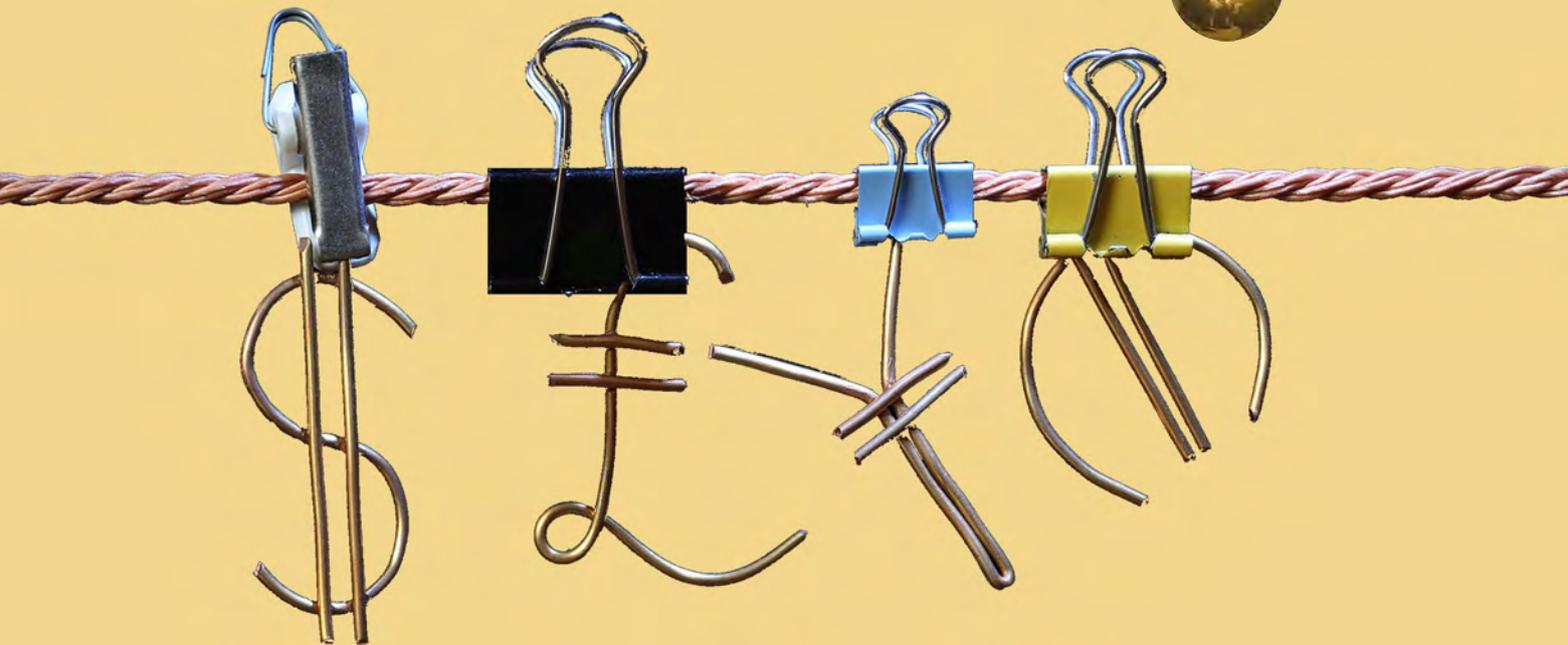


CURRENCY TRADER

Strategies, analysis, and news for FX traders

October 2010

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Passion to Perform





Pound still faces strong headwinds

The UK's austerity measures might mean one thing for the British economy — and currency — in the long term, and quite another in the near term.

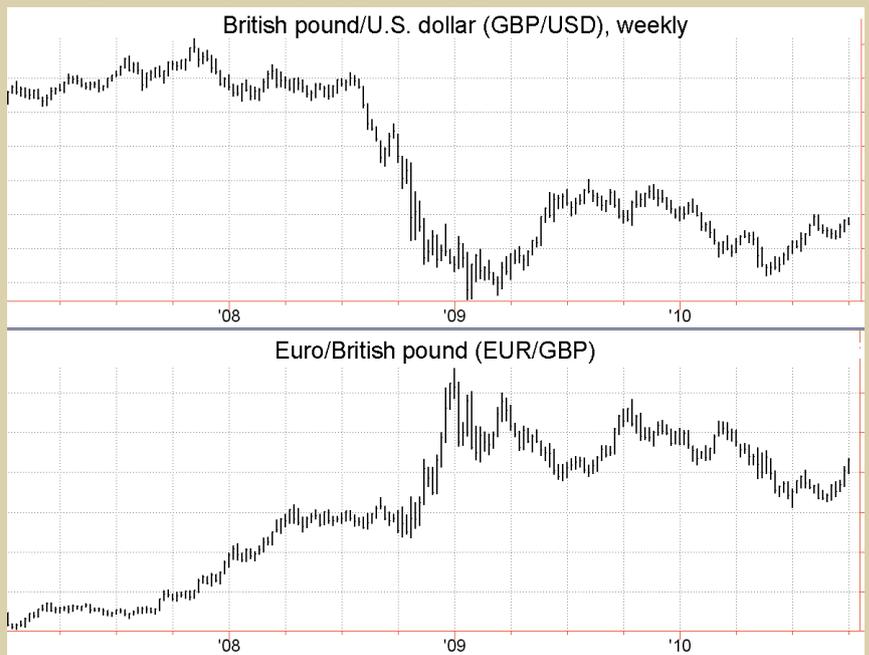
BY CURRENCY TRADER STAFF

Weighed down by a variety of challenging fundamentals, the British pound has lost ground vs. most major currencies in the first nine months of the year, with the key exception of the Euro. And with new fiscal austerity measures on the horizon in the UK, some market watchers are skeptical economic growth can continue to gain traction. Indeed, signs are already emerging that UK economic growth is losing momentum and could stagnate even further amid the tax hikes and budget cuts slated for the new year.

Between Dec. 31, 2009 and Sept. 30, 2010, the British pound lost ground against most major currencies: a 12.72-percent loss vs. the yen, a 9.88-percent decline against the Aussie dollar, a 7.77-percent loss vs. the Swiss franc, a 4.97-percent decline vs. the Canadian dollar, a 3.85-percent loss vs. the New Zealand dollar, and a 2.78-percent decline vs. the U.S. dollar. However, perhaps thanks to the potentially bleaker fundamentals plaguing the Eurozone, the pound did manage to gain 2.08 percent vs. the Euro. Figure 1 shows the pound/U.S. dollar pair (GBP/USD) and the Euro/pound (EUR/GBP) pair.

Despite some recent bullish economic numbers, the larger fundamental picture is uncertain, to say the least. The UK's second-quarter gross domestic product (GDP) surged at a 4.9-percent annualized rate, but economists say this bounce was driven by inventory building and is unlikely to repeat later in the year. Forecasts for 2010 overall GDP

FIGURE 1: POUND VS. DOLLAR AND EURO



The British pound has suffered against most currencies, including the dollar (top). The only major currency it has strengthened against has been the Euro (bottom).

Source: TradeStation

are much more sluggish, in the area of 1.5 to 1.6 percent — only modest growth, but nonetheless a recovery from the UK's 4.9-percent GDP contraction in 2009.

Like many economists, Enam Ahmed, senior economist with Moody's Analytics is cautious about the UK's economic prospects, forecasting 1.5-percent GDP growth for 2010, and a 1-percent rate for 2011. "The UK's recovery will face strong headwinds in coming quarters," he warns.

Stephen Webster, director of London economic consul-

tancy TopEcon, also sees a 1.5-percent 2010 GDP rate for the UK, and stresses the singular nature of the Q2 economic numbers.

"The rebound in output was mostly the result of a turn in the inventory cycle, strong household spending, and a massive rebound in construction output, albeit from a low base," he says. "However, the second quarter is likely to have been the peak. Indeed, in its August inflation report, the BOE (*Bank of England*) referred to 'choppy recovery' prospects and the consensus is for weaker rates of growth in the second half of the year. The VAT (*value added tax*) is set to increase in January, which could bring consumer spending forward to the fourth quarter from the first quarter. Nevertheless, although 2011 could well get off to a weak start, I wouldn't be surprised to see average growth for the year as a whole at around 2.5 percent, though the risks are to the downside."

Austerity measures

The January VAT increase, first announced in June as part of the UK government's austerity measures, will bump the tax from 17.5 percent to 20 percent.

That, along with cuts in government spending (which will mean job losses), are expected to help trim the current UK budget deficit.

The moves reflect the cross-Atlantic difference of opinion regarding the benefits of more economic stimulus vs. fiscal belt-tightening. Although Britain is often at odds with the rest of Europe on policy, it is firmly in agreement with the continent that it is time to control spending, rather than engage in the renewed stimulus efforts favored by the U.S.

"UK public finances deteriorated rapidly during the recession, and it was one of four countries in the EU25 where the shortfall hit double-digit numbers as a share of GDP," Ahmed says. "In 2009 the fiscal deficit was over 11 percent of GDP — almost four times the EU 3 percent of GDP threshold that is considered to be consistent with sustainability of public finances."

Wells Fargo Bank Currency Strategist Vassili Serebriakov wrote about the details of the austerity plan in the Aug. 20 Wells Fargo FX Express Currency Update research note: "The government's budget outlined an aggressive deficit

reduction plan. According to the details of the report, public sector net borrowing will fall from 11 percent of GDP in the 2009-10 fiscal year to around 1 percent of GDP in 2015-16. Consequently, general government gross debt is projected to peak at 86 percent of GDP in 2012-13 and fall to about 80 percent of GDP by 2015-16. While the bulk of the fiscal consolidation will come from spending cuts, the government has also scheduled a hike in the VAT tax from 17.5 percent to 20 percent and the introduction of a levy on banks."

Impact on growth

Some market watchers are pessimistic about the impact the austerity measures will have on economic growth prospects, not to mention the British pound.

"In the long run it is good, but it also means their growth rate will be sluggish for the foreseeable future," says Jay Bryson, global economist at Wells Fargo Securities.

Brian Dolan, chief currency strategist at Forex.com is more to the point regarding the currency implications. "I'm still

pretty bearish on the British pound," he says. "The economy is starting to show more indications of slowing and there are upcoming tax hikes and spending cuts."

Elaborating further, Dolan notes that between a half-million and a million government jobs will likely be cut.

"It's lousy timing," he says. "By going for austerity now, you undermine growth and revenues drop. They are left with a deficit-neutral outcome and a lousy economy. There are some arguments for more stimuli to stimulate growth in the years ahead. Growth is key to long-run deficit reduction."

The inflation issue

Unlike the U.S., where economists continue to voice concerns about potential deflation, the UK is already battling a bout of inflation, which Dolan says is above the Bank of England's (BOE's) 2-percent target rate. UK consumer price index (CPI) data was steady at 3.1 percent in August, according to the Office for National Statistics.

Webster says there are mounting upside risks to CPI. "The impending increase in VAT and [the rise in] wheat

The VAT increase, along with cuts in government spending, are expected to help trim the current UK budget deficit.



and cotton prices are threatening to 'de-anchor' inflation expectations," he says. "The dovish Monetary Policy Committee members seem to be trying to brush this under the carpet by conceding only that they're 'uncomfortable' with high inflation, while the market seems content to price in a more dovish view on growth and inflation, and — perhaps influenced by Fed speak — talk of the possibility of further BOE stimulus. However, any more upside CPI surprises in the UK will threaten the credibility of BOE forecasts for an inflation slowdown."

Although Forex.com's Dolan notes the market has been speculating the BOE will be forced to tighten rates because of inflation, he doesn't believe the bank will do so because of the many challenges to economic growth. Referencing recent BOE meeting minutes, Dolan says, "It showed discussion was moving toward additional quantitative easing."

Most analysts agree the BOE will not adjust interest rates this year, and will instead wait until late 2011.

"The uncertainty over the outlook means UK monetary policy is likely to be on hold for some time to come," Moody's Analytics Ahmed says. "We do not expect the Bank of England to start raising its key policy rate until the end of 2011."

Wells Fargo economists agreed in their Sept. 15 Global Chartbook research letter: "We believe the Bank of England will refrain from raising rates until economic recovery becomes more firmly established. Thus, we expect the Bank will keep its main policy rate at 0.50 percent, where it has been maintained since March 2009, well into 2011."

Relative performance

Most economists say all of Europe faces a tough economic challenge. "Both the UK and the Eurozone are going to be sluggish," Bryson says. "If it is 1.4 percent vs. 1.3 percent [GDP] at the end of the day, who cares?"

However, some say the UK could have an edge, which could present an opportunity in the EUR/GBP pair.

"The Euro is going to be the bigger loser," Dolan says.

The differences may seem small, but they can make a significant impact.

"The UK and the Eurozone as a bloc are faring similarly," Ahmed says. "Both grew around 1 percent quarter over quarter in the second quarter, and are likely to record robust growth in the third quarter. However, some Eurozone countries are doing much worse than the UK. The obvious ones are the fiscally troubled countries of Greece, Spain, Portugal, and Ireland. But others, like

Germany, are doing much better. Germany's economy grew 2.2 percent quarter-over-quarter in the second quarter. The Euro zone and UK's future paths are different, though. The outlook for the single-currency area is much bleaker given the Eurozone debt crisis, which is yet to be resolved."

Sterling action

The pound has made relatively big swings vs. the U.S. dollar since the beginning of 2010; the GBP/USD pair fell from about \$1.64 to \$1.42 into late May. Ahmed explains the key drivers behind that move.

"The European debt crisis dominated investor sentiment early in 2010, driving up the demand for safe-haven assets such as the U.S. dollar," he says. "While the problems lay with Greece, Eurozone investors were also worried about the UK's large fiscal deficit and contagion. Uncertainty over the UK elections also weighed on the British currency."

May and June ushered in a shift in sentiment and the pair managed to rally toward \$1.60 by early August — gains that occurred amid better-than-expected economic reports out of the UK, and also following the announcement of austerity measures.

"Those fiscal consolidation plans were the main factor behind improved sentiment for the pound," Wells Fargo's Serebriakov says. However, he also underscores the longer-term significance of these policies.

"There is a difference between the short-term and long-term implications of these fiscal austerity plans," he says. "In the short run, they reduce the risk premium on UK assets and help the pound. In the long run, you have to look at the impact on the real economy. The economy is fragile and this is probably going to hurt growth."

The pound/dollar slid back from \$1.60 to about \$1.53 in early September as economic data began to soften. Bryson highlights the PMI (manufacturing) number. "In May it hit 58, but in August slid to 54.3. It's still in positive territory (*above 50*), but it is slowing," he says.

In highlighting the key factors currently impacting the pound, Ahmed emphasizes the role uncertainty is likely to play.

"The high uncertainty over the [economic] outlook means investors are more sensitive to high-frequency economic data than they were in the past," he says. "This is likely to create more volatility in the financial markets. Also, any major slippage in the government's plans to reduce the ballooning budget deficit will weaken the

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pound. How quickly or slowly will the BOE withdraw its extraordinary support to the economy? Investors are therefore likely to keep a close eye on UK inflation, because it

has been stubbornly high relative to the BOE target."

TopEcon's Webster sees the potential for sterling to weaken in the near term.

"I am looking for around 1.45 at end-2010," he says. "The case for sterling weakness, independent of the trend in the EUR/USD, can be made on a number of grounds. First, renewed deflation in the UK housing market. That tends to correlate with broader economic weakness and the return of recession, which could be aggravated by the upcoming scale of fiscal austerity [measures]. In this scenario, additional BOE quantitative easing becomes a distinct possibility."

Dolan forecasts a \$1.48 to 1.61 range for the pound/dollar in the fourth quarter. However, he warns the risks are to the downside, and a break of \$1.48 would open the door to additional losses toward \$1.38 (Figure 2).

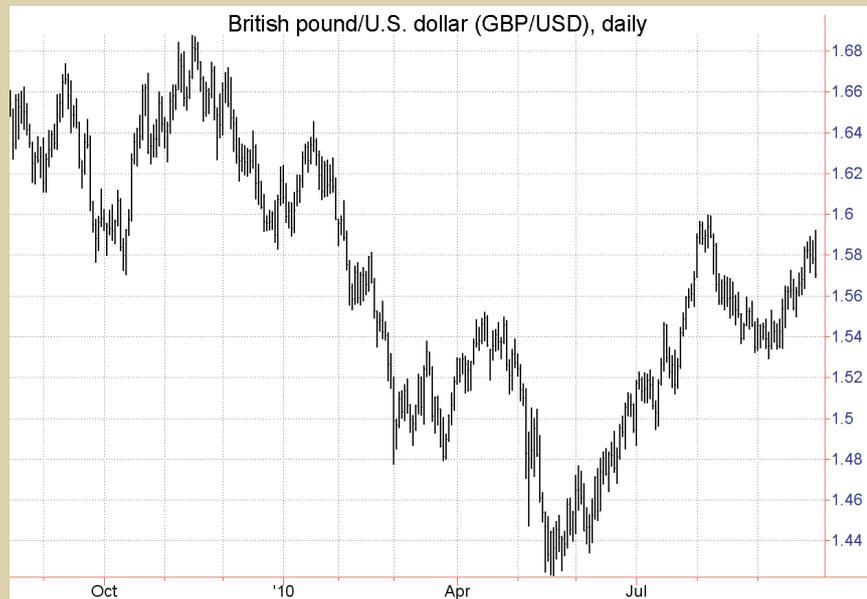
Of the potential for the BOE to institute another round of quantitative easing, Dolan says, "That typically has a negative impact on a currency. The intent of quantitative easing is to drive market interest rates lower to support the economy. But lower interest rates are always a currency negative."

He advises selling the pound/dollar in the \$1.58-1.61 area, and also says the pound/Canadian dollar cross as a potential sell in the \$1.62-1.64 region, "looking for a move to \$1.53" (Figure 3).

Michael Woolfolk, managing director at BNY Mellon cites his firm's year-end forecast for pound/dollar at \$1.51, with the Euro/pound at 0.8275, "marginally lower from current levels reflecting Euro weakness and sterling strength," he says.

Longer-term, Serebriakov gives a 0.8100 target in the Euro/pound in 2011. "There is more room for the Euro to fall from a long-term valuation perspective," he says. ☒

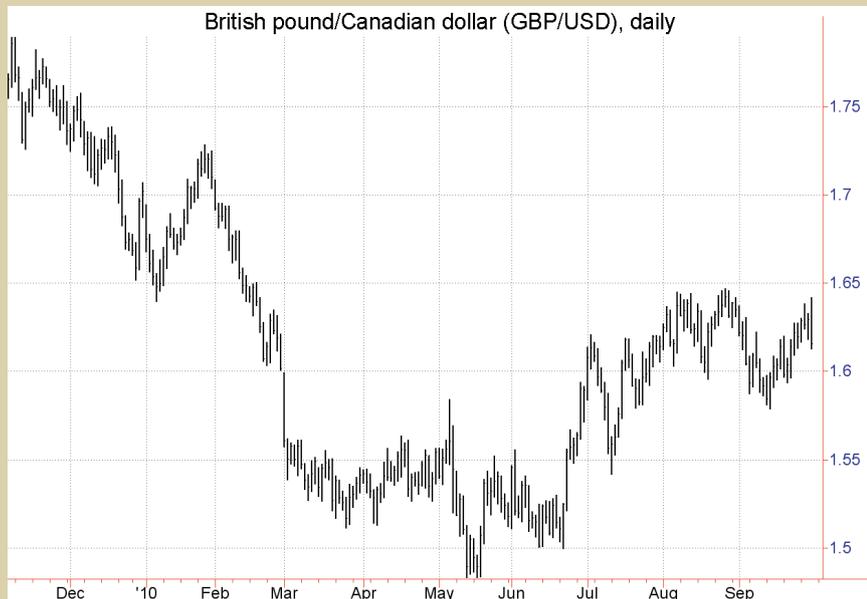
FIGURE 2: RISK TO THE DOWNSIDE



Analyst forecasts target the pound/dollar rate to drop into the end of the year, with the magnitude of the drop varying.

Source: TradeStation

FIGURE 3: POUND/CANADA



Some analysts see potential further pound weakness vs. the Canadian dollar.

Source: TradeStation

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Axes to grind

Is gold fever causing unexpected symptoms in other markets, including the dollar?

BY BARBARA ROCKEFELLER

The FX market can be maddeningly perverse and irrational. Whoever said “The market is always right” was referring only to the inability of a single trader to move the market, not to any truth that must inherently reside in the consensus analysis. In late September, it’s clear to anyone with a grain of common sense that thinking in the FX market has run off the rails. And not just the FX market — equity traders can’t tell if they are coming or going, and hard commodities like oil and gold are in an intellectual

tangle, too.

The FX market is being led by gold, temporarily — but chances are it’s going to be led by interest rates — eventually. The dollar’s nearly 300-point giant nosedive vs. the Euro in less than 24 hours was triggered by the Fed’s policy statement in late September that it would “provide additional accommodation if needed to support the economic recovery and to return inflation, over time, to levels consistent with its mandate.” This should have inspired

a big yawn. We already knew from the minutes of the August Federal Open Market Committee (FOMC) meeting and from Fed Chairman Ben Bernanke’s comments in Jackson Hole, Wyo., the Fed was considering another round of **quantitative easing** (QE2) — i.e., buying Treasuries and thus pumping liquidity into the economy.

In a normal market, anyone who wanted to sell dollars on this news already had plenty of time to do it ahead of the announcement date itself. Instead, we got sudden panic selling (Figure 1).

The press made much of gold rising immediately on the “automatic” inflationary effect of quantitative easing. Some commentators made another leap, asserting that to engage in additional easing is equivalent to a dollar-devaluation policy. This reveals a fossilized mind-set. Dollar devaluation occurs if, and only if, monetary easing leads to inflation. And not just any degree of inflation, but inflation that is higher than in other G7 countries. But the Fed is worried about deflation, not inflation. As of August, inflation in the U.S. was steady, at a rate below 1 percent. Even core inflation (excluding food and

FIGURE 1: THE EURO'S REMARKABLE RECOVERY



The dollar’s nosedive vs. the Euro in less than 24 hours (final candle on chart) was triggered by the Fed’s Sept. 21 policy statement that it was ready to engage in another round of quantitative easing. The Euro had been gaining ground against the dollar since June.

Source for all figures: Chart — Metastock; data — Reuters and eSignal

energy) was only 1.3 percent. The Fed came right out and said this low inflation rate is not consistent over the longer run “with its mandate to promote maximum employment and price stability.”

Besides, adopting a deliberate policy of dollar devaluation is simply not how the Fed operates. For one thing, “the dollar” is the policy property of the Treasury, not the Fed. The Fed has no mandate that mentions the dollar. When he was Fed Chairman, Alan Greenspan often said the dollar is secondary in Fed considerations.

That doesn’t mean entirely absent, though. The Fed does have a mandate to promote full employment, and a weaker dollar does that to the extent it facilitates exports. In addition, a weaker dollar means imports are more expensive and this boosts both the producer price index and the consumer price index. It would be naive to imagine the Fed didn’t foresee some dollar weakness and its attendant benefits, but it’s a stretch to think it was a primary goal. To say the Fed was seeking to get a weaker dollar from the QE2 announcement is like saying you rake leaves for the exercise, not to prevent the leaves from suffocating the lawn. The Fed’s true purpose is to prevent Japanese-style deflation and that is done with easing before deflation gets a grip.

What is the Fed’s concern about deflation? Let’s consult an inflation hawk, St. Louis Fed President James Bullard. He supports quantitative easing as an emergency measure to goose the economy and disagrees with Bernanke on keeping rates low indefinitely, which he feels is counterproductive. Raising rates would send a more useful message to potential borrowers: get going or miss out on lovely low rates. In a paper ominously titled “Seven Faces of ‘The Peril,’” Bullard discusses the possibility of the U.S. going the way of Japan and its two lost decades. QE is worthwhile to avoid Japanese-style deflation, while indefinitely low rates raise the probability of the U.S. joining Japan.

If we have inflation so low that fear of deflation is legitimate, from what planet did fear of inflation come?

Whence the fear?

Not from the usual source, the bond vigilantes. Right after the Fed announcement, the yield on U.S. Treasuries fell across the yield curve — along with some flattening of the curve, which means less fear of inflation, not more. Long-end rates come down when inflation fear recedes. In other words, real bond traders with real money to invest didn’t buy the inflation fable.

The yield drop is the one cause of the dollar’s drop that fits into conventional

economic analysis: money flows out of low-return countries and into those with the highest real rate of return. Australia, for example, is poised for another 100 basis points of rate hikes, perhaps starting as early as October. The Australian dollar is firm.

Inflation fear didn’t come from the oil gang, either. For once, they were the sensible traders, reasoning that QE would help U.S. growth and thus demand for energy. Oil prices rose on the announcement, but only modestly, because we are, after all, in a weak recovery. In fact, only a day later, the Energy Department’s weekly report showed an increase in energy supplies, and oil retreated in line with that information.

For their part, stock market participants are still sitting on the fence. Like oil traders, they “should” see an additional round of quantitative easing as promoting demand and growth, good things for equity prices.

The only intermarket culprit left is the gold market. The front-month gold futures contract jumped from \$1,278 at the open on Fed day to \$1,294.50 at the high the next day. Why? Part of the rise can be attributed to the existing trend (Figure 2). The rising gold trend started back in October 2008 with a low of \$681.00 and peaked the first time in December 2009 at \$1,226.40, making it the best-performing asset in the world. Note the Euro was rising at about the same pace and with roughly the same low and high dates. Starting in February 2010, though, gold dipped a little but the Euro kept heading south. In May and June 2010, as rescue operations for Greece were under way, the Euro

FIGURE 2: GOLD AND THE EURO



The gold uptrend (black line) dates back to October 2008 and a low of \$681.00. It first peaked in December 2009 at \$1,226.40. The Euro (green line) was rising at approximately the same pace, and with roughly the same low and high dates.

FIGURE 3: REUTERS 10-YEAR T-NOTE YIELD INDEX



If U.S. economic data suggests a decent recovery, yields will return to the "normal" recovery zone of 3.25-3.75 percent (gold lines). If the data is bad, the Fed is likely to renew quantitative easing, which could drive the yield as low as 2.064 percent, the worst level since late-December 2008.

started to rise again and gold broke out above the intermediate high resistance.

You would think the giant sell-off in the FX market would still be the Euro, not the dollar. This raises the issue of the gold market having an answer to everything, and every answer supporting a rise in gold. It's often said gold is rising because the dollar is falling, or because the Euro is falling, or because some other commodity is rising, or because political uncertainty is high.

Just about anything can be used to justify a rise in gold. The gold bulls have an axe to grind. If they can't find something specific, they can always fall back on the universal distrust of governments that are sure to do something boneheaded again — start a trade war with China, fail to prevent an asset bubble in China, neglect to shore up enough defense against terrorism, and so on. We can poke fun at the gold bulls for inflating the prospects for the need of a safe-haven in gold, but at the same time we have to admit that fear-mongering works when fears are not entirely unreasonable. Fear of inflation right now is not reasonable, but it can become reasonable, and pretty darn quickly. Anyone can invent an extreme scenario to beguile the gullible and sell them an "investment" that carries no rate of return.

The correlation between the dollar and gold, or the Euro and gold, is suspect. In the first period, gold and the Euro traded together, meaning the correlation of gold with the dollar was inverse. From last December, when the Greek drama began, gold seemingly became inversely correlated with the Euro, meaning it was positively correlated

with the dollar. Now, in the latest period (roughly, from the end of July) the Euro is rising again with gold.

This makes as little sense as seeing inflation lurking under the bed in the U.S. New confidence in the Euro is founded on a loss of fear over the European debt problem. After all, the new European Financial Stability Facility (EFSF) got a triple-A rating from all three major ratings agencies. Some European officials, such as Spanish Prime Minister Jose Luis Rodriguez Zapatero, are running around saying the European sovereign-debt crisis is over.

Really? The EFSF has yet to be approved by each of the European Monetary Union (EMU) countries. One country already said it won't agree, and the EMU leadership rushed in to say, OK, we'll re-allocate that share to the

rest of the members. The Facility is authorized to issue up to €440 billion of bonds in its own name, but because of strict reserve requirements, in practice the amount that will really be available is more like €250 billion. Greek debt alone is about €260 billion.

Greece has said it intends to use short-term paper to fund repayment of the €110 billion borrowed from the European Central Bank (ECB) and International Monetary Fund (IMF) in the spring, but any crisis that takes Greece out of the private market would potentially eat up the entire EFSF, leaving nothing for Ireland, Portugal, Spain, or anyone else. Greece is already paying almost 9 percent more than Germany for 10-year paper, while Ireland and Portugal are paying about 4 percent more. Besides, remember the Facility's triple-A rating is contingent on ratification by all members.

The so-called peripheral European countries are able to sell government paper to high private-market demand — but at horrible prices. At the same time, Germany is enjoying a booming export economy and its natural accompaniment, higher tax collections. As a result, in Q4 it will issue €29 billion less in government debt than originally expected, or only about €60 billion. The inevitable result of smaller German supply and fear of default by peripherals was a drop in the yield on the German Bund to a mere 2.30 percent.

With the U.S. 10-year interest rate at about 2.5 percent, that gives the U.S. a small nominal advantage. Ah, but it's not the nominal advantage that counts, it's the real advan-

tage after inflation. QE2 has, evidently, taken that away, meaning investors expect the U.S. to have higher inflation than Europe over the life of the investment.

This is probably true. Historically, the U.S. tolerates higher inflation because of its greater flexibility and adaptability. Today, both the Eurozone and the U.S. have approximately the same level of inflation, but the U.S. is expected to pull ahead of Europe eventually. This is a good thing. Defeating deflation is the primary policy goal, and it's premature to be thinking about controlling inflation before it exists.

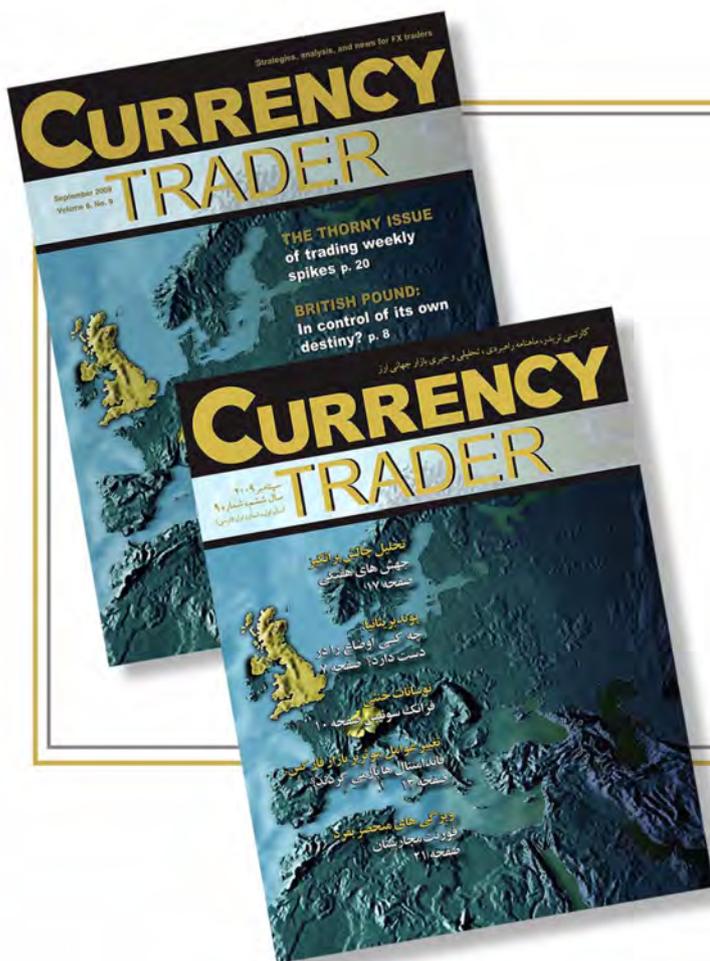
In late September, what the FX market is missing is that the Fed may not have to engage in a new round of quantitative easing. If U.S. economic data shows a decent recovery, yields will return to the "normal" recovery zone of 3.25-3.75 percent (marked by gold lines in Figure 3). Only if economic data starts coming in at frighteningly bad levels will the Fed actually activate QE2, whereupon the yield

could fall as low as 2.064 percent, the worst level from December 2008, right after the Lehman bust.

Gold bulls and others fear that once the inflation genie is out of the bottle, it can't be put back in, our experience with Mr. Volcker notwithstanding. This is why the emerging U.S. yield advantage over Germany is not resulting in the pro-dollar effect it should, at least so far. But if the sovereign debt crisis continues to get hotter — and it should, with the European Financial Stability Facility probably underfunded, and some countries yet to admit they will need to access it — Bund yields could fall further as investors want the one top-European country debt and no other.

It is not an extreme scenario to imagine the U.S. yield advantage over Bunds as high as 1-1.5 percent. Is that enough to overcome the expected inflation differential and country risk? We shall see, and probably in the fourth quarter. ☒

For information on the author, see p. 4.



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Validating candlestick patterns with tick volume

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

BY DANIEL FERNANDEZ

One disadvantage forex traders have had relative to futures and stock traders is the general lack of accurate volume information. The absence of a central exchange and the FX market’s large turnover make gathering any meaningful real-time volume information impractical, if not impossible.

However, because there is a correlation between the number of ticks (simply the number of price changes that occur within a given time increment) issued by a given forex dealer and the volume in a currency pair, “tick-volume” data can be used as a proxy for true market volume. An interesting example using this concept was illustrated in “Time-adjusted range and volume” (*Currency Trader*, August 2010), in which Caspar Marney designed a system using tick-volume information and the patterns that

develop within it.

If tick volume information can reliably represent actual forex volume, we can use it to interpret different price patterns. The “double doji” — a candlestick pattern consisting of two consecutive candles with very narrow bodies and large shadows, or wicks — is a perfect pattern to exemplify this concept (Figure 1).

Candlestick patterns and tick volume

Traditionally, the double-doji pattern is interpreted as a signal of market uncertainty, but sometimes it can simply reflect a general lack of trading volume. Tick-volume data makes it possible to identify those patterns that are accompanied by significant volume, which makes them viable candidates for a breakout strategy.

However, because different brokers may use different liquidity providers, they can produce very different absolute tick-volume data (even though the general characteristics or profiles of the data are likely to be similar). As a result, it’s necessary to normalize tick volume so results are as broker-independent as possible.

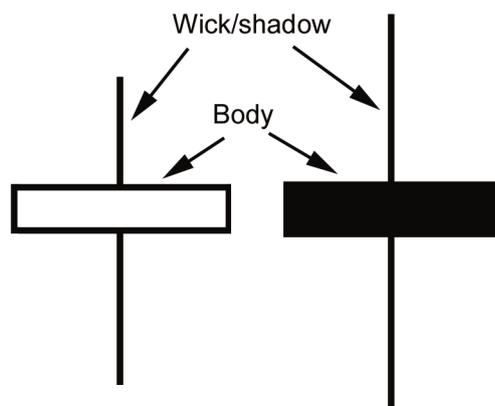
In this case we’ll use a “normalized volume oscillator” (NVO) that creates a histogram of tick volume based on its 50-period high and low values, with the highest value being 100 and the lowest value being -100. Figure 2 shows an example of the indicator, along with regular tick volume, in the Euro/U.S. dollar pair (EUR/USD). (A free NVO indicator for Metatrader 4 can be downloaded from <http://codebase.mql4.com/source/9250>.)

Double-doji breakout strategy

Now that we have an indicator that displays normalized tick volume, we can design a strategy around the double-doji pattern in the EUR/USD pair. The following strategy uses hourly (60-minute) data.

The first thing we need to do is to establish a mathemat-

FIGURE 1: DOUBLE-DOJI PATTERN



The double doji consists of two consecutive candles with very narrow bodies and large shadows, or wicks.

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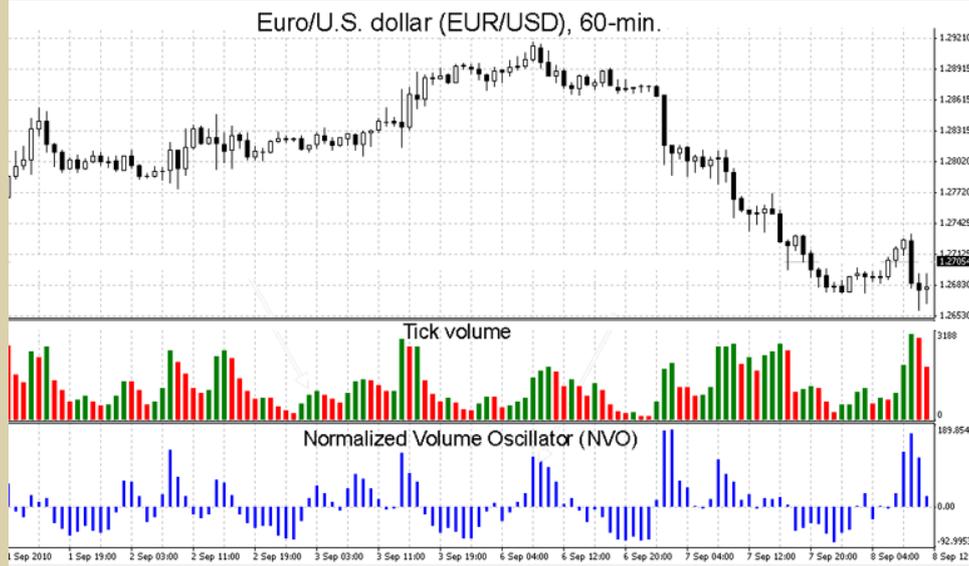
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ical definition of a double doji so that we can identify the patterns accurately and consistently. A valid pattern will fulfill the following requirements:

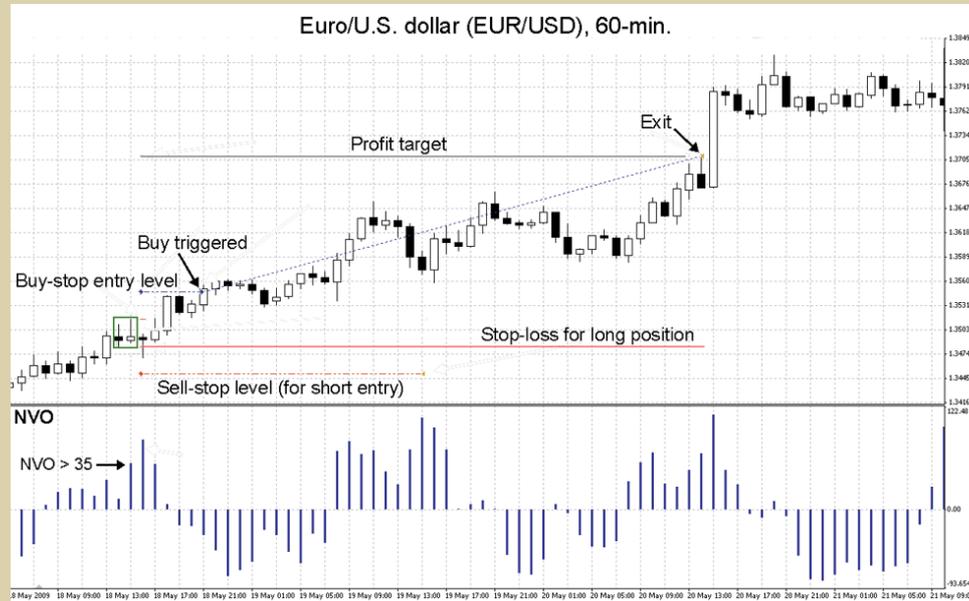
1. The ratio of the range of the two candles (High-Low) and the body of the candles (Close-Open) must be greater than five.
2. The body of the candles must be less than 20 percent of the value of the 14-period daily average true range (ATR).
3. The 50-period NVO indicator for the second candle must be above 35.

FIGURE 2: NORMALIZED VOLUME OSCILLATOR



The NVO normalizes tick volume by measuring each period's volume relative to the highest and lowest volume readings of the past 50 periods.

FIGURE 3: TRADE EXAMPLE



This long trade was signaled when price pushed above the high of the double-doji pattern by an amount equal to the high-low range of the pattern itself.

After a valid double doji is detected, buy-stop and sell-stop orders are placed to take advantage of a possible breakout from the pattern. The buy-stop is placed one "pattern size" (the high-low range of the larger of the two candles) above the pattern's high and the sell-stop is placed one pattern size below the pattern's low. Conversely, the pattern low becomes the stop-loss for long trades while the pattern high is the stop-loss for short trades. The profit target is five times the pattern size. Both stop orders expire after 24 hours. (Note: None of these values were previously optimized.)

For example, if a valid pattern had a low of 1.2450 and a high of 1.2460 (pattern size of 10 pips), a buy-stop would be placed at 1.2470 (1.2460 plus 10 pips) with a stop-loss at 1.2450 (pattern low) and a profit target at 1.2520 (1.2470 plus five times the pattern size), while a sell-stop would be placed at 1.2440 (1.2450 minus 10 pips) with a stop-loss at 1.2460 (pattern high) and a profit target at 1.2390 (1.2440 minus five times the pattern size). Figure 3 shows a sample trade.

Because these patterns are usually very small and their ranges are not representative of typical market volatility, it is a good idea to adjust trade size according to the 14-period daily ATR, which is a better measurement of potential market movement. In general, the use of the following position-sizing equation will result in a risk of approximately 2 percent per trade:

$$\text{Lot Size} = (400 * \text{Account Balance} / (\text{Contract size} * (14\text{-daily ATR in pips})))$$

For example, using a \$100,000 standard lot size, if the account balance was \$100,000 and the 14-day ATR was 150 pips, the position size taken would be 2.6 lots.

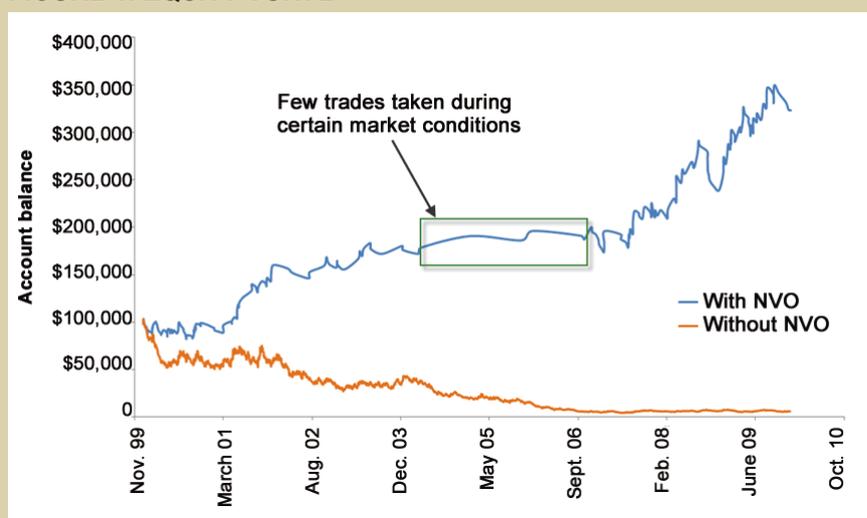
Testing the strategy

The strategy was tested in the Metatrader platform using hourly EUR/USD data from Jan. 1, 2000, to Jan. 1, 2010, with an initial account value of \$100,000. Even though Metaquotes does not provide actual tick data, hourly tick volume — which is adequate for the implementation of this strategy — was available. Comparing the NVO values across select time periods in this data to other data sources, including Gain Capital tick data, revealed only minor differences after volume normalization, which suggests the NVO approach allows the strategy to work under various different feeds. Trading costs were set at two pips per trade.

The strategy was profitable in simulation, but more importantly, the NVO volume filter was vital to its success. Removing the NVO filter resulted in approximately 10 times as many trades and wiped out almost all the account's initial equity in the first four years of testing (Figure 4). This indicates volume validated the pattern, as double dojis resulting from market uncertainty tend to end in successful breakouts while those resulting from a general lack of volume do not lead to any outcome with a significant probability.

The performance summary in Table 1 also highlights some interesting characteristics of the system. First, because valid patterns are quite rare, the strategy does not trade very frequently — it triggered only 221 trades during the test period, for an average of 22 trades per year. (Also, there was a tendency for valid patterns to cluster in certain months, with almost a year with no signal.) The strategy's

FIGURE 4: EQUITY CURVE



The system's primary shortcoming was its failure to signal trades for long stretches, but its overall performance was still profitable — in stark contrast to the trading the same pattern without the NVO filter.

reward-to-risk ratio is also very favorable, with the average trade being 2.3 times the size of the average loser. The system also achieved new equity highs in every year, with only two slightly negative years in 2000 (-2.46 percent) and 2003 (-0.41 percent).

The strategy might not trade frequently enough to be used exclusively, but it does provide a valuable tool for any trading strategy based on candlestick patterns. The system illustrates how to get a better understanding of candlestick patterns by using tick-volume data. Testing on other currency pairs, as well as experimenting with other patterns (or optimization techniques) will shed more light on the approach's potential. ☒

For information on the author, see p. 4.

TABLE 1: PERFORMANCE SUMMARY

	With NVO	Without NVO
Total profit	223%	-95.62%
Avg. compounded yearly profit	12%	-19.58%
Maximum drawdown	19%	-95.62%
Avg. profit-to-loss ratio	2.3	2.3
Winning percentage	38%	26%
Number of trades	221	2094
Profit factor	1.44	0.87

Filtering trades with the normalized volume oscillator improved the system in almost every aspect of its performance.



Trend transitions in forex

Transitional patterns offer earlier entry into developing price moves than typical trend-following techniques.

BY DAVE LANDRY

Trends don't last forever, but they often extend much further than most people anticipate. Trying to buy a currency pair because it's low or short one because it's high is a loser's game. Fortunately, markets can leave clues the trend is turning: After an initial reversal, they will often make a minor correction before resuming the new trend. Entering after that minor correction, but only if the new trend shows signs of resuming, is the goal of "transitional" patterns.

The payoff of catching a new trend early is huge. Obviously, this comes with risk. Sometimes what appears to be a market transition might turn out to be only a correction in the longer-term trend. It's like the old saying, "Pioneers got the gold, but they also got the arrows."

Following a few guidelines will help you minimize the arrows you take as a "trend pioneer."

Before looking at different transitional setups, let's first consider the concept of efficient vs. inefficient markets, trends, and the forex market.

Efficient vs. inefficient markets

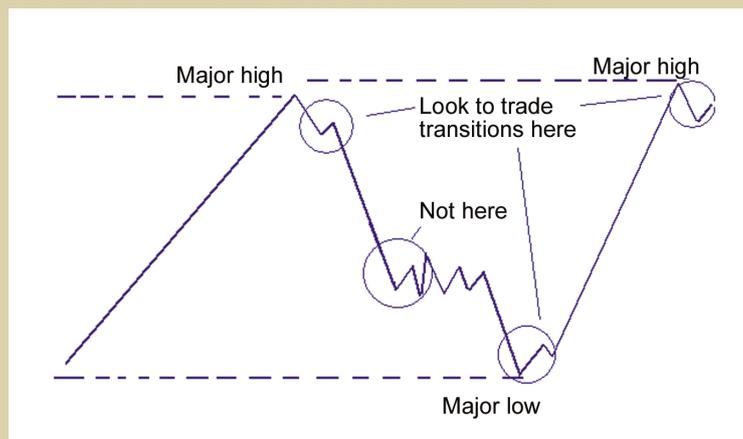
An inefficient market is one in which all information isn't "priced in." These markets trend as increasing numbers of traders and investors discover them and pile into them.

An efficient market is, on the other hand, is well-analyzed and traded, and most information is priced in it. Efficient markets are crowded playing fields. Speculators, longer-term investors, hedgers, and other participants (e.g., consumers and producers of specific commodities) tend to cancel each other out. More often than not efficient markets tend to "chop around," or oscillate. Stock indices, commodities, and major currencies tend to be more efficient. Lower volume stocks (within reason) tend to be more inefficient.

This doesn't mean longer-term trends don't occur in more efficient markets; it just means you have to pick your spots more carefully. When attempting to capture major transitions, the best trades occur when the currency pair is coming off major lows (for long trades) or major highs (for shorts). Multi-year or even all-time highs or lows tend to work best, as illustrated in Figure 1. In these situations the maximum number of people are trapped on the wrong side of the market, and their predicament will help your position when the new trend develops.

Although the following analysis of "First

FIGURE 1: TRANSITIONAL OPPORTUNITIES



The best transitional trades occur when a currency pair is coming off major lows (for long trades) or major highs (for shorts). Multi-year or even all-time highs or lows tend to work best.

Thrusts," "Bow Ties," and "First Kiss After Daylight" setups focuses on capturing longer-term trends, shorter-term traders could apply these patterns on intraday charts. Ideally though, take signals only when price is hitting significant new highs or lows on the higher time frame.

First Thrusts

Markets in major trend transitions often start by making a sharp move in the new direction — a "first thrust" that tends to catch traders off guard. Trapped on the wrong side of the market, these traders find themselves waiting for the market to reverse so they can get out of the market with as little damage as possible. Bottom pickers and top pickers who missed their mark and do not want to pay up are also waiting for some sort of meaningful correction.

Unfortunately, that meaningful correction may never come. In these situations the market often pulls back only briefly before resuming its new trend, and the trapped market participants are soon forced out at unfavorable prices.

The First Thrust strategy has two advantages. First, by waiting for the market to make a sharp move in a new direction, you avoid the pitfalls associated with trying to pick highs or lows. Second, by entering at the first sign of a correction rather than waiting for a more substantial move, the position can potentially be helped along by the trapped traders' efforts to scramble out of the market.

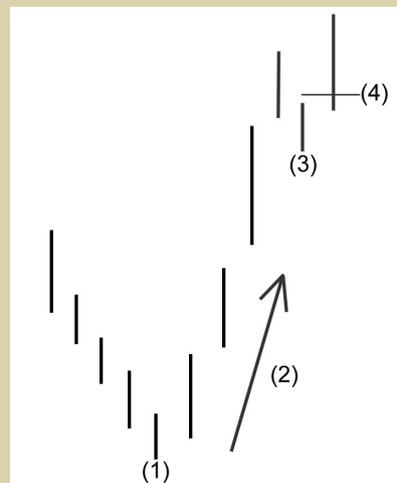
Figure 2 shows how after making a significant new low (1) price should make a sharp thrust in the new direction (2), followed by at least a one-bar pullback (a lower low and lower high) at point 3. A long trade is signaled when price moves above the high of the pullback bar (4). The setup rules

are reversed for short trades.

One important point: Sometimes the pullback is very brief and shallow — i.e., the market only makes a lower high. These instances represent riskier trades because the market has corrected very little, but in trading, risk often comes with reward. These brief corrections give players very little time to get in; most are waiting for a more meaningful pullback. If the thrust resumes after this brief pause, these traders must either jump in or risk being left behind.

Figure 3 shows a First Thrust short setup. In November 2009 the Euro/U.S. dollar pair (EUR/USD) hit a one-year-plus high (1), followed by a sharp thrust lower (2). The pair then corrected to the upside, making two consecutive higher lows and higher

FIGURE 2: FIRST THRUST



By entering at the first sign of a correction after a sharp thrust, rather than waiting for a more substantial move, the position can potentially benefit from the trapped traders' efforts to get out of the market.

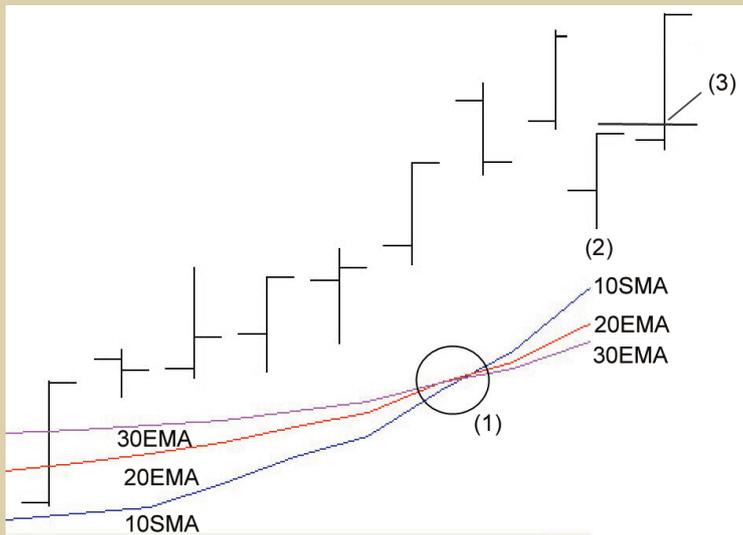
FIGURE 3: FIRST THRUST SHORT SETUP



A short trade is triggered (4) when the price turned back down after making higher highs and higher lows (3). However, a more aggressive entry would be to enter on the first down move after the pair made only a higher low (a).



FIGURE 4: BOW-TIE PATTERN



The pattern is formed by the inversion of a 10-day simple moving average and 20-day and 30-day exponential moving averages over a short period of time.

highs (3). A short trade was signaled after price made its first lower low after beginning the correction (4). After some adverse price action, the pair began to implode. The more aggressive entry would be to enter on the first down move after the pair made only a higher low (the inside day at point a).

Bow Ties

The First-Thrust pattern does a good job of capturing new trends that begin with an obvious bang. Sometimes though, these moves start more gradually: The market goes through a “distribution” phase before accelerating in the new direction.

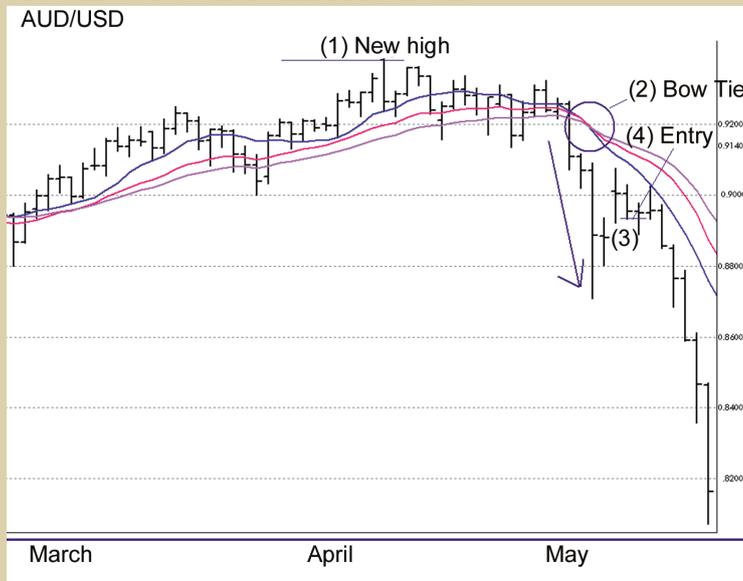
The Bow-Tie pattern uses a series of moving averages to signal these transitions. Although all indicators are prone to lag, the Bow-Tie moving averages can often alert you to a trend change in markets that have been going through extended consolidations, especially those that have recently made a major high or low.

For this pattern, use a 10-day simple moving average (SMA) and 20-day and 30-day exponential moving averages (EMAs). These averages often come together and then spread out in the opposite direction right before a market makes a major transition. That is, they go from “proper” downtrend order (the faster moving average lengths below the slower moving average lengths) to proper uptrend order (the faster moving averages above the slower moving averages).

When this happens over a short time period, it gives the appearance of a bow tie, as shown in Figure 4. Notice the moving averages are in proper downtrend order (10-bar SMA < 20-bar EMA < 30-bar EMA), but quickly invert after point 1 to proper uptrend order (10-bar SMA > 20-bar EMA > 30-bar EMA). Ideally, this should happen over a period of three to four bars. The inversion suggests the market has made a major trend shift.

Because the market is still prone to correct in these situations, entry occurs only after the market makes at least a one-bar pullback (2). A long trade

FIGURE 5: AUSSIE DOLLAR BOW TIE

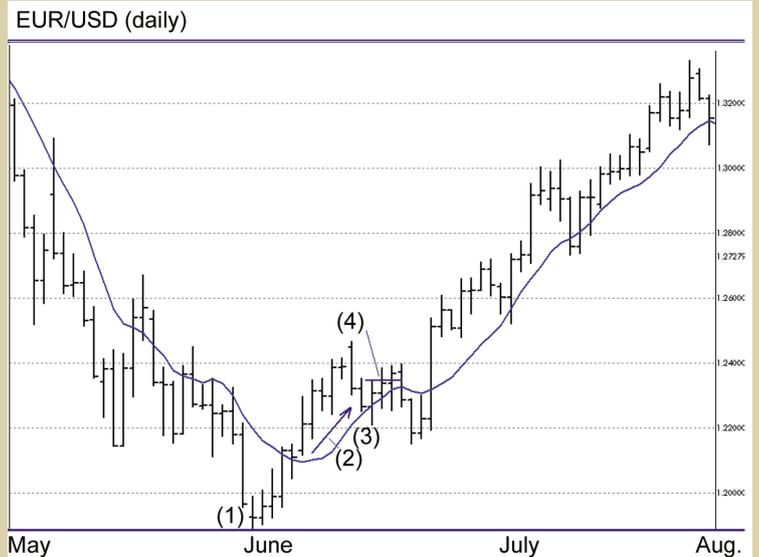


After the moving averages inverted their order, the pair completed the pattern at point 3 by making a higher high and higher low. A short trade was signaled when the pair then made a lower low.

is signaled when price makes a higher high after that minor correction (3). Like all the transitional patterns, those that occur in the wake of major highs or lows are preferable.

Figure 5 illustrates an example in the Aussie dollar /U.S. dollar (AUD /USD). The pair made a multi-month high in November 2009 (1), which was just a few ticks shy of a multi-year high. The market consolidated for a while before beginning to sell off. This action caused the moving averages to flip from uptrend proper order (10-bar SMA > 20-bar EMA > 30-bar EMA) to downtrend proper order (10-bar SMA < 20-bar EMA < 30-bar EMA) over the course of three bars, creating the appearance of a bow tie (2). The pair then made a higher high and higher low to complete the pattern (3). Short entry occurred when the pair then made a lower low (4).

FIGURE 6: THE FIRST KISS AFTER DAYLIGHT



For this setup, the market must make five or more lows above the 10-day SMA for a long trade, or five or more highs below the SMA for a short trade. Here, long entry occurs when the AUD/USD pair makes its first higher high after the subsequent correction to the moving average.

The First Kiss After Daylight

The First Kiss After Daylight setup is similar to the First Thrust, except it uses a moving average to define the thrust: The market must make five or more lows above the 10-day SMA for a long trade, or five or more highs below the SMA for a short trade.

The market must first make a major new low (the lower the better — all-time lows make the best setups). The market should subsequently begin to rally. During this rally, the lows of at least five bars must be above the 10-day SMA, after which the market must pull back and touch, or “kiss,” the moving average — the low must be at or below the moving average. Enter when the trend resumes. (This is similar to Linda Raschke’s “Holy Grail” setup except Raschke uses an indicator to define trend while this pattern only looks for daylight after a major low.)

In Figure 6 the EUR/USD pair makes a multi-year low (1) and then begins to rally off this bottom. There are at least five days where (seven, in this case) of “daylight” — lows above the moving average (2). The pair then pulls back to the moving average (3), and a long entry is signaled when price makes its first higher high after this correction (4).

Major transitions don’t occur every day

Not all transitional patterns will turn into major tops or bottoms, but all major tops or bottoms will have transitional patterns. Major trend transitions don’t occur every day. As of late-September, however, several currency pairs were at or near multi-year highs or lows. Now is the time to begin watching for the next big trend transition.

Trying to pick tops or bottoms is a loser’s game. You’re much better off waiting for the market to show signs the trend is turning and then look to enter after the first correction. First Thrusts, First Kiss After Daylight, and Bow Ties can be used to catch new trends early. The best setups occur after major highs and lows, because this increases the odds a large number of traders are trapped on the wrong side of the market. Like the pioneers, when trading transitions you are either going to get the gold or the arrows. The chance for gold makes it all worthwhile. ☒

For information on the author, see p. 4.

To read about these and other transitional setups applied to stocks, see Dave Landry’s article in the December issue of Active Trader magazine (on newsstands in November).



Crude oil and major currencies

Searching for long-term predictive relationships between currencies, yield curves, and equity markets is an exercise in futility.

BY HOWARD L. SIMONS

Time magazine may have dubbed 2000-2009 “The Decade From Hell,” but a better name might be the “The Decade of Unusual Intermarket Relationships.”

How that magazine has managed to stay in operation with such dull copywriters is beyond us, but life is full of mysteries.

Some of these unusual intermarket relationships included, in no particular order, negative short-term interest rates, negative long-term swap spreads, negative breakeven rates of inflation, stocks falling while interest

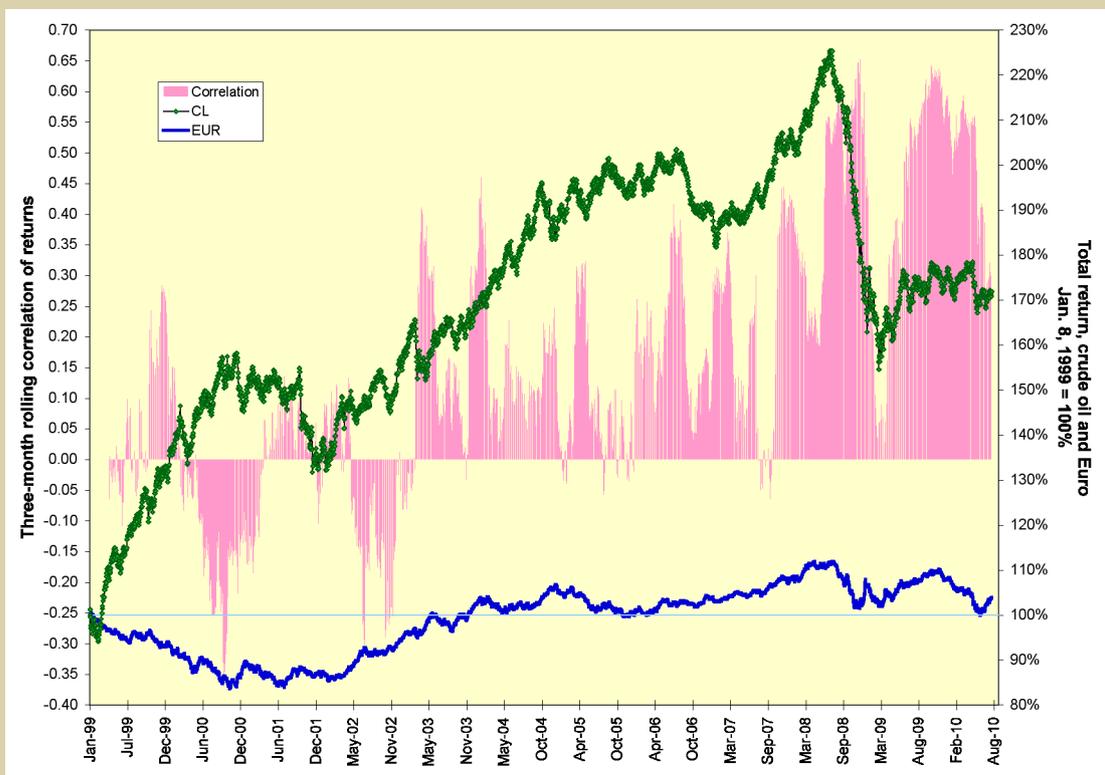
rates were being cut and rallying when interest rates were rising, bonds rallying while the price of various commodities soared, the dollar firming when interest rates fell and the trade deficit soared, inflation remaining under control while the price of various commodities soared, gold plunging during times of financial crisis, and so on.

If the world’s traders had to grapple with such, how could policymakers possibly have succeeded? Moreover, we did not even mention the ability of long-term U.S. interest rates to fall while the U.S. budget deficit reached stratospheric levels.

But just as no clothing fashion lasts forever, neither does any market fashion, as we saw in “Currencies, curves and correlations” (*Currency Trader*, September 2010). Let’s extend this analysis to the correlation of returns between total returns of the U.S. dollar into the six components of the dollar index (the Euro, Japanese yen, Canadian dollar, British pound, Swiss franc, and Swedish krona) and the total return of crude oil futures. The motivation here is to test the oft-asserted proposition that “the dollar” either benefits from or is hurt by the rising or falling price of crude oil.

The total return of the dollar into the six components of the dollar index subsumes the combination of

FIGURE 1: CRUDE OIL AND EURO POSITIVELY CORRELATED



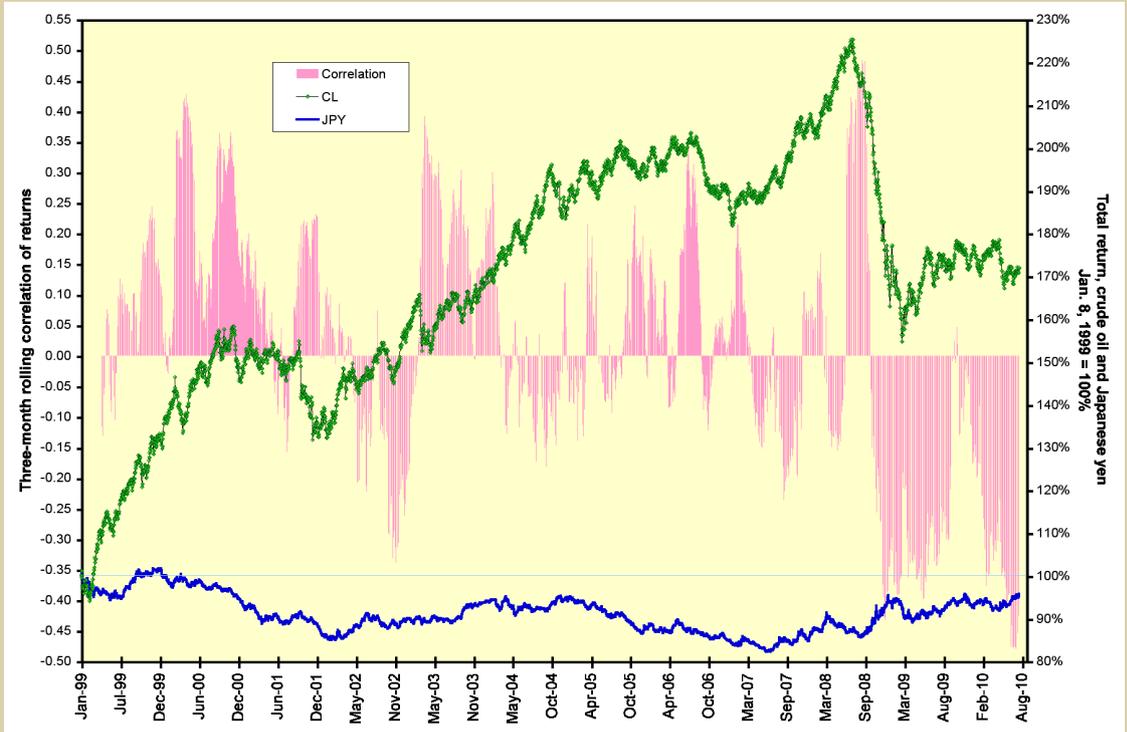
The oscillating correlation pattern gave way to a nearly continuous stretch of positive correlations after May 2003. As the Euro represents 57.6 percent of the dollar index, this post-May 2003 pattern accounts for the general sentiment.

spot rate changes and interest-rate spreads, and is a more realistic representation than the continuous spot rate of what an investor will earn by expatriating funds. The total return on crude oil futures as calculated by Dow Jones-UBS includes the impact of roll yield as well as gains on the funds deposited in collateral against a futures position. It, too, is a continuous buy-and-hold strategy.

The following charts begin with the January 1999 advent of the Euro. As currencies were trading well before that and crude oil futures were trading from 1983 onward, we should mention in passing the correlations between the dollar index and crude oil from 1983 through 1998 were unimpressive and seldom entered into the realm of serious discussion. Most certainly, the pseudo-analysis heard in recent years — “Crude oil rose/fell as the dollar fell/rose” — was not part of the thought process of either crude oil or currency traders.

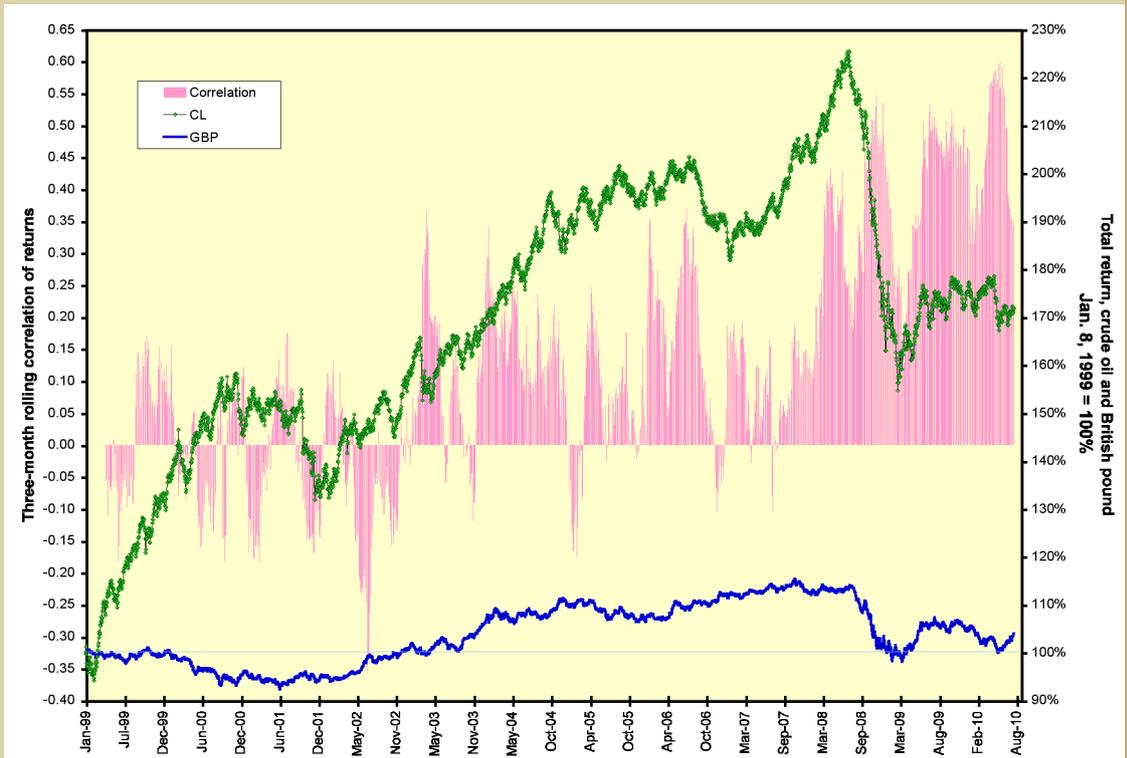
How did we get to that unhappy point? The starting point was the Federal Reserve’s first War on Deflation, commencing in May 2003. The central bank’s monetary largesse weakened the dollar on a supply/demand basis and stimulated demand for crude oil globally by shifting production from the U.S. to China.

FIGURE 2: CRUDE OIL AND JAPANESE YEN NEGATIVELY CORRELATED



The yen demonstrates a very different pattern than Euro, with nothing notable occurring around May 2003 and correlations oscillating in long stretches from positive to negative. The relationship shifted to strongly negative in mid-2009.

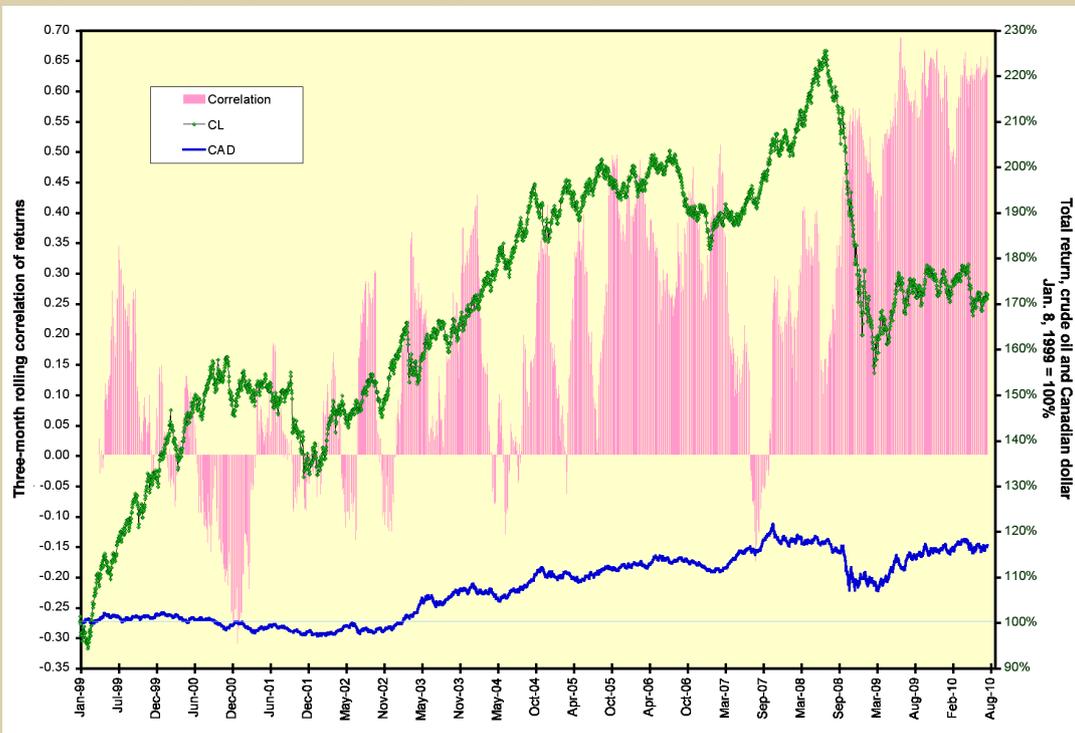
FIGURE 3: CRUDE OIL AND POUND POSITIVELY CORRELATED



The British pound’s correlation history looks like a variation of the Euro’s (Figure 1). Its correlation of returns against crude oil did not turn consistently positive until the financial crisis began in August 2007.



FIGURE 4: CRUDE OIL AND CAD POSITIVELY CORRELATED

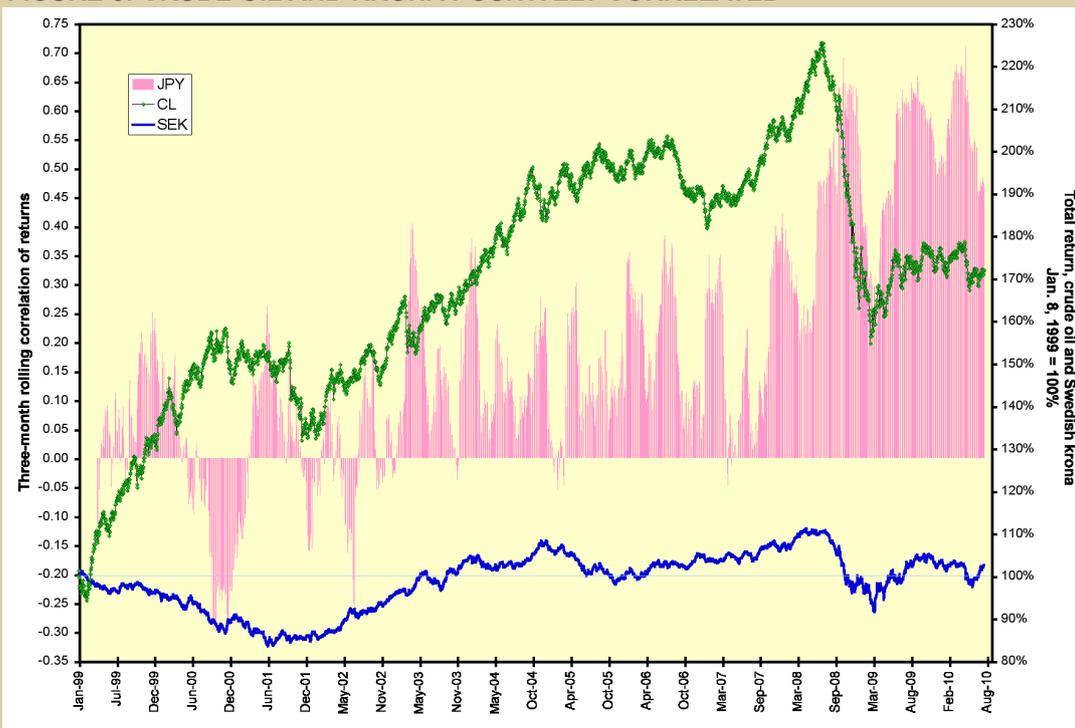


Because of Canada's large crude oil production base, the Canadian dollar has the strongest and most consistent correlation of returns vs. crude oil, with the exception of the period of CAD weakness against the dollar in 2000.

Thus a joint response to a common underlying factor looked like a causal relationship, and once this connection was established, it was impossible to break. It is to saying, "The jury will disregard that," while everyone present in the courtroom wonders, "How?"

In all the charts, the total return of the Dow Jones-UBS crude oil index is displayed in green and the total return on the carry of the USD into that currency is displayed in blue. The magenta columns are the rolling three-month correlation of returns.

FIGURE 5: CRUDE OIL AND KRONA POSITIVELY CORRELATED



Given the Swedish Riksbank's efforts to keep the SEK in a band against the EUR, we should expect to see the krona's correlation pattern resemble that of the Euro, and once again we are not disappointed (Figure 5).

Case studies

The May 6, 2003 declaration of war on deflation really stands out in the case of the Euro (Figure 1). Here the correlation of returns shifts from a pattern of meaningless oscillation to a nearly continuous stretch of positive correlations culminating in the spectacular rise of crude oil into July 2008 and then again during the global monetary excess of October 2009. As the Euro accounts for 57.6 percent of the dollar index, this post-May 2003 pattern accounts for the general sentiment.

Next, let's shift to the Japanese yen, which has a 13.6 percent weight in the dollar index (Figure 2). This has a very different pattern than Euro: The May 2003 date is scarcely noticeable and

the correlations oscillate in long stretches from positive to negative. A positive surge occurred during the financial crisis of late 2008 as crude oil collapsed and yen carry trades were unwound simultaneously, and then the correlations shifted to strongly negative levels in mid-2009. The yen often is a special case, and this is no exception: If someone approached the issue of the relationship between currencies and crude oil from a yen-first rather than a Euro-first perspective, the issue would have been over and done with quickly.

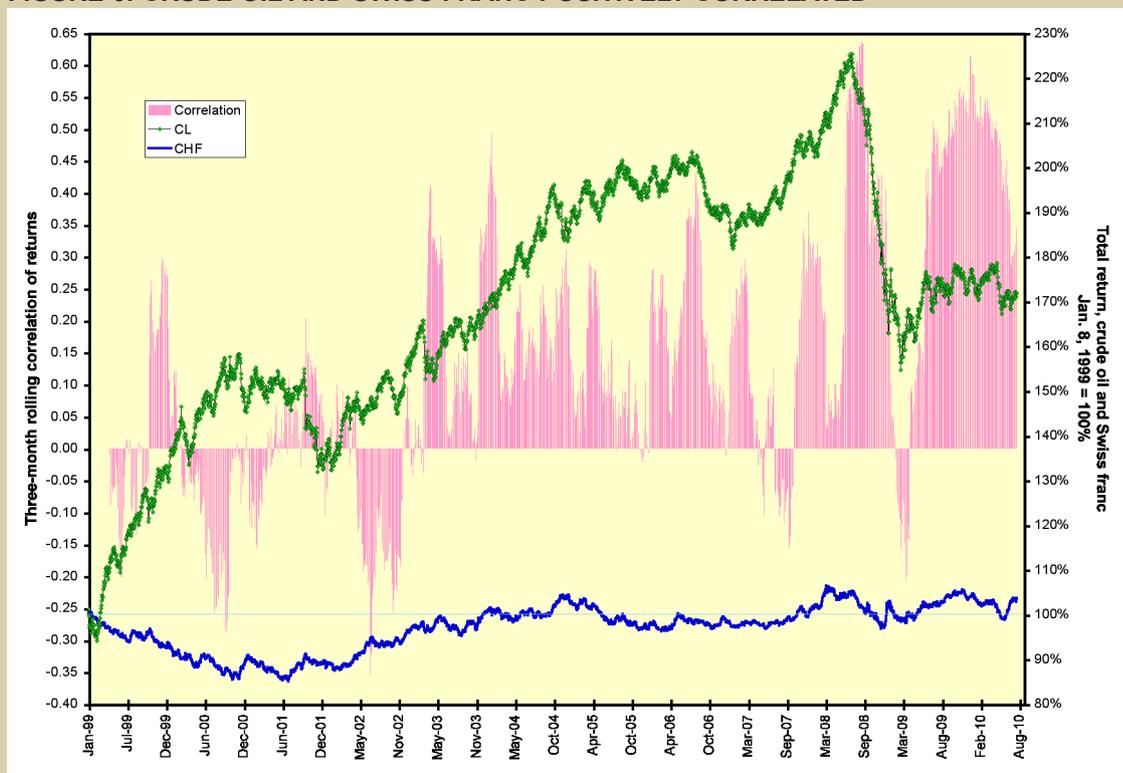
The British pound, which has an 11.9 percent weight in the dollar index, has a correlation history that looks like a variation on the Euro's (Figure 3). Its correlation of returns against crude oil did not turn consistently positive until the financial crisis began in August 2007. This is when the Federal Reserve began its rate-cut adventure and the price of crude oil began its 10-month doubling adventure. Large sums of money strewn across the landscape can and do force changes in market behavior.

Of all the currencies, we should expect the Canadian dollar, which accounts for 9.1 percent of the dollar index, to have the strongest and most consistent correlations of returns against crude oil by virtue of Canada's large crude oil production base, and we are not disappointed (Figure 4). The only real exception here occurred when the CAD was weak against the dollar during 2000.

Finally we come to the two smallest components of the dollar index, the Swedish krona at 4.2 percent and the Swiss franc at 3.6 percent. Given the Swedish Riksbank's efforts to keep the SEK in a band against the EUR, we should expect to see the krona's correlation pattern resemble that of the Euro, and once again we are not disappointed (Figure 5).

The franc is different (see "The Swiss franc's commodity connection," October 2008). Switzerland is a money repository for crude oil exporters in Russia, North Africa, and

FIGURE 6: CRUDE OIL AND SWISS FRANC POSITIVELY CORRELATED



This function has shifted the franc's correlation of returns away from the Euro's in recent years.

the Middle East. One writer recalls walking by the Geneva offices of the Arab Bank of Switzerland with a suppressed grin; the "Don't ask, don't tell" policy was not invented by the Clinton administration in response to gays serving in the U.S. military. This function has shifted the franc's correlation of returns away from the Euro's in recent years (Figure 6).

We can summarize these relationships over in-sample log-log regressions of the return series as follows:

The r^2 values for the EUR and JPY are not very impressive and have betas with opposite signs. The small-weight SEK and CHF have insignificant r^2 's as well. Only the CAD has something approaching a consistent fit over time.

In all cases, however, the synopses are plagued by massive serial correlation in the residuals. This always indicates two things: First, the crude oil total return series is autoregressive or reliant on its own past values, and second, other explanatory variables are required. A stable Durbin-Watson statistic should be near 2.00; these DW statistics are all near zero.

We affirm the conclusion that the perceived link between crude oil and "the dollar" is a short-term artifact and not a long-term fundamental relationship. Of all the unusual intermarket relationships over the past decade, this one may be the easiest to explain where it works and easiest to debunk in those cases, such as for the yen, where it does not. ☒

For information on the author, see p. 4.

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Forex world adjusts to leverage “compromise”

BY CURRENCY TRADER STAFF

At the end of August, the Commodity Futures Trading Commission (CFTC) made a long-awaited announcement regarding the amount of leverage that would be allowed in the U.S. forex market. The verdict: Not as much of a limitation as many in the industry feared, but enough that some participants will likely still grumble. Leverage for the major currency pairs will be capped at 50:1, and 20:1 for all other pairs.

The “major” currency pair designation has traditionally applied to the Euro/U.S. dollar (EUR/USD), U.S. dollar/Japanese yen (USD/JPY), British pound/U.S. dollar (GBP/USD), U.S. dollar/Swiss franc (USD/CHF), and the Australian dollar/U.S. dollar (AUD/USD) pairs. The new rules charge the National Futures Association (NFA) with determining which currencies are “major currencies,” and require at least an annual review of these designations to potentially “adjust the designations and requirements as necessary in light of changes in the volatility of currencies and other economic and market factors.”

The CFTC released its final ruling on Aug. 30. The leverage rule was part of a larger slate of regulatory changes impacting various aspects of the retail off-exchange forex industry, including FX broker licensing and registration and minimum capitalization requirements for retail FX firms.

“These rules of the road will help protect the American public in the largest area of retail fraud that the CFTC oversees: retail foreign exchange,” CFTC Chairman Gary Gensler said in a press release on the organization’s website. “All CFTC registrants involved in soliciting and selling retail forex contracts to consumers will now have to comply with rules to protect the investing public. This is also the first final rule the Commission has published to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act. We look forward to publishing additional rules to protect the American public.”

The CFTC alarmed the forex community in January 2010 when it initially proposed rule changes for retail forex transactions, including limiting leverage to 10:1 — the equivalent of a 10-percent margin rate. The January proposal incited a flood of comments (9,100 according to the CFTC) from retail brokerages and traders, most of whom claimed limiting leverage to 10:1 would kill the U.S. forex market by sending business overseas, or at least onto futures exchanges.

Leverage in currency futures ranges from approximately 25:1 to 40:1, so although the new rules officially side-

stepped the spot industry’s fear it would be put at a competitive disadvantage to the futures market, the regulations nonetheless mean U.S. forex brokerages will come up short relative to overseas firms offering as much as 400:1 leverage.

While acknowledging the prevalence of comments from individual traders and brokerages about the threat of business migrating out of the U.S., the CFTC noted it “does not believe that most retail foreign exchange customers select a counterparty based solely on the maximum allowable leverage, otherwise these investors would have already migrated to foreign markets, some of which have no limitation on leverage.” Among the other factors the CFTC cited in making its decision were “futures exchange margin levels, [the] NFA’s current security deposit requirements, and comparable requirements found in other jurisdictions.” (Japan recently capped forex leverage at 50:1 and is scheduled to further reduce it to 25:1 next year.)

The announcement appeared to be met with relief by most in the forex industry. Under a headline reading “We’ve been ready for this” forex brokerage FXCM issued the following message from CEO Drew Niv: “We believe that the reduction in leverage is a reasonable compromise from the initial CFTC proposal of 10:1 leverage. FXCM does believe lower leverage will be to the benefit of traders as higher leverage can often times result in a few losing trades offsetting many winning trades,” he said. Niv also noted FXCM has already implemented 50:1 as the default margin setting on FXCM standard forex trading accounts.

The new rules will go into effect on Oct. 18. ☒



KEY CONCEPTS

Quantitative easing is a tool a central bank uses to attempt to stimulate the economy when cutting interest rates is not feasible — such as when rates are already at or near zero. Through quantitative easing, the central bank purchases assets (e.g., treasuries, mortgages, securities) from financial institutions to pump money into the financial system. Quantitative easing is often referred to as “printing money.” Critics contend the practice runs a high risk of creating high inflation, among other drawbacks. ☒



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).

Market	Sym	Exch	Vol	OI	10-day move / rank	20-day move / rank	60-day move / rank	Volatility ratio / rank
EUR/USD	EC	CME	310.3	199.9	4.88% / 82%	7.70% / 100%	8.03% / 93%	.54 / 97%
JPY/USD	JY	CME	132.7	123.1	2.38% / 100%	0.61% / 11%	4.55% / 16%	.28 / 65%
GBP/USD	BP	CME	108.1	104.6	1.12% / 25%	2.95% / 53%	4.22% / 33%	.21 / 30%
AUD/USD	AD	CME	86.4	113.7	3.59% / 68%	8.47% / 98%	14.13% / 97%	.31 / 65%
CAD/USD	CD	CME	81.9	86.2	-0.30% / 20%	3.39% / 97%	2.30% / 45%	.18 / 2%
CHF/USD	SF	CME	40.6	52.8	2.76% / 80%	4.10% / 59%	8.38% / 47%	.28 / 90%
MXN/USD	MP	CME	27.8	87.4	2.52% / 71%	5.28% / 100%	3.79% / 50%	.70 / 97%
U.S. dollar index	DX	ICE	20.6	25.0	-3.48% / 94%	-4.41% / 88%	-6.11% / 81%	.40 / 98%
NZD/USD	NE	CME	8.3	22.4	1.21% / 39%	5.55% / 88%	6.65% / 93%	.26 / 27%
E-Mini EUR/USD	ZE	CME	4.1	3.4	4.88% / 82%	7.70% / 100%	8.03% / 93%	.54 / 97%

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.

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 (as of 8/31/10, ranked by August 2010 return)

Top 10 currency traders managing more than \$10 million

	Trading Advisor	August Return	2010 YTD Return	\$ Under Mgmt. (Millions)
1.	Highland Stone Capital (HSC Fund)	7.42%	49.91%	229.4
2.	24FX Management Ltd	4.90%	32.81%	31.7
3.	Excalibur Absolute Return Fund	2.52%	10.59%	45.4
4.	QFS Asset Mgmt (QFS Currency)	2.38%	6.69%	689.0
5.	Auriel Currency 2X Fund	2.33%	-1.18%	171.0
6.	Premium Currency (Curr. Plus)	2.08%	-1.61%	135.3
7.	Capricorn Advisory Mgmt (fxST VOL+)	2.07%	11.66%	52.0
8.	Sunrise Cap'I Partners (Cur. Fund)	2.03%	-4.88%	18.7
9.	Ortus Capital Mgmt. (Currency)	1.92%	15.24%	1452.0
10.	Gables Capital Mgmt (Global FX)	1.87%	9.99%	15.7

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

1.	D2W Capital Mgmt (Radical Wealth)	7.40%	94.27%	1.2
2.	Vaskas Capital Mgmt (Global FX)	6.82%	-6.04%	3.6
3.	Sagacity (HedgeFX100)	4.44%	-9.51%	1.1
4.	Rove Capital (Dresden)	3.11%	5.32%	2.2
5.	BEAM (FX Prop)	2.79%	6.83%	1.7
6.	M2 Global Mgmt (2.5X)	2.33%	2.33%	2.5
7.	GTA Group (FX Trading)	1.50%	20.35%	1.4
8.	Wealth Builder FX Group	1.40%	-3.70%	3.2
9.	Quant Trading (FX Quant 11)	0.63%	-1.86%	4.8
10.	Marek D. Chelkowski (Forex)	0.18%	-0.66%	4.5

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	Sept. 27 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	Swedish krona	0.14672	9.90%	13.62%	6.41%	0.148	0.1227	16
2	Australian Dollar	0.95911	8.06%	9.75%	5.81%	0.9619	0.8069	12
3	Euro	1.349145	6.15%	9.07%	0.82%	1.5144	1.1891	14
4	Swiss franc	1.01766	4.50%	11.07%	8.67%	1.0228	0.853	3
5	New Zealand dollar	0.734055	4.26%	2.83%	4.12%	0.7635	0.6561	17
6	South African rand	0.14246	4.25%	8.61%	6.06%	0.1432	0.1204	4
7	Canadian dollar	0.976425	3.13%	1.08%	0.20%	1.0068	0.9094	15
8	Brazilian real	0.584165	2.87%	3.92%	6.40%	0.5882	0.5076	6
9	Singapore dollar	0.756405	2.55%	4.90%	6.22%	0.7571	0.702	5
10	Indian rupee	0.02189	2.46%	1.77%	-0.97%	0.02263	0.02045	7
11	Taiwan dollar	0.0318	1.89%	2.40%	1.40%	0.03201	0.03056	9
12	Great Britain pound	1.58254	1.82%	5.09%	6.40%	1.6877	1.4235	8
13	Chinese yuan	0.149165	1.43%	1.31%	1.84%	0.149165	0.146	11
14	Thai baht	0.032259	1.19%	4.48%	4.52%	0.03267	0.02932	2
15	Japanese yen	0.011875	0.47%	5.98%	9.90%	0.01206	0.01053	1
16	Hong Kong dollar	0.128915	0.26%	0.26%	0.07%	0.129	0.1281	10
17	Russian ruble	0.03255	0.18%	0.74%	-3.71%	0.03497	0.03077	13



GLOBAL STOCK INDICES

	Country	Index	Sept. 27	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	India	BSE 30	20,117.38	11.77%	13.18%	13.58%	20,267.98	15,330.60	2
2	Hong Kong	Hang Seng	22,340.84	8.46%	7.79%	5.20%	23,099.60	18,971.50	6
3	South Africa	FTSE/JSE All Share	28,959.42	8.30%	6.12%	0.88%	29,054.40	24,910.85	14
4	France	CAC 40	3,766.16	7.38%	5.30%	-5.86%	4,088.18	3,287.57	11
5	U.S.	S&P 500	1,142.16	7.29%	6.29%	-2.65%	1,219.80	1,010.91	12
6	Australia	All ordinaries	4,722.20	7.22%	7.09%	-3.77%	5,048.60	4,194.40	7
7	UK	FTSE 100	5,573.40	7.15%	9.89%	-2.40%	5,833.70	4,790.00	9
8	Japan	Nikkei 225	9,603.14	6.81%	-0.94%	-12.59%	11,408.20	8,796.45	13
9	Singapore	Straits Times	3,113.46	5.95%	8.48%	6.29%	3,125.38	2,576.84	3
10	Germany	Xetra Dax	6,278.89	5.51%	1.98%	1.98%	6,386.90	5,312.64	10
11	Brazil	Bovespa	68,816.00	4.93%	7.15%	-1.61%	71,989.00	57,634.00	5
12	Mexico	IPC	33,122.44	4.31%	1.70%	-0.88%	34,223.90	28,063.70	8
13	Italy	FTSE MIB	20,593.94	3.92%	2.30%	-10.87%	24,559	18,045	15
14	Canada	S&P/TSX composite	12,190.60	2.62%	5.03%	1.34%	12,321.80	10,745.20	1
15	Switzerland	Swiss Market	6,338.90	2.52%	0.44%	-7.47%	6,990.70	5,935.00	4

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	Sept. 27	1-month gain/loss	3-month gain/loss	6-month gain loss	52-week high	52-week low	Previous
1	Aussie \$ / Yen	AUD/JPY	80.775	7.55%	3.59%	-3.73%	88.048	72.0981	17
2	Euro / Yen	EUR/JPY	113.62	5.66%	2.95%	-8.26%	138.473	105.404	19
3	Aussie \$ / Real	AUD/BRL	1.641855	5.05%	5.61%	-0.56%	1.6978	1.4954	10
4	Aussie \$ / Canada \$	AUD/CAD	0.98227	4.78%	8.58%	5.59%	0.9895	0.8643	6
5	Euro / Pound	EUR/GBP	0.85253	4.26%	3.71%	-5.24%	0.9411	0.8065	12
6	Franc / Yen	CHF/JPY	85.705	4.03%	4.97%	-0.98%	91.549	76.36	9
7	New Zeal \$ / Yen	NZD/JPY	61.82	3.78%	-2.94%	-5.26%	69.5573	58.9096	21
8	Aussie \$ / New Zeal \$	AUD/NZD	1.30658	3.66%	6.72%	1.62%	1.3233	1.1931	4
9	Aussie \$ / Franc	AUD/CHF	0.94247	3.41%	-1.18%	-2.64%	1.0079	0.8928	16
10	Euro / Real	EUR/BRL	2.309535	3.19%	4.95%	-5.24%	2.7189	2.1772	13
11	Euro / Canada \$	EUR/CAD	1.381725	2.93%	7.90%	0.62%	1.6041	1.2502	7
12	Canada \$ / Yen	CAD/JPY	82.235	2.67%	-4.59%	-8.82%	94.1955	79.2786	20
13	Euro / Franc	EUR/CHF	1.32611	1.80%	-1.90%	-7.20%	1.5238	1.2763	18
14	Pound / Yen	GBP/JPY	133.27	1.35%	-0.86%	-3.18%	153.23	127.065	14
15	Franc / Canada \$	CHF/CAD	1.042225	1.33%	9.87%	8.45%	1.0629	0.8989	1
16	Canada \$ / Real	CAD/BRL	1.671495	0.25%	-2.73%	-5.82%	1.8244	1.6003	15
17	Pound / Canada \$	GBP/CAD	1.620755	-1.27%	3.96%	6.19%	1.7882	1.4894	3
18	Euro / Aussie \$	EUR/AUD	1.40668	-1.77%	-0.61%	-4.53%	1.6998	1.3633	8
19	Yen / Real	JPY/BRL	0.020325	-2.38%	1.93%	3.28%	0.02127	0.01838	2
20	Pound / Franc	GBP/CHF	1.555065	-2.57%	-5.53%	-2.09%	1.7112	1.5372	11
21	Pound / Aussie \$	GBP/AUD	1.65001	-5.78%	-4.25%	0.56%	1.8459	1.6328	5

GLOBAL CENTRAL BANK LENDING RATES

Country	Interest Rate	Rate	Last change	March-10	Sept-09
United States	Fed funds rate	0-0.25	0.5 (Dec. 08)	0-0.25	0-0.25
Japan	Overnight call rate	0.1	0.2 (Dec. 08)	0.1	0.1
Eurozone	Refi rate	1	0.25 (May 09)	1	1
England	Repo rate	0.5	0.5 (March 09)	0.5	0.5
Canada	Overnight funding rate	1	0.25 (Sept 10)	0.25	0.25
Switzerland	3-month Swiss Libor	0.25	0.25 (March 09)	0.25	0.25
Australia	Cash rate	4.5	0.25 (May 10)	4	3
New Zealand	Cash rate	3	0.25 (July 10)	2.5	2.5
Brazil	Selic rate	9.5	0.75 (April 10)	8.75	8.75
Korea	Overnight call rate	2	0.5 (Feb. 09)	2	2
Taiwan	Discount rate	1.25	0.25 (Feb. 09)	1.25	1.25
India	Repo rate	6	0.25 (Sept 10)	5	4.75
South Africa	Repurchase rate	6.5	0.5 (Mar. 10)	7	7



Unemployment		Period	Release date	Rate	Change	1-year change	Next release
AMERICAS	Argentina	Q2	8/23	7.9%	-0.4%	-0.9%	11/22
	Brazil	Aug.	9/23	6.7%	-0.2%	-1.4%	10/21
	Canada	Aug.	9/10	8.1%	0.1%	-0.6%	10/8
EUROPE	France	Q2	9/2	9.3%	-0.2%	0.2%	12/2
	Germany	Aug.	9/30	6.8%	-0.1%	-0.8%	10/28
	UK	May-July	9/15	7.8%	-0.1%	-0.1%	11/17
ASIA and S. PACIFIC	Australia	Aug.	9/9	5.2%	0.0%	-0.6%	10/7
	Hong Kong	June-Aug.	9/16	4.2%	-0.1%	-1.3%	10/19
	Japan	July	8/27	5.2%	-0.1%	-0.4%	10/1
	Singapore	Q2	7/30	2.3%	0.1%	-0.9%	10/29

GDP		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Q2	9/17	23.9%	12.8%	12/17
	Brazil	Q2	9/3	1.2%	9.0%	12/9
	Canada	Q2	8/31	0.7%	6.7%	11/30
EUROPE	France	Q2	8/13	0.7%	6.7%	11/30
	Germany	Q2	8/13	2.3%	4.9%	11/12
	UK	Q2	9/28	1.4%	5.8%	12/22
AFRICA	S. Africa	Q2	8/24	-4.4%	-4.7%	11/30
ASIA and S. PACIFIC	Australia	Q2	9/1	0.9%	3.2%	12/1
	Hong Kong	Q2	8/13	0.4%	6.5%	11/12
	India	Q2	8/31	19.1%	8.8%	11/30
	Japan	Q2	8/16	0.1%	0.4%	11/15
	Singapore	Q2	8/27	7.8%	18.8%	NLT 11/26

CPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	Aug.	9/15	7.6%	11.1%	10/15
	Brazil	Aug.	9/9	0.0%	3.1%	10/7
	Canada	Aug.	9/21	-0.1%	1.7%	10/22
EUROPE	France	Aug.	9/14	0.2%	1.4%	10/13
	Germany	Aug.	9/9	0.0%	1.0%	10/12
	UK	Aug.	9/14	0.5%	3.1%	10/12
AFRICA	S. Africa	Aug.	9/29	0.1%	3.5%	10/27
ASIA and S. PACIFIC	Australia	Q2	7/28	0.6%	3.1%	10/27
	Hong Kong	Aug.	9/21	-0.1%	3.0%	10/21
	India	Aug.	9/30	0.0%	9.9%	10/29
	Japan	July	8/27	-0.5%	-0.9%	10/1
	Singapore	Aug.	9/23	0.5%	3.3%	10/25

PPI		Period	Release date	Change	1-year change	Next release
AMERICAS	Argentina	July	9/3	0.8%	15.1%	10/15
	Canada	Aug.	9/29	0.4%	0.6%	10/29
EUROPE	France	Aug.	9/30	0.1%	3.5%	9/30
	Germany	Aug.	9/17	0.0%	3.2%	10/20
	UK	Aug.	9/10	0.0%	4.7%	10/8
AFRICA	S. Africa	Aug.	9/30	0.4%	7.8%	10/28
ASIA and S. PACIFIC	Australia	Q2	7/26	0.3%	1.0%	10/25
	Hong Kong	Q3	9/13	2.1%	5.9%	12/13
	India	July	9/14	0.6%	10.0%	10/14
	Japan	Aug.	9/10	0.0%	0.0%	10/14
	Singapore	Aug.	9/29	-0.1%	-1.5%	10/29

As of Sept. 30, 2010 LEGEND: Change: Change from previous report release. NLT: No later than. Rate: Unemployment rate.



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.

October 2010

26	27	28	29	30	1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31	1	2	3	4	5	6

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

1 U.S.: September ISM manufacturing report and August personal income
Japan: August employment report and CPI

2

3

4

5 Japan: Bank of Japan interest-rate announcement

6

7 Australia: September employment report

Brazil: September CPI

Mexico: September PPI and Sept. 30 CPI

ECB: Governing council interest-rate announcement

8 U.S.: September employment report

Brazil: September PPI

Canada: September employment report

UK: September PPI

LTD: October U.S. dollar index (ICE)

9

10

11

12 Germany: September CPI

UK: September CPI

13 France: September CPI

14 U.S.: September PPI and August trade balance

India: September PPI

Japan: September PPI

15

16

17

18

19 U.S.: September housing starts

Canada: Bank of Canada interest-rate announcement

Hong Kong: July-September employment report

20 U.S.: Fed beige book

Germany: September PPI

21 U.S.: September leading indicators

Brazil: September employment report

Hong Kong: September CPI

22 Canada: September CPI

Mexico: September employment report and Oct. 15 CPI

23

24

25 Australia: Q3 PPI

26

27 U.S.: September durable goods

Australia: Q3 CPI

South Africa: September CPI

28 France: September PPI

Germany: September employment report

South Africa: September PPI

29 U.S.: Q3 GDP (advance)

Canada: September PPI

India: September CPI

Japan: September employment report and CPI

30

31

November

1 U.S.: September personal income and October ISM manufacturing report

2

3 U.S.: FOMC interest-rate decision

4

5 U.S.: October employment report
LTD: November U.S. dollar index (ICE)



Event: Bollinger Bands Seminar
Date: Oct. 9-10
Location: Sheraton Gateway Hotel at LAX, Los Angeles
For more information:
<http://bollingerbands.com/seminar/>

Event: The First Qatar Traders Expo
Date: Oct. 17-18
Location: J.W. Marriott, Qatar
For more information: www.mettradersexpo.com

Event: CME Group's Global Financial Leadership Conference
Date: Oct. 18-20
Location: Ritz-Carlton Beach Resort, Naples, Fla.
For more information: www.gflc.com

Event: FXstreet.com International Traders Conference
Date: Oct. 20-22
Location: Barcelona, Spain
For more information: www.traders-conference.com

Event: Sydney Trading & Investing Seminars & Expo
Date: Oct. 29-30
Location: Sydney
For more information:
www.tradingandinvestingexpo.com.au

Event: Third Annual Inside Commodities Conference
Date: Nov. 4
Location: New York Stock Exchange
For more information: Go to www.insidecommoditiesconference.com/br

Event: Las Vegas Traders Expo
Date: Nov. 17-20
Location: Caesars Palace, Las Vegas
For more information: Go to www.moneyshow.com

Event: 2011 CBOE Risk Management Conference
Date: Feb. 27–March 1
Location: St. Regis Monarch Beach resort in Dana Point, Calif.
For more information: Go to www.cboeRMC.com

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