



CURRENCY CORNER

Bradley Gilbert provides analysis of the currency market: the euro – don't even try to put lipstick on this PIIG!

If you are like me, you're probably sick to death of hearing about the ongoing dramas in Europe and, more importantly, of the seesaw impact they are having on trading in general. The ECB/IMF/EU need to get their heads out of the sand and make some decisions that are going to benefit global economies.

In my opinion, it's inevitable the euro will be dissolved. With so many differing cultures and economies it was surprising it got off the ground in the first place. No wonder the Germans are unhappy – I would be too if I were working to subsidise the non-tax payers in Greece.

Portugal, Ireland, Italy, Greece and Spain (PIIGS) are experiencing severe economic conditions. Normally, in these economic circumstances, the currency would be devalued and that would in turn lead to stronger growth through greater productivity as demand for cheaper products increased dramatically. Tourism and the like would soar as everyone took advantage of lower prices. It's simple supply and demand economics.

The fact that the PIIGS are tied to the euro doesn't allow this natural ebb and flow of currency strength and weakness to take place. They are wallowing in the pits of despair and need to be put out of their misery. Cut them loose and let them go about rebuilding their economies for everyone's sake (especially us traders)!

The EUR/USD is the most-traded currency pair in the world. Anything that happens in Europe has ramifications for just about every traded currency pair. The ongoing debt debacle and the way it is being handled is leading to nothing short of pandemonium.

There are random unscheduled news releases every other day, which is making normal trading extremely difficult. No sooner are you on a good trade (low-risk entry) with strong direction provided from economic releases, than you are stopped out, wondering what happened. It's frustrating, to say the least.

So what can be done? Dissolve the euro as soon as possible and reintroduce all the old currencies. I worked at Citibank, London on the FX trading desk during the 90s, when there were many opportunities across many currencies before the euro came into existence. Having another dozen currencies would give all traders the opportunity to once again diversify their portfolios.

FIGURE 1: EURO DAILY CHART

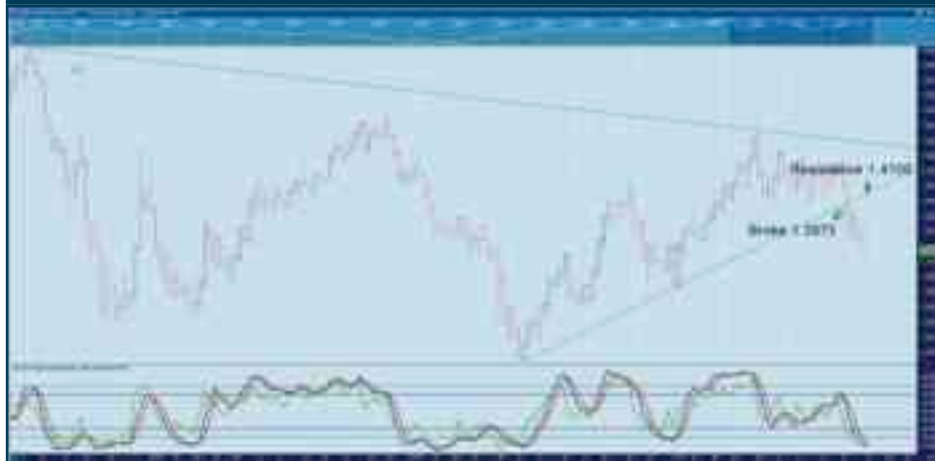


FIGURE 2: EUR/AUD



However, we are dealing with a crisis that will not go away, which is creating turbulent trading activity. There are a number of things you need to do in times like these.

First, stick to your trading plan. It's absolutely imperative you don't start randomly changing your trading plan because you're having a few losses. Part of successful trading is modifying your trading plan when conditions warrant it – but not changing it completely.

Second, you should be looking at the bigger charts for major trend shifts rather than at the shorter-term charts.

Third, your management of capital should follow your trading plan rules, regardless of the trading conditions.

Lastly, it's important you don't look too far ahead. Many traders are distracted by all the noise and the commentaries calling for major moves. You simply can't see the forest for the trees and you will start looking for levels that you otherwise would have not even considered.

Focussing on short-term opportunities and locking the cash away, then looking for the next opportunity, are key to capital growth during times of uncertainty.

What currencies are best to trade?

With the ongoing issues facing the Federal Reserve in the United States and with the roll-out of 'Operation Twist', economic sentiment is fluctuating from 'horrible' one day to 'all fixed' the next. With this in mind, it might be wise to take the USD out of the equation. Since Europe is in all sorts of trouble, this is where you should focus your attention – especially against the backdrop of currencies that are performing extremely well, such as the Australian and Canadian dollars. As well as looking at the longer-term charts such as the daily and weekly charts, look at the euro crosses. Figure 1 (euro daily chart) provides clear entry levels and clear trend direction.

When the bigger trend lines break, the best trading opportunity is on the initial break. You should have two trades running at this point. First, the basic break trade with your generic trading plan and second, a trend trade that allows you to take advantage of a much bigger move if it eventuates. In figure 1, this level is clearly visible at 1.3975.

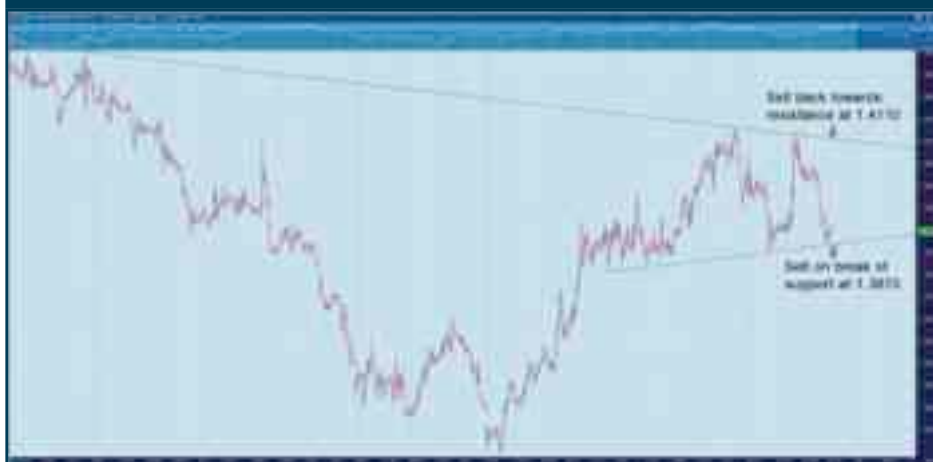
If you miss the initial break of these longer-term trend lines, you should sit out the next week.

An option strategy is another strategy you might put in place as key levels approach on the longer-term trend lines. The key to a successful option trade is timing. When these levels break it is too late, because the cost of the option will skyrocket. As the level approaches 1.3975 you should be looking at low-delta euro puts, which, if the currency breaks, will give a great low-cost trading asset to either sell or trade around.

Bypass the major currency pairs for specific crosses

Switching your day-to-day trading activities away from the major currency pairs might seem strange at first, but it can be extremely rewarding, because you won't get flushed out by a lot of the sporadic USD moves. Let me explain further by looking at the EUR/AUD.

FIGURE 3: EUR/CAD



The EUR/AUD hourly chart has clear short-trading opportunities on a day-to-day basis (figure 2). The reason is extremely weak economic conditions for the euro, with serious doubts about debt repayment. The Aussie dollar, on the other hand, has very strong economic conditions behind it, which we expect to continue for the foreseeable future. Clearly, the opportunity is to play EUR/AUD from the short side.

The currencies are correlated, so when the USD rallies or falls both currencies should move together and the overall cross will not be affected by crazy moves in the USD. However, when the data for each specific currency are released, the currencies react independently of each other. With the Australian data being consistently strong and the European data being consistently weak there are opportunities to get short the cross (or long if you are trading AUD/EUR). The smart trade is playing the cross from one specific side (short) – not overtrading and playing both sides of the market.

The two levels are clear on the hourly charts. You are either selling back towards resistance at 1.4080 or through support at 1.3770. If you are patient enough to wait for these levels, you should be rewarded with good results.

The same thinking can be applied to EUR/CAD. You might prefer to trade EUR/CAD as another proxy to USD/CAD and the oil trade.

We all know the Canadian dollar correlates extremely highly with oil prices. But many traders have found that trading straight USD/CAD has been tough for the reasons already outlined. Remove the USD and trade the EUR/CAD instead.

FIGURE 4: MAJOR CURRENCY PAIRS, EQUITIES AND COMMODITIES

AUD	0.9558-0.9667	CHF	0.9192-0.9249	DOW	+131	OIL	79.68
NZD	0.7574-0.7686	CAD	1.0395-1.0541	S&P 500	+20	GOLD	1641.00
EUR	1.3277-1.3382	YEN	76.63-77.07	USDIX	78.99	COPPER	313.10
GBP	1.5393-1.5483	ZAR	7.9480-8.1490	CRB	298.77	SILVER	30.42

From the EUR/CAD chart (figure 3) you can clearly see where you should be placing your orders to get short. It is the same structure as previously outlined for EUR/AUD. In addition, you can tie the oil trade to this cross. If there are factors that might affect the price of oil, such as hurricanes, or trouble in the Middle East, this cross would work well.

Focus on the correlations, but beware, they change daily

The key to staying ahead of the market during volatile trading conditions is being aware of what is driving the market. The past month or so has shown that the correlating factors change almost daily, under the influence of equity markets and commodities and of central bank policies and economic data releases. It is important to keep up to date with all factors so you can pinpoint the driving force for all currencies. There are two ways to monitor this.

First, it is imperative to read market commentaries about what happened in each trading centre. You can then get a clear picture of what was driving prices – whether it was the bond market, the equity market, or random unscheduled news releases.

Second, having a specific daily review process will keep you up to speed with fluctuations in all markets. Seeing changes in the various markets will enable you to track the correlations.

The table in figure 4 is part of what we use at Traders4Traders. It covers the ranges for the major currency pairs, equity market fluctuations and commodity market prices.


In general, all currencies correlate either positively or negatively with each other, but the correlations go much deeper with each specific currency. For example, the Australian dollar correlates very highly with gold and commodities in general. So when commodities are the major talking point (as has been the case in the past three to six months) you can expect the AUD to fluctuate directly with changes in commodities' prices.

The correlations are a starting point for many trading decisions. When the markets are fickle, as they are at present, the correlations are the key factor to focus on. They are what the traders at the banks are always looking at. Once you know what's driving the market it is much easier to identify low-risk trading opportunities.

Where are the currencies going from here?

The EUR/USD has 1.2000 written all over it. It's more a matter of when, rather than if, it will happen. It's a tough trade though, because dramatic shifts in sentiment on the USD are causing volatile trading conditions. Look for the longer-term charts for clear trading opportunities.

The euro will be the major factor affecting all other currencies, so we are expecting USD strength across the board. This should see Sterling under 1.5000, Swiss above 1.0000, the Canadian dollar above 1.1000 and the Aussie dollar back towards 0.8500. This should correlate with severe weakness in the equity and commodity markets, which are currently precarious.

Prepare yourself for continued chaotic trading conditions as the problems in Europe continue. Look for key levels on longer-term charts and always stick to your trading plan and capital management system. Good luck! 

Bradley Gilbert has been an FX trader for 20 years, including 17 years working in investment banks. He is currently the Managing Director at Traders4Traders and CEO of Forex Capital Management. For more information see www.traders4traders.com and www.forexcapitalmanagement.com.au.

Ask FOREX.com



Your Forex trading questions answered by Kathleen Brooks, Research Director at FOREX.com.

How can the CAD possibly be going down and the USD going up? Doesn't make any sense.

Sometimes FX doesn't make any sense. Yes, the Canadian economy may seem stronger than its counterpart in the US, yes, its financial sector is in much better shape, and yes it is a major oil producer and although commodities have come under pressure in recent month's oil is still at an elevated level. However, there are a few rules in the FX market that traders need to know about. The Cad is part of the commodity bloc currencies, along with the Aussie and the Kiwi dollars. Thus, it is considered at the risky end of the FX spectrum. So, when we go through periods of market turmoil the CAD tends to do badly. In contrast, even though the US has plenty of economic problems it is still considered a safe haven since it is the most liquid currency on the planet. So when investors are scared they flock to the dollar.

When trading the CAD it helps to remember that the Canadian economy is still reliant on the US to some extent, so if the US economy is doing badly at the same time as commodity prices are falling this is bad for the CAD. I hope that makes things clearer for you.



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