Wiley Trading

Agustin Silvani

BEAT THE FOREX DEALER

An insider's look into trading today's foreign exchange market

The foreign-exchange market is often referred to as the *Slaughterhouse* where novice traders go to get 'chopped up'. It is one of egos and money, where millions of dollars are won and lost every day and phones are routinely thrown across hectic trading desks. This palpable excitement has led to the explosion of the retail FX market, which has unfortunately spawned a new breed of authors and gurus more than happy to provide misleading and often downright fraudulent information by promising traders riches while making forex trading 'easy'.

Well I'll let you in on a little secret: there is nothing easy about trading currencies. If you don't believe me then stop by Warren Buffet's office and ask him how he could lose $850m betting on the dollar or ask George Soros why his short yen bets cost him $600m not once but twice in 1994. What's wrong with these guys, don't they read FX books?

In reality, the average client's trading approach combined with the unscrupulous practices of some brokers make spot FX trading more akin to the games found on the Vegas strip than to anything seen on Wall Street. The FX market is littered with the remains of day traders and genius 'systems,' and to survive in the long-run traders have to realize that they are playing a game where the cards are clearly stacked against them.

Have you ever had your stop hit at a price that turned out to be the low/high for the day? Bad luck perhaps? Maybe. What if it happens more than once? Do you ever feel like the market is out to get you? Well guess what, in this Zero Sum game it absolutely is.

Covering the day-to-day mechanics of the FX market and the unsavoury dealings going on, *Beat the Forex Dealer* offers traders the market-proven trading techniques needed to side-step dealer traps and develop winning trading methods. Learn from an industry insider the truth behind dirty dealer practices including: stop-hunting, price shading, trading against clients and 'no dealing desk' realities.

Detailing the dealer-inspired trading techniques developed by MIGFX Inc, consistently ranked among the world's leading currency trading firms, the book helps turn average traders into winning traders; and in a market with a 90% loss rate winning traders are in fact quite rare! More than just a simple manual, *Beat the Forex Dealer* brings to life the excitement of the FX market by delivering insights into some of the greatest trading triumphs and highlighting legendary disasters; all written in an easy to read style. By stripping away the theory and getting down to the core of trading, you too will find yourself on the way to beating the forex dealer!

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One of the pioneers in foreign-exchange trading, Agustin Silvani developed one of the first retail-oriented currency programs and currently leads the team of professionals at MIGFX Inc, consistently rated among the top-ten currency traders as ranked by *Barron's*, *Futures*, and *Currency Trader Magazine*. Mr Silvani's experience in FX ranges from the interbank to the retail sector, helping manage portfolios ranging from $1 million to more than $10 billion in size, and is a regular contributor to the financial press.

To receive the latest news and updates please see the authors website **www.beattheforexdealer.com**

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I would also like to thank the great people at ProRealTime.com for granting me permission to use their fabulous charts. Every trader should visit their website and check out their charting packages, for they are truly top-notch in the industry.

Introduction

Over the years, I have tried to get my hands on every currency trading book that I could find, but as you may well know the pickings are slim when it comes to FX literature. Apart from a few notable exceptions, most of the available material seems to fall into one of two categories: unabashedly theoretical or completely misguided. The dry, outdated, and sometimes esoteric academic works tend to leave the reader with the perception that currency trading is as gentlemanly and ordered as the world of stamp collecting, when in reality nothing could be further from the truth in a market referred to as a "slaughterhouse" where traders routinely get "chopped up". The FX market I know is one of egos and money, where millions of dollars are won and lost every day, and phones are routinely thrown across hectic trading desks. This palpable excitement has led to the emergence of a second class of literature, often misleading and downright fraudulent, where authors promise the reader riches by offering to make forex trading "easy".

Well, I'll let you in on a little secret: there is nothing easy about trading currencies. If you don't believe me, then stop by Warren Buffet's office and ask him how he could lose $850 million betting on the dollar or ask "King" George Soros why his short bets lost him $600 million not once but *twice* in 1994. Don't these guys read FX trading books? If these investment legends can lose billions in the FX market, what makes anyone think there is anything easy about it?

The average retail trader must feel a terrible disconnect between what is described by famous "experts" and their actual trading experiences. Theory very rarely translates into fact when it comes to trading, and real-life FX trading is much more complicated and tricky than any guru would have you believe. In this jungle it is a kill-or-be-killed attitude that marks survival, and the minute you step on to the playing field a target has been placed next to your account number.

Realizing that most FX books in print are either written by scam artists or academics with little real-world trading experience, I decided to put my own thoughts to paper. While I certainly do not proclaim to be any sort of market wizard, the market insights I have gained while managing a successful currency fund should prove valuable to readers, even if they are just starting their trading careers. Being a firm believer in the "small is beautiful" mantra, I have therefore tried to keep this book short, and to the point.

The purpose of this book is two-fold. First, by explaining the day-to-day mechanics of the FX market and pointing out some of the more unsavory dealings going on in the retail side, I hope to make evident for the reader the risks and rewards involved in currency trading. The second objective of the book is to help turn average traders into winning traders. "Average" traders are losing traders; winning traders are in fact quite rare. However, by highlighting some market-proven trading tricks and techniques, I hope to give traders an initial leg-up.

As you may have guessed, this book takes its name from Edward O. Thorp's landmark work on blackjack, *Beat the Dealer*. In 1962, the MIT mathematics professor revealed to the public the gambling industry's tricks and traps, while at the same time managing to teach a successful method for playing the game of twenty-one. Likewise, you will find this book roughly split into two parts: the first half is dedicated to revealing the foreign exchange market's unfair practices and the second half is designed to help the retail FX trader implement an effective and winning game plan by providing trading tips and detailed examples.

FROM VEGAS TO WALL STREET

The past five years has seen the FX market open its arms to nontraditional participants, and now everyone from dotcom investors to cash-strapped grandmas are jumping in hoping to strike it rich.

What most of these new participants fail to realize is that they are stepping on to a battlefield littered with the remains of day traders and genius "systems". It is frequently noted that over 90 % of FX traders do not survive in the long run, yet you won't find that statistic in any of the publicity dished out by the FX brokers. To be profitable, retail traders must realize that the foreign exchange market was fundamentally developed as a professional's market, and its outdated conventions and procedures mean that it still is very much geared toward the professional. In a market where the retail trader exerts little (though growing) influence, most can have little hope of success.

The retail brokers who have sprung up recently would like you to believe that currency trading is a high form of financial speculation. In reality, the average client's trading approach combined with the unscrupulous practices of some brokers make spot FX trading more akin to the games found on the Vegas strip than to anything seen on Wall Street. The new breed of on-line FX brokers simply share too many of the traits employed by casinos to stack the odds in their favor, including these:

- The "house" always has the advantage (the spread).
- The "house" feeds off the player's greed and actively promotes it (by offering trading signals, excessive leverage, and fancy platforms resembling slot machines!).

- The "house" adopts various dubious risk-management controls, which include cheating and cutting off winning players.

All of these benefits ensure that, in the long run, the house (broker) will end up with virtually all of the player's (trader's) money. The odds are simply stacked in their favor.

Thorp's original *Beat the Dealer* was brilliant in that he focused his energy on a niche game (blackjack) which featured changing odds. In a game with fixed odds (such as the lottery) a player is virtually assured ruin, while a game with shifting odds allows the smart player to effectively control his risk while maximizing his gains. Although the long-run odds may not favor the player, a set of rules can be adopted that allow the gambler to "play" only when the odds are in his favor, thus greatly improving his chance for success. Playing in this way enables you to refrain from gambling (betting on luck) and concentrate on playing the probabilities. FX traders need to take a cue from their card-playing counterparts and learn to trade only when the odds are shifted in their favor. In this spirit, the last part of this book is dedicated to exposing high-probability trades commonly seen in the intra-day FX market, which can effectively be used to "double up" when they are seen.

BEAT THE DEALER

In my experience, most retail FX traders seem to have a decent system or genuine "feel" for the market, yet more often than not they still find themselves posting steady losses. They see the possibility for greatness, yet they are unable to grasp it. Something must be missing...but what? Although they may spend hours dutifully studying technical analysis, candle charting, and the history of the market, seldom do they take a moment to concentrate on their number one killer: the forex dealer. By preying on the small speculator, these shadowy characters are often single-handedly responsible for turning winning trades into losers.

Both casinos and FX brokers have an ace up their sleeve which ensures that the odds are always shifted aggressively against a player, and not surprisingly these villains share a common name. Dealers are much more than simple order-processors (do you want to buy/sell, hit/stay?); they are in fact the house's fail-safe device sent out to take down any player who is deemed to be winning "too much". Their direct and purposeful interference can ruin even the most advanced or elegant trading system.

Have you ever had your stop hit at a price that turned out to be the low/high for the day? Bad luck perhaps? Maybe. What if it happens more than once? Do you ever feel like the market is "out to get you?" Well, guess what...in this zero-sum game it absolutely is.

Dealers make particularly tough opponents for traders because they act on better information. Although it is hard to bluff when the other party knows your cards, you *can* however profit by betting on their actions, and a dealer's actions are, after all, very predictable. You know what they want (your money) and you have a rough idea of how they will come after it (running stops, shading prices, fading moves, etc.); all that you now need is a way to exploit these actions. Throughout this book you will find information meant to help you identify and counteract typical dealer traps, which if implemented correctly can instantly improve your trading profits. Many of these are exactly the same techniques used by hedge funds and CTAs to exploit loopholes left by their dealers, which can also be used successfully by the retail trader.

Make no mistake about it. There is a lot of money to be made in currency trading; you just have to know where to look. Sidestepping dealer traps is one simple way of improving your daily P/L, but it is surely not the only one. Successful trading comes down to taking care of the details, and for me the only way to do this is by providing concrete, up-to-date, real-life examples, and sharing the FX trading tips that have proved so profitable over the years.

In the end, it is my hope that by stripping away the theory and getting down to the core of trading you too may find yourself well on your way to beating the forex dealer!

Some Terms Commonly Used In This Book

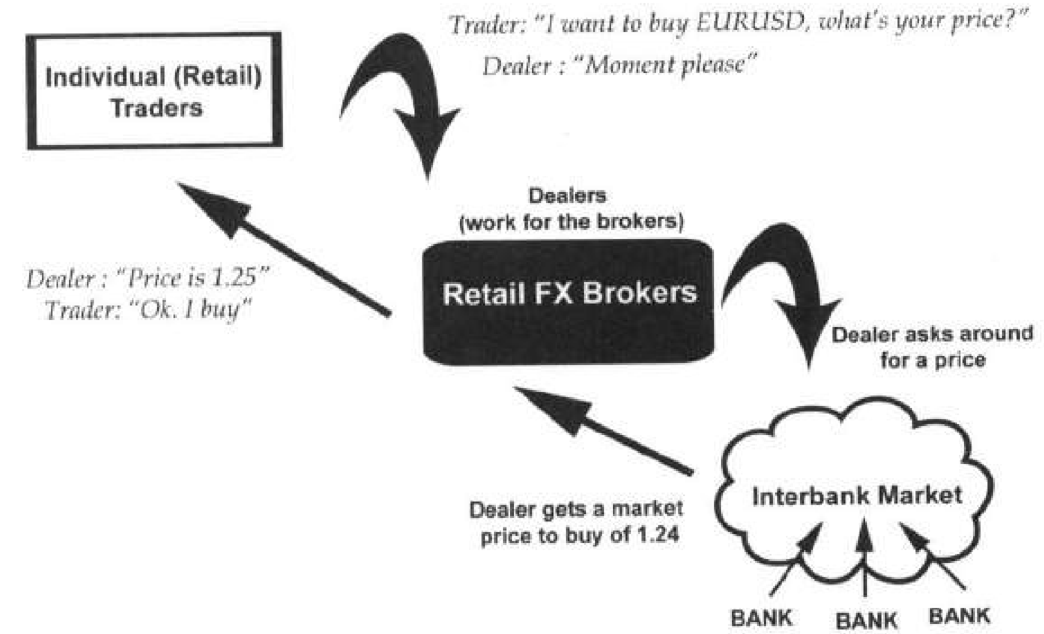
Individual (Retail) Trader Nonprofessional trader; i.e. speculates for his own account as opposed to trading for a bank or hedge fund. Normally trades small sizes (under $1 million), usually either for speculation or fun.

Interbank Market Loose term used to describe the FX trading done by banks directly with each other, as opposed to trading with clients. Can essentially be thought of as the "wholesale" FX market, where entry is restricted to professionals. Not a physical market or exchange, the interbank market is a web of credit facilities built over time and used by banks to trade with each other directly or through electronic matching platforms such as Reuters and EBS.

Retail FX Broker Also called Futures Commission Merchant (FCM), these are companies created to "open up" the spot currency market to the retail trader through their small minimum account sizes (as low as $300). In theory, they should simply be the middlemen between the FX wholesalers and their retail client base, charging a small fee (the spread) for their service. Much like on-line stock brokers (E-trade, etc.), they promise to "connect" the retail trader to the market at reduced costs, yet often fall well short of this promise.

FX Dealer If the interbank is the wholesale market and the brokers are the middlemen, then the dealers are the salesmen. Dealers typically work for FCMs or banks, and their primary responsibility is to process client transactions (buy/sell orders). If wanting to trade, clients have the option of phoning their dealer or trading electronically. The dealer then goes to the wholesale market, executes the order, and keeps the price difference (in theory at least). Retail dealers concern themselves mostly with providing accurate prices (through their on-line trading platforms), handling client flows, and running stops of course!

Simplistic view of a retail FX transaction



Note. If you are not at all familiar with the foreign exchange market or trading in general, then you may well benefit from reading up on the subject before proceeding. There are many valuable books that teach technical analysis, candlestick reading, history of the markets, economic theory, etc. Most of those books give the beginning trader a basic grounding in the financial theory that underpins successful trading, and should be dutifully studied by all traders; this book is not meant to replace any of them. The material covered in this book is strictly centered on sharing professional "buy-side" insights for trading the spot foreign exchange market.

I

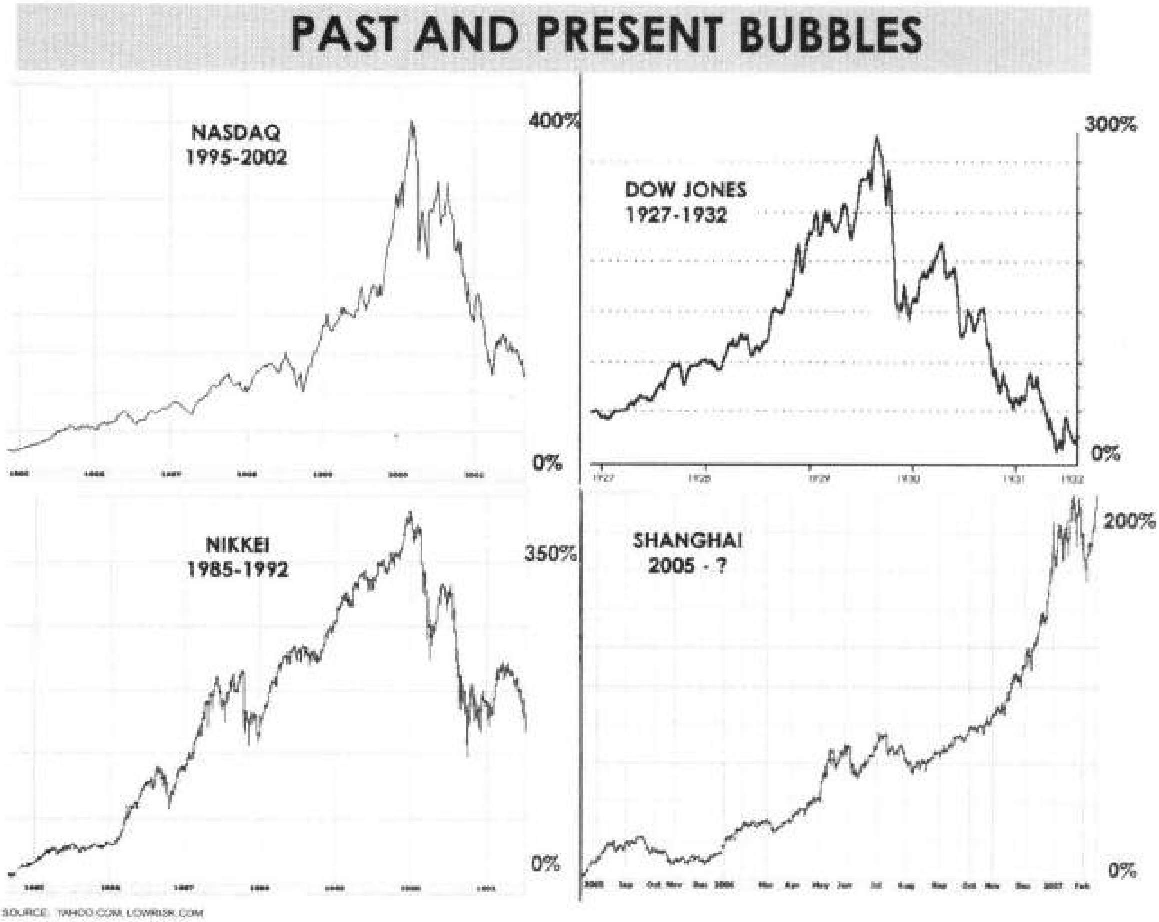
THROUGH THE EYES OF A TRADER

1 On Markets

If one believes in a random universe, a strong case can be made for the fact that any sort of technical analysis and trading tactics are in fact quite useless. Under this scenario, random and unpredictable price movements makes research, analysis, and market timing an exercise in futility, and relegates any kind of strategy (other than buy-and-hold) to a game of chance, not skill. As Burton Malkiel famously noted, "A blindfolded monkey throwing darts at the financial pages of a newspaper can select a portfolio that will do just as well as one carefully selected by the experts". This market view is supported by the fact that the vast majority of mutual funds fail to beat the broader market year after year, and history shows us that the ten best-performing funds in any one year will drop to the bottom of the pack in the following two to four years, meaning that a manager's outperformance is largely the product of luck, like a gambler's short-term winning streak. Simply put, there is no way to consistently beat the market.

Needless to say, this view of things does not sit well with Wall Street, which preaches that research, analysis, and relying on expertise are the keys to investing (and their business model!). Assuming that we can draw a similar parallel to other markets, then why bother trading? Why spend so much time researching the market and analyzing prices when we could just as simply close our eyes and buy or sell?

Thankfully for traders, although the random walk theory paints a strong case against mutual funds, it is not entirely bullet-proof. Investors consistently fall prey to fear, envy, overconfidence, faddism, and other recognizably human imperfections that make markets not only inefficient but predictably inefficient. In the short run, recognizable patterns *are* indeed visible in the stock market. Bubbles are created, and then burst. If the DOW goes up one week, it is more likely to go up the next week. In the long run all of these moves smooth themselves out, but in the short run, predicting and trading these constant adjustments can actually make for quite a profitable proposition. Through research and analysis we can visually identify these inefficiencies and market anomalies in charts, and then trade their



Stock market bubbles tend to be of similar length, duration, and size. The chart patterns are similar since the impetus behind them is the same (low borrowing costs, greed, and overconfidence). "This time it's different...."

expected outcomes. The point in trading is therefore not to forecast the future events themselves, but rather to predict and profit from their consequences instead.

The day the financial community realized exactly how imperfect a science it practices was 19 October 1987. On this "Black Monday" US stock markets managed to drop an incredible 22.6 % for no apparent reason, which proved especially shocking to the brilliant mathematical minds that had spent their academic careers solving most of the puzzles surrounding proper pricing and valuation. By the late 1980s it seemed that markets had finally been "figured out" and trading was no longer the realm of risk-hungry cowboys as technology quickly came to replace the gut in pricing (and trading) decisions. Yet in light of all this, the world's biggest and most sophisticated market still managed to shed nearly one-quarter of its value in *one day* and on no news, putting into question even the most basic financial assumptions. By noon of that day, IBM's stock stopped trading in the face of only sell orders; literally no one wanted to buy. If a stock is only worth as much as someone is willing to pay for it, did this mean that IBM's stock was, at least for the time being, worthless? What exactly was going on? How could we call the market rational and efficient, let alone figured out?

The fact that this event now seems as distant as the stock market crash of 1929 is evidence of just how much we have moved forward, yet many of the underlying reasons behind the crash are still around today and the trading lessons behind these underline the major differences from what we may call the "academic" view of markets and the trader's view.

A LITTLE MARKET THEORY

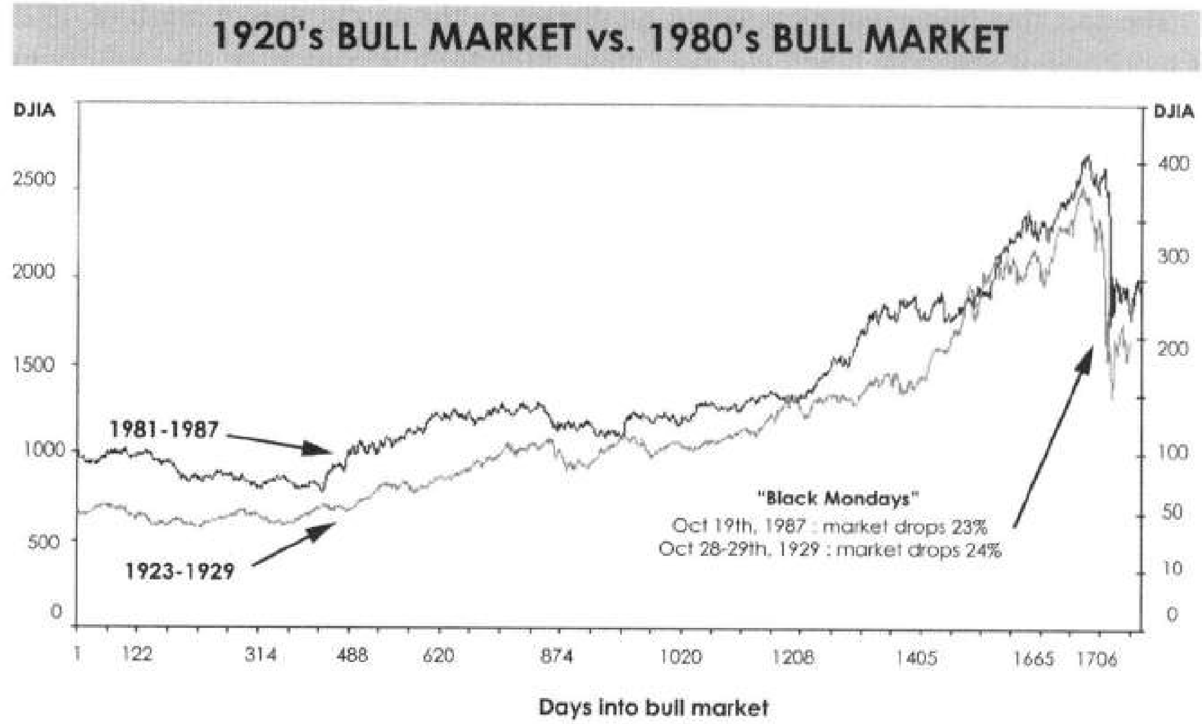
As we know, professors love formulae, and perfect formulae make for perfect markets. The problem with this kind of oversimplified interpretation of the market is that it tends to marginalize an individual's contribution, while traders realize that sometimes individual actions are actually the driving force behind markets. Why did people sell on Black Monday? It was because everyone else was selling; it is as simple as that.

The problem for the academic world is that while real risks (interest rates, stock prices, etc.) are easy enough to understand, *perceived* risks are much harder to quantify and are therefore generally ignored. After all, how on earth can we measure Joe Investor's sensitivity to risk when on the one hand he spends days researching and analyzing which car to buy and on the other hand he buys Pets.com stock on a friend's tip?

Over the years traders have learned to get a grasp on this tricky subject, and some interesting things about the perception of risk have emerged. We know that risk tolerance decreases once the market is fully invested, which is why asset bubbles build up slowly and deflate violently. We also know that our brain is hard-wired to shy away from pain and regret, thus making us sell our winning stocks while holding on to losers hoping that they will turn around. How many dead internet stocks do you still have in your portfolio?

What we now know is that markets are efficient, but they are not perfectly efficient. The point where buyers and sellers meet does not always reflect "equilibrium", and the sheer number of arbitrage-hungry hedge funds out there can be taken as an indication of the market's imperfection. Since prices are man-made creations that reflect our biases as much as they do economic reality, markets may stay in a state of disequilibrium for a long time when the very reason for buying (prices going up) in turn leads other people to buy.

Those used to doing the day-to-day dirty work in the markets, the traders, dealers, and "locals" in the pit, have all come to realize that at least in the short run, markets are often manipulated and highly irrational. Psychology matters, fear matters. Momentum often trumps economic fact, and we can be fairly certain that as long as there is human involvement in the financial markets they will continue to exhibit the same erratic behavior patterns as human beings. Logic often takes a back seat to greed and fear since at the end of the day it is the trader/money manager that has his job and bonus to look after.



"A perfect market thinks only of the future, not the past." The market may not have a memory, but traders certainly do. The eerie similarity between the crash of 1929 and 1987 can probably be attributed to traders in 1987 using the past as a way of predicting the future, unwittingly creating a self-fulfilling prophecy with their actions. (Source: Lope Markets)

Traders that overlook these behavioral aspects end up in trouble when confronted with tumultuous and emotional markets, even if for a brief period of time; hence there is the famous saying, "The market can stay irrational longer than you can stay solvent". This saying is more true that you can imagine, and the Wall Street graveyard is littered with traders that made money trading rational markets 99 % of the time, yet got wiped out by that irrational 1 %.

Legendary hedge fund manager Julian Robertson found out just how dangerous it can be to fade[1] irrational markets when he rationally shorted the tech bubble of the 1990s and turned his stellar $22 billion dollar fund into a mere $6 billion basically overnight. His farewell letter to investors pretty much says it all:

> The key to Tiger's success over the years has been a steady commitment to buying the best stocks and shorting the worst. In a rational environment, this strategy functions well. But in an irrational market, where earnings and price considerations take a back seat to mouse clicks and momentum, such logic, as we have learned, does not count for much.

[1]To fade a move is to trade against the prevailing direction. Fading a move higher would mean selling short into the rally.

From a trader's perspective, this means that the market is always right. If irrational investors make a bundle on the way up, while rational investors lose their shirts shorting the move, then who is rational and who is not? Markets are not rational or irrational, they just are, and the only view that traders will ever hold sacred is their need for volatility, because it holds the key to their profits. As long as people are buying and selling, short-term speculators are indifferent as to the rationale behind the moves because they know there is money to be made on both sides of any trade. All that traders care about is maximizing their profits by positioning themselves in advance of the next move, while academics often miss the forest for the trees by being so far removed from the trading floors of the world.

2
The Currency Market

Foreign exchange trading has essentially been around since the advent of money, and although the mechanics have advanced somewhat since the time of the money-changers in the temple, it still boils down to the exchange of one currency for another.

Of all financial markets, the FX market can probably be considered to be among the most "pure" in the sense that supply and demand (in the free-floating currencies) is strictly what determines prices. For the most part, the market is unregulated and free of distorting red tape, and the sheer size of the trading volume means that government intervention has little long-term effect on prices. After all, in a market that trades over $2 trillion a day government intervention can only go so far, and at the end of the day it is the two hundred thousand traders around the world that act as Adam Smith's invisible hand in guiding prices.

Since a market this free and liquid is typically hard to out-guess, you would be right to think: "is it even worth trading such an efficient market?" The good news for traders is that the FX market is not as efficient as it may first appear, and the root of this inefficiency can be traced back to the participant's motivation. The FX market has never been a value creator, but rather a vehicle for other transactions. A US portfolio manager buying Japanese stocks or an Italian company acquiring raw materials from Brazil both inadvertently become FX participants, yet the currency part of their transactions are not usually motivated by profit. The portfolio manager simply needs the yen to buy the stocks and the company needs dollars to buy the coffee.

This type of behavior breeds inefficiencies eagerly exploited by more active market participants, and fortunately for FX traders small arbitrage opportunities still abound. Although the market may be very efficient at giving you a price, whether that price is an accurate reflection of the currency's true "value" is another story altogether, which is why good analysis and trading techniques do pay off in the long run.

Research and analysis in FX proves valuable because the currency market *is* different than Wall Street. The interbank market is by no means a perfect market since information is not freely available, market access is restricted, manipulation takes place, governments intervene, and a large number of participants routinely buy and sell irrespective of profit, which all comes together to turn conventional trading wisdom (such as "let your winners run, cut losers short") on its head in this mostly range-bound market. The FX market is different than other markets, and if you can find a way to recognize, predict, and exploit these imperfections, then there is a great deal of money to be made. Profitable trading strategies do exist and can be found.

A SELECT CLUB

Off-balance sheet earnings are the declared aim of most banks, and spot dealing in FX, which presents high loss potential (as far as price is concerned) but practically no credit risk, falls directly into this category. To understand a bank's motivation for getting involved in this market, all you have to know is that by combining a large FX dealing desk with a decent prop trading group, pretty soon you will be talking about billions in profits. These types of numbers have long made FX the playground of only the biggest and baddest global banks, and because at its core the FX market continues to be a credit market, their dominance is unlikely to be challenged any time soon.

The Big Boys of FX

Out of the 6,322 institutions polled (totaling over $85 trillion in turnover), ten banks were responsible for more than three quarters of all FX turnover.

	Marketshare
1. Deutsche Bank	19.26%
2. UBS	11.86%
3. Citigroup	10.39%
4. Barclay's Capital	6.61%
5. RBS	6.43%
6. Goldman Sachs	5.25%
7. HSBC	5.04%
8. Bank of America	3.97%
9. JPMorgan Chase	3.89%
10. Merrill Lynch	3.68%

Source: Euromoney FX Poll, May 2006

Unlike other markets, an FX transaction is not the exchange of cash for another asset (stocks or oil, for example), but rather the exchange of cash today in return for the acceptance of cash at a later date. The interbank market operates on this somewhat unusual principle, where one party depends on the other to meet their obligation without extending credit to each other. As you may well imagine, when dealing in this way it is crucial to know that your counterparty is of the highest credit standing, lest you be left holding the bag on one side of the transaction. For this reason, big banks prefer to deal with big banks, and smaller fish are essentially shut out of the FX pond. As a result, a small group of commercial and central banks (you can call it a cartel if you wish) has always handled the majority of FX turnover with each other, and for each other.

Technology has managed to open up this tight-knit group somewhat, although not to the extent that you may think. Most banks now either operate their own electronic dealing platforms or provide liquidity to a matching system/prime brokerage platform. Products from EBS, Currenex, FXAll, etc., enable banks to reach a larger client base while still maintaining full control over their risk, yet in the end, who do you think owns most of these platforms anyway? The reality is that the same small group of banks still controls the FX market.

AN UNFAIR PLAYING FIELD

From the very beginning, the FX market was designed to ensure that market "insiders" had a considerable edge over market "outsiders". Because of the tight-knit nature of the market and its lack of regulation, the FX market is a fundamentally unfair market for the nonprofessional to operate in. For example, in some emerging countries a Citibank or UBS may be the only game in town, so anyone wanting to trade that currency is forced to "pay up" to play in their turf. A player's positioning on the FX food chain depends on his/her access to information and speed, and with no central clearing exchange, it can be difficult for nonprofessionals to gain access to this information and come up with an accurate view of the market. More often than not, this leaves those with limited access to information at the mercy of their bank dealer.

This is where the FX world differs from traditional financial markets, and things deemed illegal in most other markets are simply regarded as "part of the game" in FX. Insider trading, front running, price shading, etc., are all regularly seen in FX trading, and have absolutely no legal repercussions.

No government oversight and no central dealbook to compare trades means that banks are pretty much free to do whatever they want to their unsuspecting customers. Unlike exchange-traded markets (NYSE) where a market maker has a responsibility to quote the same price to two different parties, an FX dealer may quote his clients whatever price he wishes. Spreads mysteriously widen and shrink, and the "who's who" factor dominates. Good customers receive decent prices (a salesman will shout to the dealer "good price, mate!"), but for irregular or complicated clients it becomes practically impossible to receive fair market prices. God forbid that the dealer "read" you correctly and guessed your intentions (try calling up your dealer and ask him "I wish to buy, what's the price on euro-dollar?"). An FX trader who did not want to get ripped off before had to place 5 to 10 calls to different banks and take their average as the "fair" market price. These inefficiencies, of course, all play into the hands (and pockets) of the brokers.

Dealers are free to behave in this way because they are very often the only game in town, and they know that there is not much customers can do about it. In the same way that you and I knowingly get ripped off by the exchange booth guys at the airport, traders know they are getting short-changed but often have little recourse. If Goldman is the only one willing to take your trade at that moment, you can either take it or leave it; it is as simple as that.

3
A Rare Breed

Putting aside all arguments about efficient markets, traders are around for one thing and one thing only: to make money from their views on the market. Although theory states that investors should not be capable of beating the market in the long run, people like Paul Tudor Jones[1] are happy to go against conventional wisdom by consistently beating the market year after year. Either their success is merely the result of a statistical fluke or great traders are simply a breed apart.

The mark of a great trader is their ability to walk the walk and talk the talk. While most people actually find that on paper they make great trading decisions, when real money becomes involved they soon lose the upper hand. That is because as soon you enter the market, you become emotionally attached to your position and the switch from paper profits to real dollars and cents clouds your thinking by inserting doubt into your reasoning. Think about the past investment decisions you regret the most. They usually involve sound investments that you pulled the plug on too soon (I knew I should have held on to that property in Florida!) or never entered into (I knew I should have bought the Google IPO!). Either way, the error in judgment is frequently caused by the emotional rush brought on when switching from percentages to greenbacks. This mental toughness is the reason great traders are often referred to as having ice-water running through their veins or having private parts made out of steel.

Trading is one of the few professions that enable you to quantify exactly how good you are, since all it takes is a quick glance at your P/L. How does a consultant/engineer/manager know they are good at what they do? Usually it is through a combination of peer respect, promotions, and recognition that they use for measurement. And how do they know if they had a good or bad day? Traffic? Problems

[1]Part of the University of Virginia hedgies, started Tudor Investment in 1985. Never a down year, the worst performance was in 2000, when Tudor BVI Global Portfolio fund delivered 11.6 %. Of note, he managed to time the October 1987 market crash and turn it into a 210 % gain.

with suppliers? Now imagine being able to look at your screen at the end of your shift and let *it* tell *you* how your day was. For traders, the measuring stick is simple: money. The more you make, the better you are at your job. If you made more than the guy to your right that must mean that you are better at your job than he is, and if you lost money today that means you had a bad day at work. This turns trading floors into pure meritocracies, and those that make money have the power, while those that don't are soon out the door.

Unlike investing, where the focus is on creating wealth (e.g. dividends), traders make money by catching short-term moves for quick gains. Trading, like poker, can be described as a zero-sum game. If you are winning then someone else must be losing. This battlefield aspect to the markets is something that the novice trader disregards at his/her own peril, since humans sit behind those trading screens and you can bet that they will do everything in their power to take your money, even if that means bending the rules in their favor.

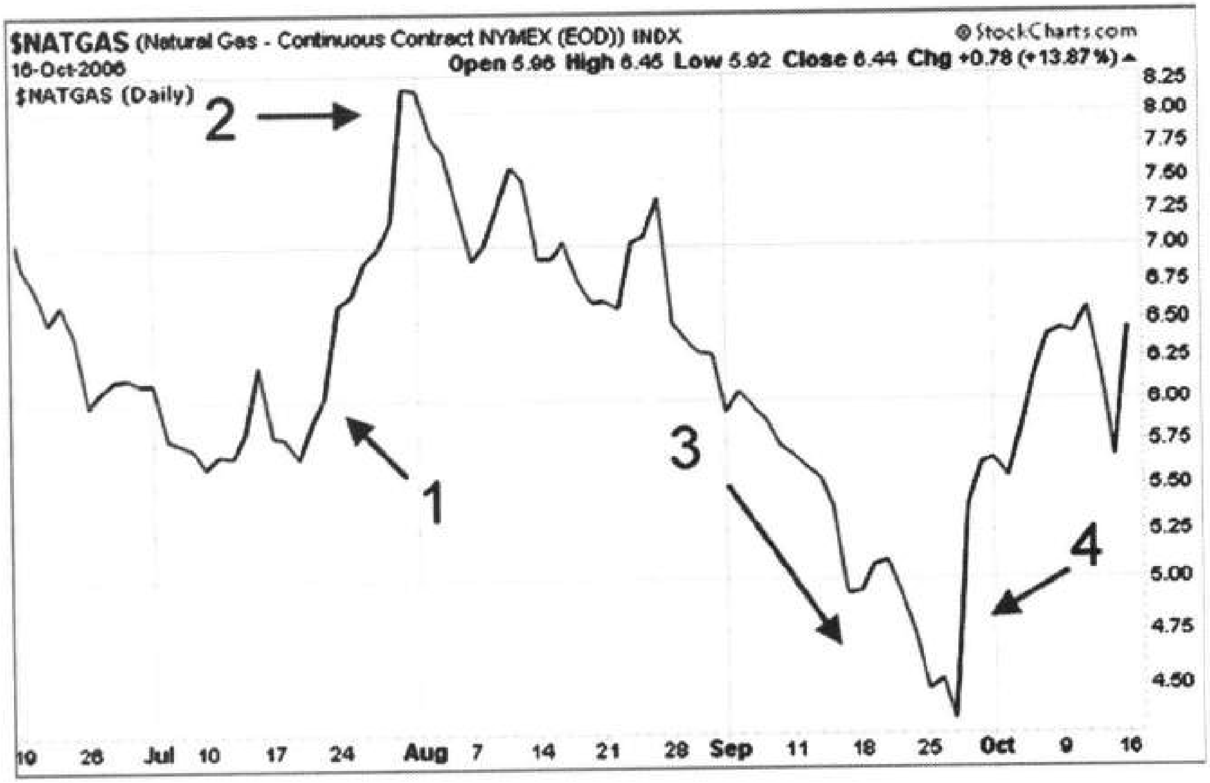
The fact that most traders are also avid gamblers should come as no surprise, and thus you may find at any one time that bets on sporting events or the eating capacity of the latest intern overshadow any market activity on the desk. Another interesting quality about traders is that proficiency with numbers does not automatically translate into positive trading results, and over the years you find great minds like Sir Isaac Newton losing fortunes in the market while atypical participants, such as novelist Julius Verne, become great stock pickers. The ability to look beyond the obvious facts and figures, to think of the market not only from an objective standpoint but also from a subjective view, is what sets great traders apart. *Average traders look to the left-side of the chart, great traders look to the right.*

THE TRADER'S EDGE

A trader's edge is their ability to deal with uncertainty at minimum risk, which is exactly how the Rothschild family made their fortune in the 18th century. The idea was simple yet brilliant: in a time of slow communications, courier pigeons could be used to transmit gold prices across the English Channel, giving you a day's head start on the market and opening the door to arbitrage opportunities. When the price was lower in Paris, they would purchase it there and sell it in London, keeping the difference. Their advantage was information, which was thoughtfully transformed into profits.

Dealing with uncertainty can also mean being pro-active and forcing your opponent's hand. When asked about his playing, Ed Lasker, one of the greatest chess players of all time, noted that in order to succeed he would ask himself, "What is my opponent's present state of mind, and how can I worry him the most?" Similarly, the very best traders have the innate ability to look at the market objectively while at the same time perceiving it from the eyes of their opponents. What move do they fear the most? What will they do if prices go down? Lasker explained that he "sometimes achieved victory by boring my opponents to death, or by luring them into attacks when attacks weren't in their nature". Successful traders apply these same concepts on a day-to-day basis, and use this edge to actively shape their future by playing to their opponent's weaknesses.

Market participants (and pawn shops) know that it is much easier to rip-off someone in trouble than to make money through your own trading skills, so over the years they have evolved into efficient killing machines that would make Darwin proud. If the market catches a wisp of a hedge fund in trouble, you can be sure



How to lose $6 billion in two months.

1. Anticipating higher natural gas prices, hedge fund Amaranth places huge bets through bullish spread plays.
2. At this point, the big bets are actually deep in the black and the fund begins to cash in on some of their positions. The sudden flood of supply gets the market's attention, and the NYMEX boys soon realize that Amaranth is sitting on a huge long position. Liquidity dries up and the market begins to turn as the fund desperately tries to get out of their trade.
3. The selling soon snowballs into a rout and natural gas prices fall 50 % in two months. Fundamentals are pushed aside as traders move in for an easy play, and word of the fund's trouble begins to leak out to the public.
4. By late September Amaranth is wiped out. The friendly financial community gladly offers to "bail them out" by buying their positions at heavily discounted prices. Not surprisingly, once the bloodbath is over the market returns to normal trading and the sweethearts that bailed them out cash in their positions for great gains.

that the sharks will move in and actively push the market against them until they are dead in the water. This active "hunting" role is something that most model developers do not take into account, and to a large degree it can be said that their "sigma-nine"[2] events are often self-perpetuated. If Amaranth had not gone balls-out long on natural gas, for example, the market would probably not have dropped like it did.

FOREX TRADERS

Foreign exchange speculators are often regarded by developing nations as "economic war criminals" who prey on the weak and defenseless, yet ask FX traders and they will tell you that they are simply the instruments of global macroeconomic forces. As George Soros famously proclaimed, "As a market participant, I don't need to be concerned with the consequences of my [financial] actions." In other words, he did not create the imbalance, so why should he be blamed when he corrects it?

Forex traders are a unique brand of speculator with an almost monastic devotion to their profession, working obscene hours and concerning themselves with global macro events. What effect will the Tokyo earthquake have on the Swiss franc? How will the US dollar react to inflationary signs coming out of Germany? Try explaining how you make a living to a stranger (or your spouse) and they will look at you as if you are crazy. The ability to select, process, and take advantage of seemingly unrelated and unending data points in the blink of an eye is what sets currency traders apart. Through the eyes of a forex trader every asset trade is essentially a bet on exchange rates, and those that learn to connect the dots faster than anyone else end up on top.

The world's economies are now one giant interconnected machine, and the grease that keeps the gears running smoothly is foreign exchange. Legendary FX traders have made their careers by figuring out, before anyone else, what repercussions event X will have on country Y's currency. This clairvoyance often instills a level of self-confidence that would humble professional athletes, and when combined with the tremendous amounts of leverage available to traders it often leads to some truly mind-boggling bets.

In 1988, for example, when Bankers Trust hotshot Andrew Krieger was asked about his short Kiwi position he famously replied, "How large is the monetary supply of New Zealand?" Believe it or not, through the use of derivatives Krieger managed at one point to actually short *more* than New Zealand's entire monetary supply! Although this gutsy bet ended up netting him a cool $300 million, when self-confidence turns into arrogance the effects can be devastating.

[2]Nine standard deviations away from the mean, or basically a statistically impossible event.

Why is it a bad idea to give your star trader the keys to the backoffice?

The trading world is filled with stories of one-man demolition crews often referred to as "rogue traders". Here are some of the most infamous:

Yasui Hamanaka. The Sumitomo Corp. trader's positions were so huge, that he earned the nickname "Mr. 5%" for allegedly controlling five percent of the world's copper market. Unfortunately for Sumitomo, his 10 year career was mostly filled with bogus contracts and fictitious entries meant to hide his mounting losses. By the time he was discovered, he had racked up $2.6 billion in losses which he paid for by doing eight years in jail.

Nick Leeson. Star trader for Barings Bank, his derivative losses hidden in his secret 88888 account ended up costing the "Queen's Bank" $1.2 billion and managed to bring down one of the world's most venerable banking institutions overnight.

John Rusnak. Allied Irish Bank's chief rogue trader. His out-of-control fx trades ended up costing the bank a cool $691 million.

Peter Young. Morgan Grenfell's star trader is not best remembered for his unauthorized trades (a mere $350m), but the fact that he showed up to court wearing women's clothes in an attempt to plead insanity. Seems like Young got the last laugh since the court declared him unfit for trial!

4
FX Dealers

To understand how dealers trade, you simply have to understand how dealers think (i.e. make money). If the big banks are the FX wholesalers, then dealers are the salesmen trusted to push their inventory. Like the used car salesman who wants to clear his lot, FX dealers are looking to move as much inventory as possible ("chopping wood" in dealer speak) and regularly adjust their profit margins here and there in order to accomplish this. It may be worth accommodating a transaction for a customer at a slightly lower commission (or loss) if it means locking up business from that client in the future.

Because of the wheeling-and-dealing style of their work, dealers have historically been more associated with the streets of Brooklyn than any Ivy League school, and they are renowned for being quick on their feet and excelling at order-flow trading; they are the definition of the intra-day trader.

ALWAYS BE FADING

A dealer's motto. Market moves are rarely one-way and dealers understand that the majority of the time intra-day markets are range-bound (around 80 %), so any sharp move (gap) is likely to be faded by dealers who have the deep pockets and knowledge that the price will eventually come back to them . . . at least most of the time!

Another favorite trading rule of the spot dealer is to never trust the first price. After a news release, dealers know that the first price print is the knee-jerk reaction of the market and most often wrong, so dealers routinely use news events to flush out any weak positions by moving the market against them. This is commonly known as the "head fake," whereby the price moves sharply in one direction before reversing course, catching many traders off-guard in the process.

Dealers always fade the first move; hence the saying "never trust the first price."

CAN DEALERS LOSE MONEY?

Yes. A dealer's biggest nightmare is a runaway market, where they are forced to either stop quoting prices (and risk losing customers) or continue taking the other side of the trade and risk being stuck with a losing position. Prices can at times run away from a dealer so quickly that they are unable to offset their exposure, and leaves the stressed-out dealer with positions deep underwater. Many risk-hungry dealers that continued to quote prices during the USDJPY crash of 1998, for example, were wiped out. In general, any one-way market is bad for dealers, since prices do not retrace and they are forced to eventually unload their positions at a loss. However, from a dealer's perspective, this is simply seen as the "cost of doing business."

TRADERS VERSUS DEALERS

Like two heavyweights in the ring, traders and dealers regularly duke it out in the markets, with speculators complaining about dealers committing "highway robbery" through their quotes and fills, and dealers complaining about traders "picking them off" in arbitrage opportunities. Both have valid points in this love–hate relationship (actually mostly hate), but in the end one cannot do without the other. As in any business, good market contacts and relationships are fundamental to success in the market, and a trader may put up with a dealer's shoddy quotes if he knows he can count on him to take a large CADJPY order on a Friday afternoon, for example. You can have the best ideas in the world, but if you cannot find a counterparty to take your trade then you are going to be stuck with just that: an idea.

Of course, having a good relationship does not mean you are not willing to take the other party's money. Every time a trader picks up the phone to deal, he knows that the person on the other end of the line is going to try to rip him off, but smart traders also routinely play tricks on their brokers. A favorite FX trick was to leave small stops with dealers all over the city and wait for them to take the bait before entering the market with your real move in the form of massive orders that would catch dealers wrong-footed and looking silly. Similarly, dealers often know the position of their client directly (through the margin deposit) or indirectly (through industry contacts) and actively push the market against them. The street is littered with stories of one party pulling the wool over the eyes of the other in what seems like an endless game of cat and mouse.

NOT ALL FX DEALERS ARE CREATED THE SAME

Forward/Swap Dealers: The most cerebral of the bunch. More concerned with time than price, these guys have to constantly keep track of value dates and expirations. Calculations can turn complicated in a hurry when clients approach them with obscure set-ups for which they must either quote a price or risk losing a client.
Spot Dealers: Fly-by-the-seat-of-your-pants crowd. Rely more on their gut than their head. Can instantly calculate averages and are above all concerned with their net exposure at any given time. Generally more street-smart than book-smart, they are very attuned to human behavior and trade according to flows. If they smell blood they pounce.
Retail Spot Dealers: Usually ex-bank dealers that were "retired" or decided to move on to a cushier gig. They occupy an awkward place between the interbank and the retail market, with most transactions being generally straight-forward. Cushy job that entails little more than tracking customer flows and offsetting risk with their market makers. Now and then they organize ambushes on their clients, something they revel in. To put it in perspective, the head dealer at one of the major retail FCMs used to show up to work wearing a cap that read "FUCK YOU."

Pretty much sums it up doesn't it?

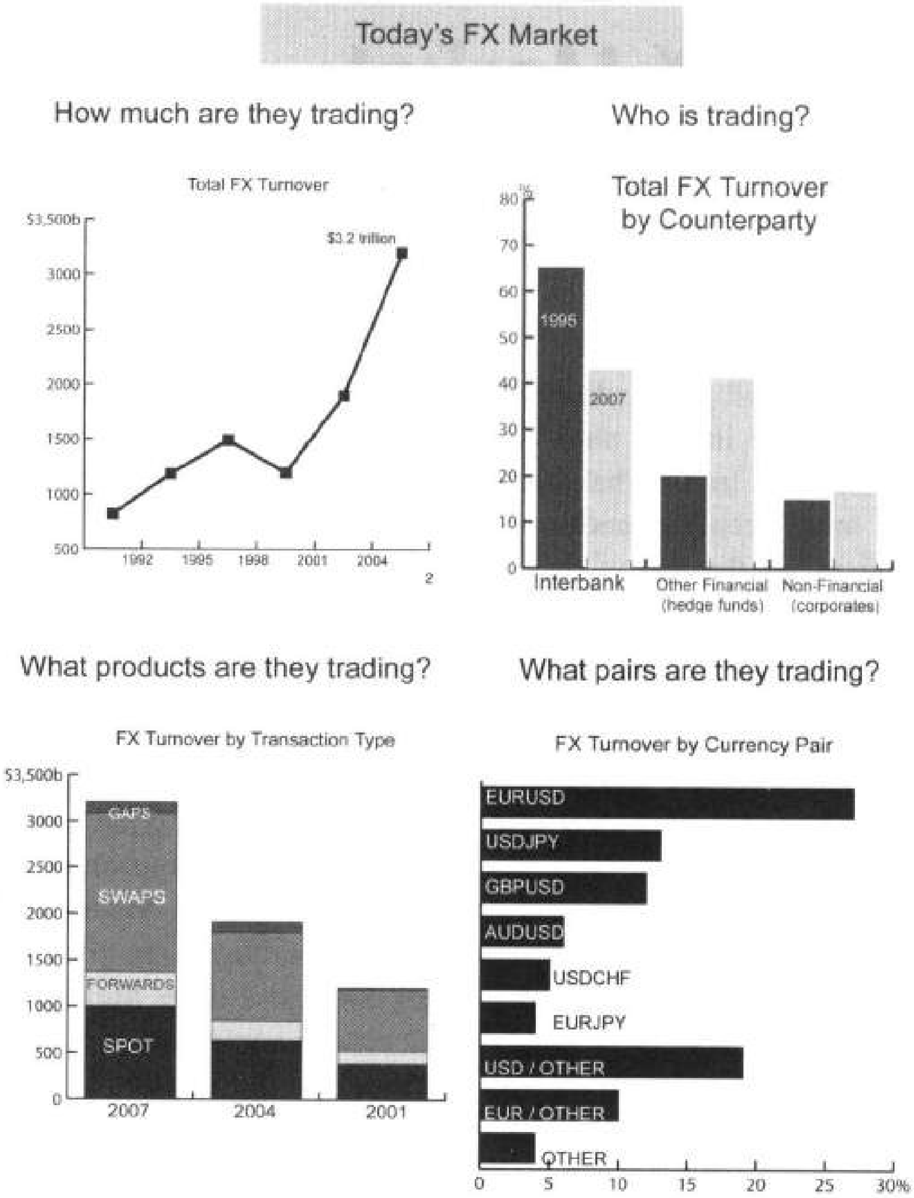
5
Today's FX Market

The enormous technological advances that we have seen over the last 20 years have had a profound impact on how the FX market operates. Everything from backoffice systems to trading has been affected by the changes, generally making things faster, more accurate, and more reliable. Bank dealers are now less likely to find "surprises" at the end of the day, having second-by-second access to their exposure. Technology has also enabled a new breed of competition to arise for the old-school voice brokers, namely electronic platforms like Reuters, FXAll, EBS, Currenex, etc.

Whereas before a trader was forced to make the rounds in an effort to find a price, he can now instantly see the best tradable bid/ask with a single key stroke. With all of the liquidity providers now imputing their best price into a common platform, it should in theory be a much better way of going about things, and for the most part it is. However, don't feel too sorry for the dealer, for there will always be a place for his trade. Although electronic platforms are great for "vanilla" transactions, if you are a fund trying to push through a large Mexican peso trade in early Sydney time, your only hope for success is contacting a good dealer that can make it happen. No e-platform will ever make a market out of thin air.

A QUESTION OF NUMBERS

Technological advances have helped drive the growth in FX turnover, and although much is said of the tremendous volumes traded on a daily basis, the oft-quoted statistics should be taken with a grain of salt. The FX market is by far the largest and most liquid market in the world, with daily FX turnover estimated at around \$2 *trillion*. If this seems like a lot to you, it is because it is. Compare FX volumes to the tiny \$50 billion traded at the NYSE or the \$800 billion traded in government debt and you get an idea of the size of the market, yet the first thing to take into consideration when hearing that "FX turnover has increased 50 % over the last 3 years" is that turnover is measured in US dollars. A depreciating dollar will directly translate into ballooning turnover volume.[1] However, even if the figures are somewhat skewed, the fact remains that billions and billions are being traded every day. So the question becomes, "Who is trading all of these thousands of billions of dollars?"



International commerce may at first seem like the obvious answer, yet with the global economy estimated at 40 trillion dollars a year, in theory all of the commercial transactions and corporate hedging would be taken care of in a mere 20 days of trading! The next obvious candidate would have to be hedge fund money, since nowadays everything is blamed on hedge funds. However, since the hedge

[1] At constant exchange rates, the turnover increase is around 35 %.

[2] BIS Triennial Survey 2007. Visit www.bis.org for the full report.

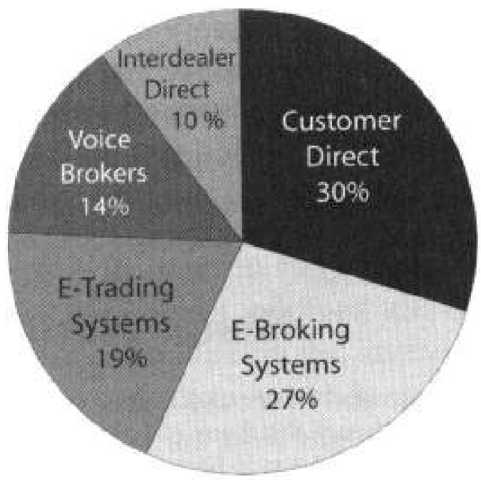
fund money allocated to FX is estimated to be around 1 trillion, even leveraging this amount aggressively would still leave a gigantic gap in reporting. So who is doing all the trading?

Where are they trading?

COUNTRY	SHARE
UNITED KINGDOM	34 %
UNITED STATES	17 %
JAPAN	6 %
SINGAPORE	6 %
SWITZERLAND	6 %
HONG KONG	4 %
AUSTRALIA	4 %
GERMANY	3 %

How are they trading?

Average Daily Volume by Dealing Channel



The truth is that nobody really knows, but it may be the case that turnover numbers are greatly exaggerated due to the multiplying effect of FX transactions and the use of notional funds. For example, when multinational *X* approaches their bank to trade 100 million euros for dollars, a two-way transaction takes place, so the €100 million goes on both of their books. The bank then quickly contacts one of their counterparties to offset their exposure, which may in turn offset their exposure through the derivatives market. A single transaction can therefore set in motion a whole set of subsequent transactions totaling well over the original €100 million in cash.

Although it is hard to tell exactly where these flows are coming from, what is undeniably true is that FX volumes have been steadily increasing. Volumes are in fact rising at such a tremendous pace that only a fundamental shift in people's perception of FX can explain the current situation.

THE NEW ASSET CLASS

As little as ten years ago, most asset managers regarded FX as an annoying side transaction that simply *had* to be done, and most did not particularly care for it. If a large international mutual fund wanted to buy European stocks, they would simply approach their custodian bank and tell them to take care of it. This was a case of the simpler the better, since in their minds their core competencies lay in picking stocks, not the direction of the dollar. This may seem like a reasonable approach when things are going well, but in times of uncertainty and low yields, every penny begins to matter.

After the bursting of the stock market bubble and 11 September, times got tougher for asset managers and they soon began to look at FX with kinder eyes. They realized that their FX holdings could actually be regarded as a separate asset class, which had to be "optimized" in their constant search for alpha (excess return).

This change in perception proved to be a radical shift for the investment community, and continues to be a major driving force in the FX markets today. More and more funds are now actively managing their FX exposure, either in-house or by employing a currency overlay manager (COM). This renewed the focus on FX and the search for yield has in turn led to the resurgence of the carry trade,[3] which in turn often leaves strong trends in its wake. In an age of low yields and increasingly competitive (efficient) markets, this new brand of FX participant is here to stay.

Black Wednesday, 1992

Perhaps the most infamous FX trade was George Soros & Co's short sterling bet that managed to "break the Bank of England." By September of 1992, Soros and other speculators had begun to take increasingly large short sterling positions on the grounds that the UK economy was suffering from high inflation and a slumping housing market. At the time, the UK had entered the ERM (forerunner to the Euro) at 2.95 Deutsche Marks to the pound, and the GBP/DM pair was allowed to trade a narrow range, with 2.778 set as the bottom. If the rate fell below that level, the Bank of England would have to intervene in order to prop up their currency. On Sep.13th, now known as "Black Wednesday" several big players including Soros and Goldman Sachs realized that the BoE would not be able to support the pound indefinitely, so they decided to stage a massive speculative attack on the currency. The UK Chancellor tried to stir up some demand for the pound by raising rates not once, but *twice* in the same day, yet by evening it became obvious that they could not continue to prop up "Her Majesty" so they decided to throw in the towel and unceremoniously withdrew from the ERM. The pound was then free to trade outside of the fixed range and eventually fell to as low as 2.20 DM. The UK government is said to have lost around 3 billion pounds in their effort to prop up their currency, while Soros is said to have personally taken home around $1 billion in the process......not winning him many friends in the UK!

Moral of the story: When everything is in your favor, go for the home-run trade.

[3]Borrowing a low-yielding instrument and trading it for a higher yielding one in an effort to make money from the yield difference. For example, you take a loan from the bank at 5 % and buy bonds yielding 7 %, in effect keeping the 2 % difference.

6
The Players

Since FX prices are shaped by customer flows, in order to fully understand what makes the market tick we need to understand the players involved and their motivations. Although over half of all FX turnover is handled by the interbank market (essentially banks trading with each other) this percentage has been rapidly shrinking (it accounted for two-thirds of all trading 10 years ago) due to the increased participation of sophisticated and varied investors. Where FX was once solely the domain of global banks, nowadays a growing number of speculators such as hedge funds and CTAs actively jostle for space alongside the more traditional players.

In a way, it seems only fitting that the largest market in the world should also have the most varied group of participants, and everybody from the hedge fund crowd to the frequent flier crowd now has an interest in foreign exchange rates. In order to simplify things, we can divide the FX market into the four major types of participants: marker makers, corporate accounts, speculators, and central banks.

MARKET MAKERS (Dealers)

In contrast to the other FX participants, market makers are the only noncustomers in the market and are there instead to provide a service to paying clients. Banks are the only ones with deep-enough pockets to handle the biggest of FX transactions, from billion dollar M&A flows to structured products for corporate clients, but since not everyone can trade directly with a bank specialist brokerage houses have long existed to handle the "leftovers". Unlike bank dealers, whose primary purpose is to make markets for their corporate client base, a dealer for an FX brokerage should play a blind third-party role by simply matching up the orders of their wide customer base and collecting a spread for their trouble (much like a specialist on the NYSE). Speculators can use them to gain anonymity while trading, prop desks may use them for arbitrage, and individuals may use them because of their smaller size.

Although a dealer's role in the market should theoretically be limited to providing liquidity for their clients, in reality much more is expected of a good dealer, and an FX desk is expected to generate substantial "off-the-books" profits for the company by actively trading against their client base.

CORPORATES

Multinationals are the bread-and-butter of the FX world and are, by and large, seen as the most logical participants in the foreign exchange market. Along with insurance and pension funds, they are known as "real money" accounts as opposed to the leveraged crowd, which borrows substantial amounts to trade. The Coca-Colas and GEs of the world receive and make payments all over the world, which necessitates their involvement in the foreign exchange market. These corporate flows need to be carefully predicted and hedged in advance so that accurate budgets and projections may be created. Since corporate clients are not a particularly speculative bunch, they are primarily interested in hedging flows through the forward market. For them, the less volatility, the better.

A well-run and pro-active treasury can have a tremendous impact on a company's bottom line, as in the case of BMW, which successfully avoided being hurt by a 13% rise in the value of the euro against the dollar in 2003 – unlike rival Volkswagen, which had to take a €400 million hit because of bad hedging decisions.

SPECULATORS (Hedge Funds, CTAs, Prop Desks, COMs)

Speculative traders come in all shapes and sizes and tend to be the most interesting bunch in the FX world. Their primary aim is to generate profits through their views on the market, as opposed to simply collecting transaction fees (brokers) or using FX as a means to an end (corporates). The big players in this group include prop desks (banks trading their own proprietary accounts), hedge funds, commodity trading advisors (CTAs), and currency overlay managers (COMs). These traders have an appetite for risk and a put-your-money-where-your-mouth-is mentality, but their use of leverage also means that they are more prone to "blowing-up" than other participants. Along with dealers, they are responsible for the majority of intra-day moves.

CENTRAL BANKS

The central banks of the world act as the administrators of the FX market. Each national bank is responsible for their currency, and it is no secret that they often play active roles "nudging" the market in their preferred direction. Central banks are loathe to see their currency being used for speculation, and although their primary aim in the FX world is to reduce harmful volatility, if fundamental imbalances exist they will sooner or later be reflected in the exchange rate. Since CBs love to see speculators get hurt, interventions in the market are made at strategic moments to catch the market off-guard, and smaller countries may choose to close the doors to speculators altogether by limiting capital flows.

THE FOOD CHAIN

FX participants are arranged in a certain pecking order that ensures that the top rung always feeds on the bottom dwellers. In this world, the bottom rung of the food pyramid is occupied by the "public", usually customers whose field of expertise lies outside trading currencies (corporates) or unsophisticated market participants (retail). Since everybody feeds off the public (especially banks and brokers) this is not where you want to be, and if you are a retail trader paying a 5 pip spread for a 20 pip trade then you immediately fall into this category.

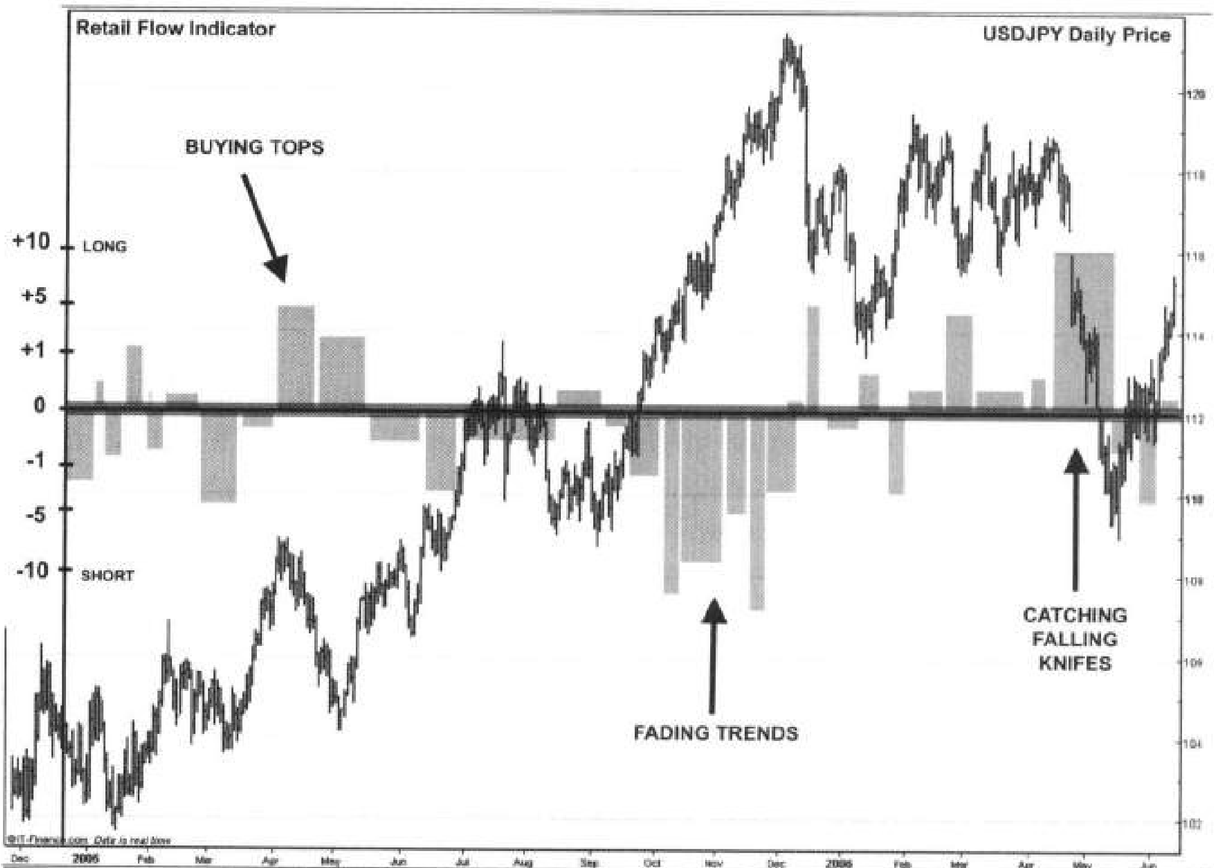
Hedge funds and other sophisticated speculators, on the other hand, are at the top of this food chain. Due to their speed and market insights, these advanced players are able to prey on banks and brokers that are more concerned with collecting spreads than identifying arbitrage opportunities. It's a speculator's duty to take some of the bank's risk-free profits and pocket them for themselves.

Because a player's positioning on the food chain is dictated by their level of information and speed, retail investors unfortunately often have a hard time overcoming the disadvantages that keep them at the level of the "public".

THE ROLE OF THE SMALL SPECULATOR

Small speculators occupy a very peculiar position in the FX world, and often find themselves at the bottom of the food pyramid being preyed upon by more experienced players. Although the odds are stacked against them, some retail traders do, however, manage to overcome the odds with a mix of confidence and skill that any bank trader would envy. Such is the story of Yukiko Ikebe, a 59-year-old housewife in Tokyo who was recently indicted for evading income taxes from her roughly 400 million yen trading profits, a story that inspired the head of foreign exchange at Société Générale in Tokyo to proclaim: "She must have made more than us! Find her and hire her!" These outstanding individuals have learned not to "fight" the market, because the market is certainly not fighting them, so they instead focus their attention on taking whatever the market is willing to give them, and going by Mrs Ikebe's example it is apparently quite a lot!

Unfortunately these bright stars seem to be few and far between, since the vast majority of retail spot FX traders are just not very good in the long run. After all, if market makers profit by trading against their client base, then their client base must be wrong most of the time for them to make money. Retail traders in any market make great contrarian indicators, and their positioning is in fact a valued commodity that is actively traded upon by many funds and money managers. Although you may think their chances of success are 50/50, somehow amateur traders have the innate ability to pick tops and bottoms and consistently get chewed up by the market because of their misguided trading decisions and lax money management rules (see below).



MIGFX's proprietary sentiment indicator overlayed on USDJPY chart. Retail flow data is shown in grey bars. Retail trader's relative positioning (long/short) is indicated by the distance from the zero line, with flow-size reflected in bar width. Notice retail trader's extreme positioning tends to correspond to market top/bottoms(arrows).

Retail positioning data provide a great contrarian indicator.

This chart illustrates some of the erroneous logic that is habitually exhibited by the retail crowd and exploited by professionals. Creative Technologies (CREAF) is the maker of the "Zen" mp3 player, commonly seen as the biggest competitor to the iPod. Of course, being number two does not count for much in a market dominated by Apple, and the stock price has reflected this sentiment by trending lower for much of the year. One day in late August, however, Creative announced after the bell that it had won a patent-infringement lawsuit against Apple and that it would receive a one-off payment of $100 million in the settlement.

On the back of the great news, Creative's stock gapped higher the next day and traded as high as 7.60, having closed around 6.00 the previous day. The volume traded was almost ten times the daily average, indicating large retail participation. Dealers were well aware of the news, but maybe surprisingly they begin to sell soon after the opening bell (they were selling while the masses were buying). Why did they choose to go against the tide? If you look at the bigger picture you soon realize that although $100 million may be a nice chunk of change, it will in no way alter the prevailing trend – i.e. the iPod will continue to dominate the market. If the lawsuit had changed the fundamentals of the industry (forcing Apple to stop producing their product, for example) then their reaction would probably have been different, but in this scenario they were happy to sell all day long to the unsuspecting buyers and finish the day with a healthy profit when the buying subsides and the price returns to its pre-news level.

Dealers in any market know how to make money off retail traders.

The trend is obvious, and the market has clearly decided that Apple has brighter prospects.

II

THE RETAIL SIDE OF THINGS

"A broker will only make you broker"

Wall Street saying

Retail FX is not interbank FX, no matter what any broker may want you to believe. The prices are not interbank, the size is not interbank, the counterparty is not interbank, and the rules are not interbank. So what exactly about it is interbank?

How a retail FCM's profits are divided

The generous spread paid by retail traders is the bounty divided up by your broker, the manager of your account, and some large banks. Their motivation is obvious, since the more you trade, the more they make. In a scenario like this, who's looking out for your best interests?

7
Card Stacking

Retail participation in the FX market is nothing new. Before the advent of the euro, Europeans were accustomed to dealing with foreign exchange all the time, and anyone who has lived in a country with a volatile currency will tell you that they always like to keep one eye on the exchange rate. In the UK, spread-betting shops have long offered "punters" the chance to bet on exchange rates[1] and in Asia "Japanese housewives" and their $10 billion of daily trading have been the bane of market professionals for some time, yet the real explosion in on-line currency trading that we have seen in the last five years can be directly attributed to the deregulation in US markets.

Throughout the 1990s, US futures exchanges complained to the government that they were drowning under a mountain of red-tape and outdated reporting measures, which increased their transaction costs and stifled their growth. In order to help the exchanges streamline their operations, the CFTC[2] passed the Commodity Exchange Act and Commodity Futures Modernization Act (CFMA). Under the CFMA, over-the-counter markets were kept exempt from US government oversight and some of the more restrictive regulations on futures exchanges were removed to ensure their global competitiveness. This, combined with the internet revolution, opened the doors for FX brokers (also called FCMs) to target a retail audience and begin offering on-line margin trading accounts. Retail FX brokers thus gained legitimacy by placing the "regulated by the NFA" logo on their website, and the power of the internet meant that these start-ups needed little more than a Reuters line and a toll-free number in order to compete with traditional brokerage houses.

The early years of the retail FX market featured a number of rag-tag outfits consisting of over-caffeinated dealers in tiny Manhattan offices offering their clients spreads wide enough to drive a truck through, and most would surely have continued to live an uneventful life had it not been for the collapse of the internet bubble.

[1]Fittingly, these operations fall under the umbrella of the UK's gambling laws.

[2]Commodity Futures Trading Commission.

With the burst of the bubble, FX brokers now had what they had been lacking all this time: a client base in love with day trading that was dying to try something different. The three or four firms that recognized this opportunity and focused all of their attention on their marketing efforts quickly became the market leaders and have never looked back.

These retail operations that have mushroomed in the last five years sit in a still-to-be-defined gray area within the FX market. In theory they should act as little more than middlemen between the true interbank market and their retail client base, but unfortunately because of the nature of the FX market and the lack of regulation some of these outfits bring to mind the unscrupulous "bucket shops" that operated in the early part of the 20th century.

In a time when stock market euphoria was gripping the nation, the typical bucket shop of the 1920s catered to the small investor with big dreams but little market experience. All of the transactions they handled were off-exchange (with the firm taking the other side of all trades), and in order to increase speed customer orders were simply taken at the counter[3] and dumped into a "bucket", to be matched and filled at a later point. Because the orders where not immediately offset in the market, the shops could either wait until the price moved in their favor before filling them (keeping the difference) or wait until the end of the day to match buys and sells at their own "adjusted" price. The dealers that ran the shops knew that in a time of delayed quotes and nontransparent pricing, clients had little way of knowing where the market stood at the exact moment they placed their orders, and thus they would likely be satisfied as long as their orders were filled within the high/low of the day. Because of these advantages, bucket shop operators found it relatively easy to shade prices and take large chunks from both the buyers and the sellers.

Unfortunately, today's retail FX brokers share many traits with these outlawed operations, including:

Nontransparent pricing. The FX market is an over-the-counter market, meaning the price your broker gives you is the price you get. You have no choice in the matter. Pricing is not done through a central exchange, so it may be difficult for the trader to determine if their broker is quoting them "fair" prices or if they are shading the price in their favor.

Encouraging overleveraging. Like the bucket shops, retail FX brokerage firms prey on the small, unsophisticated investor. By extolling the virtues of 200-1 leverage, traders are encouraged to overexpose themselves and be quickly wiped out by small price moves.

Trading against your clients. It is standard practice in the FX world to trade against your client base. Retail trade sizes are too small to be immediately offset in

[3]Hence the term over-the-counter (OTC) for nonexchange transactions.

the interbank market, so your broker is forced to take the opposite side of the trade, at least temporarily. The broker may then wait until the client flow is sufficient to offset with their market maker or they may choose to hold the position and effectively trade against their clients. A "no dealing desk" policy simply means that dealers have been replaced with machines, but the fact that they trade against you remains.

> **Order book information typically available to your market maker:**
>
> Real-time summary of client positions.
> Average cost of open positions
> Size and P/L of all open trades
> Outstanding orders
> Location and size of stops
> Flow information
> (who has been buying what/where)
> Real-time positioning of large clients
>
> This information is actively traded upon and often shared with 'preferred' clients/partners.
>
> Ask your broker why all clients aren't given access to this information..

Unfair practices. Although the odds were stacked against the bucket shop client, smart traders could, and did, make money from them. Jesse Livermore,[4] for example, became so good at picking stocks that he was soon banned from all the bucket shops in the East Coast. Casinos do not like winners and neither do FX brokers. A casino may send a crooked dealer to stop the winner's streak and retail FX firms may resort to denying service or complicating execution to such a degree that it makes trading impossible. If anything, this should be a clear sign that your broker is trading against you, since it becomes evident that your broker is losing money if you are posting profits.

The question that comes to mind is, "Why would brokers behave in this manner? Isn't it in their interest to see traders prosper and have them as long-term clients?"

[4]Commonly known as the "greatest trader of all time" for his tape-reading ability and his correct timing of the stock market crash of 1929. After a series of ups and downs Livermore ended up taking his own life in a NYC hotel room in 1940, helping solidify the notion that great traders often make for miserable individuals.

The simple answer is "no". Since statistics show that most traders blow-up their accounts before reaching their first anniversary, it is in a broker's best interest to get as much as they can as quickly as they can. There is no such thing as a "long-term" relationship between a market maker and his clients, and while the degree of dodgyness may vary from shop to shop, the capital markets were founded on greed, not charity. Stories of big investment banks ripping off large corporate clients routinely make the news, so is it really any surprise to hear that retail traders do not fare any better? Since dealers routinely change jobs and live on a day-to-day basis (or bonus-to-bonus, actually) it should come as no surprise to learn that they focus purely on short-term profits. A trade is a trade and a deal is a deal, so do not expect any sympathy from your broker/dealer anytime soon. After all, he is not exactly selling ladies shoes, either. A dealer's job is a risky one, and he knows that if you could, you would probably rip him off in a second, so why should he treat you any differently? Although I am sure squeaky-clean shops exist somewhere, I have yet to come across any.

MARKETING MACHINES

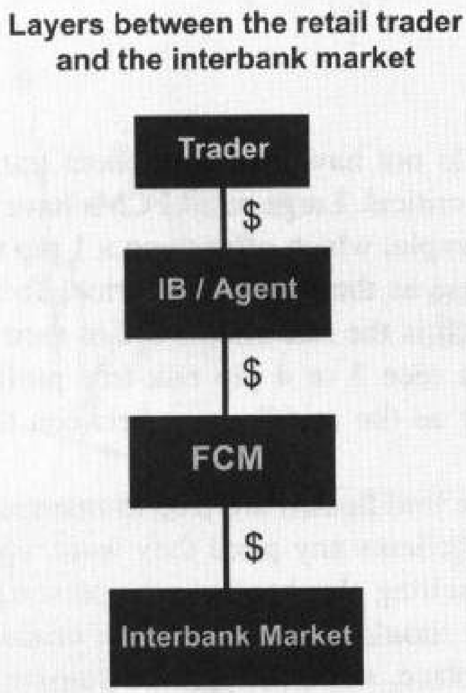
Traders have to realize that behind all of the smoke and mirrors retail FX brokers are, above all, marketing machines. The more accounts they open, the more money they make. Because the average survival rate for traders is so low, in order to survive they need a constant flow of new or returning clients, and although some brokers may claim to have over "50K+ clients" in reality the vast majority of those accounts have been dead for quite some time. The actual figure is probably closer to a 10 % retention rate, and even the people running the trading houses have no problems discussing the dreadful odds their clients face. According to Drew Niv, chief executive of FXCM, "If 15 % of day traders are profitable, I'd be surprised."[5]

To secure this constant flow of clients, brokers spend vast amounts of money on marketing schemes that I am sure you have been the target of in the past. They will try everything from huge internet advertising campaigns to direct mail offerings, even going as far as holding trading "conferences" or "seminars". In the end, you can rest assured that they want a return on their investment: your money.

Take, for example, their much-hyped "forex trading contests" that promise to reward the best traders with monthly cash prizes. What could possibly be wrong with rewarding good traders? A lot, actually. Trading contests and dreams of a large payoff place people in direct competition with each other, which, as you may know, tends to only encourage risk taking and lead to terrible money management decisions. If you are trading to beat your neighbor, not simply to make money for your own account, then you can rest assured that you (and your neighbor) will soon find yourself broke. Even if we manage to put aside the ethical dilemma these contests

[5]Currency Markets Draw Speculation, Fraud. *Wall St Journal*, 26 July 2005.

bring up and focus squarely on the dollars and cents, we still find brokers coming out on top even when they are the ones paying out to traders on a monthly basis.



Each layer represents an extra cost. The more layers between you and the market, the higher the costs.

Going by the figures posted by one prominent broker in their "mini" trading contest, four hundred participants with a minimum of $500 in their accounts were involved in the monthly trading contest, which gave out cash prizes to the top three performers ($2500, $1000, and $500) as measured on a monthly percentage return basis. Out of the four hundred accounts, the top three winners all recorded monthly returns in excess of 200 %. Most probably these guys simply leveraged their accounts to the max, picked a volatile pair, closed their eyes, and bought. Not much skill was involved in that brilliant strategy. The really interesting part comes when we shift the attention away from the winners and focus instead on the results of the rest of the field. Out of four hundred participants, less than 150 finished the month above breakeven (a surprisingly high number, actually), and the rest finished with a losing record. Of those with losing records, 55 recorded losses in excess of 95 %; in other words, their accounts were completely wiped out. Now if we compare the payout the broker made to winners ($4000) versus the accounts that were blown-up (at least $27 000) you quickly get an idea of who exactly the winners in this game are. This type of game where lots of small accounts vie for a big payoff is not new; it is usually just called a lottery.

In this sense, forex brokers are simply great at twisting the truth and transforming the laughable into something deemed valuable by traders. Such is the case with their now-popular "hedging" capability. Who else could convince traders that paying twice the spread simply to be flat is actually of benefit to them? These guys should run for Congress!

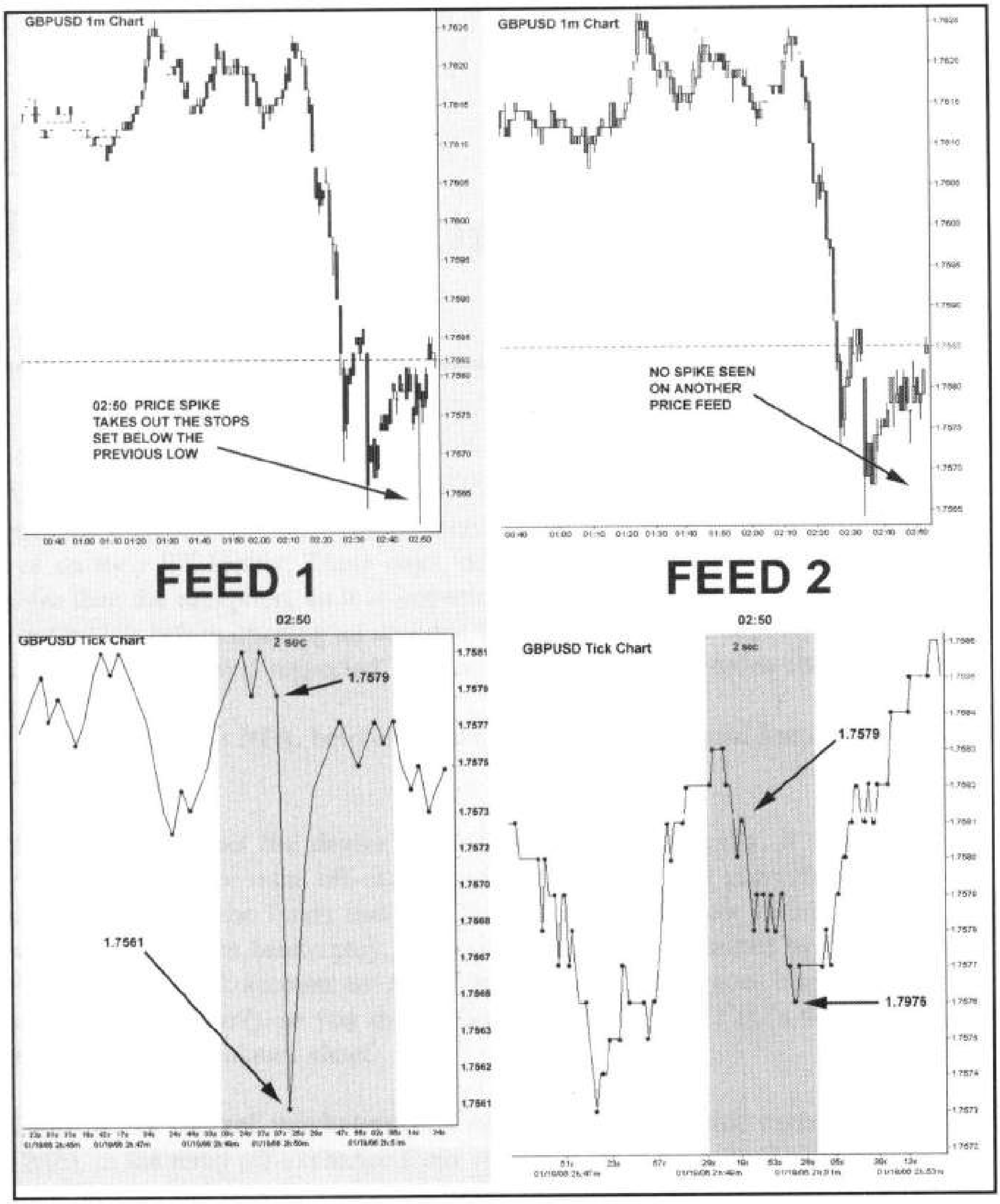
PRICING

Since retail FX brokers do not have to offset client transactions in an exchange, pricing decisions become critical. Large retail FCMs have their own market makers, a Citi or Goldman for example, which offer them a 1 pip spread or less on the most liquid pairs, which they use as their indicative price. To this rate, they add their 2 or 3 pips (or more!), which is the rate clients see in their trading platforms, which enables them to capture a nice 3 or 4 pip risk-free profit on a round-trip trade – not bad for simply acting as the middle man between the FX "wholesalers" and the retail buyer.

However, because these middlemen are free to manipulate their price feed, they can essentially show their clients any price they want, and the same person that is doing the buying and the selling also becomes the person that controls the prices. If this smells fishy to you, it should; after all, it is the primary reason why exchanges were created in the first place, since the lack of transparency always plays into a dealer's hands.

Price shading occurs when a broker either deliberately stalls their price or shows slightly higher/lower rates in anticipation of a move. If a broker is convinced that the euro is going higher, for example, he will shade his quotes slightly higher to benefit from the move. This is all fairly common practice in the FX world, yet even more appalling manipulation takes place when brokers deliberately spike their feed in order to take out customer orders. If a dealer notices that a bunch of good-sized stops have gathered nearby (remember, they know where your stops lie!), he may choose to mount an attack on them with his buddies or momentarily spike his price feed just enough to take them out.

Naturally, the move will be seen as single blip, not enough to be traded on, but enough to trip the client stops (see below). If a client complains, brokers are shielded by the fact that there is no central exchange from which to compare second-by-second pricing, and are free to offer up any excuse for the move: "There was a large order that pushed through the market" or the classic "Our feeds are faster and reflect true interbank movements." In reality what they are dying to tell you is, "Thanks for noticing; that was a great move! We nailed you!" I'm sure most retail traders have experienced such infuriating behavior, but the nature of the market makes it hard to enforce such downright fraudulent actions.



An example of price manipulation. With two feeds from two different FX brokers, you can see how at the same moment one price spikes while the other one does not.

8
Don't Trust Your FCM

As the Chinese general Sun-Tzu once said, "Keep your friends close and your enemies even closer." All traders should heed this advice and keep a watchful eye on their FX broker. These days, dodgy activity seems to be more often the norm than the exception, so it is imperative to conduct your own due diligence on your broker before opening an account. Do not assume that because they proclaim to be large and "well respected" in the industry that that makes them upstanding guys.

According to the NFA, before choosing a broker you should keep some of these things in mind:

You are relying on the dealer's creditworthiness. Basically, if they go down, you go down. Since retail off-exchange forex trades are not guaranteed by a clearing organization, the funds that you have deposited are not insured and do not receive a priority in bankruptcy. Even customer funds deposited by a dealer in an FDIC-insured bank account are not protected if the dealer goes bankrupt (remember REFCO anyone?), so you should first check with the CFTC's website and see the state of their balance sheet.

There is no central marketplace. Unlike regulated futures exchanges (CBOT, CME), in the retail off-exchange forex market there is no central marketplace with many buyers and sellers. The forex dealer determines the execution price, so you are relying on the dealer's integrity for a fair price.

The trading system could break down. If you are using an internet-based electronic system to place trades, some part of the system could fail. In the event of a system failure, it is possible that, for a certain time period, you may not be able to enter new orders, execute existing orders, or modify or cancel orders that were previously entered. A system failure may also result in loss of orders or order priority.

You could be a victim of fraud. As with any investment, you should protect yourself from fraud. Beware of investment schemes that promise significant returns with little risk. You should take a close and cautious look at the investment offer itself and continue to monitor any investment you do make.

At the time of writing, third-party solicitors for retail spot forex trading were still not subject to regulatory oversight, and may make misleading statements and false promises to their heart's content. A Google search on the term "forex" will quickly reveal all kinds of scams and false promises made possible by lax government oversight.

OVERSIGHT

NFA Compliance Rule 2-36(b)(1) states that:

> No Forex Dealer Member or Associate of a Forex Dealer Member engaging in any currency futures or options transactions shall cheat, defraud or deceive, or attempt to cheat, defraud or deceive any person.

However, one quick visit to the NFA, CFTC, or FSA (UK) websites reveals that some of the largest retail FCMs have been reprimanded for things such as:

- Claiming slippage-free execution, guaranteed fills on stop-loss and limit orders and price guarantees on market orders, when in fact the FCM did not provide any of the above.
- In times of volatility, changing the execution trade price post-fact after it had already been confirmed to customers earlier in the day.
- Continuing to advertise "slippage-free" execution even though they knew it was not possible.
- Advertising "commission-free trading", implying that the FCM does not make any money from the transactions.
- Employing nonmember third-party solicitors using misleading promotional materials to solicit customers.
- Claiming that "customer funds are segregated and safe at all times" when in fact they are not.[1]

[1] You can check your broker instantly using NFA BASIC (http://www.nfa.futures.org/basic).

Even if they do get caught, most firms are let off with a slap-on-the-wrist fine and never have to admit any guilt. The problem is that although it is a valuable institution, in the end the National Futures Association is a self-regulatory agency, and asking forex brokers to "self-regulate" themselves is like asking athletes to self-regulate themselves for steroid abuse. It is just not very effective.

The Commodity and Futures Trading Commission, on the other hand, is the government-sponsored body that oversees all exchange-related activity in the US (FSA in the UK). These are the guys that send crooked dealers and ponzi schemes to jail, but their FX oversight is limited because of the spot market's over-the-counter nature. The CFTC is set up to regulate exchange-traded markets, so in FX they can do little more than enforce outright scams and fraud.

The one way that the CFTC and NFA have found to effectively push the smaller FCMs out of the market is by enforcing the minimum net capital requirements, which up until recently have been little more than a joke. Because the rise of the retail forex market caught regulators sleeping, loopholes in outdated 30-year-old minimum funding regulation enabled new FX brokers to establish themselves with little, if any, capital. These fly-by-night outfits (often companies repeatedly created, and closed, by the same individuals) were opened with as little as \$250 000 in capital, and could therefore not withstand even the smallest adverse turn of events before going under. Although this should have scared the daylights out of their retail clients with millions of dollars in nonsegregated trading accounts, most of the time they were blissfully unaware of the consequences (until it was too late) due to a lack of awareness programs. The subsequent bankruptcy of several small brokers (that took their client's money with them) finally led the government to raise the minimum net capital requirement and begin to crack down on these woefully underfinanced operations.

As of now, the minimum net capital requirements have been raised to several million dollars (see Notes section for the full regulation) and the once-nonexistent audits have been stepped up dramatically. A futures commission merchant who is not in compliance with these requirements has ten business days to achieve compliance or immediately cease doing business and go into liquidation, which still leaves retail clients out in the cold. Slowly but surely this has begun to weed out most of the dangerously under-funded brokers, yet many more "borderline" brokers still remain. The only way to ensure the safety of your funds is to only trade with brokers who are well above their minimum capital requirements. FCMs are required to file monthly reports with the CFTC stating their current finances, but remember that since these reports are only audited once a year you are for the most part relying on your broker's word.[2]

[2]A full version is available online: http://www.cftc.gov/marketreports/financialdataforfcms/index.htm.

As of 31 May 2007, this was how the major FX brokers stood:

In good standing	Borderline
FXCM $51 000 000	Money Garden (MG) $3 399 844
GFT $48 000 000	Forex Club $3 304 000
Oanda $44 000 000	MB Futures $3 080 000
FX Solutions $20 000 000	GFS Futures & Forex $3 074 000
Gain Capital $20 000 000	Nations Investments $1 699 000
CMS $10 000 000	Velocity4X $1 587 000
	SNC Investments $1 565 000
	Direct Forex LLC $1 523 000
	FiniFX $1 464 000
	One World Capital $1 105 000
	Royal Forex Trading $1 102 000
	FXDD $781 000

The bottom line is that today's retail spot FX market is the Wild West of the investment world, where virtually anything goes. Government oversight of such a complex and fundamentally OTC market is very hard to implement, but if the shoddy dealings continue then look for much tighter regulations to be implemented down the line, although the retail FX brokers will surely not go down without a fight. In fact, FX brokers are raking in so much money these days (hundreds of millions of dollars) that they have even hired their own lobbyists to keep government at bay. You know you have hit the big time when you can afford to buy a lobby!

DEMAND CHANGE

For the retail trader to get a fair shake, the deceptive dealings (long outlawed in most other markets) must simply come to an end. How can the FX brokers defend their actions (some of which call for jail time in other markets) and continue to tell the general public that intra-day FX trading is a great "investment" and deeming it "easy"? How can they continue to do business with people that solicit clients through false marketing and fraudulent claims?

New regulation needs to be put into place that will guarantee transparency in pricing and safety of funds to the retail client, but it is up to the average trader to plant the seeds of change by complaining vigorously to the government authorities at the slightest hint of dishonorable dealings. We will all be in a better place once a fair set of rules are adopted that lets both brokers and traders flourish. After all, fair dealings should be every broker's duty, not choice.

9
Third-Party Services

The retail FX market's rise in popularity has created a whole new side-industry focused on providing a range of services geared toward the retail trader. Hundreds of companies now offer clients great money-making trading signals or programs, and hitherto unknown market participants have now suddenly become recognized market "experts" eager to dispel their boundless wisdom to traders (for a fee, of course). Needless to say, the actual services they provide leave much to be desired.

Let me put it this way: if you had a proven, money-making FX trading system would you sell it to the general public? If you had a proven system that accurately predicted winning lottery numbers, would you sell it for $50 a pop? Probably not. Hedge funds and private traders spend millions of dollars developing and safeguarding their trading systems, but you can still find hundreds of different trading programs for sale on the internet or trading magazines. Common sense tells us that these "systems" are probably not very good to begin with.

When looking at third-party providers, it is good to be more than a bit skeptical of their services. For example, if the "guru" you are looking at does not trade his own recommendations, then what is his downside? If the results cannot be verified (note that simply posting them on a website is not verifying them!) then what is the point?

IF THE SUBSCRIPTION IS FREE, HOW DO THEY MAKE MONEY?

To ensure that you are getting a fair shake, it is best to make sure that the "expert" or "system" has no relationship with any broker. A dead giveaway is them asking you to trade with their "preferred" broker, which is just another way of saying that they make a pip or two out of every trade that you place. You want to steer clear of anyone making money from your trading, since at the end of the day they do not care if you win or lose money; they just want you to trade.

Looking around the internet I have also seen many "mentors" popping up, who offer to show traders the ropes in exchange for a fee. Although the practice of mentoring has long been established in the markets, paying someone for this kind of service is simply a bad idea; all you have to do is understand their motivation.

When a new trader joins a firm he will pair up with a more experienced trader who will teach him how to become a great trader. The motivation there is simple: they have a vested interest in seeing their pupils succeed because of the time and money they have invested in them, and the hope is that they make millions for the whole company. Now compare that to mentors offering to teach you for a fee. What is their motivation? To make their pupils succeed or to simply generate fees? If this mentor/trader is so great, why is he teaching random strangers? The truth is that before these guys became popular FX gurus, they were selling miracle brooms on infomercials. In the real world, mentors *choose* their students, not the other way around.

The best mentors you can possibly find are friends or acquaintances whom you know to be good traders, since they have verifiable results and their motivation is clear.

SCAMS

According to the CFTC, the amount of FX scams has skyrocketed in the last few years. This is a direct result of the increase in popularity of forex trading and the lax oversight by government agencies. A quick web search is enough to show the full range of forex scams out there, some promising 1000 % return with no risk! Before entering into any investment scheme, every investor should regularly check the CFTC's website and also make a point to regularly check www.futuresbuzz.com for the latest industry news and FX scams.

THE GOOD GUYS

Therefore, if looking for a second opinion, who do you trust? There are many great analysts and third-party services out there; you just have to make sure you pick the right ones. A whole community of professional technicians, economists, and analysts exists to service the institutional trading industry, providing innovative trading ideas or market advice. The difference is that they make their money through their calls (reputation) not through your trading (by getting referral money from the broker). I have personally used several subscription services in the past, with varying results, but have noticed that good services have a few things in common:

- **First, they are not cheap.** As the saying goes, you get what you pay for.
- **Second, they have a track record.** Not just a cool website.
- **Third, they have real-world FX trading experience.** They can be ex-prop traders, dealers, treasurers, etc. Basically they know how the real FX world

works, and take into account the manipulation, aberrations, and "irrationality" that sometimes prevails in these markets.

- **Fourth, there is a time and money-management aspect to their analysis.** It is useless to tell the average trader that the euro will drop to 1.20 if first they have to go through 300 pip gyrations and wait for three months. Opportunity cost is a real cost for most traders with limited liquidity. The last thing you want to do is have your equity locked in a trade that is not moving while bypassing other (maybe better) trading opportunities.

The bottom line is that every great trader has paid their "tuition" to the market, usually in the way of years and thousands of dollars. Don't expect much from a $19.99 system. Success is the direct product of hard work and determination, and you have to learn to trust your own analysis and trading skills. Remember that self-confidence is a hallmark of all great traders.

RULE 1. Never take the advice of someone who is not willing to put money behind their so-called analysis. If they are not willing to take a hit, then what is their downside to making a prediction?

RULE 2. Never listen to anyone "talking their book". Most jokers on chat forums are sitting on positions deep underwater and are desperate to get out. Any advice they can possibly give you is losing advice and should be used as a contrarian indicator if anything. Even the big names routinely talk their book. When Bill Gross of PIMCO (biggest bond trader in the world) appears on CNBC to give his views on the market, do you really think he is going to say something that goes against his positions?

10
Fighting Back

If you are feeling discouraged having realized just how far the odds have been stacked against the individual trader, rest assured that there are a few simple measures that can be immediately implemented to gain back some of the lost ground. The brokers may have initially gained the upper hand, but they have by no means left the retail trader without recourse.

USE DIFFERENT PRICE FEEDS

If you use the same price feed on your trading platform and your charting applications, then you are essentially trading with blinkers on. By limiting yourself to your FCM's artificially created bubble, you are giving up the power to become judge and executioner. Your stops may be run or you may trade off manipulated prices, but you would never realize that the moves did not correspond to the general market.

As a trader, you want to remain at all times objective and have as broad a view as possible of the market, something that cannot be accomplished using a single feed. Having a second or third feed is your way of getting a "second opinion" on the market and gives you a way to confirm the price action. Your platform feed should only be used for placing trades, but your strategy and analysis should rely on the purest, most unbiased price feed you can find. Most retail traders do not have the luxury of trading with a Reuters or EBS feed, but rest assured that alternative sources can be found. Every trader should spend some time comparing different feeds and charts to see how they perform in fast-moving markets when retail platforms regularly freeze their prices (and notice that demo feeds are different from live feeds). Having a stable and faithful charting application is especially vital to all short-term traders.

Do a search for yourself and find one that suits your needs, but remember that most of these "informative" websites are actually run or sponsored by brokers, so make sure that you know where the price feed is coming from. It may be worth the