

Strategies, analysis, and news for FX traders

# CURRENCY TRADER

March 2012

Volume 9, No. 3

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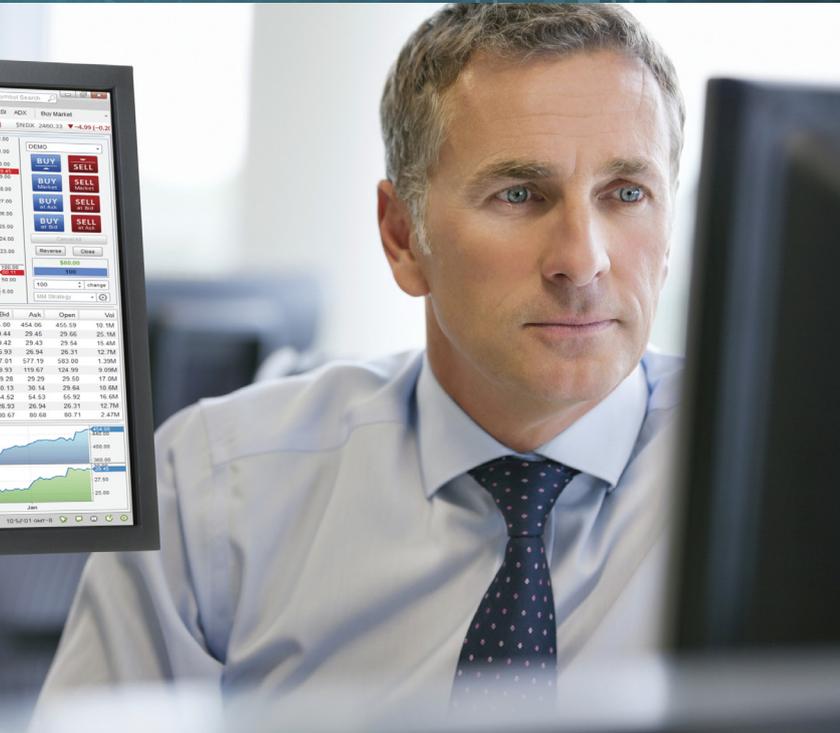
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A publication of Active Trader®

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# The pound flying under FX radar

The British pound has shown a tendency to move sideways more than up or down, but it faces different near-term prospects vs. the dollar and the Euro.

BY CURRENCY TRADER STAFF

The British pound has largely traded in a wide range vs. the dollar over the past six months, stuck between resistance around 1.6150 and support a little above 1.5200 (Figure 1). The UK economy continues to limp along in early 2012, following a short bout of contraction in late 2011. A heavy dose of fiscal austerity has weighed on growth prospects, as has the weakness of one of its largest trading partners — the Eurozone.

Lacking in sex appeal, the pound (aka, “sterling” or

“cable”) has been largely left out of the risk-on rallies that have occasionally gripped the financial markets in recent months. With a low (0.5 percent) central bank lending rate and weak economic growth, there’s little else available to fuel a strong trend in the British currency.

Considering the forecasts for GDP growth to come in below 1 percent in 2012, Jay Bryson, Wells Fargo global economist, doesn’t see that picture changing in the immediate future.

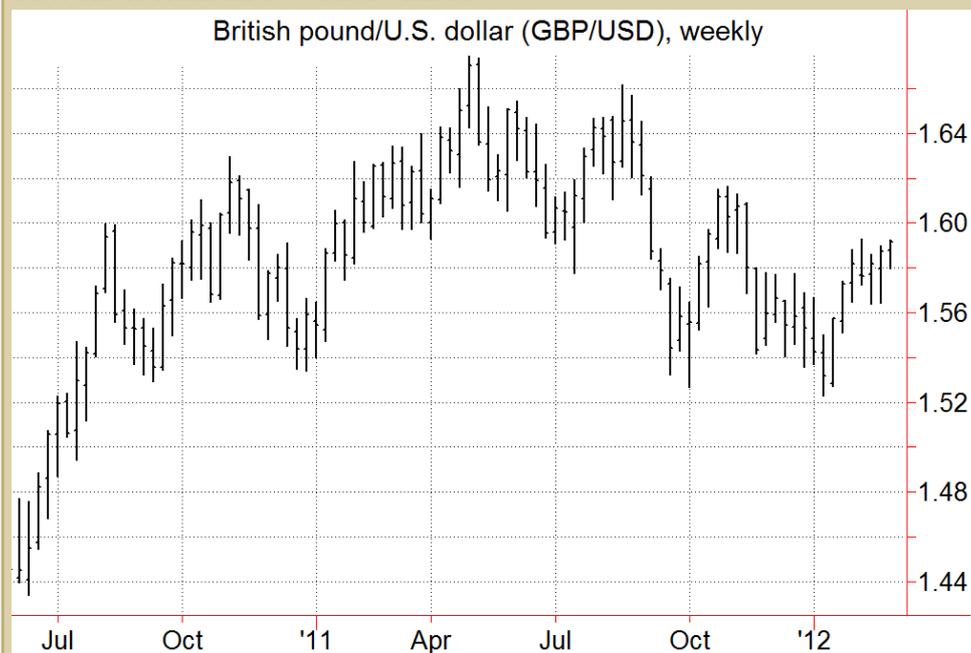
“We’re not looking at a technical recession, but I don’t think anyone is going to kid themselves that growth will be red-hot anytime soon,” he says.

### Barely growing

4Cast Inc. expects 2012 UK GDP growth to average 0.4-0.5 percent, while Moody’s Analytics forecasts a mere 0.3-percent growth. IDEAglobal forecasts a 0.6-percent GDP rate for the year. Economists cite the government’s attempt to reduce its deficit through fiscal austerity measures as a key factor in the slower growth outlook.

“Fiscal austerity at home is weighing heavily on domestic demand,” says Melanie Bowler, economist at Moody’s Analytics in London. “The UK government has implemented sharp fiscal tightening in a bid

FIGURE 1: WEEKLY POUND/DOLLAR



The British pound has largely traded in a wide trading range vs. the dollar over the past several months.

to improve public finances — raising the value-added tax rate by 2.5 percent to 20 percent, slashing welfare spending, and freezing public sector wages, as well as planning to cut the number of public sector workers by 710,000 by 2017 and reform several sectors, including the National Health Service. With tensions elevated over the European sovereign debt crisis, the UK government will likely ensure any slippage in its austerity measures is small.”

Bowler notes the UK budget deficit was one of the highest in the European Union in 2010, coming in at 10.6 percent of GDP, compared to 6.2 percent for the Eurozone as a whole and 4.3 percent of GDP for Germany. “Only Greece and Ireland had larger deficits,” she says.

Landé Abisogun, head of European economic research at IDEAglobal Ltd. in London, highlights several potential challenges Britain faces, including the Eurozone sovereign-debt crisis, which could keep UK credit conditions tight and undermine exports to the Eurozone. “Continued household balance sheet restructuring could hurt household spending growth, and government adherence to fiscal consolidation, as it tries to reduce the size of the budget deficit and limit the rise of the debt/GDP ratio, is also a factor,” she says.

Bowler also finds little cheer in the economic outlook.

“Households face a number of other headwinds that will ensure discretionary spending remains subdued,” she says.

“Unemployment has headed sharply higher over the past year and will trend further northward through 2012. With business conditions deteriorating, firms will be reluctant to hire, while those sectors particularly expected to struggle, such as manufacturing and retail, are most likely to reduce workforces.

“Tight credit will further drag on the economy in 2012,” she continues. “Contracting lending to the important small- and medium-size enterprise sector is a particular concern given that the private sector is being increasingly relied upon to drive growth as fiscal austerity shrinks the public sector.”

### Credit ratings watch

Despite the UK government’s attempts to reduce its deficit, in mid-February Moody’s rating agency gave the UK a “negative outlook,” warning it could lose its AAA credit rating.

“With fragile domestic growth prospects threatening to damage tax revenues from income over the year, the risk to existing deficit projections in the UK lays firmly to the upside,” says Danielle Haralambous, UK economist at

4Cast Inc. “Moody’s recognized [this] when it downgraded the UK outlook to negative, blaming the weaker macroeconomic environment, which will challenge the government’s efforts to place its debt burden on a downward trajectory over the coming years. The move has given the Labor opposition ammunition to criticize the Coalition’s strict austerity program.”

Bryson explains the somewhat vicious circle of fiscal austerity and deficits. “If you depress your economy enough [through fiscal austerity], it affects your tax revenues, and [the UK] will continue to run large deficits for years to come,” he explains. “We think their deficit will come down, but it will be a long, slow process, and it’s going to weigh on growth. It wouldn’t take a lot to tip them back into recession. Any number of shocks would cause them to fall back into recession, and then tax revenues come back down and they’ve got a problem with the deficit again.”



### Eurozone connection

Trade linkages are large between the UK and the Eurozone — Bryson notes that 50 percent of UK exports land in the Eurozone. The ongoing struggles in the Eurozone, of course, remain a critical worry and risk for Britain. There simply appears to be more downside risk than upside potential for the UK economy.

“If there is a big recession in Europe, it will have a big impact on UK exports,” warns Charles St-Arnaud, FX strategist at Nomura.

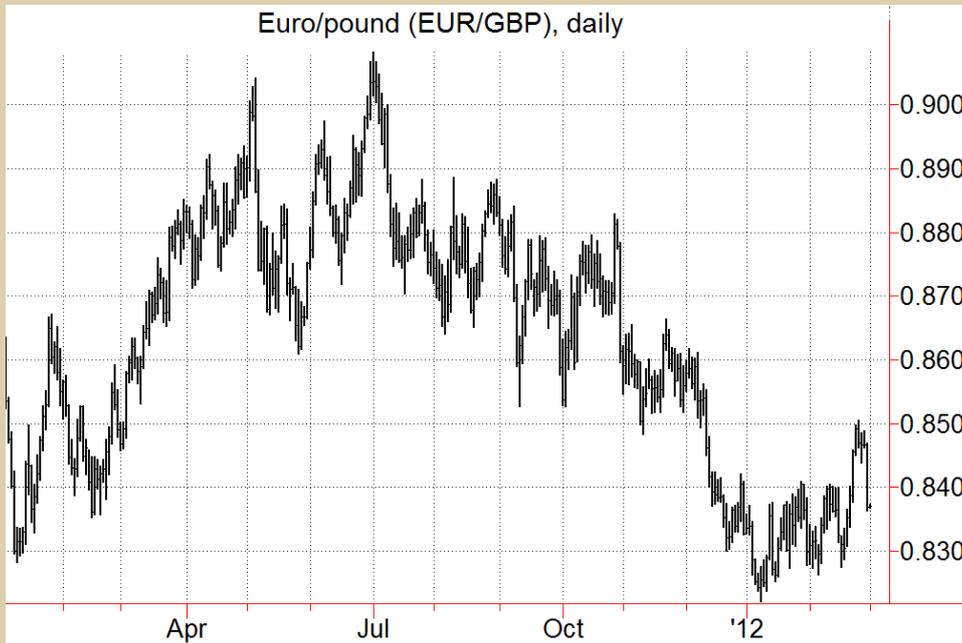
According to Bowler, British exports to the Eurozone are, in fact, expected to underperform this year. She notes exports to Germany, the Netherlands, and Ireland all declined in December. Germany is the UK’s key European export market, followed by the Netherlands and France. Ireland is the UK’s fourth-largest European export market and its fifth-largest export market globally. “The pound’s appreciation against the Euro will add to British exporter problems,” she says. Figure 2 shows the Euro/British pound (EUR/GBP) pair over the past year. The overall downtrend reflects the pound’s appreciation vs. the Euro.

And despite recent promising developments, the Eurozone is not out of the woods yet.

“The lingering Eurozone crisis also threatens to ignite a new banking crisis and credit crunch,” Bowler says. “Financial linkages are substantial, and while UK banks are not as exposed as those of other nations to Europe’s fiscally troubled economies, there is some risk, particularly from Ireland and Spain. Tight credit through 2012 will hinder the normal functioning of the economy and prevent a quick return to self-sustaining growth. However, a new credit crunch, which is a possibility if the Eurozone crisis

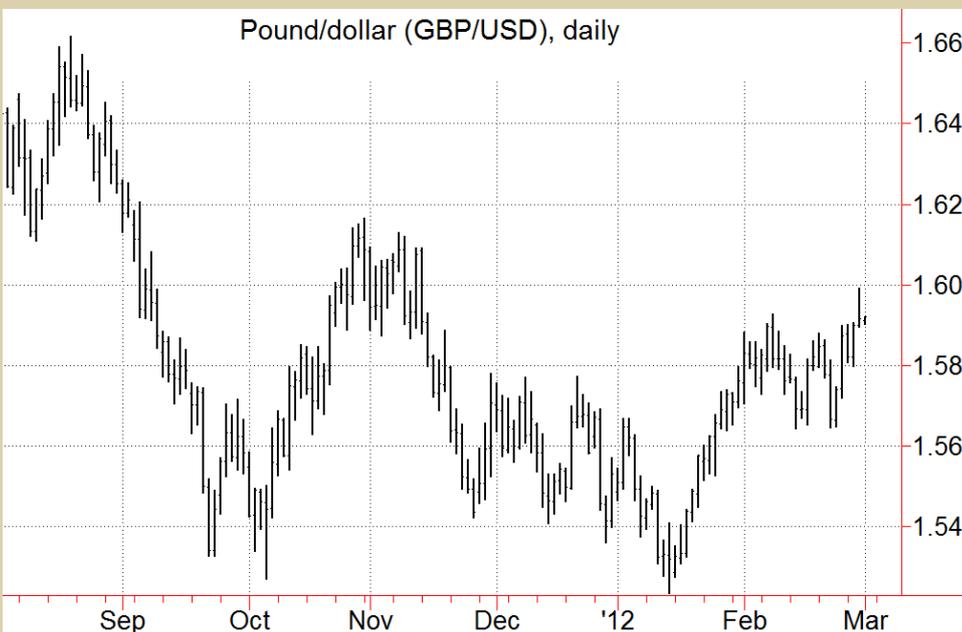


FIGURE 2: EURO/POUND



The Euro/British pound (EUR/GBP) pair has been dominated by a downtrend since July 2011, reflecting pound strength.

FIGURE 3: DAILY POUND/DOLLAR



The pound/dollar consolidated during most of February, but has rallied off its January low.

does not end soon, would result in an even deeper-than-forecast recession and a much slower return to growth.”

**The BOE and QE**

The Bank of England (BOE) has shouldered the burden of restarting the sluggish UK economy, as the government focuses its efforts on deficit reduction. The BOE is expected to hold official lending rates at the record-low 0.50 percent until 2014, in addition to continuing quantitative easing policies. At its February meeting, the BOE increased its asset-purchase program by £50 billion to £325 billion (\$512 billion).

In its Feb. 23 Global Macro Daily research note, Barclays Capital analysts wrote: “The BOE is expanding QE to more than 20 percent of annual GDP, and some investors are concerned this could result in a damaging surge in the inflation rate ... We find that the economy’s liquidity structure is not out of kilter with historical norms, and we do not believe that QE poses a worrying threat of excessive inflation. There is a risk, however, that interest rates jump sharply when the policy is reversed.”

The key question is whether the BOE’s action will have the desired impact. “We have been surprised by the Bank’s February view of both growth and inflation, with a firmer-than-anticipated outlook for both seemingly

testament to the BOE's faith that its recent round of QE purchases will have the desired effect two years down the line," Haralambous says.

Analysts expect no change in monetary policy to emerge from the BOE's next scheduled meeting on March 8.

### FX implications

Taking into account the expected growth differentials between the UK and the U.S., Bowler says the weak economic outlook will weigh on the pound vs. the dollar in 2012.

Downside risk looms in the short term. "The scope exists for cable to ease to 1.54 in the coming weeks," Abisogun says, pointing to the potential for additional QE by the BOE, countered by a lower likelihood of renewed QE by the U.S. Fed. She also sees the possibility for a ratings downgrade of UK sovereign debt.

Medium- and longer-term outlooks are bearish as well. Figure 3 shows the pound/dollar's recent low is around 1.5230, set in January; the pair's 2010 low was around 1.4230. "Our fundamental FX rate forecasts put GDP/USD at 1.5250 by the end of April, 1.4750 by mid-year, and 1.3925 by end of January 2013," Haralambous says. The dollar/pound's financial crisis low, set in January 2009, was 1.3500.

On the other hand, the pound has been strengthening vs. the Euro for the past several months, with the EUR/GBP rate falling from above .9000 in July 2011 to the early January low at .8220. However, a potential bottom formation appeared to be emerging on the daily chart, with a minor series of higher highs and higher lows in early 2012. In late February the pair surged out of a consolidation, through resistance around .8400.

The bullish upside breakout was inspired partly by better-than-expected news from Germany. The IFO's February business survey posted a seven-month high at 109.6 points, and all its components increased. This bolstered sentiment that Germany would likely escape recession.

BNY Mellon managing director Michael Woolfolk, whose firm has a target for the Euro/pound at 85.00, says, "Once we get beyond the Greek debt crisis, we believe the Euro has more upside potential [than sterling]. The Euro has been beaten down and oversold

during the past year."

The pound/yen pair (GBP/JPY) has traded in a wide range over the past six months, between roughly 116.85 and 127.30. However, since mid-January the pair has made a large up move from near the bottom toward the top of the range (Figure 4).

Ray Attrill, head of FX strategy North America at BNP Paribas, says the strength in GBP/JPY "is almost uniquely due to the yen. The yen has seen weakness across the board." (The Japanese yen hit a seven-month low vs. the U.S. dollar in mid-February.)

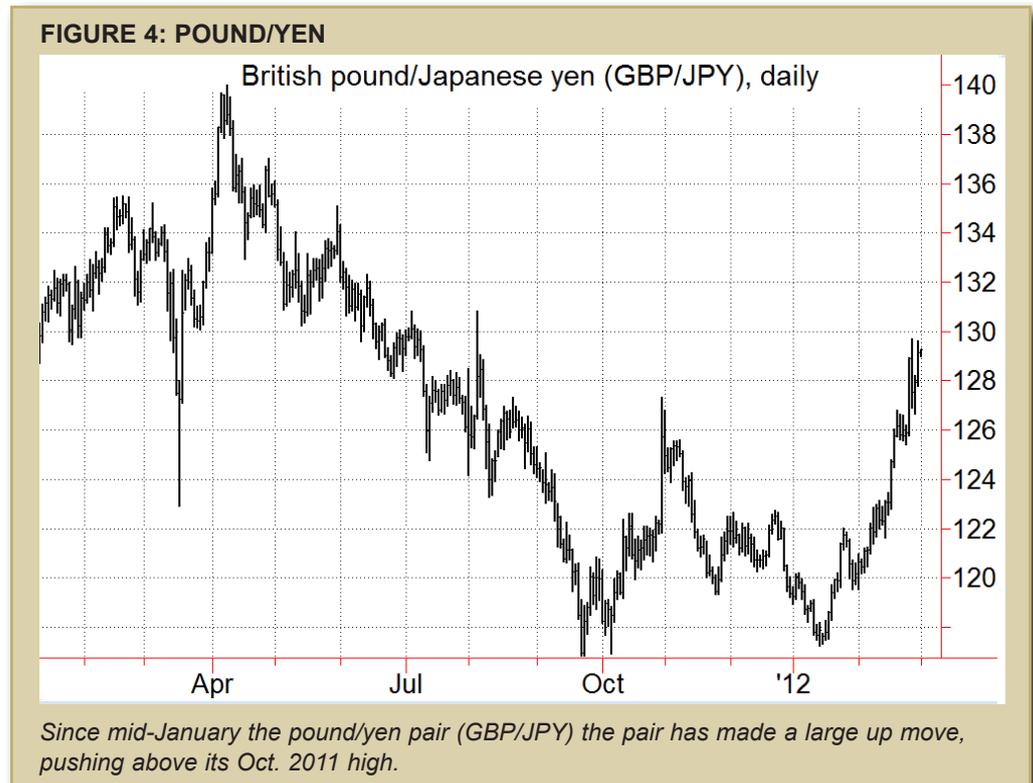
"In part this has been driven by the Bank of Japan unexpectedly easing policy," Attrill explains. In mid-February, the BOJ surprised financial markets with an announcement to add ¥10 trillion to its asset-buying program, in an effort to stimulate the Japanese economy.

St-Arnaud forecasts further yen weakness toward 81.00, which he says could continue to bolster the GBP/JPY rate.

### Flying low

The pound's relatively haphazard trajectory in recent history has likely not increased its popularity with traders. But it may be the nature of the beast for the foreseeable future.

"It's probably not the currency that is on the radar screen of most traders right now," St-Arnaud says. "It's hard in the currency markets to have strong trends like we did in the mid-2000s. We are not seeing multi-year appreciation trends. We probably won't see that for a significant time to come." ☒





# Yen reality check

The yen has exploded higher vs. the dollar and Euro. Do the new Japanese government initiatives mean this move might have longer-term legs?

BY BARBARA ROCKEFELLER

Currencies overshoot their fundamentals. It's one of the abiding puzzles of the FX market. And no currency is more puzzling than the Japanese yen — against both the dollar and the Euro.

If we look at a few of the top factors at work today, we can deduce the upside breakouts in the dollar/yen (USD/JPY) and Euro/yen (EUR/JPY) are the real deal. Therefore, the Nikkei stock index's strong inverse relationship to the yen should come into play soon: If the breakout is real, the

yen is a screaming sell and the Nikkei is a screaming buy. We need to do a reality check on the weakening yen.

Figure 1 shows the USD/JPY pair falling from a peak around 93.24 in 2010 to a low last October at 78.02. Not shown is that earlier the dollar/yen had been as high as 123.76 in June 2007, so the start date on this chart is somewhat arbitrary. Price broke out of the upside of the [standard error channel](#) in February 2012.

But there's another breakout to consider here (Figure 2).

After the Bank of Japan FX market intervention on Oct. 31, 2011, the dollar/yen traded in a range of 76.58 to 78.25 for more than three months. The move above that range is a legitimate "breakout," too. As a technical footnote, remember that a sideways move in a narrow range always precedes a breakout. In fact, the average daily high-low range during these three months was the narrowest since 1997.

Now let's look at the yen in Euro terms. Figure 3 shows the EUR/JPY pair falling from a high of 123.32 April 2011 to the January 2012 low of 97.04, and then in February breaking out of the upside of its channel. Again, the chart doesn't show the earlier Euro/yen high of 169.97 from July 2008.

The inverse relationship of the yen and the Nikkei is one of the strongest anywhere — far stronger than the one between the dollar index and the S&P, for example, which is weak and inconsistent over time. As the yen

FIGURE 1: USD/JPY UPSIDE BREAKOUT



The USD/JPY pair fell from around 93.24 in 2010 to 78.02 in October 2011. Price broke out of the upside of the channel in February.

Source: Chart — Metastock; data — Reuters and eSignal

gets weaker, the Nikkei gets stronger, almost in lock-step (Figure 4).

### The oil factor

There could be some very large flies in the soup, however, the first of which is the price of oil. Forecasters are predicting U.S.-based West Texas Intermediate (WTI) crude will rise between \$120 to \$150 this year. Rising energy costs are deeply unfavorable to manufacturers, even those whose export prospects are brightened by a cheaper currency. Can the Nikkei really go up as corporate fundamentals are stressed by high energy prices?

Figure 5 shows the price of European Brent crude oil in yen terms vs. the price of WTI oil in dollar terms. The strong yen gave Japanese buyers an advantage over U.S. oil consumers in terms of lower prices, but not much of one, and without changing the higher-price trend. At the request of the U.S., in February Japan agreed to cut oil imports from Iran by about 20 percent, and in return will get a waiver from sanctions on the remainder. (The U.S. may be helping Japan obtain new supply from Saudi Arabia.) Whatever the oil supply constraints and difficulties, Japan faces the same high and rising energy costs as the rest of the world.

Now let's see what effect oil prices have on the Nikkei (Figure 6). Surprisingly, the price of oil has a varying relationship with the Nikkei. From 1995 to 2002, these markets had an inverse relationship. Between 2003 and 2009, they moved together. Since then, they have diverged, but have not nec-

**FIGURE 2: USD/JPY POST-INTERVENTION RANGE**



*After the Bank of Japan forex market intervention on Oct. 31, 2011, the dollar/yen traded in a range of 76.58 to 78.25 for more than three months. The move above that range is also a legitimate breakout.*

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

**FIGURE 3: EUR/JPY UPSIDE BREAKOUT**



*The EUR/JPY pair fell from 123.32 April 2011 to 97.04 in January 2012, and then in February broke out of the upside of its channel.*

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



FIGURE 4: DOLLAR/YEN (INVERTED) VS. NIKKEI STOCK INDEX (BLUE)



The inverse relationship of the yen and the Nikkei stock index is far stronger than the one between the dollar index and the S&P.

Source: Chart — Metastock; data — Reuters and eSignal

FIGURE 5: PRICE OF BRENT OIL IN YEN TERMS (BLACK) VS. WTI OIL IN DOLLAR TERMS (GOLD)



The strong yen gave Japanese buyers an advantage over U.S. oil consumers, but not much of one, and without changing the higher-price trend.

Source: Chart — Metastock; data — Reuters and eSignal

essarily been inverse. We can deduce that the yen is a far more powerful influence on the Nikkei than on oil.

**The carry trade**

One theory for the stronger yen is the unwinding of carry trades by Japanese investors. The story goes like this: Traders who had borrowed yen and sold it to invest in higher-yielding assets, including other currencies, became fearful of the European debt crisis and a potential hard landing in China. They repatriated their yen, despite miniscule domestic rates of return. At least it's a trusted return of capital. If you are Japanese, the yen is a safe haven. Once risk seemed to be receding in mid-February 2012, though, Japanese carry-traders were said to be ramping up carry trades again.

The only reasonable response to this scenario is "maybe." After all, the dollar/yen rate has been in a massive downtrend since the late 1970s. It was at 260.55 in March 1985 and 147.37 as recently as 1998. The carry trade can't be credited with causing a multi-decade price trend, and besides, periodic unwindings have failed to restore the yen to earlier weak levels. We appreciate a lack of symmetry because other factors must be at work, but the carry-trade explanation is woefully inadequate.

Estimates of the carry trade have been as high as \$1 trillion and as low as a few hundred million. Or is it billions? Nobody really knows, or if they know, they're not telling. Most carry trades are done as FX trades on credit

lines and literally do not appear on banks' balance sheets. The weekly capital flow report from the Bank of Japan (BOJ) is always very interesting, but deals with "real" assets — stocks, bonds, CDs and short-term deposits. It would probably be a bad idea to extrapolate carry trade activity from the capital flow reports, since the characteristics and risk appetite of the investing group may be very different from those of the trading group.

If we can't blame the carry trade, why is the yen breaking out to the downside? And can we determine whether it's a temporary move?

### The account balance sheet

One idea is that Japan is losing its current account surplus at an alarming rate. The surplus fell 43.9 percent from 2010 to 2011 — the first drop in two years, the lowest number (¥9.629 trillion, or about \$125.45 billion) since 1996, and the sharpest contraction since 1986. An outright trade deficit would be a long way off, since Japan remains an exporting superpower, but with the country's demographic time bomb now starting to go off, savers are drawing down their investments, so foreign interest and dividends earned will continue to fall.

Conventional wisdom holds that the country with a current account surplus, especially one formed mostly from the trade balance component, should have the strengthening currency. This is supposed to be the equalizing factor in the global system, if with the classic 18-month lag. In practice, Japan's current account surplus persisted for three decades and regardless of multiple yen pullbacks, pretty much discrediting the theory of equilibrating currency changes. All the same, a falling surplus creates the environment in which the conventional-minded can allow the idea of a weaker yen, suggesting that a

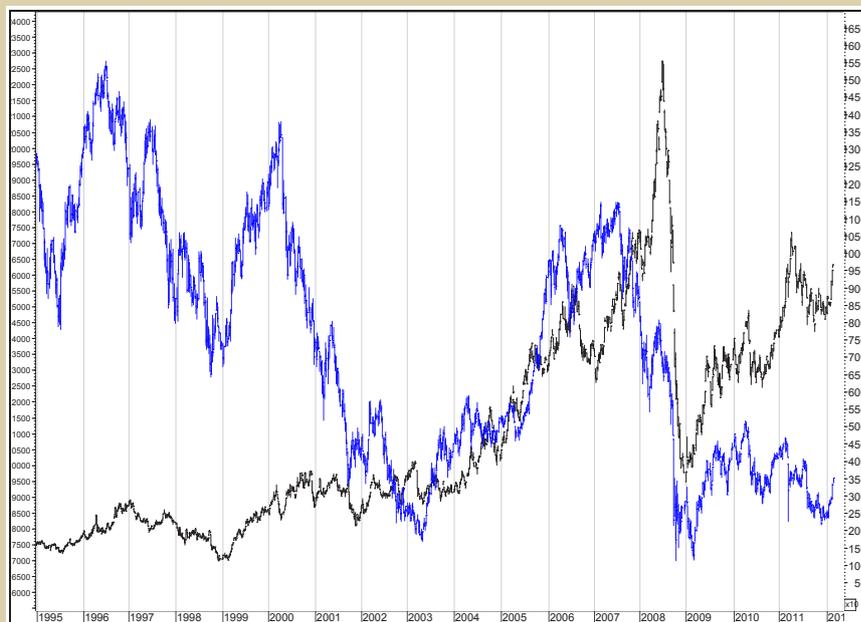
deficit would have even more influence.

### Lost decades

Another factor is the endless Japanese deflationary recession. In February the government initiated yet another **quantitative easing** (another ¥10 trillion, to ¥65 trillion) and the Bank of Japan announced it is adopting a target rate of inflation for the first time. Japan has been engaged in quantitative easing since March 2001, with a notable lack of success. Even the Federal Reserve has published papers on how and why QE has failed in Japan, including the observation that raising bank liquidity failed to induce demand for credit because it wasn't big enough in the grand scheme of things.

You'd think that yet another boost in QE would hardly be able to turn a sow's ear into a silk purse, but the cou-

**FIGURE 6: PRICE OF BRENT OIL IN YEN TERMS (BLACK) VS. NIKKEI (BLUE)**



*The price of oil has had an inconsistent relationship with the Nikkei stock index. Source: Brent oil in yen terms courtesy of James Williams, wtrg.com*

pling with the inflation target announcement made markets sit up and take notice. The “price stability” goal is 1 percent, to be raised to 2 percent over the longer term.

The mechanism by which inflation is to be created out of whole cloth seems not to be a market mechanism but a regulatory one. A week after the increase in QE and inflation target notice, the BOJ warned that any interest rate increase would have a massively deleterious effect on the banks. BOJ Governor Masaaki Shirakawa has said Japanese banks are overinvested in Japanese government bonds (JGBs), and if interest rates were to rise by 1 percent the losses would be astronomical — ¥3.5 trillion for big banks and ¥2.8 trillion for regional banks. As of the end of Q3 2011, banks held 44 percent of all outstanding JGBs, while domestic insurers were in second place at 21 percent.

The implications are wide, if scattered. First, retiring baby boomers are already removing deposits from banks. The savings rate has fallen to 5 percent, quite low for Japan, and potentially going negative (i.e., net withdrawals from the banking system). Banks are slowly responding, chiefly by reducing maturities to two to three years instead of five-year and 10-year notes. The implication is that if banks, pension funds, and direct investors are reducing demand for JGBs, the price should rise. The Japanese Ministry of Finance has the tricky task of increasing supply at the right pace to avoid overwhelming the drop in demand and get higher yields out of the two opposing forces.

Second, it’s a safe assumption the BOJ is working busily behind the scenes to incentivize banks to make loans with the surplus liquidity instead of just parking it in government paper.

Third, a source of demand for Japanese government bonds might be China, which already announced some purchases, to consternation in some quarters but relief in others. Foreign participation in the Japanese bond market is almost nonexistent. Less than 5 percent of the total is held by foreigners, and with yields below 1 percent, nobody can blame them. Goosing yields higher and getting foreigners to replace retiring domestic demand is a complex and difficult task, especially since Japan’s rating is so low because its debt-to-GDP ratio is so high. Last summer, all three ratings agencies downgraded Japan’s sovereign rating to AA-, three notches below AAA. But the U.S., France, and many others have also been downgraded, so Japan’s fiscal problems, while dire, are not exactly front-

page news. In fact, the ratings agencies keep harrying Japan to hurry up and raise the sales tax and take other actions to reduce the debt-to-GDP ratio, and many of those actions are inherently inflationary.

Japan wants to replace domestic investors with foreign ones, and the way to do that is with higher yields. It would be helpful if credit activity picked up, whether boosted by the central bank or not, fueling a little inflation, which in turn would justify higher yields.

Even more interesting is the great economics experiment of whether Keynes’ “pushing on string” — deflationary recession — really can be cured by massive government spending. It hasn’t worked so far, but we literally have no other ideas, credible or not. We can say QE has failed in Japan because the Japanese are culturally conservative and nonmaterialistic, but remember, we haven’t seen the current generation in an environment of rising prices.

So, picture the Japanese fund manager and individual investor/trader facing inflation at home with yield struggling to keep up, while the rest of the world offers not-too-risky and definitely higher-yielding alternatives. One measure of equity market risk, the volatility index (VIX), has been at the low end of its range for several months now, falling to 17.76 in early February from a high of 48 last August. Equity markets everywhere are at multi-month if not multi-year highs. Europe has not imploded, China seems to be making a soft landing. Why would the carry trade not resume?

Then the question becomes whether the carry trade alone can propel the yen to significantly weaker levels. It has not done that so far, and often faces the offset of the repatriation notion, which holds that individuals and institutions alike literally bring money home, converting it to yen, at quarter ends and especially the end of the fiscal year on March 31. Repatriation doesn’t really occur, the data shows, but never mind — it’s an enduring fiction and influences markets.

The yen breakout may turn out to be a false one and the currency may appreciate back to nose-bleed intervention levels below 80. But the breakout, together with government initiatives and the logic of the carry trade, may suffice to make the yen a screaming sell, with gains to 90 or 95 possible in the USD/JPY pair. The prospect is certainly food for thought. ☒

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

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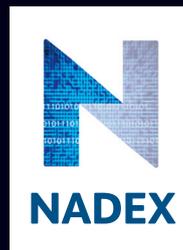


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# FX consolidation breakout

Two indicators combine to identify short-term low-volatility ranges that can set up breakout trades.

BY CURRENCY TRADER STAFF

If you put together a hypothetical wish list for a short-term breakout trade, what would it include? Most people would answer something along the lines of, “A low-volatility condition — when price is in a tight consolidation.” Because, as well all know, volatility “reverts to the mean” — low volatility is followed by high volatility, and vice-versa.

In reality, volatility can trend higher or lower, or remain at relatively high or low levels, for much longer than most traders are willing to admit (or test). The equity market’s expanding/high volatility in the latter half of the 1990s and its contracting/low volatility between 2003-2007 are obvious examples. Nonetheless, if you wanted to take on

the daunting challenge of predicting, say, days that would provide larger-than-average price moves — such as the ones marked with arrows in Figure 1 — you would likely rule out situations where volatility was already high and the market had made a significant move over the past several days. You would instead focus on congestion periods where price moved mostly sideways, with little volatility.

There are a number of ways to identify such patterns and conditions. Here, we will experiment with two tools: one that identifies a relatively low-volatility situation, and a second that highlights periods when there has been a great deal of overlap in the price action from one day to the next.

FIGURE 1: SEARCHING FOR WIDE-RANGE BARS



The marked “high-volatility” bars are those that would provide intraday and short-term traders the best opportunities for a quick profit — if they’re on the correct side of the market.

Source for all charts: TradeStation

### Relative volatility and the MTR

The volatility indicator used in this approach is median true range (MTR), which is similar to the average true range (ATR). Both indicators are based on the true range calculation, which is the greatest absolute value of the following:

1. The difference between the current bar’s high and low;
2. The difference between the current high and the previous close;
3. The difference between the previous close and the current low.

True range more accurately reflects bar-to-bar volatility than high-low range because it accounts for any gaps that occur between price bars. While

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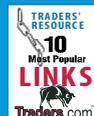
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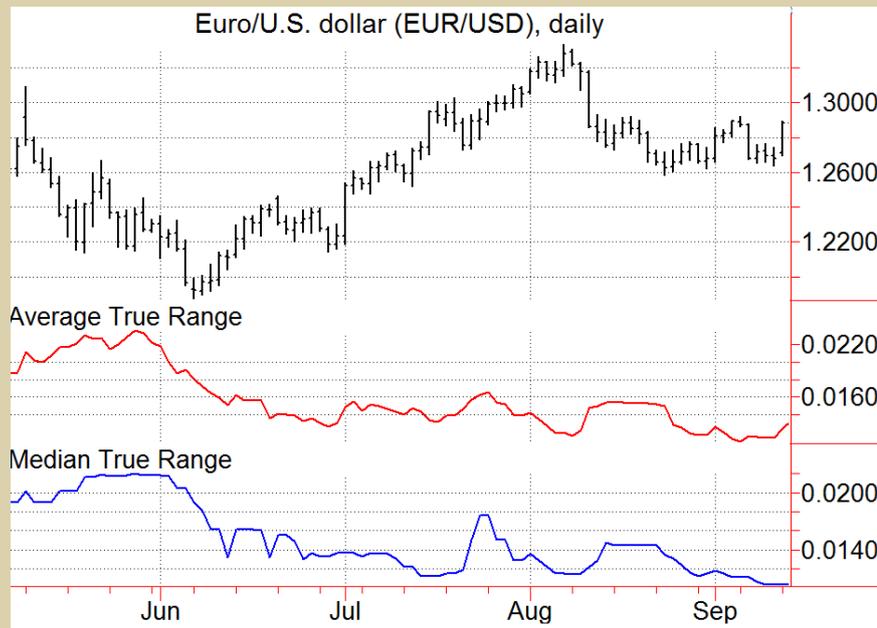


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FIGURE 2: MTR VS. ATR

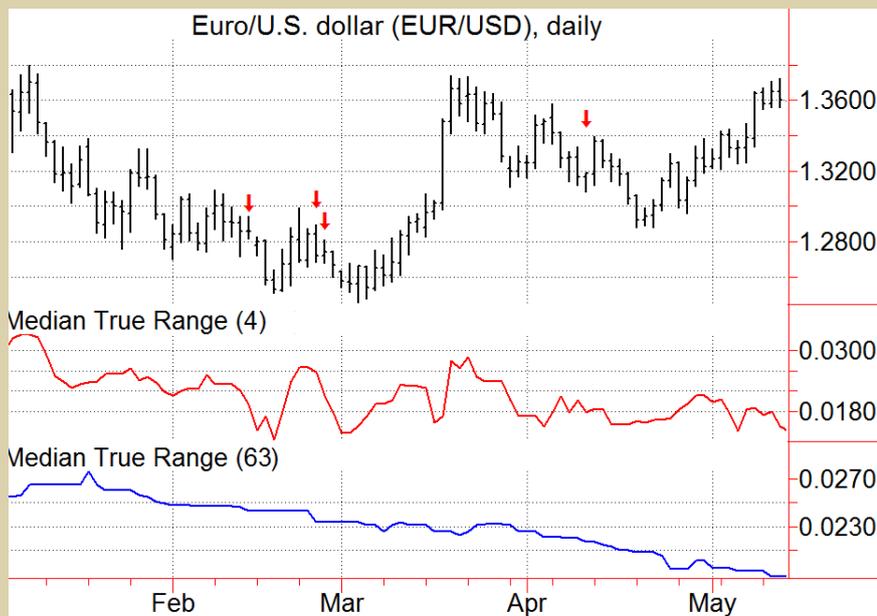


The median true range (MTR) replaces the average with the median in the ATR calculation.

the ATR indicator is the average of the true range over a given period, the MTR is the median of the true range over that period. The idea behind using the median instead of the average is to avoid the lag that averaging introduces into a calculation. Figure 2 compares 10-day ATR and MTR calculations. The indicators are generally similar, but their behavior in late-July 2010 highlights their differences: The MTR (bottom) responds much more quickly than the ATR (middle) to the increase in price volatility.

To attempt to define low-volatility situation, a short-term MTR calculation will be compared to a longer-term MTR. In this case, we will use representative values (those not based on optimization) of four days for the short-term MTR and 63 days (roughly three months) for the long-term MTR. In the roughly 3,600 trading days between Jan. 2, 1998 and Feb. 29, 2012, the ratio of the four-day MTR divided by the 63-day MTR ranged from 0.41 to 2.43, with an average value of 1.04.

FIGURE 3: LOWER RELATIVE VOLATILITY



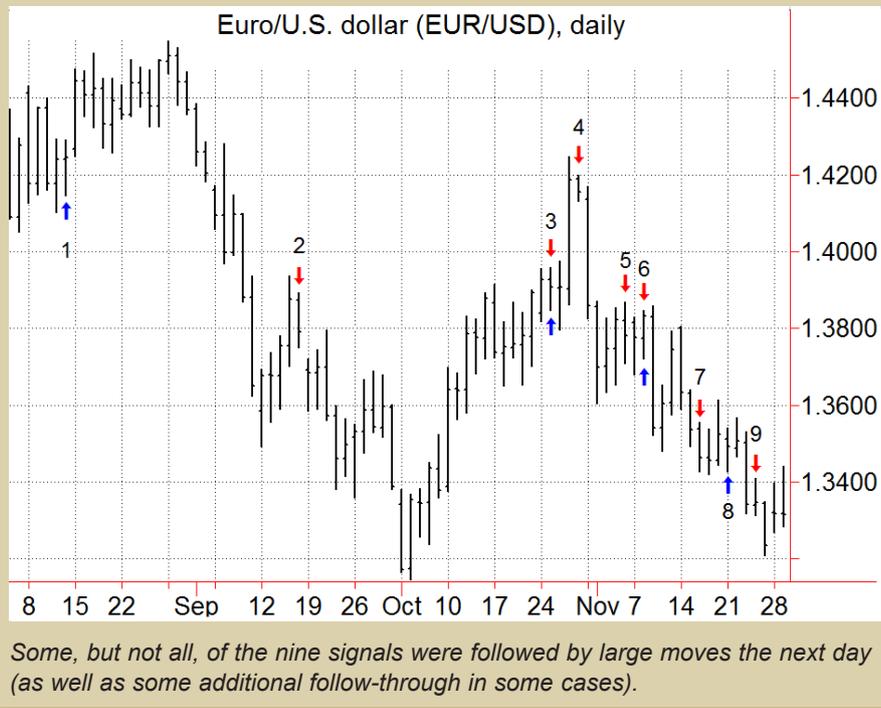
Red arrows mark bars for which the 4-day/63-day MTR ratio was lower than it was for the preceding bar, indicating short-term volatility relative to longer-term volatility has decreased.

**Identifying congestion**

Figure 3 shows the Euro/U.S. dollar pair (EUR/USD) with four-day and 63-day MTRs. Red arrows mark days the five-day/63-day MTR ratio was less than the previous day's ratio, but also satisfied a second criterion that measure the recent level of price congestion: how much of a given day's range was outside the previous day's range divided by how much was within the previous day's range.

For example, if yesterday's high was 10.5 and its low was 8, and today's high is 11 and the low is 8.5, the ratio

**FIGURE 4: SIGNALS**



of outside/inside price action is  $.5/2 = .25$ , which means a quarter of the current day's price action occurred outside the previous day's range relative to the amount that occurred inside that range. The higher the outside/inside ratio (OIR), the more the current bar has pushed outside the previous day's range. The trade setup will use a five-day running sum of the outside/inside ratio. In Figure 3, the five-day outside/inside threshold is 4, meaning qualifying days have values below 4.00 and must also be less than or equal to the previous day's value. The ratio, which was as high as 217 during the analysis period, had an average value of 4.38.

### Entry setup

In addition to these criteria, the setup also requires the current (one-day) true range to be no larger than the true ranges of the previous three bars. Together, the rules are intended to identify days on which: 1) the current true range is moderate compared to the recent price action; 2) the short-term/long-term volatility ratio is lower than it was yesterday, and 3) the five-day sum of the outside/inside ratio is lower than average, and is less than or equal to its value yesterday. These points will hopefully precede renewed volatility. As formulas the setup rules are:

1.  $TR[0] \leq \text{MIN}(TR, 3)$
2.  $(5\text{-day MTR}/63\text{-day MTR})[0] < (5\text{-day MTR}/63\text{-day$

$MTR)[1]$

3.  $\text{Sum}(\text{OIR}, 5)[0] < 4$

4.  $\text{Sum}(\text{OIR}, 5)[0] \leq \text{Sum}(\text{OIR}, 5)[1]$

where

TR = true range

OIR = outside/inside ratio

0, 1 = today, yesterday

All the parameters used here are departure points for the analysis, selected through observation of indicator behavior early in the analysis period.

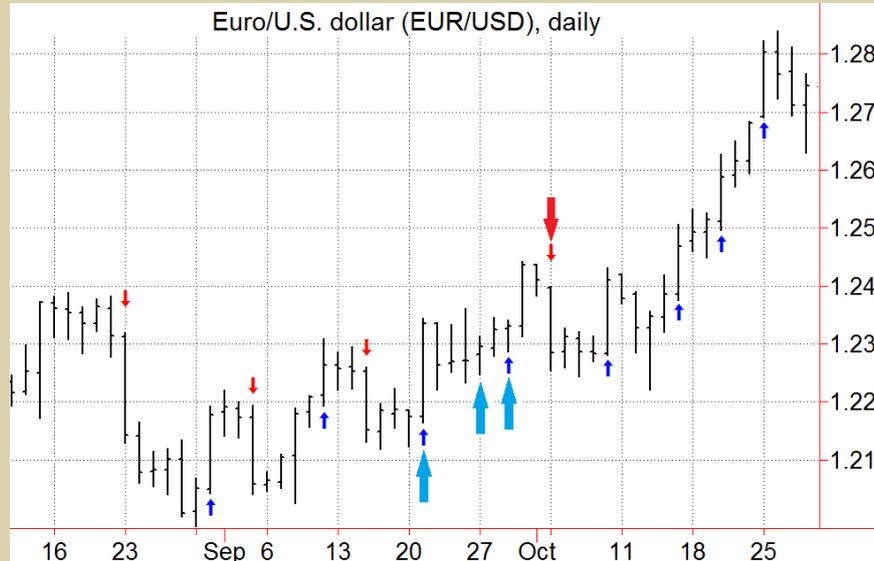
The highlighted bars in Figure 3 suggest the setup does a fair job of identifying short-term consolidations — but certainly not all of them, and not necessarily ones that are followed by immediate high-volatility moves (i.e., wide-range bars). The most conspicuous example of this is the wide-range down bar in late-March that was preceded by a week of horizontal, relatively compressed price action.

### Trading the setup

Figure 4 shows several setups from late 2011 (a more recent example, from February 2012, is the subject of this month's [Forex Trade Journal](#)). Because this kind of pattern is designed primarily to identify points at which price is likely to make a larger-than-average move — but not the



**FIGURE 5: SELECTIVE SIGNALS**



*Although two of the three signals highlighted with large blue arrows were followed by big up bars, the setup identified less than a handful of the 12 wide-range bars that formed during this period.*

direction of the potential move — a basic way to trade the setup is to buy on a move above a recent high and go short on a move below a recent low.

In Figure 4, the blue arrow represents long entries and the red arrows represent short entries, based on moves above or below the most recent day's high or low (the criteria-fulfilling bar). An additional buffer (e.g., five pips, or ticks) can be included to reduce the risk of bad entries when price quickly reverses after just reaching the previous day's high or low. If an inside day follows the signal day, in which no entry occurs because price fails to exceed the previous high or low, trade entry is pushed forward to the next day. Sample rules:

1. Go long (x ticks) above the most recent high, with a stop x ticks below the entry point
2. Go short (x ticks) below the most recent low, with a stop x ticks above the entry point.

Trade entries in Figure 4 would have been triggered just above the highs of the bars with blue arrows and just below the lows of the bars with red arrows. The bars with both blue and red arrows highlight one of the inherent problems of using this type of trading approach: If you identify a relatively narrow-range bar in a low-volatility situation, you run the risk of attempting to enter on a bar that trades both above and below the signal bar's range, in which case you run the risk of getting stopped out and

missing the next move — unless you incorporate a rule to reverse direction after an initial stop-out:

3. If the initial position is stopped out, enter on the signal at the opposite end of the previous day's range.

Overall, five of the nine signals in Figure 4 (1, 2, 4, 6, and 9) were followed the next day by relatively wide-range bars whose ranges were outside those of the bars that preceded them. Signals 3 and 5 were too early, and signals 3, 5, 7, and 8 experienced negligible follow-through the next day. Also, note that incorporating a position reversal after an initial stop-out would have resulted in a winning trade for signal 6 but a double loss after signal 3.

**Suggestions**

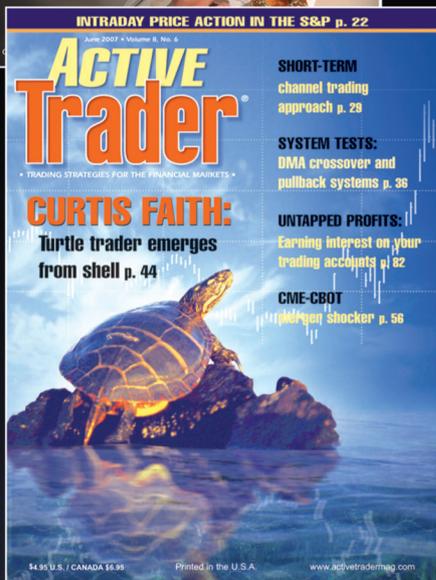
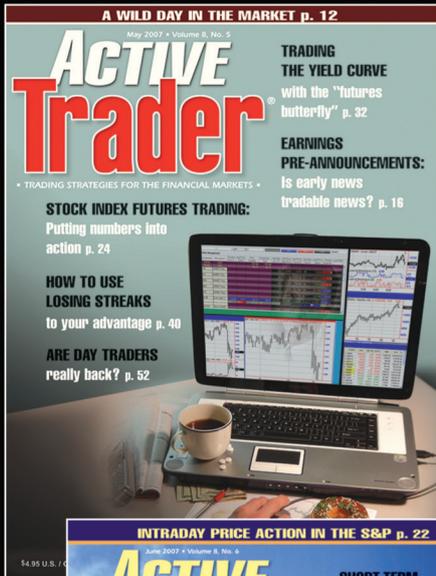
Figure 5 shows Figure 1 with the three trade signals that would have occurred using the trade setup. Despite some of the shortcomings with the setup — especially in terms of missing certain trade opportunities — the basic premise shows promise. Experimenting with different look-back periods for the MTR values and the OIR, as well as applying different thresholds or filters for accepting signals based on the MTR ratio, are likely to produce promising results. Minimal research in this vein showed improved performance over the representative settings used here. Also, applying these tools to other forex pairs would be a good way to gauge how robust they are. ☒

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# Is the Peruvian PEN mightier than the sword?

If and when U.S. monetary policy ever changes, Peru's currency, the sol, is bound to suffer.

BY HOWARD L. SIMONS

For years, Peru has been one of those countries consigned to some sort of Trivial Pursuit existence in most people's minds. For example, the oldest known city in the Americas, Caral, dates back to about 2,500 B.C., and the Nazca lines visible from the air excite the imagination of those who need to believe our planet was populated by extraterrestrials. Peru's Inca Empire created rope bridges across Andean gorges and made chewing the coca leaf central to the daily lives of its inhabitants; you are free to draw your own connections.

The Incas also had the misfortune of having enough gold to attract Spanish conquistadores very early in the settlement of the New World, and that, as they say, was that: The lost city of Machu Picchu serves as a reminder of how quickly and completely the Inca collapsed. About the only saving grace — and a fitting reminder to those in the business of trading who let their greed get the better of them — is the story, perhaps apocryphal, of how the Incas killed Vicente de Valverde, first bishop of Cuzco, by pouring molten gold down his throat.

The nutrient-rich waters of the Humboldt Current gave Peru an accidental role in the huge commodity rallies of 1972-1973. The El Niño current shifted and led to the collapse of the Peruvian anchovetta fishery; its fishmeal was a primary protein additive to livestock feed, and its short-

age led to increased demand for soymeal at the very time when global soybean prices were surging. In a bull market, all news is bullish.

## A millennial success story

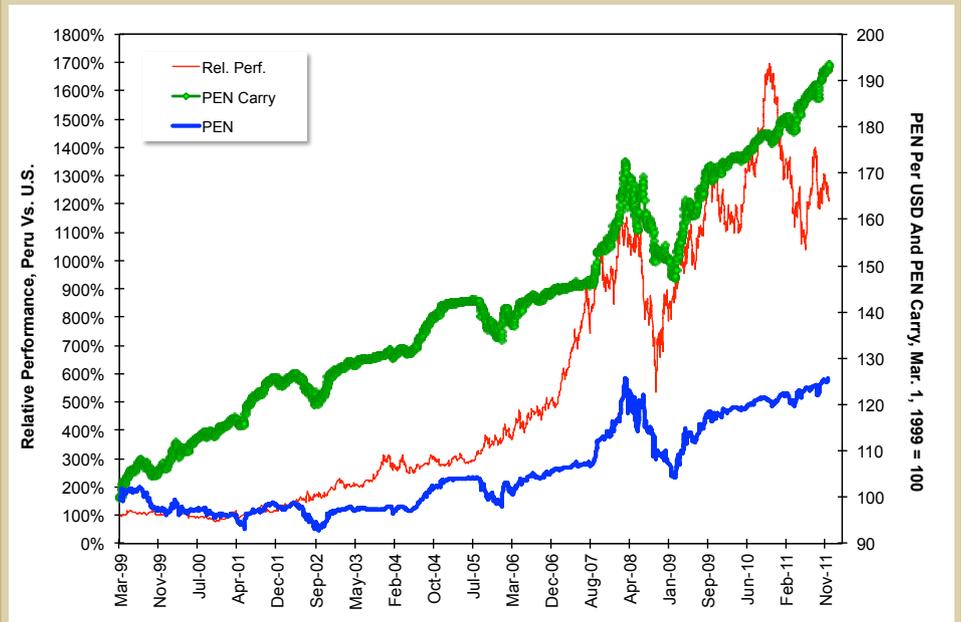
That was then, this is now. Peru, like so many other Latin American markets, benefited from both the yen and later U.S. dollar [carry trades](#) from the late-1990s onwards. Mapping the relative performance (in USD terms) of the Peruvian stock market against the course of both the Peruvian sol (PEN) and the excess carry return from borrowing the USD and lending into the PEN since March 1999 shows if an American investor had, for whatever strange reason, decided one year before the dotcom bust to shift funds into Peru, the returns would have been stunning (Figure 1). Yes, this is fun with statistics as no one in their right mind would have made this decision in 1999, and few others would have stayed the course through the violent retracement during the 2008-2009 financial crisis, but the general principle remains intact.

Once the U.S. adopted [quantitative easing](#) in March 2009, the relative performance of the Peruvian market became linked to the excess carry return on the PEN through the start of QE2 in November 2010. As has been the case for so many emerging markets, QE2 turned out

to be the “sell the news” conclusion in the great money-printing extravaganza of 2009-2010. Restated, this was truly a “Beach Boys” market: Everyone had fun, fun, fun until Benny took the T-bills away.

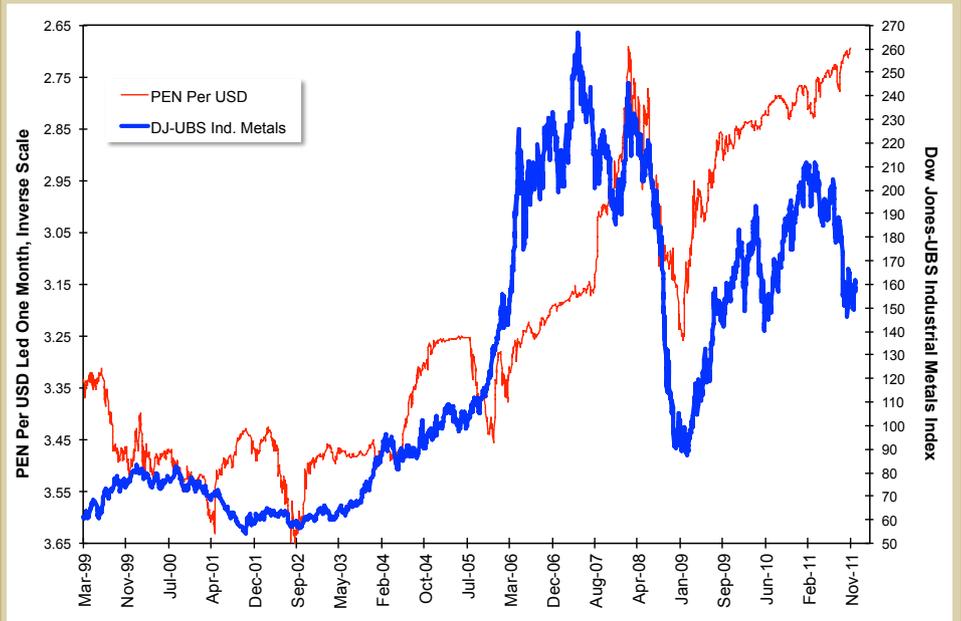
The end of the money-printing link preceded the demise of another apparently strong link for the PEN. This was the one between Peru’s robust mining sector and the prices of various physical commodities, metals especially. Over the post-March 1999 measurement period, the Dow Jones-UBS industrial metals index has led the PEN spot rate by one month on average (Figure 2). The metals peaked in 2011 along with so many other markets at the end of April, but the PEN kept grinding higher. This actually was fortunate for Peru. Commodity booms do not last forever, and dependence on them is risky. If the PEN strengthened along with metals prices, low interest rates in the U.S., and a bull market in emerging-market equities, will it be able to levitate when two of these supports, capital inflows and metals prices, move into downward cycles? This would be asking a lot.

**FIGURE 1: PERUVIAN PERFORMANCE BROKE FROM CARRY TRADE AFTER NOVEMBER 2010**



*Peruvian stocks outperformed their American counterparts by 1600 percent between 1999 and late 2010.*

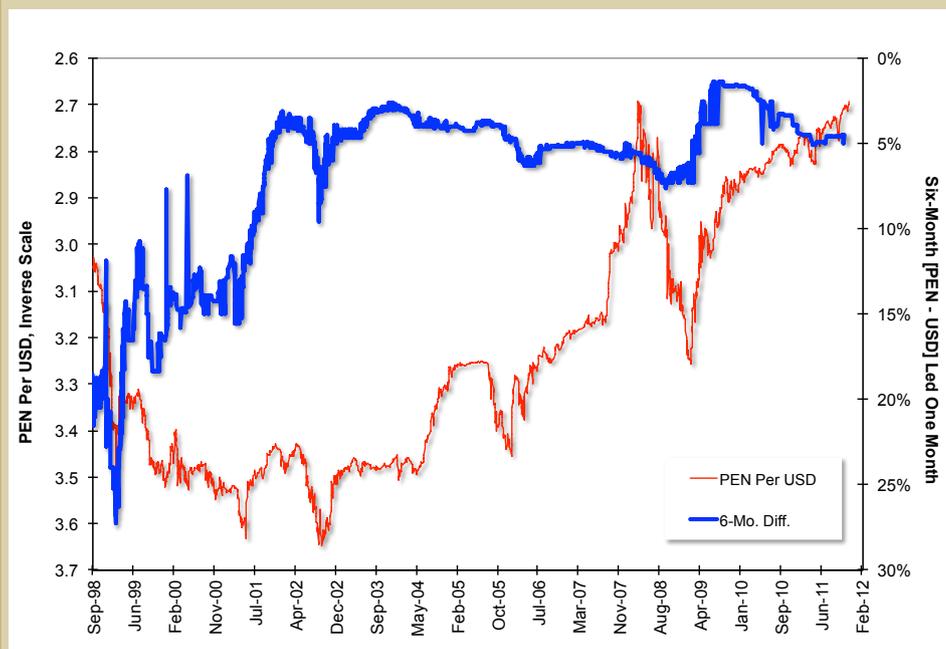
**FIGURE 2: THE SOL'S COMMODITY CONNECTION WEAKENING**



*The end of the money-printing link preceded the demise of the link between Peru’s mining sector and the prices of various physical commodities — especially metals, which peaked in 2011, while the PEN kept pushing higher.*



**FIGURE 3: PERUVIAN SOL SELDOM MOVES WITH ABSOLUTE INTEREST RATE DIFFERENTIALS**



*Absolute interest-rate spreads appear unrelated to movements in the PEN spot rate. The large PEN rally between early 2003 and the onset of the 2008 financial crisis was accompanied by little movement in the six-month interest-rate gap between the PEN and the USD.*

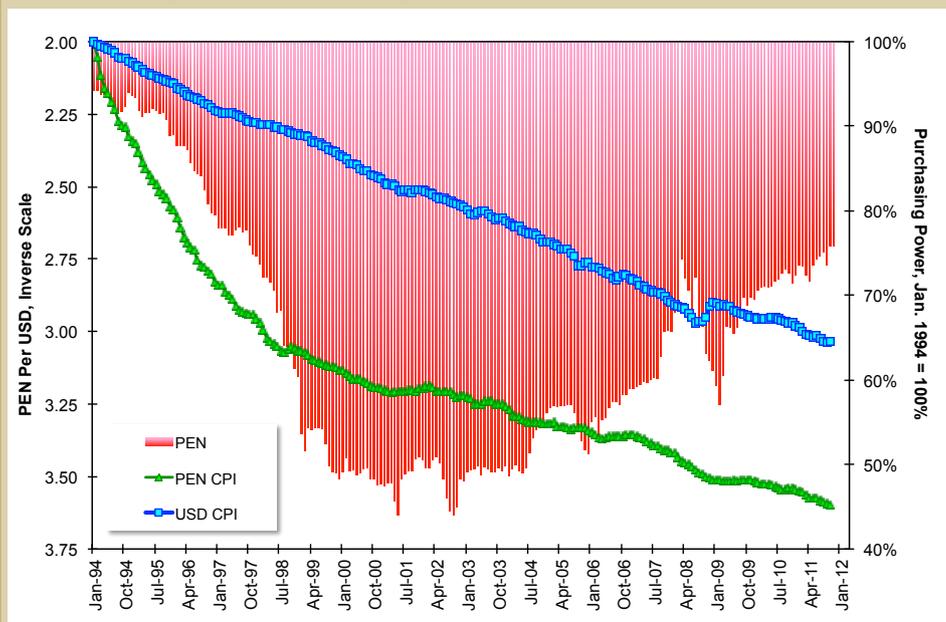
**Assets matter**

The importance of asset flows for a market such as Peru cannot be overstated. Because the structure of Peru’s short-term interest rate markets does not allow us to compare expected interest rate differentials, we must devolve to comparing absolute interest-rate spreads (Figure 3). Even here the results are highly indeterminate and apparently unrelated to movements in the PEN’s spot rate. The large PEN rally between early 2003 and the onset of the 2008 financial crisis was matched by very little movement in the six-month interest-rate gap between the PEN and the USD. This is not a market driven strongly and directly by interest-rate arbitrage.

A second observation has to be added on the interest-rate front: Once we get out of the money-market horizon, the Peruvian bond market doesn’t offer much guidance, either. The issues trade infrequently and issuance is not particularly regular. We cannot add expected changes in government debt to the prospective returns on assets mix.

Although currencies can be driven by inflation differentials, this does not appear to be the case, either. If we re-index the Peruvian and U.S. consumer price indices to January 1994 and map them against the spot rate of the PEN, we see how rising inflation in Peru during the 1990s did, in fact, coincide with a downturn in the spot PEN (Figure 4). This is all very well and good, but the

**FIGURE 4: PERUVIAN SOL LARGELY INDEPENDENT OF RELATIVE CONSUMER INFLATION**



*The PEN doesn’t appear to be driven by inflation differentials, either. Rising inflation in Peru during the 1990s coincided with a downturn in the PEN spot rate, but the two CPI measures have moved parallel since 1999 while the PEN has gained on the USD since late 2004.*

two CPI measures have moved in parallel since 1999, while the PEN has gained on the USD since late-2004. If inflation differentials mattered, they would have to matter in a two-way fashion for us to use them as a currency analysis tool.

### A note on volatility

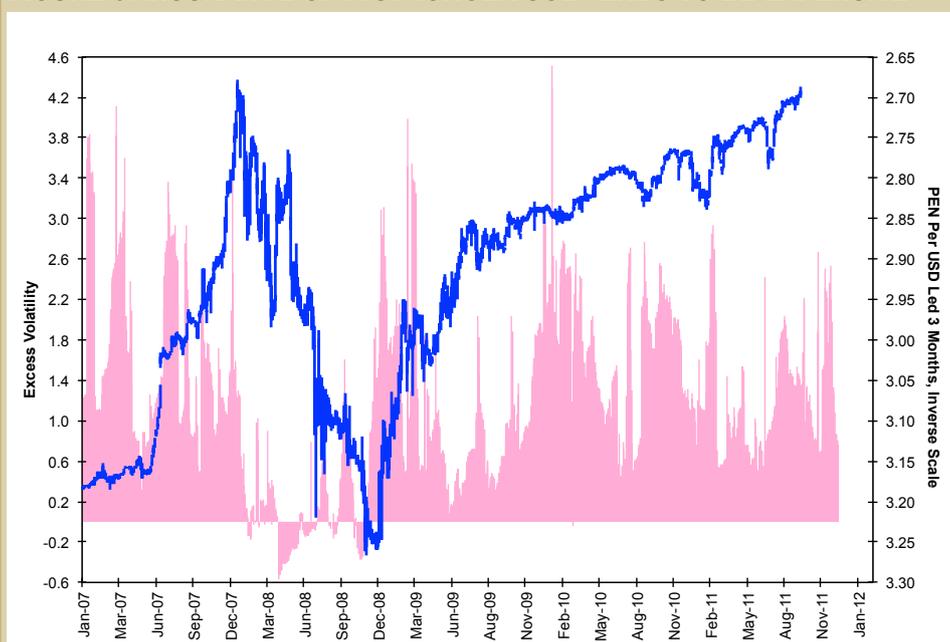
The obvious self-reinforcing cycle (we hesitate to call this, as the driver in runaway money-printing in the U.S., a “virtuous cycle”) of asset flows and currency gains makes the relatively new market in options on PEN non-deliverable forwards nervous. As in other articles, we will use excess volatility, the ratio of implied volatility to HLC volatility, minus 1.00, as a measure of the market’s demand for insurance. HLC volatility is defined as:

$$\sum_{i=1}^N \left[ \frac{.5 * \left( \ln \left( \frac{\max(H, C_{t-1})}{\min(L, C_{t-1})} \right) \right)^2 - .39 * \left( \ln \left( \frac{C}{C_{t-1}} \right) \right)^2}{N} * 260 \right]^{1/2}$$

Where N is the number of days between 4 and 29 that minimizes the function:

$$\frac{1}{N} * \sum_{i=1}^N \frac{N}{Vol^2} * |(P - MA)| * |\Delta MA|$$

**FIGURE 5: INSURANCE ON A STRONGER SOL TENDS TO BE EXPENSIVE**



*The combination of negative excess volatility during the PEN’s 2008-2009 decline and high excess volatility during its later rallies suggests the market distrusts a strong PEN.*

In the case of the PEN and its short option history, the market almost always has been in a high excess-volatility environment, especially in those periods when the Federal Reserve went out of its way to demonstrate its willingness to keep the money spigot open (Figure 5).

The connection is not as strong as we might like it to be, but the combination of negative excess volatility during the PEN’s 2008-2009 decline and high excess volatility during its later rallies leads us to believe the market distrusts a strong PEN.

John Connally, secretary of the treasury under President Nixon, once told a European audience the dollar was “our currency, but your problem.” Peru might understand the situation with the sol in a similar fashion: It is Peru’s currency, but its course seems to be driven by U.S. monetary policies and will suffer if and when those ever change. ☐

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



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

Economic release (U.S.)	Release time (ET)
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CPI	8:30 a.m.
ECI	8:30 a.m.
PPI	8:30 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.
ISM	10:00 a.m.

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<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>France:</b> Q4 employment report <b>Mexico:</b> Feb. 29 CPI and February PPI <b>UK:</b> Bank of England interest-rate announcement <b>ECB:</b> Governing Council interest-rate announcement
<b>9</b>	<b>U.S.:</b> February employment report <b>Brazil:</b> February CPI <b>Canada:</b> February employment report <b>Germany:</b> February CPI <b>UK:</b> February PPI <b>LTD:</b> March forex options; U.S. dollar index options (ICE)
<b>10</b>	
<b>11</b>	
<b>12</b>	<b>Japan:</b> February PPI
<b>13</b>	<b>U.S.:</b> February retail sales and FOMC interest-rate announcement <b>France:</b> February CPI <b>Hong Kong:</b> Q4 PPI
<b>14</b>	<b>India:</b> February PPI <b>UK:</b> February employment report
<b>15</b>	<b>U.S.:</b> February PPI
<b>16</b>	<b>U.S.:</b> February CPI <b>Japan:</b> Bank of Japan interest-rate announcement <b>LTD:</b> March U.S. dollar index futures (ICE)
<b>17</b>	
<b>18</b>	

<b>19</b>	<b>Hong Kong:</b> December-February employment report <b>LTD:</b> March forex futures <b>FND:</b> U.S. dollar index futures (ICE)
<b>20</b>	<b>U.S.:</b> February housing starts <b>Germany:</b> February PPI <b>Hong Kong:</b> Q4 GDP <b>South Africa:</b> Q4 employment report <b>UK:</b> February CPI
<b>21</b>	<b>FDD:</b> March forex futures; March U.S. dollar index futures (ICE)
<b>22</b>	<b>U.S.:</b> February leading indicators <b>Brazil:</b> February employment report <b>Hong Kong:</b> February CPI <b>Mexico:</b> March 15 CPI <b>South Africa:</b> February CPI
<b>23</b>	<b>Canada:</b> February CPI <b>Mexico:</b> February employment report
<b>24</b>	
<b>25</b>	
<b>26</b>	
<b>27</b>	
<b>28</b>	<b>U.S.:</b> February durable goods <b>France:</b> Q4 GDP <b>UK:</b> Q4 GDP
<b>29</b>	<b>U.S.:</b> Q4 GDP (third) <b>Canada:</b> February PPI <b>Germany:</b> February employment report <b>South Africa:</b> February PPI
<b>30</b>	<b>France:</b> February PPI <b>India:</b> February CPI <b>Japan:</b> February employment report and CPI
<b>31</b>	
April	
<b>1</b>	
<b>2</b>	<b>U.S.:</b> March ISM manufacturing report
<b>3</b>	
<b>4</b>	<b>ECB:</b> Governing Council interest-rate announcement
<b>5</b>	<b>Brazil:</b> March CPI <b>Canada:</b> March employment report <b>UK:</b> Bank of England interest-rate announcement <b>LTD:</b> April forex options; U.S. dollar index options (ICE)
<b>6</b>	<b>U.S.:</b> March employment report

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



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	291.9	1.92% / 81%	2.53% / 61%	0.16% / 0%	.40 / 92%
AUD/USD	AD	CME	122.2	146.8	0.25% / 13%	1.81% / 32%	4.80% / 64%	.15 / 5%
GBP/USD	BP	CME	95.5	193.3	0.74% / 40%	1.24% / 41%	1.20% / 72%	.42 / 83%
JPY/USD	JY	CME	85.6	160.5	-3.64% / 67%	-5.31% / 100%	-3.74% / 100%	.80 / 67%
CAD/USD	CD	CME	82.2	117.5	0.30% / 14%	0.74% / 28%	2.38% / 58%	.14 / 2%
MXN/USD	MP	CME	35.9	140.2	-1.37% / 83%	1.04% / 18%	6.20% / 63%	.09 / 5%
CHF/USD	SF	CME	34.3	44.6	2.25% / 80%	2.50% / 61%	1.94% / 40%	.50 / 100%
U.S. dollar index	DX	ICE	25.9	54.8	-1.75% / 83%	-1.41% / 50%	-0.55% / 83%	.31 / 78%
NZD/USD	NE	CME	8.8	31.5	0.29% / 18%	2.28% / 24%	7.37% / 76%	.12 / 15%
E-Mini EUR/USD	ZE	CME	5.0	5.1	1.92% / 81%	2.53% / 61%	0.16% / 0%	.40 / 92%

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.

<b>BarclayHedge Rankings: Top 10 currency traders managing more than \$10 million (as of Jan. 31 ranked by January 2012 return)</b>				
	Trading advisor	January return	2012 YTD return	\$ Under mgmt. (millions)
1.	CenturionFx Ltd (6X)	16.40%	16.40%	18.0
2.	ROW Asset Mgmt (Currency)	11.49%	11.49%	10.0
3.	Silva Capital Mgmt (Cap. Partners)	6.10%	6.10%	17.0
4.	FX Concepts (GCP)	5.22%	5.22%	1563.0
5.	Analytic Invest. Mgmt (ASC Enhanced)	4.79%	4.79%	108.0
6.	QFS Asset Mgmt (QFS Currency)	3.28%	3.28%	901.0
7.	FX Concepts (Multi-Strategy)	2.85%	2.85%	1768.0
8.	Excalibur Absolute Return Fund	2.63%	2.63%	43.4
9.	INSCH Capital Mgmt (Kintillo X3)	2.42%	2.42%	54.0
10.	Vortex FX AG (VFMA)	2.04%	2.04%	25.4
<b>Top 10 currency traders managing less than \$10M &amp; more than \$1M</b>				
1.	Overlay Asset Mgmt. (Emerging Mkts)	6.48%	6.48%	9.1
2.	MFG (Bulpred USD)	5.46%	5.46%	1.1
3.	GAM Currency Hedge (USD)	3.81%	3.81%	1.6
4.	BEAM (FX Prop)	1.73%	1.73%	2.0
5.	Omaha Foreign Exchange Corp. (FX)	1.26%	1.26%	4.5
6.	Drury Capital (Currency)	0.96%	0.95%	3.2
7.	Capricorn Currency Mgmt (FXG10 EUR)	0.96%	0.95%	1.8
8.	Vaskas Capital Mgmt (Global FX)	0.08%	0.08%	2.0
9.	Overlay Asset Mgmt. (SHCFP)	0.04%	0.03%	7.7
10.	Forexmax (Prop)	0.03%	0.03%	5.9
<p><i>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.</i></p>				



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

Rank	Currency	Feb. 24 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	Russian ruble	0.03373	5.05%	5.55%	-2.15%	0.0366	0.0303	8
2	Thai baht	0.032855	3.33%	2.80%	-1.97%	0.0336	0.031	17
3	South African rand	0.1298	3.12%	9.81%	-6.63%	0.1518	0.1166	5
4	Brazilian real	0.585775	3.00%	7.41%	-6.07%	0.65	0.5288	2
5	Swiss franc	1.101935	2.77%	1.02%	-13.05%	1.3779	1.0459	12
6	New Zealand dollar	0.83117	2.77%	11.76%	0.19%	0.8797	0.7207	3
7	Indian rupee	0.02018	2.70%	6.38%	-7.62%	0.0226	0.0181	1
8	Euro	1.328525	2.60%	-1.08%	-7.81%	1.4842	1.2657	16
9	Swedish krona	0.15047	1.93%	3.44%	-4.65%	0.1662	0.1427	7
10	Australian Dollar	1.066555	1.49%	9.32%	1.91%	1.1028	0.9478	4
11	Canadian dollar	1.001365	1.28%	4.40%	-1.00%	1.059	0.9467	10
12	Taiwan dollar	0.03380	1.11%	2.67%	-2.03%	0.03510	0.032	9
13	Singapore dollar	0.795385	0.99%	3.90%	-4.12%	0.832	0.7606	6
14	Great Britain pound	1.56912	0.87%	0.69%	-4.89%	1.6702	1.5308	15
15	Chinese yuan	0.15876	0.09%	1.22%	1.34%	0.1589	0.1518	11
16	Hong Kong dollar	0.12894	0.07%	0.48%	0.55%	0.129	0.1281	13
17	Japanese yen	0.01247	-4.00%	-3.78%	-4.37%	0.0132	0.0117	14

## GLOBAL STOCK INDICES

	Country	Index	Feb. 24	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Japan	Nikkei 225	9,647.38	9.81%	18.15%	11.66%	10,768.40	8,160.01	12
2	Germany	Xetra Dax	6,864.43	6.94%	26.46%	20.83%	7,600.41	4,965.80	1
3	Brazil	Bovespa	65,943.00	5.53%	19.29%	22.58%	70,108.00	47,793.00	3
4	India	BSE 30	17,923.57	5.46%	13.02%	10.06%	19,811.10	15,135.90	4
5	Hong Kong	Hang Seng	21,406.86	4.73%	19.36%	9.97%	24,468.60	16,170.30	2
6	Singapore	Straits Times	2,978.08	4.52%	12.64%	9.42%	3,227.28	2,521.95	6
7	France	CAC 40	3,467.03	4.35%	22.85%	10.43%	4,145.73	2,693.21	5
8	U.S.	S&P 500	1,365.74	3.89%	17.87%	15.98%	1,370.58	1,074.77	13
9	Italy	FTSE MIB	16,487.53	3.50%	18.44%	10.05%	22,717.20	13,115.00	7
10	UK	FTSE 100	5,935.10	3.19%	15.75%	16.62%	6,103.70	4,791.00	10
11	Mexico	IPC	37,945.22	2.96%	7.42%	9.53%	38,413.20	31,659.30	15
12	Canada	S&P/TSX composite	12,725.77	2.67%	10.80%	3.09%	14,329.50	10,848.20	8
13	Australia	All ordinaries	4,389.00	2.39%	6.65%	3.62%	5,069.50	3,829.40	11
14	South Africa	FTSE/JSE All Share	34,260.76	1.56%	9.80%	16.73%	34,386.97	28,391.18	9
15	Switzerland	Swiss Market	6,184.10	0.80%	15.44%	16.06%	6,667.10	4,695.30	14

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

Rank	Currency pair	Symbol	Feb. 24	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Franc / Yen	CHF/JPY	88.36	7.03%	5.02%	-9.10%	105.79	80.46	6
2	New Zeal \$ / Yen	NZD/JPY	66.645	7.03%	16.18%	4.74%	67.97	56.86	1
3	Euro / Yen	EUR/JPY	106.52	6.85%	2.83%	-3.63%	122.63	97.22	10
4	Aussie \$ / Yen	AUD/JPY	85.515	5.69%	13.63%	6.53%	89.46	72.72	2
5	Canada \$ / Yen	CAD/JPY	80.29	5.49%	8.52%	3.50%	88.95	72.63	5
6	Pound / Yen	GBP/JPY	125.815	5.05%	4.66%	-0.57%	139.19	117.58	7
7	Euro / Pound	EUR/GBP	0.846665	1.72%	-1.75%	-3.07%	0.9038	0.8239	9
8	Franc / Canada \$	CHF/CAD	1.10043	1.47%	-3.23%	-12.17%	1.3569	1.0397	8
9	Euro / Canada \$	EUR/CAD	1.32671	1.30%	-5.25%	-6.88%	1.4316	1.2917	15
10	Euro / Aussie \$	EUR/AUD	1.245625	1.09%	-9.51%	-9.54%	1.4228	1.2188	18
11	Aussie \$ / Canada \$	AUD/CAD	1.0651	0.20%	4.71%	2.94%	1.0755	0.9708	4
12	Euro / Franc	EUR/CHF	1.205615	-0.17%	-2.08%	6.02%	1.3158	1.0376	14
13	Euro / Real	EUR/BRL	2.26799	-0.39%	-7.90%	-1.85%	2.5367	2.204	21
14	Pound / Canada \$	GBP/CAD	1.56698	-0.41%	-3.56%	-3.93%	1.6354	1.5302	12
15	Pound / Aussie \$	GBP/AUD	1.4712	-0.61%	-7.90%	-6.67%	1.6373	1.4637	17
16	Aussie \$ / New Zeal \$	AUD/NZD	1.28316	-1.24%	-2.18%	1.72%	1.3746	1.2354	13
17	Aussie \$ / Franc	AUD/CHF	0.96789	-1.25%	8.21%	17.20%	0.99	0.7477	3
18	Aussie \$ / Real	AUD/BRL	1.820765	-1.47%	-3.60%	2.17%	1.9129	1.6402	16
19	Canada \$ / Real	CAD/BRL	1.709485	-1.67%	-2.80%	5.40%	1.83	1.5997	19
20	Pound / Franc	GBP/CHF	1.42393	-1.86%	-0.33%	9.38%	1.5165	1.1778	11
21	Yen / Real	JPY/BRL	0.021295	-6.74%	-10.41%	1.87%	0.0246	0.0186	20

### GLOBAL CENTRAL BANK LENDING RATES

Country	Interest rate	Rate	Last change	August 2011	February 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)	0-0.25	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	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
<b>AMERICAS</b>	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
<b>EUROPE</b>	France	Q3	12/23	0.3%	3.1%	3/28
	Germany	Q4	2/15	0.0%	2.6%	5/15
	UK	Q3	12/22	1.1%	3.0%	3/27
<b>AFRICA</b>	S. Africa	Q4	2/28	3.3%	10.3%	3/29
<b>ASIA and S. PACIFIC</b>	Australia	Q3	12/7	1.6%	6.1%	3/7
	Hong Kong	Q4	2/1	3.0%	6.5%	5/11
	India	Q4	2/29	12.0%	14.2%	5/31
	Japan	Q4	2/13	-0.6%	-2.3%	5/17
	Singapore	Q4	2/24	15.1%	3.8%	3/26

Unemployment		Period	Release date	Rate	Change	1-year change	Next release
<b>AMERICAS</b>	Argentina	Q3	11/21	7.2%	-0.1%	-0.3%	delayed
	Brazil	Jan.	2/17	5.5%	0.7%	-0.6%	3/22
	Canada	Jan.	2/3	7.6%	0.1%	-0.1%	3/9
<b>EUROPE</b>	France	Q3	12/1	9.3%	0.2%	-0.1%	3/1
	Germany	Jan.	2/29	5.6%	0.0%	-0.8%	3/29
	UK	Oct.-Dec.	2/15	8.4%	0.1%	0.5%	3/14
<b>ASIA and S. PACIFIC</b>	Australia	Jan.	2/16	5.2%	0.0%	0.1%	3/8
	Hong Kong	Jan.-Feb.	2/21	3.3%	-0.1%	-0.6%	3/19
	Japan	Dec.	1/31	4.2%	-0.3%	-0.7%	3/2
	Singapore	Q4	1/31	2.0%	0.0%	-0.2%	4/30

CPI		Period	Release date	Change	1-year change	Next release
<b>AMERICAS</b>	Argentina	Jan.	2/10	0.9%	9.1%	3/13
	Brazil	Jan.	2/10	0.6%	6.2%	3/9
	Canada	Jan.	2/17	0.4%	2.5%	3/23
<b>EUROPE</b>	France	Jan.	2/22	-0.4%	2.3%	3/13
	Germany	Jan.	2/10	-0.4%	2.1%	3/9
	UK	Jan.	2/14	-0.5%	3.6%	3/20
<b>AFRICA</b>	S. Africa	Jan.	2/22	0.6%	6.3%	3/22
<b>ASIA and S. PACIFIC</b>	Australia	Q4	1/25	0.0%	3.1%	4/24
	Hong Kong	Jan.	2/20	0.9%	6.1%	3/22
	India	Jan.	2/29	0.5%	5.3%	3/30
	Japan	Dec.	1/27	0.0%	-0.2%	3/2
	Singapore	Jan.	2/23	0.9%	4.8%	3/23

PPI		Period	Release date	Change	1-year change	Next release
<b>AMERICAS</b>	Argentina	Dec.	1/13	0.9%	12.7%	delayed
	Canada	Dec.	1/31	-0.6%	2.3%	3/1
<b>EUROPE</b>	France	Jan.	2/27	0.6%	3.5%	3/30
	Germany	Jan.	2/17	0.6%	3.4%	3/20
	UK	Jan.	2/10	0.5%	4.1%	3/9
<b>AFRICA</b>	S. Africa	Jan.	2/23	0.3%	8.9%	3/29
<b>ASIA and S. PACIFIC</b>	Australia	Q4	1/23	0.3%	2.9%	4/23
	Hong Kong	Q3	12/13	1.2%	9.6%	3/13
	India	Jan.	2/14	0.5%	6.6%	3/14
	Japan	Jan.	2/10	-0.1%	0.5%	3/12
	Singapore	Jan.	2/29	1.9%	8.0%	3/29

As of Feb. 29 LEGEND: Change: Change from previous report release. NLT: No later than. Rate: Unemployment rate.



Low-volatility breakout setup gets in on the Euro's young uptrend.

## TRADE

**Date:** Thursday, Feb. 23, 2012.

**Entry:** Long the Euro/U.S. dollar pair (EUR/USD) at 1.3268.

**Reason for trade/setup:** This paper trade was triggered when the criteria for the setup described in "FX consolidation breakout" were satisfied on Feb. 22. Basically, a low-volatility condition is identified, and a trade is taken on a breakout of the most recent bar's range. In this case, an entry was set up to occur either two ticks above the Feb. 22 high (1.3268) or two ticks below its low (1.3209).

**Initial stop:** The stop for a long trade will be the projected entry level for a short trade; the stop for a short trade will be the projected entry level for a long trade.

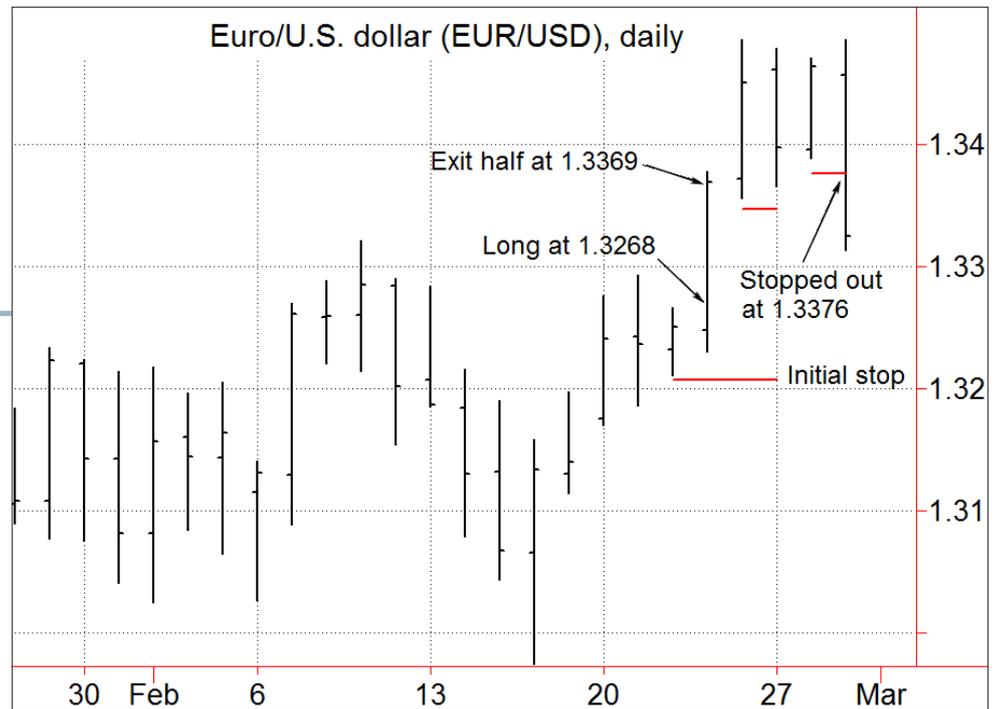
**Initial target:** Take partial profits at the close of the entry day, or intraday if price is 1 percent or more above the previous day's high. Take partial profits and trail stop for the remainder of the position.

## RESULT

**Exit:** 1.3369 (first half); 1.3376 (second half).

**Profit/loss:** 0.0101 (first half); 0.0108 (second half).

**Outcome:** Although outside days follow this setup quite frequently (requiring a stop-out and reversal of the initial



Source: TradeStation

position), this entry was simplified because the Euro/dollar pair traded only above the Feb. 22 high.

The next day's (Feb. 24) rally was relatively robust, and half the position was liquidated on the close at 1.3369. The remaining position was protected by a liberal trailing stop of 12 ticks below the most recent daily low.

Price rallied strongly again the next day (Feb. 25) before consolidating the next two days with consecutive inside bars. Although it appeared the market might be setting up for another upside thrust, the next wide-range day (Feb. 29) was a down bar, stopping out the remainder of the position at 1.3376. It would have been wiser to keep the stop tighter, or simply exit after the second consecutive big up day on Feb. 24, when the pair rallied as high as 1.3486. ☒

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

## TRADE SUMMARY

Date	Currency pair	Entry price	Initial stop	Initial target	IRR	Exit	Date	P/L		LOP	LOL	Trade length
								point	%			
2/23/12	EUR/USD	1.3268	1.3209	1.3399	2.22	1.3369	2/24/12	0.0101	0.76%	.0110	-.0037	1 day
						1.3376	2/29/12	0.0108	0.81%	.0218	-.0037	5 days

*Legend — IRR: initial reward/risk ratio (initial target amount/initial stop amount). LOP: largest open profit (maximum available profit during lifetime of trade). LOL: largest open loss (maximum potential loss during life of trade). MTM: marked-to-market — the open trade profit or loss at a given point in time.*