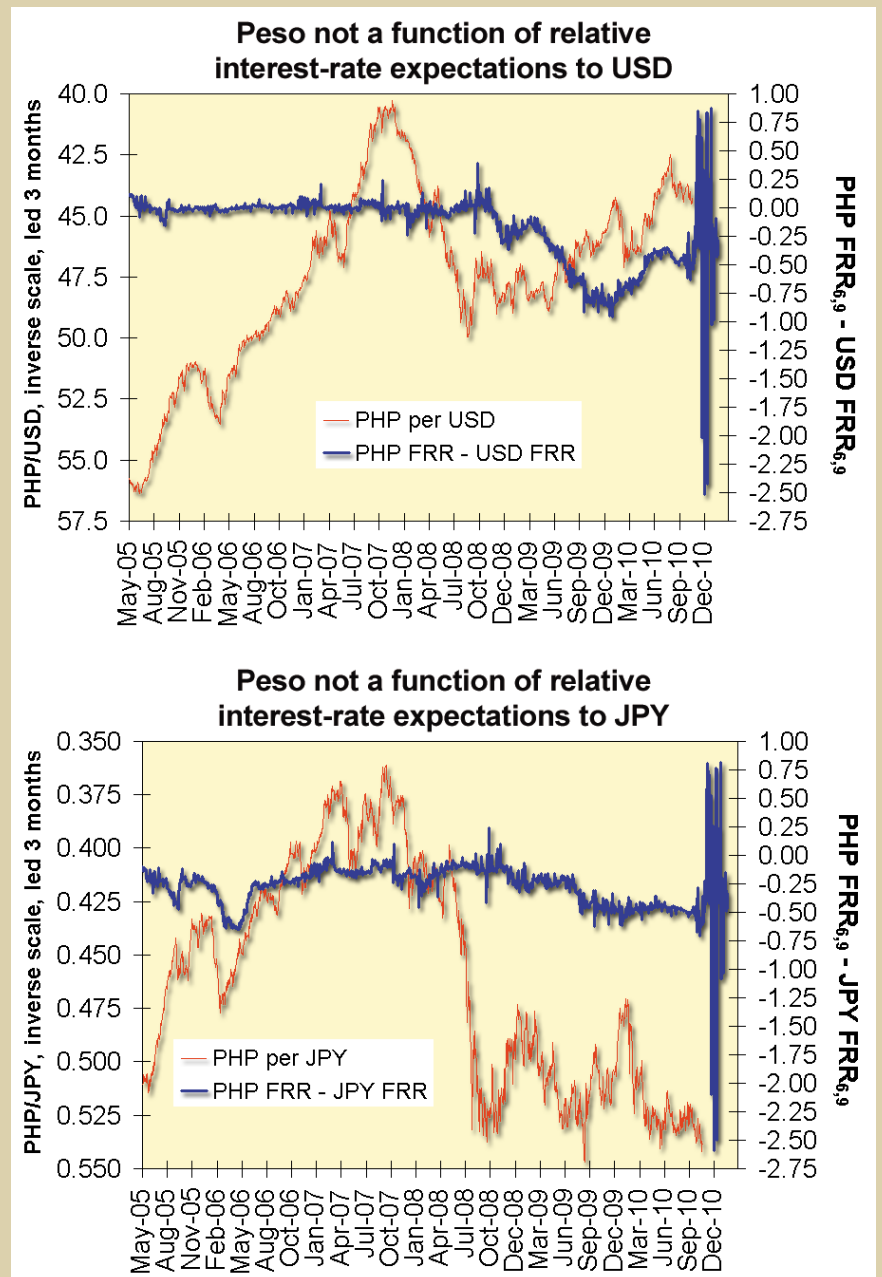
The PHP/JPY rate features weakness into 2005, a rebound, a downturn in the 2008 global financial crisis (when many yen carry trades were unwound), and a second, short-lived rebound once the yen began to weaken in 2010.

Admiral Dewey's famed victory at Manila in 1898. The brutal suppression of the insurrection under Governor-General and later President and Chief Justice William Howard Taft against the American colonization gave the U.S. its first taste of land war in Asia.

All of that was forgiven, and then some, by the shared experience of the U.S. and the Philippines during World War II. The Japanese victories and occupation, which included the infamous Bataan Death March, were seared into the Filipinos' souls; MacArthur's eventual return in 1944 was seen as nothing short of divine liberation. As an aside, the American naval victory at Leyte Gulf in 1944 was not only the largest naval battle in history; it was and probably shall remain the last surface battle fought by the U.S. Navy. Subic Bay and Clark Air base in the Philippines became the home of a gigantic American military presence that ended only after the eruption of Mt. Pinatubo in 1991 rendered these facilities inoperable. The nearby town of Olangapo City was famed as an, um, rest-and-recreation spot well within the budgetary reach of American servicemen and "tourists" from elsewhere.

Just as remittances from Mexican workers in the U.S. constitute an important part of the Mexican economy, remittances from a large Filipino diaspora are vital to the Philippines' economy; they constitute approximately 10 percent of the country's GDP. This huge import of capital from expatriates is both a tribute to the Filipino work ethic and a damnation

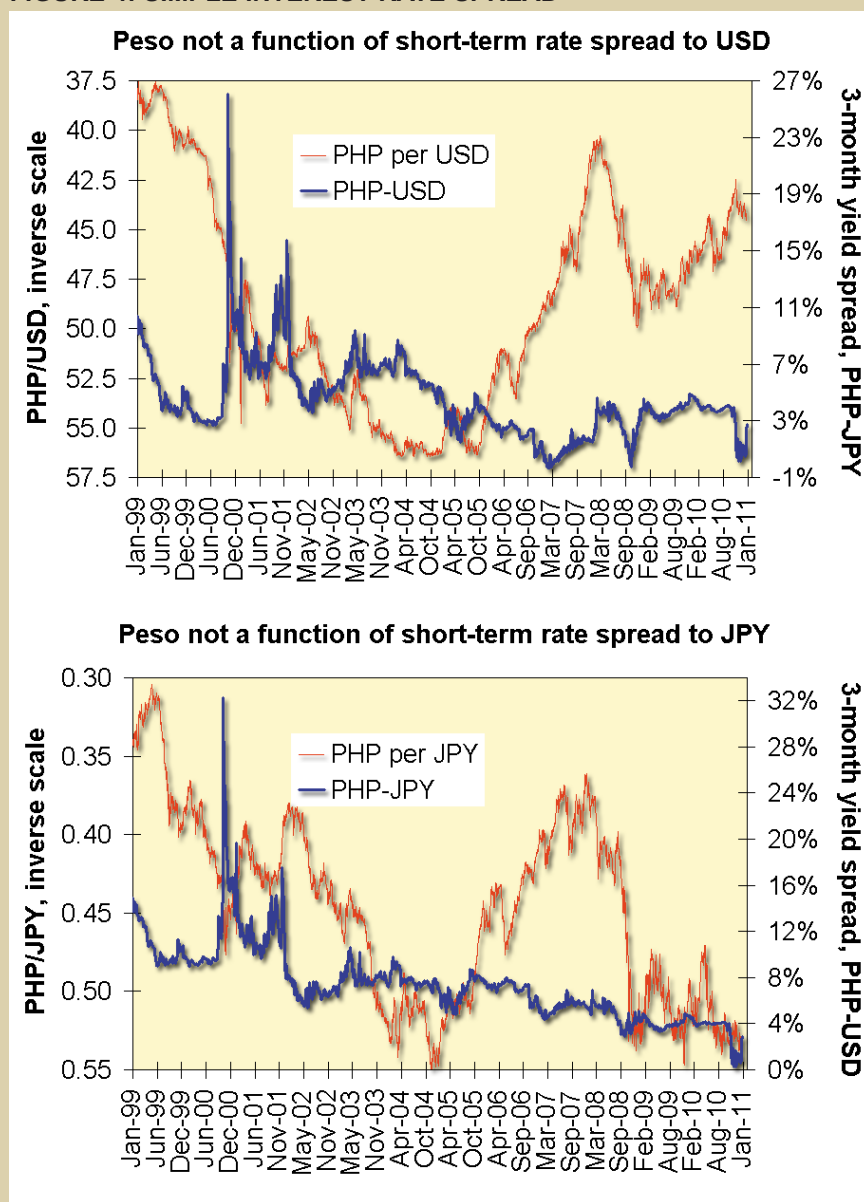
FIGURE 3: INTEREST-RATE EXPECTATION DIFFERENTIAL



Even before the PHP FRR_{6,9} began to gyrate seismically after the Federal Reserve's adoption of QE2 in November 2010, the differential was not a strong determinant of the exchange rate against either the dollar (top) or the yen (bottom).



FIGURE 4: SIMPLE INTEREST RATE SPREAD



A more common metric for the minor currencies is for the currency to track the simple interest rate spread at three months, but this does not appear to be the case for either the USD (top) or JPY (bottom) three-month rate differentials.

of the failure to create a self-sustaining demand for labor internally; the same can be said for the Mexican workforce in the U.S., of course.

The importance of remittances and the lack of a single dominant domestic industry or export to generate foreign exchange have left the Philippine peso (PHP) in a most unusual situation. As we shall see, none of the usual drivers of an exchange rate seem to matter much to the PHP in its exchange rate against either the dollar or the yen. Japan is the second-largest trading partner of the Philippines.

Recent history and trend

Although the PHP was hit during the Asian financial crisis of 1997, it has avoided many of the ups and downs associated with the region since then; a cynic might note it has done a stellar job of the avoiding the region's successes. The currency's tepid history, which has included a five-year sell-off against the USD between 1999 and 2005, a strong rebound into 2008, followed by another weakening during the 2008 global financial crisis and yet another rebound starting with the March 2009 low, has been greeted with a yawn in the options market.

If we map the PHP against its "excess volatility," which is the ratio of the implied volatility of three-month forwards to the high-low-close (HLC) volatility, minus 1.00, we see how the options market remains in a permanent state of "buying protection" against a

declining peso, regardless of the PHP's course (Figure 1). There is a slight leading relationship at a three-month lag between excess volatility and the peso, but one would be hard-pressed to monetize this observation.

The PHP per JPY rate has had an equally unexciting history (Figure 2). Here we see the same history of weakness into 2005, a rebound, a downturn in the 2008 global financial crisis (wherein many yen carry trades were unwound), and a second, short-lived rebound once the yen began to weaken in 2010. There is no comparable options market from which to extract an excess volatility measure.

Interest rates

We can split the comparative interest-rate picture for the PHP into two views. The first, always preferred for major currencies and seldom calculable for minor currencies, is the interest-rate expectation differential as a measure of the forward rate ratios between six and nine months ($FRR_{6,9}$). This is the rate at which we can lock in borrowing for three months starting six months from now, divided by the nine-month rate itself. The more this $FRR_{6,9}$ exceeds 1.00, the steeper the money market yield curve.

We should expect the differential between the PHP $FRR_{6,9}$ and those of both the USD $FRR_{6,9}$ and the JPY $FRR_{6,9}$ to lead the PHP by three months, with the normal effect being a greater differential leading to a stronger PHP. Even before the PHP $FRR_{6,9}$ began to gyrate seismically after the Federal Reserve's adoption of QE2 in November 2010, the differential was not a strong determinant of the exchange rate against either currency (Figure 3). However, we only have data extending back to May 2005 with which to make this comparison.

A more common metric for the minor currencies (see "Indonesian Rupiah: River deep, Bali high," *Currency Trader*, March 2011) is for the currency to track the simple interest rate spread at three

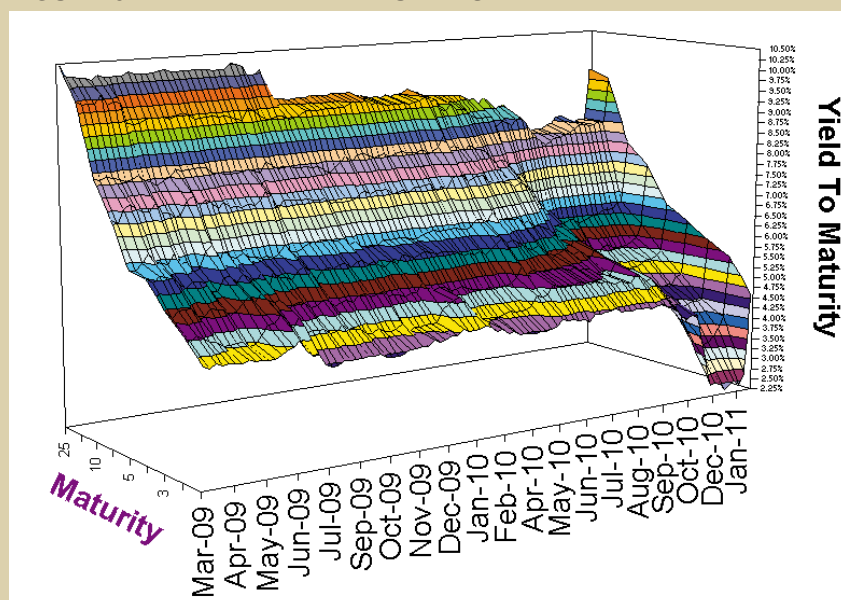
months (Figure 4). Yet this does not appear to be the case for either the USD or JPY three-month rate differentials; here we have data extending back through the January 1999 start date of the Euro we use for so many analyses.

If we wish to extend the interest rate analysis from the money market horizon out along the note horizon, we run into a low-information yield curve, at least since the March 2009 global market low (Figure 5). The yield curve surface here had been unusually stable until QE2 and did not give us any clues to future growth trends or inflationary pressures. The extreme steepening of the Filipino yield curve after November 2010 was unimportant for the PHP.

Asset markets

Finally, has the peso been affected by carry trades from either the U.S. or from Japan? If we map the total carry return between the two funding currencies vs. the relative total returns in USD terms for the Philippine stock market against the American and Japanese markets, we see an

FIGURE 5: PHILIPPINE YIELD CURVE STEEPENED



The yield curve surface had been unusually stable until QE2 and didn't offer any clues to future growth trends or inflationary pressures. The extreme steepening of the Filipino yield curve after November 2010 was unimportant for the PHP.



interesting divergence beginning with the March 2009 low. The carry return of the USD into the PHP had been moving in parallel prior to the spate of U.S. rate cuts beginning in late 2007 (Figure 6, top). Those increased both the carry returns and improved the relative performance of the Filipino stock market to the U.S. until an eventual relative performance peak was reached in October 2010.

An opposite shift occurred with respect to the JPY carry into the PHP (Figure 6, bottom). Here what had been a strong correlation between the carry trade and the relative performance of Japanese equities broke once U.S. rates started to approach Japanese rates and eventually moved under those rates by late August 2009. Once the yen ceased to be the preferred funding currency for the Philippines,

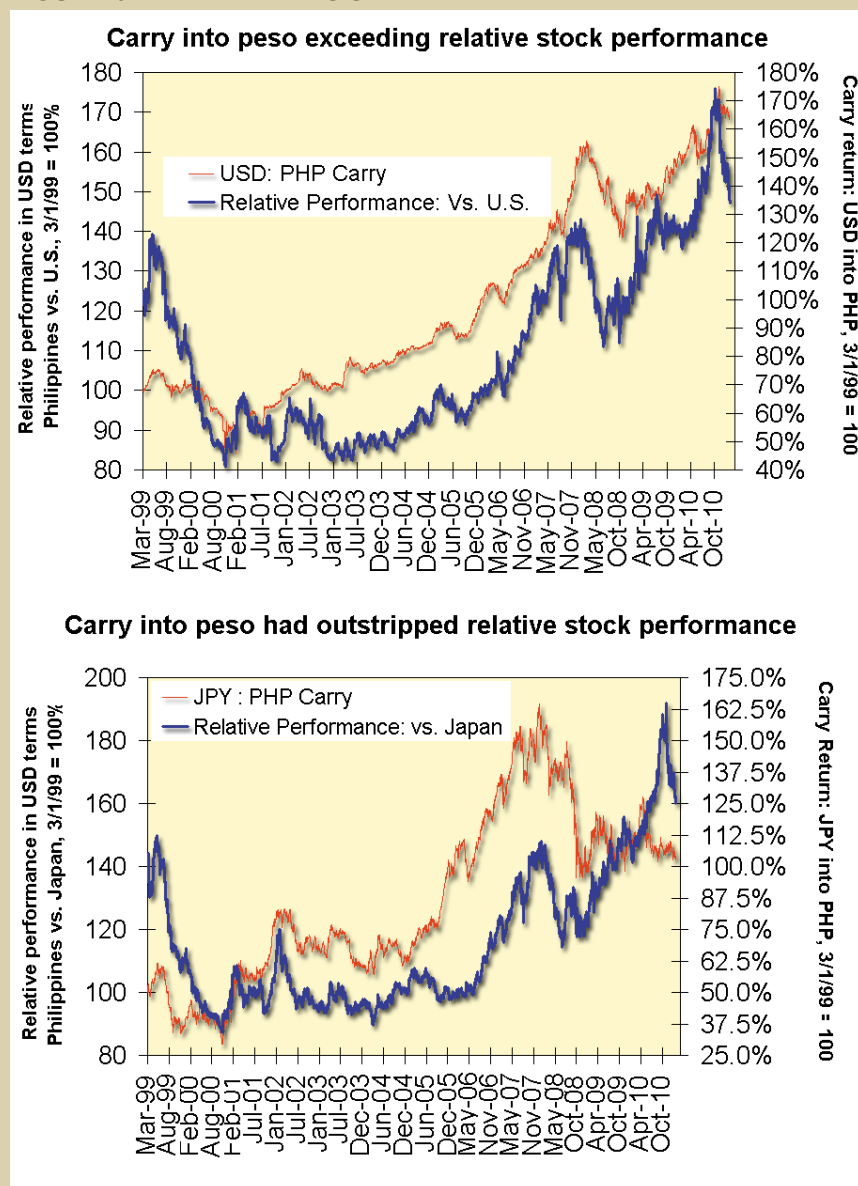
Filipino stocks began outperforming Japanese stocks in USD terms into November 2010. Both examples confirm the long-proffered principle that low interest rates tend to benefit external debtors more than internal debtors: Even after the late-2010 downturns in relative performance, Filipino equities have outperformed those of the two major funding currencies.

The Philippine peso seems to exist in a sort of netherworld, one where it is used internally by its citizens and bought by expatriates remitting funds, but without a direct connection to the financial and economic drivers seen for other currencies. The country and the currency probably can limp along indefinitely like this; after all, a list of exports from the Philippines has “Goods returned and then re-exported” in the 10th slot. A world-beating economy this is not, but then again, who says the Filipinos have to adopt the frenetic export-driven lifestyles of their East Asian neighbors.

When the U.S. dollar was taking one of its periodic nosedives in 2004, it was derided by some as “The American peso,” the association with the Spanish-heritage currency not being made as a compliment. Here we see the Asian peso, but somehow we do not see the country as having failed in some mission. It is, in a pop psychology sense, a country and a currency accepting of its role. ☒

For information on the author, see p. 4.

FIGURE 6: CARRY ANALYSIS



Both carry return examples confirm the principle that low interest rates tend to benefit external debtors more than internal debtors: Even after the late-2010 downturns in relative performance, Filipino equities have outperformed those of the two major funding currencies, USD and JPY.



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.

April 2011

27	28	29	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	29	30

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

April

1	U.S.: March employment report and ISM manufacturing report
2	
3	
4	
5	
6	
7	Australia: March employment report Brazil: March CPI and PPI Japan: Bank of Japan interest-rate announcement Mexico: March PPI and March 31 CPI UK: Bank of England interest-rate announcement ECB: Governing council interest-rate announcement
8	Canada: March employment report UK: March PPI LTD: April forex options; April U.S. dollar index options (ICE)
9	
10	
11	
12	U.S.: February trade balance Canada: Bank of Canada interest rate announcement Germany: March CPI UK: March CPI
13	U.S.: March retail sales and April Fed beige book France: March CPI Japan: March PPI
14	U.S.: March PPI India: March PPI
15	U.S.: March CPI
16	
17	
18	
19	Brazil: March employment report Canada: March CPI Hong Kong: Jan.-March employment report

20

Germany: March PPI
Mexico: March employment report and April 15 CPI
South Africa: March

21

U.S.: March leading indicators
Australia: Q1 PPI
Hong Kong: March CPI

22

23

24

25

26

U.S.: March durable goods and FOMC interest-rate announcement
Australia: Q1 CPI

27

U.S.: Q1 GDP and employment cost index
Germany: March employment report
Japan: March employment report and CPI
Mexico: March PPI

28

U.S.: March personal income
France: March PPI
India: March CPI

29

30

31

May

1	
2	U.S.: April ISM manufacturing index Canada: March PPI
3	
4	
5	UK: Bank of England interest-rate announcement ECB: Governing council interest-rate announcement
6	U.S.: April employment report Brazil: April CPI Canada: April employment UK: April PPI LTD: May forex options; May U.S. dollar index options (ICE)



Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	303.6	199.8	1.38% / 47%	1.61% / 34%	6.62% / 64%	.16 / 0%
JPY/USD	JY	CME	148.1	112.0	-4.86% / 100%	-0.82% / 59%	-1.36% / 57%	.84 / 87%
GBP/USD	BP	CME	120.1	111.4	-0.42% / 42%	-1.36% / 53%	3.08% / 61%	.50 / 80%
AUD/USD	AD	CME	106.9	118.3	5.89% / 100%	1.31% / 63%	3.09% / 39%	.83 / 82%
CAD/USD	CD	CME	82.3	124.2	1.93% / 67%	0.18% / 6%	3.17% / 63%	.34 / 57%
CHF/USD	SF	CME	52.1	53.7	-1.75% / 100%	1.74% / 49%	3.61% / 42%	.30 / 22%
MXN/USD	MP	CME	35.0	131.0	1.98% / 90%	0.30% / 8%	2.83% / 52%	.27 / 30%
U.S. dollar index	DX	ICE	24.5	47.6	-0.35% / 22%	-0.55% / 5%	-6.19% / 88%	.19 / 0%
NZD/USD	NE	CME	9.5	19.8	6.43% / 100%	2.70% / 86%	-0.46% / 8%	.73 / 97%
E-Mini EUR/USD	ZE	CME	5.1	5.1	0.27% / 11%	1.36% / 28%	7.83% / 84%	.16 / 2%

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 Feb. 28 ranked by February 2011 return)

	Trading advisor	February return	2011 YTD return	\$ Under mgmt. (millions)
1.	Alder Cap'l (Alder Global 20)	4.20%	0.96%	630.0
2.	DynexCorp Ltd. (Currency)	3.68%	4.99%	48.2
3.	SuisseCap MA (Everest Strategy)	2.89%	5.00%	18.2
4.	QFS Asset Mgmt (QFS Currency)	2.79%	-3.61%	763.0
5.	Metro Forex Inc	2.64%	6.98%	107.2
6.	Ortus Capital Mgmt. (Currency)	2.52%	-0.87%	2191.0
7.	Alder Cap'l (Alder Global 10)	2.20%	0.76%	29.0
8.	State Street Assoc. (Gl. FX Alpha)	1.88%	-1.30%	67.5
9.	Henderson Global Currency	1.82%	-1.97%	50.0
10.	ACT Currency Partners (PAMFX)	1.78%	4.81%	16.0

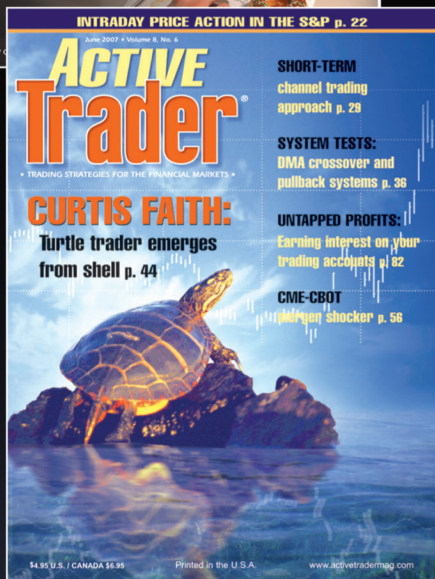
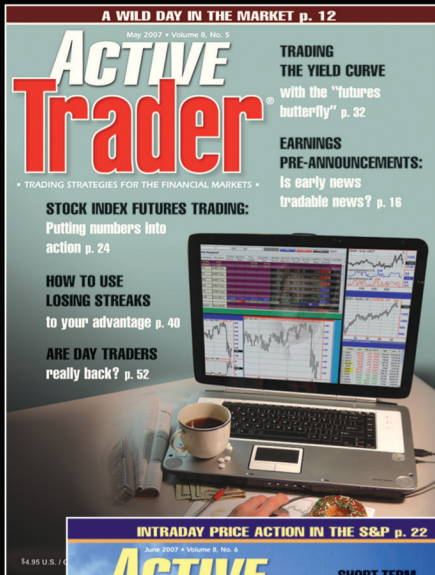
Top 10 currency traders managing less than \$10M & more than \$1M

1.	D2W Capital Mgmt (Radical Wealth)	8.90%	31.33%	1.9
2.	Sagacity (HedgeFX100)	8.76%	9.47%	1.2
3.	Iron Fortress FX Mgmt	3.98%	7.34%	1.3
4.	Wealth Builder FX Group (Aggressive)	3.40%	1.33%	2.0
5.	Overlay Asset Mgmt. (Emerging Mkts)	2.73%	4.04%	8.3
6.	Greenwave Capital Mgmt (GDS Beta)	1.99%	0.34%	4.0
7.	Drury Capital (Currency)	1.88%	-0.70%	3.4
8.	Basu and Braun (Everest)	1.47%	2.10%	1.9
9.	ForexAtom	1.40%	2.94%	3.4
10.	Aurapoint Asset Mgmt (QV)	1.33%	1.94%	2.3

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CURRENCIES (vs. U.S. DOLLAR)

Rank	Currency	March 28 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	South African rand	0.146005	2.53%	-1.67%	2.32%	0.1509	0.1257	15
2	Euro	1.408095	2.38%	7.19%	4.54%	1.4218	1.1942	6
3	Russian ruble	0.03528	2.13%	7.19%	7.89%	0.0355	0.0309	3
4	Thai baht	0.033045	1.19%	-0.26%	1.09%	0.0338	0.0302	10
5	Singapore dollar	0.792955	0.94%	3.05%	4.81%	0.793	0.7051	11
6	Swiss franc	1.08679	0.90%	4.50%	6.99%	1.1096	0.8593	1
7	Australian Dollar	1.02573	0.81%	2.28%	6.78%	1.02573	0.8149	4
8	Indian rupee	0.02208	0.59%	0.82%	-0.56%	0.0227	0.021	7
9	Swedish krona	0.156475	0.50%	6.85%	6.73%	0.1594	0.1236	2
10	Japanese yen	0.01229	0.41%	1.82%	3.54%	0.0127	0.0106	9
11	New Zealand dollar	0.75332	0.23%	0.71%	2.53%	0.7951	0.6626	16
12	Chinese yuan	0.15241	0.18%	1.08%	2.00%	0.15241	0.1461	13
13	Brazilian real	0.60312	0.15%	1.94%	3.18%	0.6082	0.5257	12
14	Hong Kong dollar	0.128295	-0.02%	-0.17%	-0.48%	0.129	0.1281	14
15	Taiwan dollar	0.033975	-0.23%	3.36%	6.40%	0.0347	0.0307	17
16	Canadian dollar	1.01991	-0.29%	2.81%	4.57%	1.0307	0.9285	8
17	Great Britain pound	1.60384	-0.48%	4.01%	1.29%	1.6343	1.4334	5



GLOBAL STOCK INDICES

	Country	Index	March 28	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	India	BSE 30	18,799.57	6.10%	-5.92%	-6.49%	21,108.60	15,960.20	15
2	Singapore	Straits Times	3,057.38	1.56%	-3.97%	-1.29%	3,313.61	2,648.15	14
3	Brazil	Bovespa	67,193.00	-0.28%	-1.25%	-2.94%	73,103.00	57,634.00	12
4	Mexico	IPC	36,767.86	-0.68%	-3.62%	10.55%	38,876.80	30,074.10	11
5	Hong Kong	Hang Seng	23,068.19	-1.16%	1.97%	4.33%	24,988.60	18,971.50	13
6	U.S.	S&P 500	1,310.19	-1.28%	4.11%	14.16%	1,344.07	1,010.91	2
7	UK	FTSE 100	5,904.50	-1.49%	-1.53%	5.85%	6,105.80	4,790.00	5
8	Canada	S&P/TSX composite	13,892.73	-1.72%	3.30%	13.14%	14,329.50	11,065.50	1
9	Australia	All ordinaries	4,831.90	-1.86%	-0.81%	2.44%	5,048.60	4,194.40	9
10	Italy	FTSE MIB	22,009.95	-2.03%	7.64%	7.15%	23,593.10	18,044.50	3
11	South Africa	FTSE/JSE All Share	31,377.12	-2.77%	-1.98%	8.30%	33,094.06	26,182.67	7
12	France	CAC 40	3,976.95	-3.25%	3.06%	5.70%	4,169.87	3,287.57	6
13	Switzerland	Swiss Market	6,359.00	-3.80%	-3.20%	0.39%	6,990.70	5,935.00	10
14	Germany	Xetra Dax	6,938.63	-4.59%	-0.48%	10.56%	7,441.82	5,607.68	4
15	Japan	Nikkei 225	9,478.53	-10.78%	-7.91%	-0.18%	11,408.20	1,071.25	8

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	March 28	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Euro / Pound	EUR/GBP	0.87804	2.90%	3.07%	3.22%	0.8998	0.8098	16
2	Euro / Canada \$	EUR/CAD	1.38061	2.68%	4.27%	-0.03%	1.4304	1.2493	13
3	Euro / Real	EUR/BRL	2.33469	2.23%	5.15%	1.32%	2.4356	2.1366	5
4	Euro / Yen	EUR/JPY	114.58	1.99%	5.28%	1.00%	127.65	106.43	12
5	Euro / Aussie \$	EUR/AUD	1.372745	1.55%	4.80%	-2.10%	1.516	1.2947	17
6	Euro / Franc	EUR/CHF	1.29563	1.47%	2.58%	-2.29%	1.4445	1.2458	20
7	Franc / Canada \$	CHF/CAD	1.06558	1.19%	1.64%	2.31%	1.0972	0.8972	3
8	Aussie \$ / Canada \$	AUD/CAD	1.005705	1.10%	-0.51%	2.11%	1.0198	0.8636	8
9	Aussie \$ / Real	AUD/BRL	1.700715	0.67%	0.33%	3.49%	1.7164	1.4528	4
10	Aussie \$ / New Zeal \$	AUD/NZD	1.36166	0.58%	1.57%	4.15%	1.3746	1.2174	1
11	Franc / Yen	CHF/JPY	88.43	0.51%	2.62%	3.35%	89.71	77.2	2
12	Aussie \$ / Yen	AUD/JPY	83.46	0.42%	0.45%	3.15%	87.46	73.15	6
13	Yen / Real	JPY/BRL	0.020375	0.22%	-0.12%	0.32%	0.0212	0.0179	9
14	Aussie \$ / Franc	AUD/CHF	0.943815	-0.08%	-2.12%	-0.19%	1.0073	0.8845	18
15	New Zeal \$ / Yen	NZD/JPY	61.3	-0.15%	-1.09%	-0.94%	68.81	56.86	21
16	Pound / Canada \$	GBP/CAD	1.572535	-0.20%	1.17%	-3.14%	1.6412	1.4885	11
17	Canada \$ / Real	CAD/BRL	1.689106	-0.55%	0.73%	1.23%	1.7726	1.589	7
18	Canada \$ / Yen	CAD/JPY	82.99	-0.67%	0.97%	1.03%	94.13	78.75	14
19	Pound / Yen	GBP/JPY	130.5	-0.87%	2.15%	-2.12%	145.35	126.1	10
20	Pound / Aussie \$	GBP/AUD	1.563605	-1.29%	1.69%	-5.14%	1.8042	1.521	15
21	Pound / Franc	GBP/CHF	1.47567	-1.38%	-0.47%	-5.33%	1.6956	1.4486	19

GLOBAL CENTRAL BANK LENDING RATES

Country	Interest Rate	Rate	Last change	Sept. 2010	March 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 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	4
New Zealand	Cash rate	2.5	0.5 (March 11)	3	2.5
Brazil	Selic rate	11.75	0.5 (March 11)	10.75	8.75
Korea	Korea base rate	3	0.25 (March 11)	2.25	2
Taiwan	Discount rate	1.75	0.125 (March 11)	1.375	1.25
India	Repo rate	6.75	0.25 (March 11)	5.75	5
South Africa	Repurchase rate	5.5	0.5 (Nov.10)	7	7



GDP		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Q4	3/18	7.7%	18.0%	6/17
	Brazil	Q4	3/3	0.7%	5.0%	6/3
	Canada	Q4	2/28	1.7%	5.8%	5/30
EUROPE	France	Q4	3/25	0.4%	1.5%	6/29
	Germany	Q4	2/15	0.4%	4.3%	5/13
	UK	Q4	3/29	0.5%	4.2%	6/28
AFRICA	S. Africa	Q4	2/22	-3.8%	-15.9%	5/31
ASIA and S. PACIFIC	Australia	Q4	3/2	0.5%	2.7%	6/1
	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	Feb.	3/24	6.4%	0.3%	-1.0%	4/19
	Canada	Feb.	3/11	7.8%	0.0%	-0.4%	4/8
EUROPE	France	Q4	3/3	9.6%	-0.1%	-0.3%	6/3
	Germany	Feb.	3/31	6.3%	-0.2%	-1.0%	4/28
	UK	Nov.-Jan.	3/16	8.0%	0.1%	0.2%	4/6
ASIA and S. PACIFIC	Australia	Feb.	3/10	5.0%	0.1%	-0.3%	4/7
	Hong Kong	Dec.-Feb.	3/17	3.6%	-0.2%	-1.0%	4/19
	Japan	Feb.	3/29	4.6%	-0.3%	-0.4%	5/19
	Singapore	Q4	1/31	2.2%	0.1%	-0.1%	4/29

CPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Feb.	3/15	0.7%	10.0%	4/15
	Brazil	Feb.	3/4	0.8%	6.0%	4/7
	Canada	Feb.	3/18	0.3%	2.2%	4/19
EUROPE	France	Feb.	3/15	0.5%	1.7%	4/13
	Germany	Feb.	3/11	0.5%	2.1%	4/12
	UK	Feb.	3/4	0.7%	4.4%	4/12
AFRICA	S. Africa	Feb.	3/23	0.7%	3.7%	4/29
ASIA and S. PACIFIC	Australia	Q4	1/25	0.4%	2.7%	4/27
	Hong Kong	Feb.	3/22	1.1%	3.7%	4/21
	India	Feb.	3/31	-1.6%	8.8%	4/29
	Japan	Feb.	3/25	-0.1%	0.0%	4/28
	Singapore	Feb.	3/23	-0.1%	5.0%	4/25

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Feb.	3/15	0.9%	13.8%	4/15
	Canada	Feb.	3/30	0.7%	3.4%	5/2
EUROPE	France	Jan.	2/28	0.9%	5.6%	delayed
	Germany	Feb.	3/18	0.7%	6.4%	4/20
	UK	Feb.	3/4	0.5%	5.3%	4/8
AFRICA	S. Africa	Feb.	3/31	1.5%	6.7%	4/29
ASIA and S. PACIFIC	Australia	Q4	1/24	0.1%	2.7%	4/21
	Hong Kong	Q1	3/11	3.0%	7.6%	6/13
	India	Feb.	3/14	0.1%	8.3%	4/14
	Japan	Feb.	3/25	-1.0%	0.3%	4/13
	Singapore	Feb.	3/29	3.2%	6.6%	4/29

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

**Event:** Dallas Traders Expo**Date:** June 15-18**Location:** Hyatt Regency Dallas at Reunion**For more information:** Go to www.tradersexpo.com**Event:** The World MoneyShow Vancouver 2011**Date:** July 7-9**Location:** Vancouver Convention Centre**For more information:** Go to www.moneyshow.com/vcms/?scode=013104**Event:** The Futures & Forex Expo Las Vegas**Date:** Sept. 22-24**Location:** Caesars Palace, Las Vegas**For more information:** Go to www.moneyshow.com/events/Forex_Options_Expos.asp**Event:** International Traders Expo**Date:** Nov. 16-19**Location:** Caesars Palace, Las Vegas**For more information:** Go to www.moneyshow.com/events/Traders_Expo.asp*continued from p. 15*

to slow down the pace of yen appreciation, which had earlier manifested itself a shocking rise from 260 in February 1985 to 81.27 by April 1995 (Figure 3).

The yen continued to rise, but first benefited from the Asian crisis that was already starting in 2005. The currency did not reach the export-killing 1995 level again until 2011.

The Plaza Accord intervention and relentless official harangues worked, too. The dollar/mark rate fell from a high of DM 3.3602 in March 1985 to DM 2.3815 by January 1986. The pragmatic Swiss National Bank, intervening in recent years in the EUR/CHF pair, would not continue to do so if it didn't get results.

It's hard to avoid the conclusion that central bankers say intervention doesn't work in the face of the evidence because intervention uses up a country's wealth for no

obvious direct benefit to the citizens. Intervention runs counter to other policy objectives, such as the U.S. wishing to promote exports in 2010 and 2011 and wind down QE2 by June, although we should assume the Fed will sterilize the March 18 intervention.

What's next for the yen?

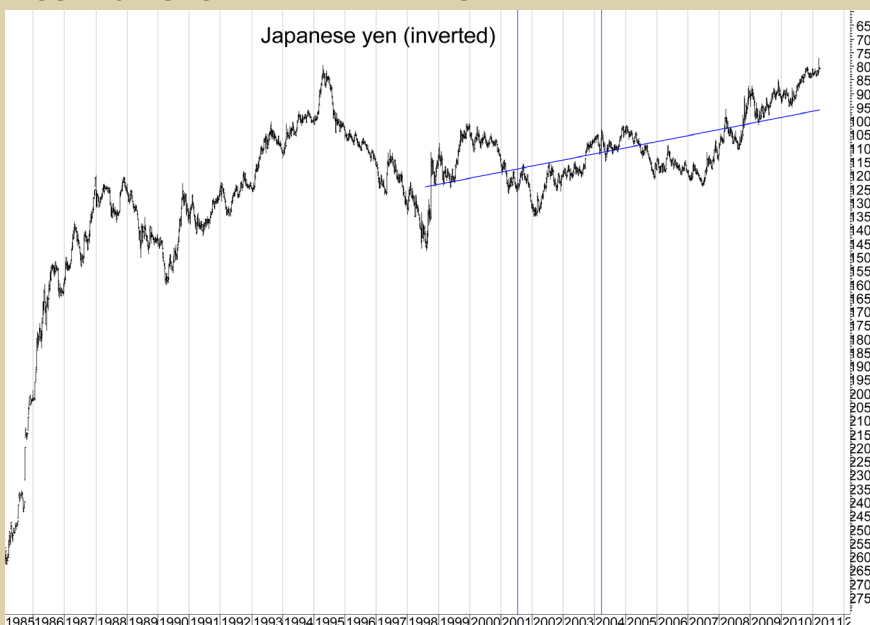
The yen has to reconcile two powerful countervailing forces. The first is the desire for home currency cash by the Japanese in the midst of a historic disaster. So far we do not have data on repatriation, but it's a good bet that individuals and institutions alike dumped foreign investments for yen cash.

Meanwhile, U.S. investors and presumably others are seeing a blood-in-the-street moment in Japan and have

bought Japanese ETFs to the tune of over \$1.2 billion in just the first week after the disaster. Recent history, including the Asian crisis of 1997-98, shows that capital flows to stricken economies after a crisis. Rebuilding offers profitable opportunities for those who get in on the ground floor, at least in advanced economies.

The offsetting influence is the natural desire of the Japanese to get more yield than they can get domestically, and the cheap lending rates in Japan, which accounts for the carry trade. This profit opportunity is not going away any time soon. In the near term (six months) the cash-first force may prevail. If so, it means the Japanese government may be hesitant to intervene against its own citizens and incoming foreign capital. As long as the dollar/yen does not go too far, say 78.00, we will probably not see another round of intervention. But stay tuned. ☐

FIGURE 3: LONG-TERM INTERVENTION



Japan's 2001 to 2004 intervention campaign sent a message to slow down yen appreciation. The USD/JPY rate had fallen from 260 in February 1985 to 81.27 by April 1995.

For information on the author, see p. 4.