Strategies, News, and Analysis for FX Traders

CURRENCY TRADER

December 2006
Volume 3, No. 12

BREAKOUT! DOLLAR DIVE kicks currencies into gear p. 34

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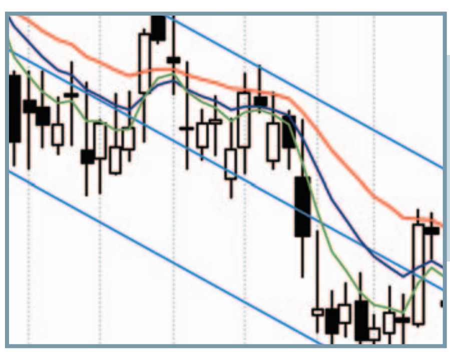

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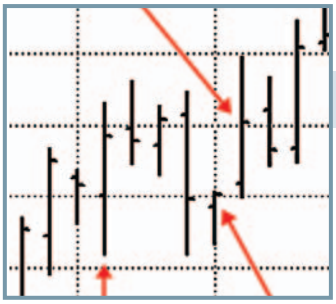

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More where that came from

I found the article "Breaking down the euro" in the November issue very useful. Where can I get similar data on other currency pairs?

–Ole C.G. Olesen
Cyprus

We are planning a series of similar articles on different currency pairs in the upcoming issues of Currency Trader*. The euro article was the first in the series, and this month's issue looks at the euro/yen.*

CMO 0?

I'm interested in the Intraday CMO-FX system tested in the November 2006 issue (Currency System Analysis, p. 26). The rules state to exit the trade if CMO hits +50. On the chart, however, the systems seems to exit when the indicator reaches zero. Can you clear this up for me?

–R. Elia

The system has two exit rules in addition to the rule to exit on a CMO move above +50: Exit after 20 bars if price is below the entry price and exit with a profit of 0.2 percent. The latter rule is the one that appears to coincide with the CMO crossing the zero line.

Big bad Ben

I have some questions about the article "Day trading the FX market: A different approach to the pound" by Kristian Kerr (*Active Trader*, June 2004).

Take a look at Figure 2 ("Big Ben"). I can't see the beginning and the end of the "range" I should be using to reference the first price move. Also, which time frame should be used for the second rule? Does this strategy work on the opposite side of the market? What trailing stop should I take after covering half the position?

–Enn Be

The "range" in question is the range established by the pound/dollar (GBP/USD) after the London/Frankfurt open (1 a.m. ET). The rules simply state price should first move 0.0025 points below that opening price, then 0.0025 points above that opening price.

The time frame is not relevant, although an intraday chart makes monitoring the price action much easier. In the article, a five-minute chart was used. A two-minute, one-minute, or 10-minute chart (and so on) chart could also be used. As far as the time period, the trade is designed for the price action occurring in the first few hours after the London/Frankfurt open.

Finally, in the article, the author writes the "rules are for short trades, but the strategy can be reversed to trade the long side." He does not mention a specific trailing stop size, though. Additional exit or stop techniques are something to experiment with when testing this trading approach.

Slowdown in the Eurozone?

Sluggish growth and potentially counterproductive tax policies may weigh on the Eurozone in 2007. What does it mean for the continent's range-bound major currencies?

BY CURRENCY TRADER STAFF

A mixture of higher taxes, higher interest rates, and slower global growth may congeal into lower growth figures for the Eurozone in 2007. The European Central Bank (ECB) and the Bank of England (BOE) have tightened monetary policy recently, and it remains to be seen whether this tightening will ultimately weigh on economic growth over the next year.

Another issue on the horizon is the largest post-war tax hike in Germany. In January, Deutschland's value-adds-tax (VAT) will jump 3 percent, from 16 to 19 percent. Concerns are rampant within the economic community the tax hike will dampen already sluggish growth prospects.

While the euro (EUR/USD) has been locked within a frustratingly consistent range between $1.29 and $1.24 from mid-May through late-November (Figure 1), the British pound (GBP/USD) has also been range-bound, but much more volatile (Figure 2). Let's take a look at the underlying economics, interest-rate scenarios, and other factors that could affect forex action over the near to intermediate term.

Europe getting the finger(s)?

"We are looking for a slowdown in euro-land — we think the economy is grinding to a halt," says Carl Weinberg, chief economist at High Frequency Economics. "It is suffering under the five fingers of death. Let's look at how to kill an economy: raise taxes and raise interest rates."

Weinberg's other "fingers of death" for euro-land include the high price of the euro, which ultimately makes Eurozone exports more expensive around the globe (and is bad for the trade balance), a slowdown in the U.S. economy, and enlargement of the Eurozone.

Then there's that 3-percent sales tax increase that becomes effective Jan. 1 in Germany.

"The authorities intend to use part [of it] to cut labor costs for employers," says Paul Guest, chief European economist at Moody's Economy.com. "The tax hike will be a short-term negative for the German economy, as it will depress already lackluster household spending during the early part of next year."

But is it a healthy step, longer-term?

"This is one measure the German government put into place in order to get fiscal balance back into place," says Naomi Fink, senior currency analyst at BNP Paribas. "They've done this because Germany and Europe as a whole are recovering and they thought they could raise taxes without too adverse an effect on consumption."

However, this is a tax that directly affects consumers. Fink mentions an economic concept, called the "Ricardian effect," which describes the relationship between fiscal policy and consumption.

"If you are in a situation where consumer sentiment is healthy and you raise taxes — and the tax hike is well-anticipated — [the "Ricardian effect"] can fuel an acceleration of consumption ahead of implementation," Fink explains.

Some economists say this has already happened in Germany, with consumers beefing up purchases in the sec-

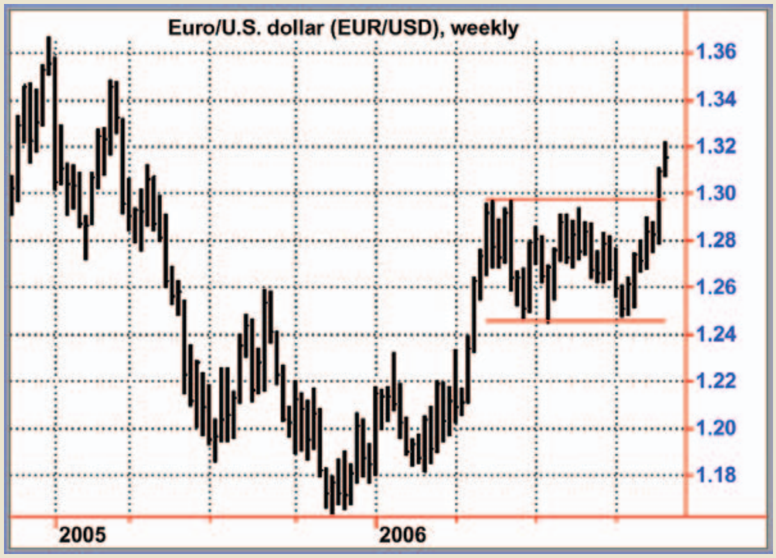
EUROPE AT A GLANCE

	EUR/USD	GBP/USD	USD/CHF	EUR/JPY
Average daily range (past 40 days)	0.0073	0.0113	0.0088	0.66
Average weekly range (past 26 weeks)	0.0199	0.0326	0.0226	1.81
52-week high/low	1.3347/1.1687	1.9874/1.7128	1.3236/1.1898	154.08/137.11
	EU	**UK**	**SW**	**US**
Prevailing interest rates (%)	3.25	5.25	1.75	5.25
Next central bank meetings	12/7, 1/11	12/7, 1/11	12/14	12/12
GDP — Q3 2006	**EU** / **UK**	**SW** / **US**		
	2.6 / 2.7	0.4 / 2.2		

All data as of Dec. 1

FIGURE 1 — EURO RANGE AND BREAKOUT

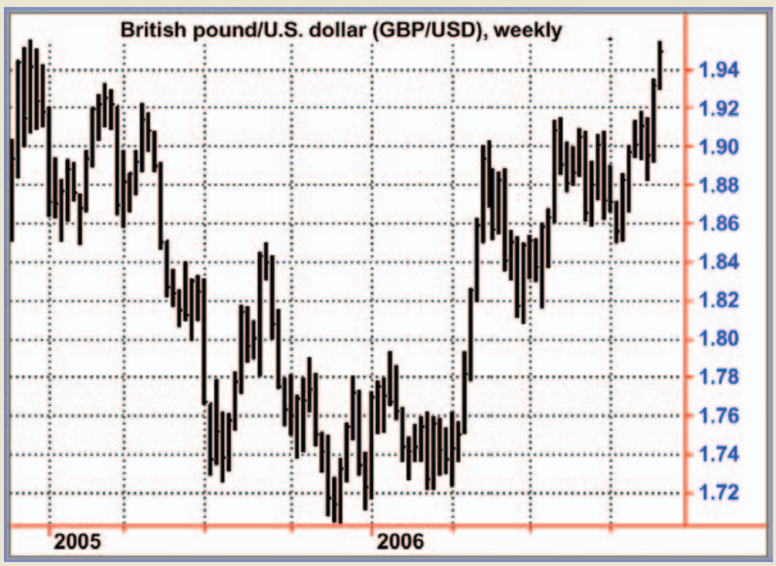
Until the recent breakout, the EUR/USD rate had been stuck in a range between $1.29 and $1.24 from mid-May through mid-November.



Source: TradeStation

FIGURE 2 — CHOPPY POUND

Like the euro, the British pound (GBP/USD) had also been in a range for much of the year, but a more volatile one with more of an upside bias.



Source: TradeStation

ond half of 2006 in an attempt to beat the tax increase. However, while it may provide a boost to gross domestic product (GDP) in the tail end of 2006, it equally should weigh on consumption and overall GDP readings in 2007, or so the theory goes.

BNP Paribas economists have attempted to quantify the actual impact of the VAT tax increase on GDP growth. Fourth-quarter 2006 German GDP growth is estimated at 3.2 percent year-over-year; without the VAT hike, BNP Paribas economists say it would have been only 3 percent. In 2007, BNP expects German GDP first-quarter growth at a 2.2-percent annual pace and to reach a trough at 0.7 percent in Q3 on an annualized basis. By third quarter 2007, they expect effects from the VAT hike to trickle into Eurozone GDP data, with a 1.1-percent reading vs. a 1.3-percent figure without the VAT hike.

"The hike is expected to lob 0.1 percent off fourth-quarter GDP next year, with a forecast for a 0.9 percent increase year-over-year," Fink says.

Looking at overall GDP forecasts Moody's Economy.com's Guest forecasts a 1.8-percent GDP reading for the Eurozone for 2007, compared to about 2.4 percent in 2006.

Hiking mode

The ECB has been in rate-hiking mode, having pushed up the repo rate up .25 basis points to 3.25 percent at its early October meeting. Forex traders and analysts widely expect the ECB to pull the trigger on another rate hike at its Dec. 7 meeting, bringing the rate to 3.50 percent by year-end — a scenario many market watchers say is already priced into the market.

"The ECB is raising interest rates back into a neutral range, where policy is neither adding to nor holding back growth," Guest explains.

The following meeting is Jan. 11. Along with other market watchers, Guest agrees the ECB will hike again Dec. 7. Beyond that, however, expectations are less certain.

"We expect one more quarter-point hike from the ECB by May of next year," he explains. "There will likely be a slight pause at the start of 2007 in order to assess the impact of the VAT hike."

Britannia Est Insula

Britain stands apart — the way they like it. For better or worse, Britain is an island, and its entrance into the EMU is not even a distant speck on the horizon. Analysts point to an overall solid domestic picture, a hawkish central bank and foreign reserve diversification into the pound as underlying supportive factors for the currency over the near and intermediate term.

In early November, the Bank of England (BOE) raised rates 25 basis points, pushing the base rate to 5 percent for the first time in five years. With the next meeting fast approaching on Dec. 7, market watchers expect the BOE to stand pat for now. The next meeting is scheduled for Jan. 11.

Guest forecasts a slowdown in Britain's real GDP growth

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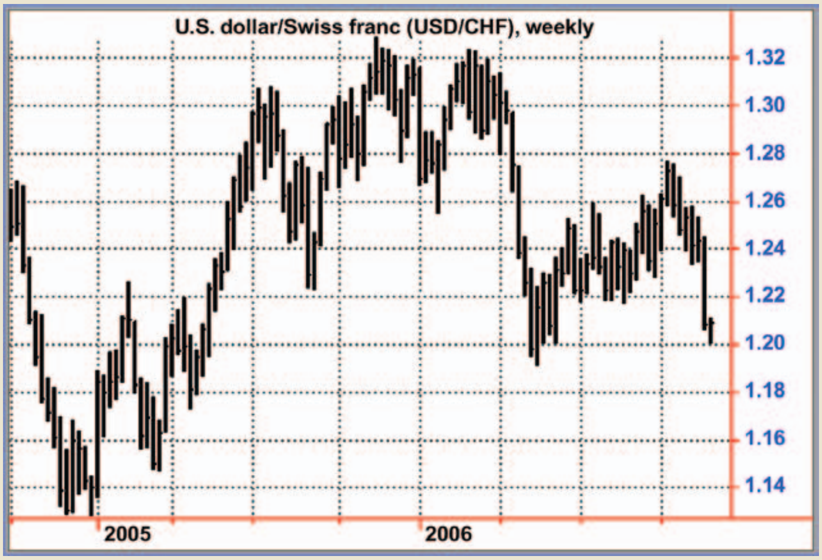
FIGURE 3 — DOLLAR/SWISS

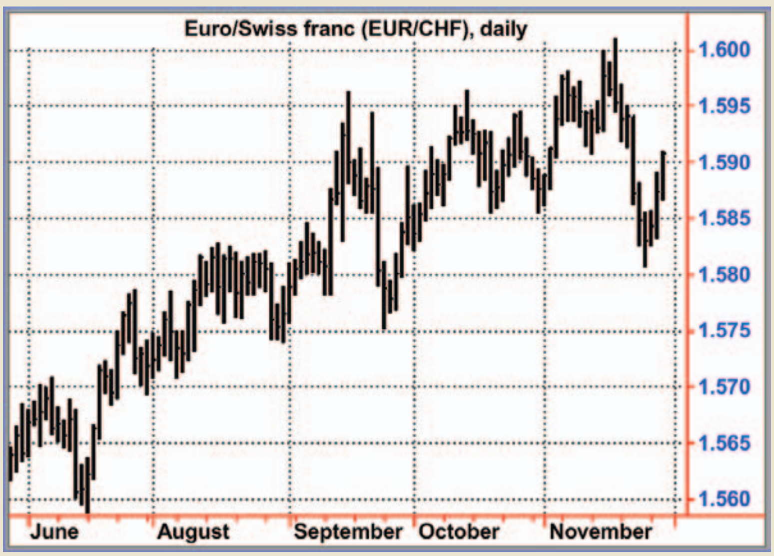
The dollar/Swiss rate sold off in spring, then rose slowly until October, when it turned lower again.



Source: TradeStation

FIGURE 4 — EURO/SWISS

When forex traders want to focus on the Swiss economy and currency, they favor the euro/Swiss rate. Throughout 2006, euro/Swiss strengthened as the euro gained vs. the Swiss franc. The pair dropped sharply in late November, then rebounded a little.



Source: TradeStation

in 2007 to 2.0 percent, down from 2.4 percent in 2006. However, Guest actually sees potential for stronger-than-expected performance in some aspects of the UK economy.

"Income growth is the main uncertainty," he says. "Our forecast is conservative and events in the housing market could lead to more rapid household income growth that we currently foresee."

Overall, Guest believes the UK's medium-term prospects are sound.

"The recovery is a question of pace, not direction, although we do believe the speed of growth will flatten next year as private consumption growth remains slow," he adds. "If an unexpected downturn occurs, the central bank has some room to lower interest rates in order to boost domestic growth."

Regarding both the Eurozone and Britain, David Solin, partner at Foreign Exchange Analytics notes, "You go through these periods where all the economies line up. The economies in Britain and the Eurozone have picked up and they are both in tightening modes. That puts the currencies on a seemingly similar glide path.

"Through year-end, you should still see the same type of movement [for the euro and the pound] — swinging back and forth within the ranges," he adds.

Pound for pound

Despite its volatility throughout 2006, the pound has actually posted a healthy rally. From the January low around $1.71, the pound soared to a high around $1.91 in early November. Expectations of the August 2006 BOE rate hike were a factor propelling the currency higher mid-year, along with stronger-than-expected economic growth readings.

"A more-rapid-than-anticipated rebound in the housing market and the turnaround in manufacturing all played a role in boosting the economic fundamentals for the UK," Guest says. "This in turn supported the rationale for rate hikes and boosted the yield appeal of the pound."

Most analysts see strong resistance around $1.91, with potential for modest weakness into 2007.

"The major leg of the rally in sterling has already occurred," says Charmaine Buskas, economist at Moody's Economy.com. "This is just the tail end of the rally. At best, the BOE has one more rate hike, but most likely not."

Solin looked at the technical aspects of recent sterling trade and identified resistance around $1.93 and support at $1.8650.

"It looks like a rising wedge to me," he says.

For the euro, Solin identifies resistance at $1.29 and support at $1.24, which could easily confine trade for the next several months, he adds.

The forgotten currency

Historically, dollar/Swiss (USD/CHF) was sought out as a safe place to dump assets during times of war, international turmoil, or inflation uncertainty.

However, this role appears to have diminished. During the emerging markets sell-off that hit global markets in May, "the Swiss franc seemed to lose its safe-haven bid," says David Powell, currency analyst at Ideaglobal. "Many have said that relationship no longer holds."

A weekly chart of the dollar/Swiss (Figure 3), shows an almost identical (though inverse) picture of weekly action of the euro/dollar. The dollar/Swiss sold off from March through May, tumbling from $1.32 to $1.19, but has been consolidating within a rising channel. Short-term resistance is apparent at the mid-October peak at $1.27 and support at the late-September low at $1.22.

Dollar/Swiss and euro/dollar generally trade inversely because the Eurozone and Swiss economies are closely correlated. When forex traders want to zero in on the Swiss economy and currency, they favor the euro/Swiss rate (EUR/CHF), which was trading around 1.59 in mid-November. Throughout 2006, euro/Swiss strengthened as the euro gained vs. the Swiss franc (Figure 4).

Interest-rate differentials clearly favored the euro for much of 2006, with the ECB rate currently at 3.25 percent and the Swiss National Bank's (SNB) key interest rate at 1.75 percent. While growth differentials favored the Swiss franc in 2006, forex players focus more on the interest-rate comparison. The latest GDP data comparison reveals a second-quarter 3.2-percent year-over-year gain for Switzerland vs. a 2.7-percent reading for the Eurozone.

A major factor depressing EUR/CHF has been the popularity of hedge funds and other major global players utilizing the franc as a financing currency.

"Switzerland has the second-lowest interest rate in the G-10 after Japan," Powell notes. "The last Commitment of Traders data revealed the short position in Swiss franc [futures] had actually surpassed that of the yen."

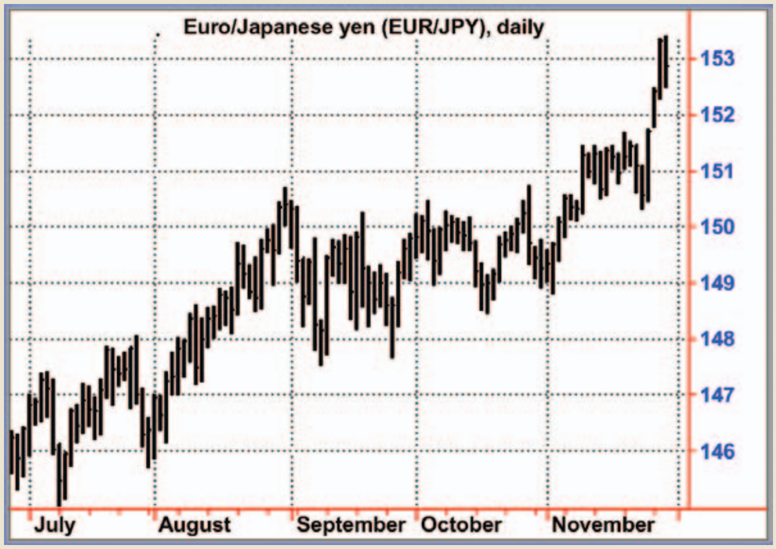
Hedge funds and other large players have been actively shorting the Swiss franc and buying higher-yielding currencies to profit on the carry (or positive interest-rate differential gained).

Although both the ECB and the SNB are expected to hike rates at their December meetings, the pace of ECB tightening is still perceived as faster, which should continue to support euro/Swiss strength into early 2007. The SNB meets next on Dec. 14 and market players widely expect a 25-basis-point hike.

Ideaglobal targets euro/Swiss gains to 1.60 at year end and 1.62 by the end of the first quarter. Dollar/Swiss is seen at $1.2550 by year-end and $1.2440 by the end of the first quarter.

FIGURE 5 — EURO/YEN TOPPY?

The Euro/yen has been hot in recent months, pushing to consolidating around the 151.48 before breaking out to the upside.



Source: TradeStation

Other cross rates

Euro/yen (Figure 5) has been hot in recent months, pushing to new all-time highs into mid-November around 151.48.

"Many trades cross as a proxy for Europe/Asia as a whole," BNP Paribas' Fink explains.

Rising ECB rates vs. a slow-to-act Bank of Japan has augmented the euro's appeal in that cross rate, analysts say. However, Fink sees limited upside from current levels.

"It should top out at 153.00 in the first quarter 2007," she says, noting the ECB will pull in the reins on additional rate hikes in 2007 once the signs of slower global growth emerge. She forecasted a retreat around 145.00 into the second quarter.

"Euro/yen is getting a little tired. I'd be leery of getting too bullish on it," Solin agrees.

Keep an eye on...

Central bank reserve diversification may top currency traders' items of hot issues to monitor into 2007. Central banks have begun to diversify away from U.S. dollar assets and into currencies such as the euro and pound.

In early November, the Chinese central bank governor Zhou Xiaochuan said the country plans to diversify its $1 trillion of foreign exchange reserves, which is the world's largest forex reserve. His comments triggered immediate bearish reactions in the U.S. dollar and U.S. bond markets when they were released.

"Over the second half of 2006 there has been a long stream of central bank officials talking about how they will diversify their portfolios," Buskas says. "It has run the gamut from the Italians to Middle East central banks and, most recently, the Chinese central bank.

"If we continue to see that kind of talk, it might become the dominant play in 2007. The yield play has run its course and, increasingly, the diversification story will be the top driver for the FX market in 2007."

Charts
are not enough

Price movement can be meaningless noise if you don't understand the fundamental context in which it occurs.

BY BARBARA ROCKEFELLER

Nearly every trader today uses charts to make trading decisions, and by now practically everyone knows how to identify a breakout, measure overbought and oversold conditions, and recite the names of different candlestick patterns. In fact, chart reading is getting harder all the time because there is rarely a clear consensus among signals. Most of the time, they are mixed.

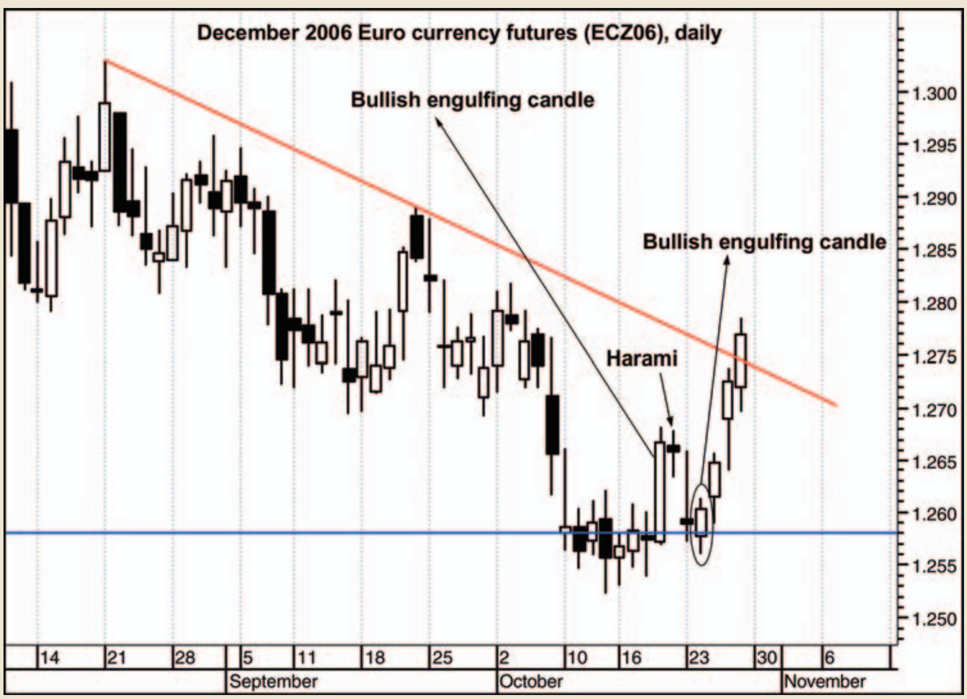
The proliferation of chart-reading techniques and the resulting contradictory readings may be a key reason time frames have shrunk from days to hours (along with the typically low capital stake). You may be confused about what a chart is saying about next week, but you feel confident about what it's telling you will happen over the next few minutes.

While you may be successful trading the super-short intraday time frame, you are vulnerable to making costly mistakes if you do not have the big-picture context in which to judge a move. Trading is nerve-wracking even when you know you will be exiting the trade very quickly; the potential for getting stopped out with a loss is high.

Instead of spending more time refining chart indicators, consider that the first "indicator" — the news that causes the price to make a decisive move — isn't on the chart at all. Many traders don't have the time or the inclination to follow the news, but this is often the easiest way to see a setup coming. After all, indicators were devised to measure market sentiment, but usu-

FIGURE 1 — EURO BREAKOUT

The second bullish engulfing candlestick, which occurred the day before the Fed announcement, reflected trader skepticism — they wanted a "hawkish" statement and were ready to "punish" the dollar if they didn't get it.



Source: charts — Metastock; data — Reuters Online ally you can go directly to market sentiment itself. Then, if the chart confirms what the fundamentals are saying, your trade has an added chance of being right.

Euro breakout

A fine example came in the last week of October. The market expected the Fed to make a hawkish statement after the Federal Open Market Committee (FOMC) meeting on Oct. 25, emphasizing that fighting inflation is the Fed's first job.

Based on numerous comments by Fed officials ahead of the meeting, many analysts had gone so far as to forecast additional rate hikes instead of a new cycle of rate cuts, which had been the conventional wisdom only a few weeks before. The yield on the 10-year T-note rose from 4.53 percent on Sept. 25 to 4.86 percent on Oct. 23.

But the Fed disappointed the market. The statement was not hawkish, and it even removed language about oil and other commodity price pressures. The yield on the 10-year note fell to 4.72 percent the next day. The dollar doesn't necessarily follow the 10-year note in lockstep, but the fixed-income market often sets the tone for the foreign exchange market.

If the Fed is less worried about inflation, a key reason is that it expects overall growth to slow down and thus remove inflationary pressure. This is what Fed chief Ben Bernanke said after the September meeting, and so third quarter GDP, due out on Friday, Oct. 27 (two days after the Fed meeting), became the most powerful number in the trading universe.

The consensus forecast was for 2 percent in Q3 after 2.6 percent in Q2 (4.1 percent overall for the first half). We generally assume the consensus forecast is priced into the dollar, so if the number had been exactly 2 percent, perhaps nothing much would have happened. The range was 1.2 percent to 3.2 percent. A number well above 2 percent would mean the rate-hike scenario was still a real possibility, while a number notably below 2 percent would support the rate-cut scenario. GDP became the tipping point.

GDP came in well under 2 percent (only 1.6 percent), so all ideas of inflation-fighting rate hikes went out the window. The bond yield fell to 4.68 percent after the release, and the dollar crashed.

A different bit of information hinted the dollar was being set up for a crash: Volatility was abnormally low, and *low volatility precedes a breakout*. Right after the Fed decision, one-year euro/U.S. dollar (EUR/USD) volatility was at a 10-year low of 6.95. Before the GDP release, the key option barrier in EUR/USD was 1.2700, so a breakout above that level would constitute a turning point. Within 15 minutes of the GDP release, EUR/USD broke over 1.2700 and hit 1.2747. Traders smelled blood.

A word of warning about low volatility: While breakouts are almost always preceded by low volatility, not all instances of low volatility are followed by breakouts. Sometimes the market is simply uncertain about what is going to happen or how to trade a particular set of condi-

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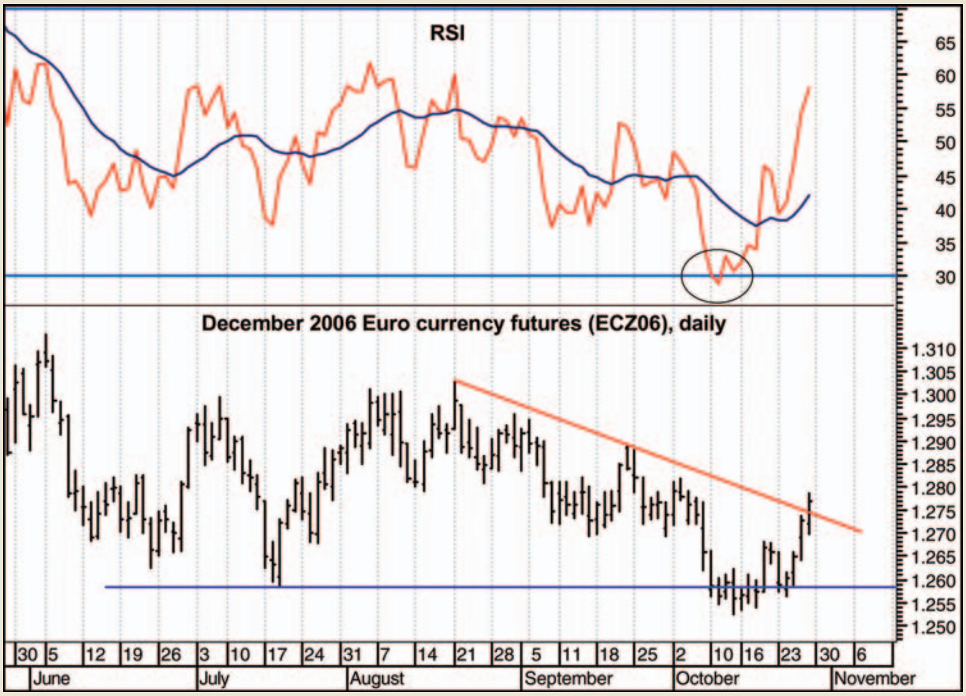
FIGURE 2 — INDICATOR SUPPORT

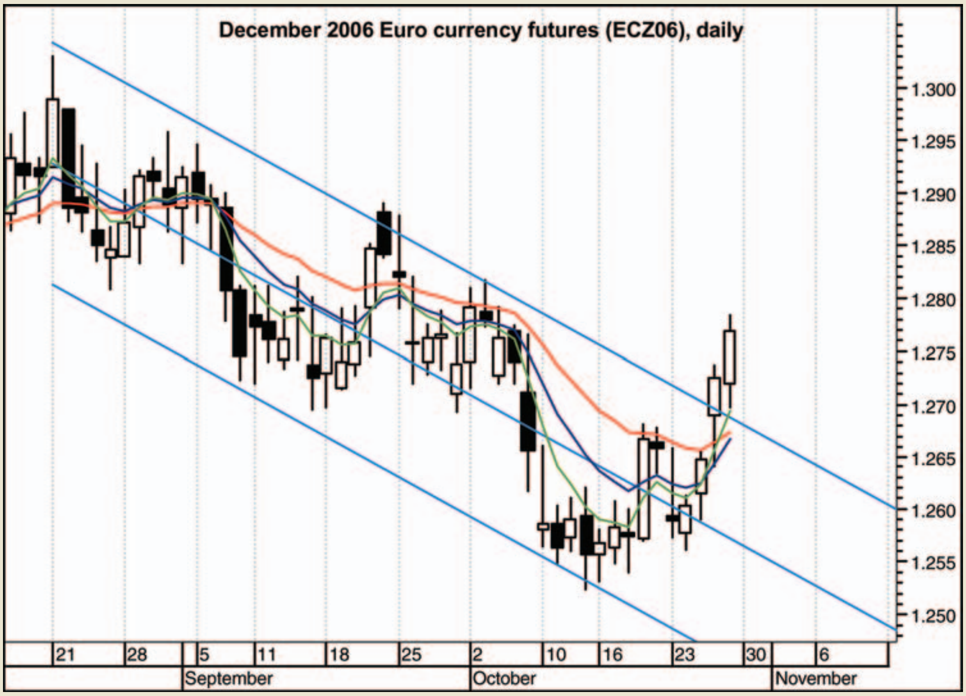
The upturn was accompanied by the RSI bouncing off the oversold level that preceded the breakout.



Source: charts — Metastock; data — Reuters Online

FIGURE 3 — REGRESSION CHANNEL

Price also crossed above the upper boundary of the linear regression channel.



Source: charts — Metastock; data — Reuters Online

FIGURE 4 — YEN GAP-UP OPENING

The opening up-gap occurred above the top of the linear regression channel.

Source: charts — Metastock; data — Reuters Online

tions. Volatility can remain low for long periods with no breakout.

Figure 1 shows the breakout above resistance and the bullish engulfing candlesticks that preceded the breakout. The first bullish engulfing candlestick was followed by a "bearish harami," which cast doubt on the bullish candlestick. But two days later another bullish engulfing candlestick formed, offsetting the "indecisiveness" of the bearish harami. This second bullish engulfing candlestick occurred the day before the Fed announcement and indicated trader skepticism — they really needed to hear a hawkish statement and were ready to "punish" the dollar if they didn't get it. Finally, the week ended with three white candles, another bullish signal. At this point price had also broken out above the down trendline.

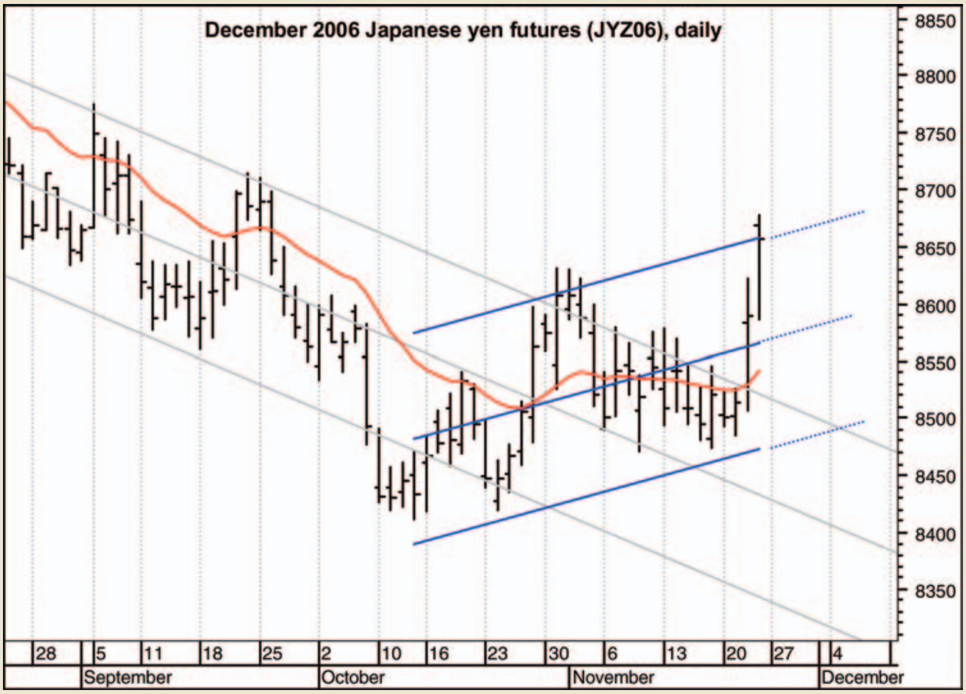
Figure 2 shows a 14-day relative strength index (RSI) rising up from the oversold level that preceded the breakout. Overbought or oversold conditions don't always precede a move in the opposite direction, but this time it was an excellent clue. Finally, Figure 3 shows the breakout in a different way — price rising over the top of the linear regression channel. This channel measures the standard error on either side of the center linear regression, so a break of the channel means the move is statistically abnormal — an opportunity in chart-reading.

If you didn't act during the day as these indicators were developing, by the end of the day you were convinced.

You could have bought the euro/dollar rate without ever seeing a chart, though. The day after the bad GDP report and breakout move, the euro opened at 1.2747. It hit a high 10 days later at 1.2926. If you had captured that move, your gain would have been 179 points — which is more than you will ever make in a single day unless you are trading a far bigger position size (the average daily range in the euro is about 140 points). And where would you get the courage to trade 10 contracts if you didn't know the stories behind a price move?

FIGURE 5 — CONTINUATION MOVE

Nov. 24 brought another upside surge — and this time it was supported by news of a trip by U.S. officials to China.



Source: charts — Metastock; data — Reuters Online

Yen breakout

The day before Thanksgiving (Nov. 24), rumors were swirling around the yen, including European officials complaining (after the September G7 meeting) about the yen being too weak vs. the euro.

The Japanese response was ambiguous. While admitting the weak yen was "rough" for European exporters, the Japanese Ministry of Finance said the usual stuff about exchange rates being set by the market and the need to follow fundamentals. They claimed to be puzzled themselves, since the Japanese economy was in a multi-year recovery phase. The implication was that Japan would not raise interest rates to please the Europeans until the Bank of Japan (BOJ) was good and ready to raise rates for domestic reasons — and the bank would not intervene in the forex market, either.

In fact, the official Japanese Cabinet Office "assessment" of the economy on Nov. 22 was a downgrade. Normally this would be yen-negative, since it suggests a BOJ rate hike is even further off in the future.

The yen had been in a downtrend since it peaked on May 17 at 0.9442. But when the market opened in the U.S. on Nov. 22, the yen gapped higher on the open at 0.8584 from the previous day's close at 0.8514. Aside from the observation the yen is undervalued by the most it has been since 1985 (when the Plaza Accord artificially engineered the dollar down and the yen and other currencies up), there was no hard, specific reason

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for the gap up and the higher yen high.

Searching for the purported cause, we find only that U.S. weekly unemployment claims released that morning were higher than expected. The University of Michigan consumer confidence index fell a bit when a small rise was forecast. Some traders jumped to the conclusion a Fed rate cut was closer than imagined the day before. If so, a narrowing of the yield differential favors the yen, even though the 10-year differential is a whopping 2.90 percent.

But wait a minute. This new information doesn't pass the "So what?" test. Weekly unemployment claims and the University of Michigan consumer confidence index are second-tier data. We shouldn't be drawing any conclusions about Fed policy from second-tier data, and even if the market is making the correct deduction — that the Fed will be cutting rates soon — the yield differential will remain very, very wide. For some traders to be dropping out of the yen carry trade on this evidence is an overreaction. Possibly it is true that some hedge funds have taken big losses on the recent downward correction in oil and other commodity prices and need to raise a little cash from profitable positions, but the new data is no real threat to the carry trade.

Figure 4 shows that in addition to an opening up-gap, the new yen price bar was outside the top of the linear regression channel. In fact, the yen had been pressing against the top of the channel for three weeks already, and had penetrated it for a few days in early November. The opening up-gap is considered a reliable indicator — why should we care if the background story is full of holes? If you were a day trader and jumped opportunistically on the gap, you could already be out with a nice little profit.

This might be true, but do you know what to do on the next trading day? This particular technical move was a surprise, and you can't count on surprises. The only way to have confidence in your next trade is to know the fundamental context, and in this case the context did not support a continuation of the breakout move.

However, it didn't support selling the yen in line with the overall downtrend, either. As it happened, the next trading day (Nov. 24, the day after Thanksgiving) delivered another giant upside breakout move (Figure 5). This time there *was* news to support the move: the announcement of a trip to China by an unprecedented number of high U.S. officials (including the U.S. Treasury Secretary and Fed Chairman, plus an unusually large number of other cabinet officials) to discuss raising the value of the renminbi (yuan), which by definition would lower the dollar.

This is going to be a historic event. The last time two countries got together regarding currencies was the late 70s when the U.S. and Japan met and Japan eventually agreed (in 1980) to a "voluntary restraint" on auto exports to the U.S.

Does the move coming before the news mean the news was leaked? Not necessarily. The market was very thin around the holiday and once the rock started rolling downhill, it hit stops left and right. The important point is the fundamentals are now supporting the technicals, and that's a more comfortable place from which to trade. We can draw a new channel with confidence the new direction is correct.

For information on the author *see p. 6.*

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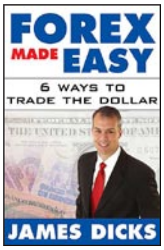

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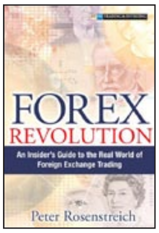

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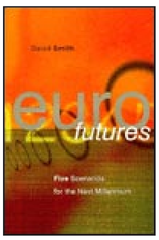

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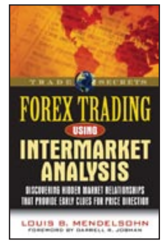

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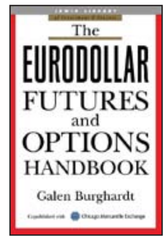

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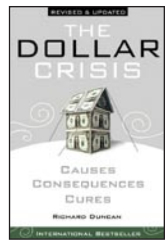

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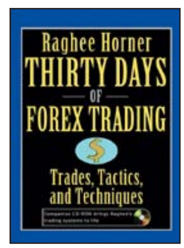

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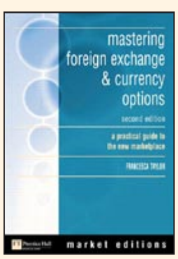

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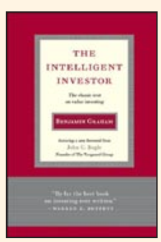

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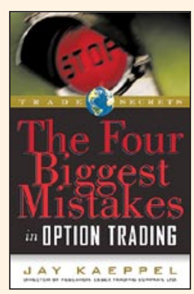

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Euro/yen:
Tips and tendencies

Breaking down the euro/yen by daily and intraday tendencies provides practical guidelines for trading this currency pair.

BY THOM HARTLE

Traders in any market benefit from having practical market data at their fingertips: how much a market is likely to move in a single trading session, or from one close to the next, or how often the market drops x points from the previous close but still closes higher on the day.

The forex market has been extremely challenging this year, with many major currency pairs stuck in trading ranges. Any tool that can shed light on a market's typical behavior and provide even a small edge is valuable. Here, we break down the short-term performance of the euro/Japanese yen pair (EUR/JPY) over the past year.

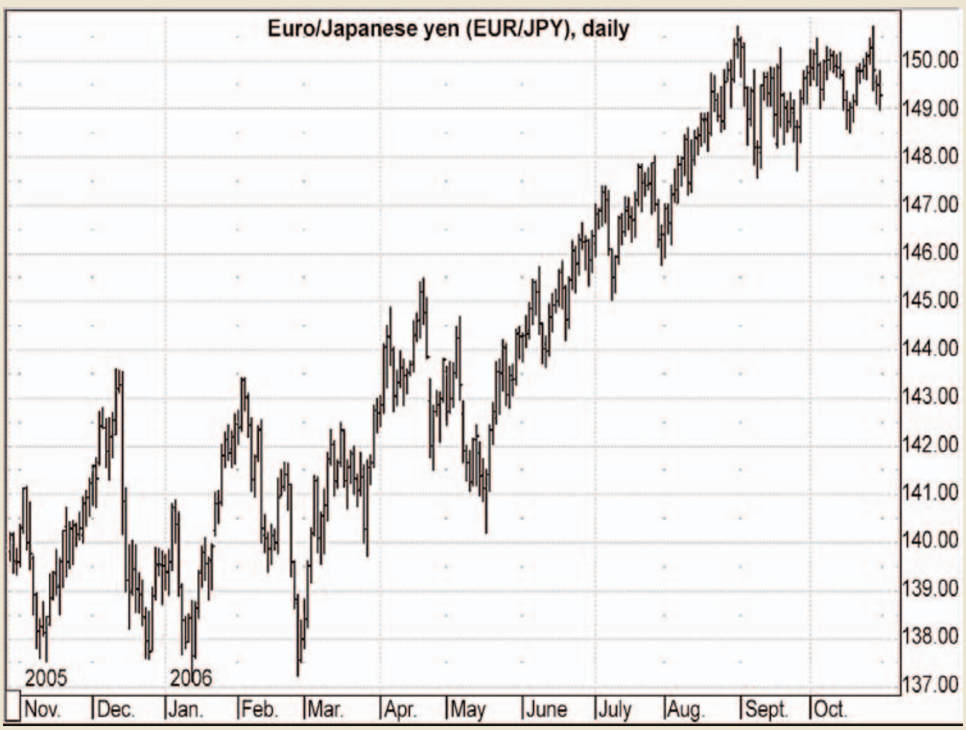
The daily analysis period spanned 261 trading days from Nov. 1, 2005 to Oct. 31, 2006. In addition, intraday analysis was conducted on 60-minute price bars from Sept. 1, 2006 to Oct. 31, 2006 (1,032 bars).

Figure 1 is a daily bar chart of the review period. The market was in a choppy trading range for the first few months, then embarked on an extended uptrend from March 2006 to late-August 2006. In September and October, it was apparent the pair was again consolidating.

Let's break down the euro/yen's price behavior into daily and intraday increments.

FIGURE 1 — DAILY ANALYSIS PERIOD

The first four months of the review period were dominated by a wide trading range, which was followed by a sustained uptrend and then another trading range.



Source: CQGNet (www.cqg.com)

Daily ranges

Figure 2 sorts the euro/yen's daily ranges from smallest to largest. The smallest was 0.0030 points on April 14, 2006, while the largest was 0.338 points on Dec. 14, 2005. The average daily range was 0.0097 points, and the median was 0.0091. Notice only a handful of days had ranges larger than 0.0200 points.

Figure 3 shows the distribution of daily ranges. Each cate-

FIGURE 2 — DAILY RANGES

The smallest daily range was just 0.0030 points, while the largest was 10 times bigger — 0.0338 points. The average daily range was 0.097 points (the median was 0.091 points).

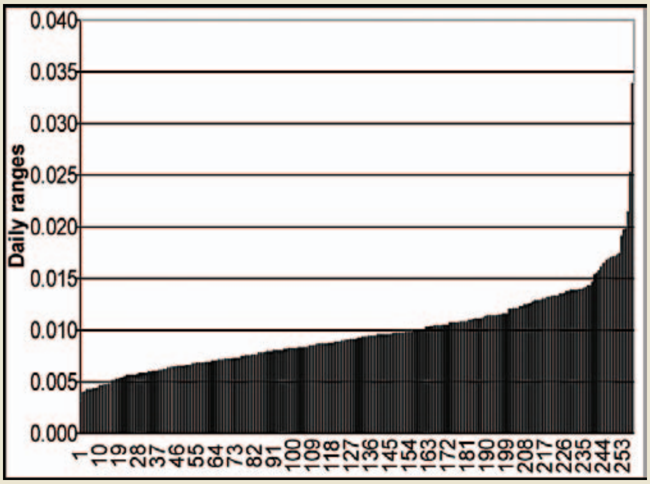
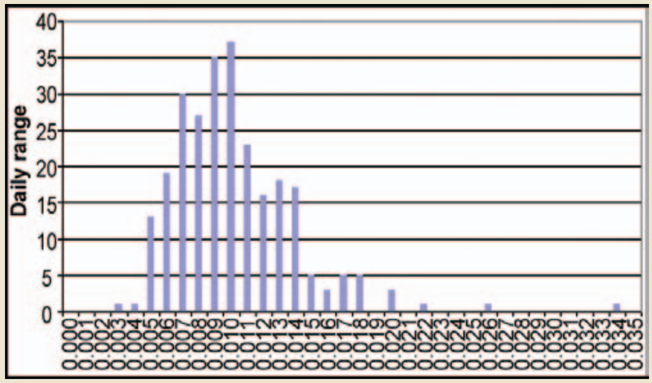


FIGURE 3 — DAILY RANGE DISTRIBUTION

The most daily ranges were in the 0.0090 to 0.0100 category, and 71 percent of the daily ranges were between 0.0070 points and 0.140 points. The single largest range — an obvious outlier — was the 0.0338 reading in the 0.0340 category (far right).



gory defines a bar as a certain range of daily ranges and each bar shows how many daily ranges there were of that size. For example, the category labeled "0.0100" represents all daily ranges greater than 0.0090 up to and including 0.0100. In this case there were 37 days with ranges in this category. The category labeled 0.0030 contains daily ranges greater than 0.0020 up to and including 0.0030; there was only one daily range in this category — the aforementioned smallest daily range that occurred on April 14, 2006.

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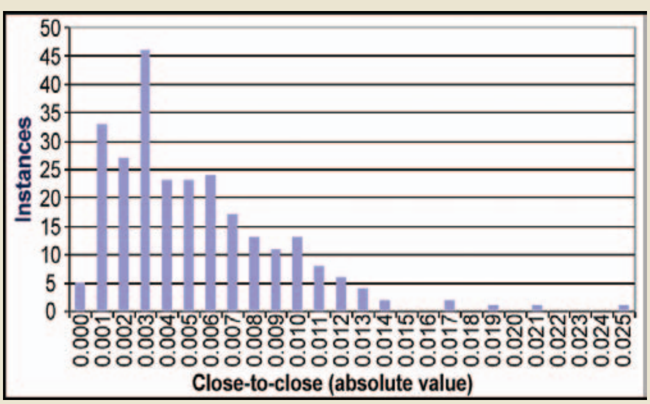
FIGURE 4 — DISTRIBUTION OF DAILY CLOSE-TO-CLOSE MOVES

During the review period, the euro/yen made a close-to-close move (up or down) of 0.0040 points or less 134 times (52 percent).



Currency characteristics: Euro/yen

Some insights from analyzing the euro/yen from Nov. 1, 2005 to Oct. 31, 2006:

1. The average daily range was 0.0097 points and the range exceeded 0.0138 points only 10 percent of the time. Seventy-one percent of the daily ranges were greater than 0.0070 points but less than or equal to 0.0140 points.

2. The close-to-close change exceeded 0.0100 points only 10 percent of the time.

3. If the pair traded more than 0.0055 points below the previous day's close, it had only a 9-percent chance of closing up for the day.

4. If the pair traded 0.0050 above the previous day's high, it had only a five-percent chance of closing down for the day.

5. Intraday analysis of September and October 2006 show the most volatile 60-minute bars were 2 a.m. and 9 a.m. (CT). The 2 a.m. hour's average range was 0.0026 points and the 9 a.m. hour's average range was 0.0024 points. Both hours had median ranges of 0.0022 points.

FIGURE 5 — UP-CLOSING DAYS: HIGH, LOW, CLOSE BARS

Each bar is plotted relative to the previous day's close (0.0000) to highlight how much the euro/yen traded above or below the previous day's close on days the market closed higher.

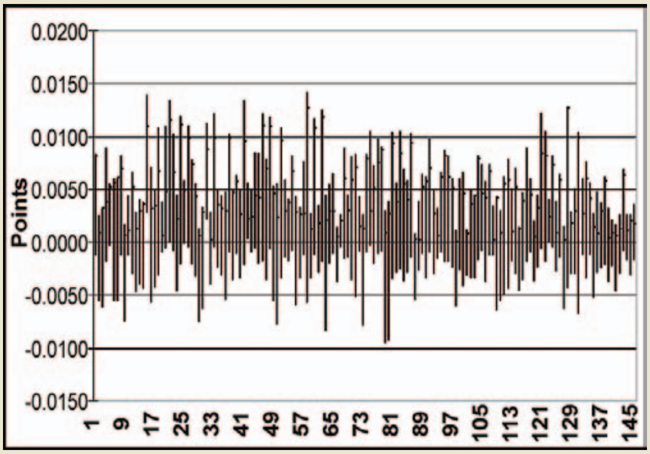
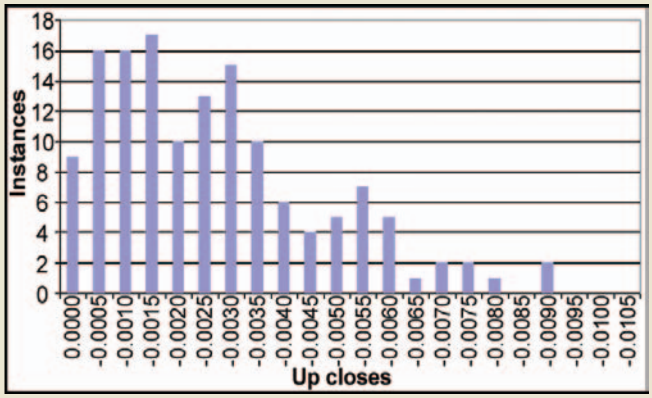


FIGURE 6 — UP-CLOSING DAYS: PREVIOUS CLOSE AND LOW DIFFERENCES

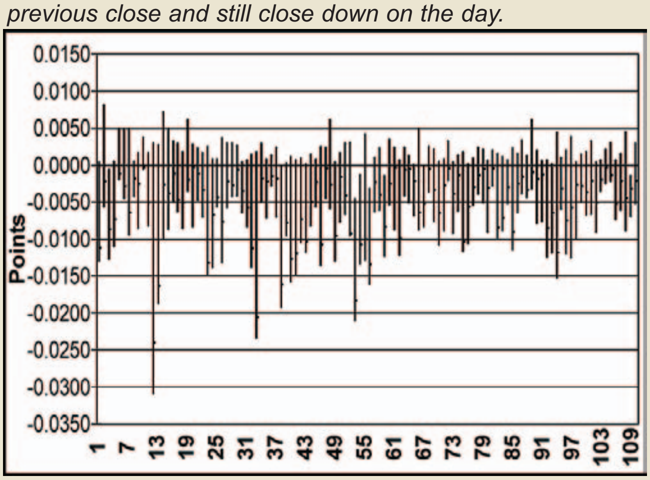
If the euro/yen traded more than -0.0055 below the previous close, it had only a 9-percent chance of rallying to close higher on the day.



Seventy-one percent of daily ranges were above 0.0070 up to and including 0.0140, and 90 percent were less than 0.0138 points. The three large outliers, 0.0214, 0.0252, and 0.0338, pushed the average range reading (0.0097) above the median reading (0.0091).

FIGURE 7 — DOWN-CLOSING DAYS: HIGH, LOW, CLOSE BARS

Each bar is plotted relative to the previous day's close for the days the market closed down (110 instances). It's rare for the euro/yen to trade 0.0050 points or more above the previous close and still close down on the day.



Close-to-close changes

Figure 4 shows the distribution of daily close-to-close differences (absolute values). The euro/yen closed unchanged four times (the 0.000 category, far left). The largest one-day close-to-close move was a 0.0240-point loss, which is contained in the 0.0250 category at the far right.

Fifty-two percent of the time the market closed 0.0040 points or less from the previous day's close, up or down. There is a steady decline after the 0.0060 category. The market had a close-to-close change of 0.0100 or more only 10 percent of the time.

Up-closing days vs. down-closing days

The euro/yen closed up for the day 146 times, closed down for the day 110 times, and closed unchanged four times. Figure 5 contains the 146 days the market closed up for the day, adjusted so that each bar is plotted relative to the previous day's close, which is represented by 0.000 on the vertical axis. This shows how much of each day's range was above or below the previous day's close. There is a great deal of variation in the differences between the low and the previous close for up-closing days.

Figure 6 expands on Figure 5 by showing the distribution of the differences between the previous close and the low

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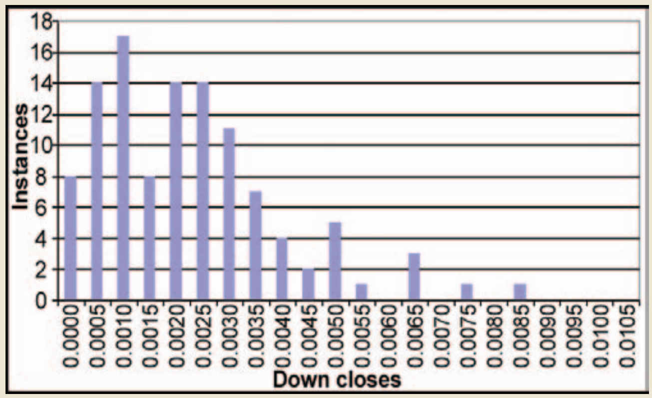
There were five days the market never traded in negative territory. Of the 141 days the market traded down from the previous close, it rebounded to close higher on the day only nine percent of the time after trading lower by more than 0.0055.

Figure 7 shows the daily bars (adjusted to the previous day's close) for the days the euro/yen closed down. For these days, trading up by more than 0.0050 points and still closing down appears to be unusual. Figure 8 shows the distribution of the previous close-to-high changes for down-closing days.

The euro/yen traded more than 0.0050 points above the previous close and still closed down on the day only five percent of the time. Sixty-eight percent of the time the market never exceeded a high greater than 0.0025 points. The market never traded into positive territory only five times.

FIGURE 8 — DOWN-CLOSING DAYS: PREVIOUS CLOSE AND HIGH DIFFERENCES

The market traded higher than 0.0050 points and still closed down on the day only five percent of the time.



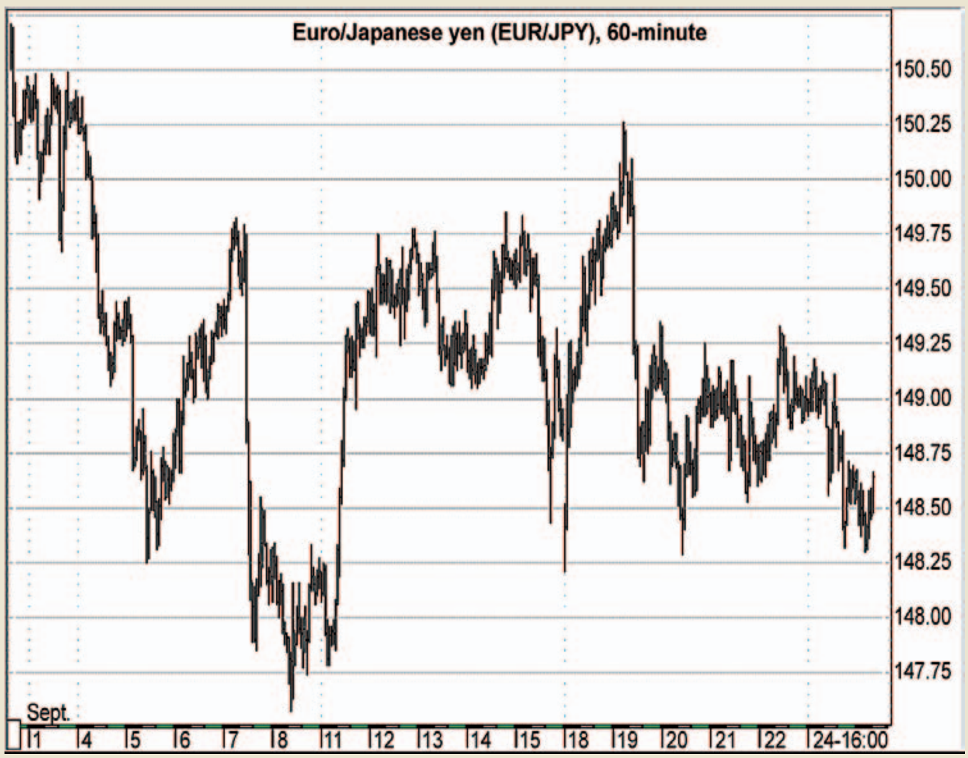
Intraday tendencies

The intraday analysis was based on 60-minute bars, using a 24-hour clock and Central time (CT). Each Friday the market closes at 15:00 (3 p.m. CT) and reopens at 16:00 (4 p.m.) on Sunday. Monday through Thursday, the "close" is at 23:59 (11:59 p.m.) and the re-open is at 0:00 (12 a.m.). Figures 9, 10, and 11 are charts of the 60-minute bars from the Sept. 1 through Oct. 31, 2006 analysis period (the charts overlap somewhat).

To determine whether there is any consistent time of

FIGURE 9 — INTRADAY ANALYSIS PERIOD 1: SEPT. 1-24, 2006

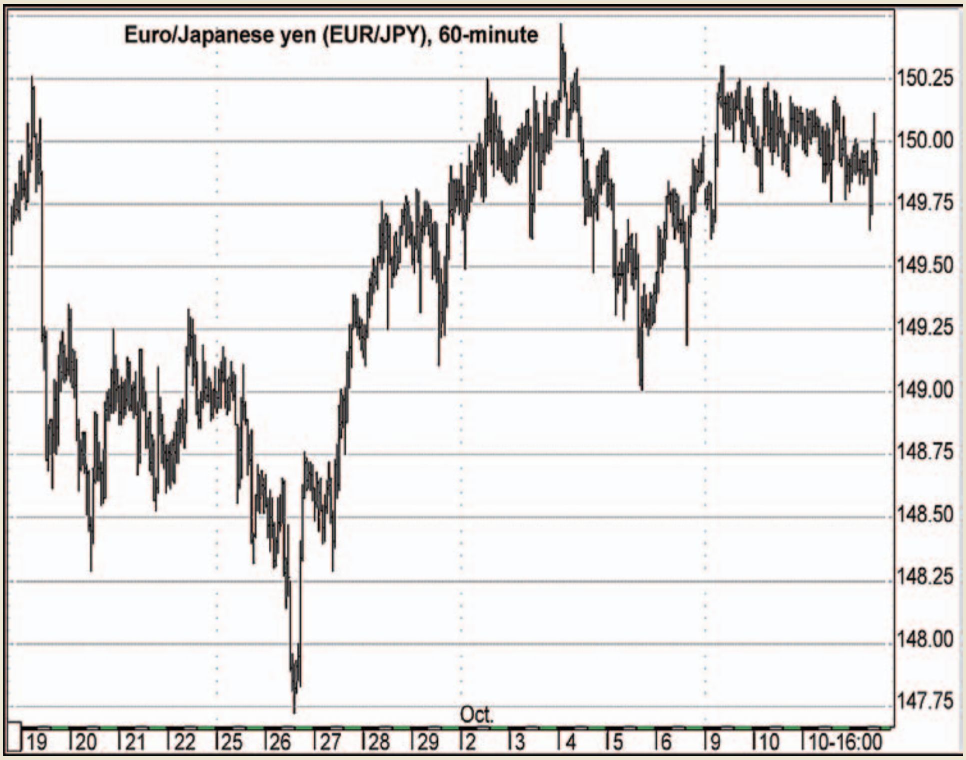
The euro/yen market trades in a 24-hour session, with the exception of closing on Friday at 3 p.m. CT and reopening at 4 p.m. Sunday.



Source: CQGNet (www.cqg.com)

FIGURE 10 — INTRADAY ANALYSIS PERIOD 2: SEPT. 19-OCT. 10, 2006

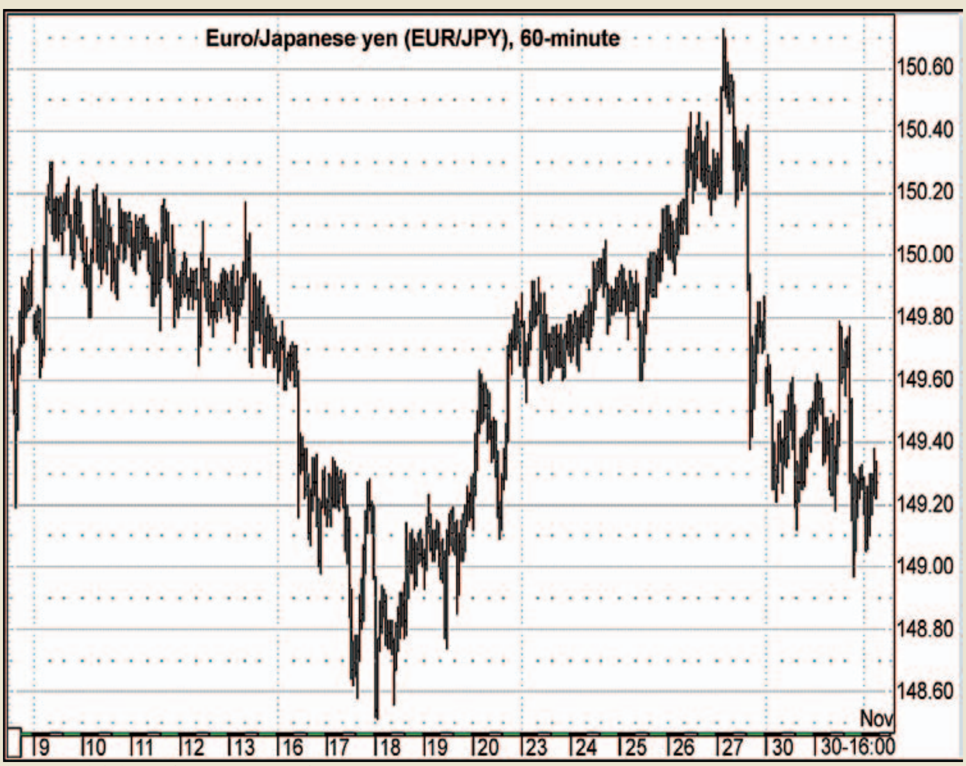
The market shows some sharp intraday trend moves, followed by trading ranges.



Source: CQGNet (www.cqg.com)

FIGURE 11 — INTRADAY ANALYSIS PERIOD 3: OCT. 9-31, 2006

Although trends are apparent, the price action appears quite volatile on a 60-minute chart.



Source: CQGNet (www.cqg.com)

day the euro/yen pair tends to trend, the ranges for all the 60-minute bars were calculated and sorted by hour. Next, both the average and the median ranges were determined for each hour. Figure 12 shows the average and median for each hour of the trading day.

The 60-minute bar with the largest average range was the hour beginning at 2 a.m. CT. The average was 0.0026 points while the median was 0.0022 points, implying a few larger-than-normal ranges are skewing the average higher than the median. The hour with the next-highest average range was 9 a.m. with an average range of 0.0024 (median 0.0022 points).

Figure 13 focuses on the individual ranges for the 2 a.m. bar. Six bars exceeded 0.0040 points and there was one very large bar of 0.0068 points, which occurred on Sept. 16, 2006. As the median value suggests, most of the ranges tended to cluster on either side of 0.0022 points.

Finally, Figure 14 shows the ranges for all the 9 a.m. bars. The largest range was 0.0058 points (from Sept. 26, 2006). However, there were 10 ranges larger than 0.0030 points. As was the case with the 2 a.m. bars, the median was 0.0022 points, which here was a result of the number of ranges around 0.0010 points.

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FIGURE 12 — 60-MINUTE BAR RANGES SORTED BY TIME

The two hours with the largest average ranges are 2 a.m. and 9 a.m. CT.

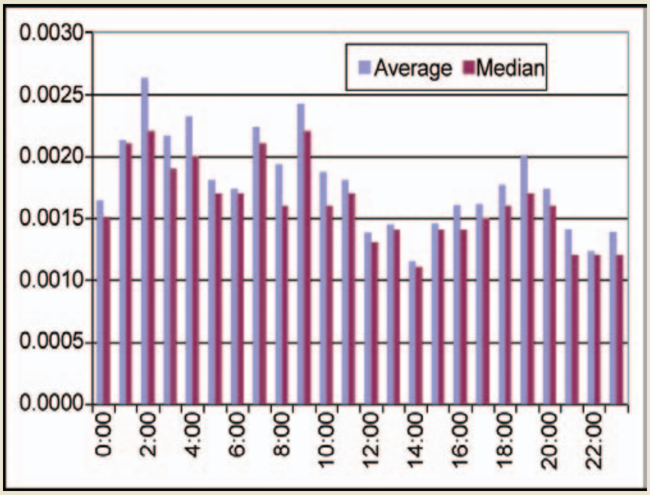


FIGURE 13 — 60-MINUTE RANGE FOR 02:00

The largest of the 2 a.m. hourly bars was 0.0068 points; most were clustered above and below the median range, 0.0022.

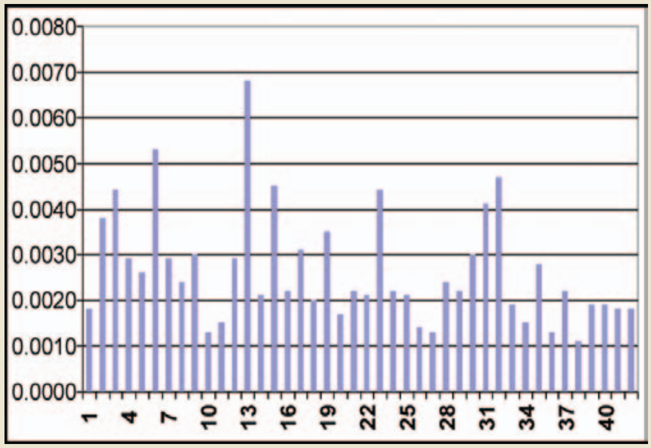
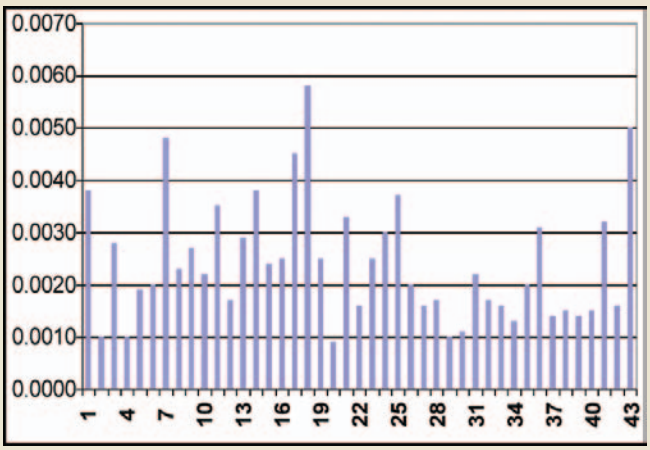


FIGURE 14 — 60-MINUTE RANGE FOR 09:00

The largest hourly range for the 9 a.m. bar was 0.0058 points, but seven others were between 0.0030 and 0.0040 points and three were greater than 0.0040 points.



Food for thought, fuel for trading

Researching the typical behavior of the market can provide you with "quick-use" tables that can help you make trading decisions based on statistics rather than gut feel. "Currency Characteristics" summarizes some of the trading implications from this analysis of the euro/yen.

These characteristics and similar statistics can augment existing entry setups and stop-loss risk and profit-target levels.

For more on the euro, euro/yen, and the outlook for Europe in 2007, see "Slowdown in the Eurozone?"

For information on the author *see p. 6.*

Related reading

"Breaking down the euro"
Currency Trader, November 2006.
Studying the euro's daily and intraday performance statistics offers guidelines for systematic and discretionary traders.

You can purchase and download articles at www.activetradermag.com/purchase_articles.htm

The pros make it look hard

In an increasingly challenging and complex forex environment, the dollar index is the great simplifier.

BY HOWARD L. SIMONS

One of the great pleasures of watching a true professional in any field is how they can make a difficult task look easy. This is not the case for currency traders, as evidenced by the performance of six widely followed indices for currency-only money managers:

- The Barclay Currency Traders Index (CTI)
- The BTOP FX Index
- The Center for International Securities and Derivatives Markets (CISDM) asset-weighted index
- The CISDM equal-weighted index
- The Parker index
- The AFX index

With the very prominent exception of the CISDM equal-weighted index's performance over the 24-month period preceding the time of this writing, the performance of these indices is either negative or insignificantly positive.

Currency index returns

	3-Mo	2006 YTD	12-Mo	24-Mo	36-Mo
CISDM (Asset)	-2.92%	-5.40%	-5.04%	-1.13%	1.16%
BTOP FX	NA	-3.78%	-5.04%	-1.13%	1.16%
AFX	0.07%	-2.81%	-3.18%	-2.73%	-3.93%
Barclay CTI	NA	-1.53%	-1.21%	2.36%	NA
Parker	-1.34%	-1.34%	-0.72%	-2.80%	-0.90%
CISDM (Equal)	1.71%	-0.44%	0.25%	7.82%	3.12%

If the pros have had such a difficult time in the market, how can individual traders hope to succeed?

Making a tough game tougher

We have to ask whether the professional traders have made life unnecessarily difficult for themselves. A currency trader can get lost in all of the interlocking factors affecting the markets, such as macroeconomic fundamentals, geopolitics, and each country's yield curve.

This 24/6 market, famously dubbed "the currency bazaar," by Andrew Krieger, cycles almost $2 trillion per day throughout its global network. Yes, it is deep and liquid, but that in itself has some drawbacks, such as the presence of orders in the $100 million and higher range.

Anyone swinging such orders about is likely a very sophisticated investor. There are an estimated 8,000 hedge funds and 1,800 CTAs loose upon the land; only 124, or approximately 1.3 percent of this total, can be described as "currency-only" funds. These traders approach the markets through the usual variety of trading styles across more than 30 different commonly traded currency pairs, with targeted trade durations from minutes to months.

Some are discretionary traders, while some hew to rigid quantitative systems. The majority of these traders are trend-followers; but countertrend or mean-reverting strategies are employed by many short-term quantitative traders. Many longer-term traders rely on interest rate "carry" strategies to earn more in the currency lent than in the currency borrowed. And the most sophisticated traders construct both plain-vanilla and exotic option strategies to achieve narrow return targets.

But through it all, one reality remains: The low percentage of currency-only traders is either a tribute to the virtues of intermarket diversification or evidence of just how difficult it is to reside exclusively in the currency markets.

Simple solutions

Alexander the Great may not have known all the buzzwords of modern management consulting, but he was a terrific simplifier. Legend has it he "solved" the intractable Gordian knot by cutting it with his sword. Currency traders, including the many spiritual successors of the NASDAQ day-traders of the 90s, can duplicate this solution by replacing a wide array of currency pairs with the simple dollar index (DXY).

In a market that gravitates towards complexity, the reason we should cut the knot is simple: Nearly all traders, whether they choose to admit it or not, really bet on whether the U.S. dollar (USD) is going to rise or fall. Then they search out vehicles with which to express this opinion.

As Alexander would have said, if you want to trade the dollar, then trade the dollar. Just as most stock traders really bet on whether the market is going to rise or fall and minimize their asset-selection risk by trading an index such as the S&P 500 or Russell 1000, currency traders should minimize their selection risk by trading the DXY.

The DXY is a basket of six major currencies; euro, Japanese yen, British pound, Canadian dollar, Swedish krona, and Swiss franc. Each currency is liquid and has a reliable structured interest rate market; collectively they create an index that represents the directional flow of the USD globally with tight, efficient, low-cost bid-ask spreads.

Futures and options on the DXY trade at the New York Board of Trade, which in turn is the primary marketplace for price discovery. DXY spreads are 2-3 pips wide, far narrower than what could be achieved by trading each currency individually.

Of course, just as traders can over- or underweight stocks in an index, they can over- or underweight currencies in the six-currency DXY, and the more-active investor can even arbitrage the member currencies against the DXY. In addition, a currency manager with multiple cross-rate exposures can use the DXY futures and options as a hedge.

Performance

Now let's turn to longer-term performance. As noted, professional currency

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Indices for currency-only money managers

The Barclay Currency Traders Index (CTI): An equal-weighted composite of managed programs that trade currency futures and/or cash forwards in the interbank market. This index currently includes 106 managers.

The BTOP FX Index: A subset of the CTI that accounts for no less than 50 percent of its investable assets. It seeks to replicate the overall composition of the currency sector of the managed futures industry with regard to trading style and overall market exposure.

The Center for International Securities and Derivatives Markets (CISDM) asset-weighted index: Reflects the dollar-weighted performance of currency commodity trading advisors (CTAs) who trade currency futures/options and forward contracts based on a wide variety of trading models. CTAs must have at least $500,000 under management and at least a 12-month track record to be included in this index.

The CISDM equal-weighted index: Measures the average performance of the above set of advisors.

The Parker index: A performance-based benchmark that measures both the reported and the risk-adjusted returns of global currency managers. It is the first index to analyze unleveraged, or risk-adjusted, manager performance to calculate their alpha, or incremental performance added, of managers. It is equal-weighted to preclude unrepresentative distortions from large-manager performance. The Parker FX Index currently includes 66 programs managed by 45 firms located in the U.S., Canada, UK, Ireland, and Switzerland. These programs manage over $15.7 billion in currency assets split between 46 systematic and 20 discretionary traders.

The AFX index: Replicates the trading actions of an active manager and thus attempts to provide a more realistic benchmark for active currency traders.

traders have not turned their sophistication into profits in recent years. Two index-oriented mutual-fund pairs, one from ProFunds and one from Rydex, have (Figure 1). Both fund families offer DXY-long and DXY-short funds to meet the needs of active traders. If we combine the long and short funds from each fund group, we replicate closely the long/short performance of active fund managers.

FIGURE 1 — SUCCESS OF DOLLAR INDEX MUTUAL FUNDS

Combining the long and short funds from the ProFunds and Rydex groups closely replicates the long/short performance of active fund managers. The combined results are both positive and better than the currency managers who actively trade unique currency pairs.

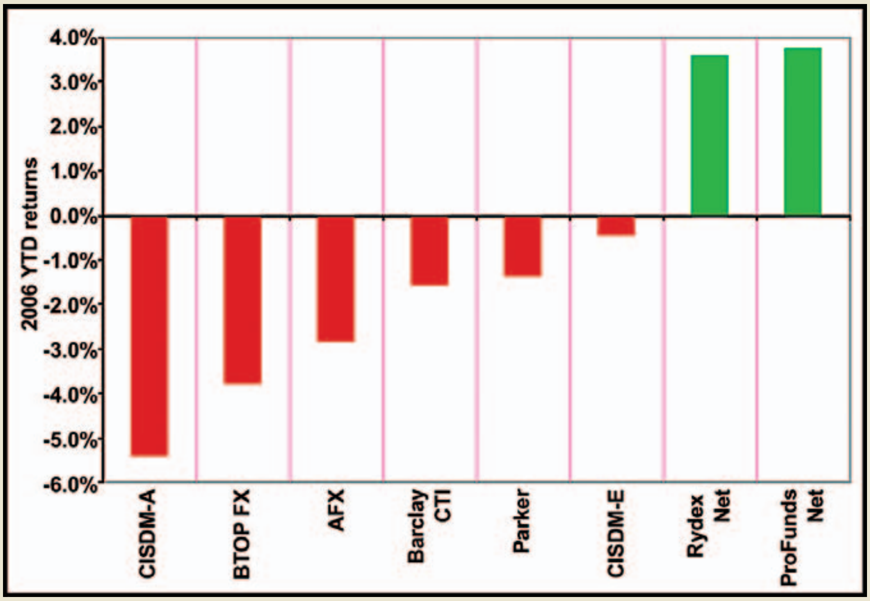
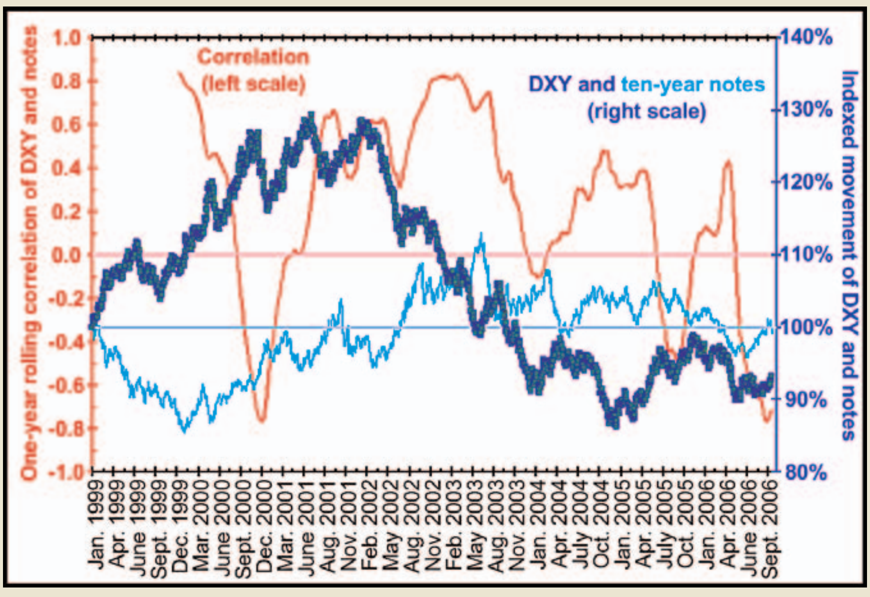


FIGURE 2 — THE DOLLAR INDEX AND TEN-YEAR NOTES

Currently, a stronger DXY is associated with higher bond prices — a condition that was not the case from mid-2001 though 2003 and again from the spring of 2004 through mid-2005.



Moreover, the gains from the winning DXY orientation exceed the losses from the losing DXY orientation on a systematic basis. Therefore, the combined results are both positive and better than those of the currency managers who actively trade unique currency pairs. The average of the DXY-benchmarked funds outperformed the average performance of the currency indexes by 6.2 percent. The two extreme performance comparisons of DXY funds to individual currency index returns are:

- ProFunds (net) DXY funds outperformed the CISDM asset-weighted currency index by 9.15 percent for the first 7 months of 2006.

- ProFunds (net) DXY funds outperformed the CISDM equal-weighted currency index by 4.19 percent.

Intermarket relationships

Few variables in finance are blamed or credited improperly for influencing other markets as much as is the USD. How can we be so confident in others' ability to get it wrong? One way is to display a set of one-year rolling correlations along with prices indexed to Jan. 4, 1999 = 100 percent of the DXY against other key markets. If a market such as the DXY causes another's movements, the correlation between the two should both be stable and should never switch signs. This is most certainly not the case with the DXY.

The unstable correlations seen in Figures 2 to 4 create trading opportunities. They also provide useful analytic information for those who focus on the non-DXY markets and who may wish to sidestep the poor analysis so widely available in the public media.

The correlation between the DXY and ten-year notes is an excellent case in point for these observations. It presently is highly negative; that is a stronger DXY is associated with higher bond prices. Such was not the case from mid-2001 though 2003 and again from the spring of 2004 through mid-2005 (Figure 2). A trader aware of these shifts should be able to profit from them.

We can make a similar statement with regards to commodity prices as represented by the Reuters/Jefferies CRB index (Figure 3). At present, a stronger DXY is associated with higher commodity prices; the precise opposite was true in the second half of 2005 and during several earlier periods. Those who blithely attribute higher commodity prices to a weaker dollar have some explaining to do.

We can extend the relationship noted for the CRB index to the single commodity of gold. Gold is commonly regarded as a way to protect against dollar weakness, and yet it has been strongly positively correlated with the DXY of late and for most of the 2002-2005 period. In fact, only during the apex of the gold rally in late 2005 — early 2006 did the two markets exhibit the expected negative correlation (Figure 4).

FIGURE 3 — THE DOLLAR INDEX AND THE REUTERS/JEFFERIES CRB INDEX

A stronger DXY is correlated to higher commodity prices, but the opposite was true in the second half of 2005 as well as several earlier periods.

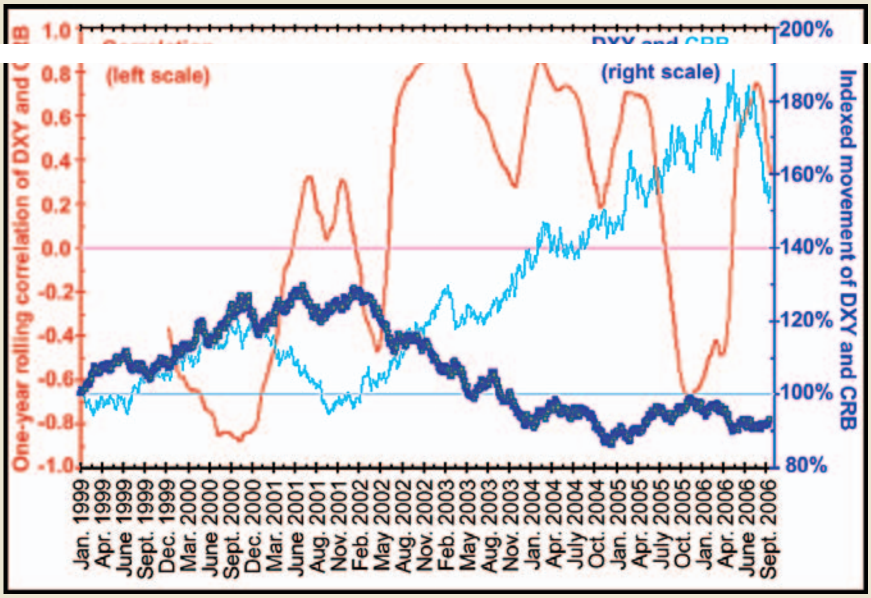
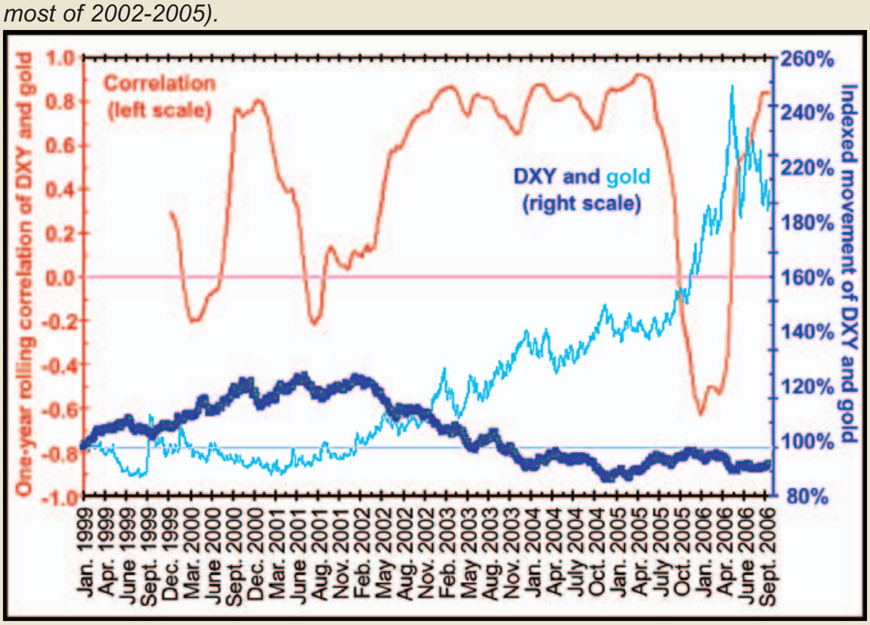


FIGURE 4 — THE DOLLAR INDEX AND GOLD

Although gold has typically been thought of as a way to protect against dollar weakness, it has had a strong positive correlation to the DXY lately (and for most of 2002-2005).



More than the euro

It would be easy for skeptics to say the DXY is little more than the euro in disguise. Given the euro's 57.6 percent weight in the DXY, that sentiment is understandable.

But sentiment is not fact. If we index the euro and the DXY since the former's introduction in January 1999, we find long periods of divergent performance between the euro and the DXY. The spread between these performance indices as a percentage of the DXY has risen and fallen as a function of the euro's strength (Figure 5). This means the two markets are quite different in what drives them higher or lower. A singular focus on the euro will result in a USD-focused trader missing large moves in, say, the Canadian dollar or Japanese yen.

Too many traders confuse being fancy with being effective. If you want a simple-to-trade, liquid expression of

continued on p. 32

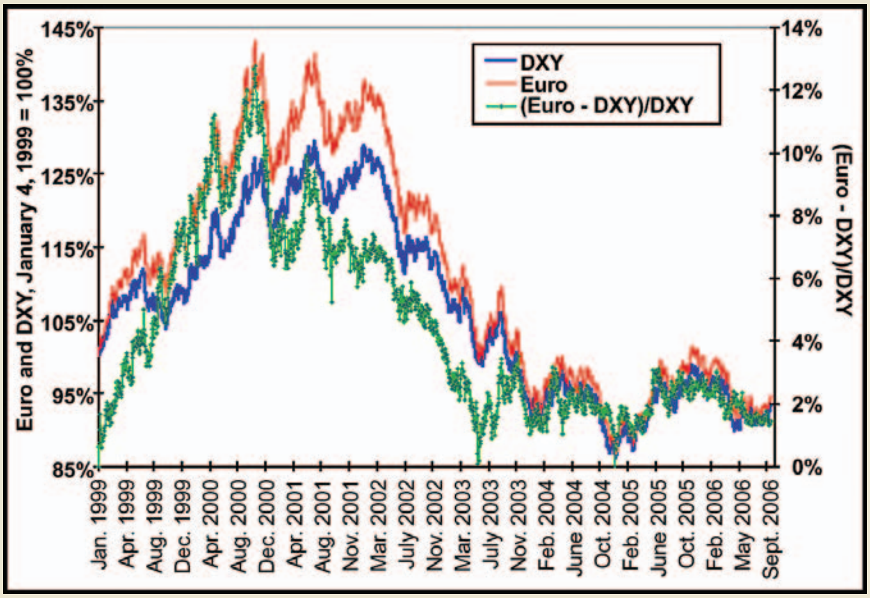
your dollar opinion, one linked heavily to other markets in surprising ways, forget the fancy stuff. Where has it gotten all of the trading professionals who would rather face exile than do something understandable by the common man? It does not take a rocket scientist to trade DXY futures and options effectively — or to trade the ProFunds or Rydex DXY-oriented funds effectively — nor should it.

This is a business that pays you for being right, not for elaborate explanations of why various external factors throw you off-guard. Don't make it any harder than that.

For information on the author *see p. 6.*

FIGURE 5 — THE EURO/DOLLAR INDEX SPREAD

Indexing the euro and the DXY since the euro's introduction in January 1999 shows long periods of divergent performance.



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Currency Trader, November 2006.
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Dollar breakdown: Solid signal or red herring?

The greenback's sharp drop has helped kick many currency pairs out of the doldrums, at least for now. Early December price action could set the tone for several more weeks.

BY CURRENCY TRADER STAFF

Weeks — if not months — of congestion in many major currency pairs has made 2006 more than frustrating for forex traders of all stripes. However, a major drop in the U.S. dollar in late November forced the buck and other currencies valued against it out of longstanding trading ranges. The question is whether this move is an anomaly or a sign of renewed directional movement in the forex market.

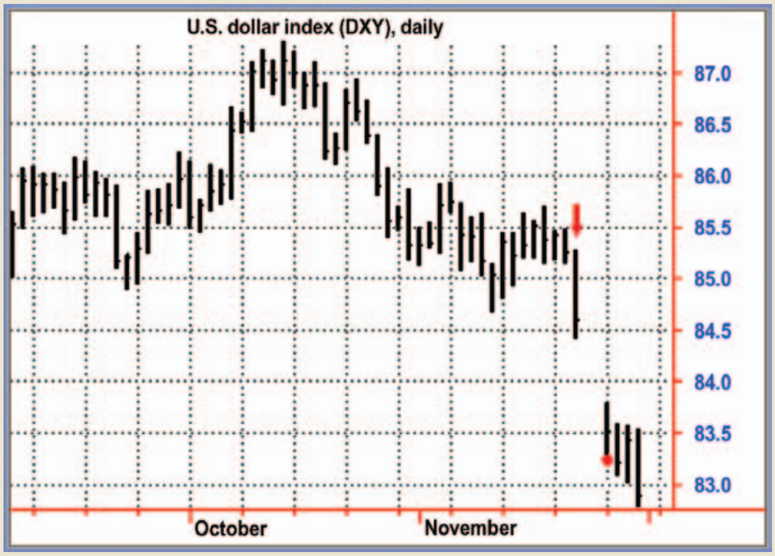
Figure 1 shows the big decline in U.S. dollar index (DXY) on Nov. 22, which was immediately followed by a big down gap on Nov. 24 — a 2.4-percent drop (high to low) over the course of these two trading days.

Figures 2 and 3 are weekly charts showing the resulting moves in the euro/U.S. dollar (EUR/USD) and the U.S. dollar/Japanese yen (USD/JPY) rates. The euro's upside breakout took it out of a trading range dating back to May.

Figure 4 is a weekly DXY chart. It also shows the dollar index gapping lower — a rare occurrence on the weekly time frame. The down gap might attract the attention of casual chart gazers and other

FIGURE 1 — DOLLAR DIVE

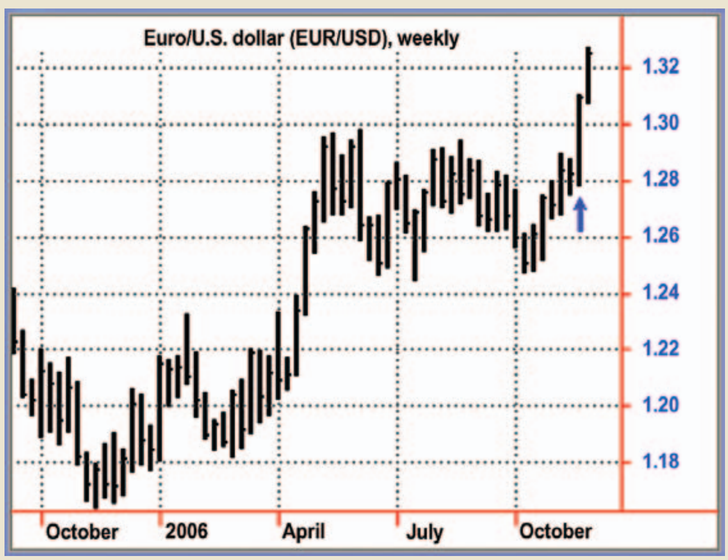
After dropping sharply on Nov. 22, the dollar index gapped lower on Nov. 24.



Source: TradeStation

FIGURE 2 — EURO SURGE

The dollar index's decline is reflected in the euro's breakout from an extended trading range.



Source: TradeStation

technicians, but the fact that it has occurred only three other times in the past 15 years makes it impossible to draw any conclusions about what might happen in the aftermath of such price action. (For the record, two of the three instances — all of which occurred in 2001 or later — marked multi-week bottoms.)

The size of the down move — regardless of the gap — is something that warrants studying. Is such a move indicative of a certain kind of market behavior or is it more likely to be random event?

We decided to analyze events in the dollar index comparable to the move from the high of the week ending Nov. 24 to the low of the week ending Dec. 1 — that is, declines of 2 points or more from one week to the next.

However, the down move as of Dec. 1 had another important characteristic — it was the lowest low in many weeks. Accordingly, we added the criteria that the pattern must also establish the lowest low in 20 weeks.

To summarize, we want to analyze what happens when:

1. The dollar index drops two or more points from the high of one week to the low of the following week.
2. The dollar index's low of the second week is the lowest low in 20 or more weeks.

Table 1 shows the price action in the 12 weeks following the 95 other instances of such patterns that have occurred in the dollar index since 1987. The table shows the average, median, maximum, and minimum price changes from the closing price of the pattern to the closing prices of each of the following 12 weeks (W1, W2, W3, etc.). Also included are the statistics for the largest up moves (LUM) and largest down moves (LDM) for each of these weeks. The LUMs are the price changes from the pattern's close price to the high of each of the 12 subsequent weeks; the LDMs are the price changes from the pattern's closing price to each of the lows. The final row shows the percentage of times the market was below the pattern's closing price at the close of all the following weeks.

For example, at week 4 the average closing price was .50 lower than the pattern's closing price; the median closing

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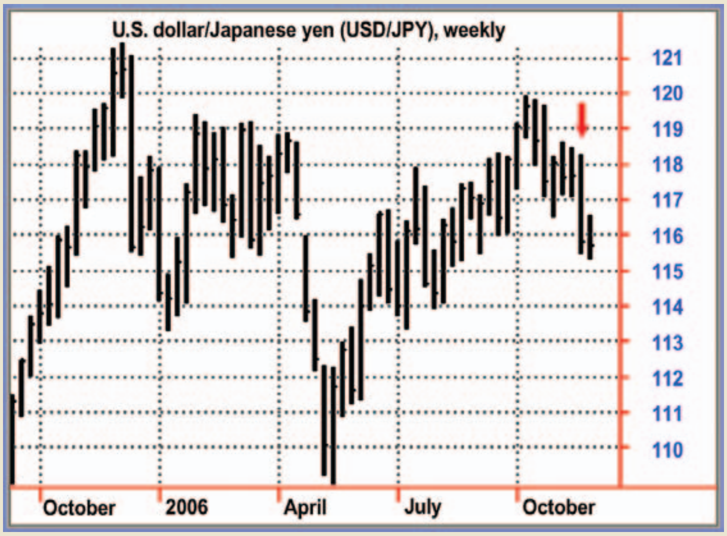
FIGURE 3 — YEN REVERSAL

The dollar/yen rate had already turned lower when the dollar dropped, and the effect is not as dramatic in this currency pair.



Source: TradeStation

price was .56 lower. The average LUM was 1.47, which means the biggest gain from the pattern's close to the highest high in the first four weeks was, on average, 1.47 points; the median value was 1.15 points. The average and median LDM was -2.02, which means the typical largest move from the pattern's close to the lowest low of the first four weeks was -2.02 points. Also, at week 4, the dollar index closed below the pattern's closing price 58.95 percent of the time. Finally, the single largest LUM was a gain of 5.41 points while the single largest LDM was a loss of 6.41 points.

These statistics indicate a downside bias four weeks after the pattern — the market closes lower almost six times out of 10, and the down moves are typically larger than the up moves. Overall, the other weeks support the idea that the market tends to drop after the weekly pattern we've identified. The average and median LDMs are larger than the average and median LUMs for all weeks, and the closing changes are negative at least 51.58 percent of the time.

Based on the closing price moves, the biggest bang for the buck, so to speak, appears to occur in week 2: The dollar index has a 64.21-percent chance of closing lower, and the median close is .47 below the pattern's close. The median LDM is -1.07, which means the market has typically dropped this much at some point during week 2.

Another interesting aspect of the post-pattern performance was revealed in a test to see how often the dollar index bounced back in week 1 to trade above the high of the pattern's second bar. Extreme price moves are often overreactions to extra-market events that are reversed quickly, at least in part.

In this case, however, the dollar index showed little proclivity to recapture lost ground during week 1. Of the 95 examples, the dollar index rallied in week 1 above the previous week's close only 23 times (24.21 percent), with the median move .67 points above that high. More than three-quarters of the time price stayed below the high of the pattern's second week.

FIGURE 4 — WEEKLY GAP

The dollar index gap is also apparent on the weekly chart — a rarity. However, the size of the price decline — not the fact that a gap occurred — is the key aspect of the market's behavior.

Source: TradeStation

Looking at another aspect of price behavior

However, there's another aspect of the two-week price pattern this analysis did not take into account — how the second week of the

TABLE 1 — PERFORMANCE AFTER TWO-WEEK SELL-OFFS

The dollar index's performance after it drops two or more points from the high of one week to the low of the next week (and when the low of the second week is the lowest low in 20 or more weeks) has a clear downside bias.

	W1	LUM	LDM	W2	LUM	LDM	W3	LUM	LDM	W4	LUM	LDM
Avg.	-0.06	0.80	-0.84	-0.36	1.07	-1.26	-0.31	1.31	-1.64	-0.50	1.47	-2.02
Med.	-0.23	0.68	-0.72	-0.47	0.87	-1.07	-0.24	1.02	-1.50	-0.56	1.15	-2.02
Max.	2.54	3.14	0.00	3.93	4.16	0.00	5.06	5.16	0.00	5.41	5.41	0.00
Min.	-2.62	0.00	-4.80	-3.15	0.00	-4.80	-4.09	0.00	-6.07	-5.73	0.00	-6.41
%<0	53.68%			64.21%			53.68%			58.95%		
	W5	**LUM**	**LDM**	**W6**	**LUM**	**LDM**	**W7**	**LUM**	**LDM**	**W8**	**LUM**	**LDM**
Avg.	-0.56	1.61	-2.29	-0.50	1.77	-2.48	-0.60	1.90	-2.73	-0.49	2.05	-2.96
Med.	-0.44	1.24	-2.06	-0.43	1.46	-2.12	-0.66	1.63	-2.52	-0.68	1.63	-2.71
Max.	6.98	6.98	0.00	8.40	8.64	0.00	11.16	11.25	0.00	9.67	11.25	0.00
Min.	-6.69	0.00	-7.63	-6.92	0.00	-7.63	-7.77	0.00	-8.00	-8.73	0.00	-8.96
%<0	57.89%			54.74%			57.89%			57.89%		
	W9	**LUM**	**LDM**	**W10**	**LUM**	**LDM**	**W11**	**LUM**	**LDM**	**W12**	**LUM**	**LDM**
Avg.	-0.38	2.16	-3.10	0.00	2.73	-3.30	-0.07	2.45	-3.38	-0.06	2.56	-3.46
Med.	-0.46	1.63	-2.95	0.00	2.23	-3.07	-0.13	1.82	-3.14	-0.18	1.82	-3.27
Max.	9.61	11.25	0.00	0.15	11.80	-0.10	12.48	13.00	0.00	12.60	13.00	0.00
Min.	-8.96	0.00	-9.19	-0.07	0.00	-9.19	-9.53	0.00	-9.76	-6.99	0.00	-9.76
%<0	56.84%			51.58%			52.63%			51.58%		

pattern closed. Did it rally off the low to close near the high of the week's range, or did it stay depressed and close toward the weekly low? The week ending Dec. 1 ended poorly — the dollar was unable to recover much of the ground it lost. As a result, we conducted another test that added a third pattern condition:

3. The second week must close in the lower half of the week's range, below the week's opening price, and below the previous week's close.

This criteria produced 63 patterns, and overall, the downside bias evident in the first test increased. Table 2 shows the statistics for the first six weeks after these patterns. The percentage of lower closes increased and the LUMs were larger (Figure 5). Also, the week-1 high traded above the previous week's high only 12 times (19.05 percent).

These tests point to additional downside price action in the dollar after Dec. 1, but there are a couple of important points that haven't been addressed. First, there's no indication of how the post-pattern performance compares to the dollar index's typical behavior. Figure 6 is a monthly chart of the dollar index, and it shows the massive downtrend that has been in effect since the beginning of 2002. The dollar also wafted lower from 1987 to 1995 (not shown), with the one major bull move spanning 1995-2001. If the dollar has been dominated by downtrends, perhaps the bearish statistics here are simply a reflection of that bias.

Second, there's the issue of relevance — that is, is the post-pattern performance in 1987 (or 1991 or 1996, etc.)

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TABLE 2 — TWO-WEEK SELL-OFFS WITH WEAK CLOSES

Adding the condition that the second week must close in the lower half of the week's range, below the week's opening price, and below the previous week's close produced slightly more bearish statistics than the first test.

	W1	LUM	LDM	W2	LUM	LDM	W3	LUM	LDM
Avg.	-0.07	0.83	-0.84	-0.42	1.08	-1.32	-0.40	1.30	-1.67
Med.	-0.22	0.67	-0.68	-0.73	0.87	-1.11	-0.80	1.00	-1.90
Max.	2.54	3.14	0.00	3.93	4.16	0.00	5.06	5.16	0.00
Min.	-2.62	0.00	-4.80	-3.15	0.00	-4.80	-4.09	0.00	-4.80
%<0	53.97%			68.25%			58.73%		
	W4	**LUM**	**LDM**	**W5**	**LUM**	**LDM**	**W6**	**LUM**	**LDM**
Avg.	-0.55	1.45	-2.07	-0.63	1.59	-2.37	-0.54	1.78	-2.56
Med.	-0.91	1.03	-2.14	-0.79	1.03	-2.29	-1.08	1.38	-2.51
Max.	5.41	5.41	0.00	6.98	6.98	0.00	8.40	8.64	0.00
%<0	65.08%			61.90%			57.14%		

truly indicative of what the market is likely to do today?

To address these issues, we focused on the statistics from the three most recent years (2003 to present), and compared the post-pattern performance to the dollar index's typical performance during this period. There were 25 patterns during this period, with performance in line with that shown in Table 2. Figure 7 compares the closing price changes for each of the 12 weeks after the pattern with the "benchmark" price changes for the 2003-present period. The benchmark figures are the median close-to-close price changes for all one-week periods, two-week periods, and so on, up to 12 weeks.

The figure shows the dollar index did, in fact, have a downside bias during this period, as reflected in the overall decline of the benchmark price changes from one to 12 weeks (blue line). However, the post-pattern price declines (red line) were larger than the benchmark declines until week 10 — significantly larger until week 8. This implies the pattern is identifying more bearish behavior than was typically present in the market during this period.

If the current market performs in line with its past statistics, additional downside action in the dollar can be expected. As Figures 2 and 3 show, that impact will vary from currency pair to currency pair. The dollar index futures (DX) contract is the other vehicle traders can use to trade the buck.

FIGURE 5 — LARGEST UP MOVES VS. LARGEST DOWN MOVES

The median LDMs (shown as positive numbers for easier comparison) are nearly twice as large as the median LUMs in weeks 4 through 6.

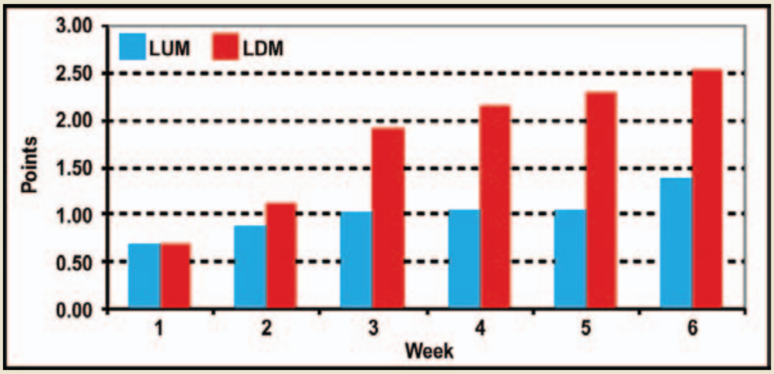


FIGURE 6 — LONG-TERM VIEW

The dollar index's recent long-term congestion followed an extended downtrend.

Source: TradeStation

Dollar for your thoughts

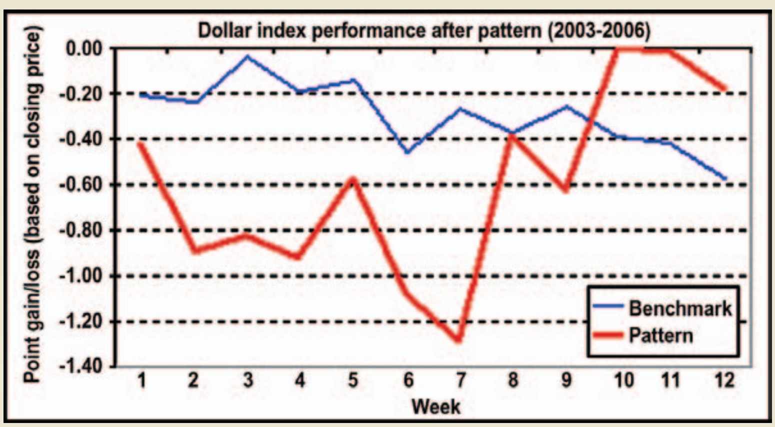
The dollar has done an excellent job the past few years confounding traders and analysts, turning up when sharp sell-offs rock the market and declining when most traders see clear skies.

The pattern analyzed here indicates weakness only on a shorter to intermediate-term horizon, and it certainly cannot account for extra-market events or surprise interest-rate moves by the Fed. Keep an eye on the week of Dec. 4-8: A move back above the previous week's high could mean the recent sell-off is destined to be a short-term anomaly.

In the meantime, though, the move could have the potential to bring back some needed volatility and direction to currencies.

FIGURE 7 — 2003-PRESENT: ADDED VALUE?

The dollar index had downside bias from 2003 through November 2006, but the price action after the pattern was even more negative.



Making a list

Gain again enters RefcoFX picture

As customers of the now-defunct RefcoFX.com consider lawsuits and settlements that might help them get some of their account holdings back, Gain Capital has entered the picture again.

In June, Gain agreed to buy the assets of RefcoFX, the currency trading arm of the bankrupt futures brokerage, but that deal fell through the cracks a month later when the two sides failed to reach a final purchase agreement. That sat fine with most RefcoFX customers, who claim the deal would have made it very difficult for them to get back all their assets.

However, after the deal crumbled, RefcoFX announced it was shutting down operations, leaving its customers with little choice but to sue Refco for whatever they could get.

On Nov. 15, Gain agreed to purchase the customer list of RefcoFX, a deal already approved by the U.S. Bankruptcy Court. Gain will pay RefcoFX $750,000 for the list, which contains the name and information of about 15,000 accounts.

Gain will pay RefcoFX $100 for every customer with an account of more than $4,000 who opens an account with Gain (or its retail division, Forex.com), and will also pay a 1-percent maintenance fee based on the average account balance of customers who switch to Gain.

Refco officials say the monies will be used by RefcoFX to increase the payouts available to creditors of RefcoFX.

Gain Capital outbid Saxobank for the right to the RefcoFX customer list. Saxobank had offered $500,000, and the two firms participated in an auction in early November.

For the most part, the new deal with Gain has failed to create much excitement among RefcoFX customers.

"The deal doesn't provide any incentives to RefcoFX customers to join Gain," says Steve Purdo, who has about $40,000 tied up at RefcoFX. "Plus, considering the deal Gain offered last time, a lot of people have a low opinion of them.

"It seems the big beneficiary of the deal is RefcoFX, and that doesn't figure to help us very much."

RefcoFX customers have been notified by lawyers about filing a claim to collect lost account holdings, but Purdo says the language of the suit is unclear and many questions abound about how much customers would actually get.

"The consensus is that nobody would get more than $4,000, regardless of how big their account was," he says. "And none of us are really willing to get our own lawyers to clear things up because the cost involved with that might outweigh any potential settlement.

"Essentially, we're still in limbo."

Going side-by-side

CME, ISE enhance FX options

The Chicago Mercantile Exchange and the International Securities Exchange are both making changes to their FX options product line.

Beginning Dec. 18, the CME will offer electronic trading of nine currency options at the same time the products are traded on the floor. The Euro FX, Japanese yen, British pound, Swiss franc, Canadian dollar, Australian dollar, New Zealand dollar, Mexican peso, and Russian ruble options will be available almost 23 hours per day on the CME's Globex system. Additional forex options will be added in 2007.

While almost 90 percent of overall forex volume at the CME is done electronically, only a small percentage of forex options volume is done off the floor. Derek Samman, managing director of foreign exchange for the CME, says electronic trading of forex options grew 81 percent in the third quarter, and that growth rate should increase with side-by-side trading now available.

The CME's forex options are American-style, meaning they can be exercised at any time before expiration.

Meanwhile, while the ISE will not begin trading forex options until 2007, it has begun disseminating the underlying data for the products, allowing users to have a better idea of what prices will be when the products begin trading.

Rates are available for options on the euro (EUI), British pound (BPX), Japanese yen (YUK), and Canadian dollar (CDD), and can be accessed from many data vendors and financial Web sites, including Bloomberg, Reuters, and Yahoo! Finance.

No turnaround for currency managers

Currency fund managers continue to suffer in 2006, as the latest statistics from Barclay Group show the Currency Traders Index gained just 0.01 percent in October and is still down more than 2 percent for the year (through Oct. 31).

The index had increased in value for 10 straight years until 2005, when it lost 1.21 percent. If things don't turn around, the index will have back-to-back losing years for the first time since 1993-94.

Some of the big names in the currency fund field are feeling the heat. John Henry's Strategic Allocation Program, a $1.25 billion fund, is down 12.5 percent on the year. While the fund has a diversified portfolio, its biggest holding is currencies, which account for more than one-third of total assets.

There have been some winners, though. The Worldwide Capital Management fund is up more than 70 percent in 2006. The fund has only $3 million under management, but it turned in triple-digit gains in 2004 and 2005.

Among funds with more than $10 million under management, the Algorithmic Trading Advisors LLC fund has enjoyed a run-up of almost 60 percent in 2006. The fund has more than $11 million under management — approximately $20 million less than in 2005, when many investors got out after the fund's value increased by almost 700 percent.

Managed money: Barclay Trading Group's currency trader rankings for October 2006

Top 10 currency traders managing more than $10 million as of Oct. 31 ranked by October 2006 return

Rank	Trading advisor	October return	2006 YTD return	$ Under mgmt. (millions)
1.	KMJ Capital (Currency)	5.61	25.48	25.0M
2.	Rhicon Currency Mgmt (4XiM)	4.97	10.04	40.0M
3.	Coe Capital Advisors (FX)	4.57	53.00	11.8M
4.	Spot Forex Mgmt. (Zurich)	4.40	23.17	14.0M
5.	Harmonic Capital (Gl. Currency)	3.78	-8.68	N/A
6.	Stonebrook Structured Products (FXC)	3.68	-2.38	17.4M
7.	Shaffer Asset Mgmt. (FX)	3.60	0.83	10.7M
8.	Wooster Asset Mgmt (Portage Ptnrs)	3.13	16.86	11.8M
9.	RiskTec (Absolute Return)	2.83	5.18	494.5M
10.	Grossman Asset Mgmt (Currency LP)	2.58	-10.82	93.0M
Top 10 currency traders managing less than $10 million and more than $1 million as of Oct. 30 ranked by October 2006 return				
1.	Wooster Asset Mgmt (Portage Fund)	3.13	16.38	8.6M
2.	Worldwide Capital Mgmt	2.00	77.59	3.0M
3.	SSgA Absolute Return Currency Fund	1.12	-0.19	8.5M
4.	FX Concepts (DMC Offshore)	1.07	-9.73	5.4M
5.	FX Concepts (DMC Series Onshore)	1.06	-9.82	5.1M
6.	DynexCorp Ltd. (Market Sentiment)	0.86	0.12	4.0M
7.	Black Flag (Gl. Macro)	0.73	4.45	2.0M
8.	FEM Currency Portfolio Ltd	0.61	-7.06	3.9M
9.	High Desert Currency Mgmt	0.54	28.02	2.7M
10.	MV Global Currency Fund	0.43	-7.17	2.5M

Source: The Barclay Group (www.barclaygrp.com)
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.

CURRENCY FUTURES SNAPSHOT
as of Nov. 27

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.

Contract	Pit sym	Elec sym	Exch	Vol	OI	10-day move	% rank	20-day move	% rank	60-day move	% rank	Volatility ratio/% rank
Eurocurrency	EC	6E	CME	158.6	163.4	2.11%	100%	2.93%	96%	2.49%	64%	1.10 / 100%
Japanese yen	JY	6J	CME	81.0	227.6	1.14%	58%	0.92%	78%	1.19%	21%	.57 / 100%
British pound	BP	6B	CME	67.2	127.6	1.34%	38%	2.12%	81%	1.69%	48%	.74 / 100%
Swiss franc	SF	6S	CME	48.7	96.4	2.66%	100%	3.17%	95%	2.01%	21%	1.16 / 100%
Canadian dollar	CD	6C	CME	42.0	109.6	-0.11%	0%	-1.25%	69%	-2.43%	90%	.47 / 30%
Australian dollar	AD	6A	CME	24.3	99.3	1.62%	42%	1.37%	41%	2.02%	66%	.62 / 87%
Mexican peso	MP	6M	CME	15.3	85.6	-1.39%	86%	-3.09%	100%	-1.53%	61%	.73 / 100%
U.S. dollar index	DX		NYBOT	3.2	32.2	-1.73%	83%	-2.26%	91%	-1.89%	53%	1.04 / 100%
New Zealand dollar	NE	6N	CME	1.7	18.5	0.62%	29%	1.21%	25%	2.11%	19%	.26 / 57%
Euro / Japanese yen	EJ		NYBOT	1.3	39.8	0.84%	74%	2.20%	98%	1.31%	16%	.36 / 83%

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:

Sym: Ticker symbol.

Vol: 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.

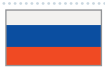
60-day move: The percentage price move from the close 60 days ago to today's close.

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 10-day move shows how the most recent 10-day move compares to the past twenty 10-day moves; for the 20-day move, the % rank field shows how the most recent 20-day move compares to the past sixty 20-day moves; for the 60-day move, the % rank field 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 lower 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.

This information is for educational purposes only. Currency Trader *provides this data in good faith, but assumes no responsibility for the use of this information.* Currency Trader *does not recommend buying or selling any market, nor does it solicit orders to buy or sell any market. There is a high level of risk in trading, especially for traders who use leverage. The reader assumes all responsibility for his or her actions in the market.*

FOREX (vs. U.S. DOLLAR)

Rank*	Country	Currency	Current price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous rank
1		South African rand	0.1406	7.74%	0.50%	-7.68%	0.1678	0.1253	8
2		Swedish krona	0.1448	6.00%	4.62%	5.54%	0.1451	0.123	9
3		Swiss franc	0.8271	4.68%	2.43%	0.69%	0.8383	0.7553	17
4		Euro	1.3098	4.15%	2.61%	2.56%	1.3109	1.166	15
5		British pound	1.9327	3.04%	2.39%	3.34%	1.9351	1.7048	14
6		Japanese yen	0.008633	2.90%	0.97%	-2.95%	0.00917	0.00824	16
7		Australian dollar	0.7794	2.53%	2.63%	3.20%	0.7794	0.7014	3
8		Thai baht	0.02749	2.00%	3.54%	5.41%	0.02749	0.02404	4
9		Russian ruble	0.03788	1.83%	1.50%	2.41%	0.03789	0.03447	10
10		New Zealand dollar	0.6725	1.68%	5.84%	5.61%	0.7198	0.5925	11
11		Taiwanese dollar	0.0305	1.57%	0.33%	-2.09%	0.03197	0.0297	13
12		Singapore dollar	0.6453	1.48%	1.86%	2.19%	0.6461	0.5888	5
13		Indian rupee	0.02238	1.31%	3.95%	2.43%	0.02273	0.02123	2
14		Chinese yuan	0.1275	0.63%	1.59%	2.16%	0.1275	0.1234	6
15		Hong Kong dollar	0.1286	0.08%	0.00%	-0.23%	0.129	0.1283	7
16		Canadian dollar	0.8816	-0.69%	-2.29%	-1.67%	0.9148	0.8475	12
17		Brazilian real	0.4625	-0.71%	-0.41%	8.75%	0.4867	0.4157	1

As of Nov. 26 *based on one-month gain/loss

ACCOUNT BALANCE

Rank	Country	2006	Ratio*	2005	2007+
1	Singapore	38.029	28.5	33.269	39.461
2	Switzerland	50.737	13.3	50.709	52.852
3	Russia	120.128	12.3	83.558	124.368
4	Hong Kong	16.431	8.7	20.276	15.665
5	Netherlands	50.091	7.6	39.986	55.997
6	China	184.172	7.2	160.818	206.478
7	Sweden	21.895	5.8	21.57	22.846
8	Taiwan	20.68	5.8	16.116	22.04
9	Germany	120.579	4.2	114.896	120.688
10	Japan	167.273	3.7	165.69	162.871
11	Canada	25.48	2.0	26.261	25.422
12	Brazil	5.808	0.6	14.193	4.43

Rank	Country	2006	Ratio*	2005	2007+
13	Mexico	-0.478	-0.1	-4.789	-1.592
14	France	-38.648	-1.7	-33.577	-40.111
15	India	-17.569	-2.1	-11.9	-25.109
16	UK	-55.943	-2.4	-48.332	-57.963
17	South Africa	-14.002	-5.5	-10.118	-12.889
18	Australia	-41.397	-5.6	-42.247	-42.325
19	U.S.	-869.129	-6.6	-791.504	-959.109
20	Spain	-100.577	-8.3	-83.001	-115.08

Totals in billions of U.S. dollars

**Account balance in percent of GDP +Estimate*

Source: International Monetary Fund, World Economic Outlook Database, September 2006

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	Nov. 26	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Franc / Canada $	CHF/CAD	0.9391	5.47%	4.89%	2.45%	0.9391	0.8646	20
2	Aussie $ / Canada $	AUD/CAD	0.8848	3.28%	5.07%	5.00%	0.8848	0.8178	9
3	Franc / Yen	CHF/JPY	95.8859	1.82%	1.51%	3.80%	95.8859	87.67	17
4	Franc / Pound	CHF/GBP	0.4281	1.61%	0.05%	-2.55%	0.447	0.4188	19
5	Euro / Yen	EUR/JPY	151.775	1.25%	1.64%	5.69%	151.775	137.09	14
6	Franc / Euro	CHF/EUR	0.6317	0.54%	-0.13%	-1.79%	0.651	0.6245	18
7	Pound / Yen	GBP/JPY	224.014	0.19%	1.46%	6.51%	225.28	200.525	12
8	Real / Canada $	BRL/CAD	0.5251	0.02%	1.98%	10.64%	0.5494	0.4746	4
9	Aussie $ / Yen	AUD/JPY	90.3317	-0.32%	1.68%	6.38%	91.34	82.09	6
10	Aussie $ / Pound	AUD/GBP	0.4035	-0.47%	0.27%	-0.07%	0.4323	0.3947	8
11	Pound / Euro	GBP/EUR	1.4768	-1.00%	-0.13%	0.82%	1.4992	1.4243	16
12	Aussie $ / Euro	AUD/EUR	0.5953	-1.54%	0.05%	0.66%	0.6402	0.5761	7
13	Aussie $ / Franc	AUD/CHF	0.943	-2.02%	0.23%	2.54%	0.9861	0.9023	5
14	Real / Aussie $	BRL/AUD	0.5941	-3.07%	-2.88%	5.47%	0.6573	0.5633	10
15	Canada $ / Yen	CAD/JPY	102.204	-3.41%	-3.17%	1.37%	106.155	97.8416	11
16	Real / Yen	BRL/JPY	53.6167	-3.45%	-1.31%	12.11%	56.0563	47.8241	1
17	Canada $ / Pound	CAD/GBP	0.4564	-3.57%	-4.54%	-4.82%	0.5041	0.4564	15
18	Real / Pound	BRL/GBP	0.2394	-3.62%	-2.72%	5.28%	0.2721	0.2274	3
19	Canada $ / Euro	CAD/EUR	0.6736	-4.58%	-4.71%	-4.06%	0.739	0.6736	13
20	Real / Euro	BRL/EUR	0.3534	-4.62%	-2.86%	6.09%	0.3976	0.3331	2

GLOBAL STOCK INDICES

Rank	Country	Index	Nov. 26	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	India	BSE 30	13,703.33	7.91%	18.42%	26.77%	13,790.82	8,760.70	14
2	Mexico	IPC	24,792.89	6.13%	18.22%	26.59%	24,857.95	16,464.62	5
3	Brazil	Bovespa	41,757.72	5.33%	16.13%	8.10%	42,308.39	31,295.76	1
4	Hong Kong	Hang Seng	19,260.3	4.94%	13.59%	21.17%	19,404.01	14,811.64	6
5	Egypt	CMA	2,284.69	4.11%	11.72%	27.93%	2,653.25	1,657.42	15
6	Italy	MIBTel	31,231	3.46%	8.38%	11.44%	31,508.00	25,894.00	12
7	Singapore	Straits Times	2,814.81	2.67%	14.74%	15.12%	2,846.75	2,277.91	2
8	Canada	S&P/TSX composite	12,631.08	2.39%	4.22%	7.38%	12,663.13	10,815.14	7
9	Germany	Xetra Dax	6,411.96	2.03%	10.33%	10.77%	6,497.06	5,155.34	8
10	Australia	All ordinaries	5,431.4	1.32%	8.69%	8.53%	5,458.90	4,506.30	3
11	U.S.	S&P 500	1,400.95	0.85%	8.17%	9.44%	1,407.89	1,219.29	11
12	Switzerland	Swiss Market	8,641.52	-0.37%	6.65%	12.53%	8,836.29	7,123.18	13
13	France	CAC 40	5,389.46	-0.82%	5.45%	6.83%	5,518.43	4,551.28	10
14	UK	FTSE 100	6,122.1	-1.01%	4.14%	5.72%	6,256.80	5,423.20	9
15	Japan	Nikkei 225	15,734.6	-6.41%	-1.28%	-1.48%	17,563.37	14,045.53	4

GLOBAL INTEREST RATES

Country	Interest rate	Rate	Last change	June 2006	December 2005
U.S.	Fed Funds Rate	5.25	0.25 (June 06)	5.25	4.55
Japan	Overnight call rate	0.25	0.25 (July 06)	0	0
Eurozone	Refi rate	3.25	0.25 (Oct. 06)	2.75	2.25
UK	Repo rate	5.00	0.25 (Nov. 06)	4.50	4.50
Canada	Overnight funding rate	4.25	0.25 (May 06)	4.25	3.25
Switzerland	3-month Swiss Libor	1.75	0.25 (Sept. 06)	1.50	1.00
Australia	Cash rate	6.25	0.25 (Nov. 06)	5.75	5.5
New Zealand	Cash rate	7.25	0.25 (Dec. 05)	7.25	7.25
Brazil	Selic rate	13.75	0.5 (Oct. 06)	15.25	18.00
Korea	Overnight call rate	4.50	0.25 (Aug. 06)	4.25	3.75
Taiwan	Discount rate	2.50	0.125 (June 06)	2.50	2.25
India	Reverse repo rate	6.00	0.25 (July 06)	5.75	5.25
South Africa	Repurchase rate	8.50	0.5 (Oct. 06)	7.50	7.00

GLOBAL BOND RATES

Rank	Country	Rate	Nov. 26	1-month	3-month	6-month	Previous
1	Germany	BUND	118.46	1.46%	0.38%	1.48%	5
2	U.S.	10-year T-note	108.16	0.94%	1.07%	2.82%	4
3	Japan	Government Bond	135.18	0.77%	0.70%	1.40%	3
4	Australia	10-year bonds	94.435	0.18%	0.10%	0.17%	1
5	UK	Short sterling	94.67	0.07%	-0.16%	-0.54%	2

EUROPE

▼ **The Bank of England raised its benchmark bank rate** 25 basis points to 5 percent in November, the highest interest rate the country has seen in five years. The rate dropped 0.25 percent to 4.5 percent in August 2005, but the BOE has now raised rates twice in four months.

▼ **The UK's October unemployment rate** increased 0.1 percent to 5.6 from the previous month. Unemployment increased 0.8 percent from October 2005.

▼ **France's Q3 economy** decreased from the previous quarter. Its September unemployment rate fell 0.2 percent from the previous month to 8.8 percent and dropped 1 percent from the same month a year prior.

▼ **Germany's third-quarter GDP** increased 1 percent compared to Q2, while it rose 2.8 percent compared to the same quarter in the previous year. The jobless rate fell 0.3 percent to 10.1 percent, 1.3 percent lower than the rate a year prior.

▼ **The Netherlands followed a European trend of voting for fringe parties** in elections, as late-November results showed centrist parties such as the Christian Democrats lost ground while leftist parties such as the Socialist Party enjoyed huge gains. The results were a continued sign of dissension against business friendly and socially conservative measures that have passed through Parliament. In the end, 10 different parties won seats.

▼ **Norway increased its benchmark deposit rate** by 0.25 percent in November, putting the rate at 3.25 percent. The increase was the sixth-straight rise of 25 basis points dating back to June 2005.

▼ **Poland's ruling party, the conservative Law and Justice party**, performed well in rural areas but poorly in many major cities in the November elections. A big loss for the party was in Warsaw where former central bank head Hanna Gronkiewicz-Waltz defeated incumbent Kazimierz Marcinkiewicw to become the city's first female mayor.

ASIA & THE SOUTH PACIFIC

▼ According to preliminary data, **Japan's third-quarter economy** grew 0.5 percent from the previous quarter and 2.7 percent from the same quarter a year ago.

▼ **The Reserve Bank of Australia** continued its tightening cycle, raising the country's benchmark cash rate 0.25 percent to 6.25 percent in November. The rate hike was the third since May.

▼ **Hong Kong's preliminary figures for Q3** show a 6.8-percent increase in the economy from the previous quarter and a 5.5-percent gain compared to Q3 2005. The growth marked the 12th consecutive quarter of above-trend growth. Helen Chan, the acting Hong Kong government economist, says 2006's GDP growth has been revised upwards to 6.5 percent from a range of 4-5 percent. The Hong Kong Q3 unemployment rate fell 0.2 percent from the second quarter to 4.5 percent, a drop of 0.8 percent from the same quarter a year ago.

▼ **Australia's Q3 jobless rate** decreased 0.2 percent from the previous quarter to 4.6 percent, a drop of 0.6 percent on the same quarter a year ago.

▼ **The Bank of Indonesia lowered the BI interest rate** 50 basis points to 10.25 percent in November, the fifth straight month of cuts. The rate is down 2.5 percent from its January 2006 level of 12.75 percent, but remains significantly up from its December 2004 rate of 7.4 percent.

▼ **Singapore's Q3 GDP** rose 0.8 percent compared to the same quarter a year earlier.

AMERICAS

▼ **Canada's October jobless rate** decreased 0.2 percent from September to 6.2 percent. Youth employment surged after four months of decline, although central Canada is still experiencing a downturn in manufacturing employment. The rate was 0.4-percent lower than the prior year.

▼ **Argentina's Q3 jobless rate** fell 0.2 percent from the previous quarter to 10.2 percent and dropped 0.9 percent compared to the same quarter in 2005. The rate has now dropped more than 1 percent from Q1 and Q2, as employment was particularly strong in areas related to tradable goods.

▼ **Brazil's September unemployment rate** decreased 0.6 percent from the previous month to 10 percent. The rate was 0.4-percent higher than September 2005.

AFRICA

▼ Joseph Kabila became the **Congo's first freely elected president**, beating Jean-Pierre Bemba in an election runoff Oct. 29. Bemba, who received 42 percent of the vote, protested the election by claiming ballot fraud, but Congo's Supreme Court upheld Kabila's victory.

Legend

CPI: Consumer Price Index
ECB: European Central Bank
FOMC: Federal Open Market Committee
GDP: Gross domestic product
ISM: Institute for Supply Management
PPI: Producer Price Index

Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
				1 **U.S.:** ISM **Japan:** Account balances **Australia:** Index of commodity prices	**2**
4 **Japan:** Monetary base	**5** **Canada:** Interest rate announcement **Australia:** Reserve bank meeting	**6** **Great Britain:** Monetary Policy Committee meeting **Germany:** Orders received and manufacturing turnover **Brazil:** Monthly survey of mining and manufacturing physical production **South Africa:** Reserve Bank meeting	**7** **ECB:** Governing council meeting **Great Britain:** Monetary Policy Committee meeting **Australia:** Official reserve assets **New Zealand:** Reserve Bank statement **Korea:** Monetary Policy Committee meeting **South Africa:** Reserve Bank meeting	**8** **U.S.:** Unemployment **Germany:** Production index; foreign trade; bankruptcies **Brazil:** CPI **Mexico:** Monetary policy announcement	
11 **U.S.:** Wholesale inventories	**12** **U.S.:** Trade balance; FOMC meeting **Japan:** Corporate goods price index **Great Britain:** CPI	**13** **U.S.:** Retail sales **Japan:** Balance of payments **Great Britain:** Unemployment **Germany:** CPI **Thailand:** Monetary Policy Committee meeting	**14** **Japan:** Monetary survey **Canada:** Manufacturing survey **Italy:** Balance of payments **Brazil:** Domestic federal public debt and open market operations **Sweden:** Executive Board monetary policy meeting **Philippines:** Monetary Board meeting	**15** **U.S.:** CPI **Brazil:** Monthly survey of trade	
18 **Japan:** Monetary policy meeting **Canada:** Leading indicators **Hungary:** Monetary council meeting	**19** **U.S.:** PPI **Japan:** Monetary policy meeting **Germany:** PPI **Canada:** CPI **Poland:** Monetary policy meeting **Slovakia:** National Bank meeting	**20** **Great Britain:** Capital issues **Canada:** Wholesale trade **Poland:** Monetary policy meeting **Czech Republic:** Central Bank board meeting	**21** **U.S.:** Leading indicators; GDP **ECB:** Governing council and general council meeting **Great Britain:** Balance of payments **Canada:** Retail trade; unemployment; GDP **Brazil:** Monetary policy and credit operations; unemployment	**22** **U.S.:** Durable goods **Brazil:** Fiscal policy	
25 **Israel:** Interest rate announce-ment	**26** **Japan:** Corporate service price index	**27**	**28**	**29** **Australia:** International reserves and foreign currency liquidity **Italy:** International reserves and foreign currency liquidity	**27**
1	**2** **U.S:** ISM **Australia:** Index of commodity prices	**3**	**4** **Japan:** Account balances	**5** **U.S:** Unemployment **Japan:** Monetary base	

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

EVENTS

Event: FXCM's Currency Trading Expo

Date: Dec. 9-10

Location: MGM Grand, Las Vegas

For more information: Visit www.fxcmexpo.com

•

Event: The Association for Technical Analysis featuring Larry McMillan as speaker

Date: Jan. 16

Location: Dallas

For more information: Call (214) 859-6900 or e-mail info@afta-dfw.org

•

Event: The World Money Show

Date: Feb. 7-10

Location: The Gaylord Palms Resort, Orlando

For more information: Visit www.worldmoneyshow.com

•

Event: The Traders Expo New York

Date: Feb. 17-20

Location: Marriott Marquis Hotel, New York, N.Y.

For more information: Visit www.tradersexpo.com

•

Event: TradeTech Foreign Exchange 2007

Date: Feb. 21-22

Location: New York Information Technology Center, New York, NY

For more information: Visit www.tradetechforeignexchange.com

•

Event: 31st Annual International Futures Industry Conference

Date: March 14-17

Location: Boca Raton Resort & Club, Boca Raton, Fla.

For more information: Visit www.futuresindustry.org/boca2007-2735.asp

•

Event: The Traders Expo San Diego

Date: June 20-23

Location: Marriott Hotel & Marina, San Diego

For more information: Visit www.tradersexpo.com

•

Event: Forex Trading Expo

Date: Sept. 15-16

Location: Mandalay Bay Hotel and Casino, Las Vegas

For more information: Visit www.forextradingexpo.com

NEW PRODUCTS AND SERVICES

▼ Online forex trading provider **Interbank FX** has introduced its platinum rewards Visa credit card and platinum Visa debit card exclusively for Interbank FX customers. The credit card not only allows traders to get points for dollars spent but also delivers 50 reward points for every round-turn standard foreign exchange lot traded. These reward points can be redeemed for airline travel, cruise vacations, and many other rewards. Because of the need for a Social Security Number, the credit card is open to U.S. residents only. The debit card eliminates the downtime and the fees associated with wire transfers. From any location in the world, Interbank FX account holders are able to move money from their margin accounts into an FDIC-insured money market or high yield checking account. These funds can then be accessed quickly and easily, exactly like a standard debit card. The debit card is available worldwide, regardless of location. More information can be found at www.interbankfx.com.

Note: The New Products and Services section is a forum for industry businesses to announce new products and upgrades. Listings are adapted from press releases and are not endorsements or recommendations from the Active Trader Magazine Group. E-mail press releases to editorial@currencytradermag.com. Publication is not guaranteed.

Average and Median: The *mean* (or average) of a set of values is the sum of the values divided by the number of values in the set. If a set consists of 10 numbers, add them and divide by 10 to get the mean.

A statistical weakness of the mean is that it can be distorted by exceptionally large or small values. For example, the mean of 1, 2, 3, 4, 5, 6, 7, and 200 is 28.5 (228/8). Take away 200, and the mean of the remaining seven numbers is 4, which is much more representative of the numbers in this set than 28.5.

The *median* can help gauge how representative a mean really is. The median of a data set is its middle value (when the set has an odd number of elements) or the mean of the middle two elements (when the set has an even number of elements). The median is less susceptible than the mean to distortion from extreme, non-representative values. The median of 1, 2, 3, 4, 5, 6, 7, and 200 is 4.5 ((4+5)/2), which is much more in line with the majority of numbers in the set.

Bullish engulfing line: A tall candle in a downswing with a white real body that engulfs (i.e., overlaps) the previous candle's real body. The bears were in charge early, as prices opened below the prior candle's real body, but the bulls took over later, as prices closed above the previous real body.

Carry trades involve buying (or lending) a currency with a high interest rate and selling (or borrowing) a currency with a low interest rate. Traders looking to "earn carry" will buy a high-yielding currency while simultaneously selling a low-yielding currency.

Commitment of Traders (COT) report: A report published by the Commodity Futures Trading Commission that show the existing positions ("open interest") of different categories of traders — commercial hedgers, large speculators, and retail traders. Traders often look for clues about upcoming market direction based on the long or short biases of these different groups of traders.

Gordian Knot: Reference to a legend of Alexander the Great. There was a prophecy that whoever was able to undo the Gordian Knot, which had supposedly been tied by King Midas, would rule Asia. When in Gordium, Turkey, Alexander supposedly slashed through the knot with the sword and claimed that by doing so he had fulfilled the prophecy.

Harami: A candle (either white or black but usually the opposite color of the preceding bar) whose real body is inside the previous candle's real body.

Linear regression ("best-fit") line: A way to calculate a straight line that best fits a set of data (such as closing prices over a certain period) — that is, a line that most accurately reflects the slope, or trend, of the data.

A regression line is calculated using the "least squares" method, which refers to finding the minimum squared (x*x, or x^2) differences between price points and a straight line. For example, if two closing prices are 2 and 3 points away (the distance being calculated vertically) from a straight line, the squared differences between the points and the line are 4 and 9, respectively.

The squared differences are used (instead of just the differences) because some differences are negative (for points below the line) and others are positive (for points above the line). Squaring all the differences creates all-positive values and allows you to calculate a formula for the straight line.

The "best-fit" line is the line for which the sum of the squared differences between each price and the straight line are minimized.

The formula for a straight line (y) is:

y = a + b*t

where

t = time

a = the initial value of the line when "t" is equal to zero (sometimes called the "intercept" value – i.e., the point at which the line intercepts the vertical y-axis) or the point at which a specific line begins;

b = the slope of the line, which is the rate at which the line rises or falls (e.g., 0.75 points per day).

When fitting a straight line to N data points, the "best-fit" coefficients a and b can be solved for by:

$$a = [2(2N+1)/N(N-1)] \sum_{t=1}^{N} p(t) + [6/(N(N-1)] \sum_{t=1}^{N} t^*p(t)$$

$$b = [12/N(N^2 - 1)] \sum_{t=1}^{N} t^*p(t) - [6/N(N-1)] \sum_{t=1}^{N} p(t)$$

where

p(t) = the price at point t;

N = the number of prices we are using to calculate the coefficients.

Moving average convergence-divergence (MACD): Although it is often grouped with oscillators, the MACD is more of an intermediate-term trend indicator (although it can reflect overbought and oversold conditions).

The default MACD line (which can also be plotted as a histogram, as is the case in the accompanying article) is created by subtracting a 26-period exponential moving average (EMA) of closing prices from a 12-period EMA of closing prices; a nine-period EMA is then applied to the MACD line to create a "signal line."

MACD = EMA(C,12)-EMA(C,26)

Signal line = EMA(MACD,9)

Relative strength index (RSI): Developed by Welles Wilder, the relative strength index (RSI) is an indicator in the "oscillator" family designed to reflect shorter-term momentum. It ranges from zero to 100, with higher readings supposedly corresponding to overbought levels and low readings reflecting the opposite. The formula is:

RSI = 100 – (100/[1+RS])

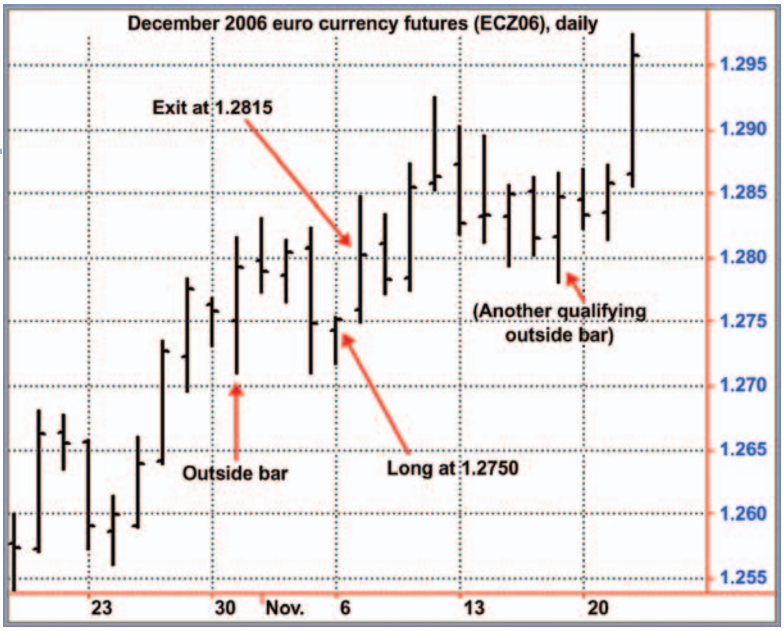
where

RS **=** relative strength = the average of the up closes over the calculation period (e.g., 10 bars, 14 bars) divided by the average of the down closes over the calculation period.

For example, when calculating a 10-day RSI, if six of the days closed higher than the previous day's close, you would subtract the previous close from the current close for these days, add up the differences, and divide the result by 10 to get the up-close average. (Note that the sum is divided by the total number of days in the look-back period and not the number of up-closing days.)

For the four days that closed lower than the previous day's close, you would subtract the current close from the previous low, add these differences, and divide by 10 to get the down-close average. If the up-close average was .8 and the down close average was .4, the relative strength over this period would be 2. The resulting RSI would be 100 - (100/[1+2]) = 100 - 33.3 = 66.67.

Last month's Currency System Analysis triggers long trade in the euro.



Source: TradeStation

TRADE

Date: Monday, Nov. 6.

Entry: Long December 2006 euro futures (ECZ06) at 1.2750.

Reason(s) for trade/setup: This trade was triggered by the "Outside bar opportunity system" (*Currency Trader*, November 2006), although the position was traded on a discretionary basis.

The system was based on research from the article "Trading the Euro inside-out" (*Currency Trader*, September 2005). The research found outside bars that close strongly and are either much higher than the preceding bar, higher than at least the three preceding bars, or both, are the most likely to be followed by upside follow-through.

The basic trade rules are:

1. Go long on tomorrow's open if today was an outside day that closed above today's open, closed above yesterday's close, and has a high above the highs of the past three days.
2. Exit with a limit order 0.0250 above the entry price.
3. Exit any open position on the close of the 10th day after the outside day.
4. Exit with a loss if the market closes below the low of the outside day.

A qualifying outside bar formed on Oct. 31, but we weren't watching the system in real-time and were unaware of the signal until three days later on Nov. 3 — a day the euro pulled back almost to the low of the outside bar, which is the system's initial stop-loss point.

We decided to watch the market the next day and enter if the euro remained above the Nov. 3 low with the idea that we would be entering on a pullback after the outside-bar up move, and would be able to risk very little. We ended up getting in the next day (Nov. 6), which was a narrow-range day that closed near its high.

Initial stop: 1.2693, which is 0.0018 below the low of the outside bar.

Initial target: 1.300, which is the entry price plus the system's 0.0250 profit target.

RESULT

Exit: 1.2815.

Profit/loss: +0.0065 (0.5 percent).

Reason for exit: Weak nerves.

Trade executed according to plan? No.

Outcome: We pulled the (exit) trigger very fast on this trade for the simple reason that currencies — particularly the euro — have been very congested lately. We were afraid the nice profit that materialized the day after entry would disappear, as has been the case with so many other trades recently. After trading up to 1.2848 on Nov. 7, the market was selling off into the close, and we thought the up move was going to end almost as soon as it began.

The euro never approached the profit target within 10 days of the outside bar, but it did rally up to 1.2926 the third day after we exited. Even using a tight trailing stop that would have exited, say, a few ticks below the most recent low would have added 0.0035-36 points to the trade. Exiting on the close 10 days after the outside bar would have added about the same. (On the other hand, entering on the pullback after the pattern improved upon the default entry price by about 0.0050.)

Interestingly, another qualifying outside bar formed on Nov. 22 as we were going to press. We entered that trade immediately at 1.2867.

Note: Initial trade targets are typically based on things such as the historical performance of a price pattern or 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	Entry	Initial stop	Initial target	IRR	Exit	Date	P/L	LOP	LOL	Trade length
11/6/06	ECZ06	1.2750	1.2693	1.300	4.39	1.2815	11/7/06	+0.0065 (0.5%)	0.0176	—	1 day

Legend: IRR — initial reward/risk ratio (initial target amount/initial stop amount); LOP — largest open profit (maximum available profit during lifetime of trade); LOL — largest open loss (maximum potential loss during life of trade).

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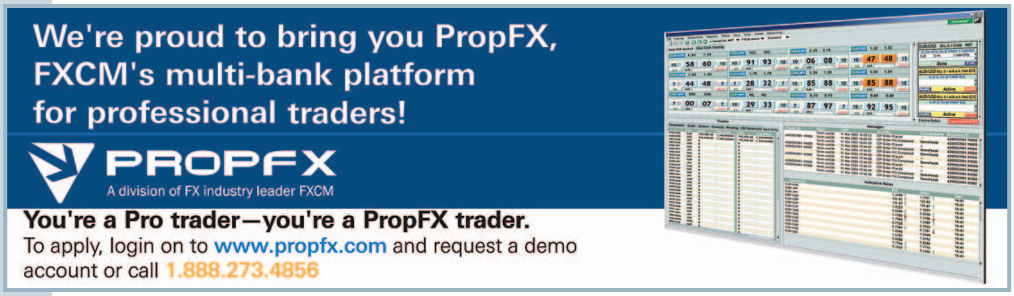


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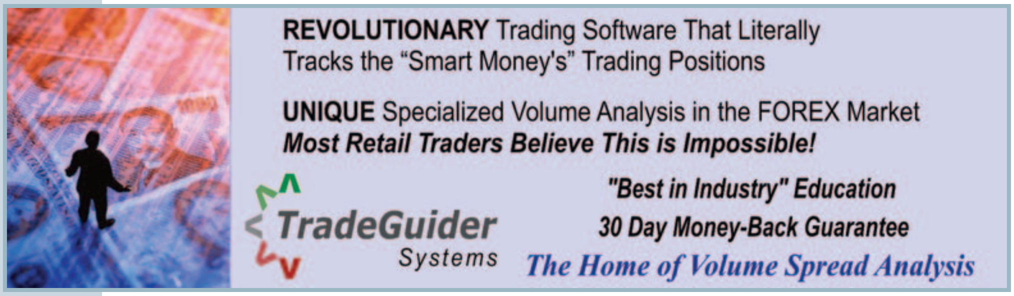
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