

# **CURRENCY TRADER**

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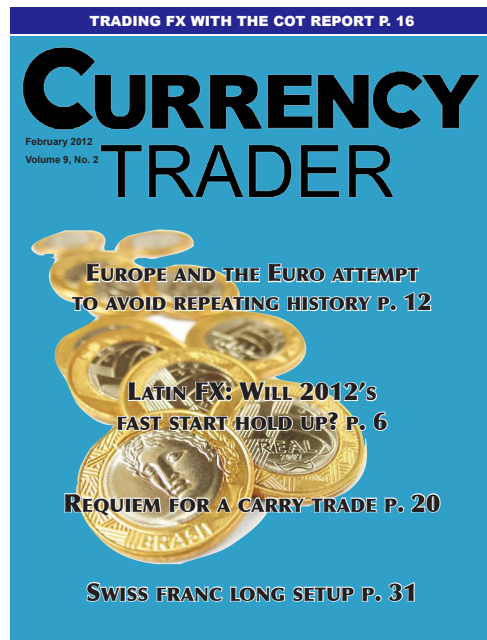
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# Latin FX rallies in New Year

Will the fast start hold? Among the region's positives looms the uncertainty of the European debt crisis.

BY CURRENCY TRADER STAFF

Latin currencies surged out of the starting gate in 2012, posting hefty gains in the first few weeks of the year. From Dec. 30, 2011 through Jan. 26, 2012, the Mexican peso surged 6.8 percent, the Colombian peso rallied 6.94 percent, the Brazilian real gained 5.95 percent, and the Chilean peso climbed 5.51 percent.

Brazil, the region's largest economy, experienced positive economic growth in 2011, but its numbers were much weaker than those that recently preceded them because the country's export sector has been hurt by the European

slowdown. Mexico, on the other hand, is more closely tied to the U.S., and the recent economic data improvements in America have bolstered prospects for the peso.

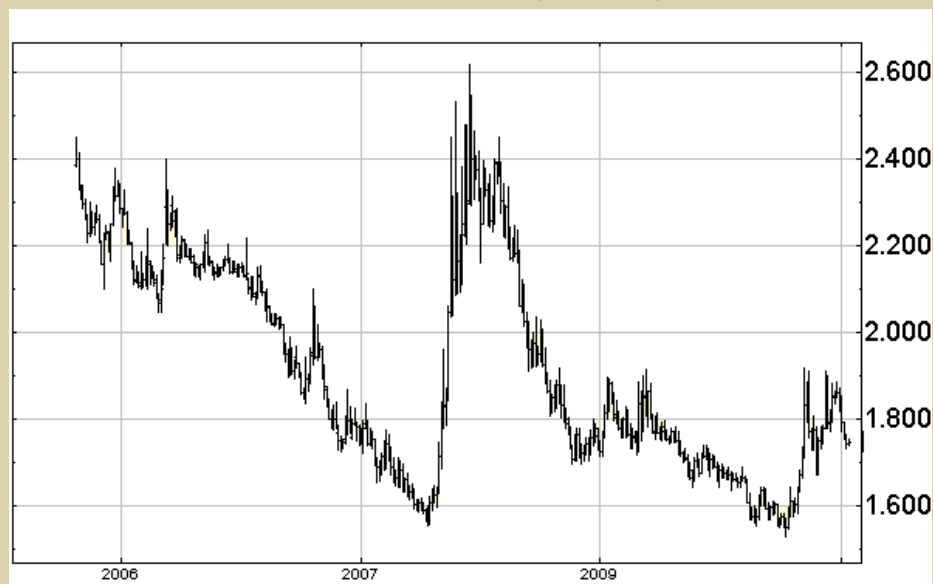
## A look back

The Brazilian real (BRL) has long been the darling of the emerging currency world. A look at a monthly chart for the real shows steady appreciation from late 2002 into the depths of the financial crisis in late 2008 (Figure 1). Over those years Brazil mostly enjoyed improving economic

fundamentals, increased fiscal discipline, and booming commodity exports. Also, importantly, the rise of a middle class consumer in Brazil helped to strengthen the country's domestic economy.

The 2008 crisis prompted money managers to liquidate almost all financial positions, and the BRL was hard hit, with the USD/BRL rate climbing from 1.55 to 2.61. It was only last summer that the real finally matched its pre-Lehman level of strength (USD/BRL around 1.5400). But then worries about European sovereign debt and its trickle-back impact from slower exports began to weigh on the Brazilian outlook and the USD/BRL rate rallied back to 1.91.

FIGURE 1: U.S. DOLLAR/BRAZILIAN REAL (USD/BRL), WEEKLY



*The Brazilian real appreciated steadily vs. the U.S. dollar (i.e., the USD/BRL rate moved lower) from late 2002 into mid-to-late 2008.*

With a strong start to the year for the real and other Latin currencies, the key question now is whether the bulls can keep driving them higher. Among the interesting mix of fundamental factors facing the region are a softer monetary policy cycle in Brazil and a presidential election later in the year in Mexico.

### **Keys to the Latin economy**

Alfredo Coutino, director of Latin American research at Moody's Analytics, expects Latin America to post annualized GDP growth of around 4.7 percent in 2012. Nomura forecasts a slower GDP rate for the region this year, at 3.3 percent. These regional forecasts still best most estimates for other areas in the world: Nomura anticipates a 2.2-percent GDP rate for the U.S., a recession for the Eurozone, and a 2.2-percent GDP pace for emerging European economies. (The brightest spot on the globe remains the Asia-Pacific zone, with Nomura forecasting 5.8-percent GDP for the region this year.)

Dr. Francisco Larios, chief emerging-market economist at Decision Economics, Inc. notes commodities are key to the Latin region. "We've seen a deceleration on the manufacturing side and the export side," he says. "Commodity [prices] are down from their post-recovery peaks, and that affects revenues and the availability of funds for financial economic action."

However, Larios adds the conditions in the region are far from recessionary. "The domestic economies are pretty strong and labor markets are close to full employment he says. "Brazil is as close to full employment as it has been in decades. Domestic fundamentals are very good."

The black cloud on the horizon — which threatens most of the globe — is the ongoing Eurozone sovereign-debt crisis. "It will only get bad [in Latin America] if we have a full-fledged crisis out of Europe," Larios says. "Latin America is likely to post moderate growth in 2012 as the year advances, given the loose monetary policy. It is at risk if a major financial implosion occurs in Europe. In that case, it would be hard to see any of these countries avoiding recession."

Larios stresses this recession risk is not due to domestic

fundamentals or structural issues within the major Latin economies. "Latin American banks are in good shape," he notes. "Companies by and large are not highly leveraged, but it would be hard for these economies to survive a shock [major European financial implosion] of that magnitude without going into recession."

Nomura's estimates for 2012 GDP put Brazil at 3.2, Mexico and Argentina at 3 percent, Colombia at 4.5 percent, and Chile leading the pack at 4.6 percent rate, pace. However, Larios says "headline GDP doesn't really tell the whole story," with individual countries facing more political risk, and with some economies more dependent on the commodity cycle.

"Brazil is safe structurally, and because they are a large and inward economy," Larios says. "But they may not be the economy that grows the fastest."

### **Brazil slowdown**

Despite overall positive GDP growth, Brazil did experience a bit of a slowdown last year. Eugenio Aleman, senior economist at Wells Fargo estimates Brazil's final 2011 GDP reading will come in at 2.8 percent, down sharply from 2010's 7.5-percent number. And Europe, he says, was a major factor behind the contraction. "The slowdown in Europe has affected Brazil considerably," Aleman explains. "Brazil's automotive industry producers are highly dependent on exports to Europe and China. It's a big chunk of their exports and it has slowed down a lot."

Interestingly, Aleman notes that while Brazilian automakers produce diesel cars, these vehicles are not available for domestic use, in part because of the regulatory power of the sugar-ethanol industry there. "Normally, it is Europe who buys [these cars]," he says.

On a December 2010 to December 2011 basis, the Brazilian real declined around 11 percent vs. the U.S. dollar, Aleman notes, with the majority of that weakness occurring in the second half of the year when weaker European demand became evident. Government policy played a supporting role. "The currency appreciated a lot up until August 2011," he says. "Then, in September the government strengthened constraints on capital inflows





and increased taxes on short-term portfolio investments. In July they decreased interest rates on the selic from 12.5 percent to 12 percent. The last four months of the year depreciated considerably."

Despite the European risk, Wells Fargo analysts expressed guarded optimism for the real, especially as the year lengthens, in their January *FX Express Monthly*: "European uncertainty and ongoing central bank easing pose downside risks in early 2012. However, given elevated inflation we expect the central bank to resist significant weakening in the currency from current levels. An eventual improvement in global market sentiment should boost the real later in the year, by which point the central bank easing should also be complete."

A strong downtrend in the USD/BRL pair (reflection strength in the real) is evident on the daily chart since the beginning of 2012 (Figure 2). There is little chart support until the October 2011 swing low at 1.67, which is the pair's next major technical objective.

Longer term, the Brazilian economy still has strong foreign direct investment and capital inflows, with major infrastructure building as the country prepares to host the 2014 World Cup and 2016 Olympics. "Even though

the government has tried to weaken the real, overall the longer-term trend is one of appreciation," Wells Fargo's Aleman says.

Larios adds, "The Brazilian real could be vulnerable in the next few months to the extent that commodities are not rising and interest rates are coming down. But I don't see the real in a secular downtrend. In the long run, the real should go up rather than down."

### Rate cuts expected

The Brazilian central bank's official monetary policy rate, the selic rate, stood at 10.50 percent at the beginning of February, and most analysts expect 1 to 2 percent of rate cuts in 2012, both to combat the slowing economy and dampen foreign interest in the currency's high yield.

Enrique Alvarez, head of Latin American research at Ideaglobal says Brazil (as well as Chile) are in stimulus mode. "My projection is the selic rate will fall another 100 basis points to 9.5 percent," he says. Nomura forecasts a 50 basis-point cut at the Brazilian central bank's March 12 meeting.

Larios, has an even more aggressive monetary policy forecast. "Brazil will cut by 150-200 basis points this year,"

he says. "The economy slowed down considerably in the second half [of 2011] and the manufacturing sector has been doing relatively poorly. This is a government that wants to actively manage the economy."

Meanwhile, Chile's central bank lending rate stands at 5 percent, with Nomura forecasting a .25 percent cut on Feb. 12, and a year-end target of 4.25 percent. Mexico is also in an easing cycle, with its official overnight rate currently at 4.50 percent. Nomura forecasts a .25 percent cut in the first quarter of 2012 for the Mexican rate.

### Shining star

Some market watchers see Mexico as the potential shining star of Latin America in 2012. "If you have addi-

**FIGURE 2: U.S. DOLLAR/BRAZILIAN REAL (USD/BRL), DAILY**



There's little chart support until the October 2011 swing low at 1.6700, which is the pair's next major technical objective.

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tional noticeable economic recovery in the U.S. in 2012, I think the Mexican peso can be the standout in the region this year," Ideaglobal's Alvarez says. "It's got a lot of room to run."

Larios agrees. He forecasts Mexican GDP growth in the neighborhood of 3.5-4 percent in 2012, and notes its economy has been gathering strength. "It looks like the stars are lined up properly for Mexico," he says. "It's numbers are solid. It is going the opposite [of Brazil] because they are more tied to the U.S. cycle. Also, the domestic Mexican economy is finally reacting to a long period of low interest rates."

Other bullish factors for Mexico include fairly high oil prices, which contribute about 30 percent of Mexican government revenues, as well as a higher level of remittances from Mexican workers in the U.S., which Larios notes "is an important source of income for Mexican households."

Another factor — and one most people overlook — is the importance of the auto industry south of the border. "Mexico is an interesting story because it is driven by U.S. auto demand," Aleman says. "Many U.S. and Japanese auto manufacturers have continued to invest in the Mexican auto manufacturing sector to sell to the U.S. market. It is a very, very strong sector."

The Mexican presidential election in the second half of 2012 could inject uncertainty into the forex arena, however. Currently, the Institutional Revolutionary Party's (PRI) Enrique Pena Nieto is the front-runner. "The PRI is leading by 20 percentage points," says Dirk Willer, head of Latin America strategy at Citi. "[Yet], you could have some election volatility in Mexico. If there is some volatility it typically begins three months before the election."

Overall, however, Alvarez expects a strengthening trend for the peso

(Figure 3). With the USD/MXN pair trading around 13.00 in late January, he says, "We could easily see it trend toward the 12.00 range."

Aleman was even more optimistic on the Mexican currency's prospects. "The peso could appreciate back to 11.50 if there is not too much bad news from the rest of the world," he says.

### Risk aversion

Finally, traders need to be mindful of the Latin currencies' traditional vulnerability to bouts of global risk aversion. Any major shock to the global financial system would likely trigger selling in these currencies as global money managers close carry trade positions and high-yield plays.

Willers note the Mexican, Chilean, and Brazilian currencies are most correlated to global risk, adding "Mexico has a U.S. flavor and Chile has a Chinese flavor," referring to the close trade ties between these respective economies. ☐

**FIGURE 3: U.S. DOLLAR/MEXICAN PESO (USD/MXN), DAILY**



*Most analysts expect more strengthening in the peso vs. the dollar, with the USD/MXN pair falling to 12.00 or lower.*



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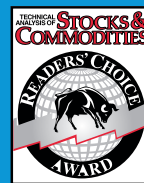
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# The lion in the savannah

Europe — and the Euro — still face significant challenges in attempting to avoid repeating history.

BY BARBARA ROCKEFELLER

The current consensus forecast for the Euro is a drop to 1.2000 or more during 2012. And yet Figure 1 shows the Euro has recently rallied from a low of 1.2700 on Jan. 13 to above 1.3050 by Jan. 24, breaking the red resistance line and delivering an upside crossover in the [moving average convergence-divergence](#) (MACD) indicator. It's only 350 points and a new move, so this could be just another corrective up move (like the one in October), or maybe it's something else. What's going on?

We need to worry about the Euro rallying to the channel top and nearing the 200-day moving average (around 1.3620 as of Jan. 24). In fact, we need to worry about an

outright reversal to an uptrend from the well-established downtrend now in place. The worry arises from a change in how the FX market is viewing risk these days.

Our understanding of financial market risk is becoming more dynamic. An Event that in its own right should be considered disastrous and cause a large price change in one time period can slide into a Non-Event in another period. What is horrible and frightening in July becomes acceptable by January. It may be a true paradigm shift whereby basic assumptions are thrown out and what appeared to be mere anomalies are now seen to be central.

The interesting thing about a paradigm shift is that it's irreversible. As the scientists say, you can't go back to attributing disease to "miasma" once you understand the germ theory of disease.

Any time there's a divergence in the usual financial correlations, we start to worry that the risk-on/risk-off model may break, or at least be viewed as insufficient and inadequate. The risk-on/risk-off model has a lot of shortcomings in the first place, not the least of which is fundamental supply and demand in individual markets. The inverse correlation of gold and the dollar is a case in point. It's a wobbly and unreliable correlation, especially in the past few years as traders who were not the least interested in gold's purported role as a safe-haven inflation hedge traded gold for its speculative return, like any other commodity.

Other intermarket relationships are changing, too. A key case is the CBOE Volatility Index (VIX), the equity market "fear index," and the dollar index (DXY). The risk-on/risk-off model holds the VIX and the DXY should

**FIGURE 1: EUR/USD, DAILY**



*Despite the prevailing gloomy outlook for the Euro, the EUR/USD rate recently rallied from 1.2700 on Jan. 13 to above 1.3050 by Jan. 24.*

*Source: Chart — Metastock; data — Reuters and eSignal*

move in sync: We expect the DXY to rise on safe-haven inflows when the VIX signals rising fear.

Sure enough, in Figure 2, the VIX and the DXY converge at the end of 2008 and track one another roughly until November 2011. Then, as Figure 3 shows, they start diverging. Rationales for the VIX being so low include good U.S. corporate earnings, U.S. recovery from recession, confidence the Fed will deliver no surprises, and hope Europe will dig itself out of its sovereign-debt crisis. But the rationale for the dollar index to be rising during November-January is *lack of confidence* that Europe will dig itself out and the dollar's job as a safe-haven. How can you have both sentiments at once?

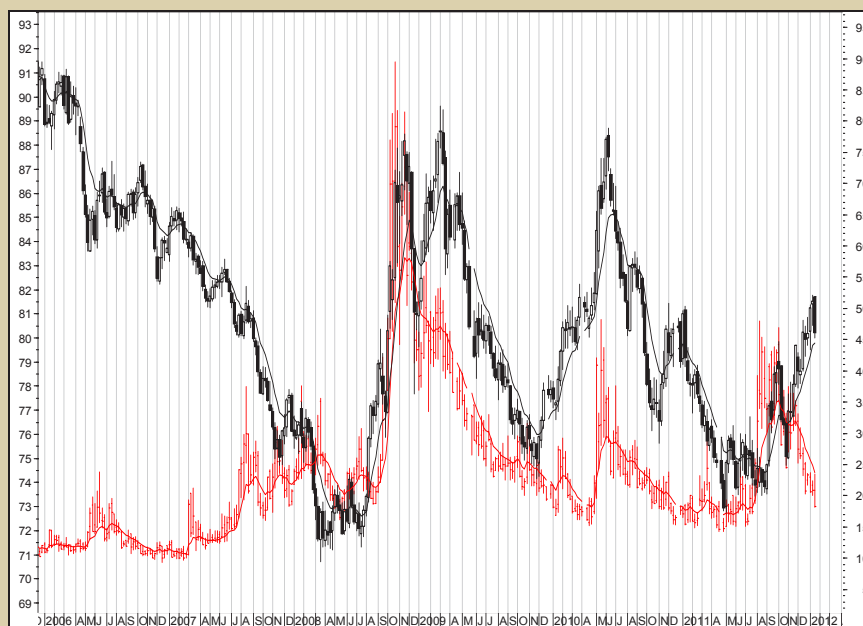
We wonder if a shift in preferences toward uncertainty could be the cause. As a rule, uncertainty and ambiguity make people uncomfortable. It is assumed high uncertainty about a pending outcome implies a high risk of the unfavorable outcome, and with normal risk-aversion in place, people will avoid situations where uncertainty is high. You avoid walking into the high grass of the savannah because lions might be lurking.

But in finance, the ratings agencies downgraded the U.S. in August and nine European countries in January, and *nothing happened*. It's as if the markets realized there are indeed still lions in the savannah, but when tapped on the nose, they will slink away.

### The downgrade that failed

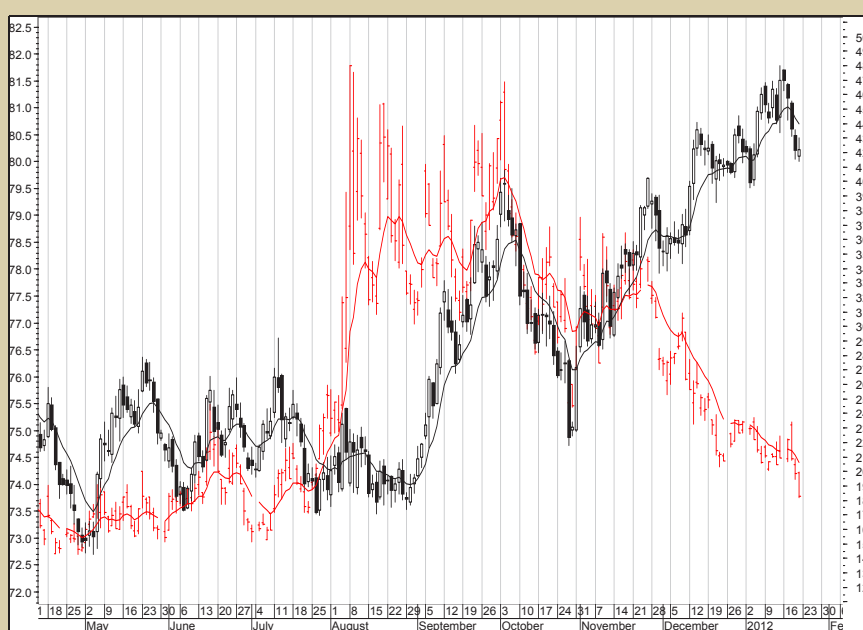
The saga starts with the curious case of the downgrade that failed. On Aug. 5, 2011, the S&P Ratings Agency downgraded U.S. sovereign risk from triple-A to double-A. The yield on the 10-year note fell from 2.458 percent on the day before the downgrade to a low of 1.808 percent on Sept. 23, 2011. The S&P 500 index, at 1200.07 the day before the

**FIGURE 2: VIX (RED) VS. DOLLAR INDEX (BLACK), WEEKLY WITH 10-WEEK MOVING AVERAGE**



*The VIX and the DXY converged at end of 2008 and traded roughly in sync until November 2011.*

**FIGURE 3: VIX (RED) VS. DOLLAR INDEX (BLACK), DAILY WITH 10-DAY MOVING AVERAGE**



*The VIX and the DXY began diverging in late 2011.*



downgrade, continued a decline that was already in place, but by Dec. 20 had risen to 1315.38. The VIX reached a high of 48 on Aug. 8, just after the downgrade, but fell to 18.28 by Jan. 20 this year.

The stunning lack of response to the downgrade was justified by saying it was a long time coming and was already built into prices. This is the old “sell on the rumor, buy on the news” phenomenon, making ratings agency downgrades a lagging indicator. After all, the ratings agencies don’t know anything the market professionals don’t know, and so their view is really just one voice among many. At junk-level ratings, the agencies can force some investors out of certain markets (such as Greece), but anyone who waits for the agencies to downgrade to junk are certainly asleep at the switch.

U.S. 10-year Treasuries were sought as a safe-haven from the European sovereign-debt crisis as the least-ugly girls at the dance. In fact, investors bid more than \$3 for each \$1 of Treasuries sold in 2011, despite falling yields.

We can also point to a disconnect between the fiscal condition of the country and the economic vitality and robustness of the companies in the S&P 500.

Another idea is the S&P downgrade was influenced to a large extent by gridlock in the Washington political process, something the voters had engineered themselves. Gridlock and looming default had been fixed once before, by Treasury Secretary Robert Rubin during the Clinton administration. Perhaps financial market professionals dismiss politicians altogether in favor of the real experts, now called “technocrats,” who can be counted on to pull a rabbit out of the hat at the last minute.

We are seeing the same thing with the European downgrades. As more or less promised in early December 2011, S&P downgraded nine European countries on Jan. 14, including France. Portugal was consigned to junk status, the only other European country to join Greece. Long-term ratings were lowered by one notch for Austria, France, Malta, Slovakia, and Slovenia, and by two notches for Cyprus, Italy, Portugal, and Spain.

The countries retaining triple-A status were Germany, Finland, the Netherlands, and Luxembourg. But S&P also sees the outlook as negative for Austria, Belgium, Cyprus, Estonia, Finland, France, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovenia, and Spain, meaning at least a one-in-three chance their ratings will be lowered this year or next.

Two days later, S&P downgraded the European Financial Stability Facility (EFSF) from triple-A to double-A on the grounds that some of its major backers, including France, were themselves downgraded. Again, as in the case of the U.S., the downgrades were long in the works and (again) [S&P based the downgrades](#) largely on the political judgment that “initiatives taken by European policymakers in recent weeks may be insufficient to fully address ongoing

systemic stresses in the eurozone.”

But in judging the power of the S&P downgrades, you have to check bond yields — and they do not reflect rising fear. On the *next trading day* after the downgrade, Spain was able to sell €4.8 billion in 12-month sovereign bills at 2.049 percent vs. 4.05 percent the month before and 18-month paper at 2.399 percent vs. 4.226 percent the month before. The Italian 10-year yield fell from above 7 percent before year-end 2011 to 6.94 percent on Jan. 4 to a seven-week low of 6.10 percent on Jan. 24. In early January, both Spain and Italy were able to place new paper of varying maturities at rates lower than late last fall, and to high demand. France, similarly, held auctions with yields only fractionally higher and to high demand. The ESFS placed new six-month paper *one day* after its downgrade at a low yield of 0.2664 percent, about the same as French paper of the same maturity and with a very nice [bid-to-cover](#) of more 3-to-1.

The market is, however, culling the herd. On Jan. 24, the yield on the Portuguese 10-year note was 14.53 percent, up 7.73 percent year-over-year. The Greek 10-year is yielding 36.70 percent, up 25.55 percent year-over-year, according to the handy [Financial Times Benchmark Government Yield table](#). But these are the exceptions. Most other sovereign benchmark yields, including those of Germany, the UK, and the U.S., are lower than the month before and the year before. In a nutshell, both S&P downgrades fizzled as fear-some market-moving Events. What happened to change the environment was Europe, the European Central Bank (ECB), and the International Monetary Fund (IMF) working behind the scenes to develop the firepower to overcome the downgrades.

## The firewall picture

The IMF is the most problematic. Managing Director Christine Lagarde wants a bigger firewall against contagion from Greece and Portugal, and is proposing a new \$500 billion fund to add to its existing reserves of €385 billion, plus pledges of €150 billion from European countries. The source would be Brazil, Russia, India, and China (the BRICs), plus Japan and oil-exporting countries. The plan is to finalize the deal at the G20 meeting in Mexico City on Feb. 25-26. The new fund plus the existing and promised funds would total about \$1 trillion. The success of this venture is not yet assured — so far, China, Brazil and Russia have said they won’t pony up unless the rest of G20 does, and the U.S. has declined to participate.

Then there is the remaining €250 billion in the ESFS, to which will be added €500 billion in the to-be-formed European Stability Mechanism, due in July. A proposal is afoot to leverage the €250 billion in the EFSF four times, to €1 trillion, something EFSF chief Klaus Regling said is easy enough to achieve, downgrade be damned. Also, the ESM amount may be raised to €750 billion if the EMU

signatories to the new fiscal compact agree to get rid of the loophole that would allow budget rules to be broken in extreme circumstances. The two bailout funds, ESFS and EMS, may run in parallel.

There also is the ECB's €489 billion long-term refinancing operation (LTRO) initiated on Dec. 21, 2011, to be followed by another of perhaps €400 billion on Feb. 29 for a total of about €889 billion. This is a perfect carry-trade gift from the central bank to the financial sector. The banks borrow at 1 percent and use the money to buy sovereign debt yielding 300-500 basis points more, and give the sovereign debt to the ECB as collateral. Some critics, including Pimco's Bill Gross, call the LTRO scheme a shell game that does absolutely nothing to repair sovereign finances. That may be true, but it's not useful. The ECB is not aiming to repair finances — it's aiming to find another buyer for sovereign paper, since under its charter the ECB cannot be a lender of last resort to sovereigns.

Table 1 shows the arithmetic. There are a lot of assumptions in here — the leveraging of EFSF, the IMF raising funds from G20 — but the total amount is not impossible. Last fall, critics called the EFSF a popgun when the situation required a bazooka, but as former U.S. Treasury Secretary Henry Paulson said about the U.S. rescue plan, you shouldn't have to *use* the bazooka — just announce it. The Europeans didn't make a one-time, knock-their-socks-off announcement; the initiatives have been given out in dribs and drabs. But the total effect is the same in the end: The European debt crisis can be overcome. Several European leaders, including the Austrian central bank governor, were offended when Treasury Secretary Timothy Geithner proposed U.S.-style TARP and TALF bailout mechanisms for Europe, saying these ideas are not compatible with European institutions and the U.S. should mind its own business. But the LTRO and leveraged EFSF funds are clearly the equivalent of TARP/TALF. (We await an apology.)

A sum like €3.3 trillion is impressive and is seemingly effective in turning off the contagion mechanism by which unsustainably higher yields in one place infect yields in another. But while the programs serve to soothe the financial markets, they do absolutely nothing to fix the underlying structural problems that led to over-indebtedness in the first place. We have the appearance of stability, but not the reality. After all, LTRO is banks borrowing money to buy downgraded paper to use as collateral to get the money — a shell game. LTRO is called "trash for cash." All it really does is buy time, albeit not an ignoble goal, and improve bank earnings for a few years.

Breaking the negative feedback loop is a worthy cause and Europe managed it. But as S&P said in its press release about the downgrades, "While we see a lack of fiscal prudence as having been a major contributing factor to high public debt levels in some countries, such as Greece, we

believe that the key underlying issue for the Eurozone as a whole is one of a growing divergence in competitiveness between the core and the so-called 'periphery.'" Fiscal austerity is necessary but not sufficient.

Then there is the pesky problem of the junk-status countries, Greece and Portugal. Greece has essentially already defaulted, even if it's not considered a "credit event" for credit default swap payout purposes. Portugal is trickier, since the country has made a genuine effort, and goodwill counts. Europe has enough money, or will have, to fend off an all-out assault on Portugal, and maybe Italy or Spain, but not all of them at one time. It's always possible that some scarcely imagined event can come along and put the peripherals into crisis simultaneously, overwhelming the bailout capacity. But now that expectations have changed, it's unlikely. Europe has enough of a cushion now to tough it out.

We need to ask at what point the FX market accepts the new environment in which downgrades don't count. According to the CFTC [Commitments of Traders](#) report for the second week of January, speculative accounts held a record number of Euro futures shorts — more than 160,000 contracts, or \$1.6 billion. This is a small amount in the FX market, but it can be viewed as a proxy for a trading universe that is massively short. Short-covering can be triggered by any number of things, including price simply surpassing a recent high. The FX market has been more cautious than others of re-embracing risk, but if it starts to like risk again, we could see the old risk-on behavior fire up again — i.e., buy commodities and the Australian dollar as well as the Euro. It could be a very big rout for the shorts.

Of course, those who do not learn from history are condemned to repeat it. Europe may have enough money cushion to get over a contagion this time, but the rules of economics are not repealed and S&P is not wrong to say Europe lacks the structures and the will to grow out of over-indebtedness. The downgrades may have fizzled as a market-moving Event, but the underlying causes of the downgrade are still valid. Watch out for lions. ☒

*For information on the author, see p. 4.*

**TABLE 1: SOVEREIGN DEBT BAILOUT FUNDS**

Source	Amount
LTRO	€889 billion
EFSF leveraged x 4	€1 trillion
EMS (July 1)	€500-750 billion
IMF*	€935 billion
Total	€3.314-3.564 trillion

*\*assumes \$500 billion from G20*



# Avoiding FX trading mishaps with the COT report

Both spot forex and currency futures traders can gain insight into market dynamics by consulting the Commitments of Traders report.

BY CARLEY GARNER

Many wise traders have noted that, in the end, it isn't how much you made, it's how much you didn't lose. Traders work hard to amass profits, but being in the wrong place at the wrong time — and worse, being unprepared when that happens — can potentially wipe out painstakingly accumulated gains in an instant.

Most FX traders use technical analysis to form opinions about upcoming price moves. Others are number crunchers who prefer to use fundamental data such as GDP, interest-rate differentials, and inflation data. However, a less discussed but perhaps more accommodating form of analysis is the study of trader sentiment and the identification of “overcrowded” trades. Here we'll look at how to use the Commodity Futures Trading Commission's (CFTC) [Commitments of Traders report](#) (COT) to identify overheated trends and possible reversals. In addition to gaining insight into when to buy or sell, this information can also let you know when it's best to be on the sidelines.

## Understanding the COT report

The COT report shows the open positions of different types of traders. To put the COT in perspective, stock traders who want to know who's buying or selling a particular company would consult the Securities and Exchange Commission's (SEC) Form 4 filings. Corporate officers, directors, and beneficiary owners holding more than 10 percent of outstanding shares are required to report transactions in their shares. Similarly, futures traders look to the COT report to find out who is buying and selling futures (and options on futures). The COT report provides a wealth of information about who is trading what, in which direction and, more importantly, in what magnitude.

Each Friday, the CFTC releases a weekly snapshot of the previous Tuesday's [open interest](#) in most U.S. exchange-listed futures contracts. Of course, open interest statistics do not include the activity of day traders (contracts

entered and offset within a single trading session). The COT report is available at the [CFTC's website](#). The CFTC compiles data only from the futures market. Because FX is not traded on a single exchange and volume is spread across several Electronic Currency Networks (ECNs) and dealing desks, it is nearly impossible to derive accurate volume figures, let alone identify the different types of traders executing transactions.

Nonetheless, the information in the COT report about currency futures trading is a useful proxy for what is occurring in the spot forex market. Futures contracts are agreements for delivery of the underlying currency; the prices in both trading arenas are closely linked. Futures data might not be a perfect representation of spot FX, but it is the only data of its type for currency traders.

## Defining components of the COT report

The COT report provides quantifiable information on market sentiment, but what makes the report so much more useful than the typical sentiment poll is that it reflects only those people who have put their money, rather than their mouths, on the line — traders. The report divides them into several distinct categories.

There are several forms of the COT report, but we'll focus on the simplest, which is called the “Futures and Options, Short Form.” This report segregates traders into two major categories, “Reportables” and “Non-Reportables.” The Reportables are positions held by single entities (individuals or funds) that exceed thresholds set by the CFTC; brokerage firms are required to report customer positions above these limits to the CFTC each day. The reportable limits vary by market and contract; most retail traders don't fall into this category. The Reportable category has two subcategories: “Commercials” (hedgers) and “Non-Commercials” (professional/institutional speculators). The large speculators, or large specs, are sometimes



described as the “smart money.”

The “Non-Reportable” group is the “everyone else” category and is comprised of small retail traders who and even some small funds. Non-Reportable traders are those do not meet the CFTC’s reportable position limit. (This group is sometimes, harshly, referred to as the “dumb money.”)

Each of the COT categories offer insights into what is happening in the markets, and what might happen in the future. Here, we will focus on positions of the large specs because of the information it can provide about whether a market is leaning too far one way or the other. The ability to survive overcrowded trades is a critical factor in determining success or failure. Warren Buffet once remarked during a CNBC interview, “We don’t want to make money on the bubble, we just want to survive it without losing our shirts.” The COT report is the most useful “red flag” for alerting you to overzealous herd trading.

### What’s the “smart money” doing?

Although analyzing the positions of the large speculators in a market can tell you a great deal about market dynamics, trading currencies isn’t simply a matter of following the so-called smart money and hoping to ride their coat-tails to success. The large spec category of the COT report is made up of well-capitalized traders who have much more room for error than the typical retail trader. Also, these traders are only human and can make mistakes just as easily as we can. Nonetheless, betting against them on a consistent basis isn’t a good idea.

Monitoring the large spec group is most helpful during the beginning and end of a market move. For instance, if your fundamental or technical analysis gives you a bullish bias and you also notice the large spec group is beginning to move from short (or neutral) to long, it provides a measure of confirmation. On the other hand, if you are late to the party and you see the large specs have already been long for a considerable period of time and are currently holding an excessive number of net long contracts, you’re probably better off accepting the fact that you have already

missed the easy money. In these situations you should refrain from trading what might be a maturing trend. After all, once all the motivated buyers are in, there’s simply no one left to support prices at lofty levels and the downside is likely lined with sell-stop orders waiting to be triggered.

Obviously, the same principles hold true for an over-extended bear market. At some point the bus simply gets too full and makes the market vulnerable to a massive short-covering rally. A move triggered by the unwinding of an overcrowded trade can occur even without a lack of change in fundamentals or any logical reason for a repricing. Instead, these moves are fueled by the simple fact that traders who sell short must buy back contracts to exit trades, and vice versa.

Unfortunately, the COT report is just like any other technical indicator or piece of fundamental information — it only tells a fraction of the story. It isn’t until after the fact that we can go back and determine when, where, and how a trend changes. That said, there are certain numbers in the COT report that function as red flags in the major currency futures traded on the CME Group. For instance, the Euro has a habit of reversing course when the large spec category amasses a net short or long position of 100,000 or more (Table 1). Similarly, trends in the Japanese yen and the British pound tend to grow tired when large specs have accumulated a net directional position of 50,000 or more. In the Canadian dollar, the level is 60,000 contracts.

COT analysis is arguably most helpful in the Euro — perhaps because the currency attracts the most speculative attention, or maybe because it is the aggregate currency to several countries. In any case, COT data has highlighted several dramatic Euro reversals in recent years. Similar to an oscillator that tells you the market is overheated and due for a correction — but doesn’t tell you exactly when — the COT is more of a “friendly reminder” there might be cause for concern.

The FX futures contracts in the COT report are quoted in American terms, which means the value of each foreign currency is stated in terms of the U.S. dollar. If you are

**TABLE 1: LARGE SPEC THRESHOLDS**

Currency futures contract	Futures ticker symbol	Excessive large spec net position	Corresponding FX pair	FX pricing relative to futures
Euro	EC	100,000	EUR/USD	Same
Japanese yen	JY	50,000	USD/JPY	Inverse
Canadian dollar	CD	60,000	USD/CAD	Inverse
British pound	BP	50,000	GBP/USD	Same

*Currencies have different points at which accumulated positions in the large speculator category signal a “tired” market.*



familiar with forex pairs, the easiest way to think of it is, in the futures market the U.S. dollar is always the secondary (or “quote”) currency. In some cases, this differs from the spot FX market standard. For example, the Euro currency futures contract is quoted in the same manner as the EUR/USD pair, but the yen futures contract is quoted inversely to the FX pair (USD/JPY), as shown in Table 1. Accordingly, if the COT report suggests the long side of the market is getting overcrowded in the yen futures, spot forex traders can assume traders are overly short the USD/JPY pair (short the dollar and long the yen).

Now let’s take a look at some specific examples of overcrowded trades that potentially ruined the lives of complacent or greedy traders.

### Examples

In May 2010 there didn’t seem to be a Euro bull on the planet. Worries over disbandment of the currency union,

### Related reading

#### Carley Garner books:

*Currency Trading in the Forex and Futures Markets*  
(Pearson, 2012)

*A Trader’s First Book on Commodities:  
An Introduction to The World’s Fastest Growing  
Market* (FT Press, 2010)

bankrupted sovereigns, and a sluggish global economy led many to predict the Euro and the U.S. dollar would soon be trading near par (\$1.00 in the EUR/USD pair).

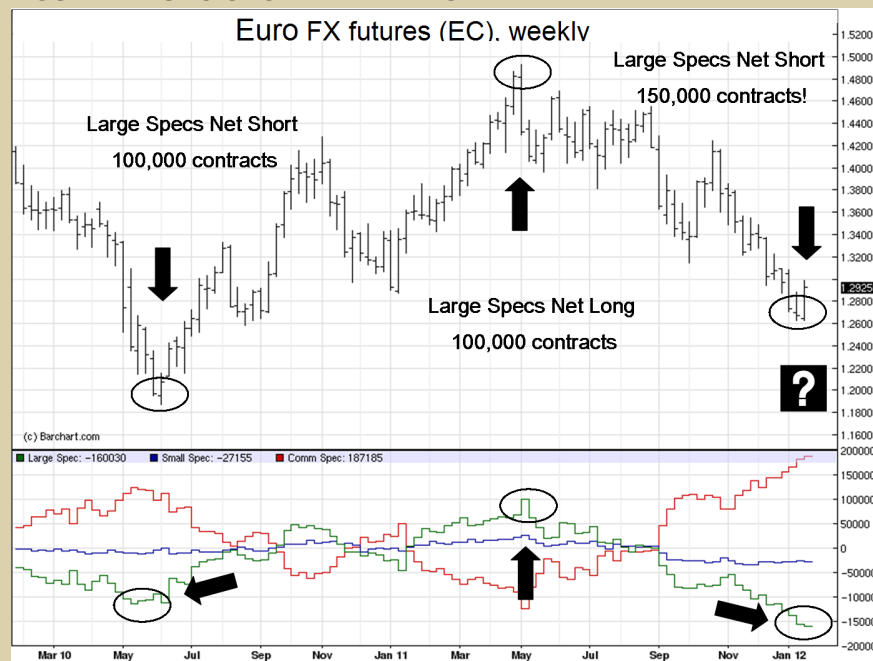
And not only were analysts voicing this opinion, traders were acting on it. At the height of the frenzy, the large spec group amassed a net short position in excess of 100,000 contracts, in the process forcing the Euro to the \$1.20 mark for the first time since 2005 (Figure 1). Just as the Euro looked destined to fail, the shorts found reason to lock in profits — triggering an impressive bout of short covering that eventually brought the Euro 20 cents higher into the mid-\$1.40s.

Assuming you would have had the fortitude to go against nearly everyone else in the market at the exact low and sell at the exact high is unrealistic. But for illustration

purposes, had you found a way to do it, you would have netted in excess of \$40,000 for each 100,000 units of the EUR/USD (\$50,000 on a single Euro FX futures contract). A more realistic result of correctly analyzing the COT data was that you could have dodged the short-covering freight train by avoiding short positions once the large specs appeared to be too short. In the near-term, this might not carry the same bragging rights as catching the rally from the long side, but in the long run, it does.

There are other ways to take advantage of this type of information. For example, even a trader who refused to believe in a bullish market move in the face of bearish fundamentals might be comfortable buying out-of-the-money “lottery ticket” call options — just in case. Although shorting options is often more advantageous than buying them, there is a time and place for long option strategies; you might be surprised how much a long option will increase in value when a violent

**FIGURE 1: EURO SHORT EXTREMES**



At the height of the sell-off in spring 2010, the large spec group amassed a net short position in excess of 100,000 contracts.

Source: BarChart.com

market correction occurs. A trader who purchased a September Euro \$1.32 call near the June 8 low (88 days until expiration) at a price below \$400 would have seen that option double in value by June 17. (A 100-percent return in a little more than a week with limited risk is an attractive proposition, but when buying options your timing must be efficient to avoid the wrath of time-value erosion.)

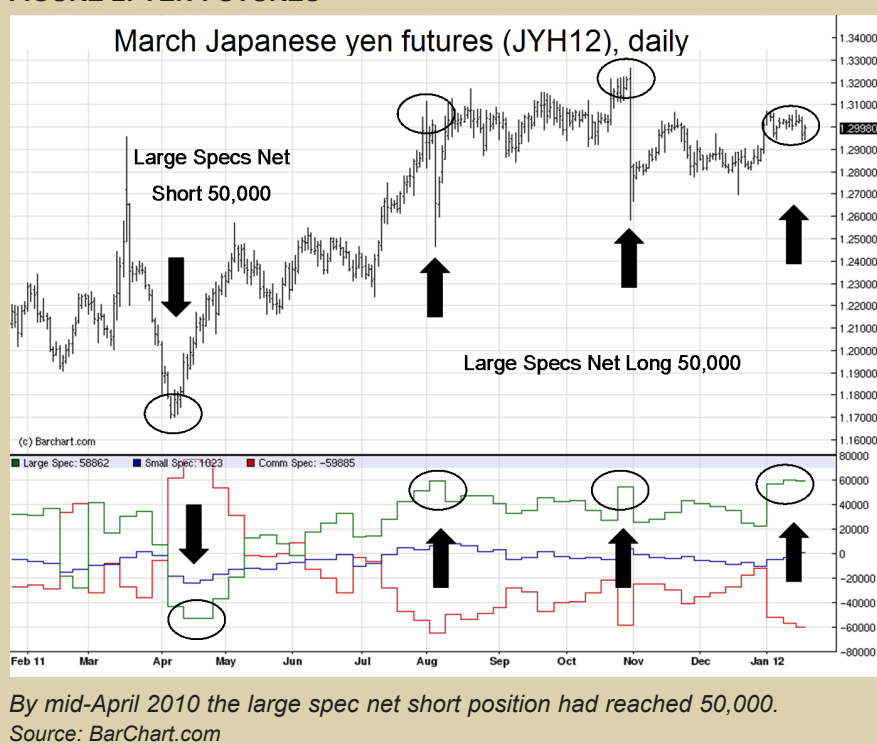
A similar opportunity in the Euro might have been setting up in late-January this year. Currency analysts and financial news commentators seemed to be overwhelmingly bearish the Euro; likewise, the large spec category had grown to an all-time record net short position in excess of 150,000 contracts. Only time will tell the rest of this story, but one thing is certain: the risk of being short at the time far outweighed the potential reward.

The Japanese yen provides another example of how to apply the COT report (Figure 2). The yen has been a repeated target of government intervention, by both the Bank of Japan and global efforts. Even so, there are times when speculators get overzealous; the subsequent unwinding of excessive positions can be fierce for those caught on the wrong side of the market.

An extreme example took place in April 2010. In the previous month the yen had rallied as speculators anticipated repatriation of funds from global investments back to Japan. However, by mid-April traders had adopted the opposite opinion, eventually pushing the large spec net short position to the exceptionally high level of 50,000. If a majority of the bears are already short, it can be difficult for a currency to continue to weaken. Not surprisingly, the market rallied sharply in the following weeks.

Although COT analysis wouldn't have told you exactly where to enter long, it would have given you an idea of the market's current balance between longs and shorts,

**FIGURE 2: YEN FUTURES**



alerting you to the dangers of being short in an overcrowded trade. To illustrate the power of a long-option "lottery ticket" play in such extreme market conditions, a June 110 call purchased for \$437.50 on April 2 was worth more than \$1,400 by April 16.

### Avoiding the trap

The COT report can signal the onset, maturation, and eventual unwinding of overcrowded trades. Although the report does not necessarily provide precise timing signals, it can alert you to situations when you are positioning yourself against the "smart money" in a currency.

Traders who find themselves victims of the wrath of a crowded trade gone bad are essentially victims of their own greed. Recognizing and avoiding "herd" trades can go a long way toward preventing you from being lured into market hype at an inopportune time, or complacently allowing winning trades to turn into painful losses. Don't be the infamous hog running headlong toward slaughter. Remember, sometimes it's more about what you don't lose than about what you don't make. ☐

*For information on the author, see p. 4.*



# Requiem for a carry trade

The case of the yen carry trade teaches us the races you want to win are those to the top, not to the bottom.

BY HOWARD L. SIMONS

One of the most critical things for any trader or, for that matter, any market commentator, is to know when to “turn the card over,” a reference to those long-ago days when transactions were executed on a trading floor and recorded on pieces of cardboard with one side devoted to longs and the other to — you guessed it — shorts.

Such is the case with the yen carry trade (see “Looking at the carry trade,” *Currency Trader*, June 2007). As Japan’s boom-and-bust cycle predated those of the United States and various paragons of exuberance in the Eurozone, its

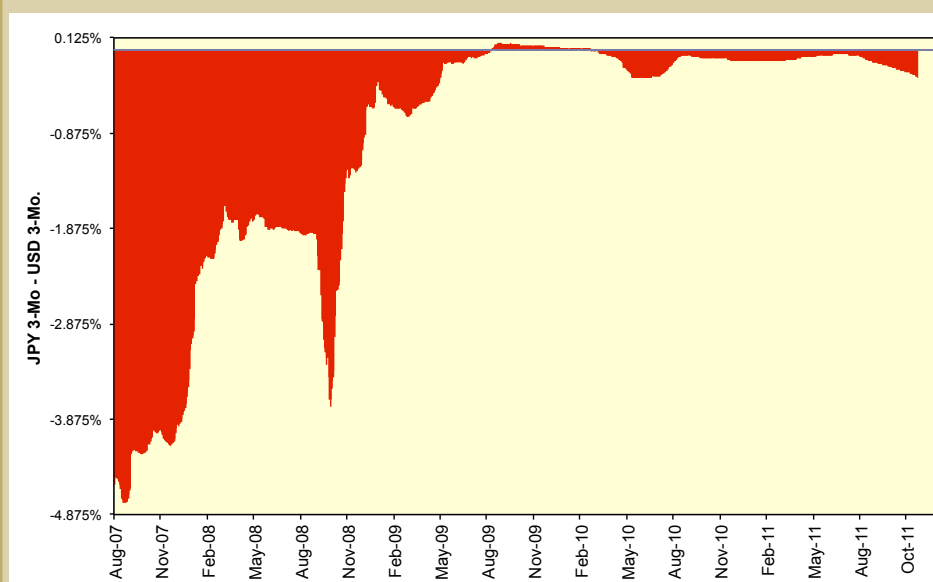
decision to drive short-term interest rates lower and to start stuffing all manner of excess yen reserves into the remnants of their banking system predated everyone else’s, too.

Japan moved to a zero interest rate policy (ZIRP) in February 1999, 13 long years ago, and first moved to money printing (excuse me, “[quantitative easing](#)”) in March 2001. Those cheap and excess yen were borrowed by other countries to finance both their growth and certainly, with the benefit of hindsight, to finance their financial market bubbles.

But competition in the free-money department started to emerge with the financial crisis beginning in August 2007. We updated an analysis of the dollar [carry trade](#) beginning on Aug. 17, 2007 in “The long, awful life of the dollar carry trade” (January 2012). Let’s do a similar update for the yen carry trade and replace the start date of the analysis, originally the Jan. 4, 1999 inception of the Euro, with the March 19, 2009 date when American quantitative easing began for those living on Asian time.

One of the important factors we need to keep in mind is the yen has been cheaper to borrow than the dollar, and often significantly so, since August 2007 with the exception of the August

**FIGURE 1: THE YEN REMAINS CHEAPER TO BORROW**



*With the exception of the August 2009-March 2010 period, the yen has been cheaper to borrow than the dollar since August 2007.*



2009-March 2010 period when the dollar became modestly cheaper to borrow (Figure 1). However, as the yen is subject to spiking higher because of importers needing to purchase yen to pay their Japanese suppliers and factors such as occasional large-scale Chinese purchases of Japanese bonds, the dollar can be a competitive and even dominant funding source even when it is more expensive to borrow than the yen.

### Carry trade decomposition

As we did last month, let's review some of the terms involved. All currency trades can be broken into their interest rate spread component and their spot rate components. The carry trade returns calculated below are based on borrowing at the three-month LIBOR rate of the lower yielding currency (LY3) and lending at the three-month LIBOR rate of the higher yielding currency (HY3). The returns on the higher yielding currency are adjusted for the daily changes in the spot rate for the lower yielding currency (LYS). A 260-day trading year is used.

$$1. \text{Long Return}_t = \left[ \left( 1 + \frac{HY_{3_t}}{260} \right) * \frac{LYS_t}{LYS_{t-1}} \right] - 1$$

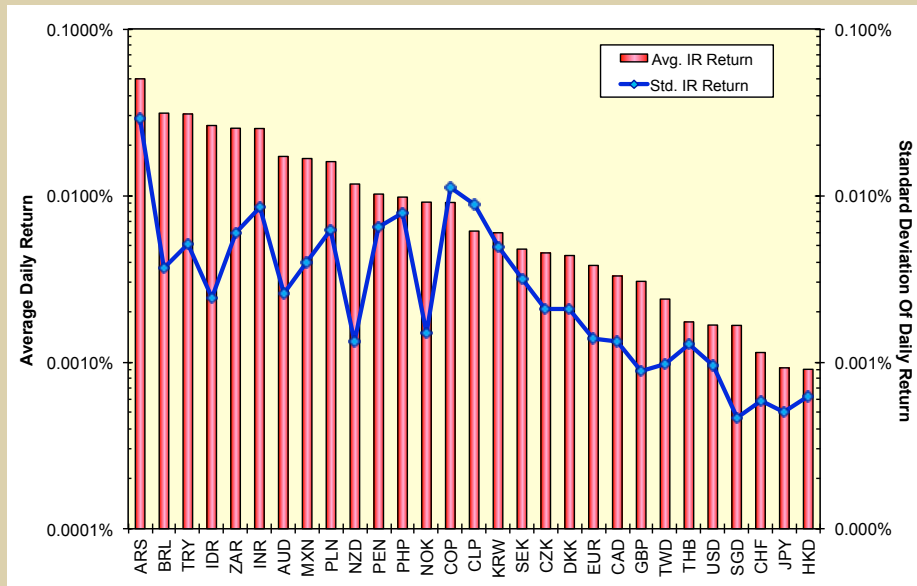
$$2. \text{Short Return}_t = \frac{LY_{3_t}}{260}$$

$$3. \text{Net Carry Return}_t = \text{Long Return}_t - \text{Short Return}_t$$

### Interest rate returns

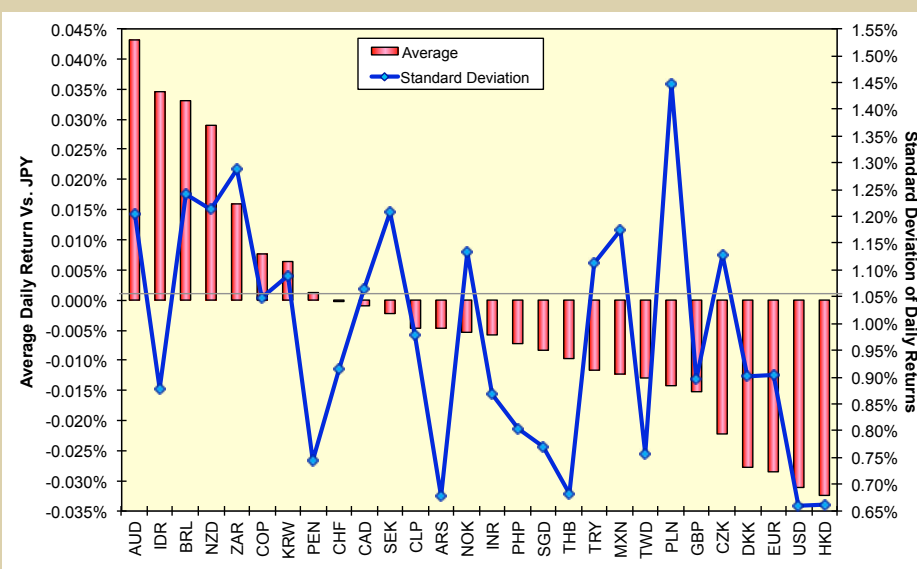
As Japan won the race to the bottom for most of the post-March 2009 period, we should expect the average inter-

**FIGURE 2: THREE-MONTH INTEREST RATE RETURNS ON SELECTED CURRENCIES MARCH 2009 ONWARD**



*Average daily interest rate returns on the JPY have been less than those of other major currencies. Only the USD is close.*

**FIGURE 3: RISK AND RETURN IN THREE-MONTH CARRY AGAINST JPY MARCH 2009 ONWARD**



*That 18 currencies have negative carries vis-à-vis the yen indicates the spot-rate changes for these currencies had to be sufficiently negative to overwhelm the interest rate gains.*

est rate returns for the JPY to be less than those of most other currencies, and indeed they have been (Figure 2). However, the Hong Kong dollar (HKD) has been slightly cheaper to borrow on average, and the USD, Swiss franc (CHF), and Singapore dollar (SGD) all are in the race. The CHF, as we have established in 2010-2011, is prone to revaluation and the SGD and HKD are relatively tiny. This brings the USD to the fore as the main competition.

While we could note last month for the dollar carry trade the correlation of interest rate returns post-August 2007 was more uniform and positive than seen for the entire post-January 1999 sample, such is not the case for the post-March 2009 sample in the case of the yen carry

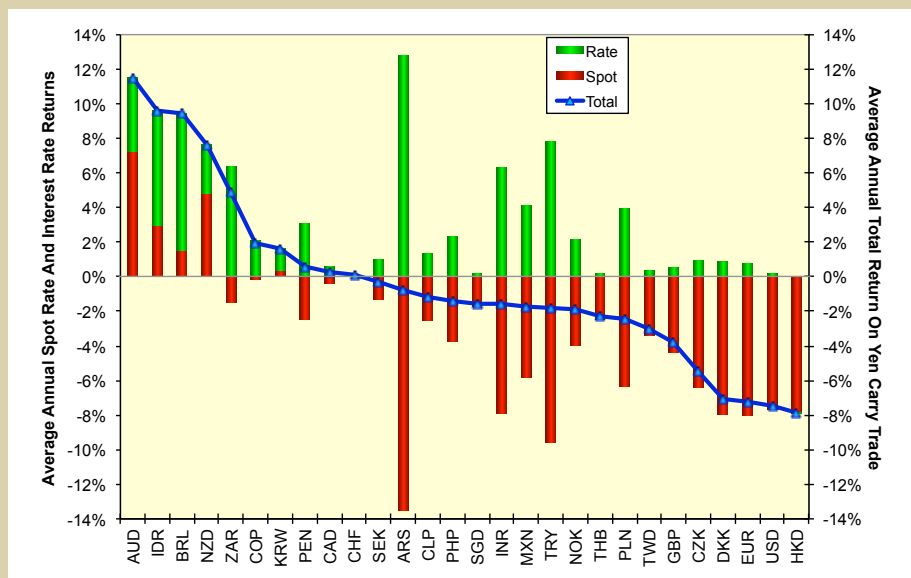
**TABLE 1: CORRELATION OF THREE-MONTH INTEREST RATE TOTAL RETURNS SINCE MARCH 2009**

	ARS	AUD	BRL	CAD	CHF	CLP	COP	CZK	DKK	EUR	GBP	HKD	IDR	INR
ARS	1.000													
AUD	-0.462	1.000												
BRL	0.275	0.045	1.000											
CAD	-0.040	0.749	0.068	1.000										
CHF	0.601	-0.511	0.310	-0.140	1.000									
CLP	0.147	0.620	0.134	0.873	-0.094	1.000								
COP	0.457	-0.806	0.009	-0.668	0.385	-0.460	1.000							
CZK	0.423	-0.878	0.144	-0.700	0.605	-0.635	0.716	1.000						
DKK	0.460	-0.584	0.059	-0.162	0.502	0.064	0.530	0.490	1.000					
EUR	0.477	0.162	0.130	0.625	0.235	0.811	-0.049	-0.226	0.510	1.000				
GBP	0.728	-0.322	0.447	0.163	0.630	0.366	0.325	0.369	0.671	0.684	1.000			
HKD	0.529	-0.226	0.538	0.158	0.575	0.255	0.280	0.367	0.519	0.476	0.840	1.000		
IDR	0.187	-0.493	0.281	-0.255	0.507	-0.138	0.443	0.571	0.651	0.174	0.611	0.662	1.000	
INR	0.001	0.664	0.071	0.909	-0.108	0.903	-0.630	-0.663	0.007	0.711	0.235	0.128	-0.185	1.000
JPY	0.545	-0.782	0.292	-0.438	0.670	-0.301	0.676	0.812	0.692	0.113	0.684	0.689	0.755	-0.378
KRW	-0.253	0.634	-0.096	0.581	-0.282	0.525	-0.555	-0.646	-0.307	0.217	-0.215	-0.246	-0.376	0.571
MXN	0.461	-0.853	0.226	-0.696	0.576	-0.542	0.809	0.877	0.583	-0.120	0.467	0.512	0.678	-0.640
NOK	0.144	0.666	0.350	0.759	-0.046	0.848	-0.389	-0.596	-0.068	0.644	0.328	0.370	-0.130	0.740
NZD	-0.033	0.230	0.373	0.235	0.135	0.034	-0.277	-0.041	-0.203	-0.099	0.114	0.315	0.069	0.100
PEN	0.045	-0.182	0.237	0.099	0.361	0.083	0.007	0.296	0.392	0.201	0.482	0.509	0.705	0.137
PHP	0.206	-0.605	0.218	-0.665	0.287	-0.586	0.628	0.651	0.223	-0.341	0.174	0.264	0.435	-0.673
PLN	0.229	0.134	0.012	0.237	-0.018	0.332	-0.030	-0.175	0.041	0.342	0.131	0.019	-0.220	0.262
SEK	0.054	0.602	-0.018	0.858	-0.154	0.925	-0.519	-0.660	0.108	0.808	0.250	0.095	-0.208	0.922
SGD	0.120	-0.814	0.003	-0.919	0.347	-0.864	0.703	0.817	0.246	-0.561	-0.009	0.044	0.411	-0.876
THB	0.500	-0.520	0.268	-0.275	0.492	-0.130	0.490	0.524	0.487	0.166	0.553	0.526	0.489	-0.221
TRY	0.741	-0.645	0.212	-0.277	0.609	-0.034	0.678	0.612	0.654	0.398	0.734	0.609	0.564	-0.193
TWD	-0.111	0.144	-0.095	0.202	-0.134	0.223	-0.105	-0.212	0.157	0.221	0.038	0.025	0.069	0.252
USD	0.650	-0.717	0.362	-0.400	0.662	-0.245	0.649	0.771	0.616	0.156	0.722	0.702	0.671	-0.353
ZAR	0.163	-0.477	0.070	-0.447	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000

Large portions of the table show negative correlations of interest rate returns (yellow cells). Both volatility and trading opportunities should follow this large-scale divergence of interest rate returns. (Table 1 continues on the next page.)

TABLE 1 (CONTINUED): CORRELATION OF THREE-MONTH INTEREST RATE TOTAL RETURNS SINCE MARCH 2009															
	JPY	KRW	MXN	NOK	NZD	PEN	PHP	PLN	SEK	SGD	THB	TRY	TWD	USD	ZAR
ARS															
AUD															
BRL															
CAD															
CHF															
CLP															
COP															
CZK															
DKK															
EUR															
GBP															
HKD															
IDR															
INR															
JPY	1.000														
KRW	-0.567	1.000													
MXN	0.871	-0.639	1.000												
NOK	-0.277	0.474	-0.427	1.000											
NZD	0.055	0.021	-0.059	0.191	1.000										
PEN	0.465	-0.144	0.297	-0.055	0.127	1.000									
PHP	0.562	-0.514	0.721	-0.416	-0.026	0.161	1.000								
PLN	-0.118	0.134	-0.147	0.307	-0.108	-0.153	-0.174	1.000							
SEK	-0.380	0.541	-0.606	0.723	-0.053	0.058	-0.665	0.327	1.000						
SGD	0.594	-0.607	0.800	-0.730	-0.122	0.062	0.721	-0.248	-0.874	1.000					
THB	0.641	-0.390	0.599	-0.078	0.055	0.246	0.401	-0.022	-0.206	0.346	1.000				
TRY	0.733	-0.414	0.702	-0.035	-0.165	0.272	0.427	0.065	-0.124	0.387	0.575	1.000			
TWD	-0.078	0.119	-0.159	0.165	-0.034	0.070	-0.131	0.041	0.292	-0.235	-0.062	-0.110	1.000		
USD	0.878	-0.551	0.836	-0.192	0.099	0.395	0.550	-0.069	-0.347	0.524	0.729	0.756	-0.113	1.000	
ZAR	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000

Large portions of the table show negative correlations of interest rate returns (yellow cells). Both volatility and trading opportunities should follow this large-scale divergence of interest rate returns.

**FIGURE 4: DECOMPOSING THE YEN CARRY TRADE MARCH 2009 ONWARD**

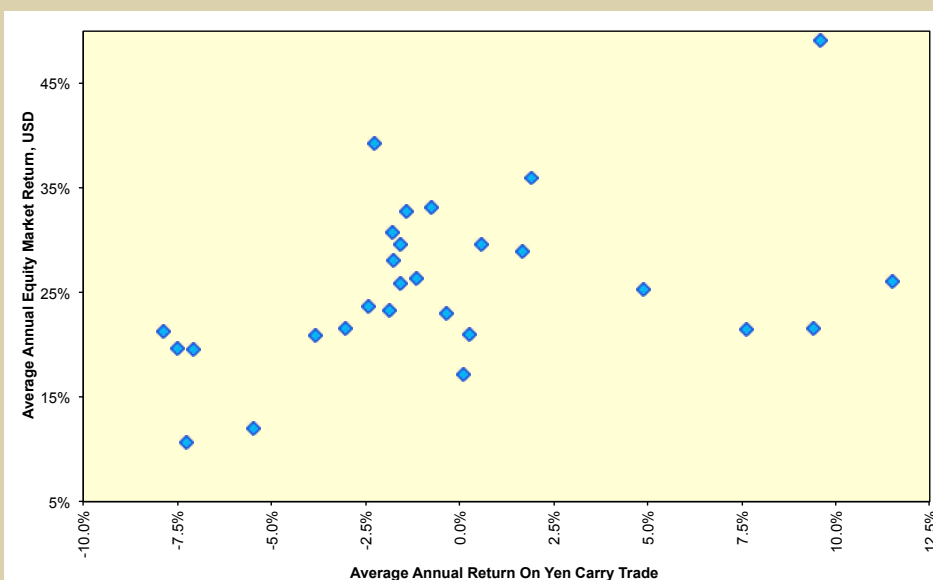
*The JPY's strong spot price appreciation over this period determined far more of the net carry trades' returns than did interest rate spreads.*

trade. Large swaths of Table 1 show negative correlations of interest rate returns (yellow cells). This large-scale divergence of interest rate returns will maintain large-scale tension in currency markets; both volatility and trading opportunities should follow.

### The yen carry

Now let's examine the total return from the carry trade of borrowing three-month JPY and lending the proceeds in three-month LIBOR of the other 28 currencies (Figure 3). Please note how 18 currencies have negative carries vis-à-vis the yen. These include the low-yielding CHF, Taiwan dollar (TWD), USD and HKD, and the (relatively) higher-yielding Argentine peso (ARS), British pound (GBP), Norwegian krone (NOK), Czech koruna (CZK), Danish krone (DKK), and Euro (EUR). This tells us immediately the spot rate changes for these currencies, discussed shortly, had to be sufficiently negative to overwhelm the interest rate gains.

If we redisplay these carry trade returns as the combination of their interest rate spreads and spot rate changes, we see how the JPY's strong spot price appreciation over this period determined far more of the net carry trades' returns than did interest rate spreads (Figure 4). Equally striking is the large number of currencies where both components of the carry trade return, interest rate spread as well as spot rate change, were positive. That list down to a 4-percent total carry return includes the Australian dollar (AUD), Indonesian rupiah

**FIGURE 5: WEAKLY POSITIVE CORRELATION BETWEEN YEN CARRY AND EQUITIES**

*The weak relationship of national index returns vs. the yen carry return since March 2009 highlights the diminished importance of the yen carry trade.*



(IDR), Brazilian real (BRL), New Zealand dollar (NZD), and South African rand (ZAR).

### The stock market connection

Our real clues to the diminished importance of the yen carry trade come in its relationship to equity returns. If we map national index returns against the yen carry return since March 2009, the relationship is weak, albeit positive (Figure 5).

If we break the interest rate and spot rate components of the carry trade from Figure 5 into separate charts, we see the same weak and generally non-tradable relationships (Figure 6).

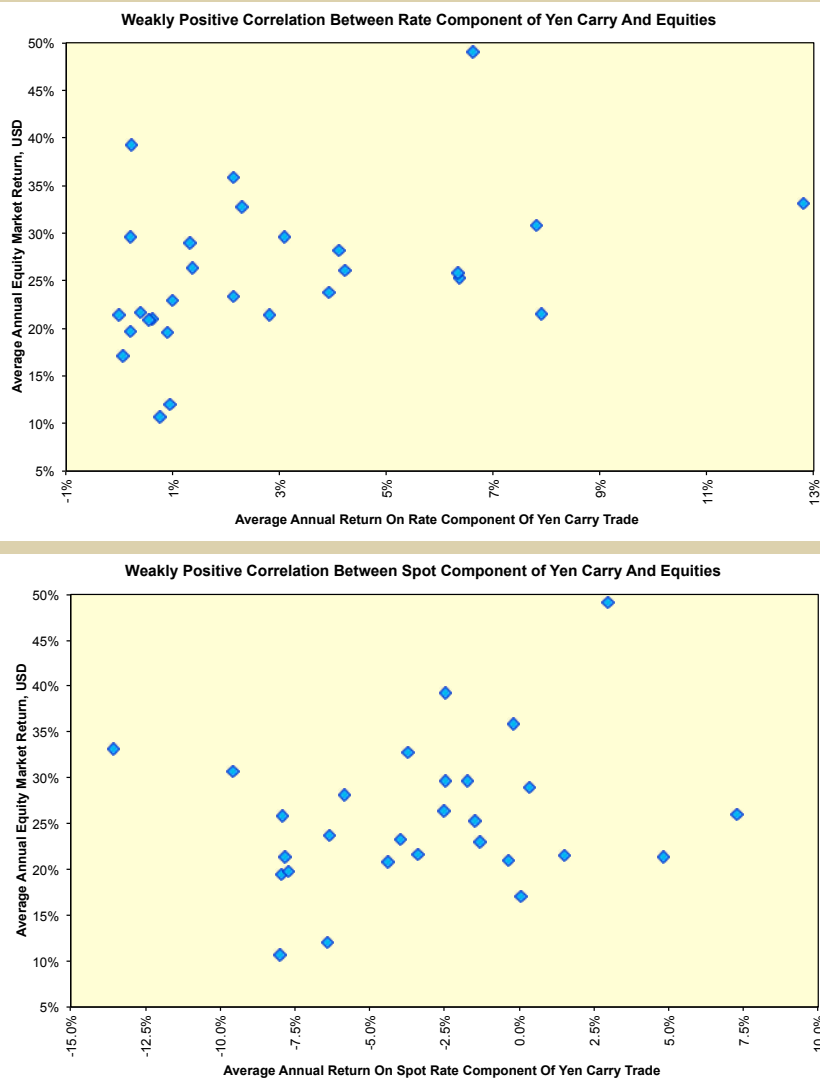
The *pièce de résistance*, however, comes not from mapping the carry trade and its components against the national equity indices but rather in comparing the dollar and yen carry trades into a basket of emerging market currencies at the weights corresponding to those in the MSCI Emerging Market Free index. Let's map the excess carry returns for the carry trades of the USD and JPY into the EM basket against the logarithm of the total return for the MSCI EM index (Figure 7).

Please note how closely the USD carry's path matches the return of the emerging market stock index after April 2009 while the relationship between the yen carry and the stock index collapses. What used to be important, the yen carry trade, has been usurped and replaced by the dollar carry even though Japan did everything in its power to win the race to the bottom.

Two lessons emerge. First, the races you want to win are those to the top, not to the bottom. Second, the Federal Reserve's protestations all through the money-printing era that it was not fueling an asset bubble in emerging markets are shown to be hogwash. If those bubbles formerly were made in Japan, they are made in the U.S. now. ☐

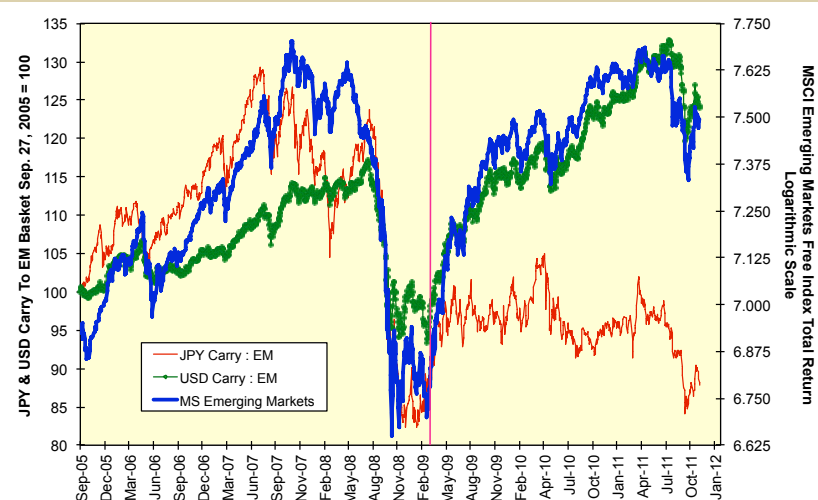
*For information on the author, see p. 4.*

**FIGURE 6: COMPONENT BREAKDOWN**



*Breaking down Figure 5 into its interest rate (top) and spot rate (bottom) components reveals the same weak and generally non-tradable relationships.*

**FIGURE 7: USD CARRY INTO EM CURRENCIES MORE IMPORTANT AFTER 2008**



*The weak relationship between emerging markets and the yen carry trade into EM currencies since March 2009 highlight the diminished importance of the yen carry trade.*



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.

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

## February

<b>1</b>	<b>U.S.:</b> January ISM manufacturing report <b>Hong Kong:</b> Q4 GDP
<b>2</b>	
<b>3</b>	<b>U.S.:</b> January employment report <b>LTD:</b> February forex options; February U.S. dollar index options (ICE)
<b>4</b>	
<b>5</b>	
<b>6</b>	
<b>7</b>	
<b>8</b>	<b>Brazil:</b> January PPI
<b>9</b>	<b>Mexico:</b> January PPI and Jan. 31 CPI <b>UK:</b> Bank of England interest-rate announcement <b>ECB:</b> Governing council interest-rate announcement
<b>10</b>	<b>U.S.:</b> December trade balance <b>Brazil, Germany:</b> January CPI <b>Japan, UK:</b> January PPI
<b>11</b>	
<b>12</b>	
<b>13</b>	<b>Japan:</b> Q4 GDP
<b>14</b>	<b>U.S.:</b> January retail sales <b>India:</b> January PPI <b>Japan:</b> Bank of Japan interest-rate announcement <b>UK:</b> January CPI
<b>15</b>	<b>Germany:</b> Q4 GDP <b>UK:</b> January employment report
<b>16</b>	<b>U.S.:</b> January PPI and housing starts <b>Australia:</b> January employment report
<b>17</b>	<b>U.S.:</b> January CPI and January leading indicators <b>Brazil:</b> January employment report <b>Germany:</b> January PPI
<b>18</b>	
<b>19</b>	
<b>20</b>	<b>Hong Kong:</b> January CPI
<b>21</b>	<b>Hong Kong:</b> November-January employment report

<b>22</b>	<b>France, South Africa:</b> January CPI
<b>23</b>	<b>Mexico:</b> Q4 GDP and Feb. 15 CPI <b>South Africa:</b> January PPI
<b>24</b>	<b>Mexico:</b> January employment report
<b>25</b>	
<b>26</b>	
<b>27</b>	<b>France:</b> January PPI
<b>28</b>	<b>U.S.:</b> January durable goods <b>South Africa:</b> Q4 GDP
<b>29</b>	<b>U.S.:</b> Q4 GDP (second) and fed beige book <b>Germany:</b> January employment report <b>India:</b> Q4 GDP and January CPI <b>South Africa:</b> Q4 employment report

## March

<b>1</b>	<b>U.S.:</b> January personal income and February ISM manufacturing index <b>Canada:</b> January PPI <b>France:</b> Q4 employment report
<b>2</b>	<b>Canada:</b> Q4 GDP <b>Japan:</b> January employment report and CPI
<b>3</b>	
<b>4</b>	
<b>5</b>	
<b>6</b>	<b>Brazil:</b> Q4 GDP
<b>7</b>	<b>Australia:</b> Q4 GDP <b>Brazil:</b> February PPI
<b>8</b>	<b>Australia:</b> February employment report <b>Canada:</b> Bank of Canada interest-rate announcement <b>Mexico:</b> February PPI and Feb. 29 CPI <b>UK:</b> Bank of England interest-rate announcement <b>ECB:</b> Governing council interest-rate announcement
<b>9</b>	<b>U.S.:</b> January trade balance and February employment report <b>Brazil, Germany:</b> February CPI <b>UK:</b> February PPI <b>LTD:</b> March forex options; March U.S. dollar index options (ICE)



## EVENTS

**Event:** The World MoneyShow Orlando

**Date:** Feb. 9-12

**Location:** Gaylord Palms Resort

**For more information:** Go to [www.moneyshow.com/trade-show/orlando/world\\_moneyShow/?scode=013104](http://www.moneyshow.com/trade-show/orlando/world_moneyShow/?scode=013104)

**Event:** The International Traders Expo New York

**Date:** Feb. 19-22

**Location:** Marriott Marquis Hotel, New York

**For more information:** [Click here.](#)

**Event:** CBOE Risk Management Conference

**Date:** March 11-13

**Location:** Hyatt Regency Coconut Point Resort and Spa at Bonita Springs, Fla.

**For more information:** Go to [www.cboermc.com](http://www.cboermc.com)

**Event:** The International Traders Expo London

**Date:** March 23-24

**Location:** Queen Elizabeth II Conference Centre, London

**For more information:** [Click here.](#)



Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	235.4	278.5	3.58% / 100%	1.38% / 44%	-4.24% / 53%	.38 / 77%
AUD/USD	AD	CME	97.6	118.4	3.10% / 80%	4.96% / 81%	2.45% / 65%	.36 / 48%
GBP/USD	BP	CME	78.5	188.6	2.61% / 100%	2.02% / 71%	-1.65% / 31%	.60 / 97%
JPY/USD	JY	CME	64.4	148.5	0.85% / 43%	1.67% / 97%	2.59% / 33%	.74 / 92%
CAD/USD	CD	CME	59.2	107.6	2.10% / 88%	1.92% / 69%	1.43% / 61%	.33 / 58%
MXN/USD	MP	CME	26.1	117.2	5.14% / 94%	8.14% / 96%	4.74% / 100%	.42 / 92%
CHF/USD	SF	CME	24.5	38.4	3.84% / 100%	2.46% / 64%	-3.50% / 15%	.42 / 98%
U.S. dollar index	DX	ICE	19.4	64.3	-3.04% / 89%	-1.52% / 56%	3.18% / 43%	.44 / 85%
NZD/USD	NE	CME	5.7	16.4	3.60% / 85%	6.60% / 97%	3.12% / 76%	.35 / 62%
E-Mini EUR/USD	ZE	CME	3.8	4.5	3.58% / 100%	1.38% / 44%	-4.24% / 53%	.38 / 77%

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 Dec. 31 ranked by December 2011 return)

	Trading advisor	December return	2011 YTD return	\$ Under mgmt. (millions)
1.	CenturionFx Ltd (6X)	8.80%	76.31%	18.5
2.	Cambridge Strategy (Emerging Mkts)	7.49%	11.68%	90.0
3.	Alder Cap'l (Alder Global 20)	6.80%	-2.36%	531.0
4.	Friedberg Comm. Mgmt. (Curr.)	4.31%	-1.46%	103.4
5.	P/E Investments (FX Aggressive)	4.12%	-0.33%	2600.0
6.	Alder Cap'l (Alder Global 10)	3.40%	0.14%	13.0
7.	A.G. Bisset (Currency Alpha)	2.72%	-4.89%	510.0
8.	Richmond Group (Gl. Currency)	2.21%	-15.25%	24.0
9.	QFS Asset Mgmt (QFS Currency)	1.28%	5.54%	838.0
10.	Ortus Capital Mgmt. (Currency)	1.23%	5.72%	3141.0

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

1.	GTA Group (FX Trading)	1.88%	-8.00%	2.1
2.	Vaskas Capital Mgmt (Global FX)	1.72%	-16.46%	2.5
3.	Adantia (FX Aggressive)	1.55%	41.63%	1.8
4.	Sunrise Cap'l Partners (Currency Fund)	1.29%	1.51%	5.7
5.	Drury Capital (Currency)	0.94%	-7.44%	3.1
6.	Overlay Asset Mgmt. (SHCFP)	0.88%	-7.27%	7.7
7.	Capricorn Currency Mgmt (FXG10 USD)	0.79%	11.51%	6.0
8.	Iron Fortress FX Mgmt	0.65%	44.17%	4.1
9.	BEAM (FX Prop)	0.60%	-0.25%	2.0
10.	Four Capital (FX)	0.47%	11.80%	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.



## CURRENCIES (vs. U.S. DOLLAR)

Rank	Currency	Jan. 26 price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Indian rupee	0.01971	6.66%	-1.33%	-11.99%	0.0226	0.0181	17
2	Brazilian real	0.56863	5.80%	-0.28%	-11.87%	0.65	0.5288	6
3	New Zealand dollar	0.809545	4.54%	0.95%	-6.41%	0.8797	0.7207	3
4	Australian Dollar	1.05061	3.51%	0.43%	-3.05%	1.1028	0.9478	2
5	South African rand	0.125615	2.53%	-0.84%	-14.72%	0.1518	0.1166	1
6	Singapore dollar	0.788955	2.08%	-0.34%	-4.71%	0.832	0.7606	7
7	Swedish krona	0.14787	1.80%	-3.14%	-6.32%	0.1662	0.1427	5
8	Russian ruble	0.032535	1.42%	-0.70%	-9.78%	0.0366	0.0303	9
9	Taiwan dollar	0.033400	1.23%	0.60%	-3.75%	0.03510	0.032	11
10	Canadian dollar	0.98952	1.00%	-0.41%	-6.13%	1.059	0.9467	4
11	Chinese yuan	0.15873	0.90%	1.09%	2.23%	0.15873	0.1512	10
12	Swiss franc	1.076725	0.83%	-5.23%	-12.94%	1.3779	1.0269	15
13	Hong Kong dollar	0.128845	0.22%	0.19%	0.39%	0.128845	0.1281	12
14	Japanese yen	0.01283	0.20%	-2.40%	0.47%	0.0132	0.0117	14
15	Great Britain pound	1.560215	0.10%	-2.45%	-4.25%	1.6702	1.5308	8
16	Euro	1.30154	-0.21%	-6.47%	-9.45%	1.4842	1.2657	16
17	Thai baht	0.03171	-0.78%	-2.27%	-5.60%	0.0336	0.031	13



## GLOBAL STOCK INDICES

	Country	Index	Jan. 26	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Germany	Xetra Dax	6,539.85	11.04%	8.71%	-11.02%	7,600.41	4,965.80	12
2	Hong Kong	Hang Seng	20,439.14	9.72%	7.20%	-9.45%	24,468.60	16,170.30	5
3	Brazil	Bovespa	62,953.00	9.16%	10.17%	6.09%	70,108.00	47,793.00	9
4	India	BSE 30	17,233.98	8.57%	-0.32%	-6.94%	19,811.10	15,135.90	15
5	France	CAC 40	3,363.23	8.38%	6.11%	-11.21%	4,169.87	2,693.21	6
6	Singapore	Straits Times	2,894.43	8.26%	4.49%	-9.17%	3,236.93	2,521.95	14
7	Italy	FTSE MIB	16,111.04	7.95%	10.51%	-15.34%	23,273.80	13,115.00	8
8	Canada	S&P/TSX composite	12,464.32	6.27%	2.28%	-6.29%	14,329.50	10,848.20	10
9	South Africa	FTSE/JSE All Share	34,065.49	6.15%	7.34%	6.89%	34,065.49	28,391.18	11
10	UK	FTSE 100	5,795.20	5.23%	4.36%	-2.27%	6,105.80	4,791.00	3
11	Australia	All ordinaries	4,348.50	4.99%	1.11%	-6.41%	5,069.50	3,829.40	13
12	Japan	Nikkei 225	8,849.47	4.84%	1.15%	-12.36%	10,891.60	8,227.63	7
13	U.S.	S&P 500	1,318.43	4.19%	6.15%	-1.01%	1,370.58	1,074.77	2
14	Switzerland	Swiss Market	6,100.40	3.63%	7.02%	1.84%	6,739.10	4,695.30	1
15	Mexico	IPC	37,240.78	0.40%	3.97%	5.37%	38,128.40	31,659.30	4



## NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	Jan. 26	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	New Zeal \$ / Yen	NZD/JPY	63.085	4.32%	3.33%	-6.87%	67.97	56.86	4
2	Aussie \$ / Yen	AUD/JPY	81.87	3.30%	2.88%	-3.52%	89.46	72.72	3
3	Aussie \$ / Franc	AUD/CHF	0.975745	2.65%	5.98%	11.36%	0.9864	0.7477	2
4	Aussie \$ / Canada \$	AUD/CAD	1.061735	2.48%	0.85%	3.29%	1.0627	0.9708	8
5	Canada \$ / Yen	CAD/JPY	77.115	0.80%	2.02%	-6.58%	88.95	72.63	6
6	Franc / Yen	CHF/JPY	83.91	0.63%	-2.92%	-13.36%	105.79	80.46	12
7	Pound / Yen	GBP/JPY	121.59	-0.11%	-0.07%	-4.72%	139.19	117.58	9
8	Franc / Canada \$	CHF/CAD	1.088125	-0.16%	-4.84%	-7.25%	1.3569	1.0135	19
9	Euro / Pound	EUR/GBP	0.834205	-0.35%	-4.12%	-5.43%	0.9038	0.8239	16
10	Euro / Yen	EUR/JPY	101.43	-0.44%	-4.18%	-9.89%	122.63	97.22	13
11	Pound / Franc	GBP/CHF	1.449035	-0.74%	2.93%	9.97%	1.5585	1.1778	7
12	Pound / Canada \$	GBP/CAD	1.57674	-0.89%	-2.05%	2.00%	1.6354	1.5302	14
13	Aussie \$ / New Zeal \$	AUD/NZD	1.29789	-0.98%	-0.50%	3.60%	1.3746	1.2354	11
14	Euro / Franc	EUR/CHF	1.208765	-1.14%	-1.31%	4.00%	1.3183	1.0376	1
15	Euro / Canada \$	EUR/CAD	1.315325	-1.20%	-6.08%	-3.53%	1.4316	1.2917	20
16	Aussie \$ / Real	AUD/BRL	1.847625	-2.17%	0.72%	10.01%	1.9129	1.6402	5
17	Pound / Aussie \$	GBP/AUD	1.485055	-3.29%	-2.88%	-1.25%	1.6373	1.4787	18
18	Euro / Aussie \$	EUR/AUD	1.23886	-3.69%	-6.87%	-6.60%	1.4228	1.2261	21
19	Canada \$ / Real	CAD/BRL	1.74019	-4.54%	-0.13%	6.51%	1.83	1.5997	10
20	Yen / Real	JPY/BRL	0.022565	-5.27%	-2.13%	14.02%	0.0246	0.0186	15
21	Euro / Real	EUR/BRL	2.288915	-5.68%	-6.20%	2.75%	2.5367	2.204	17

## GLOBAL CENTRAL BANK LENDING RATES

Country	Interest rate	Rate	Last change	July 2011	January 2011
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	0-0.1 (Oct 10)	0-0.1	0-0.1
Eurozone	Refi rate	1	0.25 (Dec 11)	1.5	1
England	Repo rate	0.5	0.5 (March 09)	0.5	0.5
Canada	Overnight rate	1	0.25 (Sept 10)	1	1
Switzerland	3-month Swiss Libor	0-0.25	0.25 (Aug 11)	0.25	0.25
Australia	Cash rate	4.25	0.25 (Dec 11)	4.75	4.75
New Zealand	Cash rate	2.5	0.5 (March 11)	2.5	3
Brazil	Selic rate	10.5	0.5 (Jan 12)	12.5	11.25
Korea	Korea base rate	3.25	0.25 (June 11)	3.25	2.75
Taiwan	Discount rate	1.875	0.125 (June 11)	1.875	1.625
India	Repo rate	8.5	0.25 (Oct 11)	8	6.5
South Africa	Repurchase rate	5.5	0.5 (Nov.10)	5.5	5.5



GDP		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Q3	12/16	-5.6%	16.4%	3/9
	Brazil	Q3	12/6	0.3%	8.6%	3/6
	Canada	Q3	11/30	1.1%	5.9%	3/2
EUROPE	France	Q3	12/23	0.3%	3.1%	3/28
	Germany	Q3	11/15	0.8%	2.5%	2/15
	UK	Q3	12/22	1.1%	3.0%	3/27
AFRICA	S. Africa	Q3	11/29	2.7%	10.8%	2/28
ASIA and S. PACIFIC	Australia	Q3	12/7	1.6%	6.1%	3/7
	Hong Kong	Q3	11/11	6.5%	4.3%	2/1
	India	Q3	11/30	1.0%	16.0%	2/29
	Japan	Q3	11/14	3.4%	14.5%	2/13
	Singapore	Q3	11/25	2.0%	6.1%	2/24

Unemployment		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS	Argentina	Q3	11/21	7.2%	-0.1%	-0.3%	2/22
	Brazil	Dec.	1/26	4.7%	-0.5%	-0.6%	2/17
	Canada	Dec.	1/6	7.5%	0.0%	-0.1%	2/3
EUROPE	France	Q3	12/1	9.3%	0.2%	-0.1%	3/1
	Germany	Dec.	1/31	5.5%	-0.1%	-1.1%	2/29
	UK	Sept.-Nov.	1/18	8.4%	0.3%	0.5%	2/15
ASIA and S. PACIFIC	Australia	Dec.	1/19	5.3%	0.0%	0.2%	2/16
	Hong Kong	Oct.-Dec.	1/19	3.3%	-0.1%	-0.7%	2/21
	Japan	Dec.	1/31	4.2%	-0.3%	-0.7%	4/2
	Singapore	Q4	1/31	2.0%	0.0%	-0.2%	4/30

CPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Dec.	1/13	0.9%	9.5%	2/10
	Brazil	Dec.	1/9	0.5%	6.5%	2/10
	Canada	Dec.	1/20	-0.6%	2.3%	2/17
EUROPE	France	Dec.	1/12	0.4%	0.3%	2/22
	Germany	Dec.	1/12	0.7%	2.1%	2/10
	UK	Dec.	1/16	0.4%	4.2%	2/14
AFRICA	S. Africa	Dec.	1/18	2.1%	6.1%	2/22
ASIA and S. PACIFIC	Australia	Q4	1/25	0.0%	3.1%	4/24
	Hong Kong	Dec.	1/20	0.5%	5.7%	2/20
	India	Dec.	1/31	-1.0%	6.5%	2/29
	Japan	Dec.	1/27	0.0%	-0.2%	3/2
	Singapore	Dec.	1/25	0.0%	5.5%	2/23

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Dec.	1/13	0.9%	12.7%	2/10
	Canada	Dec.	1/31	-0.6%	2.3%	3/1
EUROPE	France	Dec.	1/31	-0.1%	4.7%	2/27
	Germany	Dec.	1/20	-0.4%	4.0%	2/17
	UK	Dec.	1/13	-0.2%	4.8%	2/10
AFRICA	S. Africa	Dec.	1/26	0.0%	9.8%	2/23
ASIA and S. PACIFIC	Australia	Q4	1/23	0.3%	2.9%	4/23
	Hong Kong	Q3	12/13	1.2%	9.6%	3/13
	India	Dec.	1/16	0.0%	7.5%	2/14
	Japan	Dec.	1/16	0.1%	1.3%	2/10
	Singapore	Dec.	1/27	0.8%	7.9%	2/29

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



Two-day reversal  
signals buy in  
dollar/Swiss.

## TRADE

**Date:** Monday, Jan. 30, 2012.

**Entry:** Long the U.S. dollar/Swiss franc pair (USD/CHF) at .9172.

### Reason for trade/setup:

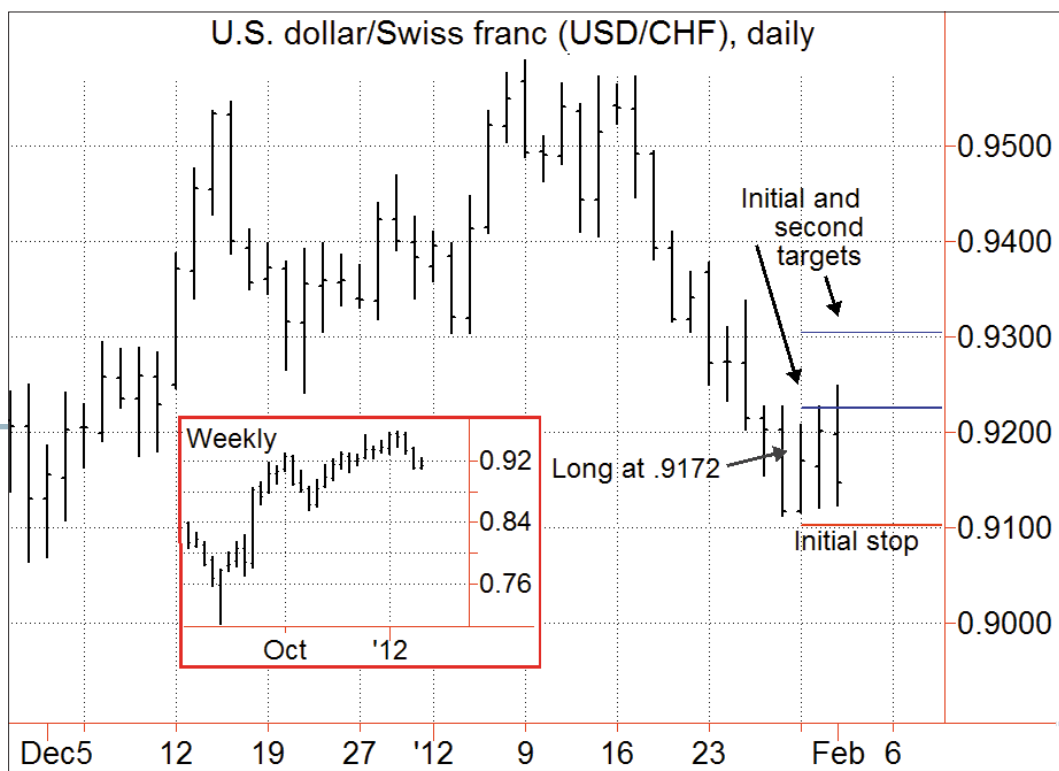
Analysis of the price activity on Jan. 27-30 indicated a higher than average probability of a short-term up move based on the following pattern: an 11-day low with a daily close in the bottom third of the day's range followed by a day with a higher low and a close in the upper half of the day's range.

The trade will be exited in two stages because of the tendency for even unsuccessful pattern examples to experience positive movement the first day after entry.

**Initial stop:** .9102, which is .0011 below the Jan. 27 low.

**Initial target:** .9225, which is just below the Jan. 27 high.

**Secondary target:** .9305.



Source: TradeStation

## RESULT

**Exit:** .9225 (partial exit; remainder of trade still open).

**Profit/loss:** .0053.

**Outcome:** The pair hit the initial target on Jan. 30 (the day after entry), and traded as high as .9250 on Feb. 1 before reversing intraday toward the lower end of what appeared to be a short-term consolidation.

Exiting part of the position quickly will cap the loss on the trade (if the remainder gets stopped out) at .0017. If the market reverses to the upside and again exceeds .9225, the stop will be raised to breakeven. ☒

## TRADE SUMMARY

Date	Currency pair	Entry price	Initial stop	Initial target	IRR	Exit	Date	P/L		LOP	LOL	Trade length
								point	%			
1/30/12	USD/CHF	.9172	.9102	.9225	0.76	.9225	1/31/12	.0053	0.58%	.0078	-.0050	1 day

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 open trade profit or loss at a given point in time.

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.