

Strategies, analysis, and news for FX traders

# CURRENCY TRADER

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Volume 9, No. 7

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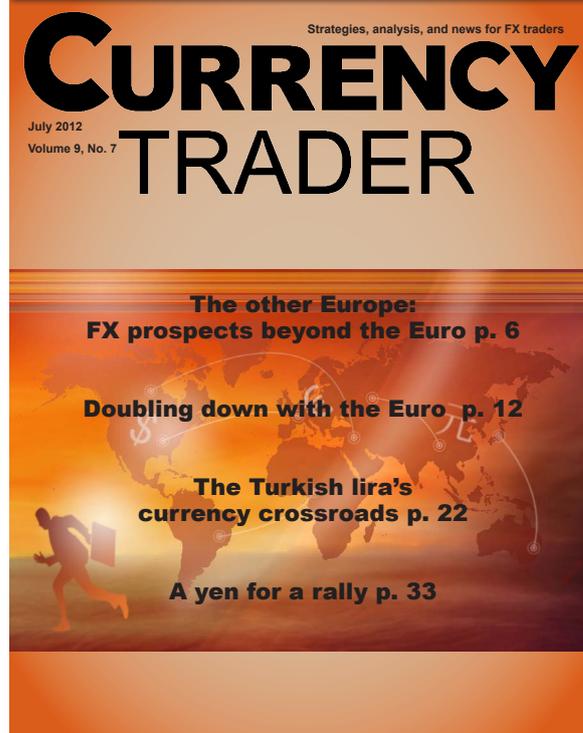
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# Eurozone neighbors not immune to crisis

...but some may have slightly more immunity than others. Find out how different Eurozone scenarios might play out and the likely impact on different European currencies.

BY CURRENCY TRADER STAFF

Three years into the Eurozone sovereign debt crisis, the European Monetary Union remains at risk, as does the economic health of neighboring countries and the global economy. Although the crisis appears to have (again) retreated from peak levels, it's still a long way from over, and traders are cautious about positioning themselves in such an uncertain environment.

There's been little in the way of good news out of Europe in quite a while. In a June 22 Monthly Review research note, Credit Suisse analysts revised their 2012 global GDP forecast from 3.6 percent to 3.3 percent: "The downward revision is broad-based across both developed and emerging markets, as strains in global financial markets continue to dampen consumer and business sentiment and pose downside risks to the economic outlook. While our current global growth forecasts fall in line with the long-term average growth rate (3.5 percent), they're much lower than the 4.6 percent growth average in the five years before the 2008-2009 global Great Recession. Also note that our 3.3 percent global growth forecast for this year is the lowest since the Great Recession."

Meanwhile, emerging market countries continue to shoulder the heavy lifting in terms of keeping global economic growth positive. Credit Suisse expects emerging economies to grow at a 5.2-percent pace in 2012 vs. 2.1 percent for the U.S. and -0.5 percent for the Eurozone.

## **Eurozone neighbors**

Although the entire region remains at risk to potential spillover, some Eurozone neighbors are holding up better than others. Of Switzerland, the UK, Norway, and Sweden, all but Britain are expected to post positive GDP in 2012.

But don't look for gangbuster economic or currency performance from any of them.

"The deceleration in economic activity in the Eurozone is having a knock-off effect on the region," says Michael Woolfolk, managing director at BNY Mellon. "There are no winners, just varying degrees of losers."

Andrew Wroblewski, chief European economist for Decision Economics, has a similar take.

"No one is going to win from the Eurozone crisis, it's just a question of who is most resilient," he says.

Credit Suisse forecasts a 0.5-percent GDP pace for Switzerland in 2012, a 0.8-percent rate for Sweden, 3.3 percent for Norway, and -0.3 percent forecast for the UK.

In the event of the worst-case scenario — a Eurozone breakup — Scandinavia in general is better equipped to survive the fallout, although there will be plenty of pain to go around, according to Greg Anderson, North American head of FX strategy at Citigroup.

"The Scandinavian banks are not exposed really to that debt," he says. "It helps those countries weather the storm. But the Eurozone is their biggest export market and they are not going to come away unscathed."

Wells Fargo global economist Jay Bryson also paints a sobering picture of the continent's predicament in the event of a full Eurozone meltdown.

"If you're looking at a deep [Eurozone] recession, it will hit those [Scandinavian] countries," he says. "If Europe truly does blow up, and we are looking at another Lehman moment, nobody is going to escape that. The Euro would weaken vs. all those currencies, and their currency strength would hit their exports as well."

## A long way to go

Even with the Greek elections in the rear-view mirror, the Eurozone debt crisis is far from resolved.

"The Greek elections were a sideshow," Bryson says. "They eliminated a near-term negative, but at the end of the day it's all about Spain and Italy." If it were a baseball game, he estimates the debt crisis is in the fifth inning, but there are still enough clouds on the horizon to rain out the game entirely.

Bryson pegs Eurozone GDP growth at -0.3 percent in 2012, with a +1-percent forecast for 2013. But he notes that outlook is contingent upon the assumption Europe will "do enough to kick the can down the road and buy some more time," even if the crisis doesn't entirely disappear.

Let's dive a little deeper into the Eurozone neighbors' economic fundamentals, starting with Britain.

## Economic fundamentals

Melanie Bowler, economist at Moody's Analytics, says fiscal austerity — both at home and abroad — is weighing on Britain's economy.

"The UK has slipped back into recession, its second in four years," she says, noting the contraction began in the fourth quarter of 2011. "Recovery may not come soon; the extended June public holiday will subtract from second-quarter growth, while the Olympics may provide only a muted boost to the third quarter." These factors, she says, combined with severe fiscal austerity, suggest the economy will struggle to grow again in 2012. "The risks to the outlook are weighted to the downside," she says.

Weak exports are also slowing growth in Britain. "With several of the UK's key European trading partners in recession, demand for British-made goods is weakening," Bowler explains. "Exports to the Eurozone account for around 47 percent of total UK external sales. Demand has also slowed elsewhere in the world, as policymakers in emerging economies try to engineer soft landings. A little more than 3 percent of UK exports are destined for China, which announced its first interest rate cut since 2008 on growth worries. Furthermore, with around 13 percent of UK exports going to the U.S., recent declines in exports to the U.S. are a concern."

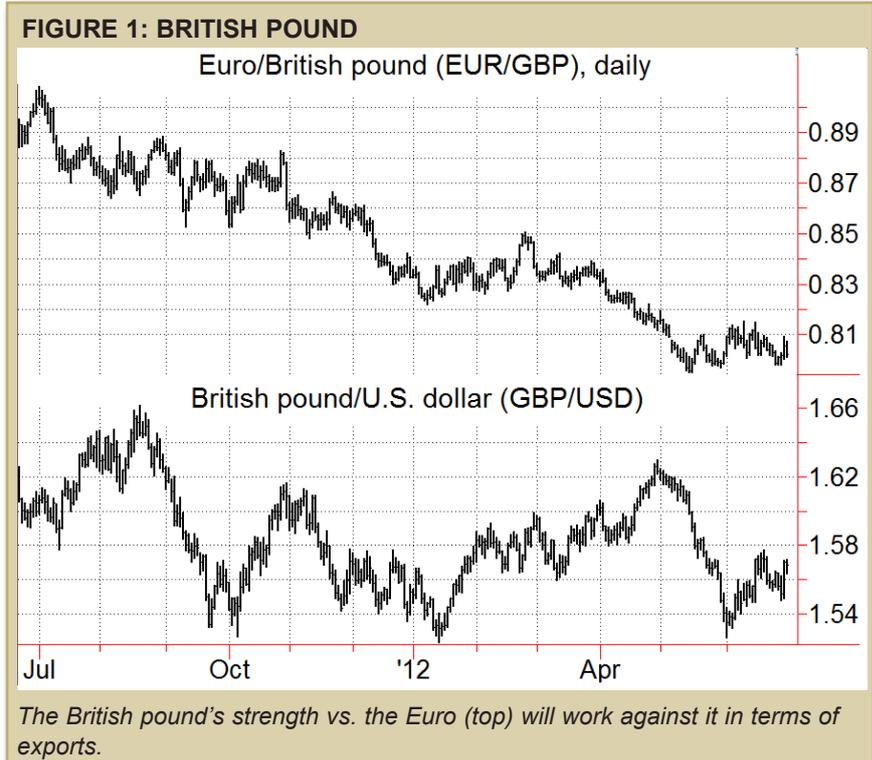
And Britain's relative currency strength

isn't helping its export weakness, Bowler adds. "Persistent problems in Euro land and currency controls on the Swiss franc — traditionally a safe haven for investors — have boosted sterling's global standing, raising its exchange value against the Euro around 10 percent in a year to levels last seen in 2008," she notes. "The UK currency could rise further as investors question the stability of the Euro. The strong pound is hitting the competitiveness of British-made goods across the Channel."

Figure 1 shows the Euro/pound pair (EUR/GBP) and the pound/U.S. dollar pair (GBP/USD).

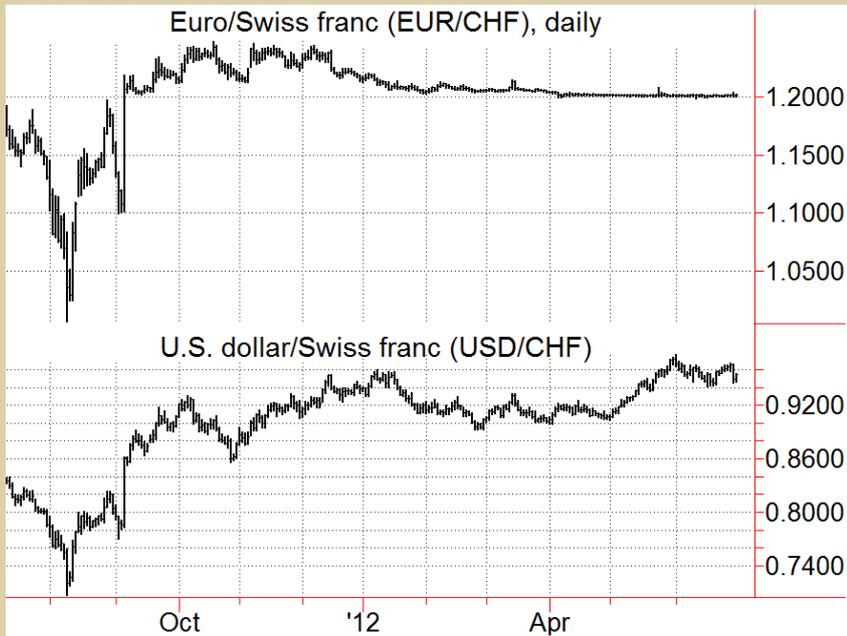
The strains on the UK economy are manifesting themselves in virtually all areas of the financial markets, with equities posing a special problem because of their popularity. As of late June, the FTSE 100 index had fallen 8 percent since April, and Bowler notes a relatively large percentage of UK households own stock shares. "British families are vulnerable to adverse market developments," she says. "Around 15 percent of UK households directly own shares, compared with 8 percent in Greece and Ireland and just 5 percent in Spain. Indirect share ownership via pension funds or other vehicles is much higher — more than 45 percent — compared to 19 percent in Germany and just 4 percent in Portugal."

Perhaps topping the list of challenges in Britain are fis-





**FIGURE 2: SWISS FRANC**



*The Swissie could see a surge in the event of a Euro collapse, despite the Swiss central bank's desire to cap its appreciation.*

cal worries. "Britain's current budget deficit is among Europe's highest at 8.5 percent of GDP as of 2011," Bowler says. "The government is hoping to lower it to 6.5 percent of GDP this year, and meet the European Union's fiscal target of a deficit of no more than 3 percent of GDP by 2015. Debt is expected to peak at 86 percent of GDP in 2014 before starting to come down."

However, bond levels will remain key to how this scenario plays out. Bowler says Moody's Analytics fiscal space analysis suggests bond yields above 7 percent would make debt repayments unsustainable for the UK government. "Yields were last above this rate in 1997, and averaged 7.47 percent throughout the 1990s. But the national debt then was less than half of its current level relative to GDP," she notes.

Overall, all countries would experience some spillover impact if a country were to exit the Eurozone, but the UK is likely to see more collateral damage, according to Bowler.

"The UK would feel the direct effects largely through the decline in its financial markets, since many companies derive a large share of their earnings from European operations," she says. "Exports would also decline as European demand weakens. The UK mainly specializes in higher-value-added manufactured goods for final consumption or capital investment, which are particularly prone to the economic cycle. An appreciation of the pound vs. the Euro would add to exporter problems."

The contagion would likely spread to UK consumer spending, housing prices, and employment.

### Switzerland

Switzerland's long-standing tradition of independence and neutrality has not made it immune to Europe's larger problems. "Ripples from the European sovereign debt crisis are hitting Switzerland's finance, tourism, and export-oriented industries" says Sean Ellis, associate economist at Moody's Analytics. "While Swiss banks are not heavily exposed to the toxic assets that have embroiled other European financial institutions, they are dealing with a highly volatile stock market, a risky investment environment, and vulnerability to a Eurozone breakup."

All of which takes its toll, Ellis notes. "Exports fell sharply over 2011 as consumption declined in the Eurozone, Switzerland's primary trading partner," he says. "To compound this, the franc's rapid appreciation made Swiss goods more expensive, eroding its competitive advantage."

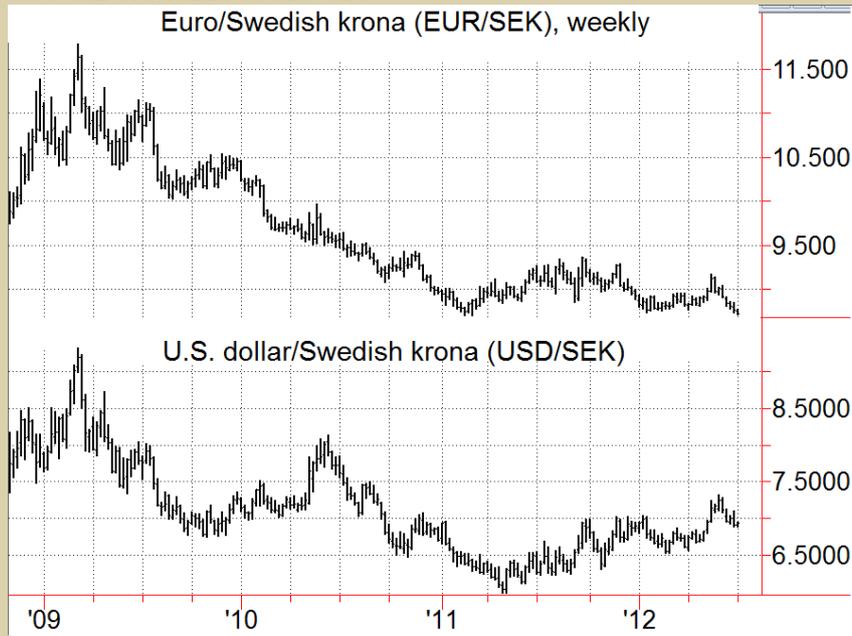
A Eurozone breakup would likely put Switzerland into a recession, according to Ellis, with already weak industries being even harder hit.

"The exact depth of the recession would depend on several factors," he says. "First, is it only one or two smaller countries leaving and the rest staying, or does the entire Euro currency break apart? Are countries exiting carefully or suddenly?"

As for the franc, Ellis says, it would appreciate significantly because of its status as a safe-haven currency — despite Switzerland's efforts to put a ceiling on its appreciation (Figure 2).

"Maintaining the peg at this point would be far more expensive to do and would cause the SNB (Swiss National Bank) to strongly reconsider its policy," he says. "If the

**FIGURE 3: SWEDISH KRONA**



*Sweden is less exposed to bad European debt than most countries, but its currency market may find it difficult to absorb a flight-to-quality run into the krona.*

peg is abandoned it would become much more difficult for Swiss goods to compete on the world market, as their prices will have risen considerably.”

### Sweden

Moody’s Analytics forecasts a 1-percent growth pace for Sweden in 2012. Justin Irving, associate economist at the company, warns current internal debate brewing inside the Swedish central bank has sparked worries.

“My big concern is that if it looks like the Eurozone will break up, people will rush into the Swedish krona for safety (Figure 3),” he says. “Say I’m a wealthy Italian and want to ensure my assets have purchasing power in the future — and make sure they aren’t turned into lira — I might want to buy up Swedish krona with my Euro. There is a risk your German bank account could be turned into lira, but there is no risk Swedish krona could ever be turned into lira.”

The ramifications of wealthy Europeans parking cash in accounts outside the Eurozone means “it will soak up the available money supply, which is deflationary — it would weigh on the amount of money flowing through the economy,” Irving explains. The big question is whether the Swedish central bank would accommodate that by printing money, and Irving believes there is a real chance it would not. “There is a fight inside the central bank and the risk they wouldn’t fully accommodate the excess demand for currency,” he says.

Irving notes his firm’s official forecast, which still holds there’s a 50-percent chance Greece will leave the Eurozone within 12 months, leaves this scenario in play. Foreigners

parking cash in Swedish krona would be the equivalent “of taking a lot of money out of circulation and putting it under the mattress,” he says. While this is an easy problem to solve, Irving is not confident the Swedish central bank has the will to address the issue forcefully and quickly, and the result could be a deflationary recession.

### Norwegian economic wood

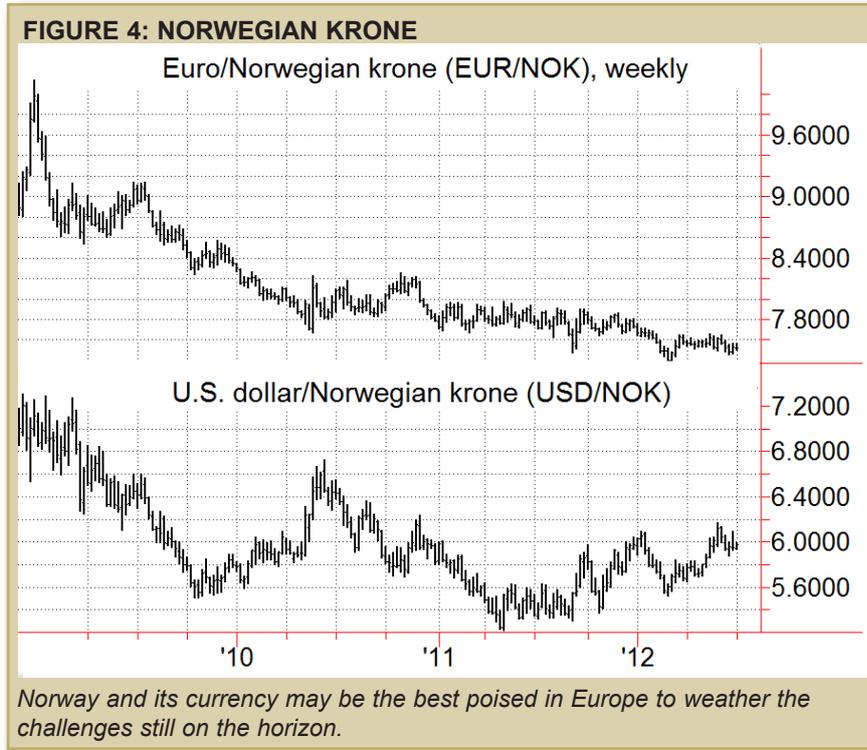
Several economists and market watchers have singled out Norway as the most attractive non-Eurozone country on the continent. “It has a healthy fiscal backdrop and is benefiting from higher oil prices,” Wroblewski says, describing Norway as the “most resilient” economy on the short list of Eurozone neighbors. Norway is an oil exporter, and the Norwegian krone (NOK) is often grouped in the so-called “commodity currencies” category (Figure 4).

Woolfolk also picks Norway as the strongest economy of the group. “I think commodity and risk appetite will rebound and the oil industry will help propel it farther, faster,” he says.

Anderson expands on Norway’s competitive advantages: “Norway is a resource economy, and one that does not have a high banking-to-GDP ratio,” he says. “It’s in a good spot. People are not going to stop buying heating oil just because there’s a crisis in Greece. I like Norway in a bad scenario, and I like it even more in a good scenario where growth comes in better than feared in the Eurozone.”

He posits if risk appetite rebounds strongly in Europe, Norway is well positioned to benefit from a likely rally in Brent crude oil to \$125/barrel.

Irving is also more optimistic about Norway, which he



says benefits from a sovereign wealth fund that gives its citizens the feeling the government can solve any economic problem. Domestic consumption remains well-anchored in Norway.

“It takes a lot to derail confidence in Norway,” he notes. “Their country has an enormous trust fund from their oil. There’s this sense that the future will be OK in Norway, so people are happy to spend money today.”

Irving was also more upbeat about the will of Norway’s central bank to attack burgeoning problems quickly. “After the Switzerland [franc] ceiling was put in, there was a sense the Norwegian krone was a safe haven, but the central bank scared people away with a surprise rate cut,” he says.

According to SEB chief strategist Erica Blomgren, the Norwegian economy, aided by the booming activity and investments in the oil sector, has been surprisingly resilient to headwinds from abroad.

“If the Eurozone debt crisis deepens and/or a country leaves the Euro, Norway would be most affected via financial markets — higher credit spreads and continued low rates,” she says. Otherwise, commodity prices would be more important for the growth outlook than the debt crisis as such. The Norwegian economy should still grow around trend, but the key deposit rate would like remain low for

longer.”

In regard to the forex market, Blomgren notes “The krone is backed by strong fiscal balances that make it attractive for foreign reserve managers who wish to diversify into more sound, fundamentally strong currencies,” she says. “The positive growth outlook means Norges Bank (Norway’s central bank) will have to start hiking rates ahead of its peers — although we expect this to happen in early 2013 — which also supports the NOK. Overall, we expect the NOK to gradually appreciate over the coming 18 months.”

**Summer markets**

Aside from an overall bearish trend in the Euro/dollar pair, forex traders may be hard pressed to identify tradable and long-lasting trends in currency pairs.

“There are no trends anywhere, because everyone is waiting for some news to see where we will be in a year from now,” says Charles St. Arnaud, FX strategist at Nomura. “Trading volumes are relatively small; no one is willing to take big positions.”

His advice for traders? “Recognize risks are both ways and be careful. Be nimble.”

The European crisis is a long way from over, and it likely still has many curve balls to throw at traders. ☒

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# Intermarket doubling down

Prevailing correlations and economic conditions put the Euro on shaky ground.

BY BARBARA ROCKEFELLER

If you are late to the game, you might imagine commodities are a “natural hedge” against the dollar, so every portfolio should contain some. The dollar trades inversely to gold in particular, as well as black gold (oil). Any increase in oil prices should push down the dollar, while any rise in the dollar should push down oil. Meanwhile, the old standby, the 10-year Treasury note yield, should lead the dollar up or down. After all, rising yields attract investors and falling yields send them elsewhere.

But since the beginning of 2012, none of this conventional wisdom has held. Figure 1 shows the Euro, not the dollar, has been tracking the price of oil and the 10-year U.S. T-note yield index. The Euro is laboring under special circumstances, to be sure, but an intermarket correlation

based in logic and with a good track record should prevail. Figure 1’s implication is that intermarket correlations are bunk, at least over the past six months.

Something similar is evident in Figure 2, which shows the dollar rising in sync with gold starting around May 2011. Wait a minute — gold is supposed to trade inversely to the dollar. To be fair, May 2011 was a watershed month for the Euro. Portugal joined Ireland in the bailout camp. The precursor to the Greek troika made a visit to Athens to talk about restructuring the economy, and it was already clear Bailout II would be the endpoint (which occurred in February 2012). European Central Bank (ECB) chief Jean-Claude Trichet refused to cut interest rates, and in response the Euro lost 250 points in four hours on May 5.

Dominique Strauss-Kahn disgraced himself in a New York hotel and was forced from his cushy International Monetary Fund (IMF) job. The UN’s Food and Agriculture Organization reported that “world food prices rose to near a record in April as grain costs advanced, adding pressure to inflation that is accelerating from Beijing to Brasilia and spurring central banks to raise interest rates.”

Most importantly, after hitting a high of 1.4940 on May 4, 2011, the Euro has been on a downward trajectory ever since (Figure 3). The first Euro drop started in November 2009 at a high of 1.5145 and ended June 4, 2010 at a low of 1.1956 — a 21-percent decline. The second downtrending cycle, if we can call it that, started in May 2011 at 1.4940 and is still in effect, hitting its lowest low (as of early July) of 1.2364 on May 31, 2012. This down move was smaller than the first decline — only 17 percent — and took about twice as long (13 months) to unfold. Because economic condi-

**FIGURE 1: 10-YEAR NOTE YIELD INDEX (BLACK), EURO (GREEN) AND WTI CRUDE OIL (ORANGE)**



Since early 2012 the Euro, rather than the dollar, has tracked the oil and the 10-year T-note yield index.

Unless noted otherwise, source for all figures: chart — Metastock; data — Reuters and eSignal

tions are indisputably worse and institutional conditions are no better today than two years ago, this is a peculiar outcome; the Euro “should” have surpassed its previous lowest low by now.

We need to analyze two distinct threads of this story: the vanishing intermarket correlation and the asymmetrical behavior of the Euro. We have long argued intermarket correlations are unreliable. After all, oil used to be positively correlated with the dollar and that was perceived as the “natural” state of affairs. Oil became a dollar hedge with the advent of big institutions (think Goldman Sachs) using it that way and publicizing it as such. The rest of the trading world swiftly followed, creating a self-fulfilling prophecy.

Something similar happened in gold: Non-ideological traders hijacked gold from the gold bugs as a first-class commodity with an already-built trading infrastructure, and no pesky problems such as weather, subsidies, or trade barriers that prevail in agricultural commodities. They picked gold because it’s a less complicated market than soybeans. It could just as easily have been copper, but copper is a smaller market and has a special attribute — it’s a proxy for Chinese growth. Gold rapidly came to be traded as a proxy for global risk instead of as a hedge against U.S. inflation that would trash the dollar. It was very helpful the U.S. didn’t suffer much inflation from the massive increase in the Fed’s balance sheet.

Also, commodities are subject to sup-

**FIGURE 2: EURO (INVERTED, GREEN) VS. GOLD (GOLD)**



*The dollar began rising in tandem with gold around May 2011.*

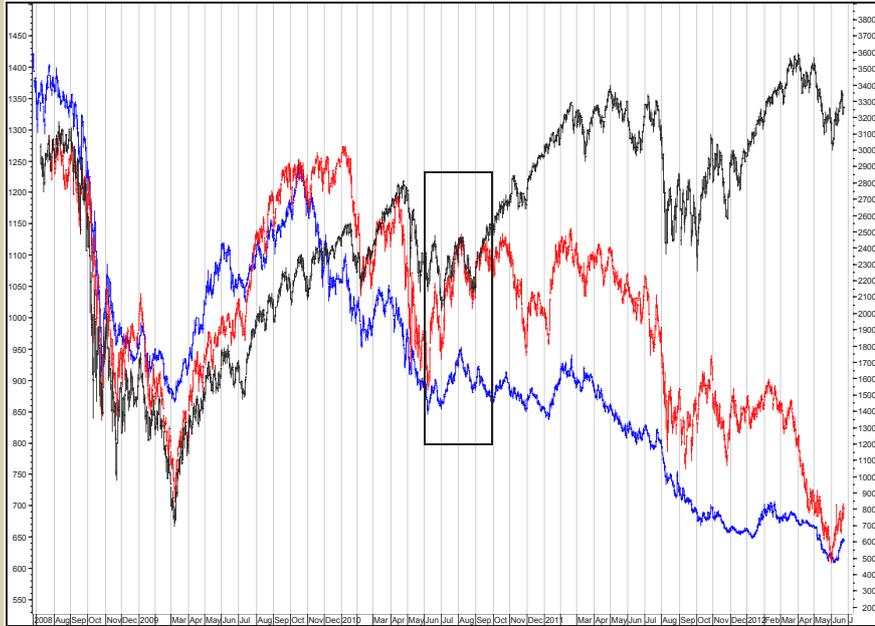
**FIGURE 3: EURO STAGES**



*The Euro has been downtrending since hitting 1.4940 on May 4, 2011.*

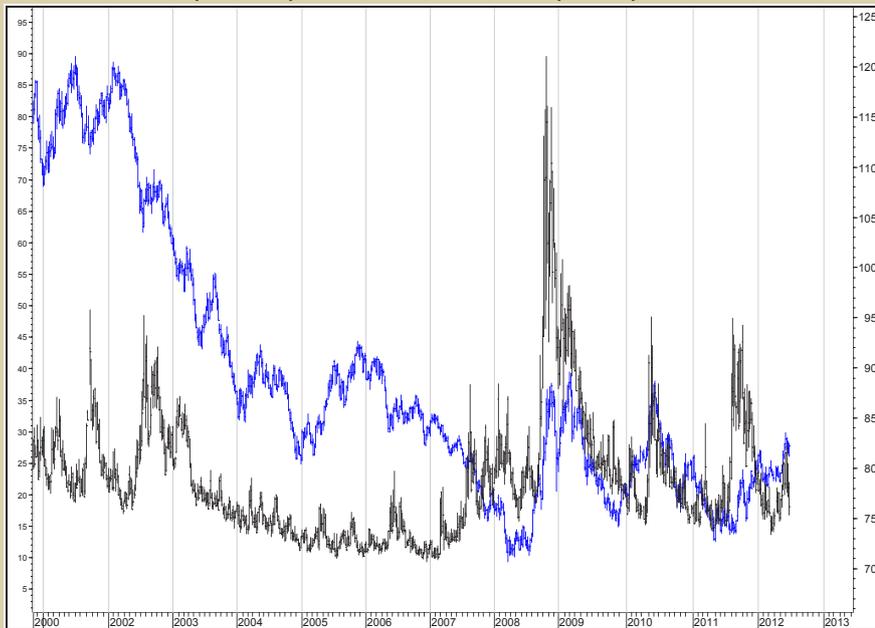


FIGURE 4: EQUITY INDICES (BLUE = ATHENS, RED = MADRID, BLACK = S&P 500)



The S&P recovered from the June 2011 dip while the Athens and Madrid indices fell dramatically.

FIGURE 5: VIX (BLACK) VS. DOLLAR INDEX (BLUE), WEEKLY



During the worst of the financial crisis in late 2008 and early 2009, the VIX and the dollar index moved together, but the correlation between the dollar and a rising VIX has generally been weak.

ply and demand factors entirely separate from the financial world, such as the number and nature of marriages in India, a big gold consumer. It has not been beneath the august *Financial Times* to inquire into those customs and practices in as much detail as it reviews of the opinions of Warren Buffett and George Soros on gold.

It's possible to argue commodities switched from being a hedge against a declining dollar to a hedge against a declining Euro, which would explain the switch in correlations. Because the Euro is the second-largest reserve currency after the dollar, this might make some sense if we think of risk aversion, inspired by events in the Eurozone, as the sole determinant of the Euro. When Eurozone leadership disappoints, when data points toward more recessionary conditions, and when the private market disdains sovereign debt so Spanish yields top 7 percent, risk-evaluators want to sell not only Euros but anything else remotely risky, such as commodities. This would mean the positive correlation between the Euro and the CRB index is a form of doubling down.

It may also account for key European equity indices — Athens and Madrid — falling while the U.S. S&P 500 thrived. We can date the change in risk appetite favoring the U.S. to summer 2011. The S&P recovered from the June dip while Athens and Madrid did not (Figure 4). The Athens index dropped from a high of 2,933 in October 2009 to a low of 471.35 in June 2012, or a loss of more than 83 percent. Madrid fell by more than 50 percent, declining from a high of 1,273.70 in January 2010 to a low of 608.80 in June 2012. This is not to say capital fleeing Athens and Madrid went to the U.S.; other European indices, such as the German DAX and the French CAC-40, are down from their peaks last spring and summer, but

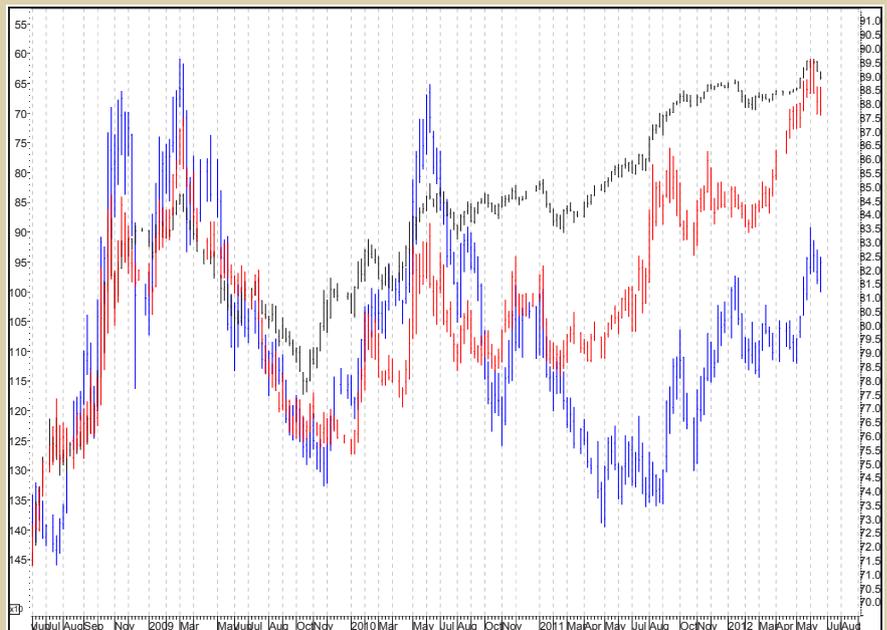
they haven't fallen to historic lows.

There is no Volatility Index (VIX), or risk measure, for the individual European stock markets. In the U.S., we have often struggled to "fit" the VIX to the dollar index as a measure of both currency market and equity market riskiness. During the worst of the financial crisis in late 2008 and 2009, VIX and the dollar index did, in fact, move together (Figure 5). However, if you wanted to forecast the dollar based on a VIX rise, the correlation is very weak. The VIX spiked months before the dollar did in 2008, as well as in 2010 and 2011. It appears the VIX may be a good measure of U.S. stock market riskiness, but it fails to capture the riskiness of other stock markets and is only vaguely related to the dollar as the beneficiary of overall world riskiness.

In fact, there's a better visual correlation between the dollar index and the Athens and Madrid stock indices (at least since summer 2008) than between the dollar index and the VIX (Figure 6). To make life even more complicated, not only is the Euro now directly correlated with oil, crude is more closely correlated with equities broadly defined, at least since late 2008, as evidenced by the relationship shown between the FTSE All-World Index and Brent crude oil (Figure 7).

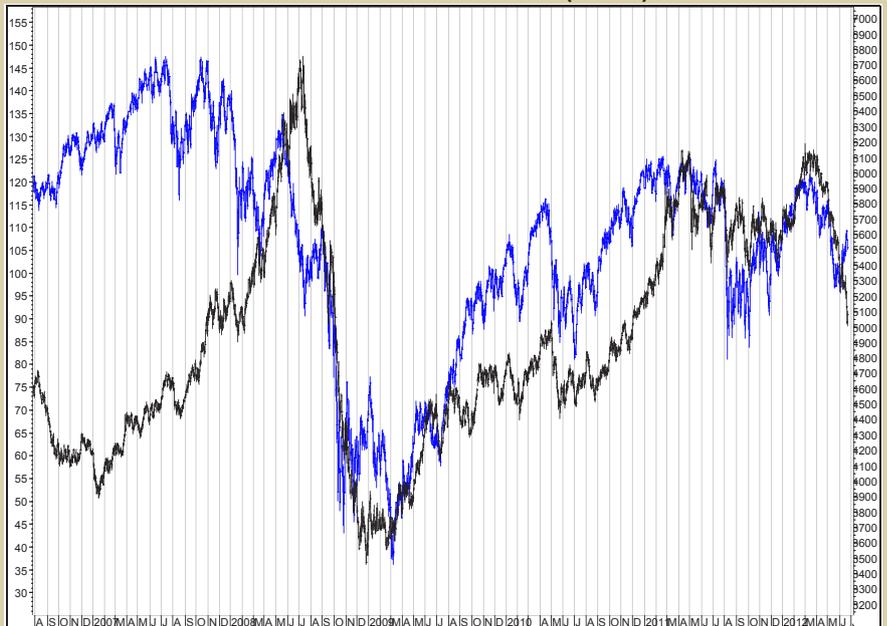
Interpreting this observation is tricky. Some analysts argue that because commodities are an asset class in their own right and equities are the brightest star in the asset-class firmament, a simultaneous drop (as in 2009 and possibly brewing today, as oil flirts with lows from last October) must mean an impending global recession. It's risk aversion on a multi-asset-class scale and a leading indicator of sentiment toward growth. The Fed has already downgraded the U.S. growth outlook, Europe is virtually certain of getting a second quarter of negatives, and China actually announced a slow-

**FIGURE 6: DOLLAR INDEX (BLUE) VS. INVERTED MADRID (RED) AND ATHENS (BLACK) EQUITY INDICES**



*The correlation between the dollar index and the Athens and Madrid stock indices has been better (at least since summer 2008) than the one between the dollar index and the VIX.*

**FIGURE 7: BRENT OIL (BLACK) VS. FTSE ALL-WORLD EQUITY INDEX (BLUE)**



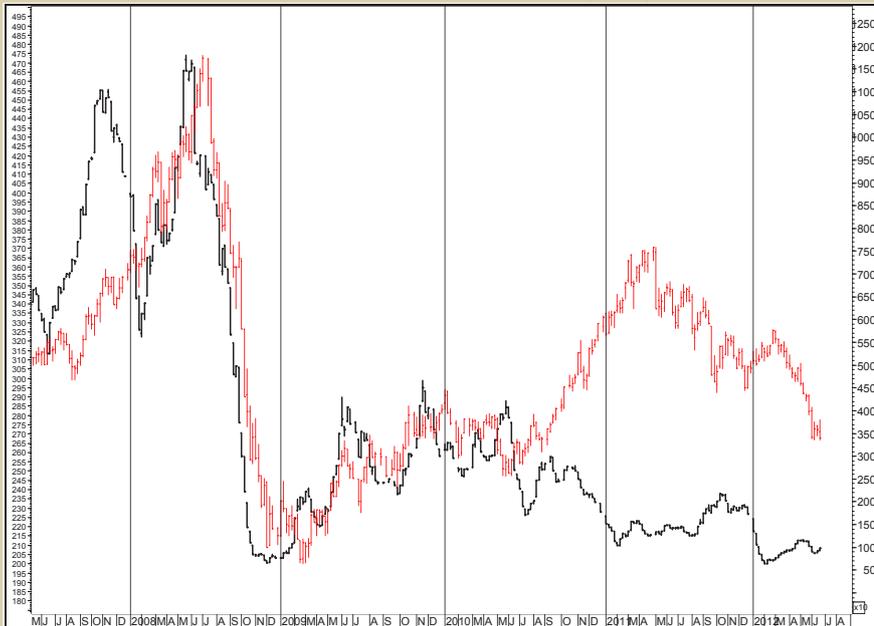
*The Euro is currently directly correlated with oil, and crude, in turn, is more closely correlated with equities.*

**FIGURE 8: CRB INDEX, WEEKLY**



As of late June, the CRB had retraced 62 percent of the up move from its 2009 low to its early 2011 high.

**FIGURE 9: BALTIC DRY INDEX VS. CRB INDEX (RED), WEEKLY**



The Baltic Dry Index formed a head-and-shoulders pattern in 2009-2010, and in early 2012 fell below its late-2008 financial crisis low.

down (although no one trusts the data and we still don't know if it's a "hard landing").

We have to take our own warnings to heart and not put too much faith in oil being a leading indicator of a recession. The supply factors are troublesome, with an embargo against Iran about to begin, but both U.S. and Saudi production full-speed-ahead for months and reserves at 20-year highs. Elsewhere in the commodity complex, agricultural prices were down 9.3 percent in May alone. Remember that UN warning from April 2011, only a year ago? The UN said food prices were accelerating at a record pace, contributing to inflation and forcing central banks to raise interest rates. Well, the UN was wrong. Food prices fell, inflation is tame everywhere in the G7 (if not quite to the 2 percent target that central banks prefer), and G7 central banks are lowering the cost of money, not raising it.

Look at the CRB index (Figure 8). As of the end of June, it has retraced exactly 62 percent of the up move from its 2009 low to its early 2011 high. If the index continues south, the doom-and-gloom analysts are likely correct — it's a true double-dip recession. We can look for confirmation from the Baltic Dry Index (Figure 9), which formed a head-and-shoulders pattern in 2009-2010. As the pattern promised, in early 2012 the index fell to a low below its lowest low from the late-2008 financial crisis. The Baltic Dry Index measures the cost of shipping raw and industrial materials

**FIGURE 10: EURO/USD (BLUE) VS. 2-YEAR NOTE DIFFERENTIAL U.S. & GERMANY (GRAY), DAILY**



*There is a clear correlation between the Germany-U.S. two-year note differential and the Euro.*

*Source: [www.fxthoughts.com](http://www.fxthoughts.com)*

and is often used a proxy for global economic health or illness. It's only logical that if trade is drying up, the Baltic Dry will fall. And trade does dry up as economies fall into recession.

If it's true the world economy is sinking to a recession, commodity prices and equity markets should fall further, and as we just saw, the currency that suffers from these declines is the Euro, not the dollar. In other words, we don't need gridlock in European leadership, a Greek Bailout III or Grexit — or any other setback in the greater European fiscal union — for the Euro to fall. It can fall from the weight of recession and the new intermarket correlations.

Besides, the dollar has a secret weapon, the one correlation that remains: relative real yield, or the relationship between the bond market and the FX market. This, too, is a tricky relationship. For many years you could show a strong correlation between the real yield differential of two countries and their exchange rates, and Bob's your uncle. Then the relationship mysteriously got contaminated and stopped working. You can blame the Internet, which exploded right around the same time (late 1990s) and allowed traders to engage in multiple new markets, with the usual wild emotion-based price outcomes — i.e., extreme overbought-oversold conditions and high volatility.

For most of the history of the past two decades, Germany has had a higher real (after-inflation) yield than the U.S. It was 2.8 percent in late 2008 and 1.83 percent as recently as year-end 2009. This is partly a function of the severe anti-inflation ECB stance, at least compared to the

Fed, and partly a function of the Fed's greater responsiveness to growth issues, especially employment.

Now the tables are turned. In May 2011, the U.S. 10-year yield was above 3 percent while the German Bund was yielding 2.3 percent. Today, the U.S. 10-year yield is 1.67 percent (and it has been down to 1.44 percent on June 1, 2012) while the Bund fell to a record low 1.37 percent on May 29, 2012. The U.S. has had the yield advantage for more than a year.

The 10-year real-yield differential chart is of little help, not least because it's a monthly chart. The two-year chart is more useful. Figure 10 shows the two-year note differential between Germany and the U.S., alongside the Euro, unadjusted by inflation to make it "real." The 10-year may be the benchmark, but in a crisis-situation crunch it's the two-year you want to look at. This chart is the most convincing of the lot — the correlation is clear.

The ECB is literally unable to engage in quantitative easing because treaties do not allow it to buy and sell sovereign debt. But the ECB can do other things, including cut rates from the current 1 percent, or cut rates for specific banks that promise to make specific loans to companies and households.

If you assume the coming recession will induce the ECB to cut rates, and also assume there will be flight from risky asset classes (commodities and equities), the Euro should fall further — regardless of how the current steps toward fiscal union work out. ☒

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



# Wide-range days in the Euro

Regardless of the market's ultimate direction, wide-range up days are often followed in the near term by sideways-to-lower price action.

BY CURRENCY TRADER STAFF

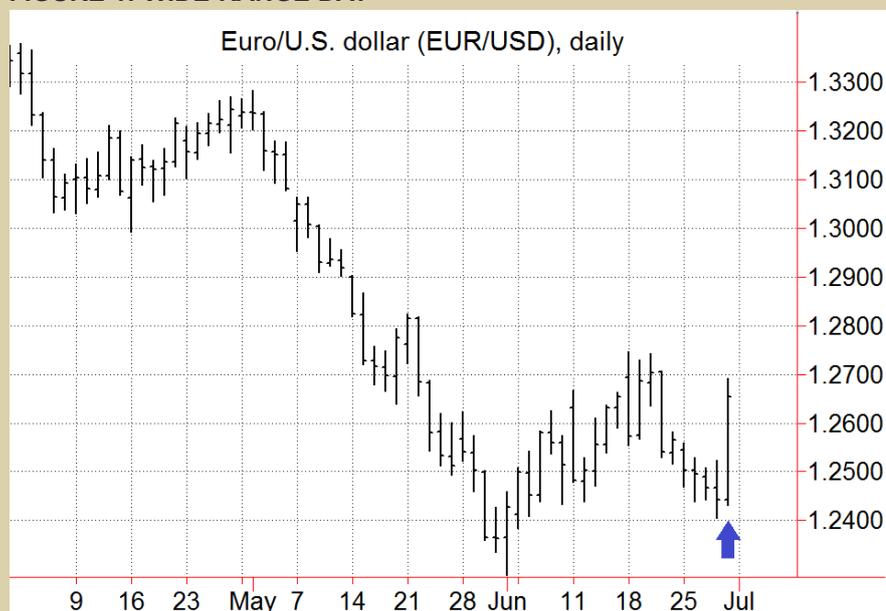
When Eurozone powers hammered out an agreement on Friday, June 29 to provide bailouts directly to Spanish banks rather than the Spanish state — loosening some of the restrictions Germany wanted to maintain on the recovery process — the Euro responded by staging its biggest one-day rally since October 2011 (Figure 1). The EUR/USD jumped around 2 percent intraday, hitting a five-day high near 1.2700 one day after the market had dropped to a more than three-week low. (The early June bottom around 1.2287 was the pair's lowest point in more than a year.)

Wide-range days such as June 29 — days with high-low ranges significantly larger than those of the preceding days — attract the attention of traders, many of whom are likely to look for follow-through. Such big days often result from news headlines that whip up market emotions, good or bad. The typical interpretation of a wide-range bar that closes strongly up or down is that the market's momentum carries price farther in the same direction — that is, a wide-range day that closes strongly higher should be followed by more upside price action, while a down-closing wide-range day implies bearish follow-through.

In this case, the near-term fundamentals seemed to jibe with the implications of the technical formation: The struggling Euro, on its way to testing a significant low, reversed dramatically when a significant step appeared to have been made in the European sovereign debt situation. The resulting up surge flushed out short-side traders and attracted new momentum players anticipating bullish follow-through in the coming days.

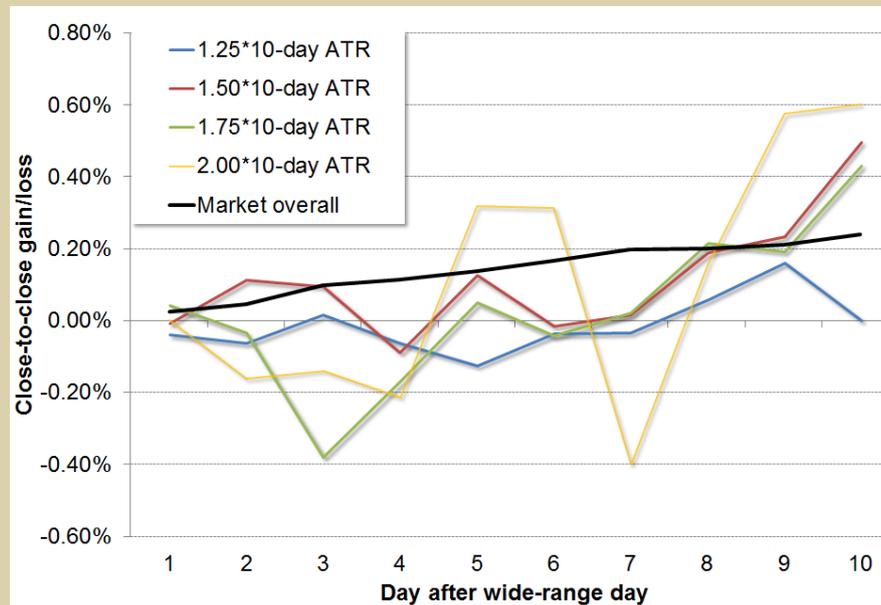
How does this interpretation of wide-range days mesh with reality? To get a better idea, we need to do two things: First, clearly define what constitutes a "wide-range day," and second, identify historical examples of these days and analyze how the Euro has behaved after them.

FIGURE 1: WIDE-RANGE DAY



The wide-range up day in the Euro on June 29 came in response to positive news on the European sovereign debt front.

**FIGURE 2: EURO PERFORMANCE AFTER WIDE-RANGE DAYS**



*The initial days after the wide-range day pattern were often weak, underperforming the Euro's benchmark and sometimes posting negative returns.*

### How wide is wide?

There are many ways to define a wide-range day — for example, one that simply looks bigger than most others on a price chart, or one that is bigger than the preceding five (or 10 or 15, etc.) days. But these are unnecessarily vague or limited descriptions. Fortunately, it's easy to come up with a detailed, objective definition that will allow us to accurately analyze past examples.

First, we should avoid measuring such days in absolute price terms because price levels change over time, and the significance of, say, a .0075-point range is different when a market is at .9100 rather than 1.5100. Using a percentage-based range measurement (e.g., 0.50 percent of the closing price) would seem to solve this problem, but it disregards the market's immediate volatility; a "wide-range day" that occurs when the preceding 10 days have had mostly smaller-than-average ranges might actually have a smaller range than the preceding 10 days during an unusually volatile period. As a result, we'll start by defining a wide-range day using a relative calculation that takes into account the market's short-term volatility: a day with a range that is at least 1.5 times the size of the "typical" daily range of the most recent 10 trading days (two weeks).

Second, we'll use a specific range calculation, "true range," that more accurately reflects day-to-day price action than the standard high-low range measurement because it accounts for the gaps between price bars. True

range can be calculated on any time frame or price bar — five-minute, hourly, daily, weekly, etc. Using daily price bars as an example, true range is the greatest (absolute) distance of the following:

1. Today's high and today's low (the standard range calculation).
2. Today's high and yesterday's close.
3. Today's low and yesterday's close.

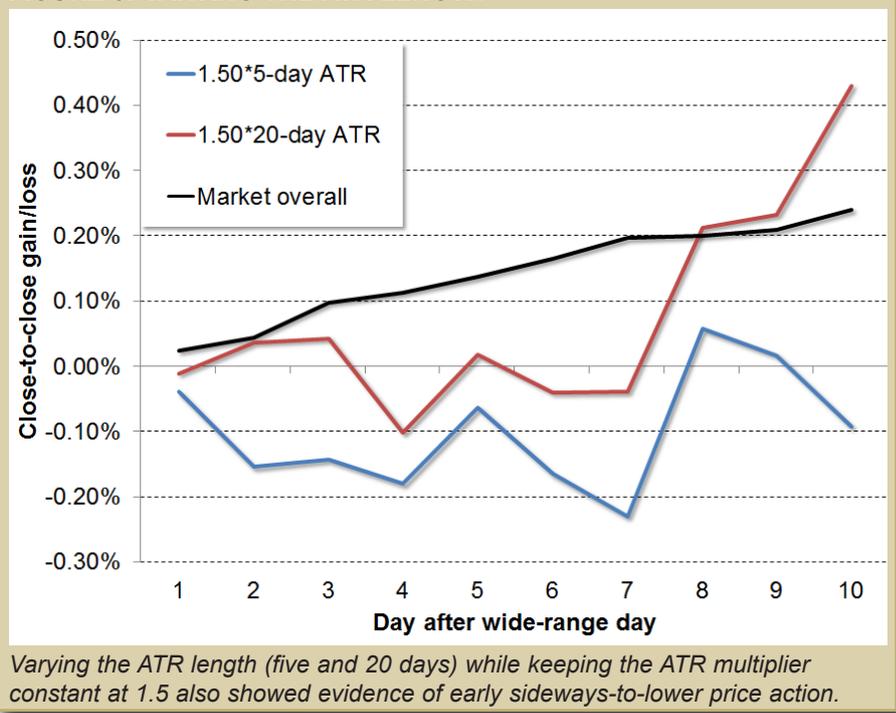
Average true range (ATR) is simply a moving average of the true range over a given time period. For example, the five-day ATR would be the average of the daily true range calculations for the most recent five days. Accordingly, in this study, a wide-range day will be a day that is 1.5 times (or more) the 10-day ATR.

The analysis will use continuous Euro futures (EC) data from May 18, 2001 through June 29, 2012 (a little more than 12 years, or 2,806 trading days). For reference, there were 237 of these days in the analysis period. (The June 29 wide-range day was actually more than twice the 10-day ATR, but such days have been so rare in the Euro futures that there wouldn't have enough examples to conduct a viable analysis.)

However, because many of these days were wide-range down days, or days that didn't close strongly one way or the other, we need to narrow our focus to those days that



**FIGURE 3: VARYING THE ATR LENGTH**



more closely resemble the up-closing wide-range day from June 29. Let's add the following criteria to our wide-range day pattern:

- The day must close above its open.
- The day must close above the previous close.
- The day's low must be above the previous day's low.

There are other ways to define the June 29 bar — for example, requiring the day's high to be above the previous five daily highs — but these initial rules have the advantage of being simple and capturing a basic bullish essence.

Adding these criteria to the basic 1.5 times the 10-day ATR rule reduced the number of examples to 83. Figure 2 shows how the Euro performed in the 10 days after these wide-range days. For comparison, the chart also includes performance of wide-range days that were at least 1.25 times the 10-day ATR (199 examples), 1.75 times the 10-day ATR (75 examples), and two times the 10-day ATR (only 12 examples); the Euro's benchmark performance for all one- to 10-day moves during the analysis period is also shown (black line). All the lines in the chart represent median close-to-close price moves — that is, measured from the closing price of the wide-range day to the closes of the 10 following days.

The benchmark line reflects the Euro's overall upside bias over any given 10-day holding period, its current downtrend notwithstanding. However, the 1.25-ATR, 1.5-ATR, and 1.75-ATR lines (the latter two being very simi-

lar) suggest the wide-range bars are sometimes initially followed by a few days of underperformance — even potentially slight negative movement through day 4 or 5 — before turning to the upside. Because there were only 12 examples, it's difficult to put much stock in the volatile results implied by the 2-ATR wide range days, but the few examples that do exist also point to the potential for some initial weakness.

Upon reflection, though, this might not be surprising: Markets often overshoot on big news items, only to retrace part of the move — even if price ends up extending the original price thrust in the longer term. In this case, even traders who expect the Euro to post a near-term follow-through rally might consider waiting for a smaller pull-back to enter long, rather than chasing price.

Figure 3 shows a couple of variations on the wide-range day pattern — definitions that could also be used to describe June 29. Instead of altering the ATR multiplier, these results vary the ATR length — five days (62 examples) and 20 days (93 examples), respectively. Although by day 10 the 20-day ATR version was a bit above the Euro's benchmark performance, both lines exhibit the same early underperformance evident in Figure 2.

However, traders should keep in mind Figure 2 and 3's results are composites of dozens of examples — any individual pattern could be followed by very bullish or very bearish price action. Market past never repeats itself exactly, but it does often rhyme. ☒

# The U.S. dollar and the Fourth of July

Extra bearishness can appear a few days after Independence Day.

BY CURRENCY TRADER STAFF

Price patterns often form around market holidays. Figure 1 shows the U.S. dollar index's (DXY) performance in the five days before and 10 days after the Fourth of July holiday. The lines represent the **average** and **median** DXY changes in that time.

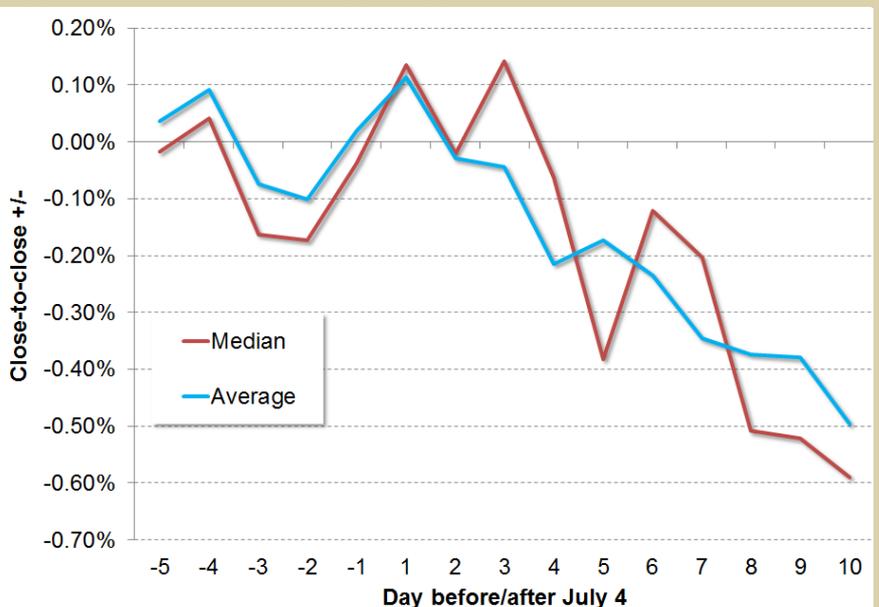
Although the chart represents the performance of only 35 years (1977 through 2011), there appears to be a fairly stable pattern of dollar weakness starting roughly one to three days after July 4, following a mild run-up just before the holiday. The average and median lines track each other fairly closely, indicating some stability in the performance they represent.

In recent years, the post-July 4 weakness pattern was evident in 2007-2010, while the DXY instead rallied energetically in the first six days after the holiday.

Which way is the market leaning this year? As of June 29, the pre-July trend was ambiguous: The DXY was in a small upswing on July 27 and 28 (days -5 and -4), while the big news from the Eurozone (see accompanying article)

sent the dollar sharply lower on June 29. July 2 and 3 correspond to days -2 and -1, respectively, while July 5, 6, and 9 correspond to days 1, 2, and 3. ☒

**FIGURE 1: THE DOLLAR AROUND JULY 4**



*The U.S. dollar index has shown a tendency to embark on a multi-day downswing a few days after the Fourth of July.*



# The Turkish lira and the eternal crossroads

Analyzing the Turkish currency shows how, despite Turkey's history and location, it's more tied to the U.S. than Europe in financial matters.



BY HOWARD L. SIMONS

As the world approaches the centennial of what was then known as The Great War, many will stop to consider the history of the modern Middle East and North Africa after the demise of the Ottoman Empire. While Turkey today has receded to middle-tier status, the long history of the Ottoman Empire defined the national struggles of an astonishing range of countries in the region.

The threat of Ottoman invasion defined both the Habsburgs in Austria and the Romanovs in Russia. Twice, in 1529 and again in 1683, Turkish armies stood at the gates of Vienna after storming through Hungary and much of modern Romania. Serbia, Bosnia, Bulgaria, Macedonia, Albania, and Greece define their histories as part of the struggle to liberate themselves from the Turks. Anyone who thinks modern warfare is brutal should read an account of the siege of Malta.

The Romanovs fought no fewer than 16 wars to claim areas around the Black Sea and Caucasus. Iraq, Syria, Lebanon, Israel, Jordan, Saudi Arabia, and all of the states on the western side of the Persian Gulf were part of the Ottoman Empire at some point. The fall of Constantinople in 1453 threatened overland trade routes to the Indies and China and prompted a search for a maritime route. While the Americas

would have been integrated — can we really say “discovered?” — into the Old World anyway, there is a definite Ottoman connection here, too.

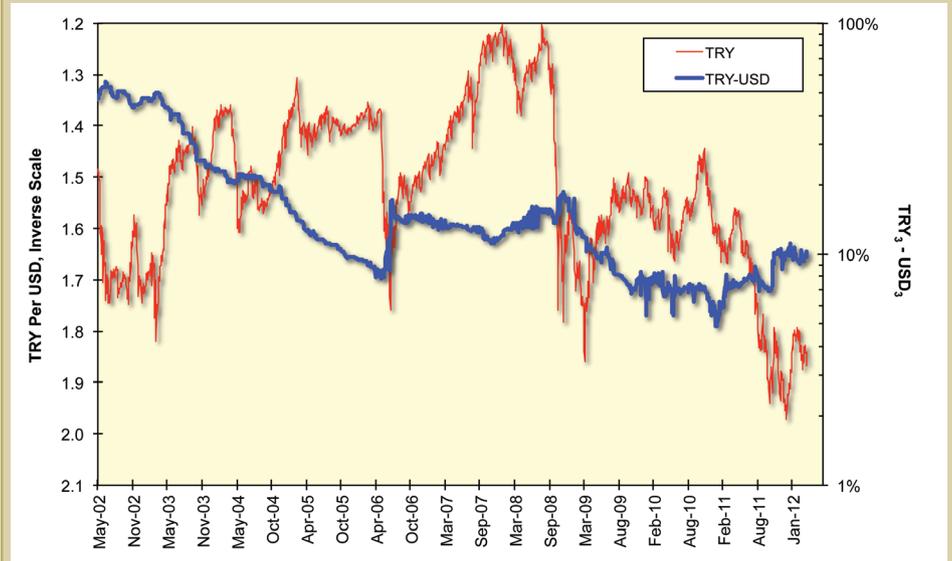
In many ways, this struggle has yet to end. Turkey has applied several times to join the European Union and has been rejected on every ground but the stingingly obvious ones of Turkey’s different cultural history and its dominant Islamic religion. Neither kept Turkey out of NATO; for years, the Turkish army stood second only to the U.S. in troop strength within the North Atlantic alliance, and it faced Soviet armies on its land border with Georgia and the Black Sea fleet.

Turkey definitely needs the European Union as a trading and investment partner, and many EU states, Germany in particular, have relied on Turkish immigrant labor. For this reason, the following analysis will focus on the cross rate between the Euro (EUR) and the Turkish lira (TRY) as much as on the TRY’s exchange rate against the USD.

**High interest rate currency**

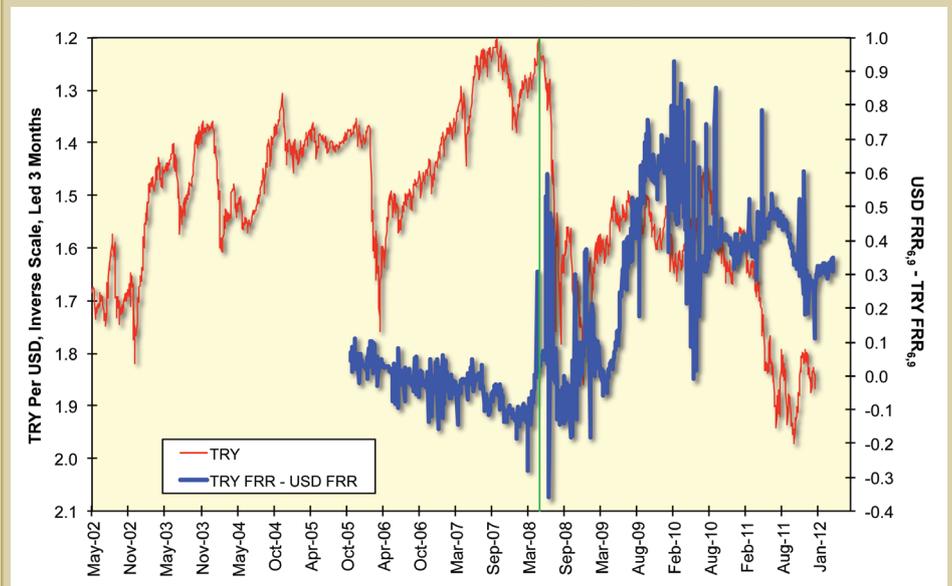
For years the TRY has been one of the world’s great (if that is the proper description) high-yielding currencies. This is one reason why carry trades into the

**FIGURE 1: TRY NOT A FUNCTION OF DIRECT INTEREST SPREADS**



*The scale of Turkish short-term rates distorts any direct relationship between the lira and the spread between three-month lira and U.S. dollar deposits.*

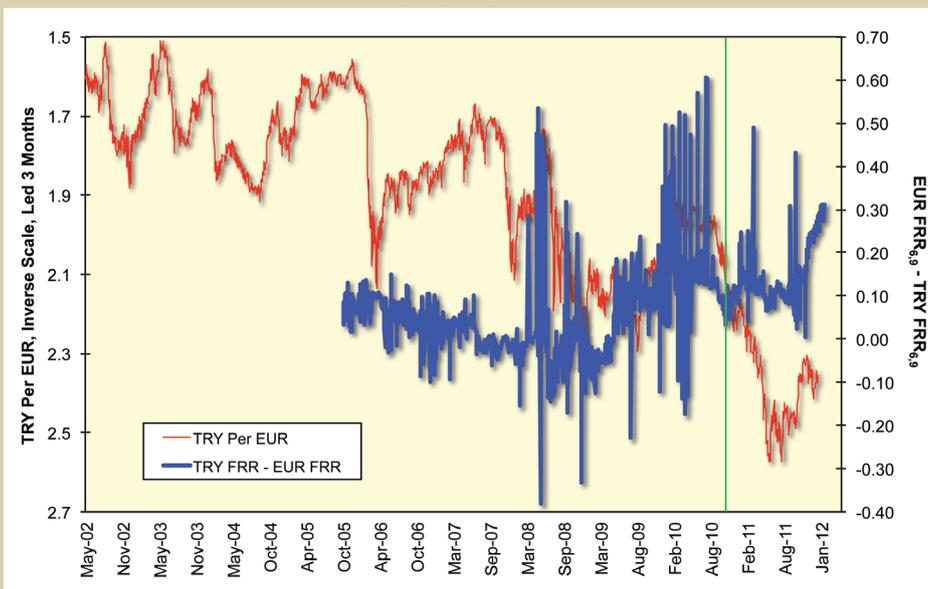
**FIGURE 2: TRY NOW AN INVERSE FUNCTION OF RELATIVE INTEREST RATE EXPECTATIONS TO USD**



*The TRY has been moving as an inverse function of the  $FRR_{6,9}$  differential between the USD and TRY since early 2008 (green vertical line). America’s near-zero interest rate and quantitative easing policies have preserved capital flows into the TRY.*

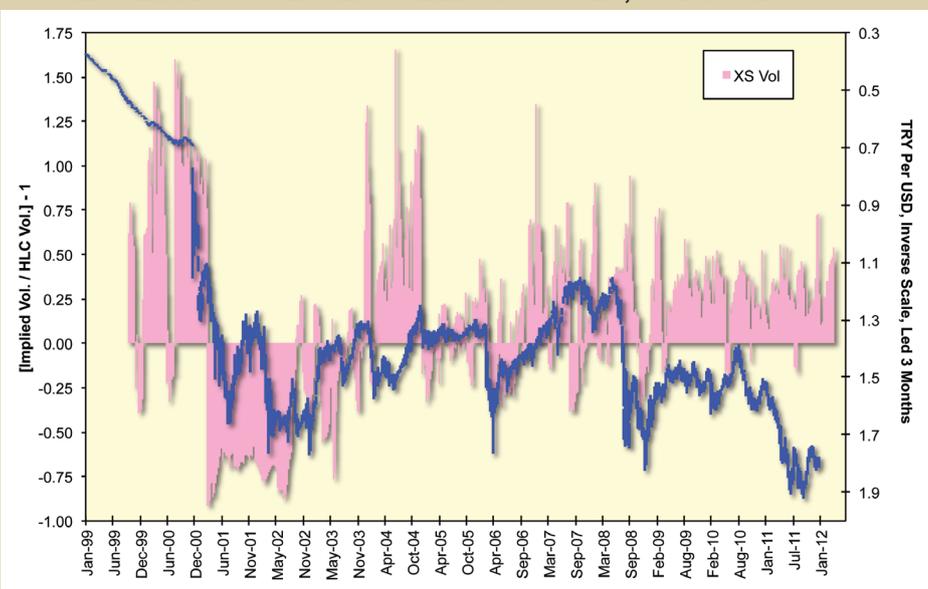


FIGURE 3: TRY AN IRREGULAR FUNCTION OF RELATIVE INTEREST RATE EXPECTATIONS TO EUR



As Europe's sovereign-debt crisis moved into Ireland in late 2010 (green vertical line), the TRY/EUR cross rate began to weaken in expectation of lower Eurozone short-term rates.

FIGURE 4: EXCESS VOLATILITY SELDOM SURGES, USD CASE



Excess volatility sometimes has declined when the TRY weakens (2001-2002, 2006), but it doesn't go the other way. The market is more or less comfortable with a weakening TRY and indifferent to a strengthening one.

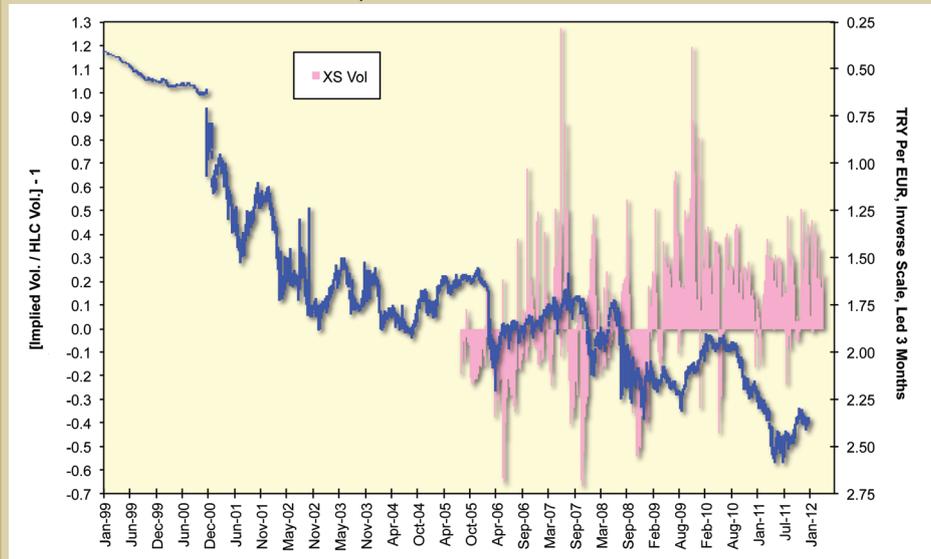
TRY, along with the Argentine peso, have been outliers in most analyses of global carry trades (see "The long, awful life of the dollar carry trade" and "Requiem for a carry trade," January and February 2012). Even if the TRY spot rate weakened, it yielded so much and was so expensive to borrow, it could attract and retain global capital flows.

How high were some of these rates? The data history of this article begins with the advent of the Euro in 1999; three- and six-month interbank deposits were in the neighborhood of 100 percent. The act of borrowing the TRY to short it must have prompted moments of, "What am I doing?"

Figure 1 illustrates how the outlandish scale of Turkish short-term rates distorts any direct relationship between the TRY and the spread between three-month TRY and USD deposits; as the story is the same for the spreads to the EUR, it will not be presented separately.

A more direct but not statistically powerful connection is visible when we shift the measure to the differentials between USD and TRY forward-rate ratios between six and nine months (FRR<sub>6,9</sub>). The FRR<sub>6,9</sub> is the rate at which borrowing can be locked in for three months starting six months from now, divided by the nine-month rate itself. The more

**FIGURE 5: OPTIONS MARKET UNCOMFORTABLE WITH RISING TRY, EURO CASE**



*The Euro market does not accept a stronger TRY. Unlike what we saw in Figure 4, here excess volatility spikes during periods of TRY strength on the EUR cross rate.*

it exceeds 1.00, the steeper the yield curve is.

In normal markets a high  $FRR_{6,9}$  indicates expectations for higher short-term interest rates; in the American case since the financial crisis began in 2007, a high  $FRR_{6,9}$  has signaled artificially low short-term interest rates. As a result, the TRY has been moving as an inverse function of the  $FRR_{6,9}$  differential between the USD and TRY since early 2008, marked with a green vertical line in Figure 2. The American policies of near-zero interest rates and quantitative easing have preserved capital flows into the TRY.

The expected interest-rate differentials between the EUR and TRY have had a much less certain effect because the benchmark rates for the Euro are set by the higher-quality credits, while much of the Eurozone's periphery has had to adopt much higher short-term interest rates to prevent capital outflow. As the rolling sovereign-debt crisis in the Eurozone moved into Ireland in late 2010, marked with a green vertical line in Figure 3, the TRY/EUR cross rate started to weaken in expectation of lower short-term benchmark rates within the Eurozone.

### Volatility

Now let's take a look at the TRY vs. both the USD and the EUR, overlaid with its excess volatility. This is the ratio of the implied volatility for three-month non-deliverable forwards to high-low-close (HLC) volatility, minus 1.00. It serves as a measure of the market's demand for insurance.

HLC volatility is defined as:

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

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

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

Excess volatility sometimes has tended to decline somewhat in the USD case whenever the TRY weakens, as was the case in 2001-2002 and again in periods such as 2006, but it does not go the other way (Figure 4). We do not see a strong demand for excess insurance against the TRY whenever it strengthens. The market is more or less comfortable with a weakening TRY and indifferent to a strengthening one.

The same cannot be said in the EUR cross rate case (Figure 5). Here over a much shorter history, we do see excess volatility spikes during periods of TRY strength on the cross rate. This market does not accept a stronger TRY.



### Asset returns

If high short-term Turkish rates are necessary to attract and retain capital, then we should expect the relative performance of Turkish to U.S. stocks to be a strong function

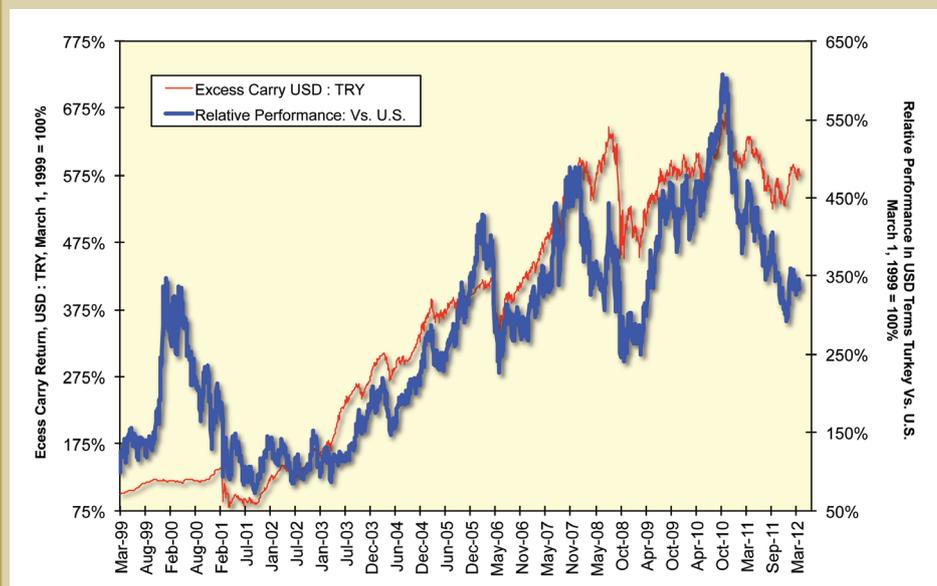
of the excess carry return from borrowing the USD and lending into the TRY. Figure 6 indicates this does, in fact, appear to be the case.

A related concept does not provide a similarly compelling argument. The relative performance of Turkish equities to the MSCI Emerging Europe and Middle East index (EEMEA) is not a particularly strong function of the excess carry return from borrowing the EUR and lending into the TRY (Figure 7).

There are two reasons for this. First, the EEMEA index includes a large number of "special cases" in the former Soviet Union and in the Middle East-North Africa region. The combination of these special cases creates an unstable base. The second reason is the Euro seldom has been a funding currency for carry trades; its interest rates have been well above American, Japanese, and Swiss rates for just about the entire period. A Turkish borrower and a European lender might convert their financing arrangement into USD terms before proceeding.

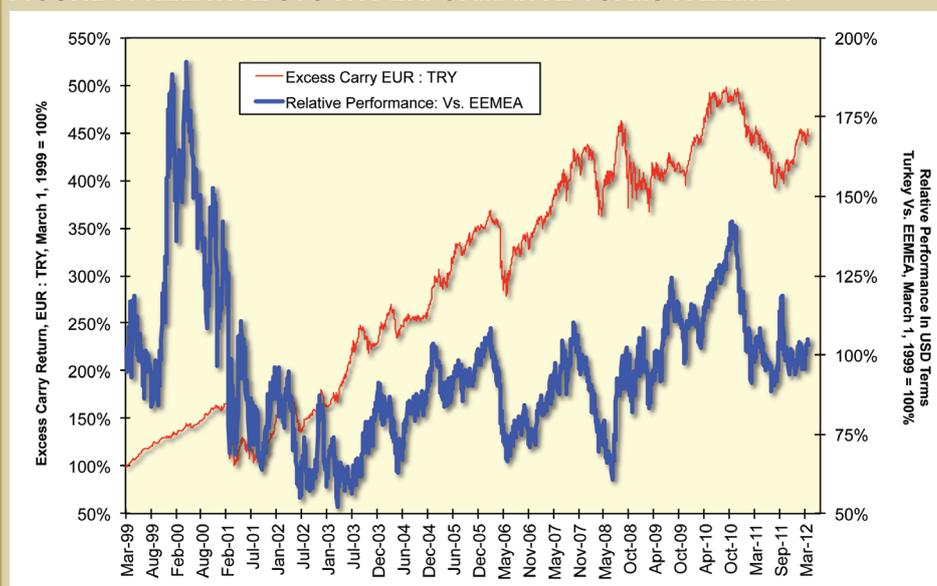
The net result in Turkey remains at a crossroads in all senses. Despite its location, history, and the large Turkish expatriate population in Europe, it still must look to the U.S. rather than to the European Union neighbors in financial matters. There is something quite sad about this residue of history, but why anyone should be surprised anymore is unclear. ☒

**FIGURE 6: RELATIVE STOCK PERFORMANCE MIRRORS DOLLAR CARRY**



*The relative performance of Turkish to U.S. stocks is a strong function of the excess carry return from borrowing the USD and lending into the TRY.*

**FIGURE 7: RELATIVE STOCK PERFORMANCE VS. MSCI-EEMEA**



*The relative performance of Turkish equities to the MSCI Emerging Europe and Middle East index (EEMEA) is not a particularly strong function of the excess carry return from borrowing the EUR and lending into the TRY.*

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



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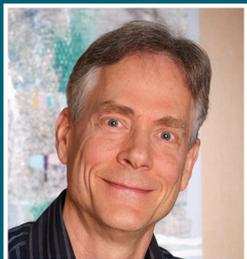
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CPI: Consumer price index  
 ECB: European Central Bank  
 FDD (first delivery day): The first day on which delivery of a commodity in fulfillment of a futures contract can take place.  
 FND (first notice day): Also known as first intent day, this 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.

July	
<b>1</b>	
<b>2</b>	<b>U.S.:</b> June ISM manufacturing report
<b>3</b>	
<b>4</b>	
<b>5</b>	<b>Brazil:</b> June PPI <b>UK:</b> Bank of England interest rate announcement <b>ECB:</b> Governing council interest rate announcement
<b>6</b>	<b>U.S.:</b> June employment report <b>Brazil:</b> June CPI <b>Canada:</b> June employment report <b>UK:</b> June PPI <b>LTD:</b> July forex options; July U.S. dollar index options (ICE)
<b>7</b>	
<b>8</b>	
<b>9</b>	<b>Mexico:</b> June 30 CPI and June PPI
<b>10</b>	
<b>11</b>	<b>U.S.:</b> May trade balance <b>Germany:</b> June CPI <b>Japan:</b> June PPI
<b>12</b>	<b>Australia:</b> June employment report <b>Japan:</b> Bank of Japan interest-rate announcement
<b>13</b>	<b>U.S.:</b> June PPI
<b>14</b>	
<b>15</b>	
<b>16</b>	<b>U.S.:</b> June retail sales <b>India:</b> June PPI
<b>17</b>	<b>U.S.:</b> June CPI <b>Canada:</b> Bank of Canada interest rate announcement <b>UK:</b> June CPI
<b>18</b>	<b>U.S.:</b> June housing starts and fed beige book <b>South Africa:</b> June CPI <b>UK:</b> June employment report

<b>19</b>	<b>U.S.:</b> June leading indicators <b>Hong Kong:</b> April-June employment report
<b>20</b>	<b>Canada:</b> June CPI <b>Germany:</b> June PPI <b>Mexico:</b> June employment report
<b>21</b>	
<b>22</b>	
<b>23</b>	<b>Australia:</b> Q2 PPI <b>Hong Kong:</b> June CPI
<b>24</b>	<b>Mexico:</b> July 15 CPI
<b>25</b>	<b>Australia:</b> Q2 CPI
<b>26</b>	<b>U.S.:</b> June durable goods <b>Brazil:</b> June employment report <b>South Africa:</b> June PPI
<b>27</b>	<b>U.S.:</b> Q2 GDP (advance) <b>Japan:</b> June CPI
<b>28</b>	
<b>29</b>	
<b>30</b>	
<b>31</b>	<b>U.S.:</b> FOMC interest rate announcement and June personal income <b>Canada:</b> June PPI <b>Germany:</b> June employment report <b>India:</b> June CPI <b>Japan:</b> June employment report <b>South Africa:</b> Q2 employment report

August	
<b>1</b>	<b>U.S.:</b> July ISM manufacturing report
<b>2</b>	<b>UK:</b> Bank of England interest rate announcement <b>ECB:</b> Governing council interest rate announcement
<b>3</b>	<b>U.S.:</b> July employment report <b>LTD:</b> August forex options; August U.S. dollar index options (ICE)



## EVENTS

**Event:** The World MoneyShow San Francisco  
**Date:** Aug. 24-26  
**Location:** San Francisco Marriott Marquis  
**Show focus:** Technology  
**For more information:** Go to [www.moneyshow.com](http://www.moneyshow.com)

**Event:** CBOE Risk Management Conference Europe  
**Date:** Sept. 5-7  
**Location:** Ritz-Carlton Powerscourt, County Wicklow, Ireland  
**For more information:** [www.cboermceurope.com](http://www.cboermceurope.com)

**Event:** The Forex & Options Expo  
**Date:** Sept. 13-15  
**Location:** Las Vegas, Paris Hotel  
**For more information:** Go to [www.moneyshow.com](http://www.moneyshow.com)

**Event:** The Free Paris Trading Show  
**Date:** Sept. 21-22  
**Location:** Espace Champerret, Paris, France  
**For more information:** [www.salonAT.com](http://www.salonAT.com)



Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	313.0	337.8	0.25% / 36%	2.05% / 100%	-3.06% / 33%	.28 / 43%
AUD/USD	AD	CME	157.6	131.3	0.83% / 25%	5.15% / 100%	-0.41% / 11%	.25 / 50%
GBP/USD	BP	CME	111.3	149.2	-0.03% / 0%	1.98% / 94%	-0.92% / 18%	.32 / 23%
CAD/USD	CD	CME	109.7	99.7	0.45% / 50%	2.11% / 100%	-2.30% / 41%	.32 / 33%
JPY/USD	JY	CME	87.0	132.2	-1.36% / 100%	-2.12% / 100%	3.18% / 56%	.30 / 85%
CHF/USD	SF	CME	52.1	62.0	0.35% / 36%	2.17% / 100%	-2.94% / 31%	.30 / 53%
MXN/USD	MP	CME	50.5	123.0	3.48% / 100%	6.67% / 100%	-3.60% / 32%	.32 / 70%
U.S. dollar index	DX	ICE	30.7	70.2	-0.26% / 22%	-1.47% / 100%	2.08% / 45%	.33 / 45%
NZD/USD	NE	CME	17.6	18.7	1.00% / 11%	6.02% / 100%	-1.75% / 23%	.19 / 38%
E-Mini EUR/USD	ZE	CME	3.4	7.1	0.25% / 36%	2.05% / 100%	-3.06% / 33%	.28 / 43%

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 May 31 ranked by May 2012 return)

	Trading advisor	May return	2012 YTD return	\$ Under mgmt. (millions)
1.	CenturionFx Ltd (6X)	34.40%	88.29%	17.3
2.	Friedberg Comm. Mgmt. (Curr.)	21.65%	2.95%	30.2
3.	INSCH Capital Mgmt (Kintillo X3)	13.13%	13.05%	62.7
4.	Trigon (Foreign Exchange)	11.42%	3.98%	120.6
5.	P/E Investments (FX Aggressive)	10.80%	10.76%	2700.0
6.	Richmond Group (Gl. Currency)	9.98%	5.17%	24.0
7.	Cambridge Strategy (Emerging Mkts)	6.53%	7.86%	55.0
8.	A.G. Bisset (Currency Alpha)	5.41%	3.88%	160.0
9.	Cambridge Strategy (Extended Mkts)	5.00%	1.55%	558.0
10.	Currency Insight (Diversified Sys.)	3.70%	-4.22%	245.0

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

1.	Smart Box Capital (Leveraged FX)	16.05%	7.17%	1.1
2.	Iron Fortress FX Mgmt	12.87%	9.28%	7.8
3.	Sunrise Cap'l Partners (Currency Fund)	3.62%	-4.16%	5.3
4.	MFG (Bulpred USD)	2.89%	14.42%	1.2
5.	TMS (Arktos GCS II)	2.74%	-0.71%	7.3
6.	Valhalla Capital Group (Int'l AB)	2.57%	2.56%	1.5
7.	Northbridge Park Asset Mgmt (Marco FX)	1.42%	3.83%	7.6
8.	Four Capital (FX)	0.15%	-2.68%	1.5
9.	Overlay Asset Mgmt. (SHCFP)	0.07%	-2.15%	7.4
10.	V50 Capital Mgmt (FX)	0.05%	-17.68%	3.7

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	June 28 price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	New Zealand dollar	0.790045	4.79%	-3.50%	2.08%	0.8797	0.7397	16
2	Australian Dollar	1.003695	2.85%	-4.26%	-1.22%	1.1028	0.9478	13
3	Swedish krona	0.141525	1.55%	-4.88%	-2.63%	0.1599	0.1374	14
4	Chinese yuan	0.1582	0.26%	-0.06%	0.56%	0.1589	0.154	3
5	Canadian dollar	0.973575	0.21%	-3.04%	-0.64%	1.059	0.9467	8
6	Japanese yen	0.012575	0.20%	4.01%	-1.95%	0.0132	0.0119	1
7	Singapore dollar	0.78124	0.13%	-1.54%	0.97%	0.832	0.7606	6
8	Hong Kong dollar	0.12888	0.06%	0.12%	0.25%	0.129	0.1281	2
9	Swiss franc	1.040655	-0.16%	-5.58%	-2.60%	1.3779	1.0294	12
10	Euro	1.249845	-0.17%	-5.91%	-4.31%	1.4534	1.2363	11
11	Great Britain pound	1.560255	-0.40%	-1.82%	-0.11%	1.6507	1.5308	7
12	Thai baht	0.03146	-0.63%	-3.32%	-1.50%	0.0336	0.031	5
13	South African rand	0.11818	-0.68%	-9.54%	-3.61%	0.1498	0.1159	15
14	Taiwan dollar	0.033375	-0.99%	-1.24%	1.11%	0.03480	0.032	4
15	Indian rupee	0.01752	-2.34%	-8.39%	-5.22%	0.0226	0.0174	9
16	Russian ruble	0.030235	-3.11%	-11.90%	-5.80%	0.0364	0.0291	17
17	Brazilian real	0.484055	-3.80%	-12.26%	-9.94%	0.65	0.4803	10

## GLOBAL STOCK INDICES

	Country	Index	June 28	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Mexico	IPC	39,490.68	4.91%	1.37%	6.47%	40,050.20	31,659.30	3
2	India	BSE 30	16,967.76	3.36%	-1.68%	6.89%	19,619.70	15,135.90	6
3	UK	FTSE 100	5,523.90	3.13%	-5.89%	0.30%	6,084.10	4,791.00	10
4	Switzerland	Swiss Market	5,996.50	2.24%	-4.35%	1.86%	6,357.50	4,695.30	2
5	Hong Kong	Hang Seng	19,176.95	2.00%	-8.88%	2.94%	22,835.00	16,170.30	13
6	Singapore	Straits Times	2,841.60	1.95%	-5.87%	6.28%	3,227.28	2,521.95	9
7	Italy	FTSE MIB	13,302.77	1.88%	-19.37%	-10.86%	20,560.20	12,568.00	14
8	Japan	Nikkei 225	8,730.49	1.60%	-14.87%	3.43%	10,255.20	8,135.79	12
9	South Africa	FTSE/JSE All Share	33,748.13	0.92%	-0.33%	5.16%	34,788.37	28,391.18	1
10	France	CAC 40	3,063.12	0.66%	-11.72%	-1.29%	4,023.59	2,693.21	4
11	U.S.	S&P 500	1,331.85	-0.04%	-5.71%	5.25%	1,422.38	1,074.77	5
12	Australia	All ordinaries	4,084.00	-0.88%	-7.00%	-1.39%	4,717.50	3,829.40	11
13	Canada	S&P/TSX composite	11,410.94	-1.34%	-6.76%	-2.71%	13,516.20	10,848.20	8
14	Germany	Xetra Dax	6,228.99	-1.49%	-12.01%	5.76%	7,523.53	4,965.80	7
15	Brazil	Bovespa	53,109.00	-3.81%	-19.58%	-8.44%	68,970.00	47,793.00	15

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

Rank	Currency pair	Symbol	June 27	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Aussie \$ / Real	AUD/BRL	2.073525	6.92%	9.11%	9.68%	2.0813	1.6402	13
2	New Zeal \$ / Yen	NZD/JPY	62.825	4.57%	-7.25%	4.10%	68.81	57.23	21
3	Canada \$ / Real	CAD/BRL	2.0113	4.18%	10.51%	10.32%	2.0301	1.5997	7
4	Yen / Real	JPY/BRL	0.02598	4.17%	18.58%	8.86%	0.0261	0.0192	1
5	Euro / Real	EUR/BRL	2.58204	3.78%	7.24%	6.24%	2.6261	2.204	9
6	Aussie \$ / Franc	AUD/CHF	0.964485	3.01%	1.39%	1.41%	0.99	0.7477	10
7	Aussie \$ / Yen	AUD/JPY	79.82	2.65%	-7.97%	0.74%	88.31	72.72	20
8	Aussie \$ / Canada \$	AUD/CAD	1.030935	2.63%	-1.26%	-0.58%	1.0755	0.9981	14
9	Euro / Pound	EUR/GBP	0.80105	0.22%	-4.17%	-4.20%	0.9038	0.7976	15
10	Canada \$ / Yen	CAD/JPY	77.425	0.01%	-6.80%	1.33%	84.49	72.63	17
11	Pound / Franc	GBP/CHF	1.49931	-0.24%	3.99%	2.55%	1.5056	1.1778	3
12	Franc / Yen	CHF/JPY	82.76	-0.37%	-9.24%	-0.66%	105.79	80.46	19
13	Franc / Canada \$	CHF/CAD	1.0689	-0.37%	-2.62%	-1.97%	1.3569	1.0618	12
14	Euro / Yen	EUR/JPY	99.39	-0.37%	-9.56%	-2.42%	117.37	96.79	18
15	Euro / Canada \$	EUR/CAD	1.283765	-0.38%	-2.96%	-3.70%	1.4253	1.2754	11
16	Pound / Yen	GBP/JPY	124.075	-0.60%	-5.63%	1.86%	132.81	117.58	16
17	Pound / Canada \$	GBP/CAD	1.602605	-0.61%	1.26%	0.53%	1.6354	1.5302	5
18	Aussie \$ / New Zeal \$	AUD/NZD	1.270415	-1.85%	-0.79%	-3.23%	1.3229	1.2354	4
19	Euro / Aussie \$	EUR/AUD	1.245255	-2.94%	-1.72%	-3.13%	1.4011	1.2188	6
20	Pound / Aussie \$	GBP/AUD	1.55451	-3.16%	2.55%	1.12%	1.626	1.4637	2
21	Euro / Franc	EUR/CHF	1.18294	-3.80%	-8.72%	-3.25%	1.29593	1.0376	8

## GLOBAL CENTRAL BANK LENDING RATES

Country	Interest rate	Rate	Last change	December 2011	June 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	1.25
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	3.5	0.25 (June 12)	4.25	4.75
New Zealand	Cash rate	2.5	0.5 (March 11)	2.5	2.5
Brazil	Selic rate	9	0.75 (Apr 12)	11	12.25
Korea	Korea base rate	3.25	0.25 (June 11)	3.25	3.25
Taiwan	Discount rate	1.875	0.125 (June 11)	1.875	1.875
India	Repo rate	8	0.5 (Apr 11)	8.5	7.25
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	Q1	6/8	-4.3%	13.7%	9/21
	Brazil	Q1	6/1	-5.6%	7.4%	8/31
	Canada	Q1	6/1	0.6%	4.1%	8/31
EUROPE	Argentina	Q1	6/8	-4.3%	13.7%	9/21
	Brazil	Q1	6/1	-5.6%	7.4%	8/31
	Canada	Q1	6/1	0.6%	4.1%	8/31
AFRICA	Q1	6/21	0.8%	7.8%	8/28	
ASIA and S. PACIFIC	Australia	Q1	6/6	0.3%	4.1%	9/5
	Hong Kong	Q1	5/11	-8.0%	3.2%	8/10
	India	Q1	5/31	3.4%	12.0%	8/31
	Japan	Q1	5/17	1.0%	4.1%	8/13
	Singapore	Q1	5/25	0.2%	1.6%	8/24

Unemployment		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS	Argentina	Q1	5/18	6.7%	-0.5%	-0.6%	8/21
	Brazil	May	6/21	5.8%	-0.2%	-0.6%	7/26
	Canada	May	1/6	7.3%	0.1%	-0.1%	7/6
EUROPE	France	Q1	6/7	9.6%	0.3%	0.4%	9/6
	Germany	May	6/28	5.5%	0.2%	-0.3%	7/31
	UK	Feb. April	6/20	8.2%	-0.2%	0.5%	7/18
ASIA and S. PACIFIC	Australia	May	6/7	5.1%	0.0%	0.1%	7/12
	Hong Kong	March-May	6/18	3.2%	-0.1%	-0.3%	7/19
	Japan	May	6/29	4.4%	-0.2%	-0.2%	7/31
	Singapore	Q1	4/30	2.1%	0.1%	0.2%	7/31

CPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	May	6/13	0.8%	9.9%	7/13
	Brazil	May	6/6	0.4%	5.0%	7/6
	Canada	May	6/2	-0.1%	1.2%	7/20
EUROPE	France	May	6/13	0.1%	2.0%	7/12
	Germany	May	6/13	-0.2%	1.9%	7/11
	UK	May	6/19	-0.1%	2.8%	7/17
AFRICA	S. Africa	May	6/20	0.1%	5.7%	7/18
ASIA and S. PACIFIC	Australia	Q1	4/24	0.1%	1.6%	7/25
	Hong Kong	May	6/21	0.1%	4.3%	7/23
	India	May	6/29	0.5%	10.2%	7/31
	Japan	May	6/29	-0.3%	0.2%	7/27
	Singapore	May	6/25	0.0%	5.0%	7/23

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	May	6/13	1.0%	12.8%	7/13
	Canada	May	6/29	0.0%	0.7%	7/31
EUROPE	France	May	6/29	-1.0%	2.2%	7/31
	Germany	May	6/20	-0.3%	2.1%	7/20
	UK	May	6/8	-0.2%	2.8%	7/6
AFRICA	S. Africa	May	6/28	0.5%	6.6%	7/26
ASIA and S. PACIFIC	Australia	Q1	4/23	-0.3%	1.4%	7/23
	Hong Kong	Q1	6/14	-14.3%	-1.6%	7/27
	India	May	6/14	0.5%	7.0%	7/16
	Japan	May	6/12	-0.4%	-0.5%	7/11
	Singapore	May	6/29	-3.3%	0.7%	7/27

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



## Betting on a bottom in the dollar/yen.

### TRADE

**Date:** Wednesday, June 27, 2012.

**Entry:** Long the U.S. dollar/ Japanese yen pair (USD/JPY) at 79.67.

**Reason for trade/setup:** In mid-June, the dollar/yen pair successfully appeared to confirm its June 1 low (77.66) as at least a short- to intermediate-term bottom by forming a higher low and rallying above 80.

After a big down day on June 25 and a stabilizing move on June 26, the pair appeared poised to embark on another upswing and challenge its previous high around 80.50.

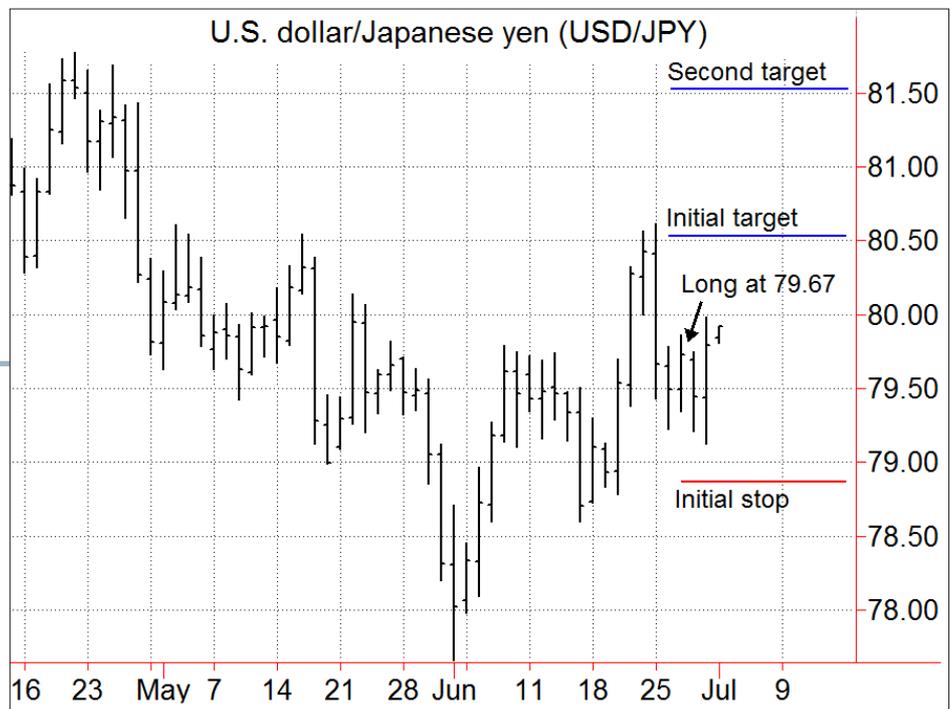
**Initial stop:** 78.87.

**Initial target:** 80.54; take partial profits and raise stop to protect remainder of position. Second target: 81.54, which is a bit below the mid-April high.

### RESULT

**Exit:** Trade still open.

**Profit/loss:** +.20, marked to market at 7 p.m. on July 1.



Source: TradeStation

**Outcome:** The high volatility on June 29 (when the Eurozone reached an agreement on addressing Spanish bank debt) created an outside day in the USD/JPY pair, which managed to close in the upper portion of the day's range despite the overall punishment the dollar took that day (it lost around 2 percent vs. the Euro).

The pair traded mildly upward early in the Asian session on July 2 (July 1 evening in the U.S.). Hopefully, a likely mild recalibration to the upside in the dollar (see ["Wide range days in the Euro"](#)) will put the trade further in the black.

A looming cloud on the trade's horizon: The bearish dollar implications laid out in ["The U.S dollar and the Fourth of July."](#) ☒

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

### TRADE SUMMARY

Date	Currency pair	Entry price	Initial stop	Initial target	IRR	MTM	Date	P/L		LOP	LOL	Trade length
								point	%			
6/27/12	USD/JPY	79.67	78.87	80.54	1.09	79.87	7/1/12	.20	0.25%	0.31	-0.54	3 days

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