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**With more than 20 years'  
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# CONTENTS

About the Author

Acknowledgments

Disclaimer

Preface

Introduction

## **Chapter 1 The World Of Foreign Exchange**

The Evolution of Forex & Professional Trading

Foreign Exchange Today

Where Does Retail Forex Fit In?

Why Do the Currencies Fluctuate?

What is a Forex Deal & What does it involve?

Additional Trading Terminology

## **Chapter 2 Currencies: The Inside Story**

Forex Currency Symbols

Major Currency Pairings

Cross Rates

Currency Correlations

The Importance of the Numbers

Risk Currencies

Volatility for Each Currency Pair is Unique

Profit & Loss (P & L)

## **Chapter 3 Know Your Markets**

Understanding the Trading Sessions

Forex Time Zone Activity

The Hidden Danger Zones

## **Chapter 4 Capital - Risk Management**

The Fundamental Importance of Risk Management

Capital Management

Risk Reward Ratio

Trading Plan

## **Chapter 5 Technical Analysis**

The Principles

The Truth about Technical Analysis

Types of Charts

Types of Trends

Trendlines - Support & Resistance

Retracement

Momentum Trading Indicators

The Final Say

## **Chapter 6 Fundamental Analysis**

What is Fundamental Analysis?

Global Economic Indicators

Important Country Indicators

Central Banks - Interest Rate Announcements

Pros and Cons of Fundamental Analysis

## **Chapter 7 Trading Strategies**

Why Use Different Strategies?

Entering / Exiting Trades

Trading Strategies the Professionals Use

Trend Trading

Range Trading

Break Trading

False Break Trading

Trading Economic Data Releases

Trailing Stops

The Carry Trade

The Truth about Scalping

## **Chapter 8 Order Types & Putting Them On**

Main Types of Orders

Market

Limit

Stop Loss

Take Profit

Stop Entry

One Cancels the Other (OCO)

If Done OCO

Trailing Stop Loss

Good Till Cancelled

## **Chapter 9 Developing & Planning Trades**

Develop a Trade Plan

Plan Your Day/Week

Planning Fundamental Release Trades

Planning Technical Trades

The Perfect Trading Strategy



## **Chapter 10 Managing Positions Once they're Live**

The Market Is Not Always the Same

Normal Conditions Plan

Choppy Conditions Plan

Volatile Conditions Plan

## **Chapter 11 Trading Psychology**

Patience, Discipline & Control

Impatience & Hesitation

Performance Anxiety – This is where the wheels fall off!

Remedy: Control Your Emotions & Stick to the Plan

Successful Trading Principles

## **Chapter 12 How to Set up Your Trade Station**

Pricing Platform

News & Economic Calendar

Technical Analysis

## **Chapter 13 Choosing a Trading Platform**

Order Functionality

Spreads & Variety of Currencies

Various Access Points

Conclusion

Appendix

Glossary

Bibliography

Index

## About the Author

Brad Gilbert has been a professional Forex Trader since 1990, having worked for Citibank, Commonwealth Bank of Australia and Toronto Dominion Securities for a total of 18 years. He graduated from Sydney University with a Degree in Economics and after starting as a Forex trainee trader he worked his way up through the ranks to be an FX Trading Team Leader and member on the Australian Foreign Exchange Committee. He has lived in Sydney, London, and New York and traded in every major financial centre.

Brad is the founder of Traders 4 Traders a professional forex training company with offices in Sydney, New York and London. He is also a regular contributor to a number of financial magazines and online publications. His clients include banks, corporations and private investors.

Brad is also the Managing Director of Forex Capital Management, an investment company that offers foreign exchange managed discretionary accounts for private investors and financial institutions.

# Acknowledgements

My thanks go to FXASIA ([www.fxasia.com](http://www.fxasia.com)) for the use of various screen shots throughout this book. They're my forex broker of choice and I can't recommend them highly enough. I would also like to thank Market Analyst ([www.market-analyst.com](http://www.market-analyst.com)) for allowing me to publish their screen shots. It is by far the most advanced technical analysis software I have ever used.

This book wouldn't have been possible if not for the guidance and mentoring of many of my old colleagues. From the very beginning when I was a 'green behind the ears' junior to a 'know it all' Chief Dealer. The trading was always top shelf, the practical jokes never ceased to surprise and the good times....well those memories will live on forever.

Finally, I'd like to thank my gorgeous wife, Amanda, and my three loving daughters Bella, Ivy and Andie. You are an inspiration to me and this book wouldn't have been possible without your support. You definitely keep me grounded!

## Disclaimer

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## Preface

There are many books out there proclaiming to 'tell all' or to 'reveal the secrets' to foreign exchange trading and there are even more guru's offering advice and suggestions on how to trade the market successfully. But do any of these people have any real industry experience in trading foreign exchange? The answer is invariably NO.

I worked on the front line for 18 years at some of the biggest investment banks in the world and made over \$70 million. If you want to make money trading FX, then follow me!

Unlike a lot of people out there who dreamed of dealing rooms and a trading career, I didn't know anything about the foreign exchange market until after I graduated from Economics at University. Sure I loved to punt, but the horses and sport were as far as it went. I never owned shares and never really had an interest in the stock market for that matter. I just so happened to be playing rugby with a few guys who were in the 'game'. After a chat about what they did (which all went over my head) they convinced me that I had all the attributes to become a successful Forex trader: confident, good with numbers, a team player, a risk taker and an ability to handle pressure situations with ease. So I applied for a graduate trading position at Citibank. Two months, one hundred-sixty applicants and five interviews later, I had landed the job. This was a huge turning point in my life.

I was a sponge for the first few years, learning all the rules, the ins and outs of the market, the terminology and how to transact in the wholesale market. Within three years I was making more money than the senior traders who had been around for years. By 1995 I had outgrown the Sydney trading desk and was promoted to senior dealer status and transferred to London.

This was a great move, although it didn't seem like it at first. The market is bigger and louder and the traders are far more aggressive. Being the only foreigner in a fifty-man trading team, I was quickly put in my place. I sat in the shadows of the top dogs for a good six months, quietly going about my business and observing their every move. I was looking for an opportunity to show my wares and it came out of the blue when one of the senior guys was off sick. I got the chance to quote the USD/YEN book for the day, which turned out to be a defining moment in my career.

I was thirty minutes into the day when the Japanese Minister of Finance Eisuke Sakakibara (Mr Yen) came out with some outrageous comments about the level of the Yen. I was caught long US dollars and the currency had dropped over 100 points in seconds, I was down well over 300K. There was a small group of senior traders laughing and I heard one of them say 'this will put him in his place'. It was all the motivation I needed, it was now or never! After the dust had settled some eight hours later, I walked out of the dealing room to a standing ovation. I had turned my initial losses into a half a million pound profit. I had officially arrived in the big leagues.

Over the next thirteen years I worked in New York, Tokyo, Singapore, Hong Kong and finally back to Sydney. I learnt to become resourceful and my trading became more dynamic as I endeavoured to stay ahead of the pack and on top of the game. The one key factor that stands out for me is that all the traders I met and worked with incorporated the same basic trading methodology. Successful traders don't use any secret strategies; they use the same simple strategies as everyone else. They are just quicker to modify and adapt them as the market conditions and driving forces change, keeping them ahead of the market.

I realised there are three major components to successful trading. Firstly, you have to understand the market, the participants in it and how it all works. In today's market 95% of traders are speculators and hence it's no surprise 95% of traders new to the market lose their money. It's the wholesale market, the remaining 5% that control the entire market. If you don't know how they trade, then you're more then likely going to end up a part of these statistics. Secondly, it's the trader themselves. Self-sabotage is one of the major reasons why traders never fully realise their full potential. Patience, discipline and control of your emotional state are imperative if you want to be successful. Thirdly, a trader needs structured trading methodology, incorporating stringent capital management and a precise trade plan. Having a precise trade plan should remove the emotions of fear and greed and set you up for continued growth in the market.

My twenty years of experience has taught me that knowing when to trade and when not to, is integral to success. Staying out of the markets in illiquid volatile conditions, during inexplicable events and in particular when the currencies are in uncharted territory can lead to significant improvements in your overall performance. It's a misnomer that traders in investment banks are trading all day long. I spend the majority of most days reading newspapers and otherwise occupying myself to avoid placing 'bored trades'. Successful traders do fewer trades, not more.

This book has been written with the clear intention of giving the retail trader a very real and practical guide to trading the forex markets based on my own personal experiences, incorporating the skills and strategies used by commercial interbank traders and hedge funds. Believe me, running with the 'big dogs' is a lot more fun and a whole lot more rewarding than running against them. Understanding this is a key part to your success.

This book purely focuses on what you need to know to build your wealth and be a successful forex trader. I have purposefully left out all the bits and pieces you don't need to know. This knowledge is not something I have read in other books nor heard about on various blogs, but real first-hand experience from my time trading in Sydney, London and New York for some of the biggest banks in the world.

Once you have completed the book you should feel comfortable knowing that you are now a part of the market instead of a random speculator. You will see the market through a new set of eyes and be able to take advantage of the many opportunities the market throws up day after day, week after week.

Good luck and happy trading.



# Introduction

With the Global Financial Crisis (GFC) and the ensuing melt-down of global stocks there has never been a better time to trade in the foreign exchange market. The forex market is the largest and most liquid in the world, with an average daily turnover of four trillion USD. To put this into perspective the New York Stock Exchange turns over twenty five billion a day, that's fifteen times less than the forex market. Unlike the stock market traders, you don't have to wait for a bell to ring. All you need is access to the internet and you can trade around the clock.

Just about all forex books and training programs claim you must follow a set of 'their' rules to be successful. This couldn't be further from the truth. There is no definitive rule in trading foreign exchange. There is no right or wrong. The one thing that differentiates one trader from the next is success. Don't be mistaken, understanding the market and the players in it and how they make their trading decisions is imperative, but there is no universal rule.

The foreign exchange market is truly dynamic and understanding this will put you a step closer to realising your dreams. You can use as many auto-trader black box programs as you like and they will all come up with the same result: random sporadic success. You'd be better off tossing a coin. The forex market is run by humans, who are by general definition emotional. So how can a mathematical formula or program replicate this human element? The answer: they can't.

The best we can do is prepare ourselves for every possible trading opportunity and to do this you need to have a complete understanding of the markets, the currencies, your capital management, technical and fundamental analysis, and the key strategies you're going to use. So without further ado let's get stuck into it!

# Chapter 1 The World Of Foreign Exchange

## The Evolution of Forex & Professional Trading

Forex = Foreign Exchange, FX, Spot FX, Currency Trading Market

People have been borrowing, lending and exchanging money for centuries, and as long as trade and investment continues in a world where sovereign governments control national currencies, they must continue to do so. The foreign exchange market exists to facilitate this conversion of one national currency into another.

I won't bore you to tears with a detailed history of foreign exchange, as this book is purely about trading and the history behind the market isn't relevant, anyway. Put simply, the Forex market began to emerge in 1978 when the worldwide currencies were allowed to 'float' according to supply and demand.

Originally it was limited to banks and central banks. This was mainly due to the counterparty and credit risks involved with transacting in the market. Each bank was given a credit rating by an independent ratings agency, and this would be used to set credit lines with other banks in the market. If you had a bad credit rating, you didn't get to trade with many, if any, banks at all. When I first started at Citibank in 1990, we wouldn't trade with any institution that had a credit rating below AAA-minus. We had to check the credit rating of irregular counterparties before every trade to make sure they could settle the transaction when the deal matured. This process was still being carried out into the late nineties.

The central banks at this stage were primarily focused on maintaining economic stability and didn't get involved in the market unless absolutely necessary. They would intervene directly in the market when there was excessive volatility or extreme one-way moves in their currencies.

Then, during the eighties, corporations that were clients of the banks started speculative trading outside their normal foreign exchange operations. The market began to evolve rapidly as the number of players in it grew exponentially. Trading at this stage was conducted

through brokers over phones, and the deals were confirmed via telex. Access to the market involved paying exorbitant brokerage fees and large spreads, making it largely inaccessible to the man on the street.

Then around 1995 there was progressive development and reform of the financial sectors. These factors combined with the development of information and communication technologies and the establishment of an international banking and settlements system, led to massive and rapid expansion of the foreign exchange market.

It was at this time the Bank of International Settlements (BIS) centralised all clearing operations in the market. If you dealt with a bank you didn't have credit with, the counterparty name would be automatically switched to a bank you did have credit with. This removed a lot of the counterparty and credit risks that were previously hindering the growth of the market. Trading was now being conducted over electronic broking networks and this had a huge impact on the volume and speed of trading. Trade processing was faster, more efficient and a lot more accurate and it enabled all financial institutions to trade in the market regardless of their credit rating.

Then during the late nineties a number of the larger banks developed trading platforms targeting smaller banks who wanted to reduce their costs. By transacting directly with the bigger banks the smaller banks could eliminate all brokerage costs. It turned out to be a booming business and led to rapid development of trading (broking) platforms.

Through the success of these trading platforms, the larger banks expanded their market to include the retail sector. By 2005 the new trading platforms gave the retail trader access to the market with the same speed, pricing and execution that commercial traders have without any of the costs.

On top of this margin lending facilities enabled investors with very little capital to trade vast sums of money. You could leverage your capital up to 500:1 making it possible to make large amounts of money in a very short period of time. It was the perfect market and it was now officially open to the retail market.

## Foreign Exchange Today

The forex market today is the largest global financial market in the world. Its growth has been unprecedented and continues to be unequalled by any other trading market. This can be credited to the ease of access to the market and the fact that the principles and conventions applied in the forex market are universal.

Participants now include banks, central banks, currency speculators, corporations, hedge funds and many other financial institutions. They are connected over an electronic network which allows them to trade the currencies of most countries of the world. Foreign currencies are simultaneously bought and sold across global markets and trader's investments increase or decrease in value based upon currency movements.

One of the big appeals of the forex market today is that it is open for investors of all levels and you can work from anywhere at anytime as long as you have access to the internet. The forex market also responds to real time events and news, creating ongoing volatility and trading opportunities. You can profit in both rising and falling markets. Also unlike the stock markets you don't have to wait for a bell to ring to start and finish trading. The markets open 5am Monday morning in Sydney and close at 5pm Friday night in New York. You can basically trade around the clock.

The wholesale market itself has not changed much in the past ten years; it's just become a whole lot more efficient. Technology advances have reduced the head count of many of the larger trading teams and since the global financial crisis the risk appetites of many of the banks has been curtailed somewhat.

They have channelled a lot of their resources into expanding and developing more efficient trading platforms for the retail market. The competition in the market place nowadays is such that the retail trader can now get better pricing than a lot of the bank traders.

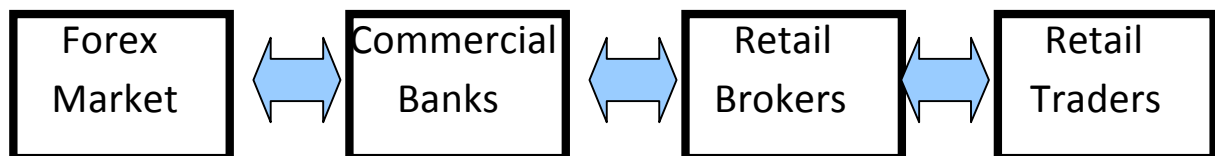
## Where Does Retail Forex Fit In?

Being part of the market is one thing but understanding where you fit in the food chain is also very important. Understanding the market and where your prices come from will help explain what's happening with the execution of your trades and give you confidence that your

trades will be executed efficiently and your consequent risk managed adequately.

It's a common misnomer that brokers skew their prices to stop you out, or change their rates to make more money out of you when you try to hit the market live. This couldn't be further from the truth.

'The Forex Trade Chain'



The retail trader relies on the retail broker for all their trading needs. The retail broker gets all their pricing and execution from the commercial banks, which in turn access the forex market to cover their risk.

Now if there are any hiccups or volatility in the main market, this will be replicated down the trade chain. The rates the retail brokers get from commercial banks are directly passed on to you. It's the commercial banks reacting to market fluctuations that are causing all the price changes and ensuing havoc. They send down the rates and you either trade or not. Sometimes the price changes will work in your favour and sometimes they will be against you. Most traders don't dwell on this and expect this to work itself out over the long haul. So next time when you see the rates jump around and you think it's the broker messing with the rates, think again.

## Why Do The Currencies Fluctuate?

It all comes back to simple economics and the theory of supply and demand. If there is too much supply (more sellers than buyers) the currencies go down and if there is too much demand (more buyers than sellers) then the currencies go up. Simple as that!

But there are three main reasons why this imbalance occurs and it comes back to: commercial transactions, economic data releases and political/central bank intervention.

Commercial transactions include the business of importing and exporting as well as mergers and acquisitions. Since the beginning of time the business of importing and exporting has created huge flows

of foreign exchange. It was in fact one of the main reasons why foreign exchange markets began.

Large shipments of goods from one country to another require transfers of large sums of money as payments are made. This sends shock waves through the market as the banks cover these customer flows. For example we had to cover a transaction where Qantas (Australian Company) had to pay for ten new planes from Boeing (American Company). The deal was worth close to \$800 million and they were required to make payment in USD. We had to buy 800 million USD and sell the Australian dollar equivalent. This transaction alone sent the AUD/USD down 200 points as supply far outweighed demand.

In this modern age of globalisation it is not uncommon for multinational companies to expand offshore and buy/sell businesses abroad, commonly referred to as mergers and acquisitions. These transactions have the same impact as the importer/exporter flows but are more often much larger amounts and invariably in the billions. These transactions will not only change the value of the currency dramatically but can often alter the trend of the currency.

These days' economic data releases are the major reason why currencies fluctuate. These economic data releases give an overall view of the state of the economy and more importantly the direction of interest rates. The overall health of the economy is assessed through these key releases and they create instant trading opportunities. They are scheduled a year in advance in all developed countries so you can easily plan your trading around these key market movers. We will be going into a lot more detail when we look at fundamental analysis in chapter 6.

Last but not least is political and central bank intervention. The currencies are continually monitored by each country's central bank. If there is any irregular activity or the markets become unstable and liquidity dries up, the central banks will intervene to stabilise the markets. This is usually a very dramatic event and once the central bank is seen in the market, it is a signal that the move is over or will reverse quickly.

The politicians on the other hand do not have access to intervene directly in the market. Instead they hold press conferences and make sweeping statements about their displeasure of current moves or

levels of the currency. This is commonly referred to as 'jawboning'. The more important the politician the more the market listens. Because there is no direct intervention in the market this type of intervention is not as potent or long lasting.

## What is a Forex Deal and What Does it Involve?

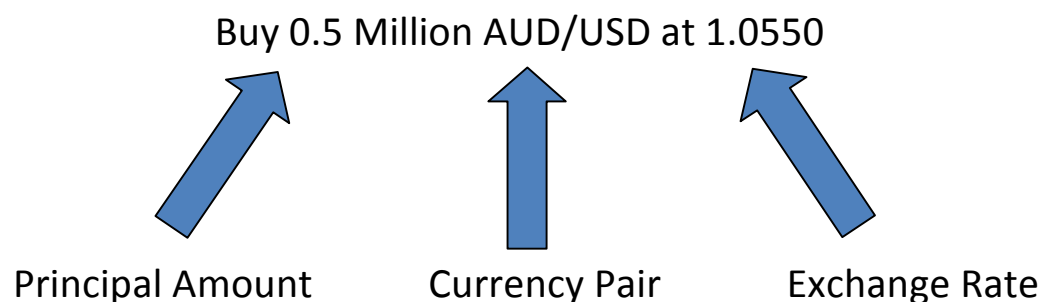
Forex trades are non-deliverable trades: Currencies are not physically traded, but rather as soon as a trade is executed a contract for difference (CFD) is agreed upon and performed between two parties-trader and broker.

A contract for difference is a legally binding agreement between the client and the CFD provider to exchange at the close of a contract the difference between the price of the underlying financial instrument at the opening and the price at closing. CFD's simply mirror the underlying market and allow investors to gain exposure to these markets without the obligations and costs of ownership.

The contract is comprised of three components:

1. The currency pair
2. The principal amount
3. The exchange rate

Example: An order to buy Aussie dollars



## The Currency Pair

Every time you enter into a trade one currency is bought and another sold simultaneously. The first currency in the exchange rate is the base currency and the second currency is the terms currency. In the above example the Australian dollar is the base currency and the USD is the terms currency.

Note: A cross rate refers to any quote which does not include the USD. They are generated by crossing the major currencies together.

When trading you refer to the currency pair you are trading by the base currency only. When doing so it is taken for granted that it is against the USD.

Example:

If you bought EUR/USD, you would say you bought EUR.

If you sold GBP/USD, you would say you sold GBP.

If you traded a currency pair where the USD is the base currency, then you would have to quantify which currency that was so you would have to say the whole pair.

Example:

If you bought USD/YEN, you would say you bought USD/YEN.

If you sold USD/CAD, you would say you sold USD/CAD.

If you are trading a cross rate, then you would say the whole cross rate in the same way you would if the USD was the base currency.

Example:

If you bought EUR/GBP, you would say you bought EUR/GBP.



If you sold EUR/CHF, you would say you sold EUR/CHF.

### The Principal Amount

This is the amount of base currency involved in the trade, or commonly referred to as the traded amount.

### The Exchange Rate

Is the defined rate at which the deal is transacted or exchanged. This will be the point from where your profits and losses are calculated. It also tells a buyer how much of the terms currency must be paid to obtain one unit of the base currency. Likewise, it tells a seller how much is received in the terms currency when selling one unit of the base currency.

Example:

An exchange rate for AUD/USD of 1.0620 specifies to the buyer of AUD that 1.0620 USD must be paid to obtain one AUD.

### Additional Trading Terminology

Bid Rate = Sell Rate (left hand side)

If you are hitting the market live, this is the rate at which you can sell the base currency. Alternatively, if you have placed a pending limit order to buy (below the market) then this is the level the market needs to go below to set your order.

Offer Rate = Buy Rate (right hand side)

If you are hitting the market live, this is the rate at which you can buy the base currency. Alternatively, if you have placed a pending limit

order to sell (above the market) then this is the level the market needs to go above to set your order.

Example: The EUR/USD is quoted

1.4232(7) – 1.4234(2)

Hitting the market live you can:

Sell at 1.4232(7) – Bid

OR

Buy at 1.4234(2) - Offer



Spread

This is the difference between the bid (buy) and the offer (sell) rate. In the example above the spread is 1.5 points.

A Point or a Pip

They mean the same thing. When we refer to trades we often refer to how many points we have made or lost. Each cent in every currency is made up of 100 points.

When you are trading forex you are basically trading the 3<sup>rd</sup> and 4<sup>th</sup> decimal. For example (EUR/USD) from 1.4200 to 1.4300 cents there is 100 points. Traders refer to all moves in points or pips.

The broker market has become so competitive that many have now introduced a 5<sup>th</sup> decimal to try and tighten the spread even more. In the example above this is why the price is quoted:

1.42327 – 1.42342

Long

When you buy the base currency, you would say you are long.

Example:

If you bought EUR/USD at 1.4225, you would say you are long Euro at 1.4225.

## Short

When you sell the base currency, you would say you are short.

Example:

If you sold GBP/USD at 1.6348, you would say you are short GBP at 1.6348.

## Square

Means you have no open positions. You are neither long nor short.

## Stop Loss (S/L Order)

This is an order or transaction where your position is squared to prevent further losses, or to stop your losses.

Example:

You are long GBP at 1.6348. You set a stop loss order in place at 1.6330. If GBP moves below 1.6330 your position will be squared automatically to prevent you from incurring further losses.

## Take Profit (T/P Order)

This is an order or transaction where your position is squared to lock in your profits, or to take profit.

Example:

You are long NZD at 0.7875. You set a take profit order in place at 0.7900. So if the NZD rallies to 0.7900 your position is squared up automatically to lock in your profits.

## Margin Trading

Margin trading allows investors to buy and sell assets that have a greater value than the capital in their account.

Forex trading is typically executed on margin accounts and the industry practice is to trade on relatively small margin amounts since currency exchange rate fluctuations tend to be less than one or two per cent on any given day.

## Leverage

This is the ratio of investment to actual value. So a ratio of 1:100 would allow you to trade \$100,000 (principal amount) with just \$1,000 invested in your trading account.

## Exposure

This is the potential amount of loss you may incur from fluctuations in the market price.

Example: If you were long 1 million AUD/USD at 1.0520 and you have a stop loss in place at 1.0510, your exposure is 10 points or \$1000 USD.

## Risk

Every foreign exchange trade involves risk. The risk of an adverse change in price of the currency you purchased against the currency you sold.

## Chapter 2 Currencies: The Inside Story

### Forex Currency Symbols

The forex currency symbols are always three letters, where the first two letters identify the name of the country and the third letter identifies the name of that country's currency.

The most popular currencies along with their symbols are shown below.

<u>Symbol</u>	<u>Country</u>	<u>Currency</u>	<u>Industry Name</u>
USD	United States	Dollar (\$)	Dollar
EUR	Euro Zone	Euro (€)	Euro
JPY	Japan	Yen (¥)	Yen
GBP	Great Britain	Pound (£)	Cable, Sterling
CHF	Switzerland	Franc (FR)	Swissy
CAD	Canada	Dollar (\$)	Loonie, Cad
AUD	Australia	Dollar (\$)	Aussie
NZD	New Zealand	Dollar (\$)	Kiwi

### THE U.S. DOLLAR

- Has the strongest influence on the rest of the world with 86% of all forex transactions involving the USD.
- It is also considered the standard currency unit in commodity markets across the globe.
- Under conditions of international economic and political crises, the USD is still considered the main safe haven currency.
- The Federal Reserve (FED) manages the USD.

## THE EURO

- Created in 1999 and implemented in 2002 as a result of monetary reform in Europe and replaced 17 currencies.
- Is the 2nd largest traded currency, involved with 37% of all forex transactions
- The European Central Bank (ECB) manages the Euro.
- The EUR/USD is the biggest traded currency pair in the world.

## THE YEN

- Is the 3rd largest traded currency, involved with 16.5% of all forex transactions and is characterised with low to medium volatility.
- The Japanese economy depends exclusively on its export manufactured goods for growth.
- It is also completely dependent on oil imports making it very sensitive to rises in crude oil prices and overall energy costs.
- The Bank of Japan (BOJ) manages the YEN.

## THE BRITISH POUND

- Is the 4th largest traded currency, involved with 15% of all forex transactions.
- Is generally the highest valued currency out of all the majors.
- The services sector represents the main percentage of the GDP.
- The Bank of England (BOE) manages the GBP.

## THE AUSTRALIAN DOLLAR

- Is the 5th largest traded currency, involved with 7% of all forex transactions.
- Is popular because of Australia's political and economic stability.
- Economy is based on domestic industrial production, tourism and export of raw materials.
- The Reserve Bank of Australia (RBA) manages the AUD.

## THE SWISS FRANC

- Is the 6th largest traded currency, involved with 6% of all forex transactions.
- The letters CHF stand for “Confederatio Helvetica Franc”.
- It is a fairly stable currency and was the traditional safe haven currency during the World Wars.
- The currency is used mostly as a reserve currency by financial institutions and wealthy private individuals.
- The Swiss National Bank (SNB) manages the CHF.

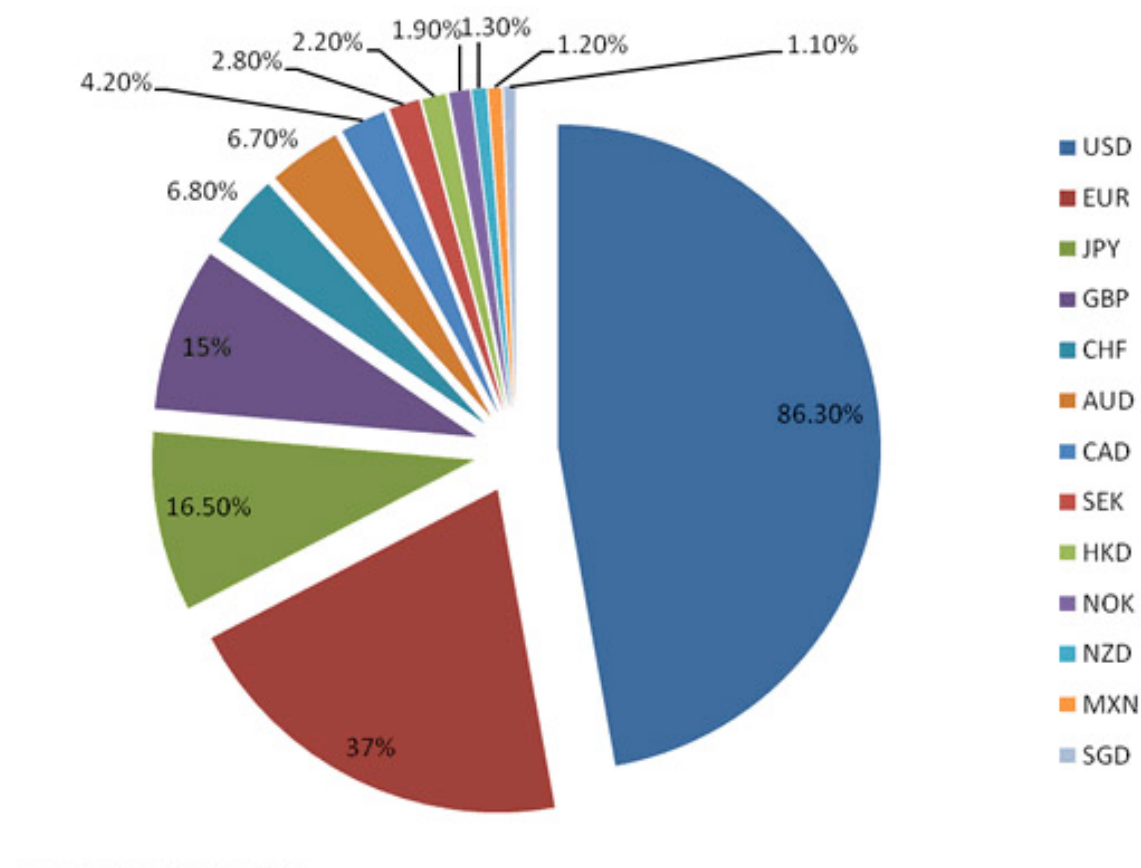
## THE CANADIAN DOLLAR

- Is the 7th largest traded currency, involved with 4% of all forex transactions.
- The volatility of the Canadian dollar is relatively low, although it is heavily related to fluctuations in oil prices (as it has large oil reserves).
- The economy is not too dissimilar to the USA with an emphasis on manufacturing, mining and services sector.
- The Bank of Canada (BOC) manages the CAD.

## THE NEW ZEALAND DOLLAR

- Is the 10th largest traded currency, involved with 1.5% of all forex transactions.
- The economy is agricultural based with a major emphasis on the dairy industry. (They are the biggest milk producer in the world)
- Is it characterised with reasonably high volatility and low levels of liquidity.
- The Reserve Bank of New Zealand (RBNZ) manages the NZD.

Figure 2.1 Currency distribution of reported forex market turnover.



Because two currencies are involved in each transaction, the sum of transactions in individual currencies comes to twice the total reported turnover.  
Source: Bank of International Settlements.



## Major Currency Pairings

The USD is the most traded currency in the world and is basically the benchmark for all currency values. The majority of currencies are traded against the USD.

The seven most traded currency pairs, commonly referred to as the 'majors' are:

EUR/USD - EURO	1.43 <u>00</u>
USD/JPY - YEN	81. <u>00</u>
GBP/USD - GBP	1.63 <u>00</u>
USD/CHF - CHF	0.91 <u>00</u>
AUD/USD - AUD	1.05 <u>00</u>
NZD/USD - NZD	0.77 <u>00</u>
USD/CAD - CAD	1.01 <u>00</u>

Note: the underlined numbers are the actual decimals traded.

Each currency pair has its own unique characteristics based on liquidity, volatility and volume traded. This is generally reflected in the spread the currency pair is quoted.

Basically the bigger the trading pair (in terms of volume) the tighter the dealing spreads. EUR/USD generally has the tightest spreads out of all the majors.

## Cross Rates

Any currency pair that does not include the USD is called a cross rate. The most commonly traded cross rates are those which include the major currency pairs. By simply multiplying or dividing the majors (depending on what currency is the base and terms), you can derive the cross rates. Nowadays the trading platforms save you the trouble of doing the math and quote these cross rates live.

The most commonly traded cross rates are:

EUR/JPY	GBP/JPY	AUD/NZD
EUR/CHF	GBP/CHF	AUD/JPY
EUR/GBP	GBP/AUD	NZD/JPY

In reality though, you can trade any two currencies. It's important to realise the cross rates are generated out of the majors and they do not generally have a life of their own. Therefore they do not behave that well technically. By this I mean the trendlines on your cross rates charts will not be as important as the trendlines on the major pairings.

The EUR cross rates are the closest thing to the major pairings and you can feel more confident charting these pairs. Overall the cross rates are more momentum driven than anything else. They are more volatile, the spreads can be much wider than the majors and they do not trade very well technically. So be cautious when planning to trade them.

## Currency Correlations

One of the most important things to be aware of is which currency pairs are interrelated or correlated. Some currencies tend to move in the same direction whilst others move in the opposite direction. Not understanding or ignoring the correlations is a sure fire way to continued losing trades. This is powerful knowledge for those who trade more than one currency pair. Understanding the correlations helps to hedge, diversify and manage your forex exposure. How do you work out what correlates with what? The correlations are simply determined by the way they are quoted globally.

EUR/USD

GBP/USD

AUD/USD

NZD/USD

USD/JPY

USD/CHF

USD/CAD

By listing the majors (as above) you can clearly see what currencies correlate and which ones don't. The tables below go into greater detail what the correlations are for each of the major currencies. Statistically measured by performance, currency pairs are given so called "correlation coefficients" from +1 to -1.

A correlation of +1 means two currency pairs will move in the same direction 100% of the time. A correlation of -1 means they will move in the opposite direction 100% of the time. A correlation of zero means no relation between currency pairs exists.

EUR/USD											
Period	AUD/USD	EUR/CHF	EUR/GBP	EUR/JPY	GBP/USD	NZD/USD	USD/CAD	USD/CHF	USD/JPY	XAG/USD	XAU/USD
1 week	0.93	-0.78	0.46	0.65	0.96	0.97	-0.79	-0.96	-0.79	0.94	0.91
1 month	0.84	0.56	0.86	0.93	0.80	0.16	-0.80	-0.48	-0.43	0.78	0.40
3 months	0.80	0.06	0.84	0.76	0.84	0.71	-0.82	-0.65	0.02	0.81	0.70
6 months	0.85	0.04	0.91	0.92	0.91	0.59	-0.91	-0.89	-0.37	0.89	0.80
1 year	0.92	-0.46	0.91	0.78	0.94	0.86	-0.84	-0.92	-0.82	0.83	0.85
2 years	0.15	0.43	0.78	0.72	0.85	0.17	0.10	-0.39	0.07	0.09	-0.20

GBP/USD											
Period	AUD/USD	EUR/CHF	EUR/GBP	EUR/JPY	EUR/USD	NZD/USD	USD/CAD	USD/CHF	USD/JPY	XAG/USD	XAU/USD
1 week	0.99	-0.91	0.18	0.41	0.96	0.98	-0.58	-0.99	-0.93	0.91	0.86
1 month	0.82	0.07	0.38	0.69	0.80	0.63	-0.51	-0.78	-0.46	0.83	0.68
3 months	0.75	-0.17	0.42	0.54	0.84	0.69	-0.70	-0.71	-0.13	0.72	0.78
6 months	0.75	0.11	0.67	0.84	0.91	0.54	-0.87	-0.78	-0.35	0.78	0.69
1 year	0.89	-0.52	0.71	0.67	0.94	0.84	-0.81	-0.91	-0.84	0.79	0.78
2 years	0.16	0.23	0.33	0.55	0.85	0.15	0.13	-0.47	-0.04	0.18	-0.11

AUD/USD											
Period	EUR/CHF	EUR/GBP	EUR/JPY	EUR/USD	GBP/USD	NZD/USD	USD/CAD	USD/CHF	USD/JPY	XAG/USD	XAU/USD
1 week	-0.93	0.10	0.34	0.93	0.99	0.97	-0.52	-0.99	-0.95	0.89	0.83
1 month	0.43	0.59	0.77	0.84	0.82	0.30	-0.80	-0.45	-0.38	0.80	0.50
3 months	-0.31	0.60	0.55	0.80	0.75	0.95	-0.74	-0.79	-0.05	0.60	0.93
6 months	-0.27	0.80	0.77	0.85	0.75	0.83	-0.84	-0.89	-0.36	0.83	0.91
1 year	-0.69	0.80	0.61	0.92	0.89	0.93	-0.91	-0.96	-0.85	0.90	0.94
2 years	-0.77	0.08	-0.50	0.15	0.16	0.94	-0.91	-0.90	-0.85	0.90	0.91

NZD/USD											
Period	AUD/USD	EUR/CHF	EUR/GBP	EUR/JPY	EUR/USD	GBP/USD	USD/CAD	USD/CHF	USD/JPY	XAG/USD	XAU/USD
1 week	0.97	-0.83	0.29	0.54	0.97	0.98	-0.69	-0.97	-0.85	0.96	0.84
1 month	0.30	-0.65	-0.28	0.20	0.16	0.63	0.20	-0.86	0.06	0.51	0.82
3 months	0.95	-0.44	0.51	0.52	0.71	0.69	-0.61	-0.83	-0.01	0.56	0.93
6 months	0.83	-0.31	0.52	0.53	0.59	0.54	-0.57	-0.67	-0.24	0.54	0.68
1 year	0.93	-0.57	0.73	0.59	0.86	0.84	-0.82	-0.87	-0.78	0.79	0.85
2 years	0.94	-0.69	0.11	-0.47	0.17	0.15	-0.86	-0.83	-0.83	0.80	0.84

USD/JPY											
Period	AUD/USD	EUR/CHF	EUR/GBP	EUR/JPY	EUR/USD	GBP/USD	NZD/USD	USD/CAD	USD/CHF	XAG/USD	XAU/USD
1 week	-0.95	1.00	0.14	-0.05	-0.79	-0.93	-0.85	0.26	0.93	-0.73	-0.78
1 month	-0.38	-0.28	-0.27	-0.06	-0.43	-0.46	0.06	0.42	0.16	-0.12	0.18
3 months	-0.05	0.66	0.17	0.67	0.02	-0.13	-0.01	-0.35	0.48	0.23	-0.23
6 months	-0.36	0.52	-0.33	0.02	-0.37	-0.35	-0.24	0.25	0.57	-0.21	-0.38
1 year	-0.85	0.63	-0.67	-0.28	-0.82	-0.84	-0.78	0.64	0.89	-0.64	-0.74
2 years	-0.85	0.86	0.18	0.75	0.07	-0.04	-0.83	0.75	0.82	-0.79	-0.90

USD/CHF											
Period	AUD/USD	EUR/CHF	EUR/GBP	EUR/JPY	EUR/USD	GBP/USD	NZD/USD	USD/CAD	USD/JPY	XAG/USD	XAU/USD
1 week	-0.99	0.93	-0.20	-0.40	-0.96	-0.99	-0.97	0.58	0.93	-0.89	-0.91
1 month	-0.45	0.46	-0.08	-0.47	-0.48	-0.78	-0.86	-0.04	0.16	-0.59	-0.75
3 months	-0.79	0.72	-0.39	-0.17	-0.65	-0.71	-0.83	0.31	0.48	-0.34	-0.90
6 months	-0.89	0.41	-0.85	-0.72	-0.89	-0.78	-0.67	0.81	0.57	-0.80	-0.89
1 year	-0.96	0.77	-0.78	-0.57	-0.92	-0.91	-0.87	0.86	0.89	-0.87	-0.90
2 years	-0.90	0.67	-0.13	0.31	-0.39	-0.47	-0.83	0.71	0.82	-0.87	-0.76

USD/CAD											
Period	AUD/USD	EUR/CHF	EUR/GBP	EUR/JPY	EUR/USD	GBP/USD	NZD/USD	USD/CHF	USD/JPY	XAG/USD	XAU/USD
1 week	-0.52	0.24	-0.88	-0.97	-0.79	-0.58	-0.69	0.58	0.26	-0.75	-0.67
1 month	-0.80	-0.85	-0.79	-0.70	-0.80	-0.51	0.20	-0.04	0.42	-0.60	-0.12
3 months	-0.74	-0.35	-0.67	-0.83	-0.82	-0.70	-0.61	0.31	-0.35	-0.82	-0.57
6 months	-0.84	-0.06	-0.80	-0.88	-0.91	-0.87	-0.57	0.81	0.25	-0.90	-0.77
1 year	-0.91	0.61	-0.74	-0.71	-0.84	-0.81	-0.82	0.86	0.64	-0.95	-0.90
2 years	-0.91	0.78	0.02	0.60	0.10	0.13	-0.86	0.71	0.75	-0.83	-0.89

The short term correlations will change from time to time as economic and imbalances in separate economies disconnect the correlations. It's plain to see though, that on a long term basis the currencies that are all quoted as the base currency against the USD correlate very high, whilst the other currency pairs move in the opposite direction.

How can a trader use this information?

A very simple use is avoiding trades that cancel each other out. For instance, knowing that EUR/USD and USD/CHF move inversely (near perfectly), there would be no point going short on both pairs as they would cancel each other out.

Alternatively there is a strategy of hedging one currency pair with another. Let's take the same pairs. If you are long EUR/USD and it starts to move against you, then you could buy a small amount of USD/CHF to offset it, if you wanted to keep the position in play. This way you would be making money on the USD/CHF as you were losing money on your EUR/USD position.

A trader may also diversify his risk if he thinks the USD is going down. Instead of putting all your eggs in the one basket, the trader may buy some EUR/USD, some GBP/USD and some AUD/USD. As these currencies all move in the same direction, sometimes it's at different speeds. So by doing this you can diversify your portfolio somewhat.

One very important thing to remember is that every now and again the correlations break down completely. So if you try and trade this method all the time you will come unstuck. It's more often than not a good method to work out whether or not you should be long or short a particular currency pair when you see what the other correlated currencies are doing.

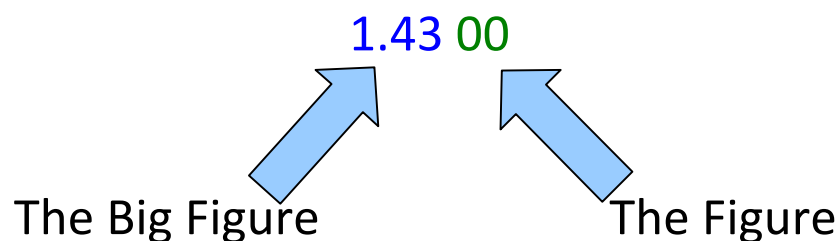
The correlations though don't just stop there. Each currency has its own unique characteristics ranging from geographical location to mineral reserves, to their individual relationship with the equity and derivatives markets. The sectors of industry each economy relies on will have a big impact on the currency, particularly when that sector booms or recedes. So there is a whole range of factors you need to be considering and analysing besides the simple currency correlations to get the overall view of a currency. The following tables give you a much greater depth of where the correlations lie.

AUD/USD	NZD/USD	Due to geographical location, these pairs tend to move in synch with one another.
AUD/USD	CARRY TRADES	AUD/JPY is one of the most commonly traded carry trades. Comes down to interest rates.
AUD & NZD	GOLD	Both are large exporters of Gold.
USD	GOLD	In poor markets, gold can be viewed as a safer investment alternative to USD.
USD/CAD	CRUDE OIL	Canada is huge exporter of oil. Oil up=CAD up
USD/JPY	CRUDE OIL	Almost all of Japan's oil is imported.
EUR/USD	CRUDE OIL	A decline in oil will typically coincide with a decline in the value of EUR/USD, & vice versa.
EUR/USD	GBP/USD	Due to geographical location, these pairs tend to move in synch with one another.
EUR/USD	USD/CHF	Due to geographical location, these pairs tend to move in synch with one another. (opposite)
EUR/USD	AUD/USD, NZD/USD, GBP/USD	Due to the way these currencies are quoted they all correlate.
USD/CHF	USD/CAD, USD/JPY	Due to the way these currencies are quoted they all correlate.
U.S EQUITIES	USD/JPY & CARRY TRADES	When equities perform well, investors take on more risk. The carry trade is bought when investors want to take on more risk. Going long anything against the JPY generally carries a higher return.
U.S EQUITIES	U.S TREASURIES	Treasuries pay fixed interest rates and are backed by the Govt. When people sell equities, they will typically buy treasuries, seeking a safer return.
OTHER EQUITY MARKETS	RESPECTIVE CURRENCY OF THE REGION	When world markets decline, the currency itself will generally depreciate. In order to hold the equity, the investor needs to hold the base currency.

## The Importance of the Numbers

There's more to the numbers than meets the eye. Specific numbers have greater underlying importance than others and it's very important you are aware of this. Unless you've worked in a bank the location of corporate and bank orders and large option strikes would generally not be known. The levels change as the currencies go from one cent to another but the general location of such orders does not vary that much. The most important of all the levels are the big round numbers (double zeros) where the currencies change from one cent to another, otherwise commonly referred to as 'The Figure'. The numbers which determine what cent it is at the front of the rate is called 'The Big Figure'.

Example: EUR/USD



The figure acts as psychological support and resistance in all currency pairs. The main reason for this is because most corporations and Funds place their orders at these levels. Generally their orders are much larger than the normal orders placed by individual traders at banks, so they dominate activity when it gets to these levels.

Also most option strikes are set at 'the figure'. As the currencies approach or go through these levels there is a massive increase in volume. One of the more popular types of option structures these days is "binary" options. The simple idea behind these options is; if the currencies touch a pre-set level then you either win or lose, depending on which way you called the move.

For example if the AUD/USD was trading at 1.0500 and you thought it wouldn't go through 1.0700, then you could buy a binary option to invest in this outcome. The option trader may give you odds of 5/1 and you simply put your capital into the trade. If it comes off you get 5 times your initial investment. At the same time the option broker maybe offering 4/1 for it to break this level and he builds up the other side of the market. The odds will be determined on current market activity. What eventuates is a massive amount of people with interest around 'the figure' which is the strike price. Hedge funds and investment banks are heavily involved in this activity and it generates huge orders at these levels. As it approaches these levels one party will try and protect the level while another tries to break it. The outcome can never really be predetermined and is usually decided by prevailing economic conditions. The point is though; these strikes are generally always set at 'the figure'.

Professional traders across the globe are aware of this and they use this fact to their advantage. The figure acts as extra support or resistance depending if it's higher or lower at the time. Traders place their stop loss orders above and below these levels to gain extra protection. In particular, they do not place their orders at these levels (or any round numbers for that matter) to make sure they don't get caught up in the 'traffic' associated with these levels.

## Risk Currencies

This is a relatively new phenomenon and needs clarification before we move on. It refers to a basket of currencies (usually backed by high local interest rates) which all move inversely/adversely to movements in the stock markets.



Now when we refer to stock markets we generally mean the Dow Jones Industrial (The Dow) on the New York Stock Exchange. It is the biggest influencing stock market in the world and generally determines the direction for global equities.

Since 2008 and the GFC the terms 'risk-on' and 'risk-off' has been bandied about all over the place. Basically if the Dow was rallying or closed up, risk is on and if it was falling or closed lower, risk is off. You can blame the media for the hype, as there's nothing quite like a good dose of 'fear' to get people to tune in.

The concept is very easy to understand. When risk is 'on' the USD falls, and when risk is 'off' the USD rallies. This is because the USD is seen as a safe haven. What eventuated out of all of this was the term 'risk currencies'. It doesn't mean those particular currencies are riskier to trade or that there is greater inherent risk in trading them, it just means they correlate with the equity markets.

So if the Dow rallied we would have a 'risk-on day' and you would expect the EUR, GBP, AUD and NZD to rally. If risk was 'off' then these currencies would go down and inversely so for the YEN, CHF and CAD.

## Volatility for Each Currency Pair is Unique

Every currency pair has its own unique volatility characteristics and you should be aware of this before you start trading. The more information you have about each currency pair the better your chances of success.

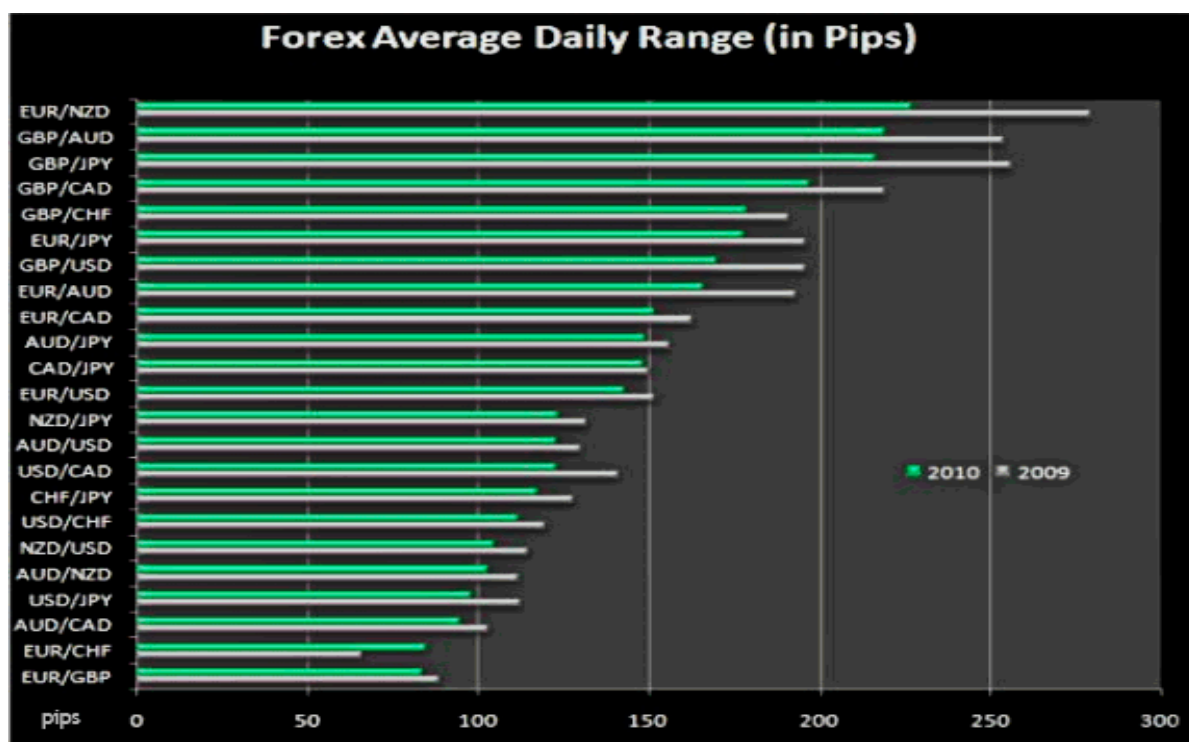
I do most of my trading on the majors not only because the economies are regulated and stable but because they have the most consistent trading structure. Most importantly they have a very consistent trading range. Their daily average trading range is around

150 points whereas the less common and less traded cross rates can have ranges consistently above 250 points.

How is this helpful? Well first and foremost it helps me analyse the market to decide what strategy I should employ and whether or not to buy or sell or do nothing.

For example if I woke up in the morning and found GBP/USD had just rallied 150 points in a straight line I wouldn't be looking to get long, primarily because I know it's already completed it's average daily range. I would be looking for levels to get short and if there were none then I would be staying out of it. It's as simply as that. Flirting with a currency pair that averages 250 points a day is a lot tougher to analyse. So knowing the volatility characteristics of each currency pair before you trade is an essential part of your trade plan.

The chart below shows the average daily range for most traded currency pairs for 2009-10.



Source: Bloomberg

## Profit & Loss (P & L)

The profit or loss (P/L) from a transaction is calculated by keeping the units of the base currency constant and determining the difference in the number of units of the terms currency. The P & L will be expressed in the units of the currency which is not kept constant.

So when you are trading the majors your P & L is initially in USD. Then whatever currency base your capital is in, it is then converted into that currency to give you the final result. For example if you were trading in Australia and you made money on GBP/USD. You would have an initial USD profit or loss, which would then be converted using the current AUD/USD exchange rate to ascertain your overall result.

An important fact to know is the pip value for each of the major currency pairs is the same, as they are all quoted against the USD. So regardless if you're trading EUR/USD or NZD/USD you will be making the same amount of money in USD. Unlike the casino where they have a range of games with all varying probabilities for success, the currencies are all generally equal so you can relax knowing your results will be the same regardless of what currency pair you choose to trade.

Your profits or losses are only realised (locked in) once both sides of the transaction, the buy and sell side have been completed or closed out.

Your profits or losses are unrealised if only one side of the transaction has been completed.

One of the best things about today's brokers are, they convert and calculate all profit and loss for you instantly. In fact your P & L will be updated through every movement in the currency pair. So you can monitor your performance the entire time your position is running.

## Chapter 3 Know Your Markets

### Understanding the Trading Sessions

Even though the forex market is open 24 hours a day, all sessions are not the same. Like the currencies, each market has its own unique characteristics. The global market is broken down into three main markets: Asia (Tokyo), Europe (London) and North America (New York).

The market that is open will determine what currencies are the major focuses and news (economic releases) from that market will dominate the direction of all currencies. This is an invaluable piece of information as it will determine what currencies you should trade or be focussing on and what currency pair is leading all the other currency correlations.

So for the Asian session the focus is on the AUD, NZD and YEN. The EUR and GBP will take a back seat and generally correlate to the movements in these currencies. So when trading this session you should be paying particular attention to AUD, NZD and YEN for insight into direction of the other currencies. Tokyo is the major centre for Asia.

Once Europe opens the focus shifts to the EUR, GBP and CHF and the other currencies take a back seat and correlate with these currencies. So when trading this session you should be paying particular attention to EUR, GBP and CHF for insight into the direction of the other currencies. London is the major centre for Europe.

Once North America opens the focus is on the USD and the CAD. Since the USD is quoted against everything its game on for all currency pairs. There is no leading currency pair to take advantage of for

direction, since when the USD moves it impacts all currencies in unison. New York is the major centre for North America.

Once the North American session closes it swings straight back to the Asian market, where the focuses once again shift to the AUD, NZD and YEN. There is an in-between (sub-session) here of 2-3 hours where Australia and New Zealand is the prime market for all trading. There is a less liquid time zone and every trader needs to be aware of occasional extra volatility during this window from New York close to Tokyo open.

So the session you trade in will or should influence your trading decisions. Say for example you prefer to trade EUR/USD and the current open market is Asia. There is an economic data release out of Australia which sends the AUD/USD rallying aggressively. If you were looking for a trading opportunity then you would buy EUR/USD as it correlates with the Aussie and will be dragged higher by it. Alternatively, if you were short EUR/USD then you would most definitely square up your position to cover any adverse move created by the Aussie dollar move. Once again it's simple stuff, but very effective in managing your positions or determining what opportunities are available.

The major trading sessions: Australian Eastern Standard Time

8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	1	2	3	4	5	6	7
										London													
															New York								
Sydney																							
		Tokyo																					

## Sydney

With only 4% of all forex market turnover it is usually less active, resulting in low liquidity and at times extreme volatility. The most traded currencies are the AUD and NZD.

## Tokyo

It is more active than Sydney and is the main driver of the Asian market. With only 6% of all forex market turnover, liquidity can often vary quite dramatically in this market. The most traded currency is the YEN and YEN crosses (EUR/YEN, AUD/YEN, GBP/YEN, CAD/YEN).

## London

It has a high level of activity, with 37% of all forex market turnover. It has very good liquidity and is usually less volatile. The most traded currencies are the EUR, GBP and CHF plus the related crosses EUR/GBP, EUR/CHF and GBP/CHF.

## New York

It has a high level of activity with 18% of all forex market turnover. It has good liquidity and is usually less volatile. The USD is the benchmark for most traded pairs so it is critical you are aware of upcoming economic releases, as they will impact all currency pairs.

## Forex Time Zone Activity

Each trading session has its own unique characteristics and it generally revolves around the time of economic data releases. The open of each session is usually a period of high activity as traders put on fresh positions for the day.

This is usually followed by a lull as the market awaits the fundamental releases. The fundamental releases can be periods of high activity or no activity, depending on whether or not the data was a surprise or not.

If the fundamental release was a surprise then the market can be busy for the rest of the session. If the fundamental release was as expected then the remainder of the session will taper out with low trading activity.

Then once the next session approaches the level of trading activity increases again as positions are squared and fresh positions are opened. This cycle of activity goes on each day, week after week. The following table gives you a snapshot of global time zone activity.

Time Zone Market Activity	AEST Sydney	JST Tokyo	GMT +2 Frankfurt	GMT +1 London	EST New York
New Zealand Fundamentals	08:45	07:45	22:45 Prev. Day	23:45 Prev. Day	18:45 Prev. Day
Australian Open	09:00	08:00	23:00	00:00	19:00
Japan Fundamentals	09:50	08:50	23:50	00:50	19:50
Tokyo Open	10:00	09:00	00:00	01:00	20:00
Australian Fundamentals	11:30	10:30	01:30	02:30	21:30
Asian Close European Open	16:00	15:00	06:00	07:00	02:00
Eurozone Fundamentals	16:45	15:45	06:45	07:45	02:45
London Open	18:00	17:00	07:00	08:00	03:00
UK Fundamentals	18:30	17:30	08:30	09:30	04:30
New York Open	22:00	21:00	12:00	13:00	08:00
USA Fundamentals	22:30	21:30	12:30	13:30	08:30
European Close	01:00 Next Day	00:00 Next Day	15:00	16:00	11:00
USA Nearing Close	06:00	05:00	20:00	21:00	16:00

## The Hidden Danger Zones

There are two major danger zones that traders need to be aware of and they revolve around the open and close of the market.

The global market officially starts at 5am Monday mornings in Sydney, Australia. Liquidity is almost non existent as the majority of global traders are still enjoying their weekends (Europe and North



America). So the market starts very slow and steady as the currencies find their feet following Friday's close in New York.

One of the major reasons this is a no go zone is because any news releases over the weekend are first traded in this low liquidity market and thus can cause major gapping in the currency levels. If you're running positions over the weekend you need to be aware of this.

If the market closes on Friday night and your stop loss is pre-set 10 points above the close, it doesn't mean you will be filled at your level. If there is a significant news event over the weekend and the markets gap 100 points on the open through your level, then your order will be filled where the currency opens.

This can obviously blow massive holes in your capital and since this risk exists every weekend, I recommend you square up all of your positions before the close on Friday 5pm in New York, regardless if they are in or out of the cash. Monday mornings are definitely a no go zone. Once Tokyo is open it is usually safe to enter the market.

The New York close is very similar to the Sydney open. By 3pm most trading for the week has been completed and traders start to close out their positions and halt trading. Liquidity thins out and the currencies start to move around with a lot more freedom.

Most global finance ministers meetings (G8 or G20) occur over the weekend. As the market nears its close and liquidity is at a premium, any news or political announcements can cause severe fluctuations in the currencies. More often than not if there is one of these big meetings scheduled, you get one or two politicians trying to make a name for themselves by coming out with outrageous comments just before the weekend, fuelling the unstable environment. I totally recommend squaring all positions well before the New York close.

# Chapter 4 Capital - Risk Management

## The Fundamental Importance of Risk Management

This is the most important aspect of any trading system and hence is what you need to spend most of your time on before you begin trading.

Controlling risk in a manner that will allow you to continue trading through the inevitable bad periods and survive to realise the profit potential of good systems, is absolutely imperative.

Simply mimicking theoretical methods, following mathematical indicators or using 'robot' auto-trade models are unlikely to work for you over the long haul. Active traders must establish and implement a method that compliments his or her unique personality, risk tolerance and capital base if they want to be successful.

Risk Management encompasses the following:

1. Capital Management
2. Risk Reward Ratio
3. Trade Plan

These three factors are intertwining and must be fully understood before you begin trading. Once you can properly 'manage your risk' you will be ready to trade in any market, without the risk of losing your capital.

## Capital Management

Capital Management is about controlling risk by not investing so much that you run out of money before the good trends come. It is the most important factor to your trading success. If you get this wrong from the get go, then it'll all be over before you know it.

Put it this way: You could be the best trader in the world but if you don't have a good capital management system you will go broke. It's just a matter of 'when', not 'if' they will. At the other end of the spectrum you could be the worse trader in the world but still make money trading if you incorporated a good capital management system. It's the one significant factor which differentiates one trader from another.

Where do you start? Your initial trading amount depends directly on how much capital you start with. On the outset I would suggest you don't risk more than 2.5% of your capital on any one trade. This may not seem like much to invest, but believe me it's plenty. Remember, it's about staying in the game; not blowing your capital up in the first week of trading.

Most traders think capital management is just about managing losses and this couldn't be further from the truth. It's as much about managing profits as it is managing losses. In my time mentoring traders, I've had loads more issues managing traders when they are making money than when they are losing money. That's generally because when they are losing money they are very focussed, whereas when they are making money they get extremely blasé and think their invincible. They throw their capital management out the window and forget about all the basics that made them the cash in the first place.

It's very important you know when to increase your trading amount and when to decrease your trading amount. This ensures you maximise your profits in good trending markets but also limit your losses in choppy volatile markets.

Once you've doubled your initial capital you should be looking to withdraw your initial capital and reinvest the cash you've made. You'll become much more relaxed as you'll feel like you've got nothing to lose. From here the best thing to do is set yourself specific goals and then when you hit these targets you should double your trade size. This will ensure exponential growth when you have a good run of trades.

Managing losses is much easier and systematic. This is because I incorporate a simple method, which I call the 'four consecutive loss rule', to determine my trade size. If I have four consecutive losses I decrease my trade size by half. That way I limit the amount of damage on my capital in times when either the market is out of control or I

am. Then once I make back those losses and my capital is back to the previous level I simply increase the trade size to what it was previously.

You shouldn't risk more than 20% of your capital over the course of your entire trading career. So if you invest \$10,000 the most you should be risking is \$2000. When you realise your capital management system is going to protect you, the fear and anxiety of trading should be eliminated.

The method of capital management explained above should ensure minimum draw downs and long term growth, as long as you stick to the same risk reward ratio.

## Risk Reward Ratio

Every time you open a position you should have a contingent take profit and stop loss order. The size of your take profit order compared to your stop loss order is the 'risk reward ratio'.

From the very early days it was drilled into me and the other junior dealers that the minimum requirement for any financial institution was a 3:1 risk reward ratio. You need to be making three times the amount you lose, to keep ahead of the game and build your capital.

To get consistent result your capital management and trade plan need to be consistent and working in unison. Your risk reward ratio is the key element which ties these two factors together. It determines the parameters for your exit orders, your stop loss and take profit.

When applied consistently it can be extremely helpful in determining correct entry levels. If you find when entering a trade that you need to extend your stop loss order to get protection from a key support or resistance level, then this tells you your initial entry level was wrong. You either need to reduce your trade size to fall back within your capital management structure, or cancel the order and re-input it at the level where your stop loss order fits in perfectly.

Also if you can't see the potential for your take profit to be executed then you maybe applying the wrong strategy. Just because your stop loss is in the right place doesn't necessarily mean your order will be successful. Your risk reward ratio will indirectly save you from putting on the wrong trade.

Once incorporated in your 'trade plan' it should also prevent any big draw downs, eliminate any hesitation on exiting positions and keep you on a steady course of capital growth.

## Trading Plan

More often than not your computer will be turned off when most of your trades are executed. If you don't have a specific trade plan you won't be able to manage your risk, nor take advantage of favourable market movements. The purpose of a trading plan is to assist you to manage the future as it unfolds in the market. It is the guide to your speculative activity.

If you don't have a plan before entering every trade you're destined for disaster. It only takes one unpredictable event to occur to wipe your capital out.

The function of your plan is to identify and execute low risk – high probability entries in the market, and then follow up. The plan enables you to exit the position if the market turns against you (stop loss), or moves in your favour (take profit).

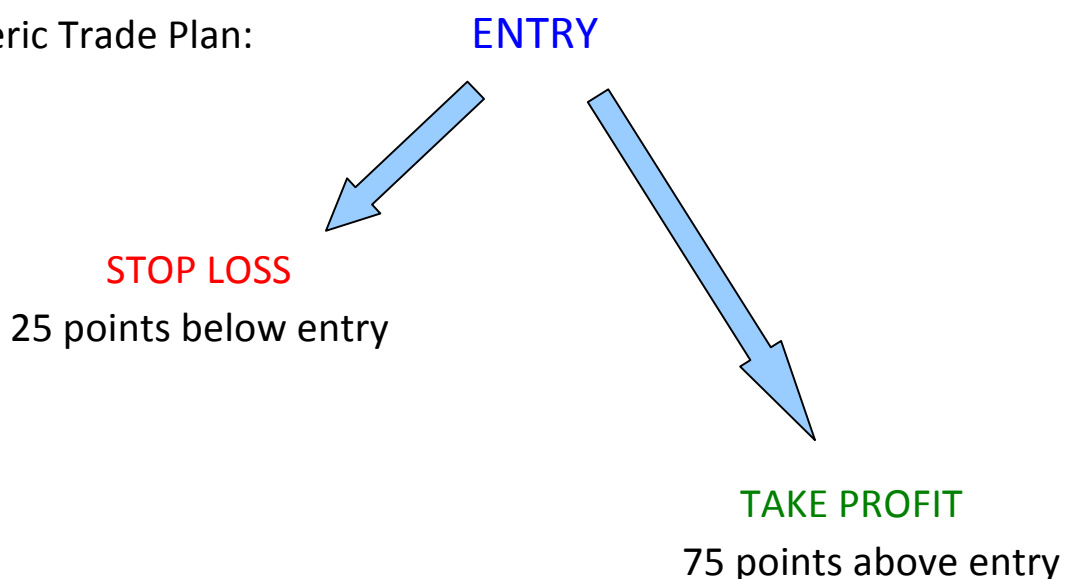
The key to a successful trade plan is working out the parameters of your take profit and stop loss orders, so that they are perfectly incorporated into your capital management.

Every traders risk appetite is unique, but regardless if you have a large or small risk appetite, or how much capital you have to trade with, there's no need to risk more money than you need to. After 20 years of trading I know through experience that in normal market conditions, you don't need to have a stop loss more than 25 points from your entry level. That is assuming of course you initially got into the market at the right levels.

Your take profit is the final piece of the puzzle and is a direct function of your risk reward ratio. This obviously equates to 75 points.

It's at this point you need to incorporate your capital management into your plan. Remember from earlier you should only risk 2.5% of your capital on any one trade (to make 7.5% if successful).

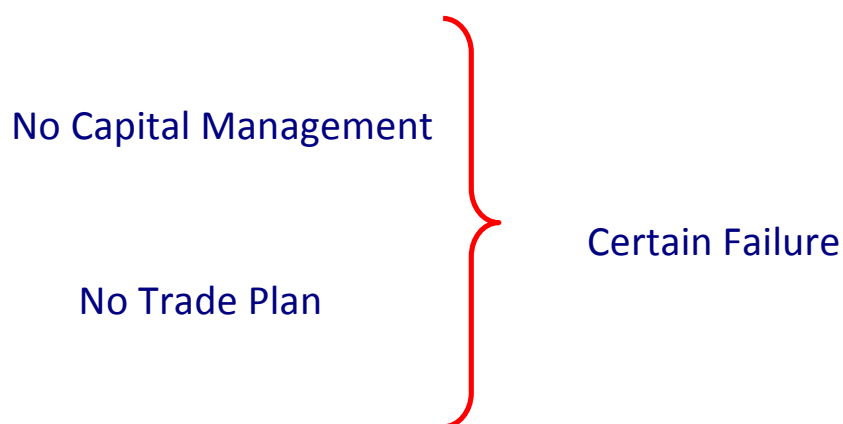
Generic Trade Plan:



Let's say for example you had an account with \$10,000 in it. Then 2.5% would equate to \$250 risked on any one trade. Using the parameters set out above: stop loss 25 points, take profit 75 points.

Your trade size would be \$100,000. This would give you a loss of \$250 or profit of \$750 per trade. Your trade plan in this example perfectly incorporates the capital management structure and risk reward ratio's required to be successful.

If your trade plan fully integrates your entry, exits and capital management, you can be very confident your capital and risk are under control at all times and this is an important part of controlling your emotions.



# Chapter 5 Technical Analysis

## The Principles

Technical analysis examines past price data to forecast future price movements. This type of analysis focuses on the formation of charts and formulae to capture major and minor trends identify buying and selling opportunities and assessing the extent of market turnarounds.

Technical analysis is based on three principles:

1. The current price of a currency fully reflects all available market information (fundamentals)
2. Prices often move in trends.
3. Past price data can help forecast future price direction

It is one of the most significant tools available for the forecasting of financial markets. The patterns that emerge in the charts are compared to historical patterns that are shown to indicate particular future trends. It is assumed that the formation of similar patterns in the market place is a sign that similar trends will emerge. Since charting is somewhat subjective, trading success largely depends on the skill of the chartist.

It's extremely important to be aware of the position of technical chart points (trendlines) because as they are breached, buying or selling of currencies by those that use technical analysis (every sensible trader) often causes exchange rates to shift.

## The Truth about Technical Analysis

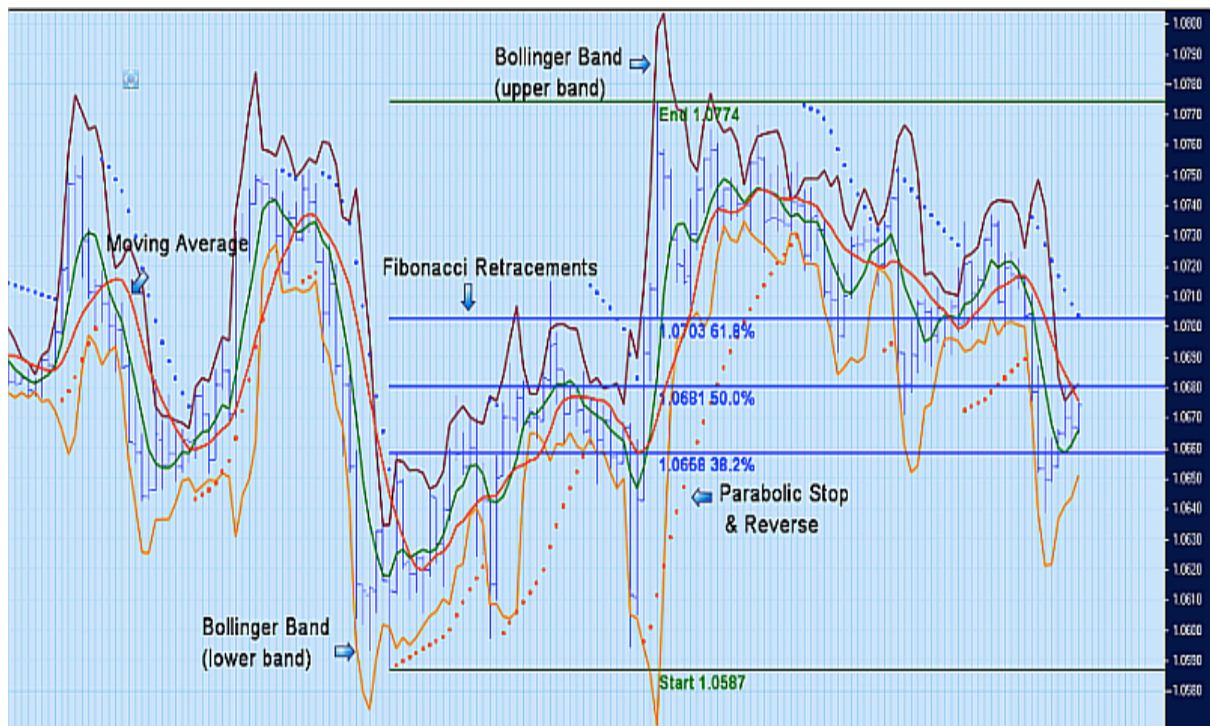
Foreign exchange is not an exact science, and hence it is not possible to predict every move in the markets. Unfortunately technical analysis does not tell you whether you should be buying or selling or what strategy to use. It simply tells you where buying or selling will be prevalent and what trend the currency is currently in. These two facts alone are enough to make technical analysis a major part of your decision making process.

Today's 'get rich quick' retail forex market neglects the function of technical analysis. They think that by incorporating trading algorithms and mathematical indicators into their technical charts that they can accurately determine the trading strategy to use. This couldn't be further from the truth.

The development of the mathematical trading indicators in the past 10 years has been nothing short of phenomenal, as traders look for an edge. They have done nothing but confuse and create self doubt in beginner traders, as they wonder which system is telling them the truth (as surely they all can't be correct).

As you can see from the chart below cluttering your charts with indicators and looking for other complicated charting formations is just going to have you second guessing yourself. Why? This is because each indicator has its own unique formula and real-time lag. For instance the moving average may be indicating a buy signal whilst the Bollinger bands maybe indicating a selling signal and the Parabolic Stop and Reverse are suggesting you do nothing. What do you do? It's now become a toss of the coin which indicator you choose and believe me that's not the way you trade. The problem with all these indicators is they all have a substantial time lag from the real market and cannot reflect changes quick enough.



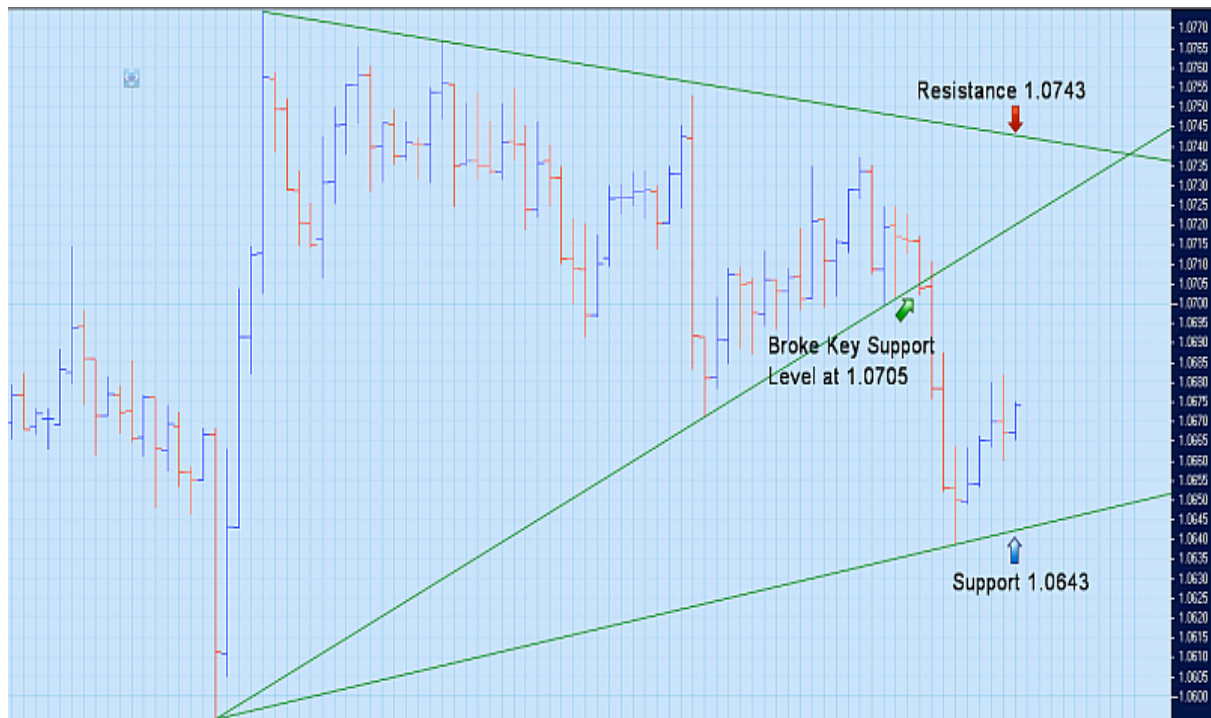


The TRUTH is Commercial traders don't use fancy technical indicators! Five per cent of the market, the commercial traders at the banks and hedge funds are the main drivers of the markets. They trade the biggest volumes and have access to the best systems and best news services money can get, so when things move it's invariably them driving the markets. They cannot afford to sit back and wait for an indicator to tell them to buy or sell. Their split second decision making and consequent trading, drive the markets and this is the leading factor for all these indicators. So you don't need the indicators at all, you just need to know how they trade and make their trading decisions.

You'll generally find that traders, who haven't spent the time and effort to learn how to trade and understand how the market operates, will be the ones using all these fancy mathematical indicators and algorithms. What else do they have to rely on to make their trading decisions, a coin toss perhaps?

So if they're not using all these algorithms and mathematical indicators, then what are they looking at? They specifically pay careful attention to price action as the currencies find major support and resistance levels. The chart below demonstrates a clear and concise chart. You can see the key levels of support and resistance as well as the previous trading opportunity where the currency broke down through

support at 1.0705. Notice there is no clutter. There is no confusion with conflicting indicators.



It comes back to the basics: price support and resistance are the most important signals in trading. Also remember when you're drawing trendlines you're looking for the simplest most generic trendlines available that the entire market will be focusing on. That way when you place trades you will be moving with the market, not against it. Drawing funky obscure trendlines (that only you have identified) is defeating the whole purpose of technical analysis. Stick to this simple principal and you'll not only be able to see the currency movements on your charts but you'll also know where to buy and sell!

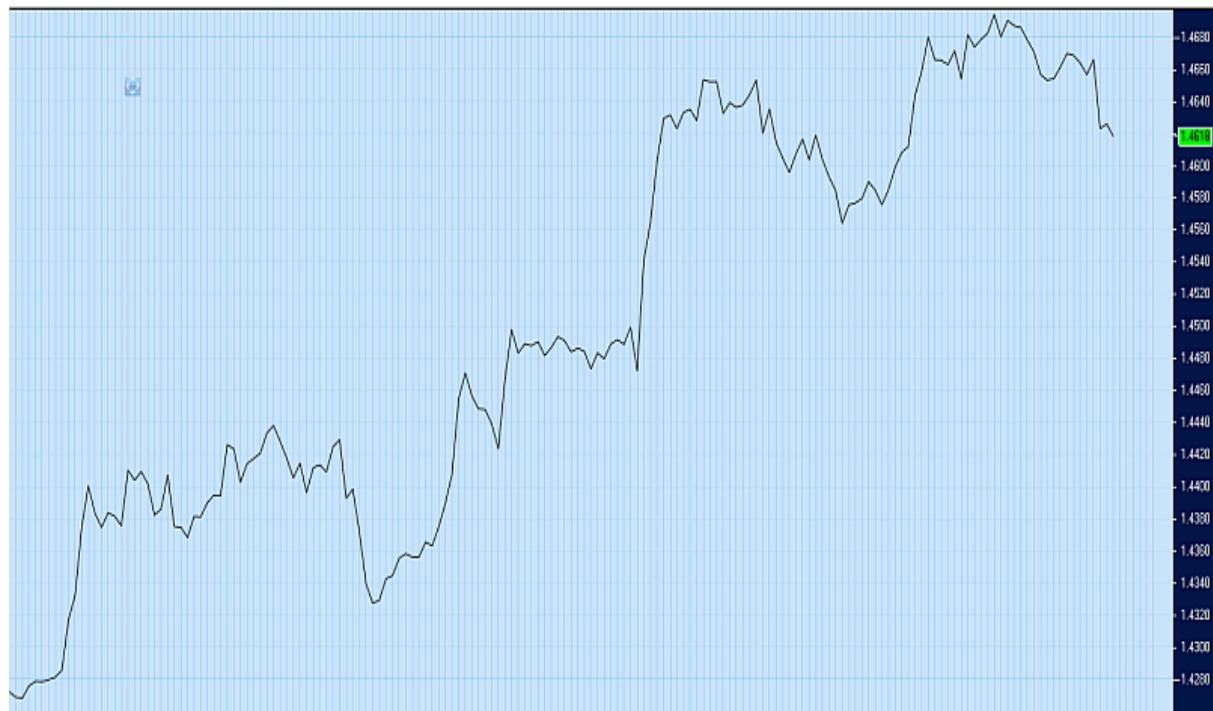
## Types of Charts

There are three main chart types:

1. Line Chart
2. Candlestick Chart
3. Bar Chart

The Line chart was the original type of charts traders used before computer generated technical analysis evolved. It was usually drawn on large strips of graph paper and manually updating by the trader each day. This was extremely cumbersome and through human error relatively inaccurate. It was still a good tool for identifying changes in the currency trends though.

Example: EUR/USD Line chart



The Candlestick charts are on record as being the oldest type of charts used for price prediction. They date back to the 1700's, when they were used for predicting rice prices. The candlesticks themselves and the formations they shape were given colourful names by the Japanese traders. There is a lot of emphasis on the size of the shapes and the associated tails and not necessarily the exact highs and the lows and this is the problem with candlestick charts.

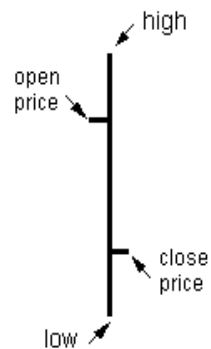
Out of all the currency pairs the Japanese Yen is the one currency that trades and behaves differently to all the other currencies. This is because the Japanese use different methods to analyse their charts. Contrary to popular opinion the majority of Japanese traders do not use candlestick charts. Instead they use an indicator called the Ichimoku (Kinko Hyo) Cloud. It won't make sense to the regular trader and I won't waste time explaining it, but you can see from the diagram below it's a strange phenomenon.

### Example: EUR/USD Candlestick chart with Ichimoku Cloud.



So if the traders at the banks don't look at this type of chart, why do candlesticks get so much air time? Primarily because those that are in the business of selling charting packages and presenting seminars love to use them. There is a whole catalogue of names given to each body shape in candlestick charts and they all mean something different. They give these people plenty to talk about and makes there selling pitch a bit edgy as they can drop a whole heap of names like doji, shooting star and the like. Funnily enough, if you check the background of these people you will invariably find they don't trade and have never traded at a financial institution. (To me trading for yourself in your own lounge room doesn't quantify you as a professional trader). The truth is candlesticks are not used by traders at the big banks or funds.

The Bar chart is the most popular type of chart in use. It consists of four main points:



The opening price, which is marked with a little horizontal line to the left of the bar. The high and low prices, which are united by a vertical bar and the closing price, which is marked with a little horizontal line to the right of the bar.

Example: EUR/USD Bar Chart



Note: The bars are generally coloured blue and red. With the blue bar identifying a rising period (open price is below the close price) and a red bar identifying a falling period (open price is above the close price). This is only for visual recognition and by no means do the colours suggest anything else besides this fact.

Bar charts have the obvious advantage of displaying the currency range for the period selected. The most popular period is the hourly, followed by the daily. Traders at financial institutions rarely, if at all go below the hourly time frame. They are looking for genuine moves, not five minute windows where the currencies might go up and down 10 points. They concentrate solely on the Hourly Bar Chart for all intraday activity. You can follow this by drawing reasonably short term trendlines and analysing what happens when they are broken.

If you're looking for bigger trend breaks then it's wise to also frequently look at the weekly and monthly time frames. An advantage of this chart is that, unlike line charts, the bar chart is able to plot price gaps that are formed in the currency markets. One of the biggest advantages you now have is that you know what the "Big Dogs" are using. By sticking to these types of charts and these particular time frames you'll find that more often than not you'll be trading with the market not against it. It'll make all the difference!

## Types of Trends

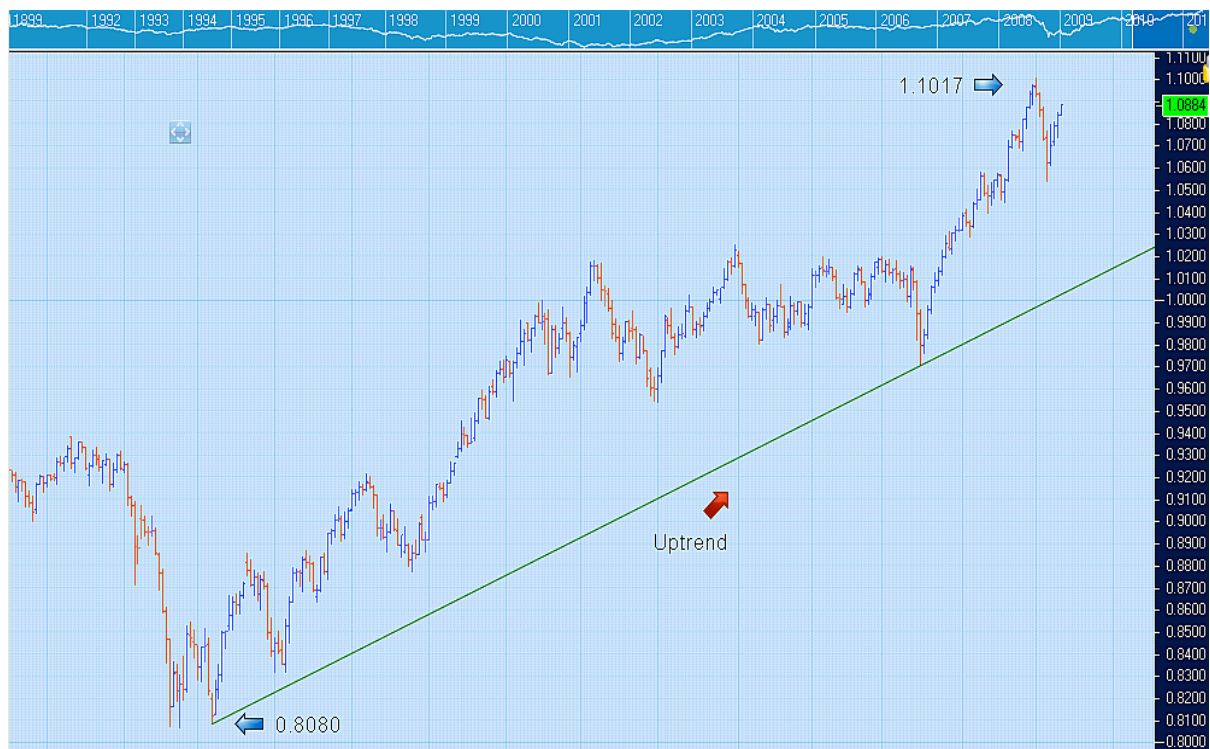
Everyone's heard the common market axiom, 'the trends your friend' but what does it mean? The trend shows a pending direction of the market movement. It can be easily recognised through technical analysis or price observation and is one of the most common trading strategies.

A trend may be:

1. Upward
2. Downward
3. Sideways (range bound market)

The upward trend refers to a market where the price direction is in a continuous upward bias. Example AUD/USD Daily chart

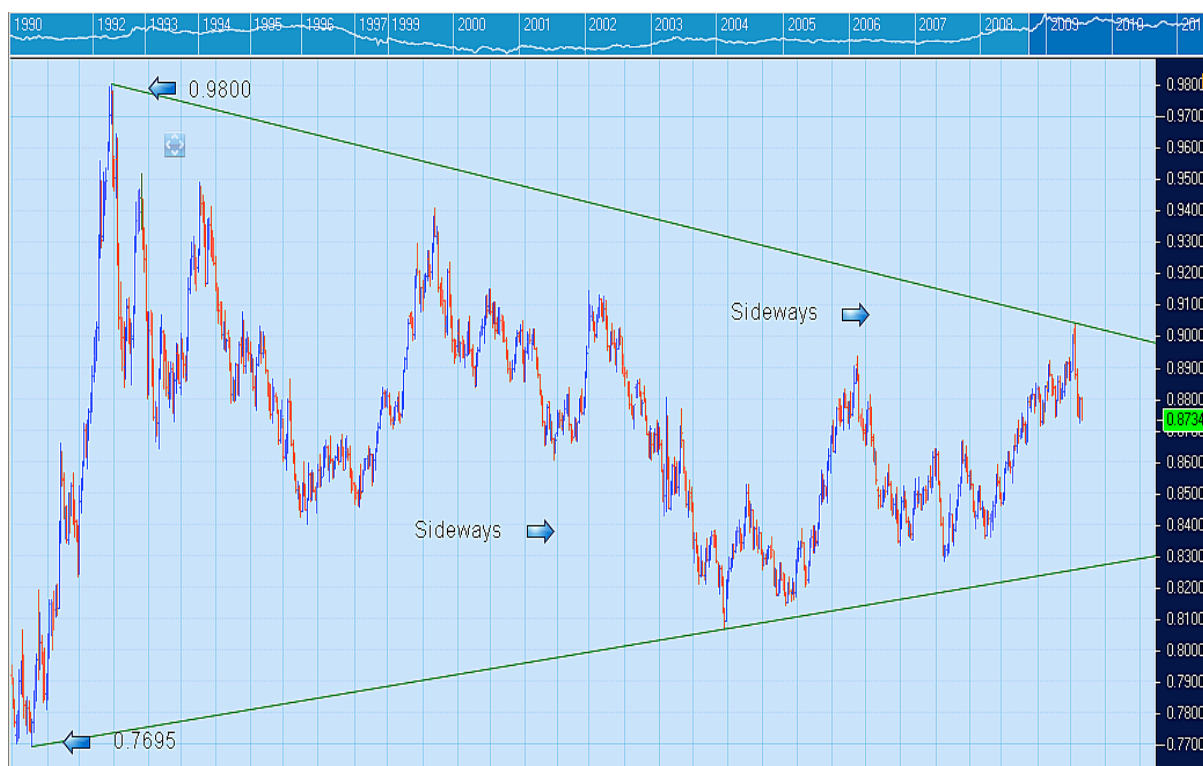




The downward trend refers to a market where the price direction is in a continuous downward bias. Example: USD/YEN Daily chart



The sideways trend refers to a market where the price direction is not biased one way or the other. It is contained within a range and fails to break higher or lower from this range. Example: EUR/GBP Daily chart.



Because the markets do not move in a straight line in any direction, but rather in zigzags, it is the direction of these peaks and troughs that creates the market trend.

In addition to direction, trends are also classified by time frame:

1. major or long-term trends (one year)
2. secondary or medium-term trends (few months)
3. near-term or short-term trends. (few weeks)

The majority of trading is done in short term trends. Traders analyse the hourly charts looking for clues for pending direction. They quantify the exact critical levels for the trend to break or hold by drawing trendlines.

## Trendlines – Support & Resistance

The trendline is one of the simplest yet most valuable technical tools as it is the natural development in tracking a trend. It simply consists of a straight line connecting the significant highs (peaks) or the significant lows (troughs). This is such an easy concept, almost like join the dots, kids without any knowledge about technical analysis could do it. In fact this is half the problem. Most people new to trading think it's so easy that there surely must be more to it and often get lost



looking for other factors to find the major levels. I'm here to tell you, this is where the action is. Right here on these simply trendlines!

Following in the tracks of the trend directions, the trendlines may be classified as:

- a. Rising trendlines - Support
- b. Declining trendlines – Resistance
- c. Horizontal trendlines – Either

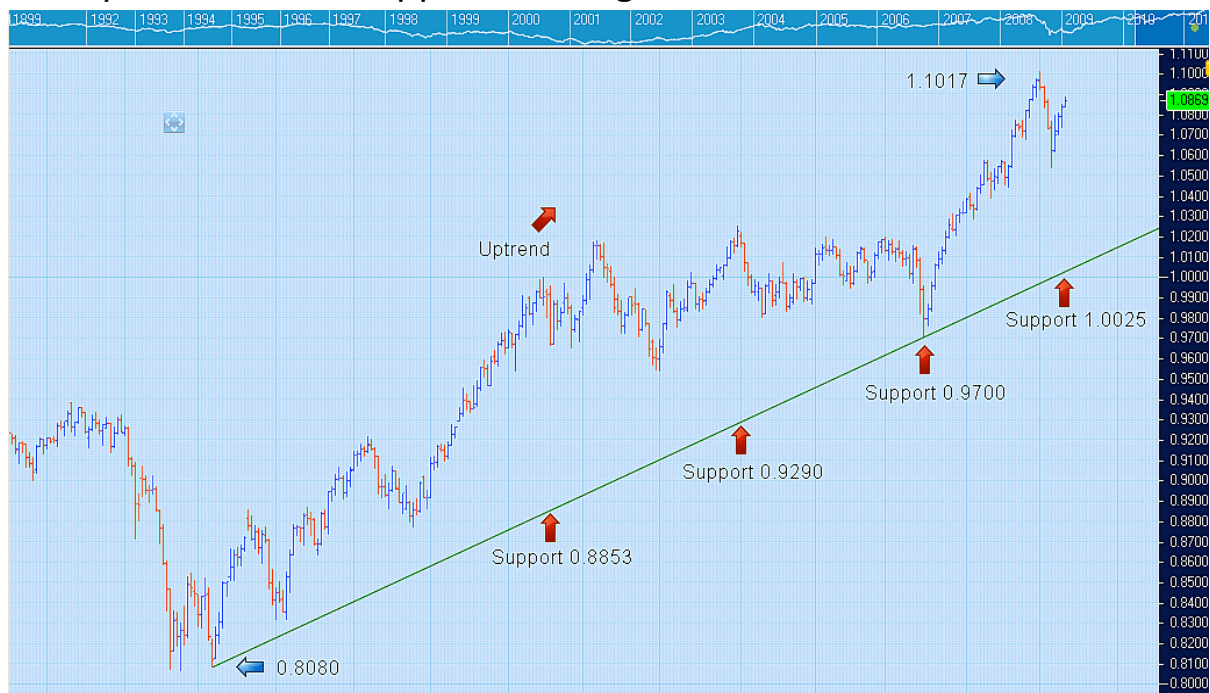
Important facts about trendlines:

1. To draw a trendline only two points are necessary and the third one is the contact point confirmation.
2. A trendline exists until it is broken as a result of a significant move of the price up or down.
3. In my experience a move greater than 10 points through support or resistance is usually enough to validate a break.
4. The longer the prices bounce off the support and resistance levels, the more significant the trend becomes.

### Support – Rising Trendlines

The bottom borders of a trade channel form lines of support. These troughs represent the levels at which the selling pressure succumbs to the buying pressure and are known as Support levels.

## Example: AUD/USD Support – Rising trendline



## Resistance – Declining trendlines

The upper borders of a trade channel form lines of resistance. These peaks represent the price levels at which the selling pressure exceeds the buying pressure and are known as Resistance levels.

## Example: USD/JPY Resistance – Declining trendline



## Horizontal trendline – Either Support or Resistance

Occasionally you get a situation where a level on the topside or downside has a number of touches at the same level. In this instance the trendline is neither rising nor declining, but horizontal.

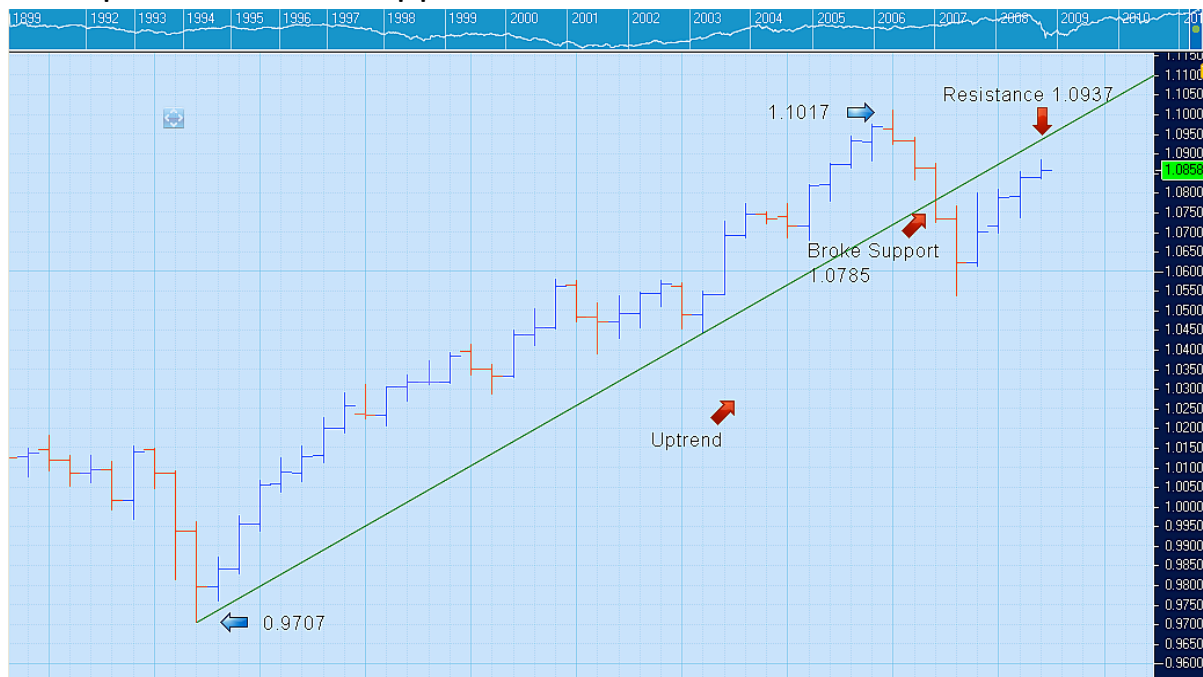
This trendline has the same significance as a rising or declining trendline and should be treated with the same respect as them. Invariably these levels coincide with big round numbers and are the result of massive orders in the market.

Example: USD/CAD Horizontal resistance.



The importance of support and resistance trendlines though, goes beyond their original functions. If these levels are convincingly penetrated, they tend to turn into just the opposite. A firm support level, once it is penetrated, will likely turn into a strong resistance level. Conversely, a strong resistance level turns into a firm support level after being penetrated. This is one of the key principles of technical analysis.

## Example: AUD/USD Support turned into resistance.



## Retracement

When we talk about retracement we are talking one of two things. Either the retracement associated with a break of a support or resistance trendline or the retracement associated with the overall trend itself. The first revolves around technical analysis trendlines and the way they behave once broken, whereas the second revolves around Fibonacci analysis.

We already know that breakouts from trendlines tend to test the strength of the former support or resistance line. This is the initial starting point for the Retracement. When a trendline breaks a large number of stop loss orders are triggered, sending the currency shooting through these levels. This initial spike is then likely to be followed by a period of consolidation. The move generally loses momentum from the initial break and stalls. This is where it usually drifts back to retest the breakout point. This is where the Retracement occurs. This Retracement of trendline breaks occurs almost every time a trendline is broken.

When a major trendline is broken this usually signals the end of a long running uptrend or downtrend. It's at this point traders are looking for answers as to the possible extent of the retracement. This is where Fibonacci analysis comes into play.

Fibonacci analysis gives ratios which play an important role in the forecasting of market movements. This theory is named after Leonardo Fibonacci of Pisa, an Italian mathematician of the late twelfth and early thirteenth centuries. He introduced an additive numerical series – the Fibonacci sequence.

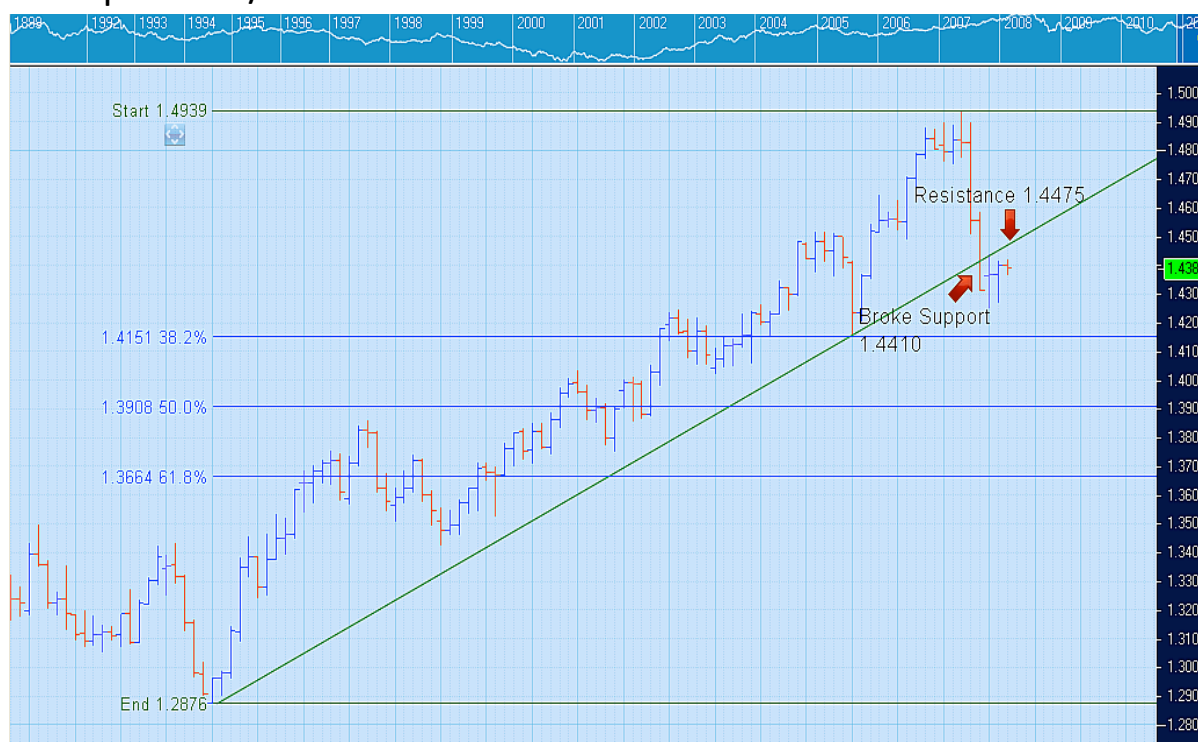
The Fibonacci sequence consists of the following series of numbers:

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377, 610, 987, .....

The sequence exhibits several remarkable relationships, in particular the ratio of any term in the series to the next higher term. This ratio tends asymptotically to 0.618 (the Fibonacci ratio).

It's these same ratios that the traders apply to their technical analysis to predict Retracement levels of the overall trends. The main ratios they focus on are: 38.2%, 50%, 61.8% and these are drawn as horizontal lines.

Example: EUR/USD Fibonacci Retracement.



Once the currencies break the major trendlines they enter a zone where there are no trendlines anywhere, making trading quite unpredictable and difficult. The Fibonacci retracements take up the role of support and resistance depending if the currency is going up or

down. These levels are recognised the world over and hence is why you need to know where and what they are.

Note: the Fibonacci ratios are best used for predicting trend break out retracements, not for everyday trading ranges.

## Momentum Trading Indicators

As mentioned earlier, forex traders do not use mathematical indicators to decide whether they should buy or sell. They use their instincts plus a few other factors to help guide this decision making process. One of these key factors is momentum indicators.

Momentum indicators do not tell you to buy or sell; they simply gauge momentum in the market. Momentum is one of the major things traders look for and knowing when the buyers are outweighing the sellers (and vice versa) can be a powerful tool in managing positions or deciding on what strategy to apply.

You shouldn't buy or sell on price alone and it's for this fact you wouldn't use momentum indicators as your sole reason for getting long or short. Remember it's an indicator, giving you an indication only, so don't over emphasise its importance and use it as your main trading tool.

The two main momentum indicators are the Relative Strength Index (RSI) and Stochastics.

## Stochastics

Stochastics generate trading signals before they appear in the price itself. Its concept is based on observations that, as the market gets high, the closing prices tend to approach the daily highs; whereas in a bottoming market, the closing prices tend to draw near the daily lows.

The oscillator consists of two lines called %K and %D. Visualize %K as the plotted instrument, and %D as its moving average. The resulting lines are plotted on a 1 to 100 scale, with overbought and oversold warning signals at 70 percent and 30 percent, respectively.

The buying (bullish reversal) signals occur under 10 percent, and conversely the selling (bearish reversal) signals come into play above 90 percent after the currency turns.



## Relative Strength Index

The relative strength index is a popular oscillator devised by Welles Wilder. The RSI measures the relative changes between the higher and lower closing prices. The RSI is also plotted on a 0 to 100 scale.

The 70 and 30 values are used as warning signals, whereas values above 85 indicate an overbought condition (selling signal) and values under 15 indicate an oversold condition (buying signal). Wilder identified the RSI's forte as its divergence versus the underlying price.

### Example: GBP/USD Stochastics (red/blue lines) & RSI (green line)



## The Final Say

Statistics show that the majority of new traders to the forex market rely solely on technical analysis and mathematical indicators to guide their trades. This is a major reason why many of them fail at the first attempt to trade the Forex market. They rely on the charts and indicators to tell them to buy and sell when in actual fact all they can give you are entry and exit levels.

Remember commercial traders don't use fancy indicators, so don't get caught up in all the hype surrounding them. They simply do not provide consistent results and this is because of the significant time

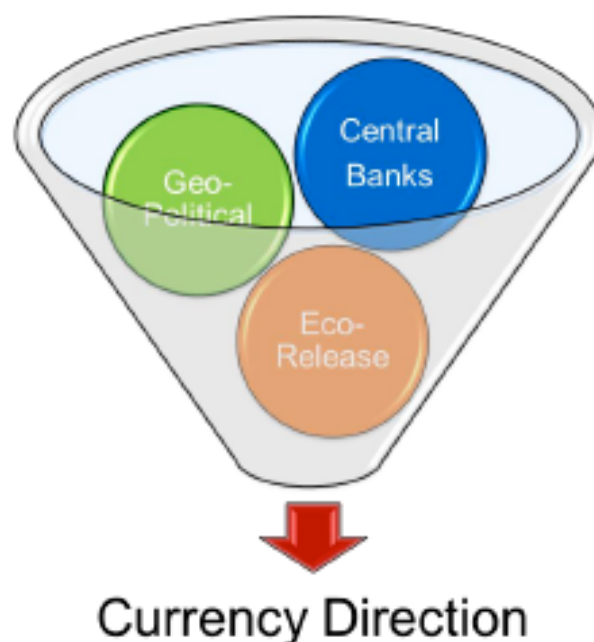
lag associated with them. Meaning they cannot reflect change in the markets quick enough. Simple support and resistance trendlines are the most important technical signals (the longer the time frame the greater the importance of support and resistance levels), so stick to these key levels to make your trading decisions.

In the short term you can rely on technical analysis on making currency decisions, but in the longer term fundamental factors will dominate and determine the currency direction and trends.

## Chapter 6 Fundamental Analysis

### What is Fundamental Analysis?

Fundamental analysis studies the cause of market movements, while technical analysis studies the effects of market movements. Fundamental analysis is a method of forecasting future price movements based on the underlying economic and political fundamentals of a currency.



The basic premise of fundamental analysis is that the value of a currency is determined by the comparative strength and weakness of a country's economy in relation to those of its trading partners.



The stronger a country's economy – measured in higher GDP growth, lower inflation, higher interest rates, greater productivity, more political stability, etc. – the stronger a country's currency.

Over time, these fundamental factors produce the long lasting price trends typical of the currency markets. To get an overall picture of the economy a fundamental analyst must consider – its strengths, weaknesses, vulnerabilities, and most importantly its future potential.

An understanding of the economic fundamental factors that impact forex markets is necessary if a longer term view is to be taken. They are statistical measures of various parts of the economy which are basically barometers of overall economic health.

## Global Economic Indicators

Economy-wide indicators are the broadest measures of productive activity and record the result for the entire economy. Usually collected by governments, they are among the most authoritative statistics. There is a core group of indicators that are released in all the major economies. These indicators are an effective way of comparing different economies around the world. Forex traders watch these releases very closely as they provide directional trading opportunities. The key global indicators are:

### Gross Domestic Product (GDP)

The gross domestic product is one of the most important economic indicators, as it provides an overall health check of the economy. It represents the total dollar value of all goods and services produced (over a specific time period) and are a good measure of the overall size of an economy. This is released quarterly in most countries.

### Consumer Price Index (CPI)

The consumer price index is the other most important economic indicator. It is a measurement of prices for a range of consumer products. It is calculated in urban areas and provides a fairly good look at how much inflation has occurred in the country. Central banks enact monetary policy specifically on this indicator. This is released monthly in most countries.

## Trade Balance

The trade balance measures the difference between exports of all goods and services, and imports. It is released in terms of exports. A trade surplus occurs when an economy exports more than it imports and a trade deficit occurs when an economy imports more than it exports. The balance of trade is one of the most misunderstood indicators of the economy. A trade deficit isn't necessarily an unfavourable number. Strong expanding economies usually import more than they export, so it may in fact indicate the economy is strong as opposed to the perception things are going so well.

## Retail Sales

Retail Sales is one of the big monthly releases that the market watches very closely. This indicator tracks the dollar value of merchandise sold within the retail trade by taking a sampling of companies engaged in the business of selling end products to consumers. Because the CPI indicator is released quarterly, traders focus on the monthly retail sales release to get a gauge of possible inflation in the economy.

## Unemployment Rate & Change

The unemployment indicator is a massive monthly release. The 'unemployment rate' refers to the number in the civilian labour force divided by the number of unemployed. The Bureau of Labour Statistics defines unemployment as people who do not have a job, have actively looked for work in the past four weeks, and are currently available for work. It doesn't count the jobless who didn't look for a job in the past four weeks, or are so discouraged that they have stopped looking for a job. Therefore the rate is susceptible to change purely if there is a change in the participation rate (those actively seeking employment). Whereas the 'unemployment change' simply refers to the number of new jobs added in the past month.

In the US it is called the Non-Farm Payrolls, because Farm related jobs are excluded as they tend to be seasonal and not necessarily indicative of employment trends.

### Producer Price Index (PPI)

The Producer Price Index measures the average change in the selling prices received by domestic producers of goods and services. The PPI measures price changes from the perspective of the producer, whilst the CPI measures price changes from the consumer's perspective.

### Industrial Production

Industrial production is a measure of changes in output for the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Industrial Production figures are used by central banks to measure inflation, as high levels of industrial production can lead to uncontrolled levels of consumption and rapid inflation.

### Consumer Confidence

Consumer confidence is a leading indicator of consumer spending, which accounts for a majority of overall economic activity. It gives a consumers perspective of overall current economic conditions. This can be a good precursor to future spending activity.

### Manufacturing Production

It's a leading indicator of economic health. Businesses react quickly to market conditions and their purchasing managers hold perhaps the most current and relevant insight into the company's view of the economy.

## Important Country Indicators

Each of the developed economies in the world is different. They have their own unique industry strengths which require specific economic indicators to track their economic performance. Most of these economies have their own set of country specific numbers which are just as important as the global numbers in measuring economic performance.

### U.S.A.

#### Durable Goods

Measures the change in the total value of new purchase orders with manufacturers for durable goods, excluding transportation items. It's a leading indicator of production as rising purchase orders signal that manufacturers will increase activity as they work to fill the orders.

#### Factory Orders

Measures the change in the total value of new purchase orders placed with manufacturers. It's a leading indicator of production as rising purchase orders signal that the manufacturers will increase activity as they work to fill the orders.

#### Existing Home Sales

It's an annualised number of 'previously owned' residential buildings that were sold during the previous month. It's important because the sale of a home has a wide reaching ripple effect. From renovations all the way through to financing.

## Unemployment Claims

This is the number of individuals who filed for unemployment insurance for the first time during the past week. This is the nation's most recent economic data. The market impact fluctuates from week to week as there tends to be more focus on the release when traders need to diagnose recent developments, or when the reading is at extremes.

## New Home Sales

It's an annualised number of newly built residential buildings that were sold during the previous month. It's important because the sale of a new home requires new furniture, appliances and financing.

## Housing Starts & Permits

It's an annualised number of new residential buildings that began construction during the previous month. It's important because the construction industry has a wide reaching ripple effect on the rest of the economy.

## Pending Home Sales

Measures the change in the number of homes under contract to be sold but still awaiting the closing transaction. It's a more forward looking number to home sales as a contract is signed several weeks before the home is counted as sold.

## Standard & Poor's/Case Shiller House Price Index

Measures the change in the selling price of single family homes in 20 metropolitan areas. It's a leading indicator of the housing industry's health because rising house prices attract investors and spur industry activity.

## Crude Oil Inventories

Measures the change in the number of crude oil held in inventory by commercial firms during the past week. It influences the price of petroleum products which affects inflation, but also impacts growth as many industries rely on oil to produce goods.

## University of Michigan Consumer Sentiment

It is highly respected due to its historical correlation with consumer sentiment since 1940. It rates the level of current and future economic conditions. There are two versions of this data released 14 days apart – preliminary and revised. The preliminary release is the earlier and thus tends to have the most impact.

## Capacity Utilisation Rate

Is the percentage of available resources being utilised by manufacturers, miners and utilities. It's a leading indicator of consumer inflation because when producers are nearing full capacity they respond by raising prices, and the higher costs are usually passed on to the consumer.

## Beige Book

Anecdotal evidence supplied by the 12 Federal Reserve banks regarding local economic conditions in their district. This analysis is used by the FOMC to help make their next decision on interest rates.

## ISM Manufacturing Purchasing Managers Index (PMI)

Is based on surveyed purchasing managers in the manufacturing industry. Respondents rate the relative level of business conditions including employment, production, new orders, prices, supplier deliveries and inventories. Above 50.0 indicates industry expansion, below indicates contraction.

## ISM Non-Manufacturing PMI

It is the same survey as the ISM Manufacturing PMI but excludes the manufacturing industry. Is also referred to as the Services PMI.

## Philly Fed Manufacturing Index

Is based on surveyed manufacturers in Philadelphia who rate the relative level of business conditions. It has been a high historical correlation with the overall business conditions for the whole country for more than 30 years. Above 0.0 indicates improving conditions, below indicates worsening conditions.

## Empire State Manufacturing Index

It is based on surveyed manufacturers in New York State. Above 0.0 indicates improving conditions, below indicates worsening conditions. This is a relatively new indicator first released in 2002.

## TIC Long Term Purchases

Difference in value between foreign long-term securities purchased by US citizens and US long-term securities purchased by foreigners during the reported period. Demand for domestic securities and currency demand are directly linked because foreigners must buy the domestic currency to purchase the nation's securities.

## EUROPE

### The Zew Survey

Is a survey of German institutional investors and analysts on Eurozone economic outlook. The Zew survey is historically focused on the

German economy and Germany tends to lead the Eurozone economy. So this overall Eurozone outlook tends to be overshadowed by the German data released at the same time. It's a leading indicator of economic health because investors and analysts are highly informed by virtue of their job and changes in their sentiment can be an early signal of future economic activity.

#### German Ifo Business Climate

Is a survey of German manufacturers, builders, wholesalers and retailers. This survey is highly respected due to its large sample size and historic correlation with German and wider Eurozone economic conditions. It tends to create a hefty market impact upon release. It's a leading indicator of economic health because businesses react quickly to market conditions and changes in their sentiment can be an early signal of future economic activity such as spending, hiring and investment.

#### GfK German Consumer Climate

Is a survey of consumers who are asked to rate the relative level of past and future economic conditions, including personal financial situation, climate for major purchases and overall economic situation. It is released monthly.

#### M3 Money Supply

Measures the change of domestic currency in circulation and deposited in banks. It's a positively correlated with interest rates because early in the economic cycle an increasing supply of money leads to additional spending and investment, and later in the cycle expanding money supply leads to inflation.



## ECB Monthly Bulletin

It reveals the statistical data that the ECB Governing Board evaluated when making the latest interest rate decision and provides detailed analysis of current and future economic conditions from the bank's viewpoint.

## UNITED KINGDOM

### Purchasing Managers Index - Manufacturing, Services, Construction

The surveys are based on purchasing managers in the various industries. They ask respondents to rate the relative level of business conditions including employment, production, new orders, prices, supplier deliveries and inventories. Above 50.0 indicates industry expansion and below indicates contraction.

### BOE Inflation Report

This report includes the BOE's projection for inflation and economic growth over the next 2 years. The BOE Governor also holds a press conference to discuss the reports contents upon release.

### Claimant Count Change

Change in the number of people claiming unemployment-related benefits during the previous month. It's the first indication of the employment situation, released a month earlier than the unemployment rate.

### Public Sector Net Borrowing

This is the difference in value between spending and income for public corporations, the central government and local governments during the previous month. A positive number indicates a budget deficit; a negative number indicates a surplus. It is released monthly.

### Halifax House Price Index (HPI)

Change in the price of homes financed by Halifax Bank of Scotland. It is a leading indicator of the health of the housing industry.

## JAPAN

### Tankan Manufacturing Index

The Tankan index is based on surveyed large manufacturers and is released quarterly. Manufacturing plays a critical role in the Japanese economy and this survey is considered the best gauge of the industry's health due to its large sample size and respected source. Above 0.0 indicates improving conditions, below indicates worsening conditions.

### Tankan Non-Manufacturing Index

This index is based on surveyed large businesses, excluding manufacturing. It is measured the same as the Manufacturing index.

### Average Cash Earnings

Change in the total value of employment income collected by workers.

## SWITZERLAND

### KOF Economic Barometer

Is the combined reading of 12 economic indicators related to banking confidence, production, new orders, consumer confidence and housing. This index is designed to predict the direction of the economy over the following 6 months. The impact tends to be significant but varies from month to month.

## CANADA

### Building Permits

Change in the total value of new building permits issued. It's released monthly and is an excellent gauge of future construction activity because obtaining a permit is among the first steps in constructing a new building.

## Ivey PMI

Survey of purchasing managers, selected geographically and by sector of activity to match the economy as a whole, which asks respondents to rate the relative level of business conditions including employment, production, new orders, prices, supplier deliveries and inventories. Above 50.0 indicates industry expansion, below indicates contraction.

## Housing Starts

It is an annualised number of new residential buildings that began construction during the previous month.

## BOC Business Outlook Survey

This report is highly respected given its source and timing in relation to interest rate decisions. It can also have predictive qualities regarding future economic conditions because the surveyed firms are selected in accordance with their composition of the nation's GDP.

## AUSTRALIA

### Building Approvals

Change in the number of new building approvals issued. Released monthly, it's an excellent gauge of future construction activity because obtaining government approval is among the first steps in constructing a new building. Construction is important because it produces a wide reaching ripple effect in the economy.

### Home Loans

Change in the number of new loans granted for owner-occupied homes. It's a leading indicator of demand in the housing market as most homes are financed, so it provides an excellent gauge of how many qualified buyers are entering the market.

### Private Capital Expenditure

Change in the total inflation-adjusted value of new capital expenditures made by private businesses. It's a leading indicator of

economic health because businesses are quickly affected by market conditions and changes in their investment levels can be an early signal of future economic activity such as hiring, spending and earnings.

## NEW ZEALAND

### Labour Cost Index

Change in the price businesses pay for labour, excluding overtime. It is released quarterly and is a leading indicator of consumer inflation because when businesses pay more for labour the higher costs are usually passed on to the consumer.

### Inflation Expectations

It is the percentage that business managers expect the price of goods and services to change annually during the next 2 years. Expectations of future inflation can manifest into real inflation, primarily because workers tend to push for higher wages when they believe prices will rise.

### NBNZ Business Confidence

It is based on surveyed manufacturers, builders, retailers, agricultural firms and service providers. It's a leading indicator of economic health. Above 0.0 indicates optimism, below indicates pessimism.

### Building Consents

Change in the number of new building approvals issued. It's an excellent gauge of future construction activity.

## Central Banks - Interest Rate Announcements

One of the main functions of the central banks is to monitor the economy and implement monetary policy depending on how they see the economy performing.

Conventional wisdom has this as the most important data release, since interest rates are the key drivers of price direction. The measures of economic health will be assessed by the market as inflationary or deflationary and thereby effect expectations of future rate changes.

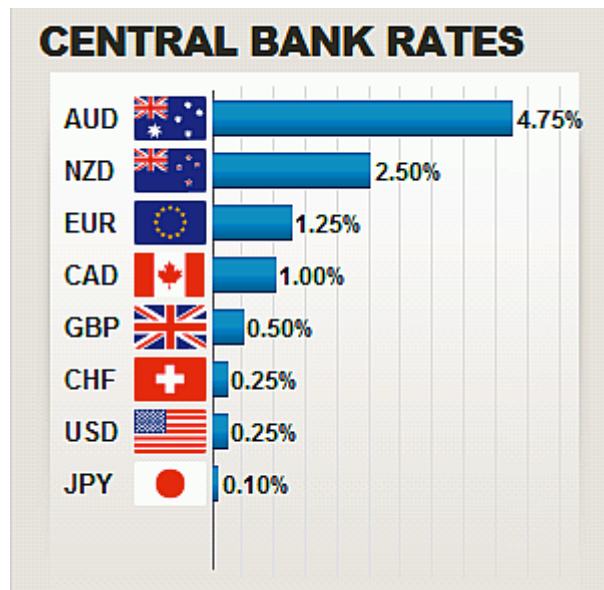
Most of the central banks in the developed world have an inflation band of 2-3%. When inflation is below 2% they cut interest rates to stimulate economic activity and when it's above 3% they raise interest rates to slow the economy down. They typically meet every 4-6 weeks and make scheduled public announcements as to their near term target interest rate, based on their assessment of economic conditions. They are presented by central bank governors and are watched with great interest and anticipation by traders.

The direction and extent of the change (if any) is mostly known by major participants and "priced-in" ahead of time, although surprise announcements can and do happen. Because of this it's not the actual interest rate announcement, but rather the statement delivered by the governor after the release which is scrutinised the most.

This statement reveals the reason for their decision on interest rates and gives clues to the future direction on interest rates. They also like to be transparent with their decision making processes so they often use the statement to let the market know exactly what they are focusing on to determine future interest rate announcements. This enables the market to factor in future rate hikes as the various economic indicators are released and reduces the amount of volatility around the announcements themselves.

Each central bank has its own unique characteristics and understanding them will give you greater incite into their decision making processes and how they release their 'extremely important' statement.

Central Bank Rates: April 2011



#### USA - Federal Open Market Committee (FOMC)

The FOMC is the committee responsible for setting monetary policy and consists of all seven members of the Board of Governors and the twelve regional bank presidents, though only five bank presidents vote on interest rates at any given time.

The FOMC Statement: It's the primary tool the FOMC uses to communicate with investors about monetary policy. It contains the outcome of their vote on interest rates and other policy measures, along with commentary about the economic conditions that influenced their votes. Most importantly, it discusses the economic outlook and offers clues on the outcome of future votes.

#### EUROPE - European Central Bank (ECB)

The Executive Board is responsible for implementing monetary policy. This comprises the President of the ECB, the Vice-President and four other members, all appointed by common agreement of the presidents or prime ministers of the euro area countries. The Executive Board members are appointed for a non-renewable term of eight years.

The ECB Press Conference: It's the primary method the ECB uses to communicate with investors regarding monetary policy. It covers in detail the factors that affected the most recent interest rate and other policy decisions, such as the overall economic outlook and inflation. Most importantly, it provides clues regarding future monetary policy.

The press conference is about an hour long and has 2 parts. First a prepared statement is read, then the conference is open to press questions. The questions often lead to unscripted answers that create heavy market volatility.

#### UNITED KINGDOM - Bank of England (BOE)

The Old Lady as it's commonly known is the model on which most modern central banks have been based. The Monetary Policy Committee (MPC) of the Bank of England is the body responsible for setting the official interest rate in the UK, along with monitoring and directing other aspects of monetary policy, such as quantitative easing. It comprises eight members, along with the Governor of the Bank (currently Mervyn King), and is responsible primarily for keeping the Consumer Price Index measure of inflation close to a target set by government.

The BOE Statement – The MPC only issues a statement when there is a change in rates. It covers in detail the factors that affected the most recent interest rate and other policy decisions, such as the overall economic outlook and inflation. Most importantly, it provides clues regarding future monetary policy.

#### JAPAN - Bank of Japan (BOJ)

The Bank of Japan has had an extremely turbulent history, experiencing many changes and reforms through feudal wars, world wars and financial crises. It is currently independent from government

and this continues to create great angst as they refuse to follow the requests of the government to change policy.

The BOJ Statement – The Governor delivers the monetary policy statement shortly after the interest rate announcement. It covers in detail the factors that affected the most recent interest rate and other policy decisions, such as the overall economic outlook and inflation. Most importantly, it provides clues regarding future monetary policy.

#### SWITZERLAND - Swiss National Bank (SNB)

The Swiss National Bank conducts the country's monetary policy as an independent central bank. It is obliged by Constitution and statute to act in accordance with the interests of the country as a whole. Its primary goal is to ensure price stability, while taking due account of economic developments. In so doing, it creates an appropriate environment for economic growth.

The SNB Press Conference – The conference is held twice a year when rates are announced in June and December. It's about an hour long and has 2 parts – first the prepared statements are read, then the conference is open to press questions. The questions often lead to unscripted answers that create market volatility.

#### CANADA - Bank of Canada (BOC)

The Bank of Canada's principal role, as defined in the BOC Act, is "to promote the economic and financial welfare of Canada." In practice, however, it has a narrower and more specific internal definition of that mandate: to keep the rate of inflation between 1% and 3%.

The BOC Statement – It's the primary tool the BOC uses to communicate with investors about monetary policy. It covers in detail the factors that affected the most recent interest rate and other policy decisions, such as the overall economic outlook and inflation. Most importantly, it provides clues regarding future monetary policy.



## AUSTRALIA - Reserve Bank of Australia (RBA)

The Reserve Bank Board consists of nine members in total. These members include the three ex officio members of the Board, consisting of the Governor of the Reserve Bank, who is Chairman of the Board, the Deputy Governor of the Reserve Bank, who is the Deputy Chairman of the Board, and the Secretary to the Treasury. In addition, the Board is composed of six external members who are appointed by the Treasurer for a period of five years. The board normally meets eleven times each year, on the first Tuesday of each month, with the exception of January which has no meeting.

The RBA Statement – It's the primary tool the RBA uses to communicate with investors about monetary policy. It covers in detail the factors that affected the most recent interest rate and other policy decisions, such as the overall economic outlook and inflation. Most importantly, it provides clues regarding future monetary policy.

## NEW ZEALAND - Reserve Bank of New Zealand (RBNZ)

The Reserve Bank is responsible for independent management of monetary policy to maintain price stability. The Governor of the Reserve Bank is responsible for New Zealand's currency and operating monetary policy and does so after consulting senior bank staff and external advisers.

The RBNZ Press Conference – Is about 30 minutes long and has 2 parts - first the prepared statements are read, then the conference is open to press questions. The questions often lead to unscripted answers that create market volatility.

## Pros & Cons of Fundamental Analysis

### Pros:

- Central banks monitor fundamentals closely and enact policy based on expectations of future economic performance.
- They can provide a useful sense of context underlying major shifts in the market.

- Volatility created by fundamental releases can provide actionable trading opportunities.

#### Cons:

- The scope of data is so huge as to be potentially overwhelming.
- Time lag for them to fully impact is hard to gauge.
- Crowd psychology sometimes completely negates the apparent bias implied by the news.
- When everyone who wants to buy has bought, then even if the fundamental story and the news is positive, the market can only go down.

## Chapter 7 Trading Strategies

### Why Use Different Strategies?

The forex market is worldwide, but the dealers differ in their geographical locations (time zones), working hours, time horizons, home currencies, access to information, transaction costs, and amount of trading capital. The variety of time horizons is large: from intra-day dealers, who close their positions every evening, to long-term investors and central banks.

Depending on the constraints, the different market participants need different strategies because they'll be faced with different day to day trading opportunities. The overall trend will be the same, but trading strategies employed by different market participants will vary, based on their needs, preferences and circumstances.

For instance a trader in Australia may be short AUD/USD on the back of a weak economic data release in Australia. By the time the New York trader looks at the market 12 hours later the currency may have already dropped 200 points. He will be faced with a completely different set of circumstances and this will invariably require a completely different strategy.

It's also extremely important to be aware of what's driving the market and this may vary from one time zone to the next. Thus as the market changes, so too will the trading strategies.

To be a successful trader you need to develop a toolbox of trading strategies to combat the ever changing market. What works this week may not work next week, so unless you have the ability to change your strategies as the market changes, you will not be as successful as you could be.

## Entering / Exiting Trades

Are you wondering, 'if everyone trades using similar trading strategies then how do they all get set at the same levels'?

The answer: They don't all get set at the same levels.

Just because you're using the same strategy as other traders it doesn't mean you have the same entry/exit levels. It all comes back to the varying levels of experience, technical analysis know-how and risk appetite of each trader.

Moreover, different strategies have opposing entry and exit levels and this enables many trades to be offset at key levels. For instance, the trend trader is going to make sure the move is well on its way before entering, they won't be entering in close vicinity to the initial break level. The break trader will be working against the range trader's interest, so more often than not they counter out each other enabling a smooth transition of both entering and exiting trades.

Since most traders know what strategies other traders are using and trying to implement, many of them make variations in their own strategies to try and get ahead of the pack. These variations in the general technical strategies create an 'entry and exit zone' as opposed to an exact entry and exit level.

This is because in reality many traders choose to try and pre-empt the move, basically in order to make a few extra points, and this is where most confusion comes into the market.

To get a better understanding let's look at the break trader. In theory the break trader should wait for the support or resistance level to break before entering the trade. But this is totally different to what happens in the real market. In reality there are three types of break traders:

1. Pre-break
2. Break

### 3. Post break

The pre-break trader enters ahead of the break in the 'hope' it does break and they can get in before the sudden break rally. The break trader enters the market at/or just after the break level, which is generally recommended. The post-break trader waits for the break to be truly confirmed before they enter the market (hoping to avoid the false break). This in essence creates a 20 point break trade entry zone.

Now apply this real market activity to all of the technical trading strategies discussed, and you can easily see why the entry/exit levels are quite large.

One other simple reason why this entry/exit zone exists is simply because many traders use inferior charting systems. This leads to many errors in identifying the exact levels where the exact key support and resistance levels are. The slightest error in tagging the wrong part of a high or low bar whilst drawing your trendlines can lead to a margin of error of up to 20 points. This is a very common occurrence in beginner traders, who do not understand the importance of getting your levels exact. In this instance you could be entering trades well before or after the break occurs. If your initial entry level is out then your whole strategy is in jeopardy. Your trade will simply be a gamble, as opposed to a trade with a high probability of success.

All these varying factors contribute to what I call the "Bar Room Brawl" trading zone, which is a definite know go zone.

Envisage walking into a bar to get a nice cold drink. You enter the bar to find a biker gang turning the place upside down, smashing chairs over the patron's heads and ransacking the joint. What do you do? Turn around and walk straight out!

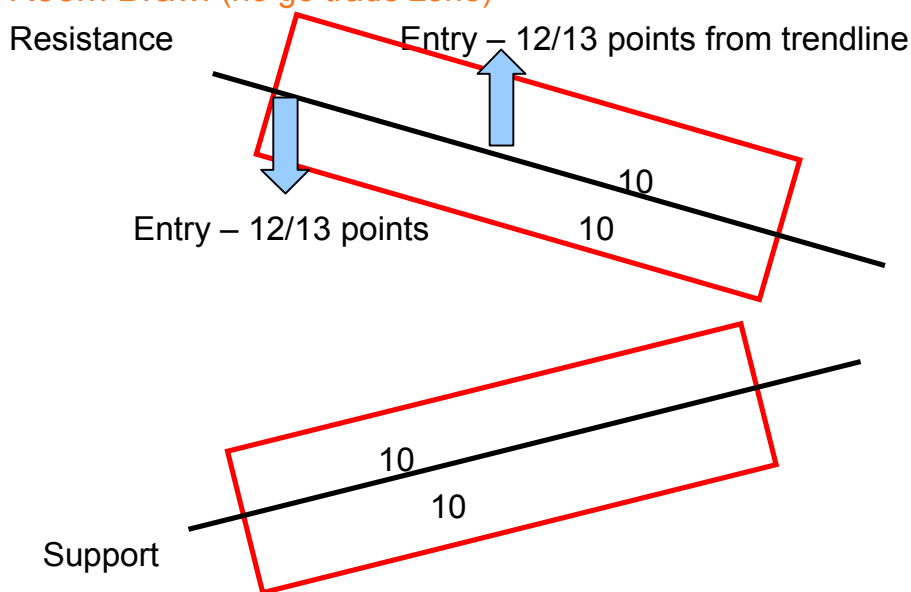
Now envisage the same situation, but this time when you enter the bar you are met with a friendly atmosphere, efficient staff and very warm surroundings. What do you do? You get a drink and probably stay for a few more!

This is exactly the same with the currencies as they go through these tricky entry/exit levels around the trendlines on your charts. You can get excited with the opportunity and lose control of your trade plan as you watch the aggressive price action. So in order not to miss out, you

rush in only to realise your levels were all wrong, the currencies turned around and before you know it, you're stopped out.

My twenty years of experience tells you, the best thing to do is avoid it all together and look for the better opportunities just outside this zone.

#### The Bar Room Brawl (no go trade zone)



When it's all said and done though, it comes down to personal preference and experience as to how you vary the technical trading strategies. Remember there is no right or wrong adaptation of these strategies, as each time a currency breaks a key level it is a unique event.

It's extremely wise to monitor your trading results and vary your entry and exit levels if your current trading strategies are producing more losers than winners.

The last factor to incorporate when choosing your entry/exit level is your capital preservation or risk management profile. It's easy enough to enter a trade wherever you choose, but the one important factor that has to remain constant relative to your capital is your exit point.

Invariably all traders use a risk/reward ratio of 3:1. So this in turn has the exit levels in roughly the same place for all traders on the same strategy. As with the entry levels above you get similar variations on

exit strategies. But this is one thing you should not vary or try and tweak.

Once your entry level has been established your stop should be automatically set and not moved, except to raise it, if the currency keeps moving in the same direction as the break. So your choice of entry level is very important and dictates your exit level. You should stick to this, no questions asked.

## Trading Strategies the Professionals Use

Trading successfully is by no means just a simple matter of luck. To give yourself the best possible consistent chance of success it's important you develop a toolbox of trading strategies and techniques.

Understand this: If you're not using a strategy then you're merely gambling. This is one of the main reasons newcomers to the Forex market lose their money before they even really get started.

In the past, most trading strategies were based on technical or fundamental analysis. Nowadays, it's not uncommon for options trading, index tilting and event trading to be incorporated into most traders' toolbox of strategies. It's important to note though that these aggressive strategies involve greater risk taking and may not be suitable to all traders.

The most popular trading strategies are:

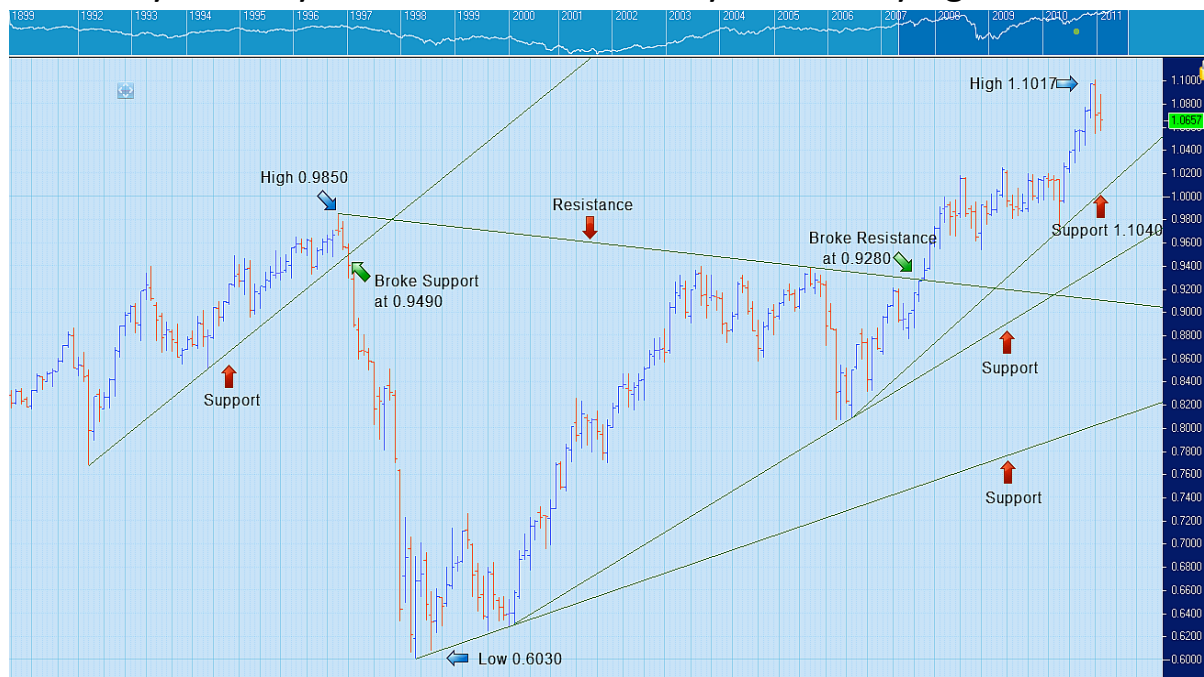
- » Trend Trading
- » Range Trading
- » Break Trading
- » False Break Trading
- » Trading Economic Data Releases
- » Trailing Stops or Adjusting Stops
- » The Carry Trade
- » The Truth about Scalping

## Trend Trading

Have you ever heard the old trading adage “The trend is your friend”? Well in the forex market, this is absolutely true.

If a currency is trending it basically means it is going in one clear direction: either up or down. The trend is easily recognised looking at the daily and weekly charts, where you can analyse the past 20 years of currency movements.

The Daily/Weekly charts will hold the key to identifying new trends.



Trend trading basically involves entering the market in the same direction as the trend, when it nears the trendline. The trend trade is one opportunity where you can potentially make significant amounts of money, if you can manage to allow the position to run long enough.

If you're looking at getting onto a trend then it may be wise to incorporate a few profit preservation techniques. It's very simple: As the currency progresses in the trend you should have specific targets for taking profit, reducing your position (locking in profits) and adjusting your stop loss.

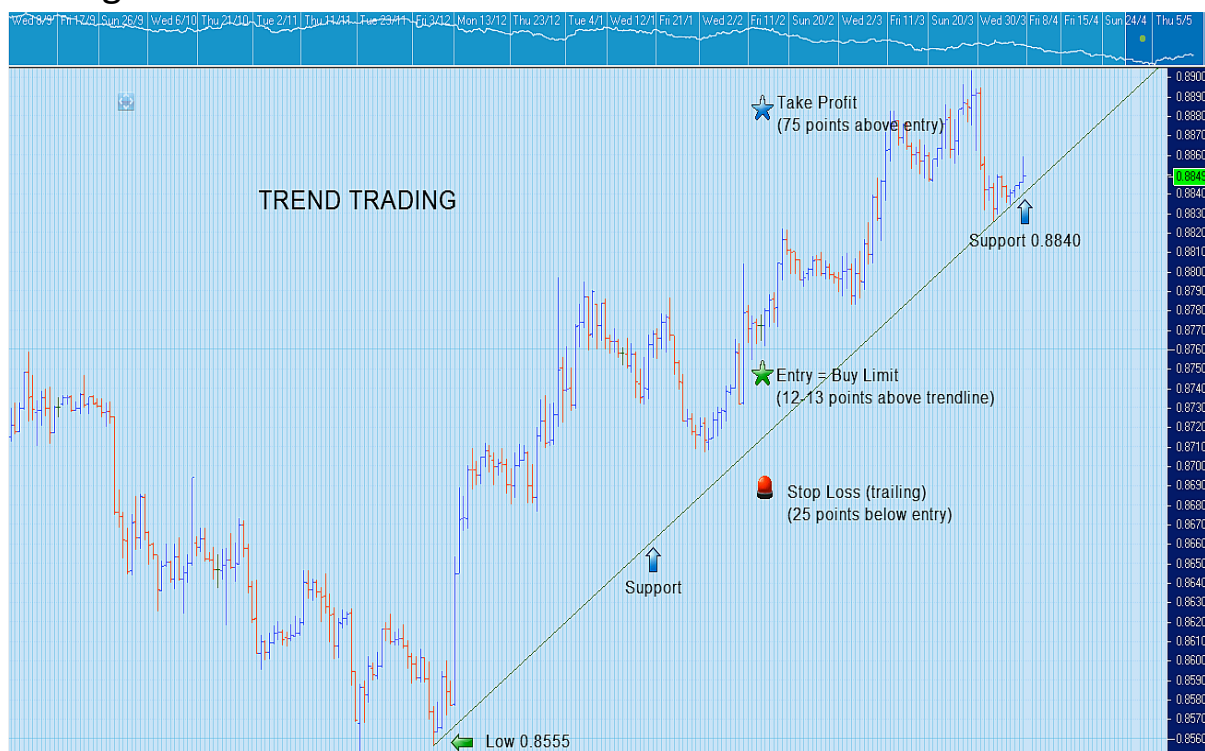
This way you can stay in the trend longer without the worry of it pulling back on you. Usually the first 100-200 points are the hardest to maintain, but once that's been achieved you're usually set for an easy ride, with order management your only concern.

Just about every new trader struggles to maintain the trend trade as more often than not when you look at all the money you've made your reluctant to put some of it back on the table.

So it may be wise not to look at your progressive profit for the trade as this will often take you away from your trade plan.

If you can get on a couple of trends in a year then you're assured good returns. The biggest trap for new traders though, is thinking every breakout is the start of a new major trend. It just doesn't happen like this!

Note: Trends are usually established at the beginning or end of major economic cycles. Specifically when there is a change in interest rate policy from the central bank, where they change from cutting rates to raising them.



## Range Trading

This is trading in its purest form and is often best utilised when the fundamentals are evenly balanced. In this instance the currencies don't usually have the momentum to break out of the current trendlines, either side of the market.

As many traders concentrate solely on break trades, there are others who concentrate only on range bound trades. It's simple and only



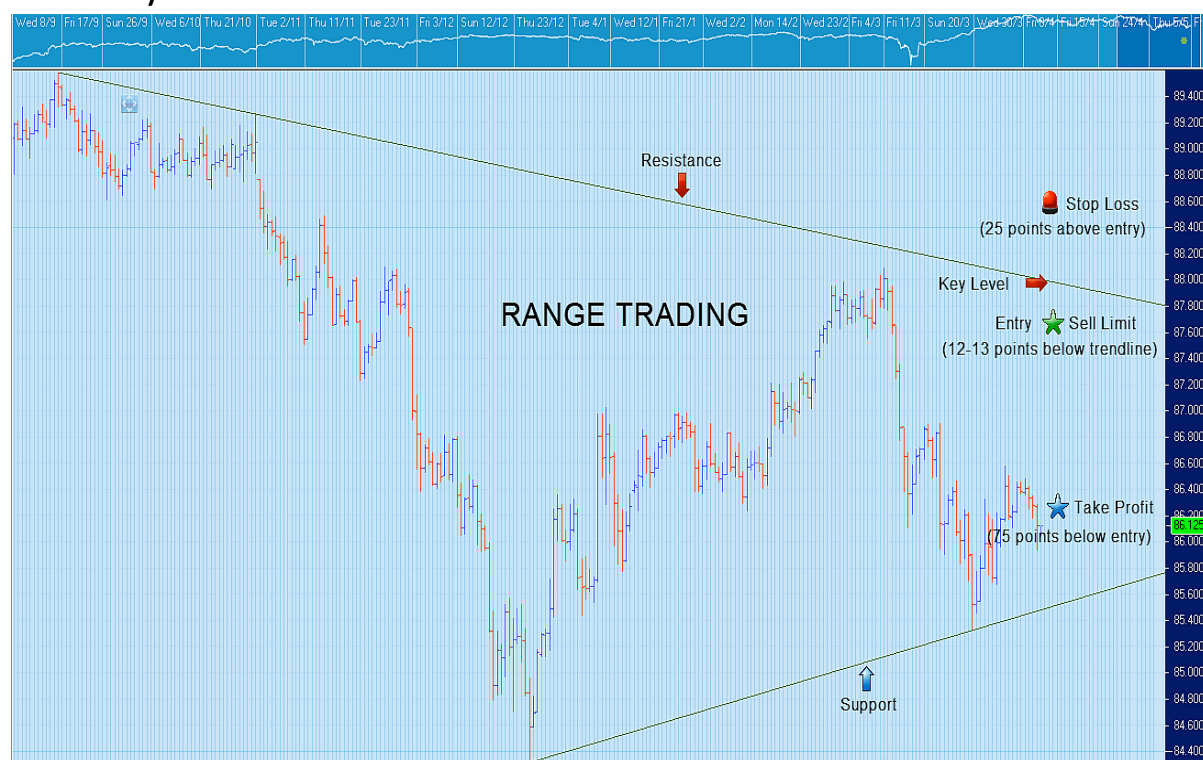
involves placing a limit order with a consequent stop loss order behind. Basically take profit and reverse.

This strategy is also very useful for “sideways moving” markets where there are no economic releases or central bank announcements due. The range trade strategy doesn’t necessarily involve reversing your position as it approaches your take profit, or the opposite end of the range. More often than not you will have a basic view on the direction of the currency and continue to trade your view each time it dips or rallies.

That way if the currency range trades for 6 months, you have still made good money with little risk attached. If you want to “up the tempo” as such, you can actively trade both sides of the market.

To utilise this strategy, all you have to do is wait for support and resistance trendlines to develop either side of the market. Once they are developed you simply identify your entry levels, apply your trade plan and let the market do the work.

The longer the range bound activity the stronger the support and resistance become, and more inclined the currencies will be to maintain the range. This strategy will remain dominant until the currency trendlines are broken.



## Break Trading

This could possibly be your from frequently used strategy and biggest money spinner as minor trend breaks occur quite frequently (inside larger trends). It doesn't necessarily involve much thought about the fundamentals of the currencies. All you need are good charts and sound trendline drawing skills, hence why it's imperative you have professional charting software.

It basically involves using stop entries orders (with contingent stop loss and take profit orders) to capture the sudden spikes through key support and resistance trendlines.

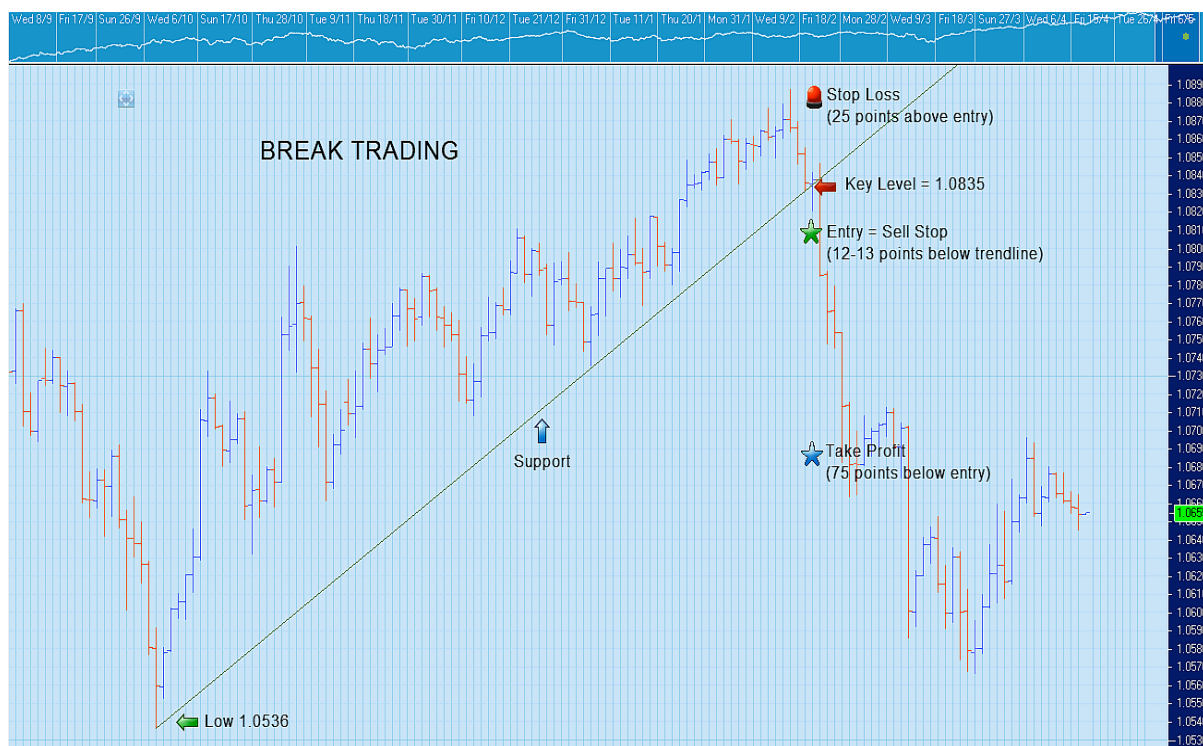
As mentioned earlier price support and resistance are the most important signals in trading. They are a major focus of traders globally and hence can be utilised to make consistent money. How do you identify what trendlines to focus on? You must wait for the support or resistance line to touch three times before it is confirmed. Once this occurs you can be sure the rest of the market would have identified the same trendline and be placing similar orders in the market. Then it's just a matter of setting your pending stop entry orders and walking away.

The good thing about these trades is that you don't necessarily need to be following the market that closely to get into them. They occur very regularly so you don't have to worry too much if you miss one, whereas if you miss the start of a trend you may have some time to wait for the next one to come along.

In the same way that the break trade is an 'easy trade', the market has also copped onto it. Leading to numerous false breaks where the traders at the banks push the currencies through the levels to try and trigger the pending stops on the other side of trendlines.

In this instance it's like stretching a rubber band to its limit and then letting the stretched end go. It gives off a massive force of recoil!

The currencies are no different. Hence why it's imperative if you're using this strategy to have a contingent stop loss in place before the first stop is triggered. In normal market conditions this strategy has a very high success rate.



## False Break Trading

This strategy is basically a failure of the break trading strategy. In the same way you are looking for the currencies to break key trendlines, this strategy involves trading on the reverse of the break trade.

There are many instances where the currencies break key trendlines but fail to go on with the move and this is particularly prevalent when the markets are washing around directionless.

Uncertain fundamental conditions surrounding financial crises in particular, often create large shifts in market sentiment. The markets in this situation are constantly searching for the next trend, but the mixed economic conditions and indicators often simply create spikes in one direction, than the other. False breaks are very common in these circumstances and that's why it's very important to be able to identify the economic conditions surrounding the market you're trading in as it may determine what strategy you should use.

The reversal back through the initial trendline break is critical and can often lead to massive moves in the opposite direction. In the same way you use stop entries to get into the market with break trading, you do the exact same with false break trading.

The critical factor is identifying the entry level for the false break. Understand this strategy can only be put in play once the break of the

trendline has taken place. This is because you need all the stop loss orders that were above the trendline to be triggered. This in turn makes all the break traders long with their stop loss orders now located just below the initial break line. You need this to occur to get the momentum shift when the currency moves back through the initial break level. As all the fresh stop loss orders are triggered, there's massive surge which drives the currency back within its recent range. A trail of carnage is left behind as both range and break traders have been stopped out on the false move through the trendline.

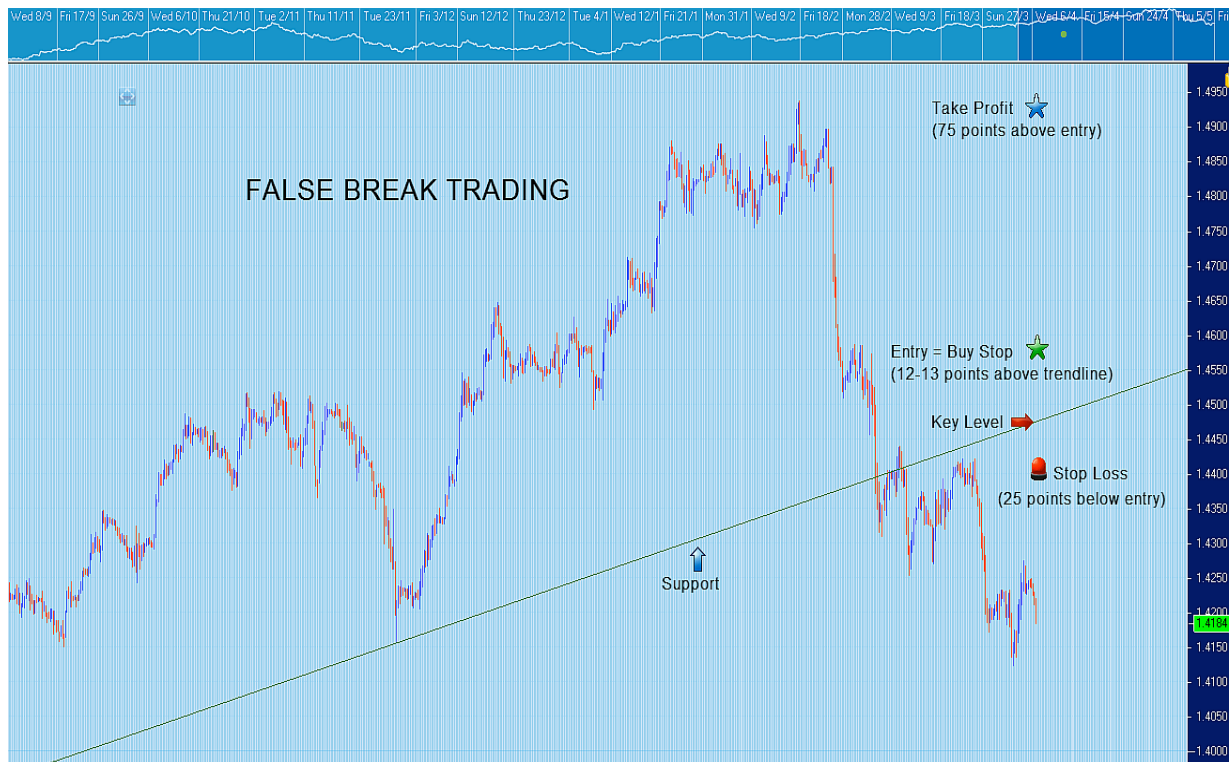
Two key factors you should consider when deciding on the break or false break trading strategy is the previous 24 hour range and stochastics.

The major currency pairs on average trade a 150-170 point range everyday. If at the time of the potential break the currency has already traded this range over the previous 12-24 hours, then there is a pretty high probability that it won't have the momentum to continue on through the break and hence the false break strategy would be best implemented.

This is the perfect situation to be considering the momentum of the market. The stochastics is your best gauge of momentum and indicate to you what's happening in the market. If at the time of the break the stochastics are extremely overbought, then once again this would imply the break will not be sustained and that the break strategy would be best implemented.

Invariably you'll find that in circumstances where the currency has rallied 170 points in a day, the stochastics will be stretched in the same direction, so it shouldn't be too hard to identify an overdone currency.

It's important to remember though, that key fundamental releases override stochastics and it's on these occasions that the average daily range is blown right out. So if you're looking at the currencies and your charts, ascertain what has been the main factor responsible for the move. If it's simply a technical break of a previous strong trendline then everything is in play. But on the other hand if there has been some fundamental indicators released with significant variance from expectations, then it would be wise to reconsider your strategy as this would generally mean the move is going to continue in the same direction.



## Trading Economic Data Releases

Event trading is viewed by the investment banking community as the most important approach to trading financial markets – distinctly different from simple technical methodologies. It is designed to capture profits from market reactions to news events, such as economic reports, interest rate changes, or political comments on the state of the economy.

Your trading plan is the same, but unlike other trades where you enter pending limit or stop orders, on event news you are hitting the market live. So you have to be ready to exit on adverse reactions after the news/data have been released, or ready to take profit as the market continues on. It's fast paced and definitely not for the faint hearted.

Before you get started you need to be aware of all market moving events that are scheduled for the day/week ahead, and specifically when they are released.

The one key factor you're looking for is any major variance in the actual number to the forecast number. It doesn't matter if it's positive or negative, if there is variance then there is a trading opportunity. If the economic release comes out as expected or close to expectations then nothing will happen and no trade presents itself. But if the release is somewhat markedly different then it's game on.

The one key factor to the success of this trading strategy is having access to real time news. You need to get the news at the exact same time the market gets it and trade correctly without hesitation.

It's easier then you think. It simply comes down to:

#### » Actual Vs Forecast

A stronger number, you BUY.

A weaker number, you SELL.

This is the same for EUR, GBP, AUD & NZD as they are all quoted against the USD.

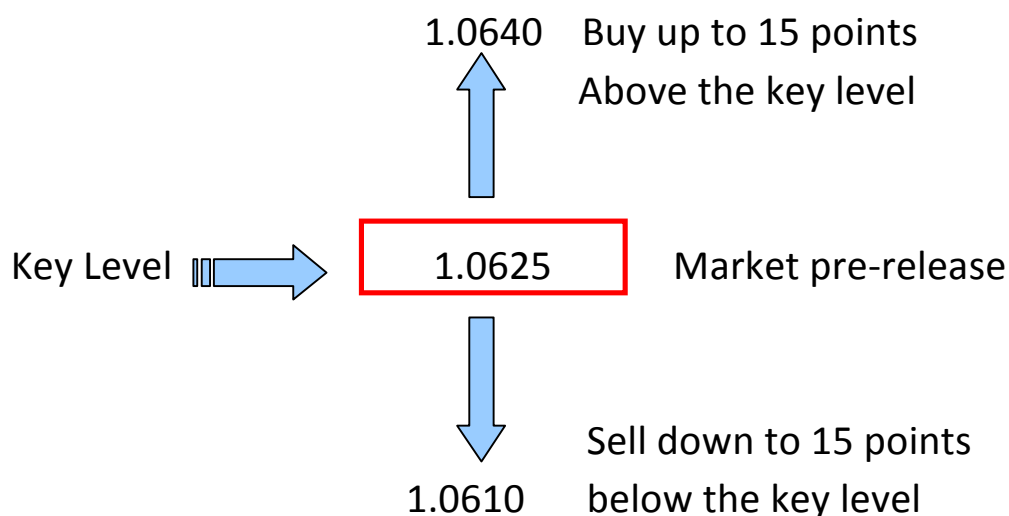
For currency pairs where the USD is the base it's the other way around. So for CAD, CHF & YEN: Strong data = Sell, Weak data = Buy.

Example: Australian Retail Sales

Actual	v	Forecast
+0.5%	No trade	+0.5% (as expected)
-0.5%	Sell	(weaker than expected)
+1.2%	Buy	(stronger than expected)

- Any variance from the forecast is a trading opportunity.
- Slight variance creates small non-aggressive moves.
- Large variance creates large aggressive moves.
- No variance = No trade.

Parameters for hitting the market live on economic data releases.



As soon as the data is released you hit the market live with the basic parameters 15 points either side of the market.

If you don't initially get set, these parameters are your retracement order levels. The levels where the currency should retrace back to, before continuing on with the move.

Once your position is set you apply your stop loss and take profit immediately. Understand this is high pressured trading and can take time to master.

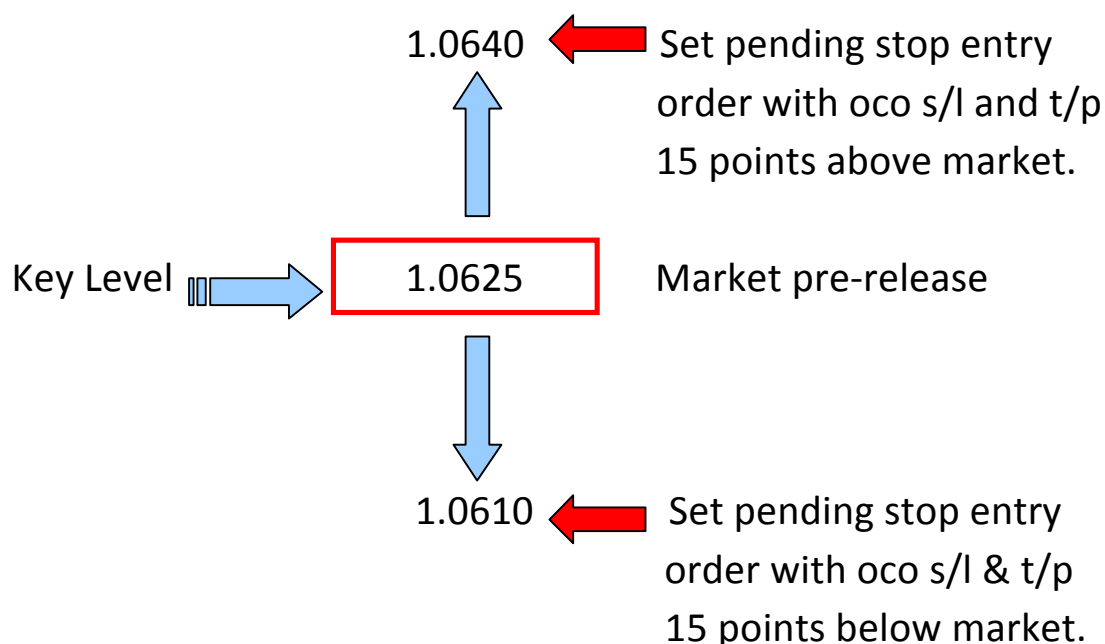
Alternatively: Pending Stop Entry Orders (both sides of the market)

This involves placing both a buy and sell pending stop entry order above and below the current price.

If you get some major variance in the data then one of your orders will be triggered. You immediately cancel the pending order that hasn't been triggered and your normal trade plan swings into action.

Note: this is a very high risk strategy. If there is significant variance the market will gap and your pending stop entry order may be filled 80-100 points away, or wherever the market resurfaces after the release.

## Parameters for Pending Stop Loss Orders Pre-Release:



## Trailing Stops

This strategy basically involves managing your stop loss level once your position is on. It is particularly useful when combined with the trend trading strategy although it can be incorporated into any of the strategies mentioned above.

The general idea of the trailing stop is to limit any losses should the market reverse its direction once your trade is well on the way and in the money. Generally I would only encourage you use this strategy once you are 40 points or more in the money.

At this point you can incorporate a trailing stop which follows the market a pre-set number of points behind it. Understand the markets do not go up and down in a straight line. So you need to make sure your trailing stop is not too close to the market, otherwise it will be taken out every time there is a small pullback in the currency.

So this may be beneficial when trading larger trend moves but is fraught with danger when trading intraday, as the currencies rarely go up or down in one straight line 75-100 points and you may get taken out on a minor retracement.



## The Carry Trade

It is a well known strategy that profits from the different interest rates between two currencies. If one currency has a relatively low interest rate, it can be sold against another currency that has a high interest rate, and the trader will profit from the positive difference that results.

In the situation where there is a significant interest rate differential it would be expected that the currency with the higher interest rate should be trading much stronger than the other currency.

So not only do you make money as the stronger currency appreciates against the weaker currency, the trader should also profit from the interest rate yield between the two currencies.

One of the most common carry trades is the AUD/YEN. It's important to understand though, that even when the differences between interest rates can be profited on, important risks still remain. Currency fluctuations can far out way the profit obtained from the interest rate differential.

The carry trade is best harnessed using the trend trade strategy.

## The Truth about Scalping

This is definitely not a strategy any trader outside a bank should employ.

Scalping or Jobbing as it's more commonly known in the wholesale market, involves buying and selling frequently for small profits.

The bankers use this strategy for two reasons:

1. To manage the flows that come through their trading books
2. To find out who is buying/selling at any given point in time.

They do not "job" the market to try and make their yearly budgets.

Scalping involves entering the market looking for between 2 to 10 points profit. There is no structured trade plan and the risk reward ratio is such that it's not a matter of will you go broke; it's just a matter of when!

Applying this strategy will see short term profits turn very quickly into massive losses. You'll be constantly chasing the market looking to get your cash back, all the while going deeper into the abyss.

This strategy is generally used by the uneducated trader who has no idea of the technical and fundamental nature of the forex markets.

## Chapter 8 Order Types & Putting Them On

### Main Types of Orders

There are a standard number of orders available on every trading platform, which you will incorporate into all of your Forex trades.

They can be tailored to a specific time frame: Good till cancelled or good till a certain time.

The main order types are:

- » Market
- » Limit
- » Stop-loss
- » Take profit
- » Stop entry
- » One cancels the other (OCO)
- » If done OCO
- » Trailing stop-loss

### Market

A market order is an order to buy or sell at the current market price and can be an entry or exit order.

Opening a Position: To open a position, you can either double-click one of the favourites from the favourites table on the left or click one of the spots in the spot panel.



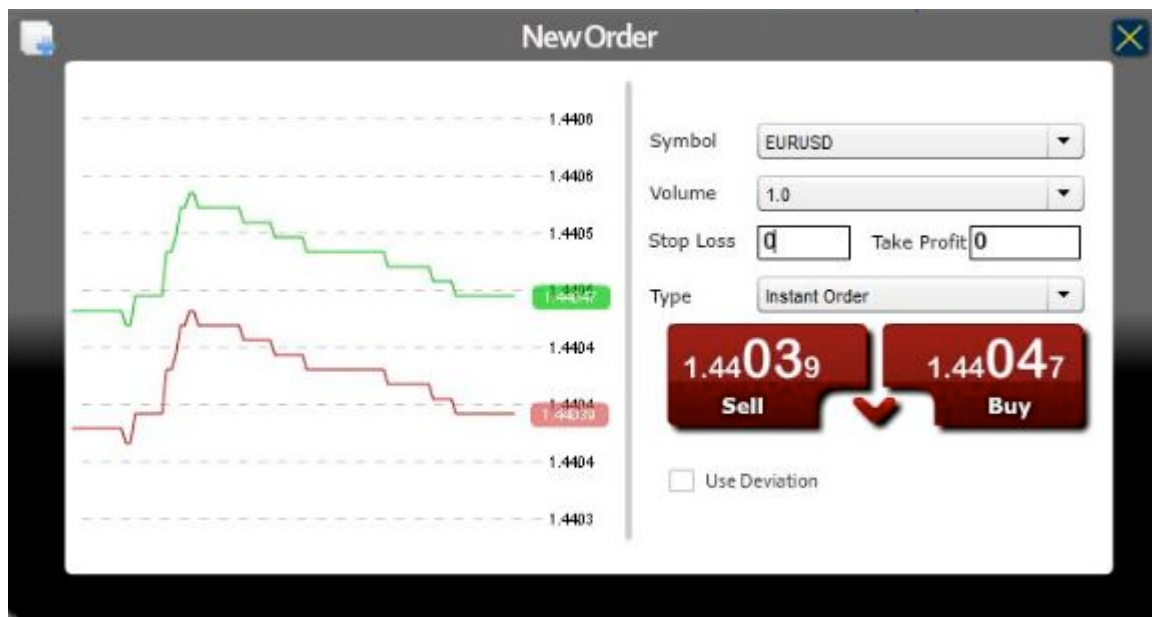
If you don't have the desired symbol in the favourites list, you can click the **Market** button.



This will complete the list of forex symbols.

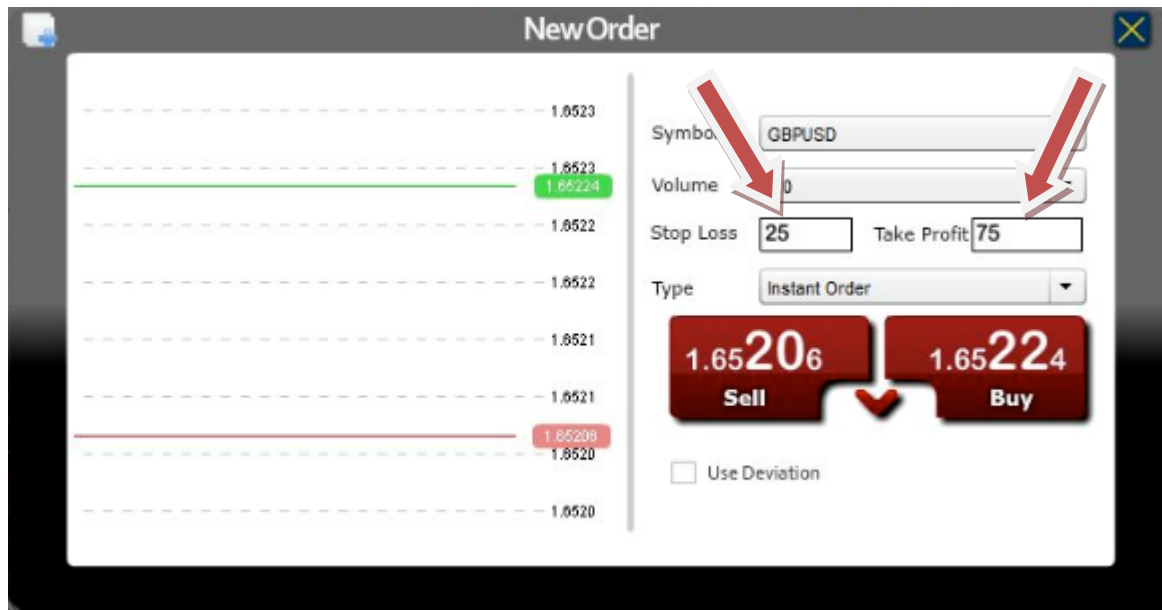


After double clicking the desired symbol you'll get a screen similar to the one below:

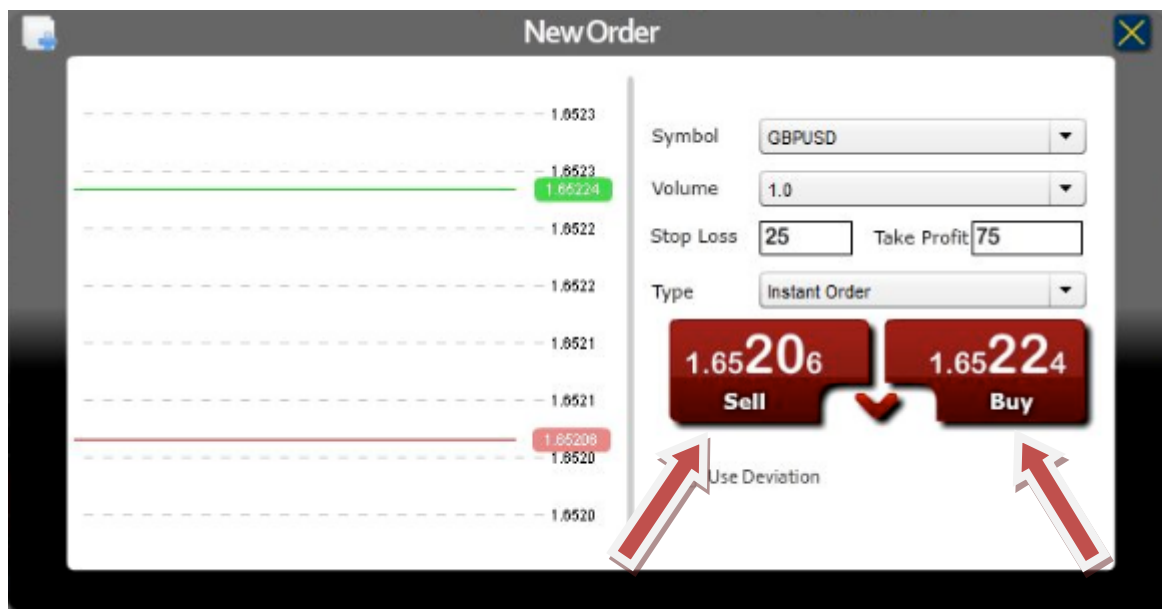


To place your order, simply click on the **Vol** combo-box to enter the amount of your transaction (or choose one of the preset ones in the combo-box). By tapping **Vol** the following screen will appear:

To enter a Stop Loss or Take Profit Order simply click on the fields designated for the Stop Loss and Take Profit and enter the price desired for the levels.



After the desired parameters have been set, choose between Buy and Sell Buttons.



You may now see your open position under the Positions Tab indicated on the screen below:



Modifying or Closing a position: To modify or close a position, simply double click a position in the **Positions** tab. You will then see a screen similar to the one below:

To close your position, simply click on **Close**. To modify your position, click **update**, you will then be able to set your new levels of Stop Loss and Take Profit levels.



## Limit Order (Pending)

In addition to allowing the placement of orders at the current market rate, all trading platforms allow orders to be placed at a price above or below the current market rate.

One type of entry order is the **Pending Order** and is only executed if the market rate reaches the rate specified in the order.

You cannot use a limit order to exit a position or trade.

A **Pending Buy Limit** order is an order to buy below the current market rate.

A **Pending Sell Limit** order is an order to sell above the current market rate.

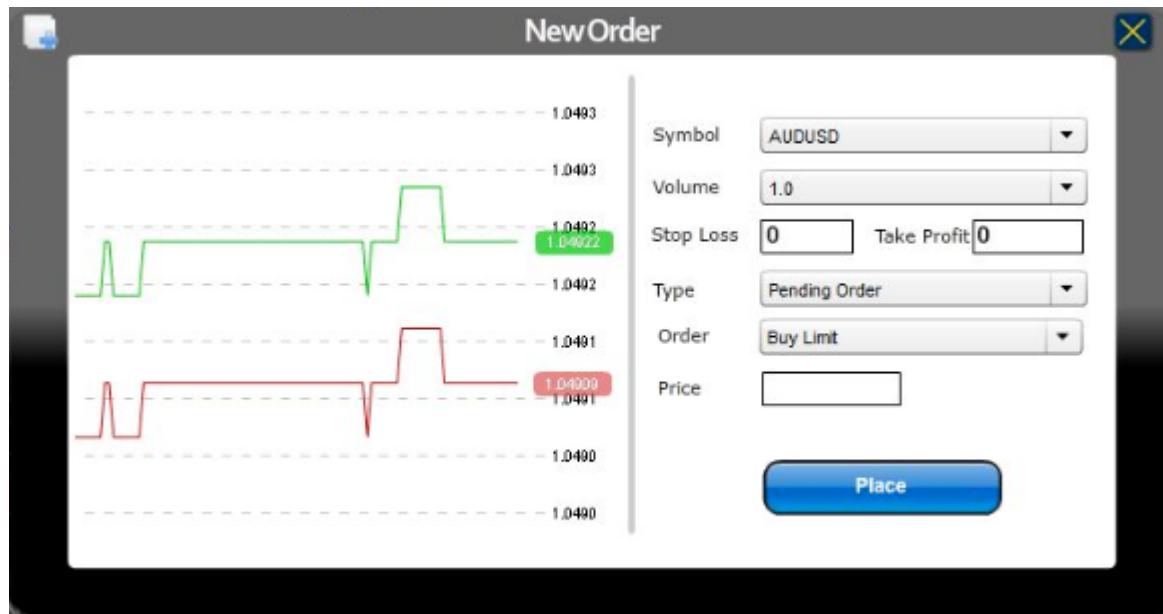
*Examples: If the current market price in EUR/USD is 1.4388 and a trader wishes to place an order to buy if the market moves to 1.4350, he or she would place a pending buy limit entry order.*

*If the current market price in EUR/USD is 1.4388 and a trader wishes to place an order to sell if the market moves to 1.4418, he or she would place a pending sell limit entry order.*



Opening a Pending Order: To enter a pending order in the Webtrader, simply double click a symbol in the favourites List or in the Market List

and on the next screen select **Pending** in the **Type** combo-box as shown below:



Then simply click on Type: **“Pending Order”**

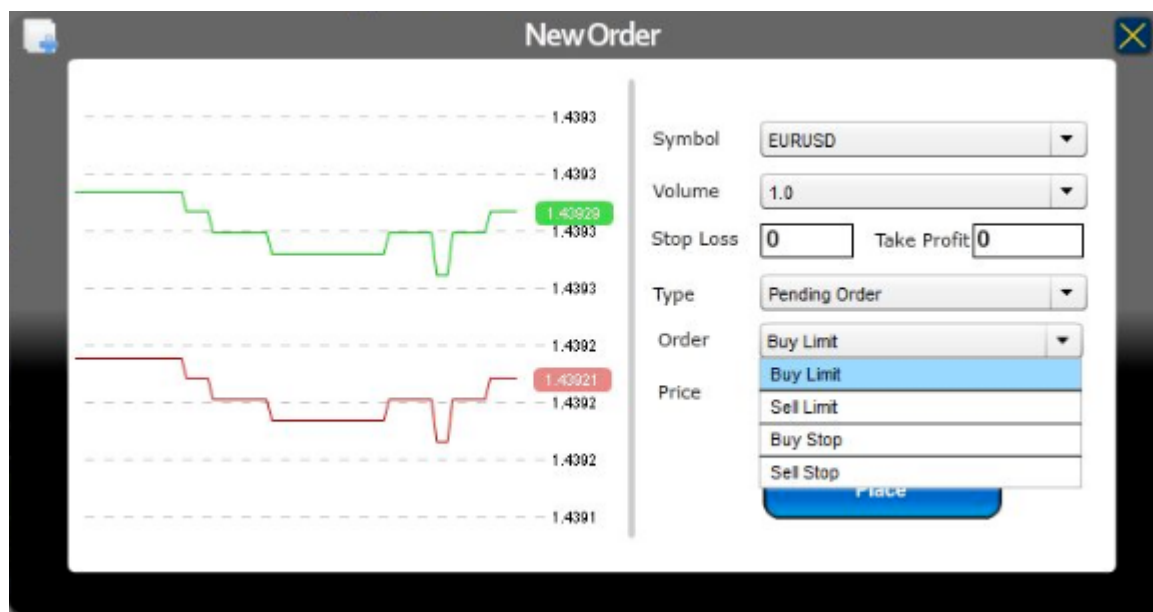
Then add the details

1. Volume
2. Price
3. Stop Loss
4. Take Profit
5. Place

A Pending order is the client's commitment to the brokerage company to buy or sell a security at a pre-defined price in the future. This type of orders is used for opening of a trade position provided the future quotes reach the pre-defined level. There are four types of pending orders available in the terminal; depending on the type of the trade you would like to place you will have four different options:



## Order Types:



**Buy Limit** — buy provided the future "ASK" price is equal to the pre-defined value. The current price level is higher than the value of the placed order. Orders of this type are usually placed in anticipation of that the security price, having fallen to a certain level, will increase;

**Sell Limit** — sell provided the future "BID" price is equal to the pre-defined value. The current price level is lower than the value of the placed order. Orders of this type are usually placed in anticipation of that the security price, having increased to a certain level, will fall;

**Buy Stop** — buy provided the future "ASK" price is equal to the pre-defined value. The current price level is lower than the value of the placed order. Orders of this type are usually placed in anticipation of that the security price, having reached a certain level, will keep on increasing;

**Sell Stop** — sell provided the future "BID" price is equal to the pre-defined value. The current price level is higher than the value of the placed order. Orders of this type are usually placed in anticipation of that the security price, having reached a certain level, will keep on falling.



Orders of Stop Loss and Take Profit can be attached to a pending order. After a pending order has triggered, its Stop Loss and Take Profit levels will be attached to the open position automatically.

## Stop Loss

Stop loss orders are used to automatically close an open position before additional losses are incurred. They are a contingent exit order attached to pending entry orders (see example above). They are one of the most important orders you use because it's these orders that 'control' your risk in the market. Your stop loss is your risk manager!

If a position is opened by buying a currency pair, the stop order will always be placed below the current market price. If a position is opened by selling, the stop order will always be placed above the current market price.

It is important to note that if you have an open position, then your position will be closed when the rate reaches your stop or take profit price, whichever comes first. The stop and take profit orders are OCO orders, which mean as soon as one is executed, the other will be cancelled.

## Take Profit

Take profit orders are used to automatically close an open position and lock in your profits. They are a contingent exit order attached to pending entry orders (see example above). They are one of the most important orders you use because it's these orders that are responsible for capital growth. Your take profit is your best friend!

If a position is opened by buying a currency pair, the take profit order will always be placed above the current market price. If a position is opened by selling, the take profit order will always be placed below the current market price.

It is important to note that if you have an open position, then your position will be closed when the rate reaches your stop or take profit price, whichever comes first. The stop and take profit orders are OCO orders, which mean as soon as one is executed, the other will be cancelled.

## Stop Entry

In addition to allowing the placement of orders at the current market rate, all trading platforms allow orders to be placed at a price above or below the current market rate.

There are two types of entry orders: limit entry orders and stop entry orders.

You can enter the market using **Pending Stop Orders**, and these are only executed if the market rate reaches the rate specified in the order.

A **Buy Stop** order is an order to buy above the current market rate.

A **Sell Stop** order is an order to sell below the current market rate.

*Examples: If the current market price in EUR/USD is 1.4388 and a trader wishes to take advantage of a move below 1.4350, he or she would place a pending sell stop entry order just below this level.*

*If the current market price in EUR/USD is 1.4388 and a trader wishes to take advantage of a move above 1.4418, he or she would place a pending buy stop entry order just above this level.*

## One Cancels the Other (OCO)

It simply means that if one part of the order is executed, the other part will be automatically cancelled.

All of the stop loss and take profit orders on the trading platforms are OCO orders. That is to say that if the stop gets hits, the take profit will automatically be deleted and vice versa.

Some trading platforms will allow you to have two different entry orders that a linked OCO. That way if the market goes in one direction then the other entire trade plan will be deleted.

This can be extremely beneficial when trading economic data releases. You can enter pending stop entry orders either side of the market and when the market moves the order that does not get triggered will be cancelled. Perfect!

## If Done OCO

This simply means that if one order is filled (done), then two contingent orders will come into play. Normally your stop loss and take profit. Once either of these contingent orders is filled, the other one will be cancelled automatically.

This order structure is the most common used and is what I would advise you use.

## Trailing Stop Loss

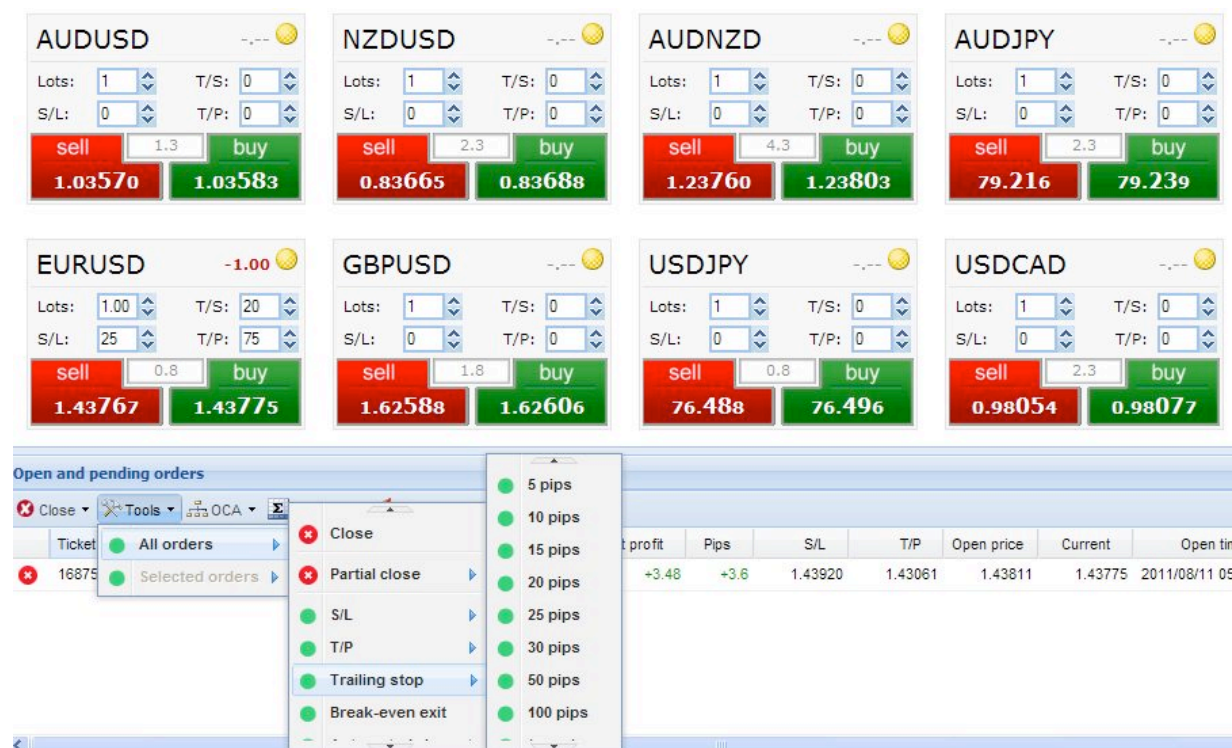
The trailing stop feature allows traders to place a stop loss order that automatically updates to lock in profit levels while the market moves in your favour. It is a contingent exit order.

Trailing stops on the FXASIA platform can be set to trail by a certain distance from the market, or be set to step levels when the market moves a certain distance. Once the step distance is reached the order automatically adjusts to the next level.

To set a trailing stop, you must first set a stop. This is the initial level where your stop order will start from. There are two ways to add a trailing stop. Either click on the “Tools” button and select the number

of pips you want the stop to trail by OR simply put in the number of pips you want the stop to trail by in the trailing stop box (T/S) in the mini terminal window.

## FXASIA - MT4i Platform



Please keep in mind that this feature does not protect against losses.

So, if you went long, your stop will move up when the currency pair rises. If you went short, your stop will move down when the currency pair falls.

## Good Till Cancelled

A GTC order remains active in the market until you decide to cancel it. The platform will not cancel the order at any time. Therefore it's your responsibility to remember that you have the order scheduled.

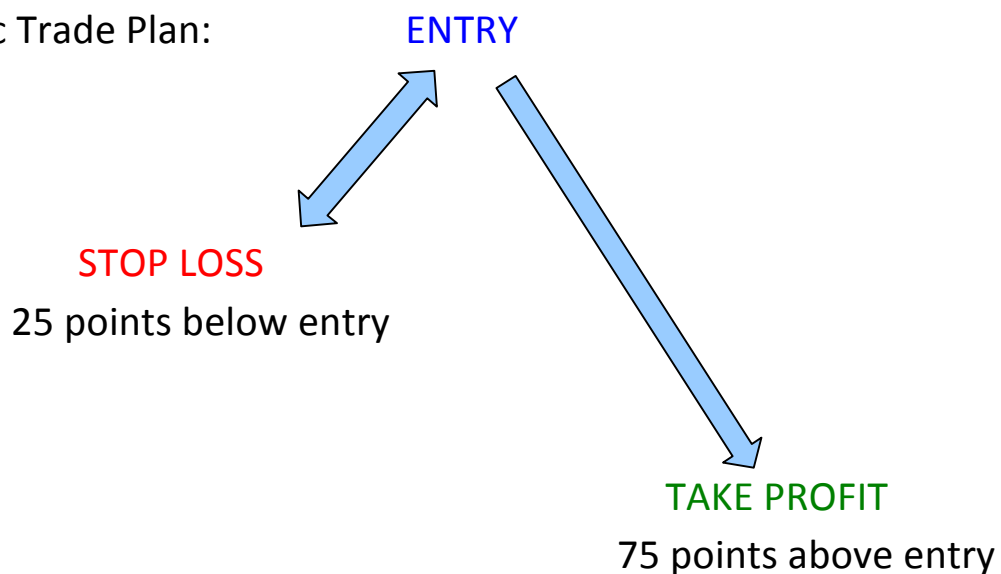
## Chapter 9 Developing & Planning Trades

### Develop a Trade Plan

We already know that having a sound trading plan is absolutely essential, if you are to be successful trading forex. Every trader needs to build and develop their own unique trading plan which fits in with their own personalities, financial position and goals.

Understanding your trade plan is a big step forward to being successful. The more you understand it, the more you will trust it and this will give you the confidence to implement it every time you see an opportunity.

A Generic Trade Plan:



Before you start to trade you need the answers to the following:

1. What currency/currencies am I going to trade in?
2. What position size am I going to use? (risk management)
3. What is my entry level? (technical analysis)
4. Where are my exit levels? (risk/reward ratio)

You only need to establish this once, so spend some time on it and ensure you have answered all the questions above. It will become second nature once you start trading.

Remember trading is all about capital preservation so you need to ensure you are trading the right amount. Your trade size needs to be big enough to make money, but not too big where losses eat into your capital.

It's also important you trade with money you can afford to lose. You've got enough on your plate without having to worry about making this next trade a winner, just so you can make the next payment on your mortgage. Trading under this sort of pressure can only end in one way and that's tears!

A good trading plan will reduce stress and maintain objectivity. The secret to your success as a trader comes down to simply having the confidence and discipline to consistently apply your trading plan. It's amazing how often traders (beginners and professionals alike), skew off their trading plans.

Note: It takes time and patience to develop a successful trading plan, so don't be too concerned if it doesn't happen overnight.

## Plan Your Day/Week

The financial markets are extremely organised and this is exactly how you need to be if you want to trade like a professional. The economic calendar is set a year in advance so there are no excuses for not knowing what economic releases are due. Now I don't mean planning your whole year in advance, but simply organising your week is enough to get ahead.

The best thing to do is print out the economic calendar for the week. Circle the major impacting releases and the times they come out. Check your working schedule and see if there are any time clashes. If there are, then try and shuffle things around so you're available for the releases.

This routine needs to become habitual. The economic calendar is the Holy Grail for a lot of your trading decisions and strategies, so make sure you follow through on this every week.

You should also develop a daily routine, which I will set out for you so there are no misunderstandings.

The first thing you need to do is get everything up and running in front of you.

Open your FX pricing platform:

- Check your account balance and make sure it is correct (plus or minus your overnights trading results).
- Cancel any pending orders that have not been set.
- Check for any open positions.

Open your charts:

- If you have an open position then analyse this currency first.
- Have a look for any shifts in the support and resistance levels.
- Adjust your orders according to your analysis.
- If you have no open positions then assess your target currencies overnight ranges and look for support and resistance levels.
- Now check all the currencies for major support and resistance levels.

If there's been a big move in a particular currency, search the news pages for the reasons as to why it moved. This will be a good trading opportunity if that news/event is reversed, by either a speech or a data release in the future.

Open your economic calendar:

- Check your target currencies data releases
- If there are releases identify if they're market moving or not.
- If so, plan your day to be at the computer when the data is released.
- If no local data then check all the majors for data releases.
- Identify which one's will be market moving and plan your afternoon/evening to be at the computer when they are released.



No fundamental releases:

- If there is no data due and the charts aren't giving you any strong trading ideas then turn everything off and go about your day.
- If there is no data due but you have identified good support and resistance levels on the charts, then work out what strategy you are going to use and apply your trading plan.
- Once your orders are set you can turn everything off and go about your day.

There's no need to wait around and watch the market as everything is in place for you to make your money. All you have to do is come back at the end of the day and check your results.

Going through the same routine every time you sit down at your computer will alleviate the stress of trading.

If there are fundamental releases you need to plan your trades thoroughly.

## Planning Fundamental Release Trades

Before the fundamental data is released there are a number of things you need to have worked out and considered before you actually trade. You need to:

- Know how your going to hit the market
- Identify the economic release
- Identify possible entry levels
- Assess market sentiment
- Consider the possible scenario's after the release
- Trade immediately, do not hesitate if there is an opportunity

## Trading Choices

There are a number of different options for hitting the market. You need to consider what is best for you and what is best for the particular piece of data coming out. It's imperative you have this worked out before you trade.

### 1. Live

In control of your risk as you choose your entry level. Definitely require real time news for this.

### 2. Pending Stop Entries

Limited control of your risk as the market/platform will determine your entry level (possible slippage). You don't require real time news. Best used when close to major trendlines.

### 3. Combination

Some control of risk. Will require real time news feeds.

## Identify the Economic Release

You need to identify the release and determine it's weighting in the market. Is it high, medium or low impacting?

How many pieces to the release? Is it just one variable, or are there two variables associated with the release?

Global indicators – GDP, CPI, Retail Sales – 1 variable – Q/Q

Local indicators - Unemployment data – 2 variables – Rate & Change

Central Bank Meetings – 2 variables – Rate & Statement

What trading option works best for each individual release?

If only 1 variable – Live or pending stop entries.

If two variables – it's much safer to trade live.

## Identify Entry Levels

You need to identify all possible entry levels. This will include technical analysis to identify any key support or resistance levels.

If there is support or resistance close by then these levels need to be incorporated into your trade plan. This is an ideal trading situation.

If the currency is mid range then you need to work out what your parameters are for hitting the market, or for placing your pending stop entry orders. (Refer to Chapter 7. Trading the economic news)

Once you have your entry levels worked out, either write them down or place your orders on the platform. Don't place the pending stop entries too early or otherwise your orders may get triggered before the data is released.

## Assess Market Sentiment

Have there been any other releases in the lead up to this release? If so were they strong or weak? What are the expectations for interest rates? This may determine if the market is sitting long or short leading into the release.

Recognising the bias is important because it will enable you to work out the soft side of the market. The soft side of the market will be more volatile and you can expect to see a bigger move on this side of the market, as the majority of the market unwinds their positions. This could be a very good trading opportunity even though it's probably the lesser of expectations.

## Scenario Analysis

What are you going to do on the release? You should hypothesis the release and the accompanying moves that would be expected. Planning all outcomes will enable easy execution and alleviate the stress associated with data releases.

1<sup>st</sup> As expected – No trade. Cancel all pending stop entry orders.

2<sup>nd</sup> Stronger than expectations – Buy

3<sup>rd</sup> Weaker than expectations – Sell

4<sup>th</sup> If two releases, one up & one down – Cancel orders as choppy non-directional trading will occur.

You should work out how much variance in the data you need to place your trades. Small variance will lead to a small move, whilst large variance will lead to large aggressive moves.

## Release of the Economic Data

Once you have fully planned the various outcomes, your trading method and you have predetermined your entry levels the only thing to do is sit back and wait for the data release.

Be confident, remain calm and set your plan into motion as soon as the data is released. If you're using pending stop entry orders than simply cancel the order that wasn't triggered. If you're trading live, ensure your stop loss and take profit orders have been set in the market.

Once your trade is in play it is best to stand back from the computer and let the market do the work for you. At this stage you are not going to change the outcome of the trade by staring at the screens. It may even be better to turn all your systems off and walk away to prevent you from taking profit too early.

## Planning Technical Trades

The key to planning technical trades starts with thorough technical analysis. If your technical analysis software isn't up to scratch then you'll be missing many opportunities or possibly identifying the opportunity but executing your entries and exits at the wrong levels and losing money. There is no excuse for this. I would encourage you to spend a little money and get professional charting software. It'll make all the difference to your planning and results.

Besides just identifying the major support and resistance levels you also need to identify what else is going on in the market.

What's happening with the major correlations? Check what the other currencies are doing, equities, commodities and relevant crosses.

Identify what the current market conditions are: normal, volatile.

What's been the recent range and where are the stochastic indicators? Overbought or oversold.

Are there any offshore releases due? If so what are they and what is the likely impact.

Once you've assessed all relevant information you should be able to identify the best strategy for the opportunity. Then simply place your pending orders in the market, sit back and let the market do its work.

## The Perfect Trading Strategy

The perfect trading strategy is the one which has a positive result almost every time you put it on. In my opinion this trade is the combination of both fundamental and technical analysis.

When these opportunities arise you have both sides of the market, the fundamental traders and technical traders, all hitting the market in the same direction.

This creates huge one way momentum and you can be pretty sure the trade will end up a good result. It's easier said than done, as entering the market at good levels on these moves can be extremely difficult. This is where your thorough planning pays dividends.

By planning the possibility of the trade you will be able to enter the trade at low risk entry levels with an almost certain probability for success. These trades don't pop up everyday so constant analysis is required to identify the opportunities when they arise. If you're not habitually checking the market and your charts for these opportunities, then they will simply slip through your fingers.

The chart below is a real example of a perfect trade. It was on the AUD/USD and involved a strong resistance level at 0.9192 and the release of the unemployment figures.

At the time of the release the currency was trading at 0.9185. I had worked out before the release that my parameters for entering the market were at 0.9200 on the topside and 0.9170 on the downside.

Since there was technical resistance at 0.9192 I knew that there would be a lot of stop loss orders in the market above here and particularly above 0.9200.

The market had been short for a few days and had been bouncing off resistance for a week, so it was safe to say that the topside of the

market was the soft side. Because of this and the proximity of the resistance level to the actual market level pre-release I knew it would be difficult to enter the market trading live. So I entered a pending stop entry order at 0.9202 (with a contingent stop loss and take profit order), and set myself to trade live, ready to hit the sell side if the data was weak. By setting my plan up this way it enabled me to focus on one side of the market, which I'm sure you will agree is much easier then focusing on both sides.

Example: AUD/USD The perfect trade.



The unemployment figures we were expecting were: +15k new jobs and a rate of 5.3%. The data came out +43k and 5.1%, two huge positive results.

The pending stop entry order had been triggered and the position was automatically in the cash. I had no orders to cancel so all I had to do was sit back and let the market do the work. I took profit on the first run up to 0.9177 (75 points) and was ready to reload on the next retracement back down towards 0.9200.

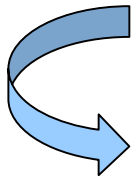
This trade went to plan perfectly. Why? Because I had thoroughly planned for all results and had the best entry options pre-set before the data was released. This was extremely simple and if you stick to

the routine of 'planning trades' you too can clean up when these perfect trading opportunities arise.

## Chapter 10 Managing Positions Once they're Live

### The Market is Not Always the Same

Varying market conditions will require varying levels of position management.



Managing Stop Loss location to limit losses & maximise profits

Regular trend trading markets where there are very few peripheral global influences will not require any management at all.

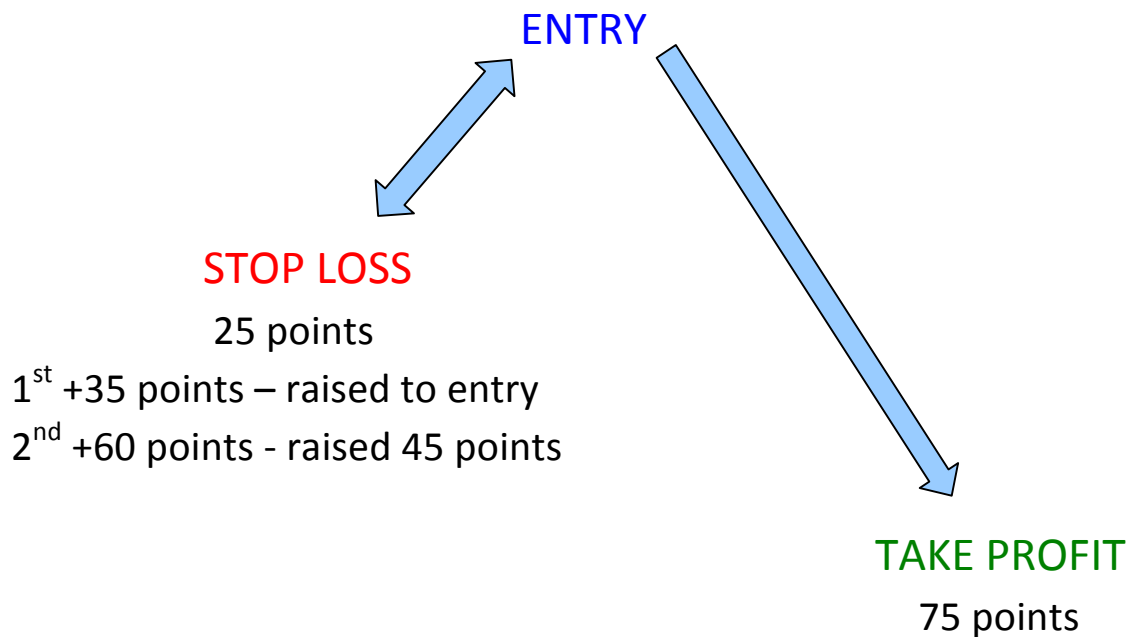
But volatile, choppy, non directional markets will require closer management of your positions. This usually coincides with many global influences impacting the currencies. For example 2011: Euro Debt crisis, Middle East Unrest, USA economic woes, Japan Earthquake/Tsunami/Reactor problems and China Inflation issues to name but a few.

In circumstances where the momentum and sentiment of the currencies is changing daily or from session to session (Asia – Europe – North America), then you need to manage your Trade Plan.

This is very simple and doesn't take much additional work; it just requires you to identify what the current market conditions are.

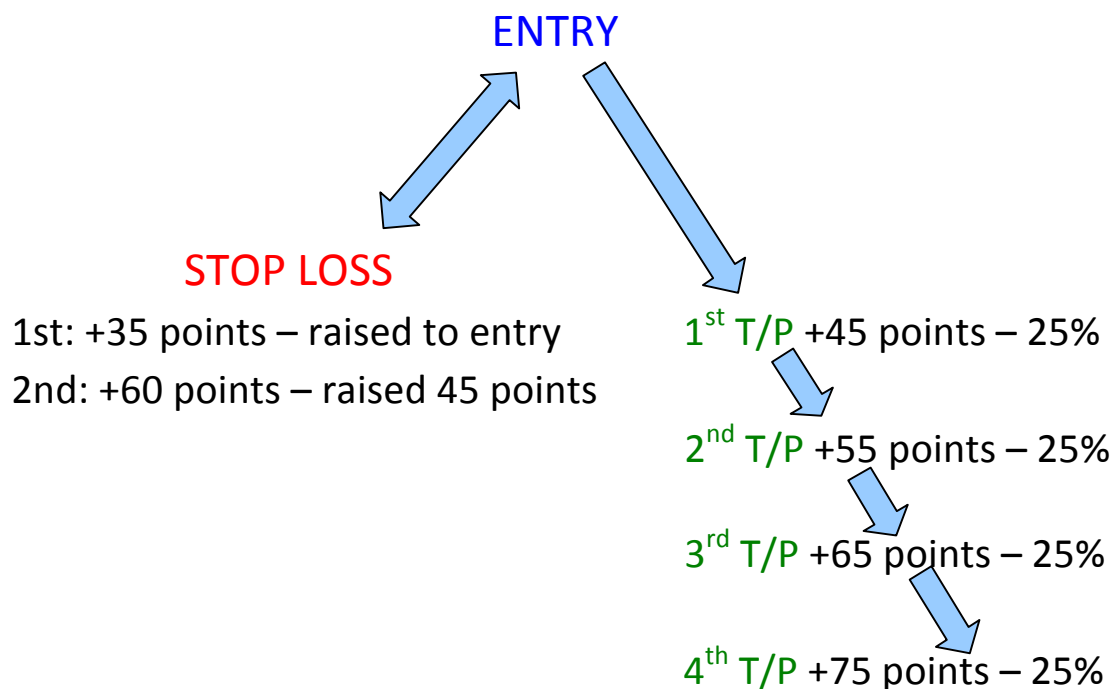
I have three variations of the generic trade plan and they cover normal market conditions, volatile market conditions and choppy market conditions. Each plan is a slight variation of the other, as all we are mainly managing are the contingent orders once the trade is live. You should have these various trade plans predetermined, so when the opportunity arises you don't have to spend too much time trying to work out what you're going to do. If you don't have them ready to roll out, then more often than not you will miss the low risk entry levels and the opportunity all together. You see, it always comes back to planning!

## Normal Conditions Plan



There are no fancy tricks in this plan. The only built in factor two adjustments to the stop loss level. Firstly, once the trade is 35 points in the money you should raise your stop loss to break even. Secondly, once the trade is 60 points in the cash, you should raise the stop to 45 points above the entry level. The take profit remains constant at 75 points.

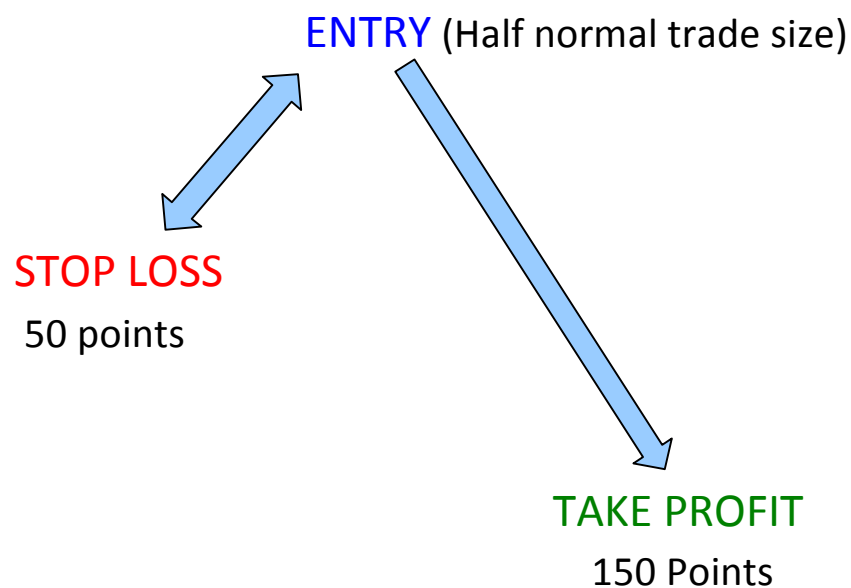
## Choppy Conditions Plan





When the markets are choppy you often get erratic movement and this includes large pullbacks, so the main idea of this plan is to lock in cash at staggered levels on the way to your final take profit, 75 points from entry. Once the position gets to 45 points in the money, we are closing out 25% of the position every 10 points. This ensures some money will be locked in if there are sudden pullbacks in the market. The stop loss order structure remains the same as the normal conditions plan.

### Volatile Conditions Plan



When the markets are volatile the first thing you should do is reduce your trade size and widen out the parameters for your contingent orders. This will give your position every chance of staying in the trade whilst maintaining your capital management structure.

The easiest method is to halve your trade size and double your stop loss and take profit orders. Once the position is on you could incorporate similar strategies for raising your stop loss and locking in your profits at staggered levels.

## Chapter 11 Trading Psychology

Trading psychology is an extremely important aspect of trading. There are a number of psychological obstacles that prevent traders who have an excellent trading plan from following it properly. These emotional roadblocks can take a serious toll on your trading performance and your capital growth. Understanding yourself and your own personality as it relates to your trading is critical.

### Patience, Discipline & Control

I'm often asked, what are the key elements to successful trading? Most people think it's either technical or fundamental analysis, while others suggest capital management is what it's all about. All of these factors are important but they aren't the key elements to your success. In fact the most important elements to successful trading have nothing to do with trading knowledge. My answer is always the same: Patience, discipline and control. Patience to wait for your levels, disciplined to stick to your trade plan and always in control of your emotions.

You can learn to trade from the best traders in the world, but if you don't have these key emotional elements then you're on a hiding to nothing.

Successful traders take a hard headed approach and regard their enterprise as a business rather than an indulgence or hobby. They expect their accounts to accumulate, despite being stopped out often and they know that with discipline they will prevail.

### Impatience & Hesitation

The two biggest killers for traders are impatience and hesitation. Being too impatient to wait for your levels can have you incurring losses even when you've identified the move correctly.

There's nothing more gut wrenching to wake up and see the currency 100 points above where you entered the market, only to find that you were stopped out on the last move before it took off. You rushed in because you didn't want to miss out, but because you did your stop loss was exactly where your initial entry level should have been. The perfect trade has turned into another loss.

On the end of the emotional spectrum is hesitation. More often than not when you see a trading opportunity, you get one chance to enter at the perfect low risk level. Any hesitation at this point and the opportunity will be gone. Continued hesitation when these good opportunities arise, followed by correct outcomes afterwards will lead you straight into 'performance anxiety'.

### Performance Anxiety – This is where the wheels fall off!

This is one of the biggest issues confronting traders and is a major reason why many traders do not realise their full potential. It's a systematic self-destruction mechanism which can affect even the most seasoned of traders and generally involves a set sequence of events.

1. Taking a trade that is not part of the plan
2. Not taking a trade that is part of the plan
3. Changing the rules of your trading plan based on an insignificant event.

Taking a trade that is not part of the plan is extremely tempting but very dangerous. This will generally arise when you are having a losing streak and are desperate for a win, or when you're on a winning streak and you think you're invincible. If you lose you feel miserable because you know you broke your own rules and trade plan and it cost you. This will more often than not lead you to place more trades (with no reference to your trade plan) as you chase the lost cash. If you win, that only encourages you to continue a behaviour that will not be profitable in the long run.

Not taking a trade that is part of the plan is probably the second most common psychological error. You may have had a few losses and are scared of another loss or you may have had five winners in a row and think the streak can't last forever. It is not uncommon for an emotional trader to pass on a trade that fits their trade plan and ends up winning, only to place a trade that doesn't conform to their plan and ends up losing. This is why most traders do not maximise the results of their trading plan.

Last but not least, changing the rules of your trading plan based on an insignificant event. Let's say you've made over five hundred trades with your current trade plan. Although you've had ups and downs, this

strategy has been extremely profitable. Then let's say you lose six trades in a row, which can very easily happen. All of a sudden you change your time tested plan based on a small sequence of trades. You will start trading on inconsequential data and news releases that you would never generally consider. You will over analyse the market and change your trade plan (usually with much bigger stop losses and much smaller take profits). Last of all you throw out your capital management structure and before you know it, your capital is all gone!

It's a horrible thought, but it happens a lot. You should never enter the market because you feel like it or because you feel you are being left behind. Don't let your emotions get in the way; only enter the market when you have 'planned-fully' determined the probability for success is very high. Trusting your trade plan will eliminate impatience and hesitation and enable you to remain in control.

### Remedy: Control Your Emotions & Stick to the Plan

Traders must be disciplined and remain emotionally detached from the market at all times. Emotional imbalance impairs the ability to make congruent decisions. In the same way that seemingly calm people can get highly emotional through the most minor incident when driving a car (road rage). In the same way, trading can induce a similar state of temporary psychosis. This is known as 'Trading Rage'. If at any time you feel like you have lost control of your emotions, you should turn your trading platform and computer off immediately. Believe me there isn't going to be a happy result if you try and trade through the rage.

This was a common problem on the trading floors at all the banks I worked at. During my time as chief dealer I had the responsibility of turning trader's computers off and sending them off the trading floor to cool down. This occurred at least a few times each week. It happens to the best of us, so it's best you factor in the event now, so when it happens you can identify it and be ready to turn your own systems off.

The most optimal state is one of complete emotional detachment, remain calm and act in accordance with your plan and strategy. That includes negative as much as positive emotions - the key word is to stay "cool".

Most people are aware of what happens to them when negative emotions rise to the surface and this can be easily addressed by taking a short break.

But what happens to your decision making process when you become over confident? When you get on a roll and you have multiple winning trades, the strangest things will happen to you without you knowing it.

Your trade plan will go out the window, your stop losses will now be randomly placed and double their normal size. You'll run trades well past your usual take profit parameters. In fact you'll change your whole approach to the markets. This is where the wheels can fall off and you can end up risking all of your capital on one trade. Doesn't sound like you? I've seen it happen to many traders and you are no exception.

After training many people how to trade the forex markets, the most common problem I've been faced with, is managing traders once they have become very successful. Strangely enough it can be a nasty old business when all your dreams come true, if you don't stay on top of your emotions.

Understand the truth – trading is a game of probabilities. Therefore you understand losses are a part of trading and they shouldn't get you down. It's all part of the job!

## Successful Trading Principles

The most important principles to remember are:

- » Trade only what you can afford to lose
- » Maintain stringent capital management
- » Trade with definite goals in mind
- » Plan trades thoroughly
- » Always stick to your plan
- » Admit when you are wrong
- » Never lose respect for the market

Having set goals will keep you focused on the job at hand.



Developing your own trading plan and personal strategy is the key to your future success. Whatever plan you adopt, make it your own.

Remember:

- Patience, discipline and control are the key elements to successful trading.
- It's important you realise you're not going to make money on every trade.
- Take complete responsibility for your trading.
- Keep trading as part of a balanced life.
- Luck is what happens when preparation meets opportunity!

## Chapter 12 How to Set-Up your Trade Station

Beginner and experienced traders alike need to have their trade stations set up correctly, so they can operate effectively and efficiently.

Have you ever wondered why the traders at the banks have a number of screens in front of them whilst there trading? Well it's so they can see all the relevant market information that they need to make split second trading decisions. This is all about being prepared for trading.

What you basically need are a couple of screens to allow you to see the forex prices, your charts, the forex calendar and your news service all at once. That way you will be relaxed and comfortable in front of your screens without having to worry about closing and opening different applications to see what's happening.

Traditionally in the commercial world, errors are the cause of most losses on trading desks. They range from missed orders, hit the wrong side of the market, over trading, didn't see the news, to errors with technical analysis. I'm sure you would agree very simple stuff. Having your trade station set up correctly reduces the risk of such errors occurring in your trading. It's a case of; spend a little, to gain a lot.

### Pricing Platform

Your pricing platform set-up should not vary at all.

It's important you have all the major currency pairs up so you can see what's happening across the board.

You can move them around to suit your own personal preference, but I would advise you to have all the correlating currencies together. This will allow you to watch all the currencies that move together, all at once without glancing away. You'll find this particularly helpful on economic releases when one currency leads the others.

There are three key blotters you need to have opened on this page at all times.

#### 1. Daily Profit/Loss

This shows your daily P/L and P/L on current open positions. This should be your first port of call each day.

## 2. Orders

This shows all pending orders you have in the market. That way you won't make an error by leaving an order in the system long after the strategy is over. Once the opportunity is gone you should cancel all orders.

## 3. Open Positions

This shows all open positions in the market and attached orders. You need to know exactly what positions you have and where your associated orders for this position are.

### FXASIA - MT4i Platform

The screenshot displays the MT4i Platform interface. At the top, there are eight currency pair order windows arranged in a 2x4 grid. Each window shows the pair name, a price change indicator (e.g., +1.00 for AUDUSD), and controls for Lots, T/S, S/L, and T/P. Below these controls are 'sell' and 'buy' buttons with associated price values.

Open and pending orders												
Close Tools OCA Summary MT4i Live Settings												
Ticket	Symbol	Action	Volume	Open price	S/L	T/P	Pips	Current	Open time	Net profit	Duration	Gross
16886	AUDUSD	Buy	1.00	1.03467	1.03217	1.04217	-0.3	1.03464	2011/08/11 06:30:04	-0.29	115 sec	

## News & Economic Calendar

Having a reliable real time news service is imperative if you intend trading 'live' over economic data releases. If you're a second or two behind then you're out of the game.



You should always get your news page up as soon as you turn on your computers. That way you will be ready to trade any unscheduled economic news releases or unexpected global events.

You don't need to spend a fortune keeping up to speed with the market. There are numerous professional packages available at retail prices. Locking yourself into a very expensive subscription is not the way to go, unless you've got extremely large capital resources. It's all quiet relative to your goals, ambitions and resources.

There are numerous free news services you can get over the internet. They probably won't provide real time news but they will have everything else. So get resourceful and search what's out there.

The two biggest news companies in the world are Bloomberg and Reuters. Their web services are well worth following although subscriptions to their live news feed may blow your budget.

- [Bloomberg.com/markets/](http://Bloomberg.com/markets/)
- [Reuters.com/finance/currencies](http://Reuters.com/finance/currencies)

Various television networks provide market analysis and commentary so they too will be worth accessing. They don't generally release the news in real time but they won't be far behind the real time release. Plus they provide commentary on the releases and this may be helpful in interpreting some releases, but in particular central bank statements and speeches.

The economic calendar is a key factor to your entire trade plan so it should be among the first pages you get up each day. Keeping your finger on the pulse of the market is imperative and there are numerous free web pages available.

Note: As with the free news services, the free web-based economic calendars will not publish the economic releases in real time. They are a good source for getting the forecasts and weightings of the various releases, but that's it. At the moment the best providers of free information about the economic releases are:

- » [forexfactory.com](http://forexfactory.com)
- » [dailyfx.com](http://dailyfx.com)

It is also worthwhile browsing through the various international financial newspapers for breaking news. General logic would tell you that if you're reading it in a newspaper, you've missed the opportunity. So be sure to check the release time of all articles you read in the newspapers. If it's the printed version then forget trading the opportunity at all. The best financial newspapers are:

» AUST – The Financial Review, SMH Business

» ASIA – The Wall Street Journal (Asia edition)

» UK – The Financial Times

» USA – The Wall Street Journal (US edition)

Keeping up to date with the market is very important. Remember there is usually one global event that has a ripple effect through all the currencies and controls direction. By keeping up to speed with current news and events you will be able to identify what this 'one key event' is. It's a simply process that will take a lot of the guess work out of finding what direction the currencies are going to go.

## Technical Analysis

It's very important your charts are updated as part of your daily routine. Ideally they should be visible on your screen at all times, but especially when economic releases are due, so you can monitor the key levels of support and resistance as the market is moving.

Your technical analysis software needs to be extremely functional, efficient and effective and that's why I would advise buying a professional package. Every trading platform provides technical charts for free, but I am yet to find one that allows you to do fast and efficient analysis. It's not to say that their charts are inaccurate because they are, it's just that their functionality is generally cumbersome. Speed and efficiency is the key to analysing the charts.

The ideal set up for your charts would be to have a saved layout for each of the majors and any crosses you may trade. Just because you don't trade a particular currency pair, doesn't mean you don't check those charts. They may at some stage provide clues as to what's happening in the rest of the market.

To make it easier still you could save all charts in two time frames: hourly and daily. That way you will be able to efficiently monitor the intraday market as well monitor the overall trends in the market with a click of the mouse.

Having your charts set up correctly (like the one below) will make identifying key levels very easy and this will flow through to the execution of your trade plan.



## Chapter 13 Choosing a Trading Platform

Choosing a forex broker can be a daunting process, but it doesn't need to be. The broking platform will obviously be an integral part of your trading, so it's important you are confident with the platform in the execution of your orders and the holding of your money. The broking market is heavily regulated so you don't have to worry too much about your money disappearing overnight. There are built in regulations to protect your money and to ensure the operation of their business, is at all times conducted at the highest level of competence and professionalism.

To make the choice easier there are a few key factors you should check: functionality, prices or spreads of currencies and their accessibility.

### Order Functionality

This will basically come back to personal preference, but the platform needs to be easy to use. Trading needs to be easy and this usually comes back to the functionality of their order system. It needs to cover all your possible trading needs. For example not many of them have OCO pending stop entry orders. So if you intend using these strategies then make sure the platform has this available before you fill out all the forms and deposit your cash.

Managing your positions once they are live, is another area where people forget to check the options available to them. You need this process to be automated, otherwise you'll have to physically turn the computer on and adjust things yourself every time you put a position on. This could be a major problem, especially if you have a full time job and do not have access to the computer for long periods of the day.

So do some research, it's not all about the bells and whistles many platforms provide. Don't let them choose you, you choose them!

### Spreads & Variety of Currencies

The spreads of the currencies should be the second thing you check. You can check the competitiveness of all forex brokers by simply checking the spreads of their major currencies against each other. The

tighter the spread between the bid and the offer (buy and sell), the better it is for you. This is very important when it comes to executing your orders. Every point counts, so if you are using a broker who has a 3 point wide spread for EUR/USD, against another who has a 1 point spread, than you will be at a distinct disadvantage. This is one factor that can really be the difference between success and failure.

More often than not you'll have to weigh up the benefits of tight spreads against the benefits of having access to a wide variety of currencies. Many ultra competitive brokers do not offer an abundance of crosses to trade, instead choosing to concentrate on the majors only. So what are you going to realistically trade? Make sure all your options are available. Don't forget there are a multitude of opportunities across many currency pairs, so limiting yourself to just a few may reduce the number of opportunities that come your way.

## Various Access Points

The last piece of the puzzle is the accessibility of the forex broker. You don't want to be limited to your main computer to access your trading account, otherwise you'd have to stay at home/work all day in case an opportunity arose and you wanted to trade.

Most brokers provide multiple access points and this enables you to trade from anywhere – anytime. The ideal broker will be accessible via:

1. Workstation – main computer
2. Web-based platform
3. Mobile phone
4. Direct phone number

This will enable you to trade and manage your risk from any location at anytime. You will be free to go about your day confident that you can observe and access the market at any time.

## Conclusion

Forex trading can be an extremely lucrative hobby or occupation. The market opens at 5am Monday morning in Sydney and closes at 5pm Friday in New York. There are a multitude of opportunities to take advantage of but you need to know what you're doing. Simply blasting away with a demo account is no way to begin your trading career.

Your success will be determined by how well you understand the market. My aim in writing this book was to give you the most accurate, up to date and thorough understanding of the market and how to trade it.

My forex trading workshops are designed to take you to the next level and show you how to implement all the information in this book. A major part of my success was down to the fact I was surrounded by experienced traders who became my mentors. Both the workshop and the T4T Forex Club hope to provide a similar experience for you. Always remember, wealth begins with better knowledge.

Good luck and happy trading!

# Glossary

## A

**Account Balance** Amount of money in your account.

**Appreciation** A currency is said to appreciate when price rises in response to market demand; an increase in the value of an asset.

**Arbitrage** Taking advantage of countervailing prices in different markets by the purchase or sale of an instrument and simultaneous taking of an equal and opposite position in a related market to profit from small price differentials.

**ASIC** Australian Securities and Investment Commission. The government body responsible under the Corporations Act for regulating companies, the issue & sale of shares & trust units, company borrowings, & investment advisers & dealers.

**Ask** The price/rate, that a willing seller is prepared to sell FX CFDs at.

**At Limit** An order that places a limit on either the highest price you will pay (bid) or the lowest price you will accept (offer).

## B

**Balance-of-payments** All the international commercial and financial transactions of the residents of one country.

**Balance** Amount of money in an account.

**Bank of Canada (BOC)** The central bank of Canada.

**Bank of England (BOE)** The central bank of the United Kingdom. It is a less independent central bank. The government may overwrite its decision.

**Bank of France (BOF)** The central bank of France.

**Bank of Japan (BOJ)** The Japanese central bank. Although its Policy Board is still fully in charge of the monetary policy, changes are still subject to the approval of the Ministry of Finance (MOF). The BOJ targets the M2 aggregate.

**Bar chart** A type of chart that consists of four significant points: the high and the low prices, which form the vertical bar; the opening price, which is marked with a little horizontal line to the left of the bar; and the closing price, which is marked with a little horizontal line

**Balance of Trade** The value of exports less imports. Invisibles are normally excluded, which is why balance of trade is also referred to as mercantile or physical trade.

**Base Currency** The currency in which an investor or issuer maintains its book of accounts; the currency that other currencies are quoted against. In the Forex market, the US dollar is normally considered the 'base' currency for quotes, meaning that quotes are expressed as a unit of \$1 USD per the other currency quoted in the pair.

**Basis Point** One hundredth of a percent.

**Bear** An investor who believes that prices/the market will decline.

**Bear Market** A market distinguished by a prolonged period of declining prices accompanied with widespread pessimism.

**Bid** The price that a buyer is prepared to buy FX-CFDs.

**Bid/Ask Spread** The difference between the bid and offer prices; used to measure market liquidity. Narrower spreads usually signify high liquidity.

**Big Figure** Dealer phrase referring to the first few digits of an exchange rate. These digits rarely change in normal market fluctuations, and therefore are omitted in dealer quotes, especially in times of high market activity.

**Bollinger bands** A quantitative method that combines a moving average with the instrument's volatility. The bands were designed to gauge whether the prices are high or low on a relative basis. They are plotted two standard deviations above and below a simple moving average. The bands look like an expanding and contracting envelope model. When the band contracts drastically, the signal is that volatility will expand sharply in the near future. An additional signal is a succession of two top formations, one outside the band followed by one inside. If it occurs above the band, it is a selling signal. When it occurs below the band, it is a buying signal.

**Broker** An individual, or firm, that acts as an intermediary, putting together buyers and sellers usually for a fee or commission. In contrast, a 'dealer' commits capital and takes one side of a position, hoping to earn a spread (profit) by closing out the position in a subsequent trade with another party.

**Bull** An investor who believes that prices/the market will rise.



**Bull Market** A market distinguished by a prolonged period of rising prices. (Opposite of bear market)

**Bundesbank** The central bank of Germany.

**Business Inventories** An economic indicator that consists of the items produced and held for future sale.

## C

**Cable** Trader jargon for the British Pound Sterling referring to the Sterling/US dollar exchange rate. Term began due to the fact that the rate was originally transmitted via a transatlantic cable starting in the mid 1800's.

**Candlestick chart** A type of chart that consists of four major prices: high, low, open, and close. The body (jittai) of the candlestick bar is formed by the opening and closing prices. To indicate that the opening was lower than the closing, the body of the bar is left blank. If the currency closes below its opening, the body is filled. The rest of the range is marked by two "shadows": the upper shadow (uwakage) and the lower shadow (shitakage).

**Capacity utilisation** An economic indicator that consists of total industrial output divided by total production capability. The term refers to the maximum level of output a plant can generate under normal business conditions.

**Central Bank** A government or quasi-governmental organization that manages a country's monetary policy and prints a nation's currency. For example, the US central bank is the Federal Reserve, others include the ECB, BOE, BOJ.

**CFD** Contract For Difference, being an Equity CFD or FX-CFD. A contract for difference or CFD is an agreement which allows you to make a profit or loss from fluctuations in the price of an underlying instrument or security without actually owning that instrument or security.

**Channel line** A parallel line that can be traced against the trendline, connecting the significant peaks in an uptrend, and the significant troughs in a downtrend.

**Chartist** An individual who uses charts and graphs and interprets historical data to find trends and predict future movements, as well as, aid in technical analysis.

**Clearing** The process of settling a trade.

**Close a Position (Position Squaring)** To eliminate an investment from one's portfolio by either buying back a short position or selling a long position.

**Commission** Fee broker charges for a transaction.

**Confirmation** A document exchanged by counterparts to a transaction that confirms the terms of said transaction.

**Consumer Price Index (CPI)** An economic indicator that gauges the average change in retail prices for a fixed market basket of goods and services.

**Consumer sentiment** A survey of households designed to gauge the individual propensity for spending. There are two studies conducted in this area, one survey by the University of Michigan, and the other by the National Family Opinion for the Conference Board. The confidence index measured by the Conference Board is sensitive to the job market, whereas the index generated by the University of Michigan is not.

**Contagion** The tendency of an economic crisis to spread from one market to another. In 1997, financial instability in Thailand caused high volatility in its domestic currency, the Baht, which triggered a contagion into other East Asian emerging currencies, and then to Latin America.

**Contingent Order** The automatic generation of market limit orders when specific market conditions are met.

**Cost of carry** The interest rate parity, whereby the forward price is determined by the cost of borrowing money in order to hold the position.

**Counter party** The other party that participates in a financial transaction. The broker is your counterparty on every trade. Every transaction must have a counterparty in order for the transaction to go through. More specifically, every buyer of an asset must be paired up with a seller that is willing to sell and vice versa.

**Cross Currency** A cross currency is any pair in which neither currency is the U.S. dollar. These pairs exhibit erratic price behaviour since the trader has, in effect, initiated two USD trades. For example, initiating a long (buy) EUR/GBP is equivalent to buying a EUR/USD currency pair

and selling a GBP/USD. Cross currency pairs frequently carry a higher transaction cost.

**Currency** A country's unit of exchange issued by their government or central bank whose value is the basis for trade.

**Currency call** A contract between the buyer and seller that holds that the buyer has the right, but not the obligation, to buy a specific quantity of a currency at a predetermined price and within a predetermined period of time, regardless of the market price of the currency. The writer assumes the obligation of delivering the specific quantity of a currency at a predetermined price and within a predetermined period of time, regardless of the market price of the currency, if the buyer wants to exercise the call option.

**Currency fixings** An open auction executed in Europe on a daily basis in which all players, regardless of size, are welcome to participate with any amount.

**Currency futures** A specific type of forward outright deal with standardized expiration date and size of the amount.

**Currency Pair** The two currencies that make up a foreign exchange rate. E.g. AUD/USD is a currency pair.

**Currency Risk** The risk of incurring losses resulting from an adverse change in exchange rates.

**Currency option** A contract between a buyer and a seller, also known as writer, that gives the buyer the right, but not the obligation, to trade a specific quantity of a currency at a predetermined price and within a predetermined period of time, regardless of the market price of the currency; and gives the seller the obligation to deliver or buy the currency under the predetermined terms, if and when the buyer wants to exercise the option.

**Currency put** A contract between the buyer and the seller that holds that the buyer has the right, but not the obligation, to sell a specific quantity of a currency at a predetermined price and within a predetermined period of time, regardless of the market price of the currency. The writer assumes the obligation to buy the specific quantity of a currency at a predetermined price and within a predetermined period of time, regardless of the market price of the currency, if the buyer wants to exercise the call option.

**Current account balance** The broadest current dollar measure of U.S. trade, which incorporates services and unilateral transfers into the merchandise trade data.

## D

**Day Trading** Opening and closing the same position or positions within the same trading session.

**Dealer** One who acts as a principal or counterpart to a transaction; places the order to buy or sell.

**Dealing systems** On-line computers that link the contributing banks around the world on a one-on-one basis.

**Deficit** A negative balance of trade (or payments); expenditures are greater than income/revenue.

**Delivery** An actual delivery where both sides transfer possession of the currencies traded.

**Depreciation** A decline in the value of a currency due to market forces.

**Derivatives** Trades that are constructed or derived from another security (stock, bond, currency, or commodity). Derivatives can be both exchange and non-exchange traded (known as Over the Counter or OTC). Examples of derivative instruments include Options, Interest Rate Swaps, Forward Rate Agreements, Caps, Floors and Swap options.

**Devaluation** The deliberate downward adjustment of a currency's value versus the value of another currency normally caused by official announcement.

**Direct dealing** An aggressive approach in which banks contact each other outside the brokers' market.

**Direct Market Access** The process by which orders are automatically placed in the related underlying market.

**Discount Rate** The interest rate at which eligible depository institutions may borrow funds directly from the Federal Reserve Banks. The rate is controlled by the Federal Reserve and is not subject to trading.

**Double bottoms** A bullish reversal pattern that consists of two bottoms of approximately equal heights. A parallel (resistance) line is

drawn against a line that connects the two bottoms. The break of the resistance line generates a move equal in size to the price difference between the average height of the bottoms and the resistance line.

**Double tops** A bearish reversal pattern that consists of two tops of approximately equal heights. A parallel (support) line is drawn against a resistance line that connects the two tops. The break of the support line generates a move equal in size to the price difference between the average height of the tops and the support line.

**Durable Goods Orders** An economic indicator that measures the changes in sales of products with a life span in excess of three years.

## E

**Economic Exposure** Reflects the impact of foreign exchange changes on the future competitive position of a company.

**Economic Indicator** A statistic that indicates current economic growth and stability issued by the government or a non-government institution (i.e. Gross Domestic Product (GDP), Employment Rates, Trade Deficits, Industrial Production, and Business Inventories).

**Efficient Market** A market in which the current price reflects all available information from past prices and volumes.

**End Of Day (or Mark to Market)** Traders account for their positions in two ways: accrual or mark-to-market. An accrual system accounts only for cash flows when they occur; hence, it only shows a profit or loss when realized. The mark-to-market method values the trader's book at the end of each working day using the closing market rates or revaluation rates. Any profit or loss is booked and the trader will start the next day with a net position.

**Euro (€)** The currency of the European Monetary Union (EMU) which replaced the European Currency Unit (ECU).

**European Central Bank** The Central Bank for the European Monetary Union.

**Exchange rate risk** (1) Foreign exchange risk that is the effect of the continuous shift in the worldwide market supply and demand balance on an outstanding foreign exchange position. (2) Trading risk pertinent to market fluctuation.

**Expiration date** The delivery date.

## F

**Factory Orders** An economic indicator that refers to total orders for durable and nondurable goods. The nondurable goods orders consist of food, clothing, light industrial products, and products designed for the maintenance of the durable goods.

**Federal funds (Fed funds)** Immediately available reserve balances at the federal reserves. The Fed funds are widely used by commercial banks or large corporations to lend to each other on an overnight basis. Although their level is established by the Fed, the prices fluctuate because they are traded in the market.

**Federal Open Market Committee (FOMC)** A committee established in 1935, through the Banking Act, to replace the Open Market Policy Conference (OMPC.) Currently active.

**Federal Reserve** The central bank of the United States. It was established in 1913 when Congress passed the Federal Reserve Act. The Act held that role of the Federal Reserve was "to furnish an elastic currency, to afford the means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

**Federal Reserve Board** The board consists of a Governor and four other regular members. The Secretary of the Treasury and the Controller of the Currency are closely consulted. The 12 regional Federal Reserve Banks around the country have sufficient autonomy to manage financial conditions in their districts. They are also managed by governors.

**Fibonacci percentage retracements** Price retracements of 0.382 and 0.618, or approximately 38 percent and 62 percent.

**Fibonacci ratio** 0.618 and 0.312.

**Fibonacci sequence** Takes a sequence of numbers that begins with 1 and adds 1 to it, then takes the sum of this operation (2) and adds it to the previous term in the sequence (1). Next it takes the sum of the second operation (3) and adds it to the previous term in the sequence (the sum of the first operation, i.e., 2). The Fibonacci sequence continues iterating in this manner, adding the most recent sum to the previous term, which is itself the sum of the two previous terms, etc.

This yields the following series of numbers: 1 1 2 3 5 8 13 21 34 55 89 144 233 377 610 987 1597 2584 4181 (etc.).

**Flat (or Square)** To be neither long nor short is the same as to be flat or square. One would have a flat book if he has no positions or if all the positions cancel each other out.

**Foreign Exchange (or Forex or FX)** The simultaneous buying of one currency and selling of another in an over-the-counter market. Most major Forex is quoted against the US dollar.

**Foreign exchange exposure** The potential effect of currency fluctuations on shareholders' equity.

**Foreign exchange rate** The price of one currency in terms of another.

**Forex Trader** Person or company who buys and sells currency to make a profit.

**Forex-CFD's** A CFD over foreign exchange or precious metal.

**Forward** A deal that will commence at an agreed date in the future. Forward trades in Forex are usually expressed as a margin above (premium) or below (discount) the spot rate. To obtain the actual forward Forex price, one adds the margin to the spot rate. The rate will reflect what the Forex rate has to be at the forward date so that if funds were re-exchanged at that rate there would be no profit or loss (i.e. a neutral trade). The rate is calculated from the relevant deposit rates in the 2 underlying currencies and the spot Forex rate. Unlike in the futures market, forward trading can be customised according to the needs of the two parties and involves more flexibility. Also, there is no centralised exchange.

**Forward spread (forward points or forward pips)** Forward price used to adjust a spot price to calculate a forward price. It is based on the current spot exchange rate, the interest rate differential, and the number of days to delivery.

## G

**Gap** The price gap between consecutive trading ranges (i.e., the low of the current range is higher than the high of the previous range).

**Good-Till-Cancelled (GTC)** An order left with a Dealer to buy or sell at a fixed price. The GTC will remain in place until executed or cancelled.

**Gross Domestic Product** The sum of all goods and services produced in the United States.

## H

**Hedge.** An investment position or combination of positions that reduces the volatility of your portfolio value. One can take an offsetting position in a related security. Instruments used are varied and include forwards, futures, options, and combinations of all of them.

**Hedging** A method used to minimize or eliminate the risk of exchange rate fluctuations.

**High/Low.** Usually the highest traded price and the lowest traded price for the underlying instrument for the current trading day.

## I

**Industrial Production** An economic indicator that consists of the total output of a nation's plants, utilities, and mines.

**Inflation** An economic condition where there is an increase in the price of consumer goods, thereby eroding purchasing power.

**Initial Margin** The required initial deposit of collateral to enter into a position as a guarantee on future performance.

**Interbank Market.** A loose network of currency transactions negotiated between financial institutions and other large companies.

**Interest rate risk** Amount of mismatches and maturity gaps among transactions in the foreign exchange book.

**Interest Rate Parity** A theory that the interest rate differential between two countries is equal to the differential between the forward exchange rate and the spot exchange rate. Interest rate parity plays an essential role in foreign exchange markets, connecting interest rates, spot exchange rates and foreign exchange rates.

## J

**J-Curve theory** Devaluation of a currency will trigger export gains in the long term, rather than the short term, because of previous contracts, existing inventories, and behaviour modification.



## K

**Key reversal day** The daily price range on the bar chart of the reversal day fully engulfs the previous day's range; also, the close is outside the preceding day's range.

## L

**Leading Indicators** Economic variables that are considered to predict future economic activity (i.e. Unemployment, Consumer Price Index, Producer Price Index, Retail Sales, Personal Income, Prime Rate, Discount Rate, and Federal Funds Rate).

**Leverage** The ability to control large dollar amount of a commodity with a comparably small amount of capital. Also known as "Gearing".

**LIBOR** Stands for London Interbank Offer Rate. The interest rate that the largest international banks will lend to each other.

**Limit Order** An order to buy at or below a specified price or to sell at or above a specified price.

**Line chart** The line connecting single prices for each of the time periods selected.

**Liquid and Illiquid Markets** The ability of a market to buy and sell at ease with no impact on price stability. A market is described as liquid if the spread between the bid and the offer is small. Another measure of liquidity is the presence of buyers and seller, with more players creating tighter spreads. Illiquid markets have few players, hence, wider dealing spreads.

**Liquidation** To close an open position through the execution of an offsetting transaction.

**Liquid Assets** Assets that can be easily converted into cash. Examples: money market fund shares, US Treasury Bills, bank deposits, etc.

**Long** A position to purchase more of an instrument than is sold, hence, an appreciation in value if market prices increase.

## M

**Margin** Customers must deposit funds as collateral to cover any potential losses from adverse movements in prices.

**Margin Call** A requirement from a broker or dealer for additional funds or other collateral to bring the margin up to a required level to guarantee performance on a position that has moved against the customer.

**Mark to Market (or End of Day)** Traders account for their positions in two ways: accrual or mark-to-market. An accrual system accounts only for cash flows when they occur; hence, it only shows a profit or loss when realized. The mark-to-market method values the trader's book at the end of each working day using the closing market rates or revaluation rates. Any profit or loss is booked and the trader will start the next day with a net position.

**Market Maker** A dealer who supplies prices and is prepared to buy or sell at those stated bid and ask prices. A market maker runs a trading book.

**Market Order** An order to buy/sell at the best price available when the order reaches the market.

**Market Price** The prevailing price of a security available for trade.

**Market Risk** Risk relating to the market in general and cannot be diversified away by hedging or holding a variety of securities.

**Maturity Date** The date when a foreign exchange contract expires.

**Money Markets** Refers to investments that are short-term (i.e. under one year) and whose participants include banks and other financial institutions. Examples include Deposits, Certificates of Deposit, Repurchase Agreements, Overnight Index Swaps and Commercial Paper. Short-term investments are safe and highly liquid.

**Moving average** An average of a predetermined number of prices over a number of days, divided by the number of entries.

## N

**Naked intervention (unsterilized intervention)** A central bank intervention in the foreign exchange market that consists solely of the foreign exchange activity. This type of intervention has a monetary

effect on the money supply and a long-term effect on foreign exchange.

**Net Worth** Amount of assets which exceed liabilities; May also be known as stockholders equity or net assets. For an individual -- the total value of all possessions such as houses, stocks, bonds, and other securities, minus all outstanding debts, such as mortgage and loans.

**Nylon** A generic designation for a family of synthetic polymers. Not an acronym for the New York/London trading zone.

## O

**Offer** The price/rate, which a willing seller is prepared to sell FX CFD's at.

**Offsetting Transaction** A trade that serves to cancel or offset some or all of the market risk of an open position.

**One Cancels the Other Order (OCO)** A contingent order where the execution of one part of the order automatically cancels the other part.

**Open Order** An order to buy or sell when a market moves to its designated price. It may remain unfilled or partially unfilled in the market.

**Open Position** A deal not yet reversed or settled and the investor is subject to exchange rate movements.

**Order** An order is an instruction, from a client to a broker to trade. An order can be placed at a specific price or at the market price. Also, it can be good until filled or until close of business.

**Oscillators** Quantitative methods designed to provide signals regarding overbought and oversold conditions

**Overnight position** A position kept overnight by traders.

## P

**Personal Income** An economic indicator that consists of the income received by individuals, non-profit institutions, and private trust funds. Some of the components of this indicator are wages and salaries, rental income, dividends, interest earnings, and transfer payments (Social Security, state unemployment insurance, and veteran's benefits).

**Pip (or Points)** The term used in currency market to represent the smallest incremental move an exchange rate can make. Depending on context, normally one basis point (0.0001 in the case of EUR/USD, GBD/USD, USD/CHF and .01 in the case of USD/JPY).

**Political Risk** Changes in a country's governmental policy, which may have an adverse effect on an investor's position.

**Position** A position is a trading view expressed by buying or selling. It can refer to the amount of a currency either owned or owed by an investor.

**Price Transparency** Every market participant has equal access to the description of quotes.

**Producer Price Index** An economic indicator that gauges the average changes in prices received by domestic producers for their output at all stages of processing.

## Q

**Quote** A live indicative market quote showing the best bid (buy order) and the best offer (sell order) available in the security at that moment.

**Quote Currency** The second currency in a currency pair is referred to as the quote currency or terms currency. E.G. in a AUD/USD currency pair the US dollar is the quote currency. Also referred to as the second currency or the terms currency.

## R

**Rate** The price of one currency in terms of another.

**Realised and Unrealised Profit and Loss** One using an accrual type accounting system has an "unrealised profit" until they sell their shares. Upon the sale of one's shares, the profit becomes "realised."

**Relative Strength Index** An oscillator that measures the relative changes between the higher and lower closing prices. The RSI is plotted on a 0 to 100 scale. The 70 and 30 values are used as warning signals, whereas values above 85 indicate an overbought condition (selling signal), and values under 15 suggest an oversold condition (buying signal).

**Reserve Bank Of Australia (RBA)** The central bank of Australia.

**Reserve Bank of New Zealand (RBNZ)** The central bank of New Zealand

**Resistance** A term used in technical analysis indicating a specific price level at which a currency will have the inability to cross above. Recurring failure for the price to move above that point produces a pattern that can usually be shaped by a straight line.

**Revaluation Rates** The revaluation rates are the market rates used when a trader runs an end-of-day to establish profit and loss for the day.

**Risk** Exposure to uncertain change, the variability of returns significantly the likelihood of less-than-expected returns.

**Risk Capital** The amount of money that an individual can afford to invest, which, if lost would not affect their lifestyle.

**Risk Management** To hedge one's risk they will employ financial analysis and trading techniques.

**Rollover** The settlement of a deal is rolled forward to another value date with the cost of this process based on the interest rate differential of the two currencies.

## S

**Settlement** The finalizing of a transaction, the trade and the counterparts are entered into the books.

**Short** To go 'short' is to have sold an instrument without actually owning it, and to hold a short position with expectations that the price will decline so it can be bought back in the future at a profit.

**Short Position** An investment position that results from short selling. Benefits from a decline in market price because the position has not been covered yet.

**Simple moving average** An average of a predetermined number of prices over a number of days, divided by the number of entries.

**Slow stochastics** A version of the original stochastic oscillator. The new, slow %K line consists of the original %D line. The new, slow %D line formula is calculated from the new %K line.

**Spot** Another name for Forex. As in spot trader, spot market, spot trading and spot price.

**Spot deal** A foreign exchange deal that consists of a bilateral contract between a party delivering a certain amount of a currency against receiving a certain amount of another currency from a second counterparty, based on an agreed exchange rate, within two business days of the deal date. The exception is the Canadian dollar, in which the spot delivery is executed within one business day.

**Spot Market** A market of immediate delivery of and payment for the product, in this case, currency.

**Spot Price.** The current market price. Spot transaction settlements usually occurs within two business days.

**Spot Transaction.** A true spot transaction is a transaction requiring prompt delivery of and full payment for the currency. In the interbank market spot transactions are usually settled in two (2) business days.

**Spread.** The difference between the bid and offer (ask) prices; used to measure market liquidity. Narrower spreads usually signify high liquidity.

**Sterilised intervention** A central bank intervention in the foreign exchange market that consists of a sale of government securities that offsets the reserve injection which occurs due to the foreign exchange intervention. The money market activity sterilises the impact of the foreign exchange intervention on the money supply. Sterilised interventions have a short to medium-term effect.

**Stochastics** Oscillators that consist of two lines called %K and %D. Visualize %K as the plotted instrument and %D as its moving average. The resulting lines are plotted on a 1 to 100 scale. Just as in the case of the RSI, the 70 percent and 30 percent values are used as warning signals. The buying (bullish reversal) signals occur at under 10 percent and the selling (bearish reversal) signals come into play at above 90 percent.

**Stop Order** An order to buy/sell at an agreed price. One could also have a pre-arranged stop order, whereby an open position is automatically liquidated when a specified price is reached or passed.

**Support Levels** A term used in technical analysis indicating a specific price level at which a currency will have the inability to cross below. Recurring failure for the price to move below that point produces a pattern that can usually be shaped by a straight line.

**Sterling (£)** Term for the Great British Pound. Also referred to as cable.

**Support level** The troughs representing the level at which demand exceeds supply.

**Swiss National Bank (SNB)** The Swiss National Bank

## T

**Tankan Economic Survey** The Japanese equivalent of the American Tan Book, which is released by the Federal Reserve. The survey is released on a quarterly basis.

**Technical Analysis** An effort to forecast future market activity by analysing market data such as charts, price trends, and volume.

**Tick** Minimum price move.

**Transaction Cost** The cost associated with buying or selling of a financial instrument.

**Transaction Date** The date on which the trade occurs.

**Transaction exposure** Potential profit and loss generated by current foreign exchange transactions.

**Trend** The general direction of the market, as shown by the significant peaks and troughs of the currency fluctuations.

**Trendline** A straight line connecting the significant highs (peaks) in a downtrend, and the significant lows (troughs) in an uptrend.

**Turnover** The volume traded, or level of trading, over a specified period, usually daily or yearly.

## U

**Unemployment Rate** An economic indicator released as a percentage that is calculated as the ratio of the difference between the total labour force and the employed labour force, divided by the total labour force.

**Uptick** A new price quote that is higher than the preceding quote for the same currency.

## **V**

**Value Date** The date that both parties of a transaction agree to exchange payments.

**Variation margin** An additional margin requirement that a broker will need from a client due to market fluctuations.

**Volatility** The degree to which the price of a currency tends to fluctuate within a certain period of time.

**Volume** The total amount of currency traded within a period of time, usually a day.

## **W**

**Whipsaw** A term used to describe a condition in a highly volatile market where a sharp price movement is quickly followed by a sharp reversal.

## **Y**

**Yard** Another term for a billion.

**Yen (¥)** Japanese currency unit.