Strategies, analysis, and news for FX Traders

CURRENCY TRADER

July 2007
Volume 4, No. 7

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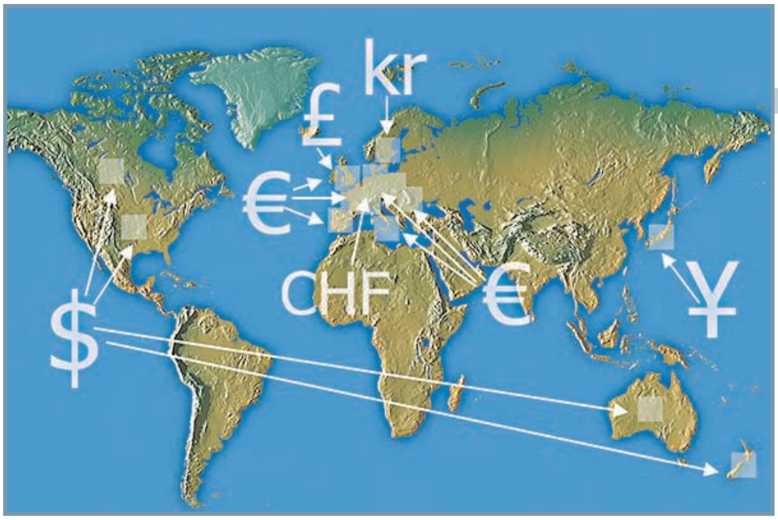

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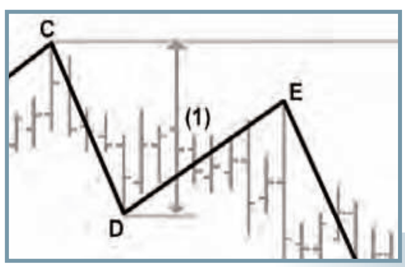

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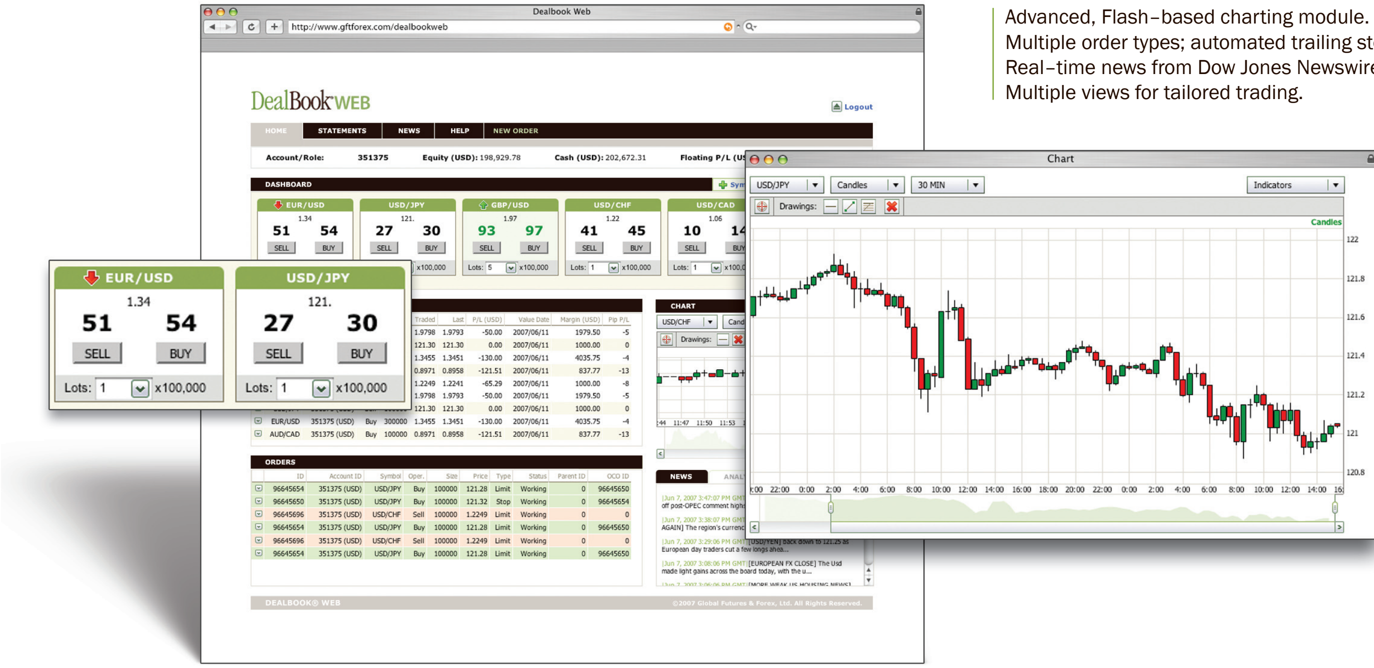

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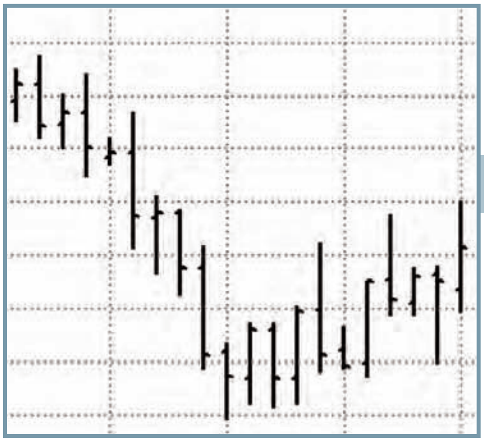

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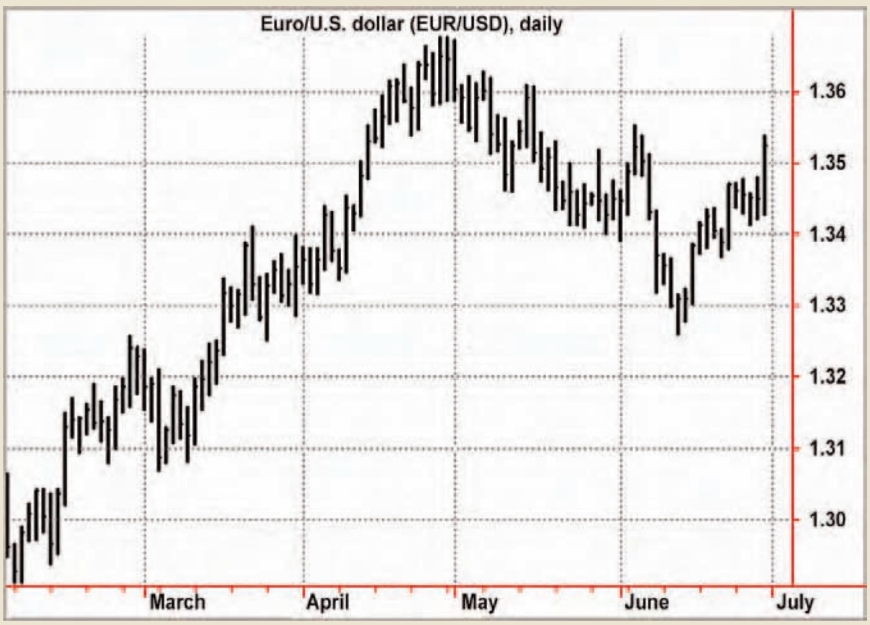
Shifting perceptions drive euro/dollar action

The euro/U.S. dollar spread flirted with an all-time high several weeks ago, but a stronger U.S. economy is pushing things back toward the greenback. However, interest rate expectations are one of several factors that will affect price going forward.

BY CURRENCY TRADER STAFF

FIGURE 1 — EURO RALLY

A strong increase in the euro vs. the U.S. dollar in late April produced near all-time highs before the dollar recovered slightly in May and early June.



Source: TradeStation

After steady gains in the euro/U.S. dollar (EUR/USD) stalled near all-time highs in the $1.36-1.37 zone in late April, shifting perceptions on Fed policy sparked a U.S. dollar rally into mid-June (Figure 1).

"The euro has been drifting lower since the end of April," says Jim Glassman, senior economist at JP Morgan Chase. "There has been a shift in perceptions that the U.S. is not as weak as people had thought. Back in February, people had been talking about recession."

However, the Fed's decision to leave U.S. interest rates unchanged on June 28 gave new life to dollar bears in late June.

Heading into mid-summer, most economists agree growth-rate differentials are improving in favor of the U.S. However, the key to EUR/USD strength and direction in the weeks and months ahead will depend on whether the stronger growth forecast for the U.S. in the second half pans out and how high the European Central Bank (ECB) pushes its repo rate later this year.

EURO/DOLLAR AT A GLANCE

Average EUR/USD daily range (past 40 days):	0.0059	
Average EUR/USD weekly range (past 26 weeks):	0.0155	
52-week high/low:	1.3680/1.2458	
	EUR	U.S.
Prevailing interest rates (%):	4.00	5.25
Next central bank meetings:	July 5, 19	Aug. 7

GDP (annualized growth)	**Q1 2007***		**Q4 2006**		**Q3 2006**		**Q2 2006**	
	EUR	US	EUR	US	EUR	US	EUR	US
	3.0	0.7	3.3	2.5	2.8	2.0	2.9	2.6

**Estimate*

Top or pause?

The euro/dollar hit its 2007 low early in mid-January around $1.28 and began to rally toward $1.36, driven higher by concerns about the U.S. economy (Figure 2). The greenback weakened amid a backdrop of disturbingly low growth in the U.S., which was weighed down by a recession in the housing market and a major inventory overhang in both the housing and auto industries.

Speculation was rampant within the financial markets regarding U.S. Federal Reserve rate cut action during the first several months of the year. Economists and traders thought the Fed might have to cut monetary policy to support limping growth numbers. Traders had priced one and even two rate cuts in the U.S. in 2007 into early April.

In the first quarter of 2007, the U.S. posted its slowest growth in more than four years with a 0.7-percent (year-over-year) gross domestic product (GDP) reading. The U.S. actually under-performed the Eurozone's robust 3.0-percent first-quarter GDP reading.

The retreat in the housing sector was a big weight on GDP growth. David Powell, currency analyst at Ideaglobal, notes that in the first quarter residential fixed investment plummeted 15.4 percent on an annualized basis.

"That was a huge drag on U.S. GDP," he says.

U.S. pulling ahead?

According to Jonathan Basile, economist at Credit Suisse, growth is likely to pick up in the second quarter. His firm has a 3.2-percent GDP forecast for the U.S. in the second quarter. JP Morgan Chase forecasts a 2.8-percent GDP growth.

Overall, Tim Rogers, chief economist at Briefing.com, expects total 2007 GDP growth in the U.S. between 2.5 and 3.0 percent.

Economists say while the housing

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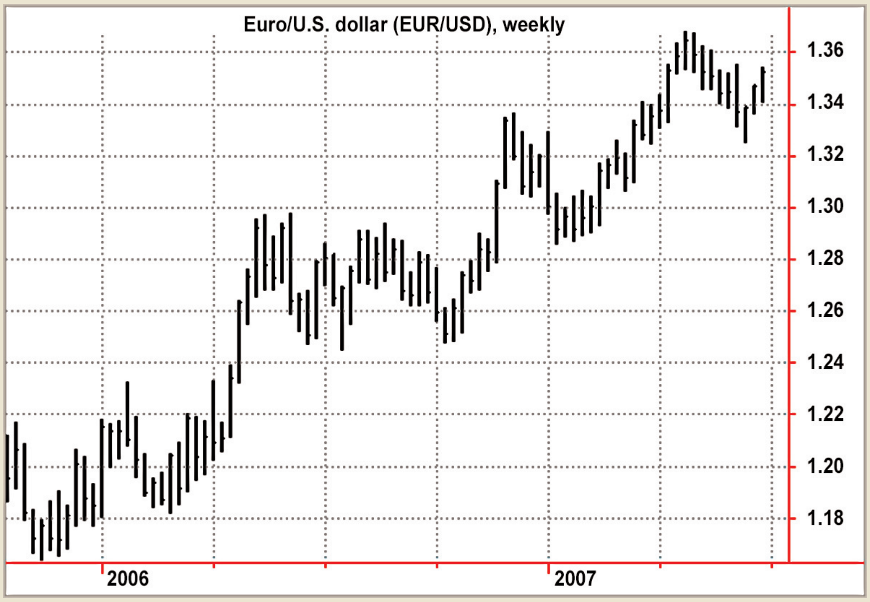
FIGURE 2 — LONG TERM RALLY

The euro/dollar pair pulled back after topping 1.3600, but it was still in a good position to extend its long-term rally in late June.



Source: TradeStation

> "While the eurozone is seen as peaking now and declining in 2008, the U.S. economy is seen as bottoming in the first quarter and improving."
>
> — David Powell, Ideaglobal

sector has, at best, stabilized, demand has picked up in the manufacturing sector, and there are signs that the inventory correction is ending.

Basile's overall GDP forecast for 2007 is 2.1 percent.

"We lost momentum through 2006 and started 2007 on a weak note," he says. "But, things will improve."

Euro/dollar growth differentials appear to be tilting in favor of the U.S.

"While the eurozone is seen as peaking now and declining in 2008, the U.S. economy is seen as bottoming in the first quarter and improving," Powell says.

"Growth differentials are widening with the U.S. doing better," adds Chase's Glassman. "Views were very negative on the U.S., but the U.S. is getting a second wind."

That shift in perceptions helped drive the U.S. dollar higher from late April to mid-June.

Business investment may be key

How much improvement actually filters through to the actual GDP numbers, however, may be a key factor in dollar action throughout this year. Currency traders will be well advised to monitor monthly data releases. A "wildcard" that may be critical for improving conditions is the business investment sector, Basile says.

"How strong the economy will perform may depend on whether companies invest at an increasing rate," he says.

Basile adds the low point for business investment came during the fourth quarter of 2006, when it declined 3.1 percent.

"We've seen a modest reversal in the first quarter," Basile says. "It is the most important thing to watch in order to gauge the speed of the U.S. economy. It will tell you whether job growth can be sustained."

Business investment grew 2.9 percent in the first quarter and Credit Suisse forecasts a 6.3-percent reading in the second quarter.

"That is where to watch for upside surprises," Basile adds. "Business investment is a very cyclical part of the economy and carries weight in telling you how fast the economy will grow."

Oil could support surprise

Another factor for currency traders to consider is oil prices. With the U.S. in the midst of the hurricane season, disruptions to the energy infrastructure could be key. If the energy sector can avoid severe damage this year, energy prices could decline, which in turn could help boost U.S. economic growth even further.

"Energy is one area that can differentiate views on Europe vs. the U.S.," Glassman says. "Energy prices have a bigger impact on the U.S. in the short-term."

FOMC on the sidelines

Recent improvement in U.S. economic statistics triggered a wave of euro/dollar selling from the late April peak around $1.36/1.37 to the June 13 low around $1.32. Currency traders basically "priced out" expectations for one or even two Fed rate cuts between now and year-end.

Based on recent data and forecasts for improvement, most economists now expect the Federal Open Market Committee (FOMC) to hold steady at upcoming meetings, with steady policy forecasts through year-end. The federal funds rate currently stands at 5.25 percent, and it's expected to stay the same at the next meeting on Aug. 7.

Inside the Eurozone

While growth forecasts are improving in the U.S., overall views on European growth haven't changed much. Growth has been relatively strong in the Eurozone, with a 3.0-percent first quarter GDP reading. Ideaglobal's Powell notes that figure is above the Eurozone's so-called "potential rate" of growth, or the rate at which non-inflationary growth can be sustained (currently 2.25 percent).

The ECB hiked its repo rate 25 basis points to 4 percent in early June in response to the stronger-than-potential growth numbers. Economists expect the central bankers to hold steady at the July 5 meeting, but the market is pricing in an additional one or two rate hikes between now and year end to 4.25 or 4.5 percent.

"They are still stepping on the gas," Glassman says. "They've had relatively low rates, but the Europeans have a little more work to do to normalize their rates. The market thinks another 50 basis points."

Overall, economists say growth in the Eurozone has been fairly broad-based, including government spending, robust consumption, and export performance.

Germany posted a 3.6-percent first-quarter GDP reading, while Spain's growth numbers surged by 4.0 percent. Germany, one of the main engines of growth for the Eurozone, continues to boast favorable forecasts for the remainder of the year. Spain, however, may be worth watching.

"The Spanish economy has been on fire fueled by a housing and construction boom," Powell says.

Given the fast pace of growth in housing, a retreat in that sector could cause problems for Spain's economy later in the year.

The ECB has forecast Eurozone growth in 2007 between 2.3 and 2.9 percent, with a slowdown predicted for 2008 (between 1.8 and 2.8 percent).

"Ideally, they'd like growth at 2.25 percent," Powell says. "Due to structural rigidities, including labor markets and slower levels of productivity growth, their potential growth rate is slower than the U.S."

Surging money supply growth

Another number to monitor in the weeks ahead is the Eurozone M3 money supply level, which has rocketed to multi-decade highs this year. M3 is the broadest measure of money supply by the Eurozone nations and includes all currency in circulation, bank deposits, money market shares, and debt securities up to two years in duration. Generally, economists believe an increasing M3 leads to price inflation. The money aggregate targeted by the ECB has been coming in at more than 10 percent in recent months.

"The high levels of M3 growth have [the Europeans] worried about future inflation," Powell says. "Currently, M3 money supply is more than double their reference rate."

While headline consumer price index inflation currently stands at 1.9 percent, just below the ECB's 2.0-percent tar-

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get, any increases would be troublesome for the central bank.

Trading points

As of late June, the euro/dollar has staged a modest rally from the $1.32 area toward $1.3475. Near term, analysts say more upside potential is likely for the euro/dollar.

"There is a better chance of heading toward $1.3670 than $1.32 anytime soon," says Tim Mazanec, senior FX strategist at Investor's Bank & Trust. "The ECB continues to be hawkish and will hike likely twice more this year, while the FOMC will be unchanged. Interest rate movers have the advantage."

Brian Dolan, chief currency strategist at Forex.com, was "euro positive" over the near term as well. He pointed to the $1.3550 level as the next hurdle for the market. Gains through that level would open the door to the $1.3680 area, with further potential toward $1.3750 and $1.3830, he says.

On the downside, Dolan said the $1.3250 floor is key to watch and a break of that support would open the door to $1.3130.

"Over the short-term, play it from the long side," Dolan says. "Use any shakeouts that might occur from a carry-trade shakeout as buying opportunity."

Jamie Coleman, managing analyst at IFR Forex Watch, highlighted $1.3550 as a key resistance point. (The pair was as high as 1.3539 on June 29.)

"If that gets through, expect a full retracement back to $1.3680," he says.

Other factors

The euro continues to benefit from carry trade flow, analysts say. Euro/yen has continued pushing higher, recently hitting an all-time high, as global players borrow yen and buy the euro. While these flows are euro supportive, analysts caution that sudden carry-trade liquidation could spark a quick retreat in euro strength.

Another factor to watch is the recent spike in U.S. bond rates.

"If the 10-year pushes above 5.5 percent, it would draw more interest into the U.S.," Coleman says.

If that were to occur, it would be U.S.-dollar supportive.

Headed into late June, euro bulls have the edge, but major resistance at $1.3680 stalled momentum in late April. That will be a key pivot point to watch in the weeks ahead.

The hammer and the yen

It's been rumored for a while, but recent statements by Japanese finance officials make a stronger yen seem increasingly likely. Is the yen carry trade really doomed, or is this too obvious a conclusion?

BY BARBARA ROCKEFELLER

The Japanese like to say the nail poking out gets hammered back in. The yen currently is poking out and the market may be about to hammer it.

In this context, that means buying it and raising its price vs. the other major currencies, especially the current victims of the yen carry-trade — the New Zealand (NZD) and Australian dollars (AUD), the British pound (GBP), the euro (EUR), and the U.S. dollar (USD).

Many foreign exchange market themes come together in today's yen situation. The first is a potentially high-risk environment. No one knows for sure whether a Japanese monetary policy change and an unwinding of carry trades is going to force a trend reversal; however, the probability of a reversal is rising.

It's a mistake to take a position on this probability too early. High-risk situations sometimes evolve slowly and sometimes they deliver shocks. If you are positioned early and wrong, a shock can ruin you.

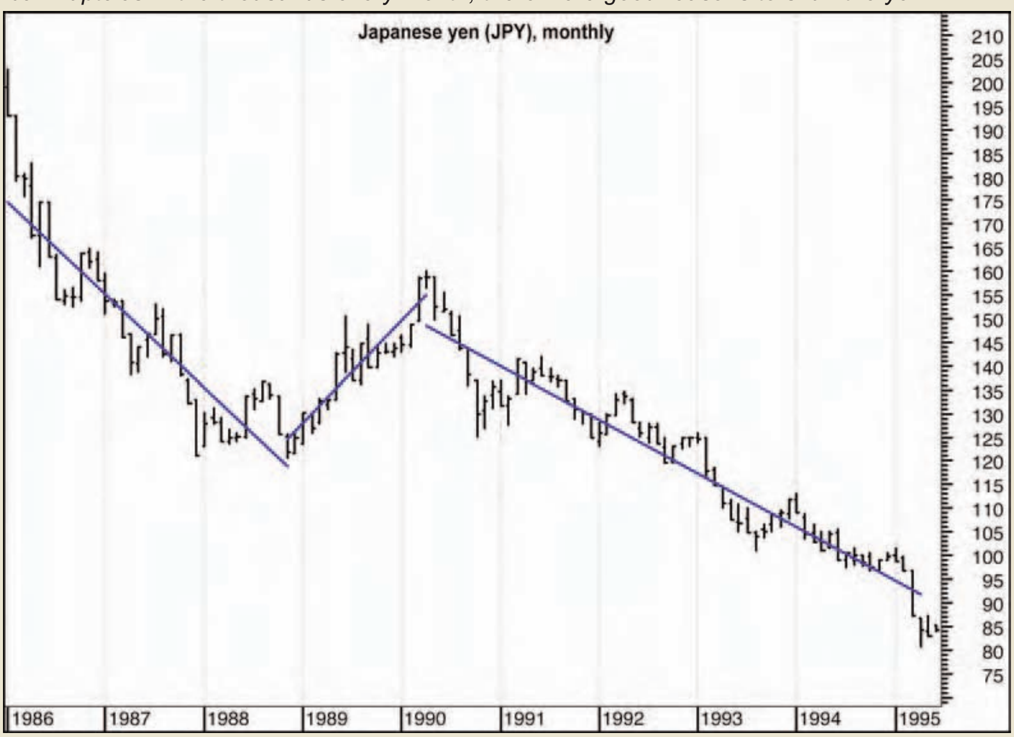
Governments strive to avoid shocks, but the yen is a perfect case of one of the rules of forex: The institutional factor outweighs all the economic and technical factors. Once a government takes a stand, market behavior flows from that. Sometimes the market immediately capitulates to the stated policy and other times it fights back; regardless, the policy is the topmost consideration.

On June 26 a policy change by the Japanese Ministry of Finance was revealed. It came in the form of a story in the normally staid *Nihon Keizai Shimbun* newspaper, which flatly reported the government no longer sees a weak yen as acceptable:

"Growing concern over the weak yen has caused Japanese monetary authorities to quietly shift their stance on yen-dollar rates to being 'watchful,' after long deeming them as 'acceptable.' The change in policy indicates that the Ministry

FIGURE 1 — YEN HISTORY

The yen rose from ¥201 to the dollar at year-end 1985, peaking at 122 in November 1988 (i.e., the dollar-yen rate shown here bottomed). But throughout the course of 1989, the yen steadily weakened to 158.20 by April of 1990. With Japanese banks failing and corporate bankruptcies in the thousands every month, there were good reasons to shun the yen.



Source: Data — Reuters DataLink; charts — MetaStock of Finance is not only concerned about mounting pressure from foreign countries to strengthen the yen, but is also worried that further weakness in the currency may reduce Japan's global competitiveness. In mid-June, senior Finance Ministry officials, including Hiroshi Watanabe, vice finance minister for international affairs, and Naoyuki Shinohara, deputy director-general of the ministry's International Bureau, discussed how to respond to the yen's depreciation, and concluded that 'a further fall in the yen's value is not desirable'.'"

The reference to reduced competitiveness has to do with the higher cost of imported materials, which hits small and medium-sized businesses the hardest, as well as the weak yen repelling international investors. Trying to make Tokyo a major financial center, competitive with New York and London, is futile. A former Ministry of Finance official says, "Only those countries with strong currencies are in a position to attract money and financial institutions from the rest of the world." In other words, a "winner" economy has to have more than robust exports.

In mid-June, top Ministry of Finance officials decided "a further fall in the yen's value is not desirable." In line with that view, the ministry revised a speech on forex rates being prepared for Finance Minister Koji Omi by adding the phrase, "We will keep a watchful eye on foreign exchange rates" to the assertion that "Foreign exchange markets should reflect Japan's economic fundamentals."

The phrasing was noticed at the time but virtually no one interpreted it as a policy shift. Now they are trumpeting the change from the rooftops.

As we all know by now, the yen has been weak because of the carry trade, which is surrounded by a certain amount of confusion. In its textbook form, a carry-trade consists of the investor borrowing a sum of money in one currency in a low-interest-rate country, converting the sum to another currency and investing the proceeds in a higher-yielding security in that currency. Logically, we would see a rise in borrowing by foreigners in Japan, a rise in spot trading volume with the higher yielding currencies, and a corresponding rise in investment in the higher-interest-rate countries.

In practice, it's impossible to track any of this from published data. There's little apparent borrowing by foreigners at Japanese banks and we don't know the volume of spot forex because it's the private business of the two counterparties.

As for foreign investment in higher-yielding countries, even in the U.S. we can't tell whether a rise in foreign investment in CDs or bonds is from a legitimate investor, such as a pension fund, or a speculator, such as a carry trader.

In fact, the vast majority of carry trades entail no actual bank borrowing at all. The carry-trade speculator uses his

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FIGURE 2 — 1998 YEN COLLAPSE

The collapse of the yen carry-trade was a byproduct of the 1997-98 world financial crisis that began in Thailand. It began when one fund, Julian Robertson's Tiger Management, bailed out of positions in early October 1998. The yen rose from 135.64 on Oct. 5, 1998 to 114.32 on Oct. 19.

Source: Data — Reuters DataLink; charts — MetaStock line of credit at a bank, Japanese or otherwise, to sell yen and simultaneously buy a high-yielding currency. While technically this forex trade is a use of credit, it's a contingency from an accounting point of view and thus an off-balance-sheet entry. The "lending" bank makes no money on the transaction, either, except the tiny bid-offer spread when it sells the yen.

FIGURE 3 — YEN REPLAY?

Although Japan presumably wants to avoid a 1998-style crisis, the red line represents a more gradual dollar/yen drop that nonetheless puts the yen at the ¥101 level two years from now, in June 2009.

Source: Data — Reuters DataLink; charts — MetaStock

This is the main reason nobody knows the size of the yen carry trade. Various estimates float around from time to time. At the high end it's hundreds of billions — possibly more than $1 trillion. In May, a top Japanese official said the carry trade was being exaggerated and it was probably only a few hundred million. (This official, by the way, was also a proponent of a weak yen since a weak yen promotes exports.)

On June 26, the Ministry of Finance announced the yen policy change and this official was reported to be leaving his job as Vice Finance Minister for International Affairs, the agency responsible for the yen in that it determines when and how to use the Bank of Japan to intervene, for example. Is the departure of this official symbolic? Maybe, although he had been in the job about the usual amount of time (three years) and the end of June is the usual time for bureaucrats to play musical chairs in Japan. We may never know.

Just about the only authentic yen carry trade is retail investment flows out of Japan to higher yielding countries, and even that is not a carry trade *per se*, since the funds represent savings, not borrowings. The size of such outflows is huge and growing. Mutual funds investing in foreign securities are adding thousands of accounts and several hundred million dollars each month. In April and May alone the Japanese bought foreign bonds (¥1.96 trillion, or about $16.1 billion) and foreign stocks (¥247.1 billion or $20.3 million) in large quantities. This is no surprise since savings accounts and bonds in Japan yield less than 2 percent vs. much higher returns abroad.

The Japanese policy change has been a long time coming. Everybody and his brother has complained about the too-weak yen, from the German Vice Finance Minister ahead of the February G8 meeting to former Fed Chairman Alan Greenspan. The most recent complaint came only one day before the Japanese newspaper announcement from the Bank for International Settlements (BIS) annual report, which stated the weak yen is "not consistent with the Japanese current account position" (a huge surplus).

The BIS is worried about a replay of October 1998 (Figure 1). The yen had been rising from ¥201 to the dollar at year-end 1985, consistent with high and rising current account surpluses. It peaked at 122 in November 1988. But throughout the course of 1989, the yen steadily weakened to 158.20 by April of 1990.

There were good reasons to shun the yen. The Japanese banking system was coming apart at the seams, with banks failing left and right and corporate bankruptcies in the thousands every month. The government had emergency spending plans in place to try to goose the recessionary economy, but the economy didn't respond.

This is when we heard Keynes being cited, as in, "You can't push on string." It was as close to a 1930s-style Depression as any country has come since. The Nikkei had already started falling in 1989 from over 40,000 to an intermediate low of 13,019 in October 1998 (it didn't bottom until 2003).

Everyone complained about the weakening yen, including the U.S. During this period, the S&P swooned from a peak of 1,190 in July 1998 to 923 in October 1998 — 2 percent more than the proverbial 20 percent required to call a down move a "bear market."

The carry trade existed then, too. The Japanese Ministry of Finance, aided by the U.S. Treasury, intervened to drive the yen back up. This was, in fact, the last time the Japanese intervened to raise the value of the yen. (The subsequent intervention, in 2003 and Q1 2004, which was the biggest ever by any central bank, was to drive it down. The amount then was a combined ¥35.2 trillion.)

In 1997-98, the world financial crisis was triggered by excess liquidity, asset bubbles, and undervalued currencies in emerging markets. Starting in Thailand and moving around the world to other emerging markets such as Brazil and Russia, asset prices fell through the floor. The culmination of the crisis was the failure of the hedge fund Long-Term Capital Management and its Fed-sponsored bailout.

The collapse of the yen carry trade was an accidental byproduct of all this. It started when one fund, Julian Robertson's Tiger Management, blew up in early October 1998 (Figure 2). The yen rose from 135.64 on Oct. 5, 1998 to 114.32 on Oct. 19 — a net change of almost 22 points in 14 days. Every day the yen moved up several big figures as additional carry traders exited. The BIS is afraid of a replay of this debacle, even though in 1998 the yen was simply an innocent bystander.

The BIS report also mentions the possibility of another global meltdown arising from the U.S. sub-prime mortgage problem, which has so far caused grief and gnashing of teeth at Bear Stearns and the failure or takeover of some 60 lesser mortgage providers — but no big-institution failures and (so far) no domino effect. The point (for the forex market) is not whether the U.S. sub-prime market is going to crash, but whether it inspires fresh risk aversion. Overall, general risk aversion is assumed to include aversion to the yen carry trade. It remains to be seen whether that is a valid assumption. No one disputes that risk aversion is too low. The JP Morgan index of emerging market bonds showed a 14-percent spread over Treasuries in 1999, and was at 1.56 percent on June 26. Perhaps in 1999 traders were overly risk-averse, but 1.56 percent sounds too low.

The Japanese Ministry of Finance is taking an unusually aggressive stance with its policy switch. At a guess, it doesn't want to be blamed for a replay of 1998 now that the BIS, International Monetary Fund, and many other authorities are pointing a finger at it. In fact, with deflationary conditions still in place in Japan despite good growth, it is perhaps taking a noble risk for the good of the world rather than its own immediate self-interest.

Notice that the Bank of Japan (BOJ) is being left out of things so far. The obvious solution to the wide yield differential is to raise interest rates. Technically the BOJ is independent and can resist government pleas for higher rates, which leaves intervention (verbal or cash) the only tool at Japan's disposal. We should probably assume that Japan wants to avert a world crisis by inching the yen up

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instead of having hedge funds exit the carry trade in a panic, causing a move similar to the 1998 rush for the exits.

Figure 3 shows how this might look, just for fun. A more gradual dollar drop/yen rise — a 45-degree slope rather than a 90-degree one — puts the yen at the desired level around ¥101 two years from now, in June 2009.

But as we all know, this is not how markets work. They work in a far choppier and violent way. If this policy change is the real deal, the Japanese (and presumably others) are going to have to intervene most judiciously — after all, the yield advantage still exists. The big question is whether there is a big firm out there like Robertson's Tiger Fund that will take away their latitude of action and jump the gun on carry-trade unwinding.

An equally big problem is if the yen starts rising, the dollar will be on the ropes against everything. We will hear again about all those tiresome pseudo-issues such as the current account deficit and reserve diversification. Still, a rise in the yen is a fall in the dollar, whatever it means.

The market has more money than the Bank of Japan, even if combined with other central banks. We should not expect a sharp rise in the yen anytime soon. But the risk of a yen short position — with the trend and with the logic of yield differentials — is now much, much higher.

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

Other Barbara Rockefeller articles:

"Too big to fail"
Currency Trader, June 2007.
If the dollar is poised to rebound, it might be getting help where it least expects it.

"Do stocks hold the key to currency levels?"
Currency Trader, May 2007.
The correlation between stock market and currency prices isn't what many people think.

"The coming commodity boom"
Currency Trader, April 2007.
Commodities are already having an impact on global economies.

"The yen: Canary in the currency coal mine"
Currency Trader, March 2007.
Keep an eye on capital flows and the yen — they could be telling you more about the dollar than first meets the eye.

"Indicator failure and scientific analysis"
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This discussion of market biases and fallacies provides a more rigorous way to think about trading.

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Comparing the majors

Which currency pair moves the most in a day? Which pair tends to rebound most often from intraday losses? This comparison of forex price behavior provides the answers.

BY CURRENCY TRADER STAFF

Over the past several months *Currency Trader* has run an extended series of articles (see "Related reading," p. 24) detailing the characteristics of each of the "majors" — the most-traded currency pairs in the forex world. The goal was to provide concrete insights into the behavior of each market and a template for future analysis. Market volatility and other conditions can change, so traders need to keep their figures current.

Common statistical measures, such as the average and median price moves in different conditions, offer basic outlines of a market's tendencies, while frequency distribution analysis gives traders even more insight into a market's likely behavior in different circumstances. For example, if you know a currency pair has in the recent past traded below the previous close between 0.004 and 0.0014 and closed higher that day 70 percent of the time, you have a solid guideline upon which to base trading decisions.

Here, we present a summary of the data from these articles for easy comparison of the different pairs. The analysis will be divided into two sections because three of the majors trade with the U.S. dollar as the base currency and four do not.

Overview

Table 1 lists (from left to right) 1) the review period for each pair; 2) the highest and lowest prices attained during the review period; 3) the percentage change (% range) from the lowest price to the highest price (which price occurred first is not considered); 4) the average daily range; 5) the average difference between the previous day's close and the low for those trading sessions that closed up, and 6) the average difference between the previous day's close and the high for those sessions that closed down. (The prices for the U.S. dollar/Japanese yen pair have been divided by 100 to make

continued on p. 20

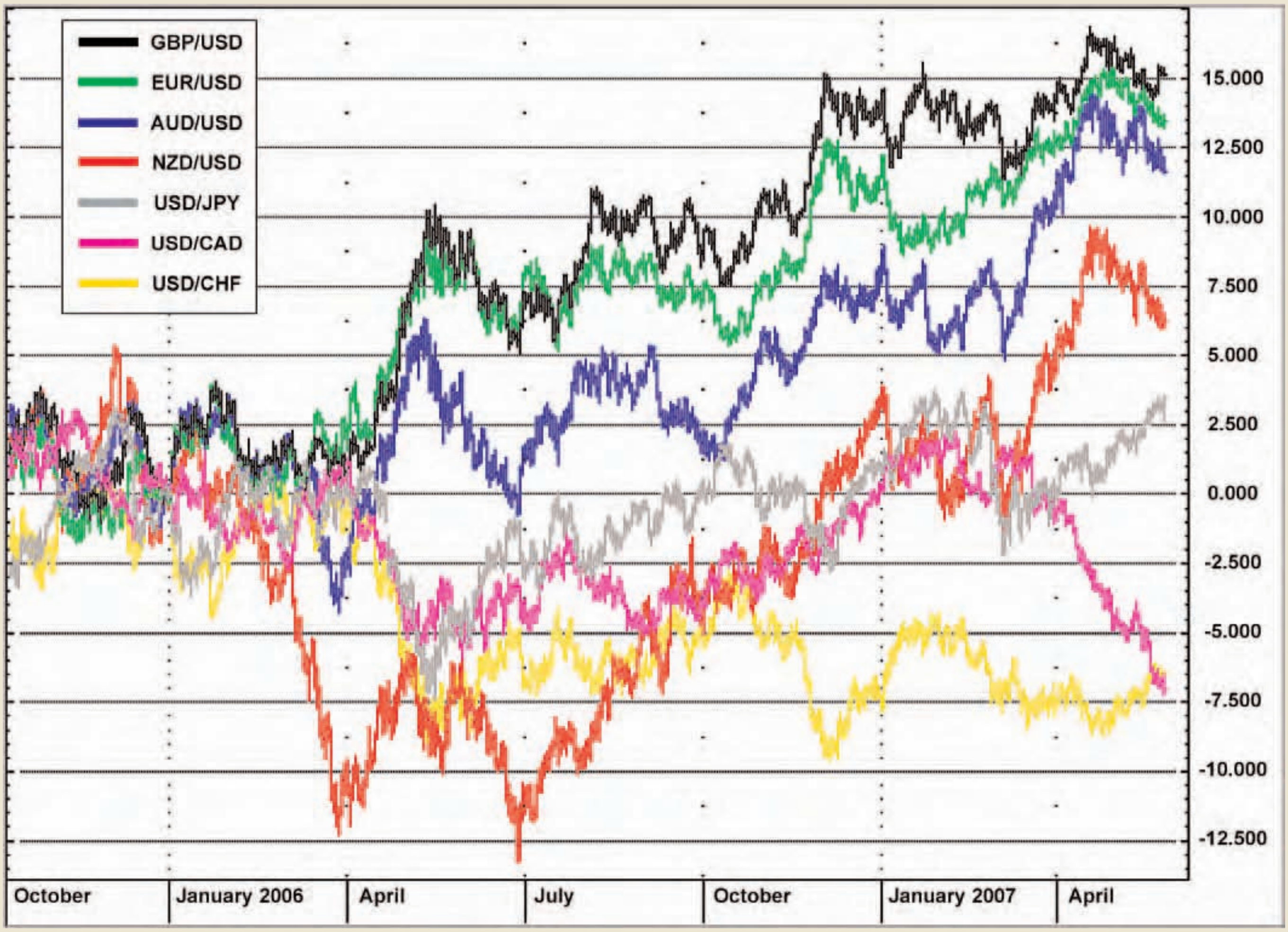
TABLE 1 — THE MAJORS

These summary statistics cover the seven major currency pairs that have been analyzed over the past several months. Note: The USD/JPY data has been divided by 100 to make its price format comparable to that of the other pairs (0.0000).

Pair	Review period	Maximum	Minimum	% range	Avg. daily range	Avg. low on up-closing days	Avg. high on down-closing days
EUR/USD	9/1/05-8/31/06	1.2978	1.1641	11.49%	0.0099	-0.0026	0.0024
USD/JPY	3/1/06-2/28/07	1.2218	1.0900	12.09%	0.0092	-0.0027	0.0020
GBP/USD	2/1/06-1/31/07	1.9915	1.7231	15.58%	0.0134	-0.0029	0.0032
USD/CHF	1/2/06-12/29/06	1.3238	1.1883	11.40%	0.0106	-0.0028	0.0023
AUD/USD	4/3/06-3/30/07	0.8126	0.7113	14.24%	0.0064	-0.0017	0.0017
USD/CAD	12/1/05-11/30/06	1.1799	1.0931	7.94%	0.0085	-0.0021	0.0024
NZD/USD	5/1/06-4/30/07	0.7493	0.5928	26.40%	0.0072	-0.0019	0.0017

FIGURE 1 — PERCENTAGE GAINS SINCE JANUARY 2006

The GBP/USD pair posted the biggest percentage gain, followed by EUR/USD, AUD/USD, and NZD/USD.



Source: CQGNet (http://www.cqg.com)

them comparable to the other pairs. For example, in Table 1 the average daily range for the USD/JPY pair shows 0.0092 points instead of 0.92.)

Figure 1 shows the percentage price changes of the majors since the beginning of 2006 (i.e., baseline set to zero as of Jan. 1, 2006). The best relative performer since then has been the British pound/U.S. dollar (GPB/USD) pair. The worst performer (relative to the U.S. dollar) has been Japanese yen (the USD/JPY pair). The U.S. dollar/Canadian dollar (USD/CAD) and U.S. dollar/Swiss franc (USD/CHF) pairs show negative values, but this is a function of the dollar being the base currency in these pairs — that is, the franc and the Canadian buck have gained ground against the dollar.

Daily ranges

Table 1 shows that currency pair with the largest average daily range was the GBP/USD, followed by the USD/CHF, euro/U.S. dollar (EUR/USD), USD/JPY, USD/CAD, New Zealand dollar/U.S. dollar (NZD/USD) and finally, the Australian dollar/U.S. dollar (AUD/USD).

Figure 2 shows the frequency distribution of the daily ranges for the EUR/USD, GBP/USD, AUD/USD, and the NZD/USD pairs. A frequency distribution analysis shows the number of times a value (in this case, daily range) falls within a certain range. In Figure 2, the tallest bar represents the NZD/USD pair, which had 55 daily ranges between 0.0051 points and 0.0060 points (the 0.0060 category on the horizontal axis). On the far right is one occurrence of a daily range (in the GBP/USD pair) that was between 0.0331 points and 0.0350 points.

This type provides more details than can be determined simply by calculating the averages. For example, the GPB/USD average daily range (0.0134) is the largest in Table 1. In Figure 2 the GBP/USD daily ranges are shifted to the right relative to the other three currency pairs. The most (26) daily ranges for the GBP/USD were in the 0.0100 category, which includes all daily ranges from 0.0101 through 0.0110 points. The average daily range is 0.0134 points because there is a large number of daily ranges in the categories farther to the right (several exceed 0.0200 points).

On the other hand, the AUD/USD and NZD/USD ranges mostly cluster to the left of the 0.0100 category; none of them exceeded 0.0200 points. The AUD/USD and the NZD/USD pairs had the smallest average daily ranges.

Figure 3 is a frequency distribution chart of the daily ranges for the USD/CHF, USD/CAD, and the USD/JPY pairs. The average daily range for the USD/JPY pair was 0.0092 points (divided by 100), the USD/CHF was 0.0106 points, and the USD/CAD was 0.0085 points. The one outlier was a range in the 0.0330 category in the USD/JPY pair. (An outlier is an anomalous data point or reading that is not representative of the majority of a data set.)

The USD/CAD pair had the lowest of the three average daily ranges. The three peak readings by the USD/CAD pair to the left of the 0.0110 category, as well as the fact that the USD/CAD did not have a daily range greater than 0.0200 points, indicate this pair is more stable than the other two.

Close-to-close price moves

After the daily ranges, the next area of interest is how the currencies tend to move from one close to the next. Figure 4 is the frequency distribution of the close-to-close moves (positive and negative) in the EUR/USD, GBP/USD, AUD/USD, and NZD/USD pairs.

Despite the overall strength of the euro relative to the dollar during the review period, the most common closing difference (52 occurrences) for the EUR/USD pair was between -0.0024 points to unchanged (the 0.0000 category).

Also, complementing its large average daily range,

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FIGURE 2 — DAILY RANGE DISTRIBUTION: EURO, POUND, AUSSIE $, KIWI $

A frequency distribution shows how often these currencies pairs have daily ranges of different sizes. The horizontal axis categories represent the upper end of a certain range of daily ranges — for example, 0.0100 represents all the daily ranges greater than 0.0090 points up to and including 0.0100 points (that is, between 0.0091 and 0.0100 points). The EUR/USD pair had 29 daily ranges within that category, while the GBP/USD pair had 15.

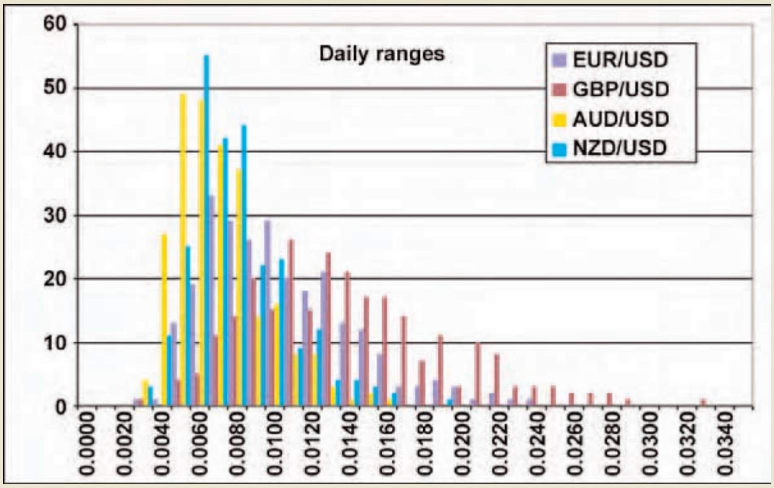


FIGURE 3 — DAILY RANGE DISTRIBUTION: FRANC, CANADIAN $, YEN

The majority of the USD/CAD reading were in the 0.0060, 0.0070, and 0.0100 categories. The USD/JPY had one extreme daily range reading (in the 0.0330 category).

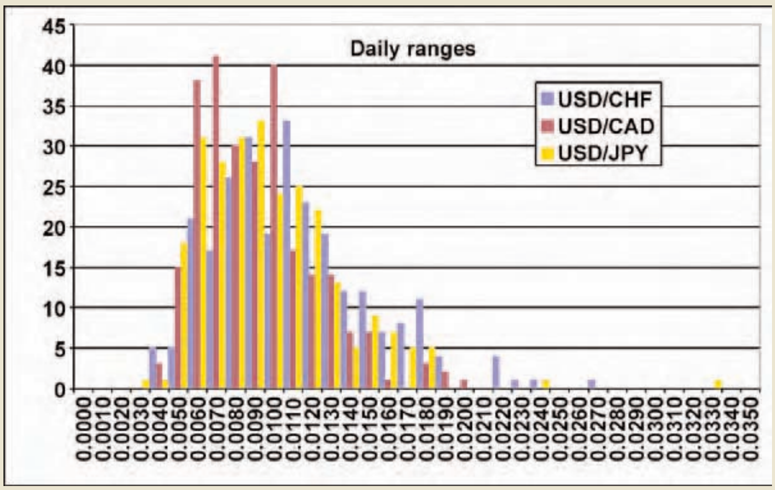


FIGURE 4 — CLOSE-TO-CLOSE CHANGE DISTRIBUTIONS: EURO, POUND, AUSSIE $, KIWI $

The GBP/USD pair had the widest range of daily closing changes. The Aussie and kiwi dollars had the most number of occurrences in the 0.0025 category.

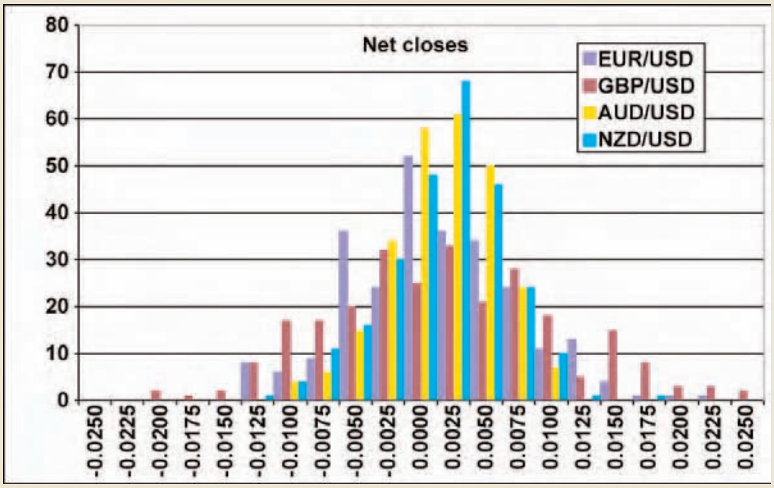
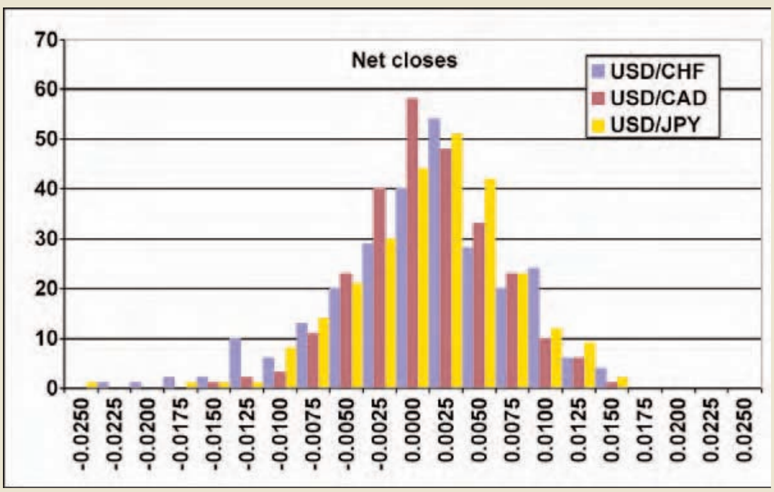


FIGURE 5 — CLOSE-TO-CLOSE CHANGE DISTRIBUTIONS: FRANC, CANADIAN $, YEN

The USD/JPY pair edged out the other two pairs for the widest range of close-to-close differences. Overall, most close-to-close changes were between a loss of -0.0025 points and a gain of +0.0025 points



the GBP/USD pair also demonstrated a wide range of closing price differences. This pair's largest close-to-close gain fell in the +0.0250 category and its largest closing loss landed in the -0.0200 category. This occurred despite a more than 15-percent gain since January 2006. This is evidence that despite the British pound's bull market, it experienced volatile shakeout periods, as well.

Although the effects of the weak dollar trend aren't readily apparent in the GBP/USD and the EUR/USD, there is a positive bias in the close-to-close data for the AUD/USD and the NZD/USD pairs. Both display peak occurrences for closes greater than unchanged (the 0.0025 category).

Figure 5 shows the distribution of the close-to-close differences of the USD/CHF, USD/CAD, and the USD/JPY pairs. USD/JPY had the widest range of closing differences, spanning a one-day loss in the -0.0250 category to a one-day gain in the 0.0150 category. The USD/CAD pair had narrowest range of close-to-close differences: Its largest closing gain was in the 0.0150-point category and its largest one-day loss was in the -0.0150 category. The peak readings for all three pairs were clustered between a 0.0025-point loss and a 0.0025-point gain.

Lows on up-closing days

The next step in the analysis is to review the data for the typical price excursions against the one-day trend. That is, how low did the market trade below the previous day's close for those sessions that closed in positive territory? Armed with this information, a trader can look for an entry point and use the historical analysis as a guide on what should be reasonable risk parameters.

Figure 6 is the frequency distribution of the difference between the low and the previous close for those sessions with positive closes by the EUR/USD, GBP/USD, AUD/USD, and NZD/USD pairs. The chart shows just how high the intraday volatility of the GBP/USD pair was: The market was once down more than 0.0140 points and still recovered to close higher on the day.

The AUD/USD and the NZD/USD pairs showed the greatest tendency to drop between -0.0005 to -0.0025 points below the previous close and still close up for the session. The EUR/USD pair also shows more extreme moves to the downside compared to the AUD/USD and the NZD/USD pairs. The EUR/USD's peak readings were lows between -0.0020 and -0.0025, but the next-highest readings were lows between -0.0045 and -0.0050 points.

Figure 7 shows the distribution of the differences between the previous close and today's low on days that closed higher for the USD/CHF, USD/CAD, and USD/JPY pairs.

The USD/CHF pair had the highest number of occurrences with lows between -0.0015 to -0.0010; the pair also had the largest intraday losses for up-closing sessions of the three pairs. The worst one-day decline for the USD/CAD pair was an intraday low in the -0.0070 category. The USD/JPY pair failed to trade below the previous close only twice; the USD/CAD pair, only once.

Similar analysis was performed to determine the range of highs on days that closed lower.

Highs on down-closing days

Figure 8 is the frequency distribution of the difference between the high and the previous close for those sessions with negative closes in the EUR/USD, GBP/USD, AUD/USD, and NZD/USD pairs.

Figure 8 shows a similar pattern to the daily low analysis in that the GBP/USD pair has the most extreme readings (i.e., more values to the right of the chart, including the outliers). The GBP/USD and the EUR/USD readings are more spread out over the distribution chart compared to the AUD/USD and the NZD/USD pairs. The NZD/USD pair had the most days (30) when the high was in the 0.0020 category.

Figure 9 is the frequency distribution of the difference between the high and the previous close for those sessions with negative closes for the USD/CHF, USD/CAD, and the USD/JPY pairs.

First, the USD/CHF pair had one outlier: a loss in the -0.0030 category. The USD/CAD pair twice exceeded 0.0090 points and closed down, while the USD/CHF and the USD/JPY pairs both had one occurrence each where the high was in the 0.0125 category.

The USD/CAD pair had a tendency to make an intraday high greater than 0.0010 up to and including 0.0025 points (its three peak readings) on down-closing days.

Intraday analysis

Each article also analyzed the two most recent months of the review period to determine intraday tendencies, based on 60-minute bars for the 24-hour trading sessions. All of the major pairs

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FIGURE 6 — INTRADAY LOWS ON UP-CLOSING DAYS: EURO, POUND, AUSSIE $, KIWI $

Again, the GBP/USD pair displays the highest level of intraday volatility.

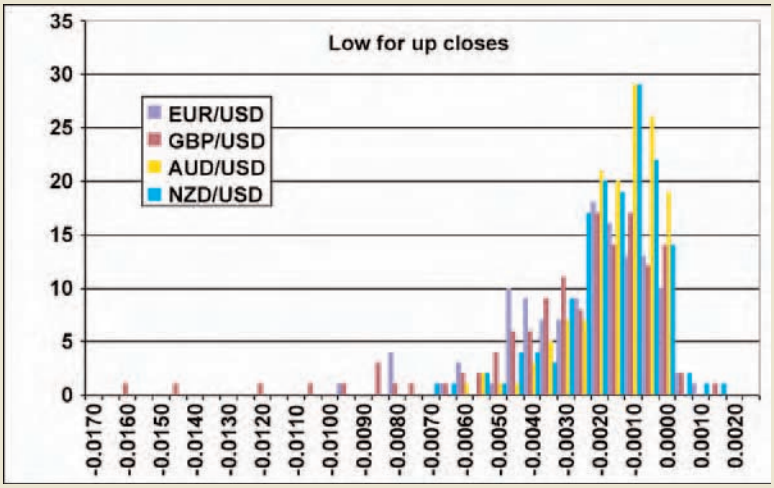


FIGURE 7 — INTRADAY LOWS ON UP-CLOSING DAYS: FRANC, CANADIAN $, YEN

The USD/CAD pair tended to have lows between unchanged down to -0.0025 points on days it closes higher.

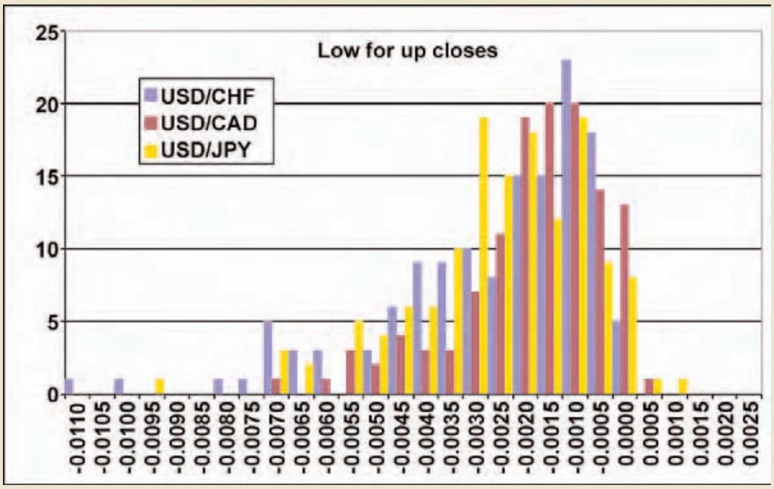
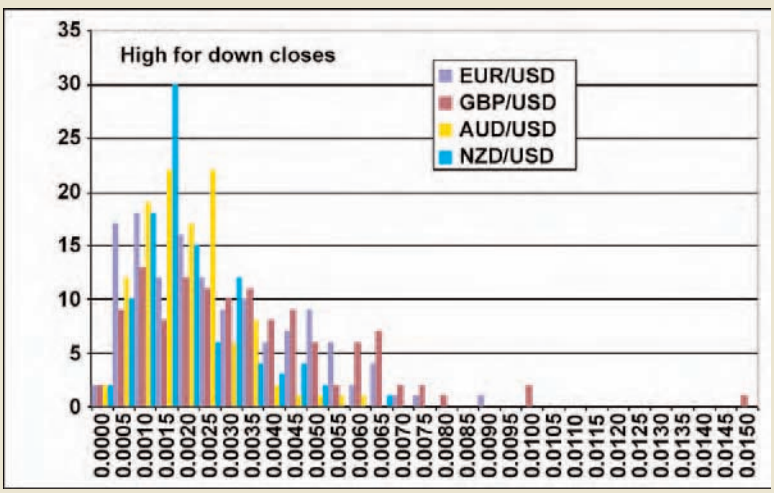


FIGURE 8 — INTRADAY HIGHS ON DOWN-CLOSING DAYS: EURO, POUND, AUSSIE $, KIWI $

The GBP/USD pair displayed a greater tendency to establish more extreme intraday highs and still reverse to close lower.



Related reading

"New Zealand dollar trading numbers"
Currency Trader, June 2007.
Detailed analysis of the "kiwi" dollar's trading tendencies and characteristics.

"Dollar-yen trading tendencies"
Currency Trader, April 2007.
The dollar-yen's trading characteristics are examined on daily and intraday time frames.

"Deciphering the British pound"
Currency Trader, March 2007.
The British pound has been a volatile — and mostly bullish — currency in recent months. Find out how it trades from day to day.

"Dollar-Canada by the numbers"
Currency Trader, January 2006.
As the only purely North American major currency pair, the dollar-Canada rate occupies a unique position. We break down its short-term performance to reveal daily and intraday tendencies.

"Euro/yen: Tips and tendencies"
Currency Trader, December 2006.
Euro/yen by the numbers: Stats and tendencies for short-term forex players.

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

"The yen stands alone"
by Howard L. Simons.
Currency Trader, March 2006.
The usual rules of the currency world don't necessarily apply to the Japanese yen. Will that continue to be the case, or is Japan poised to revamp its economic model in a way that will dramatically alter the yen's longstanding dynamics?

Note: This article is also part of the "Howard Simons: Advanced Currency Concepts, Vol. 1" article collection, which contains nine Currency Trader *articles by Howard Simons.*

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

FIGURE 9 — INTRADAY HIGHS ON DOWN-CLOSING DAYS: FRANC, CANADIAN $, YEN

The peak reading for the three pairs was the 22 times the USD/JPY pair made a intraday high in the +0.0005 category for a down session. A number of outliers pulled the average up to 0.0020 points in Table 1.

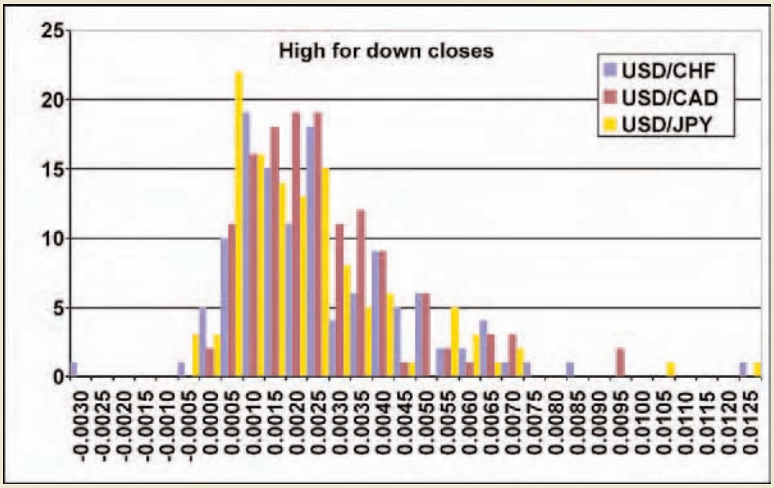
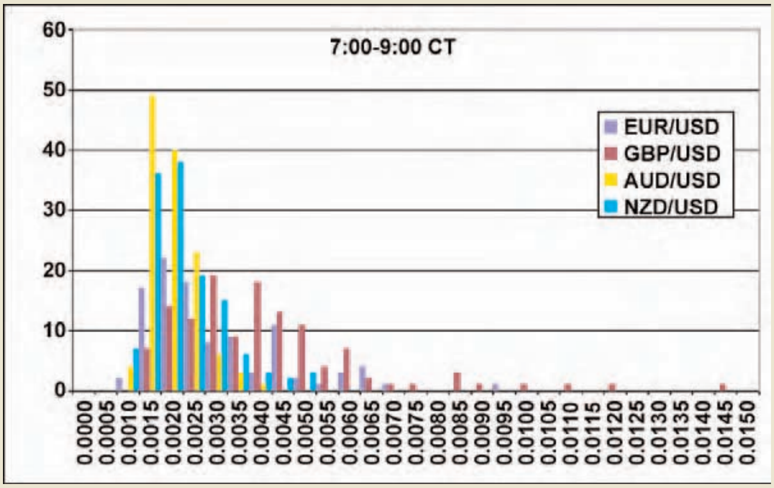


FIGURE 10 — 60-MINUTE RANGES, 6:00-8:00 ET: EURO, POUND, AUSSIE $, KIWI $

The AUD/USD and NZD/USD pairs' 60-minute ranges are clustered to the left of the GBP/USD and EUR/USD ranges.



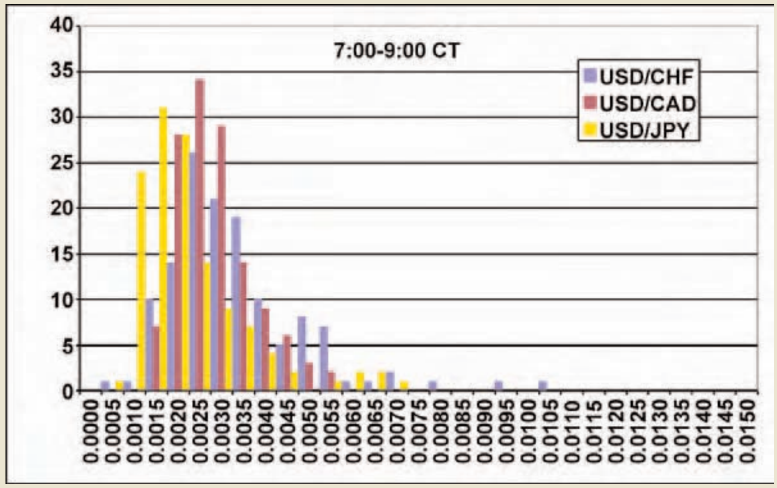
experienced their most active periods during the 7:00 a.m. to 9:00 a.m. CT period — which coincides with the release of key U.S. economic reports that can confirm or change forex traders' attitudes toward the dollar.

Figure 10 shows the frequency distribution of 60-minute ranges from 7:00 a.m. to 9:00 a.m. CT by the EUR/USD, GBP/USD, AUD/USD, and NZD/USD pairs.

The peak readings are the 60-minute ranges greater than 0.0010 points up to and including 0.0020 points. The AUD/USD and the NZD/USD pairs have the highest representation in these ranges.

FIGURE 11 — 60-MINUTE RANGES, 6:00-8:00 ET: FRANC, CANADIAN $, YEN

The USD/JPY pair data is skewed to the left of the other two pairs.



This is interesting because in Table 1 the average low for up-closing sessions by the AUD/USD is just -0.0017 points and 0.0017 points for the high for down-closing sessions. The NZD/USD average low is -0.0019 points for up-closing sessions and 0.0017 points for a high for down-closing sessions. Combining the results from Table 1 and Figure 10 indicate that the volatility that occurs by the AUD/USD and the NZD/USD happens during the 7:00 a.m. to 9:00 a.m. CT period. Further research is needed to understand how these two pairs perform following the release of U.S. economic news.

Once again, the GBP/USD pair shows the widest ranges for extreme readings, this time on an hourly basis.

Figure 11 is the frequency distribution of the 60-minute ranges from 7:00 a.m. to 9:00 a.m. CT by the USD/CHF, USD/CAD, and the USD/JPY pairs.

Figure 11 shows that the USD/JPY pair is somewhat skewed to the left compared to the USD/CAD and the USD/CHF pairs. Recall that the average daily range for the USD/JPY pair is an adjusted 0.0092 points, right between the average daily range of 0.0106 points by the USD/CHF pair and the average daily range of 0.0085 points by the USD/CAD pair. The left-hand skew for the intraday data by the USD/JPY indicates that forex traders are not focusing on the U.S. economic releases relative to how forex traders react in the USD/CHF and the USD/CAD pairs. This is not too surprising considering the primary fundamental reason driving yen traders has been the carry trade.

Final observations

This summary highlights some key attributes of the major currency pairs and provides a way to compare these markets. If a trader wants volatility, the GBP/USD pair is the place to be. On the other hand, a trader new to forex trading might consider the AUD/USD and the NZD/USD pairs: Although their average daily ranges are smaller relative to the other pairs, the average low for up closing sessions and the average high for down closing sessions are the smallest relative to the other pairs. This implies less intraday volatility and lower odds of being stopped out of a trade.

A trending market is often a volatile market. This is certainly the case with the GBP/USD, which has climbed over 15 percent since January 2006 and has an average daily range of 0.0134 points. On the other hand, while the NZD/USD has the fourth-highest total percentage gain, having climbed just more than six percent since January 2006, the kiwi has gained more than 26 percent from its low during the review period. Also, this is a market with an average daily range of just 0.0072 points — a little more than half of the average daily range of the GBP/USD pair and second lowest of the majors.

Trapping the intraday range

Keeping track of a currency pair's daily range and waiting for a pullback help take advantage of the intraday forex trend.

BY IGOR R. TOSHCHAKOV

The strategy outlined here uses simple analysis of the daily ranges in a currency pair to set up an intraday trade in the direction of the trend established early in the New York forex trading session.

The strategy is based on three principles: 1) a market move has only two possible directions; 2) the market is in perpetual motion, and 3) the market completes certain trading ranges over certain periods of time (a day, a week, a month, or a year).

On a practical level, principle 1 means that whenever there is an existing market position with a certain profit target and protected by a stop-loss level, the market will eventually reach one of those trading points. It also implies that price action on the way between the two points is "market noise" and should be disregarded.

Principle 2 means that over any period of time the market is progressing either toward the target or the stop level and that one of these points will be reached within a reasonable period of time.

Principle 3 allows traders to evaluate the specific probabilities a market will reach certain price levels within a certain time frame.

Let's see how these three principles might translate into an intraday forex trading strategy.

Strategy concept

The 24-hour forex trading day encompasses all the trading sessions around the globe, starting at 5 p.m. ET and ending the same time the next day. The trading day is split into three distinct sessions: the Far East and Asian session, the European session, and the North American session.

Let's say data collected over the past couple of months shows the average daily trading range for a certain currency pair was 120 pips (points). Over the same period of time the smallest daily range was 80 pips.

Now assume a typical market situation is occurring around 10 a.m. ET (Figure 1): The current intraday trading range is 60 pips (the distance between points C and D); the currency pair first formed its intraday low and later formed a top before drifting 30 pips lower — meaning that at this moment the price is right in the middle of the day's trading range (point E).

The daily range statistics imply the currency pair still has the potential to expand its range today because the current range is much smaller than the two-month average range (120 pips) and even smaller than the minimum range (80 pips) from that period; price must move at least 50 pips up or down from its current level just to match the minimum range.

The odds of an upside extension are better than the odds of a downside extension because the trend for the day is up. In this situation, the day's low becomes a significant support level and a long trade is opened, with a protective stop just below the support

FIGURE 1 — PATTERN TEMPLATE

This common intraday market pattern, from points A to G, represents: the day's opening price (A); the Asian session top (B); the intraday low (C); the intraday top (D); the intraday retracement low (E); the intraday high (F), and the day's closing price (G). The intraday trading range before the North American market open is represented by distance 1 and the complete daily trading range is represented by distance 2. To generate a reliable trading signal, distance 1 must be less than 70 percent of the two-month average daily trading range. It is also the buy zone for a long intraday trade.

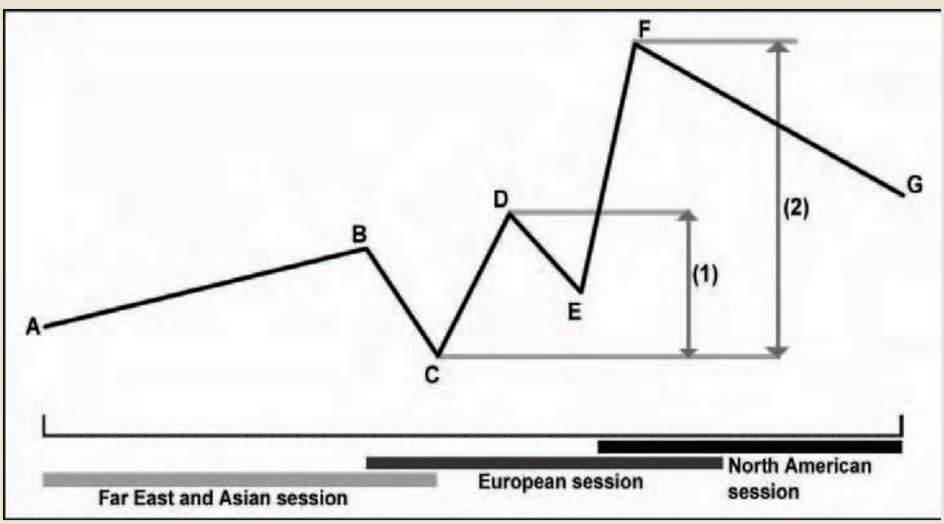
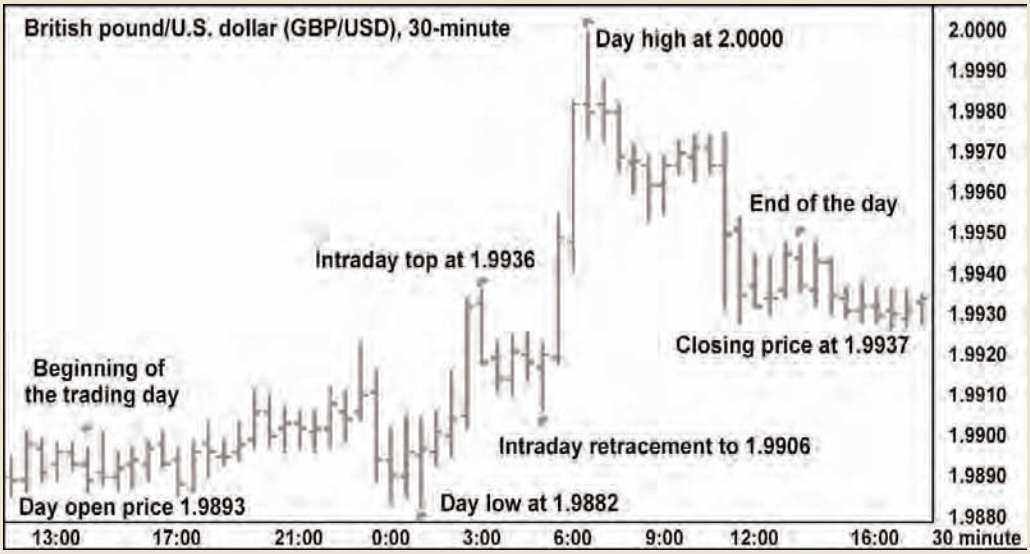


FIGURE 2 — LONG POUND-DOLLAR TRADE

By the beginning of the New York session, the GBP/USD pair had formed a 54-pip intraday range and the direction of the main move was up.



Source: Future Source Workstation

level (risk approximately 30 pips) and a profit target of 50 or more pips.

The profit target could be set anywhere between the point at which the pair matches the minimum daily range over the past two months or the price at which it matches the average range (point F). Optionally, a target could be based on other levels (trendline, alternate support-resistance levels), as well as on time-based criteria — for example, liquidating the position at the closing price of the day (point G).

If the market penetrates the support at the day's low, the stop will get hit for a 30-pip loss. However, this does not negate the odds the market will reach its average or minimum daily range values before the end of the day; rather, it suggests a high likelihood the pair will extend its range to the downside by at least another 50 pips.

In this situation, you have a couple of choices. The first is to reverse the position immediately at the stop-loss price with the expectation the market will return the 30-pip loss, or perhaps more. The only problem is the appropriate stop level for the new trade would be above the high of the day, which would establish the risk of losing another 50 pips.

The second choice is to wait until the market makes a retracement back into its intraday trading range and then follow the rules used to establish the initial long position, except this time taking a short position.

Next, let's look at some specific rules that can be used to trade this approach.

Trading rules and customization

The strategy contains both systematic and discretionary components. The systematic elements cannot be changed under any circumstances, but the discretionary elements can be modified depending on a trader's specific money management rules, trading preferences, and market conditions.

The systematic rules are:

1. The position must be opened in the direction of the main move early in the New York session.
2. The initial position should be taken only if the current intraday trading range is less than 70 percent of the average daily trading range for the currency pair over the past two months.
3. Place a protective stop on the opposite side of the current intraday trading range — i.e., above the current intraday high (for short trades) or below the current intraday low (for long trades).
4. The risk on a single trade must not exceed 40 percent of the two-month average daily range for a particular currency pair.
5. Profit target: Liquidate the position when the currency pair matches its two-month average daily trading range.

Discretionary components

Because it is known in advance where the sell stop will be placed, the initial long position can be executed anywhere between point B + 1 pip and C. ("B+1 pip" is used because the position can be taken only in the direction of the main move. Remember, however, that bid-ask spreads must always be taken into consideration.)

It depends on a trader's personal risk preference, money management technique, and price availability, but as long as the difference between a buy order and stop level does not exceed 40 percent of the average daily trading range, a profit target can be set in advance. For example, a long trade could always be opened automatically using a limit order placed 25 to 35 percent of the average daily trading range above the stop level.

The time window for opening the initial position can be shifted. For the most part, however, the earlier in the day, the safer the trade.

A position reversal, if appropriate, can be executed simultaneously with the initial stop-loss order or after a retracement back into the intraday range.

The profit target can also be chosen in advance. For example, profits could be taken after a completion of 80 to 90 percent of the average daily trading range. However, if the desired level has not been reached before the end of the

continued on p. 28

day, the position should be liquidated at the close.

Strategy setup and trade examples

Now let's look specifically at rules for a long trade, based on the information from Figure 1 and the rules and guidelines from the previous section. A long position can be opened early in the New York trading session if:

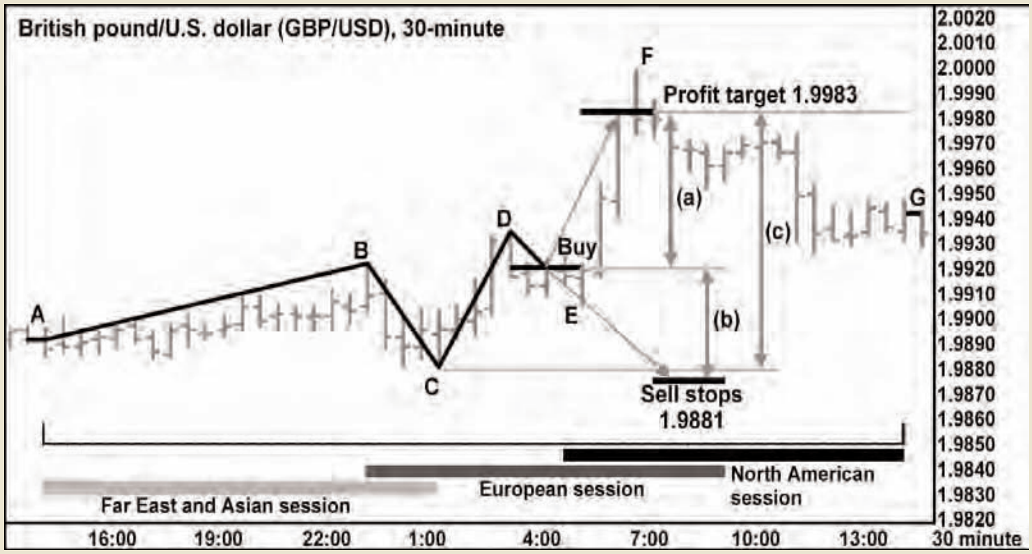
1. The primary direction of the intraday move is up.
2. The intraday trading range is less than 70 percent of the average daily trading range over the past two months.
3. The market makes an intraday retracement toward and comes within 30 pips of the low of the day.

Stop-loss and profit-target placement:

4. Place a stop-loss order just below the intraday low (around 30 pips below the initial buy level).
5. Exit as soon as the currency pair completes 90 percent of its two-month average daily trading range.
6. If price does not reach the profit target, exit the position at the close of the day.

FIGURE 3 — POUND-DOLLAR WITH TEMPLATE

To take a long trade with a 30-pip risk, the trade would be initiated 30 pips above the stop level, which would be just below intraday low. A profit target could be set anywhere between points D and F.



Source: Future Source Workstation

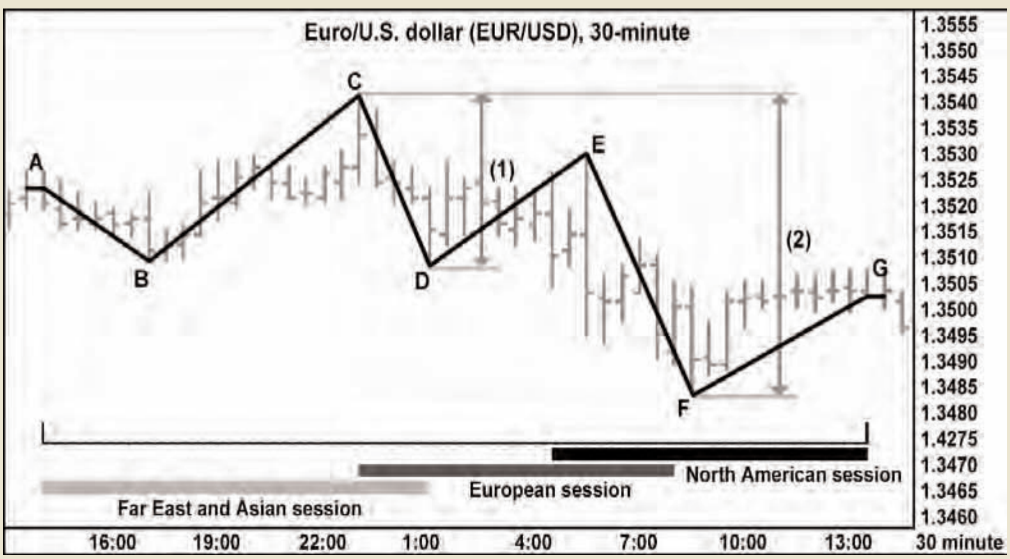
Figures 2 and 3 illustrate this strategy in the British pound/U.S. dollar pair (GBP/USD), using a 30-minute chart from May 9, 2007. This trading day opened at 1.9893 and had formed a 54-pip intraday range by the beginning of the New York session. First, the market made an intraday low at 1.9882 and then a top at 1.9936. The direction of the main move was up by the beginning of the New York trading session. This information, along with the two-month average daily range number for GBP/USD is everything you need to know to make a trade decision.

Figure 3 places the trade template from Figure 1 over the price chart from Figure 2. For instance, if a trader is willing to assume a 30-pip risk, the initial buy position should be established 30 pips above the level where the stop is placed. Because the stop must be placed just below the intraday low, the entry level would be calculated as follows: (C - 1 pip) + 0.0030 = 1.9881 + 0.0030 = 1.9921.

This allows you to place two simultaneous orders: a limit order to buy at 1.9921 and a

FIGURE 4 — SHORT EURO-DOLLAR TRADE

A short would be executed between points D and E, with a target equal to 90 percent of the two-month average trading range.



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sell stop order at 1.9881. If the market then retraces from point D to point E and triggers the limit order, a buy order gets executed automatically and is automatically protected by the sell-stop order.

A profit target is set in advance anywhere between points D and F. In this case, the target is located at 1.9983, which represents a move (from the intraday low) of approximately 90 percent of the two-month average daily trading range.

Figure 4 illustrates a short trade example in the euro/U.S. dollar (EUR/USD) pair from June 6, 2007. Point A is the opening price of the trading day (1.3525); point B is the intraday (Asian session) bottom at 1.3510; point C is the intraday top at 1.3542; point D is the subsequent intraday bottom at 1.3509; point E is the top of the retracement at 1.3530; point F is the eventual intraday bottom at 1.3484; point G is the day's closing price of 1.3502; distance 1 is the intraday trading range before the open of the New York session; and distance 2 represents the complete daily trading range.

The initial short position has to be taken somewhere between points D and E to target 90 percent of the two-month average trading range, which in this case is 0.0066 — significantly smaller than the average range that was used to illustrate the first trade example above. As a result, the strategy has to be adjusted for the change in volatility. If the risk is downsized to 0.0020, the initial sell position could be taken at the 1.3520-25 level to target 90 percent of the average two-month trading range (around the 1.3495 level) and the stop must be placed above the intraday high at 1.3545.

Simplicity and practice

It is quite likely that there will be a problem initially with recognizing the different opportunities, but once you get used to it, the trading process should become routine.

Most importantly, working with clearly defined stop-loss and profit targets based on recent price behavior provides a solid footing for placing trades.

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

Related reading:

"Currency personalities"
Currency Trader, September 2005.
Unique fundamental circumstances and the transition from one trading center to the next create distinct currency "personality traits" traders can use to their advantage.

"Intraday CMO-FX"
Currency Trader, November 2006.
This Currency System Analysis article tests an intraday system based on the Chande Momentum Oscillator (CMO).

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

Currencies and Federal Reserve trade weights

The theory that a weaker dollar makes U.S. goods and services more competitive abroad sounds nice, but the facts argue otherwise.

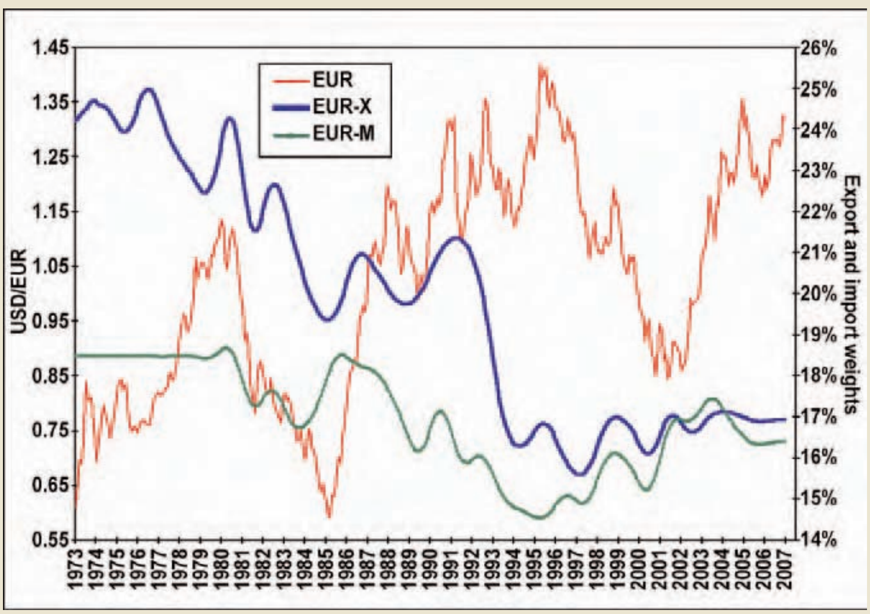
BY HOWARD L. SIMONS

Everything you know is wrong, and the global exchange rate system is based on a false premise. Now that we have those housekeeping chores out of the way, let's dig a little deeper into the data and address the second part of the statement, the one dealing with currencies.

A lot deeper, actually: In this, the first of a two-part discussion on the link between currencies and the Federal Reserve's trade weights, we review the methodology and terms used to analyze this relationship and focus on the "major" currencies and their trade weights. Next month will feature a discussion of the "minor" currencies and their trade weights.

FIGURE 1 — THE EURO AND ITS WEIGHT IN U.S. TRADE

A weaker dollar failed to make U.S. exports to the Eurozone more competitive.



Background

We have to go all the way back to the adoption of floating exchange rates between 1971 and 1973, a topic addressed in "The dollar index and 'firm' exchange rates" from the December 2005 issue of *Currency Trader* (see "Related reading" on p. 36). Let's review the argument in favor of floating exchange rates from that article:

> *The premise behind allowing currencies to float was that it would lead to self-correcting trade balances. In a fixed-rate regime such as Bretton Woods, countries in a deficit position (such as the U.S. in the late 60s) see an outflow of gold and foreign exchange reserves. These outflows lead to a reduced capacity to consume, which is detrimental both to the deficit country and to all those exporting to it. In fact, the IMF was created in the Bretton Woods agreement to address the inevitable "balance of payments crises" associated with growing economies importing too much.*
>
> *Theoretically, floating exchange rates would address payment imbalances by depreciating deficit countries' currencies on the global market, thus reducing their purchasing power. If, for example, the U.S. ran a trade deficit, it would be pumping out additional dollars to*

continued on p. 32

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Uniformity
Clarity
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exporters. Each new dollar on the world market would have a smaller claim on exporters' resources and reduce the U.S.'s ability to import more. Also, U.S. exports would become cheaper on global markets and expand American exports.

The end result of a weaker currency was supposed to be a move away from a deficit condition. The opposite was supposed to occur with a stronger currency.

The logic behind this argument has been advanced often by trade protectionists around the world and by the International Monetary Fund (IMF) itself in its repeated and usually disastrous advice to debtor countries to depreciate their currencies to improve their trade balances. It was used as a bludgeon against Japanese automakers during the 70s and 80s, against textile exporters in all decades, and has been a staple of senators Lindsey Graham (R., S.C.) and Charles Schumer (D., N.Y.) vis-à-vis China.

Even though the principal advocate of floating exchange rates, the late Milton Friedman, was the antithesis of a protectionist, his arguments have been seized by this faction to the extent that the notion a weaker currency should stimulate exports and reduce imports will be referred to as the "protectionist argument."

Data and methodology

To maintain its trade-weighted dollar index (http://www.federalreserve.gov/releases/H10/Weights/), the Federal Reserve must keep track of the changing use of various currencies the U.S. receives in return for its exports and pays for its imports. In these charts, export weights are depicted in blue and import weights in green.

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FIGURE 2 — THE JAPANESE YEN AND ITS WEIGHT IN U.S. TRADE

When the yen rallied during the 1980s Japan bubble, its weights in U.S. imports began to decline. A weaker dollar did nothing to increase export weights to Japan, which peaked in the early 1990s and have fallen ever since.

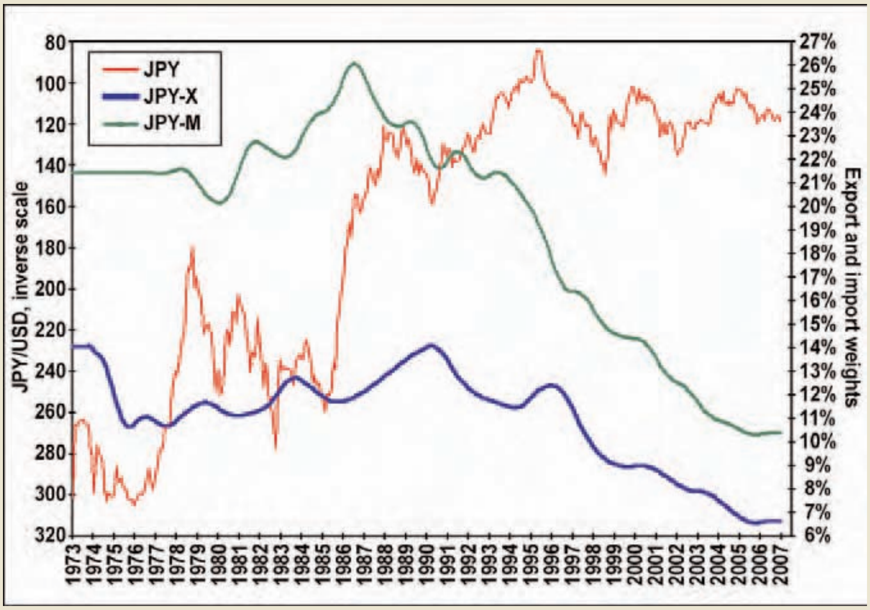
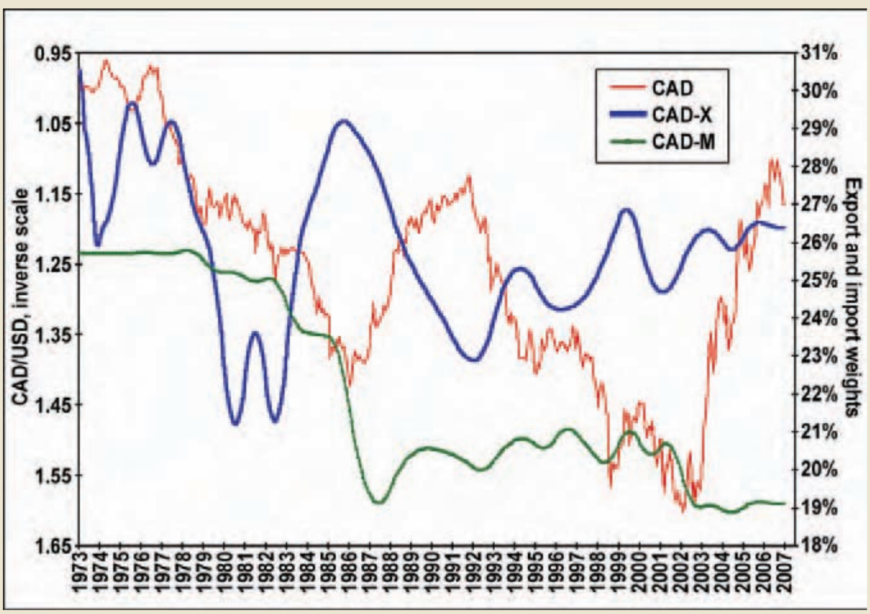


FIGURE 3 — THE CANADIAN DOLLAR AND ITS WEIGHT IN U.S. TRADE

According to the protectionist argument, the early 80s decline in the Canadian dollar should have increased its import weights and decreased its export weights. However, the exact opposite occurred, and a subsequent rebound from 1987 to 1992 had no reversing effect.



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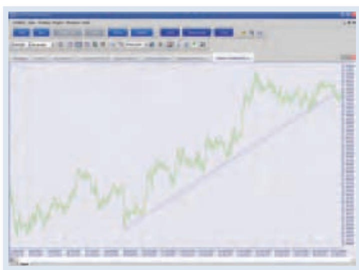

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These weights are calculated on an annual basis and, of necessity, after the fact. Because the Federal Reserve is unable to license its dollar index for commercial purposes, many traders are unfamiliar with this data.

Also, these currency weights reflect their use in bilateral trade with the U.S. and do not reflect total bilateral trade. This is critical for countries from whom the U.S. imports large quantities of goods priced in dollars, such as crude oil and various metals.

Annual data are of little trading use in a continuous market such as currencies. We can create smoothed series of import and export weights via a statistical technique called "cubic spline interpolation" (for more information, see "Related links" on p. 36). This technique is used twice in the charts below — once to create quarterly series from the annual numbers and a second time to create monthly numbers from the quarterly results.

The resulting interpolations are far easier to absorb than the annual numbers, but as they involve two separate data transformations, we did not attempt any further statistical analysis against monthly currency values (presented in red in the charts). In addition, please be advised all currencies are displayed in the "USD per" convention familiar to traders of the euro, the British pound, and currency futures. The currency scale is inverted for currencies commonly expressed as "per USD," so a rising red line always conveys strength vs. the dollar and a falling red line always conveys weakness.

Over the past 35 years we have seen the extinction of the euro's precursors and a number of disappearing currencies in countries such as Brazil and Argentina, both of whom continuously fail to manage their affairs. We also see the effects of various currency boards, direct pegs to the dollar, managed floats, trade blocs, and new currencies coming on to the scene.

Currencies are dynamic entities; they come and go, and even when they persist they represent nothing in the way of fixed purchasing power. The U.S. dollar, still the lynchpin of the

FIGURE 4 — THE BRITISH POUND AND ITS WEIGHT IN U.S. TRADE

Regardless of the pound's direction, the share of American trade claimed by the UK has declined over the past 15 years.

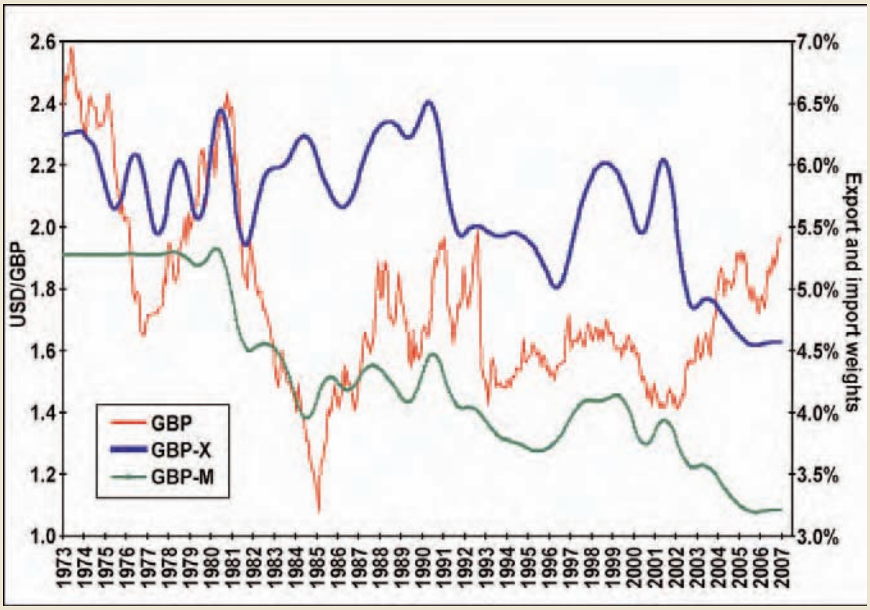
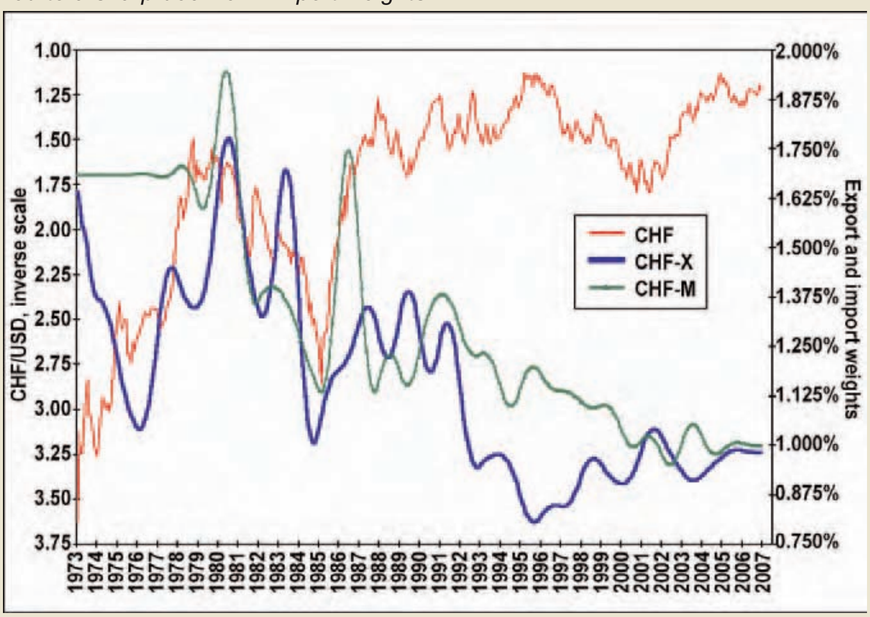


FIGURE 5 — THE SWISS FRANC AND ITS WEIGHT IN U.S. TRADE

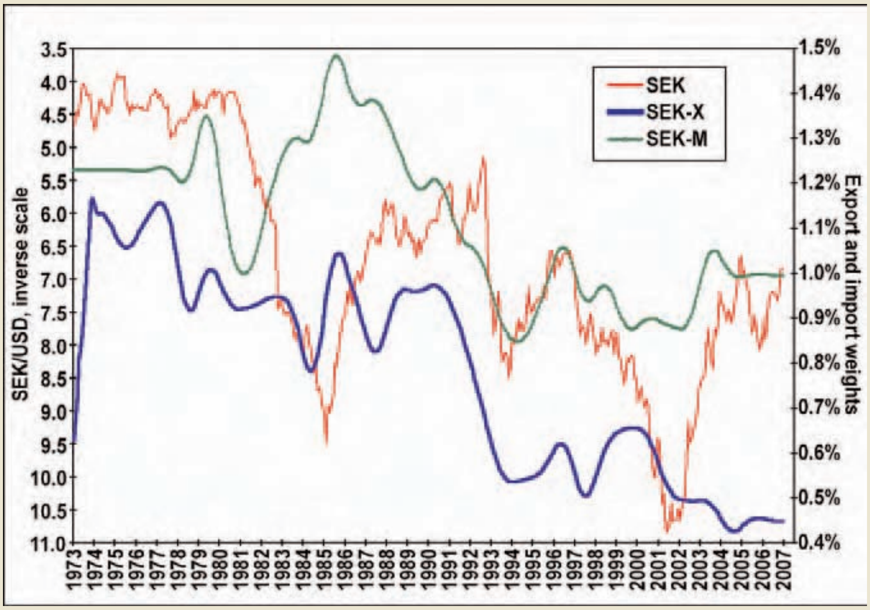
Contradicting protectionist theory, a weaker Swiss franc in the early 80s led to a sharp decline in import weights.



global economy, has lost 79.68 percent of its purchasing power since the December 1971 Smithsonian Agreement began the floating exchange rate era.

FIGURE 6 — THE SWEDISH KRONA AND ITS WEIGHT IN U.S. TRADE

Import weights behaved according to the protectionist model during the dollar rally of the early 80s, but barely moved between 1998 and 2002 as the krona weakened. Also, the sharp rebound between 2003 and 2005 had no discernible effect on either import weights or export weights.



The major currencies

The euro (EUR) is the principal alternative to the dollar and it is fair to say its movements reflect whether the dollar is strengthening or weakening.

Regardless of whether the euro or its collective predecessors were strengthening or weakening over the entire period, the general trend of U.S. export weights to the Eurozone was lower (Figure 1). This was true even during the 1987-1994 period in which the dollar weakened significantly against the euro. A weaker dollar never made U.S. exports to the Eurozone more competitive.

The opposite is not quite true. Import weights did, in fact, trend lower between 1987 and 1994. However, import weights did not fall significantly as the euro strengthened between 2002 and 2004.

The protectionist argument fails and fails significantly for the euro.

Japanese yen

The Japanese yen (JPY) used to be the favorite whipping boy of the protectionists, especially in the auto industry. The yen shot higher during the 80s stock-and-land bubble in Japan, and its weights in U.S. imports began a decline still underway (Figure 2). When the yen more than doubled against the dollar, Japanese goods did become more expensive. They were replaced (as will be explained next month) either by cheaper exports from sources such as China and other Asian exporters or from Mexico or by Japanese goods made outside of Japan, principally in Mexico and the U.S.

The weaker dollar did nothing to increase export weights to Japan, which peaked in the early 90s and have fallen ever since. Much of this is due, of course, to Japan's Lost Decade, now in its 17th year by some measures. The rest is attributable to various non-price trade barriers in Japan and to the availability of cheaper goods from Asian sources.

Canadian dollar

The early 80s decline in the Canadian dollar should, according to the protectionists, have increased its import weights and decreased its export weights. Not only did the exact opposite occur, but a subsequent rebound from 1987 to 1992 had no reversing effect (Figure 3). Finally, the huge 2003-2005 rally in the Canadian dollar had no discernible effect on either import or export weights.

The adoption of the North American Free Trade Agreement (NAFTA) in

continued on p. 36

Related reading

Other Howard Simons articles:

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late 1993 preceded a general trend of increasing export and decreasing import weights regardless of currency movements, which suggests the free trade agreement produced economic efficiencies greater than the frictions caused by any currency fluctuation.

British pound

The pound's (GBP) sharp decline in the early 80s was matched by a decline in its import weight, indicating British imports were not competitive even with the currency-derived discount. Those weights have continued on a gradual downward path to this day (Figure 4).

American export weights to the UK began a similar decline in the early 90s once the pound entered what has proven to be a trading range of unusual duration. Regardless of the pound's direction, the share of American trade claimed by the UK has declined over the past 15 years.

Swiss franc

A weaker Swiss franc in the early 80s led — in direct contradiction to the protectionist theory — to a sharp decline in import weights. Moreover, those weights increased after the franc rallied in 1986-1987, and then embarked on a long secular decline (Figure 5).

Export weights from the U.S. to Switzerland fell sharply into 1996, and then rebounded somewhat regardless of what the currency did. As much of U.S.-Switzerland bilateral trade is in specialty and luxury goods, we should not expect to see much of a price elasticity on either side of the equation, and we do not.

Swedish krona

Export weights of the Swedish krona (SEK) have declined steadily since the early 80s (Figure 6). Import weights behaved according to the protectionist model during the dollar rally of the early 80s, but scarcely moved between 1998 and 2002 as the krona weakened. The sharp rebound between 2003 and 2005 had no discernible effect on either import weights or export weights.

Australian dollar

The Australian dollar (AUD) has a mixed history. Its import weights declined between 1980 and 1995 even as the Australian dollar remained in a long-term downtrend (Figure 7). These weights have remained flat over the past decade regardless of currency movements.

However, in one of the few cases where the protectionist model works, export weights to Australia have mirrored the currency's course since the mid-80s. This is one of the few times when American goods and services became more competitive with a weaker U.S. dollar.

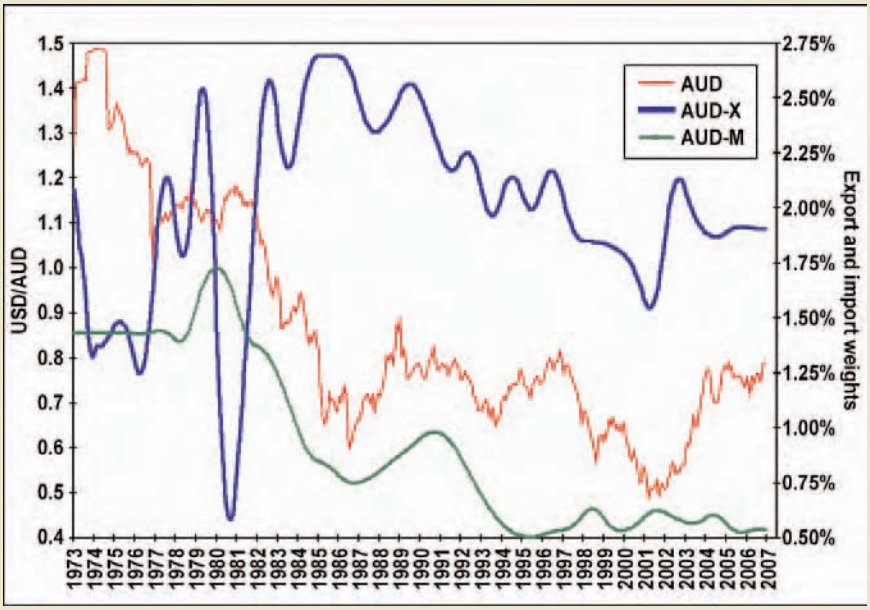
Tenuous connection

A review of U.S. trade patterns with major currency trading partners reveals little evidence that a weaker currency leads to greater export competitiveness and a lower ability to import. Next month's issue will contain the second part of this series — a discussion of the "minor" currencies and their trade weights.

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

FIGURE 7 — THE AUSSIE DOLLAR AND ITS WEIGHT IN U.S. TRADE

The Australian dollar's mixed history includes declining import weights between 1980 and 1995 as the currency remained in a long-term downtrend, while export weights to Australia have mirrored the currency's course since the mid-80s — the latter condition representing one of the few times when American goods and services became more competitive with a weaker U.S. dollar.



Manipulators beware

IMF tightens currency guidelines

In recent months, certain countries, most notably China, have been accused of maintaining a certain exchange rate for their currency in an effort to artificially keep their economy at a steady level.

This has often brought criticism and even threats from other countries — the U.S. Senate is considering legislation against China unless the Chinese change their currency policy — although there is little the international community can actually do.

The International Monetary Fund (IMF), which oversees the economic situation of its 185 member countries, is attempting to keep manipulation to a minimum. In mid-June, it announced a change to its surveillance framework, the IMF's first revision to the policy in 30 years.

"The new decision reflects current best practice in our work of monitoring members' exchange rate policies and domestic economic policies," said IMF managing director Rodrigo de Rato during a speech at the International Economic Forum of the Americas Conference. "It reaffirms that surveillance should be focused on our core mandate, namely promoting countries' external stability. And it gives clear guidance to our members on how they should run their exchange rate policies and on what is acceptable to the international community and what is not."

The IMF will keep its existing policy regarding exchange rate manipulation and intervening in the forex markets and add an additional rule: "A member should avoid exchange rate policies that result in external instability."

De Rato says the decision has support from established and developing economies alike, and demonstrates that members will be active in their self-regulation.

Specifically, the new guidelines state that countries should not set policies that undermine the stability of the international system and provide a set of standards the IMF will use to determine whether a country is complying — criteria such as large-scale currency intervention, the accumulation of reserves, and fundamental exchange-rate misalignment. They also attempt to reassure emerging markets by promising to consider the particular circumstances of a country.

Countries will be in violation if the IMF considers them to be a currency manipulator as a result of "fundamental exchange-rate misalignment" or "large and prolonged current-account deficits or surpluses."

While the new rules do not actually grant the IMF any enforcement powers, they do allow the group to apply strong-arm tactics in an effort to coerce the offenders. And, the IMF believes that simply mentioning a country as a currency manipulator will be enough to shame the country into changing.

Intent is not considered under the new rules — i.e., a country can have the best intentions and still be in violation.

China, Egypt, and Iran objected to the new rules, which were approved by the 24-member IMF Board. China could be found to be a currency manipulator under the new rules.

Home-grown rand futures

South Africa enters currency futures market

The Johannesburg Stock Exchange (JSE) listed South Africa's first exchange-traded currency futures product in mid-June. The JSE launched futures on the U.S. dollar/South African rand and hopes to add euro/rand and British pound/rand spreads at a later date.

The Reserve Bank of South Africa says about $10 billion of spot forex transactions occur daily, but the JSE did not provide an estimate of how much business it expects the futures to do.

Individual traders looking to participate in rand futures must purchase at least $1,000 worth of contracts but have no limitations. Pension funds have a 15-percent foreign allocation allowance, while asset managers are capped at 25 percent of total assets. Hedge funds are not yet allowed.

South African residents face many restrictions with exchange-traded products, but the JSE believes the futures will allow the South African Treasury to relax some of those controls.

Fed leaves rates alone

The Federal Reserve announced at the conclusion of its two-day meeting on June 28 it was keeping the benchmark fed funds rate unchanged at 5.25 percent. The U.S. dollar continued its downswing against most major currencies (a notable exception being the Japanese yen) in the first 24 hours after the announcement.

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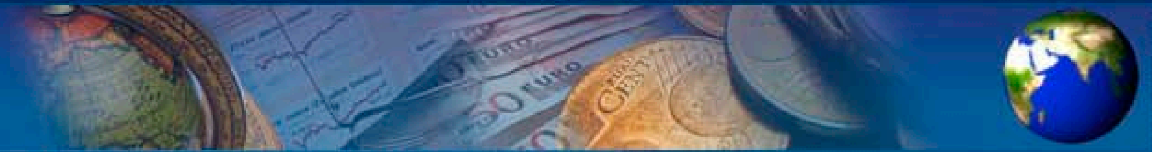

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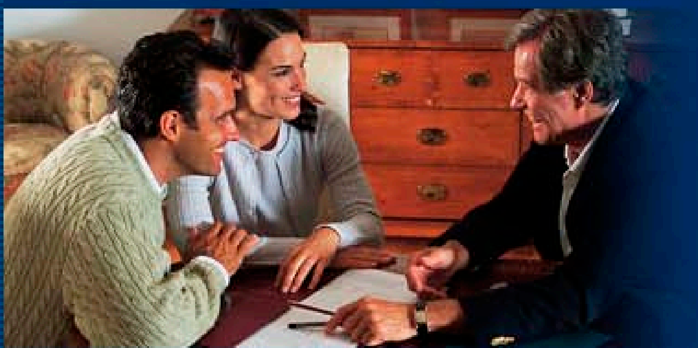
FOREX QUOTES

FOREX			22:46
USDCHF	1.2298	1.2302	▼
GBPUSD	1.9710	1.9714	▲
USDJPY	121.45	121.49	▲
EURUSD	1.3466	1.3468	▲
USDCAD	1.0849	1.0854	▲
AUDUSD	0.8218	0.8223	▼
USDSEK	6.853	6.857	▼
NZDUSD	0.7303	0.7307	▲
EURJPY	163.57	163.62	▲
EURCAD	1.4611	1.4616	▲
EURAUD	0	1.6377	▼



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Currency traders treading water

Currency traders are managing to keep their heads above water, but it's still a good idea to keep a life vest nearby. The Barclay's Currency Traders Index (CTI) was down slightly (0.13 percent) in June, dropping the index to a gain of just 0.39 percent for the first six months of the year.

What's worse is that the CTI decline came in a month when Barclay's five other sub-indices and composite CTA index showed their biggest gains of the year. While the CTI was the best-performing of the seven indices through May, it's now the second-worst performer, leading only the Agricultural Traders Index, which has dropped 1.59 percent since the beginning of the year.

The CTI, which tracks 114 managed money programs that trade currency futures and/or spot forex, is coming off back-to-back losing years and is trying to avoid its first three-year losing streak in its 20-year history.

The Barclay BTOP FX Index, which tracks the largest investable currency trading programs and accounts for at least half of the investable assets of all programs tracked by Barclay, continues to rise at a slow-but-steady pace.

The index was up 0.75 percent in June, pushing its climb since the beginning of the year to 2.6 percent. As of June 29, the BTOP was at 1,034.11, less than five points from its all-time high set on June 22.

CURRENCY FUTURES SNAPSHOT

as of June 27

The information does NOT constitute trade signals. It is intended only to provide a brief synopsis of each market's liquidity, direction, and levels of momentum and volatility. See the legend for explanations of the different fields.

Contract	Pit sym	Elec sym	Exch	Vol	OI	10-day move	% rank	20-day move	% rank	60-day move	% rank	Volatility ratio/% rank
Eurocurrency	EC	6E	CME	140.4	179.2	0.99%	80%	0.32%	10%	0.84%	13%	.26 / 75%
Japanese yen	JY	6J	CME	87.9	262.8	-0.01%	0%	0.11%	100%	-2.83%	53%	.18 / 18%
British pound	BP	6B	CME	72.6	118.9	1.23%	80%	1.02%	36%	1.11%	26%	.50 / 80%
Swiss franc	SF	6S	CME	52.7	93.1	1.12%	100%	0.18%	10%	-0.52%	25%	.52 / 97%
Canadian dollar	CD	6C	CME	46.7	146.4	-0.37%	0%	0.36%	0%	8.18%	74%	.09 / 5%
Australian dollar	AD	6A	CME	36.5	100.4	-0.38%	0%	1.52%	29%	2.90%	30%	.18 / 45%
Mexican peso	MP	6M	CME	23.5	92.1	0.99%	100%	-0.97%	67%	1.24%	35%	.30 / 55%
New Zealand dollar	NE	6N	CME	3.8	28.2	1.14%	37%	3.32%	45%	5.22%	56%	.23 / 53%
U.S. dollar index	DX		NYBOT	3.3	21.9	-0.83%	100%	-0.35%	13%	-1.03%	33%	.29 / 80%
Euro / Japanese yen	EJ		NYBOT	1.8	25.1	1.10%	79%	0.25%	0%	3.75%	50%	.24 / 43%

Note: Average volume and open interest data includes both pit and side-by-side electronic contracts (where applicable). Price activity is based on pit-traded contracts.

LEGEND:

Sym: Ticker symbol.

Vol: 30-day average daily volume, in thousands.

OI: 30-day open interest, in thousands.

10-day move: The percentage price move from the close 10 days ago to today's close.

20-day move: The percentage price move from the close 20 days ago to today's close.

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

The "% rank" fields for each time window (10-day moves, 20-day moves, etc.) show the percentile rank of the most recent move to a certain number of the previous moves of the same size and in the same direction. For example, the % rank for 10-day move shows how the most recent 10-day move compares to the past twenty 10-day moves; for the 20-day move, the % rank field shows how the most recent 20-day move compares to the past sixty 20-day moves; for the 60-day move, the % rank field shows how the most recent 60-day move compares to the past one-hundred-twenty 60-day moves. A reading of 100% means the current reading is larger than all the past readings, while a reading of 0% means the current reading is lower than the previous readings.

Volatility ratio/% rank: The ratio is the short-term volatility (10-day standard deviation of prices) divided by the long-term volatility (100-day standard deviation of prices). The % rank is the percentile rank of the volatility ratio over the past 60 days.

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

EUROPE

▼ Preliminary data indicates the **UK's Q1 economy** grew 2.8 percent from the first quarter 2006 and 0.7 percent from the previous quarter. The February-April unemployment rate remained stable at 5.5 percent compared to the previous three-month period and gained 0.2 percent from the same period a year earlier.

▼ **Germany's unemployment rate** continued to decline, falling 0.4 percent in April to 9.1 percent. That represents a 1.7-percent drop from April 2006.

▼ **France's May unemployment rate** fell 0.1 percent to 8.1 percent from the previous month, and dropped 1 percent from the same month a year ago. France's department of statistics reported the country should see a mild acceleration of GDP — about 0.7 percent — this spring, putting it on par with Germany and the rest of the Eurozone.

ASIA & AUSTRALIA

▼ **Japan's first-quarter GDP** grew 2.6 percent on an annual basis and 0.8 percent from the fourth quarter of 2006. The unemployment rate for May was 3.8 percent, unchanged from the previous month and a decline of 0.4 percent compared to the same month in 2006.

▼ **Australia's Q1 GDP** grew 8.8 percent for the year and 2.3 percent from the previous quarter. Its May unemployment rate dropped 0.2 percent from April to 4.2 percent and declined 0.6 percent from a year earlier.

▼ **Hong Kong's May jobless rate** remained at 4.3 percent from the previous month, a nine-year low. The drop from May 2006 was 0.5 percent.

AMERICAS

▼ **Canada's Q1 economy** grew 4.4 percent on an annual basis and 2.4 percent from the previous quarter. Its **May jobless rate** remained at 6.1 percent for the fourth-straight month and was also unchanged from May 2006.

▼ **Brazil's jobless rate for the three-month period ending in May** remained at 10.1 percent, a drop of 0.3 percent from the same period in 2006.

▼ **Argentina's Q1 GDP** increased 8 percent year-over-year and 1 percent from the previous quarter. The country's May unemployment rate jumped 1.2 percent compared to April, but fell 1.5 percent from the previous year.

AFRICA

▼ **South Africa's Q1 GDP** increased 4.7 percent from the previous quarter, boosted mostly by the finance, real estate, and business services industries.

Interest Rates

↑ **The European Central Bank increased its refi rate** 0.25 percent in June to 4 percent. The ECB has increased rates 25 basis points eight times since December 2005.

↑ **The Swiss National Bank raised its three-month Swiss Libor** 25 basis points in June to 2.5 percent. Rates have steadily increased in Switzerland since reaching a low of 0.25 percent in 2003.

↑ **The Swedish Riksbank raised its repo rate** 0.25 percent in late June to 3.5 percent. The repo rate stood at 1.75 percent in January 2006.

↓ **The Central Bank of Brazil lowered its Selic rate** 0.5 percent in June to a new all-time low of 12 percent. The decline was the 16th-consecutive rate cut for the Selic, which stood at 19.75 percent in mid-2005.

↑ **The Reserve Bank of South Africa raised its repurchase rate** 0.5 percent in June to 9.5 percent, the fifth 50-basis-point increase in a year.

↑ **The Reserve Bank of New Zealand raised its cash rate** 0.25 percent in June to 8 percent. The increase was the third in four months after the country had gone more than a year without a rate change.

↑ **The Bank of Mexico increased its 28-day Cetes rate** 0.1 percent in late May. The third increase in as many months pushed the rate to 7.2 percent.

↑ **The Czech National Bank raised it two-week repo rate** 0.25 percent in May to 2.75 percent, the first increase since September 2006.

↑ In early June, **the National Bank of Denmark boosted its two-week CD rate** 25 basis points to 4.25 percent. The country has not cut rates since 2003.

↑ **The Norwegian Central Bank raised its rate** in June 0.25 percent for the second straight month and the sixth time in eight months. The rate now stands at 4.5 percent.

↓ **The Bank of Indonesia continued to cut rates, lowering its reference rate** 0.25 percent to 8.5 percent. The decline is the 11th in 12 months and the 12th overall since rates stood at 12.75 percent in January 2006.

↓ **The Bank of Israel dropped its short-term lending rate** 25 basis points in late May to 3.5 percent. The drop was the seventh since October 2006.

FOREX (vs. U.S. DOLLAR)

Rank*	Country	Currency	Current price vs. U.S. dollar	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous rank
1		New Zealand dollar	0.7626	4.98%	6.26%	8.65%	0.7692	0.5925	16
2		Australian dollar	0.8414	2.81%	4.00%	7.28%	0.8511	0.7269	14
3		Thai baht	0.03168	2.52%	1.51%	13.47%	0.03168	0.02596	11
4		Taiwan dollar	0.03049	1.57%	0.83%	-0.33%	0.03107	0.02983	8
5		Canadian dollar	0.9337	0.83%	8.18%	8.42%	0.9478	0.842	2
6		Britain pound	1.9972	0.66%	1.53%	2.02%	2.0131	1.8089	12
7		Russian ruble	0.03871	0.23%	0.65%	2.03%	0.03896	0.03688	7
8		Hong Kong dollar	0.128	0.16%	0.00%	-0.47%	0.1288	0.1264	5
9		Chinese yuan	0.1311	0.15%	1.24%	2.42%	0.1315	0.1246	4
10		Euro	1.3442	-0.02%	0.77%	2.35%	1.3678	1.2456	10
11		Swiss franc	0.814	-0.05%	-1.11%	-0.56%	0.8415	0.7829	15
12		South African rand	0.1391	-0.22%	0.65%	-2.11%	0.1487	0.1253	6
13		Brazilian real	0.5131	-0.29%	5.64%	9.94%	0.5265	0.4284	1
14		Swedish krona	0.1454	-0.62%	1.47%	-0.14%	0.1497	0.1344	9
15		Singapore dollar	0.65	-0.75%	-1.44%	-0.02%	0.6626	0.6248	13
16		Japanese yen	0.008148	-0.80%	-3.77%	-3.22%	0.00881	0.00805	17
17		Indian rupee	0.02439	-0.97%	5.04%	8.11%	0.02477	0.02123	3

As of June 28 *based on one-month gain/loss

ACCOUNT BALANCE

Rank	Country	2007	Ratio*	2006	2008+
1	Singapore	39.644	27.1	36.288	41.939
2	Switzerland	68.511	17.6	69.825	68.139
3	China	303.651	10	238.536	356.617
4	Hong Kong	19.449	9.6	19.388	19.924
5	Netherlands	55.176	7.7	46.989	58.007
6	Taiwan	25.924	7.1	25.187	27.875
7	Sweden	28.06	6.6	28.447	30.096
8	Russia	72.902	6.2	95.6	67.797
9	Germany	161.938	5.3	146.361	164.71
10	Japan	166.586	3.9	170.355	159.142
11	Brazil	8.939	0.8	13.648	3.26
12	Canada	9.351	0.7	21.464	7.612
13	Mexico	-9.197	-1	-1.475	-13.461
14	France	-51.972	-2.2	-46.304	-58.5
15	India	-23.768	-2.4	-19.298	-24.568
16	UK	-81.402	-3.1	-68.122	-87.983
17	Australia	-46.24	-5.6	-40.856	-46.743
18	U.S.	-834.623	-6.1	-856.661	-866.145
19	South Africa	-17.418	-6.4	-16.415	-17.385
20	Spain	-127.459	-9.4	-108.019	-142.416

Totals in billions of U.S. dollars

**Account balance in percent of GDP +Estimate*

Source: International Monetary Fund, World Economic Outlook Database, April 2007

NON-U.S. DOLLAR FOREX CROSS RATES

Rank	Currency pair	Symbol	June 28	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Aussie $ / Yen	AUD/JPY	103.272	3.59%	8.07%	10.85%	105.356	84.58	10
2	Aussie $ / Franc	AUD/CHF	1.0339	2.79%	5.17%	7.88%	1.0492	0.9093	13
3	Aussie $ / Euro	AUD/EUR	0.626	2.77%	3.20%	4.82%	0.6338	0.5791	17
4	Aussie $ / Pound	AUD/GBP	0.4213	2.08%	2.43%	5.14%	0.4292	0.3932	15
5	Aussie $ / Canada $	AUD/CAD	0.9014	1.90%	-3.87%	-1.06%	0.9493	0.8178	19
6	Canada $ / Yen	CAD/JPY	114.604	1.57%	12.41%	12.01%	116.1	98.32	2
7	Pound / Yen	GBP/JPY	245.125	1.40%	5.50%	5.41%	247.785	209.537	9
8	Pound / Euro	GBP/EUR	1.4896	0.86%	0.98%	-0.08%	1.5296	1.4363	14
9	Canada $ / Euro	CAD/EUR	0.6947	0.80%	7.34%	5.92%	0.7117	0.639	7
10	Euro / Yen	EUR/JPY	164.979	0.75%	4.72%	5.75%	166.901	144.998	8
11	Franc / Yen	CHF/JPY	99.903	0.70%	2.76%	2.73%	100.855	92.48	11
12	Real / Yen	BRL/JPY	62.9781	0.44%	9.76%	13.59%	64.9982	52.096	1
13	Canada $ / Pound	CAD/GBP	0.4676	0.13%	6.56%	6.27%	0.4918	0.4271	6
14	Franc / Euro	CHF/EUR	0.6055	-0.05%	-1.88%	-2.86%	0.6414	0.5948	18
15	Real / Euro	BRL/EUR	0.3817	-0.34%	4.81%	7.40%	0.3932	0.34174	5
16	Franc / Pound	CHF/GBP	0.4076	-0.73%	-2.58%	-2.53%	0.444	0.4038	16
17	Franc / Canada $	CHF/CAD	0.872	-0.93%	-8.60%	-8.30%	0.9751	0.8564	20
18	Real / Pound	BRL/GBP	0.2569	-1.00%	4.01%	7.76%	0.2658	0.2339	4
19	Real / Canada $	BRL/CAD	0.5497	-1.17%	-2.36%	1.40%	0.5695	0.5029	12
20	Real / Aussie $	BRL/AUD	0.61	-3.11%	1.57%	2.49%	0.6335	0.5859	3

GLOBAL STOCK INDICES

Rank	Country	Index	June 28	1-month gain/loss	3-month gain/loss	6-month gain/loss	52-week high	52-week low	Previous
1	Hong Kong	Hang Seng	21,938.22	6.86%	12.19%	9.68%	22,085.59	15,613.20	12
2	Egypt	CMA	2,793.14	4.53%	12.21%	17.32%	2,799.16	1,681.23	3
3	Brazil	Bovespa	54,260.98	4.11%	21.98%	22.01%	55,003.28	34,127.48	4
4	Germany	Xetra Dax	7,921.36	2.35%	16.20%	19.81%	8,131.73	5,365.06	1
5	Japan	Nikkei 225	17,932.27	1.96%	3.93%	4.11%	18,300.39	14,437.24	11
6	Mexico	IPC	31,519.90	1.91%	12.18%	19.87%	32,564.35	17,837.92	6
7	India	BSE 30	14,504.57	0.74%	12.58%	4.75%	14,723.88	9,875.35	13
8	Singapore	Straits Times	3,538.23	0.71%	10.51%	19.39%	3,652.02	2,319.03	2
9	Australia	All ordinaries	6,297.40	0.36%	6.50%	11.77%	6,751.30	5,633.80	9
10	UK	FTSE 100	6,571.30	0.01%	4.85%	5.29%	6,675.00	5,467.40	8
11	U.S.	S&P 500	1,505.71	-0.66%	6.24%	5.68%	1,540.56	1,224.54	10
12	France	CAC 40	6,006.31	-1.07%	8.17%	8.55%	6,168.15	4,710.61	5
13	Canada	S&P/TSX composite	13,715.67	-2.54%	3.93%	6.24%	14,216.21	11,270.55	7
14	Switzerland	Swiss Market	9,138.91	-2.58%	3.02%	3.81%	9,548.10	7,372.80	15
15	Italy	MIBTel	32,709.00	-2.92%	1.98%	2.74%	34,369.00	26,926.00	14

GLOBAL INTEREST RATES

Country	Interest rate	Rate	Last change	Jan. 07	July 06
U.S.	Fed Funds Rate	5.25	0.25 (June 06)	5.25	5.25
Japan	Overnight call rate	0.5	0.25 (Feb. 07)	0.25	0.25
Eurozone	Refi rate	4	0.25 (June 07)	3.5	2.75
UK	Repo rate	5.5	0.25 (May 07)	5.25	4.5
Canada	Overnight funding rate	4.25	0.25 (May 06)	4.25	4.25
Switzerland	3-month Swiss Libor	2.5	0.25 (June 07)	2	1.5
Australia	Cash rate	6.25	0.25 (Nov. 06)	6.25	5.75
New Zealand	Cash rate	8	0.25 (June 07)	7.25	7.25
Brazil	Selic rate	12	0.5 (June 07)	13	14.75
Korea	Overnight call rate	4.5	0.25 (Aug. 06)	4.5	4.25
Taiwan	Discount rate	2.875	0.125 (March 07)	2.75	2.5
India	Reverse repo rate	6.5	0.5 (March 07)	6	6
South Africa	Repurchase rate	9.5	0.5 (June 06)	9	7.5

GLOBAL BOND RATES

Rank	Country	Rate	June 28	1-month	3-month	6-month	Previous
1	UK	Short sterling	93.76	-0.13%	-0.53%	-0.75%	2
2	Australia	10-year bonds	93.745	-0.28%	-0.46%	-0.41%	1
3	U.S.	10-year T-note	105.065	-1.08%	-2.83%	-1.98%	5
4	Germany	BUND	110.94	-1.23%	-3.78%	-4.43%	4
5	Japan	Government Bond	131.51	-1.39%	-1.84%	-2.06%	3

All data as of June 28

Legend

CPI: Consumer price index
ECB: European Central Bank
FOMC: Federal open market committee
GDP: Gross domestic product
ISM: Institute for supply management
PPI: Producer price index

Economic release (U.S.)	Release time (ET)
GDP	8:30 a.m.
CPI	8:30 a.m.
ECI	8:30 a.m.
PPI	8:30 a.m.
ISM	8:30 a.m.
Unemployment	8:30 a.m.
Personal income	8:30 a.m.
Durable goods	8:30 a.m.
Retail sales	8:30 a.m.
Trade balance	8:30 a.m.
Leading indicators	10 a.m.

JULY 2007

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

AUGUST 2007

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

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

July

1

2 **U.S.:** ISM
Japan: Account balances
Great Britain: Productivity
Australia: Index of commodity prices

3 **Japan:** Monetary base
Germany: Retail turnover
Australia: Reserve bank meeting

4 **Great Britain:** Monetary policy committee meeting

5 **ECB:** Governing council meeting
Great Britain: Monetary policy committee meeting

6 **U.S.:** Employment report
Germany: Orders received and manufacturing turnover
Australia: Official reserve assets

7

8

9 **Germany:** Production index; foreign trade

10 **U.S.:** Wholesale inventories
Great Britain: PPI
Canada: Interest rate announcement

11 **Japan:** Balance of payments; corporate goods price index; monetary policy meeting
Germany: Bankruptcies

12 **U.S.:** Trade balance
Japan: Monetary policy meeting
Philippines: Monetary board meeting

13 **U.S.:** Retail sales
Japan: Monetary survey

14

15

16 **Germany:** CPI
Canada: Manufacturing survey

17 **U.S.:** PPI
Great Britain: CPI
Brazil: Monetary policy committee meetings
Poland: Monetary policy council meeting

18 **U.S.:** CPI
Great Britain: Employment report
Canada: CPI; leading indicators
Brazil: Monetary policy committee meetings
Thailand: Monetary policy committee meeting

19 **U.S.:** Leading indicators
ECB: Governing council meeting
Great Britain: Capital issues; retail sales
Germany: PPI
Canada: Wholesale trade

20 **Great Britain:** GDP

21

22

23 **Israel:** Announcement of interest-rate changes

24 **Canada:** Retail trade
Poland: Monetary policy council meeting

25 **Poland:** Monetary policy council meeting

26 **U.S.:** Durable goods
Japan: Corporate service price index
Canada: Employment report
New Zealand: Official cash rate announcement
Czech Republic: Czech National Bank board meeting

27 **U.S.:** GDP

28 **Mexico:** Monetary policy announcement

29

30

31 **Germany:** Employment report
Canada: GDP
Australia: International reserves and foreign currency liquidity

August

1 **U.S.:** ISM
Japan: Account balances
Great Britain: Monetary policy committee meeting

2 **ECB:** Governing council meeting
Japan: Monetary base
Great Britain: Monetary policy committee meeting

3 **U.S.:** Employment report
Germany: Retail turnover

▼ **CQG** has released a new API that gives customers the ability to export CQG market data and analytics to external applications. The API uses Microsoft COM technology to communicate with the CQG Integrated Client, allowing it to obtain market data from CQG servers. The API also routes orders through the CQG Integrated Client to exchanges via the CQG Hosted Gateway. The CQG API also provides order-routing access through CQG's exchange gateway, connectivity to the CQG Integrated Client via Excel spreadsheets, and opportunities to build market-oriented Web sites to draw traffic. In addition, CQG has teamed up with FuturesBoard to provide an interactive resource for sharing knowledge and advice about CQG products and services. Traders and analysts can visit FuturesBoard to access insight on the futures markets. The Web site's CQG channel includes tips, help, and information on CQG's software, along with forums on CQG's strategies and formulas. For more information, go to http://www.cqg.com.

▼ **RTS Realtime Systems Group** has introduced a new automated trading tool, RTD Tango Backtester. Designed to allow traders to test their trading models before using them, the RTD Tango Backtester assists users with a full range of trading strategies. RTD Tango Backtester enables clients to test their proposed trading strategies and models by simulating transactions through a comprehensive set of real historical market data to determine how their approach would have fared over an extended period of time. Users can evaluate their anticipated trading performance after customizing their backtest by running thousands of parameter combinations or strategy components against historical tick data and market depth. RTD Tango Backtester is a server-based application with a graphical user interface (GUI) compatible to Tango. Once they are satisfied with their models, users can convert their backtests into active strategies on Tango, reducing time to deployment. Users can test against historical tick data and full market depth, and can accelerate market feeds up to 1,000 times the actual occurrences. They can also slow down testing to observe the minute detail of transactions to maximize their strategic analysis and the consistency of their logic. Backtester also enables clients to test their strategies against real time market data. RTD Tango and its Backtester tool run on multiple platforms. Because Tango is part of RTS' Middleware offering, clients do not need to go through an API to use it. For more information, contact globalsales@rtsgroup.net.

▼ **MTPredictor RT** is now offered as an add-on for the NinjaTrader platform. MTPredictor intraday traders can now use any of the NinjaTrader datafeeds. Using NinjaTrader's Market Analyzer window, MTPredictor RT can identify complete trade setups and enables them to be displayed on the trader's NinjaTrader screen with full setup, risk-reward, and trade management analysis. The latest release also features automatic money-management routines. NinjaTrader charts can be powered by datafeeds from eSignal, TradeStation, DTN.iQ, TrackData, Interactive Brokers, and others. MTPredictor RT is available with full support for $2,495. NinjaTrader is free for charting, analytics, and system development. More MTPredictor information and online ordering is available at http://www.mtpredictor.com.

▼ **Matrox Graphics Inc.'s** new DualHead2*Go* Digital Edition is now shipping. This external multi-display upgrade device allows you to connect two digital monitors to your notebook or desktop. Matrox Graphics eXpansion Modules (GXM) are small external boxes that are simple to set up — there is no need to open the computer to insert additional parts. The operating system detects the GXM as an ultra-widescreen monitor that is split into two or more standard resolutions, harnessing your system's existing 2D, 3D, and video acceleration graphics hardware. DualHead2*Go* Digital Edition includes support for Windows Vista, Windows XP, Windows 2000, Windows XP 64-bit operating systems, and Mac OS X v10.4, and is compatible with many desktops and notebooks. DualHead2*Go* Digital Edition is $229 and is available from authorized resellers worldwide or, in North America and Europe, directly from Matrox at http://shopmatrox.com.

▼ **Interbank FX** has recently introduced Interbank FX University (IBFX-U), intended to give both novice and expert traders free trading resources. IBFX-U provides forex trading tools and education for free. The online university currently only offers text and PDF collateral; future plans include video, audio, and flash collateral covering everything from the basics of the forex market to technical and fundamental analysis and various trading strategies. Interbank FX also provides its traders with an online forum, free chart pattern and recognition software, and IBFX credit and debit cards. IBFX-U includes information about the risks of forex trading. IBFX-U is located at http://www.ibfxu.com.

▼ **FNX Capital Markets Solutions** has launched a new strategy-builder platform for CAYMAN, its margin trading and client-management solution. With CAYMAN's new strategy builder, users can create and price new products and trading strategies using a single screen. Furthermore, users can enter and define trading and hedging strategies, both pre-defined and on the fly, define new strategy templates based on pre-existing transactions, view and cancel all outstanding legs of a strategy, and enter "what-if" strategy legs. The strategy builder also allows the user to link products together by rules to form a product template, which can be saved in the system and used for entering a strategy. Additional information is available at http://www.fnx.com.

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

EVENTS

Event: FXCM Currency Trading Expo
For more information: Dates and locations are listed here or visit http://www.fxcmexpo.com

Date: July 14-15
Location: Dallas, Texas

Date: Sept. 15-16
Location: Los Angeles, Calif.

Event: Forex Trading Expo
Date: Sept. 15-16
Location: Mandalay Bay Hotel and Casino, Las Vegas
For more information: Visit http://www.forextradingexpo.com

Event: FIA and OIC New York Equity Options Conference
Date: Sept. 19-20
Location: Grand Hyatt New York
For more information: Visit http://www.futuresindustry.org and click on "Conferences."

Event: Paris Trading Show
Date: Sept. 21-20
Location: Espace Champerret, Paris, France
For more information: Visit http://www.salonat.com

Event: Wealth Expo
For more information: Dates and locations are listed here or visit http://www.thewealthexpo.com

Date: Sept. 29-Oct. 1
Location: Seattle, Wash.

Date: Nov. 30-Dec. 2
Location: Schaumburg, Ill.

Event: 20th Annual IFTA Conference
Date: Nov. 8-11
Location: Sharm el Sheikh, Egypt
For more information: Visit http://www.ifta.org/events/next-conference/

Event: The Traders Expo Las Vegas
Date: Nov. 15-18
Location: Mandalay Bay Resort and Casino, Las Vegas, Nev.
For more information: Visit http://www.tradersexpo.com

Event: 23rd Annual Futures & Options Expo
Date: Nov. 27-29
Location: Hyatt Regency Chicago, Chicago, Ill.
For more information: Visit http://www.futuresindustry.org and click on "Conferences."

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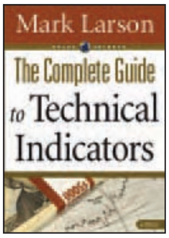

The Complete Guide to Technical Indicators

Mark Larson
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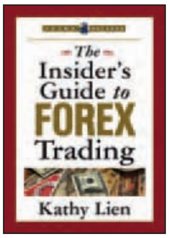

The Insider's Guide to Forex Trading

Kathy Lien
Length: 90 min
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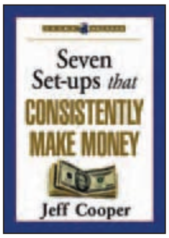
This course that gives you the tools, tactics and expertise you need to tap into the huge potential forex trading offers—from the return boosting advantage of interest paid out on currencies to the flexibility of the 24/7 markets.



Seven Set-ups that Consistently Make Money

Jeff Cooper
Length: 90 min
Item #5197574 Price: $129

A reliable trading set-up can be worth a fortune in winning trades. Jeff Cooper, hands over his seven most consistently profitable set-ups that will work in a wide variety of market conditions.

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Jeff Greenblatt
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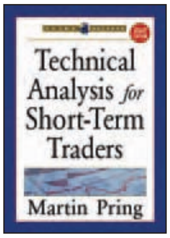

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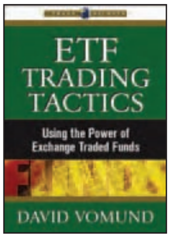
One of the greatest technicians in the industry has taken one of his best courses and made it even better with new tactics, new examples and his sharp and straight-forward insights. Traders' Hall of Fame Award Winner, Martin Pring, walks you through how to identify the trend, confirm the trends and then apply short term tactics to exploit the trend.



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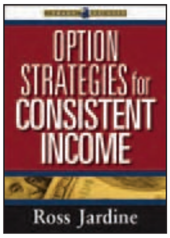

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Ross Jardine
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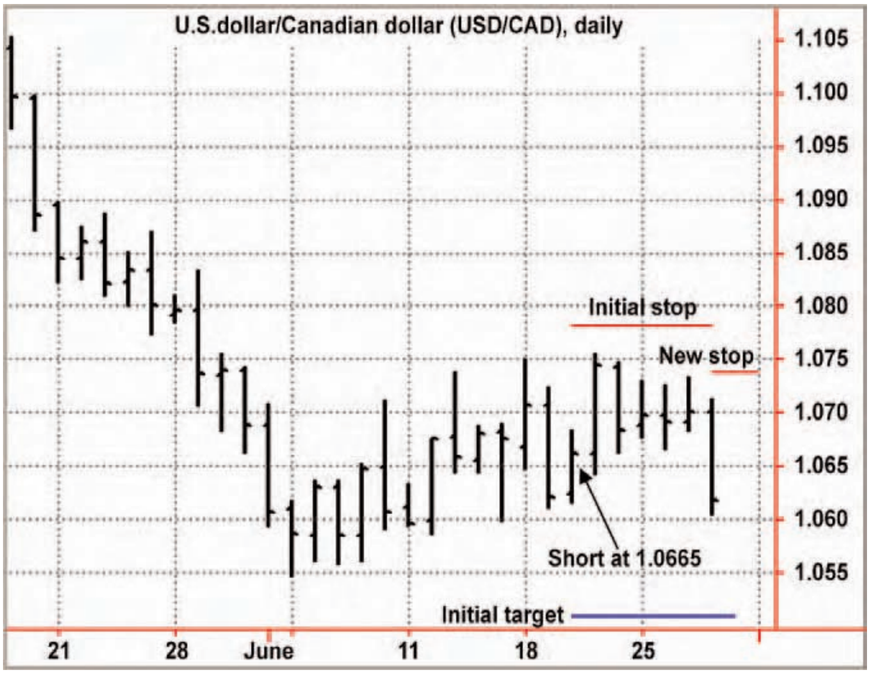
Pause in big Canadian dollar trend weighs on short USD/CAD trade.



Source: TradeStation

TRADE

Date: Wednesday, June 20, 2007.

Entry: Short the U.S. dollar/Canadian dollar (USD/CAD) pair at 1.0665.

Reason(s) for trade/setup: This trade was an extension of a multi-trade program of capitalizing on the USD/CAD's protracted downtrend.

After dropping to a 30-year low of 1.0548 on June 4, USD/CAD had crawled back to 1.0750 by June 18. Having benefited more than once since February 2007 from this accelerated leg of the USD/CAD's multi-year downtrend (see previous Forex Trade Journals), this rally presented another shorting opportunity. We expect the market to challenge its recent low even if it fails to push significantly lower. And for now, the trend is still down.

We entered two days later on June 20 when the market formed an inside day after a day with a lower high, low, and close.

Initial stop: A close above 1.0783, which is 0.0033 above the June 18 high.

Initial target: 1.0510, which is 0.0010 above the next whole number price below the June 4 low (1.0548). Take partial profits at this level and lower the stop to protect the remainder of the position.

RESULT

Exit: Trade still open.

Profit/loss: +0.0040 (0.004 percent), marked-to-market at 11:04 a.m. ET on June 28.

Trade executed according to plan? Yes.

Outcome: We noted in the previous trade diary that the downtrend could not last forever and, after a few successful short trades as the market dropped like a stone, it was increasingly difficult to keep selling for fear of getting caught at the inevitable bottom. This trade hasn't yet realized the worst of this fear, but as of June 27, the USD/CAD pair had staged its longest pause/bounce in its big downtrend since the beginning of the year.

The trade took its hardest hit in the first 24 hours, as the pair rallied as high as 1.0756 and closed at 1.0744 on June 21. It looked like we'd been suckered into selling by the market's downside feint, but the market did little over the next week, moving sideways to slightly higher.

A bit of respite came on June 28 when USD/CAD made a sharp turn to the downside, pushing the trade marginally into the black and allowing us to lower the stop to 1.0739, which is 0.0027 above the day's high. We will be able to lower the stop to breakeven if price drops to the June 4 low of 1.0548.

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

TRADE SUMMARY

Date	Currency	Entry	Initial stop	Initial target	IRR	MTM	Date	P/L	LOP	LOL	Trade length
6/20/07	USD/CAD	1.0665	1.0783	1.0510	1.31	1.0625	6/28/07	0.0040 (0.4%)	0.0058	0.0091	6 days

Legend: IRR — initial reward/risk ratio (initial target amount/initial stop amount); LOP — largest open profit (maximum available profit during lifetime of trade); LOL — largest open loss (maximum potential loss during life of trade); MTM: marked to market — an open position's profit or loss at the current market price.

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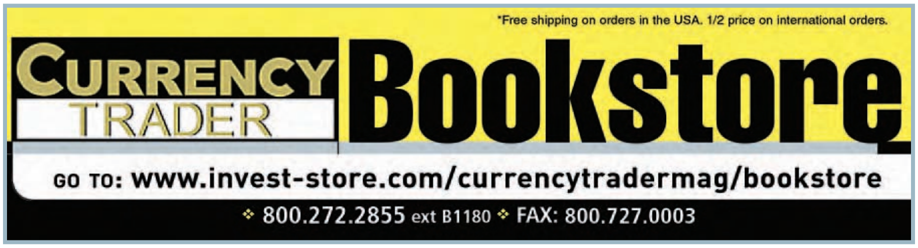
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