and apply to their trading, especially when it comes to mentality. A dealer's "go with the flow" trading mentality and the "always be fading" attitude toward news events can be immediately put to use by the individual trader, which I have tried to highlight throughout this book.

The following are examples of dealer trades that will prove useful to intra-day speculators interested in picking up some easy, low-risk pips. According to our research, the Big Figure Trade alone has a historical success rate of over 70%, and although rare, identifying these typical dealer setups will enable you to focus on high-probability trades. These trading techniques are intended for experienced traders already involved in the FX market.

22
The Big Figure Trade

As noted earlier, retail FX operators are at a disadvantage because they act as a trader's sole counterparty and in this function they are sometimes forced to make artificial markets. Although making markets for clients is most often not an issue for FX brokers since they simply offset their risk in the interbank market, in illiquid times this represents a big problem for them – and an opportunity for the trader.

The Big Figure Trade is one example of how you can take advantage of your retail FCM's limitations. As all traders know, every now and then the market will test a critical level. The actual level is not important, since it may be a well-defined Fibonacci level, a trendline, or more likely than not a big figure. During sharp, one-sided intra-day price moves, the market will often reach a critical level where traders believe it "cannot go higher". Since price moves in FX tend to be self-fulfilling, traders initiate short positions near that level (assuming the pair has been trending higher) and the market will immediately proceed to take them out. Usually there is a nice, big, round number that short sellers set their stops above, confident that an O/B market will not have the energy to push past the presumed option structures and the psychologically important (but often technically useless) number. In these situations, dealers wet their lips as they mount their attack on the stops.

The typical price action is for the price to fail near the figure a couple of times (heartening the short seller's resolve and prompting new shorts) before dealers produce a quick, coordinated attack on the number, overwhelming any option protection and quickly setting off the stops lying above. In an instant, the rate is back below the big figure. Most traders have had this happen to them before – a quick blip and your position is busted, only for it to promptly crash in your expected direction almost immediately. Nothing is more aggravating to a trader than this setup, knowing that your money was so quickly taken away.

This trade works especially well with retail brokers because their fixed spreads and "guarantees" force them to make a market where there is none. When the dealers push the rate higher and trip stops above the big figure, the action is so quick and one-sided (shorts forced to buy back their positions) that in the real interbank market virtually no trading is possible at those prices. Spreads widen and typically only the offer side of the quote runs higher since no dealer in their right mind wants to be long above the figure. Although a true bank dealer may not be able to get a fill at those prices, you can. Because of their fixed spreads, as long as the rate traded is there most retail brokers will fill you at those prices, just as they would have if they were filling your stops instead! This is how traders can fight back and actually use the dealers' tactics against them. The beauty of this trade is two-fold:

1. Your risk is limited and predetermined. If the trade goes wrong, you know exactly how much you are going to lose, which is a big plus when trying to determine position size, etc. Remember that money management should always be at the forefront of your trading decisions.
2. You get to be a thorn in the side of the dealers, which you should consider as bonus points.

Pulling off this trade requires identifying the setup, knowing the dealer's game plan, and staying one step ahead of them.

The setup.

Step 1. Identify the Setup

Look for one-way trending markets, O/B readings, obvious targets (round number). Know your dealer's game plan. You know what they want to do, so trip stops above 150.00 and collect some quick pips. As soon as the stops are tripped, the price will quickly drop back below the figure.

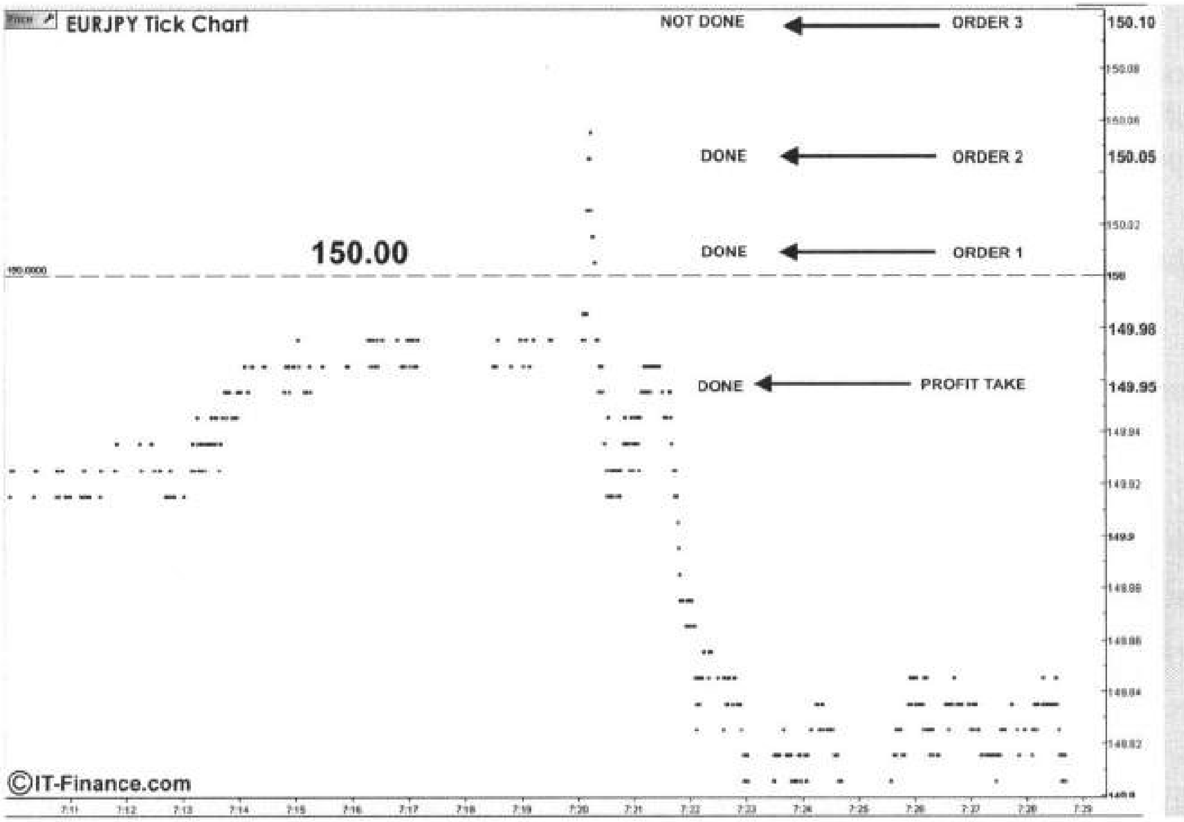
Set your orders beforehand to profit from the quick move.

Step 2. Set Your Orders

Sell 1 at the figure, sell 2 at 5 pips over the figure, sell 3 at 10 pips over the figure. Stops for all are set at 20 over the figure, with a profit take for two-thirds at 5 pips below the figure. If all goes well, you should be short a total of 6 at 150.06 (position size will vary according to your account). Risk for this trade is 14 pips. Profit take is 11 pips.

Wait a minute! What happened to the money management that I have been preaching all along? Is it completely out of whack on this trade? Not exactly.

Because of high probability of this trade working out in your favor, it is better to take the quick profit than risk losing it all by waiting for a deeper correction. We know the price action (spike higher to trip stops, then a quick decline), and that is what we are trying to exploit. Remember that we are trying to take advantage of the dealer's actions, not predict the future. The last third is left on the table in case you did happen to pick the top, although more often than not the rate will continue in the prevailing direction.



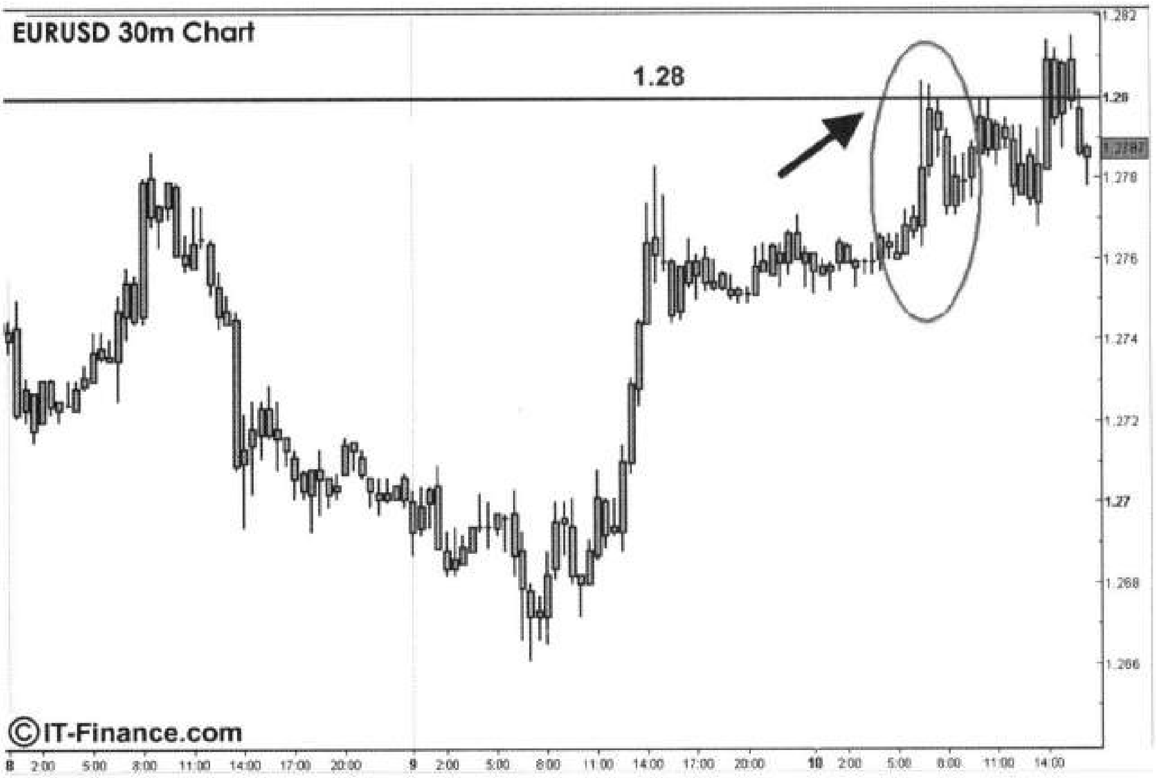
The aftermath: price action is typical. Dealers make a quick move beyond 150, stops go off, and the price trades briefly over 150 (only a couple of ticks) to print a high of 150.06. We only get filled on 2 out of our 3, and the price quickly drops under the big figure. Our profit take at 149.95 is then executed for a quick profit. Not bad for ten seconds of work!

KEYS TO THE TRADE

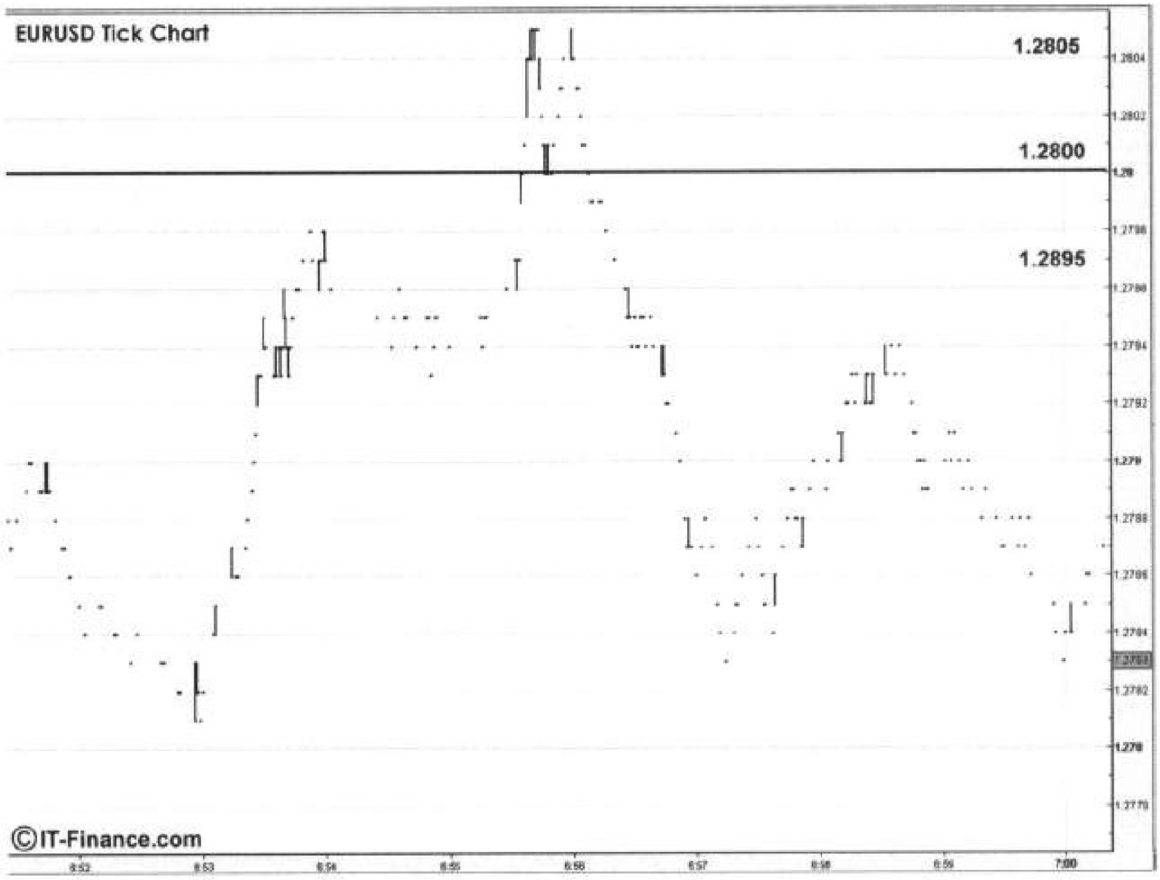
- Be prepared ahead of time and stay vigilant. If the trade does not work out immediately (maximum 15 min) then get out. The price action is telling you that the move is supported by real-money demand, not just dealer initiated.
- Although the moves are similar near most round numbers, this trade works best at the end of an O/B intra-day trending move, coupled with psychological numbers like 1.20, 150.00, 2.00, etc.

This time we get lucky and the rate slumps well below our profit target. Holding on to that last third lets you take advantage of these situations.

The trend is still definitely up (below), so do not even think about fading the move higher. All that we were looking for was a quick, easy trade.



A Big Figure Trade example on EURUSD. Notice the run-up to 1.28.



Price action near the big figure is the same; a quick blip and it is over.

Big Figure Trade example on USDJPY.

Big Figure Trade opportunities within the greater trend.

Close but no cigar!

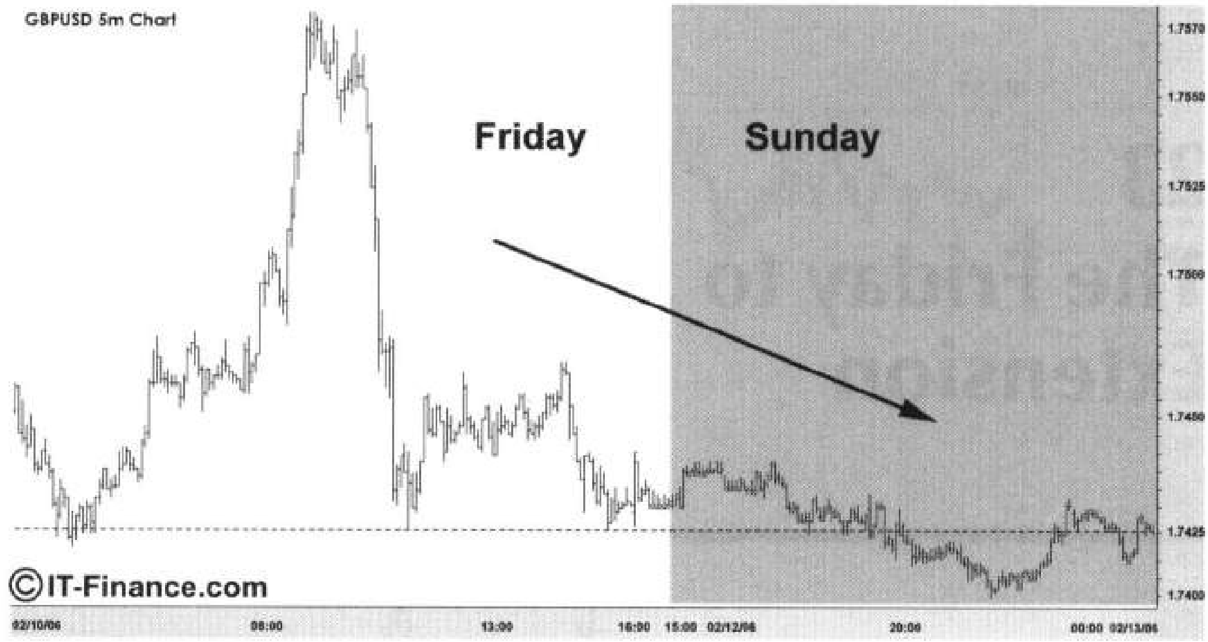
- Remember that we are not here to predict the future (reversal or continuation?); we are simply riding the dealer's coat-tails. It might continue higher for another 50 pips; it might top-out and collapse. Either way we do not care; we are in it for the low-risk 10–15 pips that the dealers are generous enough to cough up for us.
- Generally, we only want to trade the first stab above the big figure, since that is the one hiding the stops.

23
The Friday to Sunday Extension

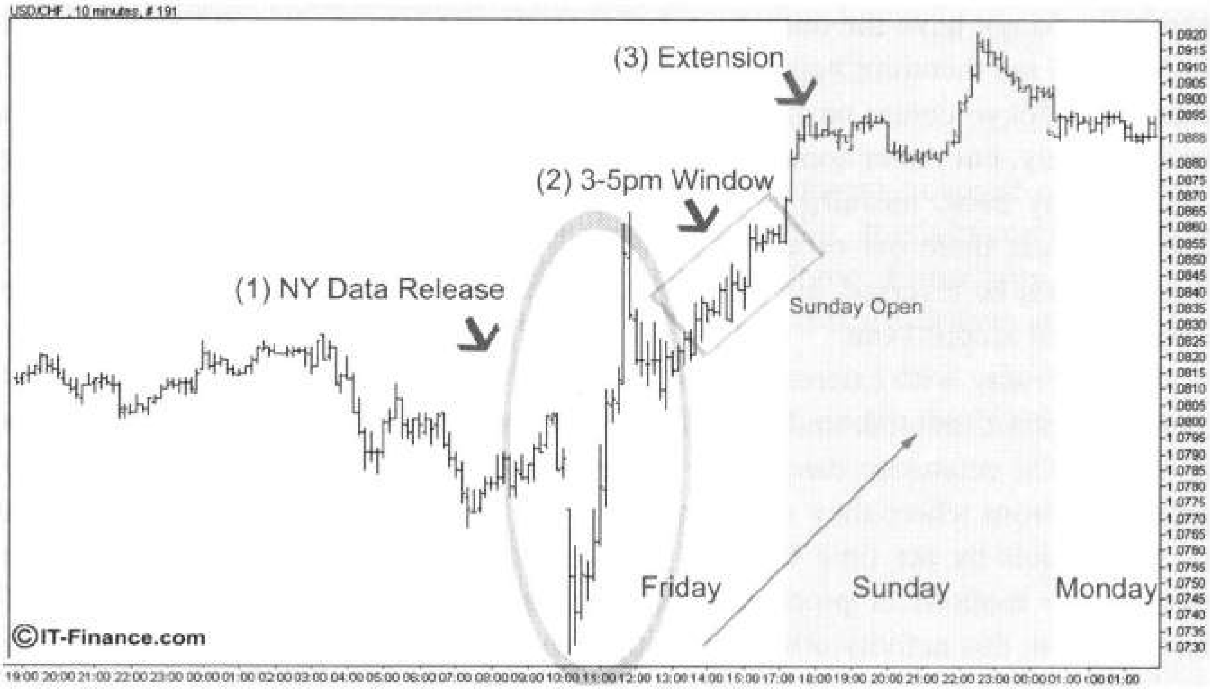
Another typical FX pattern that can be exploited by traders is the Friday to Sunday price extension. This simple yet by-and-large correct assumption is the fact that prices will open the new trading week (Sunday NY time) in the same prevailing direction as they closed on Friday evening. After the weekend, Sydney traders generally do not have the oomph or desire to reverse any meaningful decline seen in NY, and are therefore happy to see prices steadily drift in the direction NY left them until Tokyo comes on-line. Most of the time this behavior is not something to trade actively, but rather something to keep in mind if nursing positions or entering a late Friday trade, meaning that traders should not rely on a miracle reversal on Sunday to get them out of a jam. Once Tokyo and London enter the market the direction may be reversed, but often those traders nursing losing positions will have already been stopped out.

After a Friday with extreme volatility, however, this typical pattern is enhanced and turns into a low-risk trade opportunity for traders. The reason this trade works is simple. On economic data-heavy Fridays, prices often end up several hundred pips away from where they started the day and leave Sydney dealers with a mess on their hands by the time they get to work early Monday morning. As they go through the motions of processing the outstanding orders that the moves in NY have created, this activity often shows up as a Sunday morning "bump" created by dealers trying to fill their orders in a thin market.

This scenario is illustrated above. A big economic number released in the NY morning causes prices to jump wildly in both directions (1). Eventually, the market settles on a direction and proceeds to follow it for the rest of the day, and once European traders go home liquidity quickly dries up and NY traders begin to plan their weekends. In this 3–5 pm window, the price will thus slowly trickle in the same direction until the close of the week (2). Although you may have some late-minute stop hunting by dealers, it will be in the same general direction since



Typical price action seen after a volatile Friday; price continues to move in the same direction until Tokyo comes on-line.



The pattern is always the same: volatility spike, pre-weekend window, Sunday extension.

the market is too thin to stage any kind of meaningful reversal. This window of opportunity enables traders to safely enter the market in anticipation of a Sunday extension, confident that they will not be stopped out before then. When Sydney opens the new trading week, the move is quickly extended a further 20–30 pips before settling in for the Tokyo open (3).

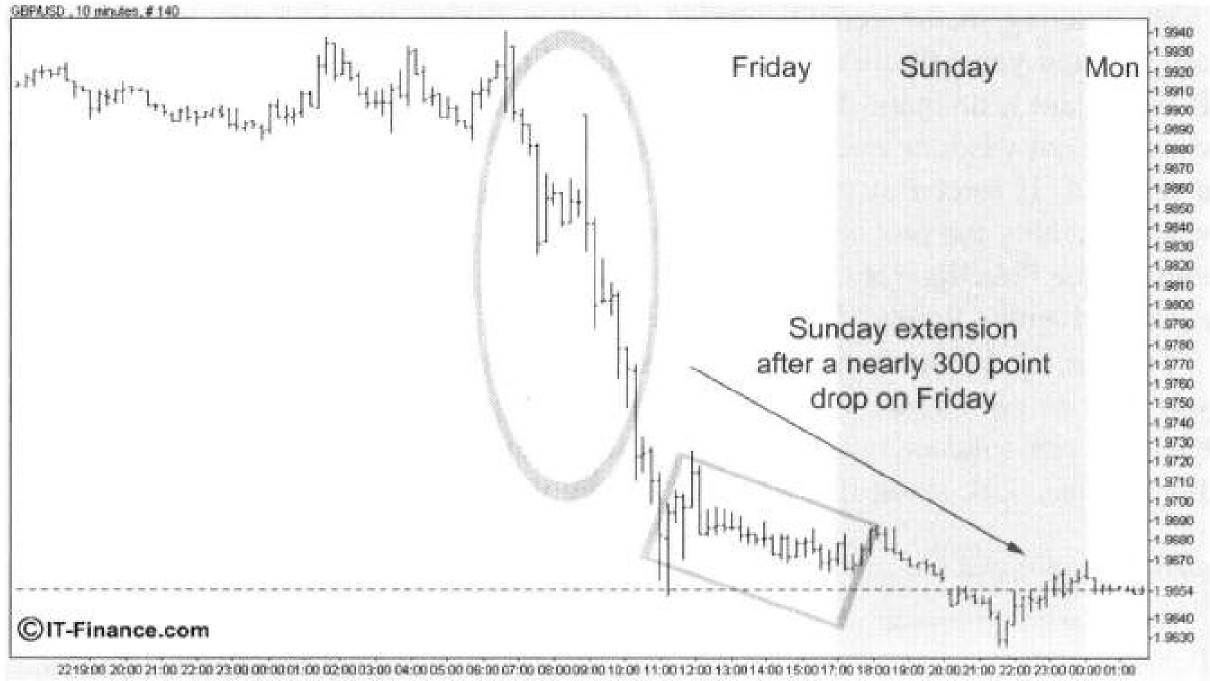
By entering in the general market direction during the 3–5 pm window, you can position yourself ahead of the market and probably against most retail traders. If cable had a dramatic Friday selloff in NY and dropped 300 pips for the day, conventional wisdom would state that the market was deeply oversold and due for a rebound. If forced to choose, most traders would prefer to take the long side, when in reality the probability is much higher that the pair would continue to trade in the same direction (at least until the Tokyo open). This high-probability outcome combined with a limited downside gives this trade great risk–return characteristics.

Trading the Friday to Sunday extension is simple, yet highly effective. All that you have to do is close your eyes, enter in the prevailing market direction during the 3–5 pm window, and return on Sunday evening (NY time) to collect your 10–30 pips. Talk about making your money work while you sleep!

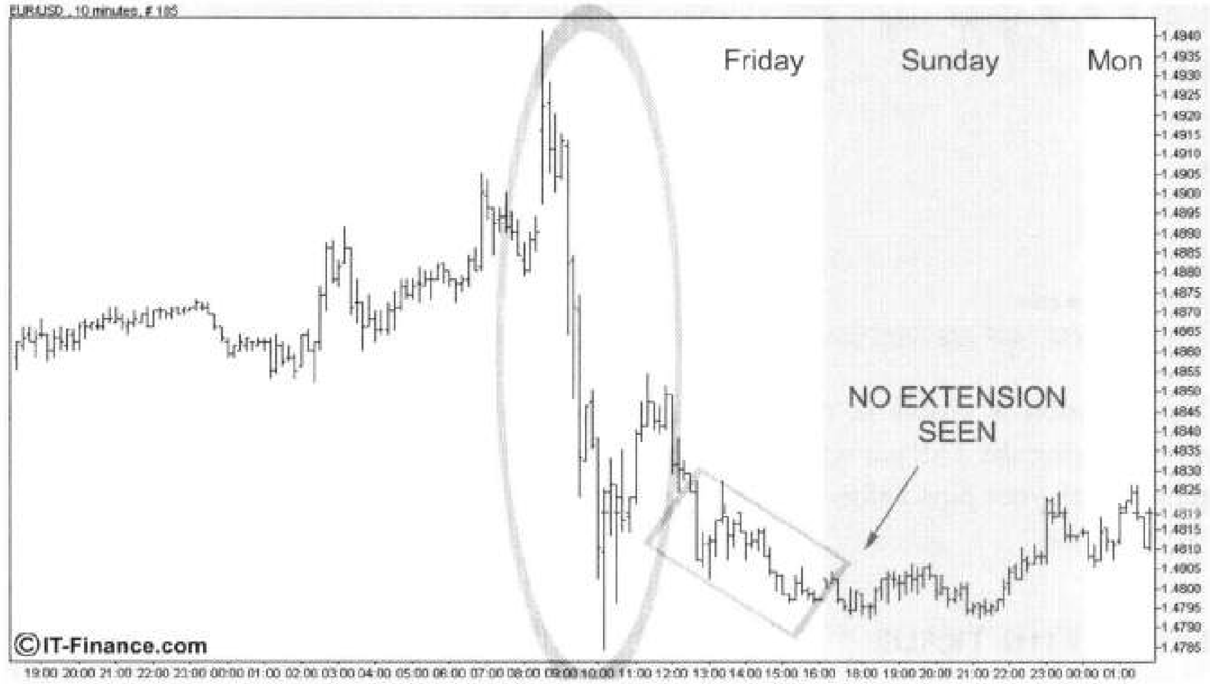
The extension is visible in most USD pairs, and can be actively traded by entering the market during the 3–5 pm window. When the market opens again in Sydney, make sure to get out with your pips before Tokyo joins the fray.

KEYS TO THE TRADE

- Don't be foolish enough to catch a falling knife; trade with the dealers, not against them.
- Since the economic news released impacts the USD, make sure to trade USD pairs only. Other crosses may trade in a wider and choppier range, which increases the downside risk.



After a big day in NY, Sydney dealers are left with a mountain of outstanding orders that they have to process in a thin market.



Thankfully, the dynamics of this trade limits its downside. Even when no price extension is seen, the lazy Sunday market will enable you to exit at cost or with a small loss.

- Don't trade the AUD or NZD crosses since you want to focus on thinly traded pairs and they are at the height of liquidity during these times.
- To limit your downside, make sure that no important news events are scheduled to take place during the weekend (G7 meeting, elections, etc.) since these could have huge ramifications on price.

24
Sticking it to Your Dealer

Traders shudder at the mention of the term "slippage", since it implies getting a terrible fill. The amount of slippage a trader receives often depends on the counterparty, who may either have slow dealers or difficulty finding liquidity in volatile markets, both of which can exacerbate the problem. Either way, slippage is a matter-of-fact problem in most fast-moving or illiquid markets, and as you may have noticed it usually goes against the trader.

When was the last time you heard: "Your buy order was actually filled five points lower, sir"? I'm guessing never. This is because in the case of any gaps or large sudden price swings, the dealers pass along the cost to the client but pocket the difference if it gaps in your favor (you had a buy order at 30 but it gapped down from 40 to 20, never trading in between). The advent of on-line FX brokers and their "guaranteed" orders were supposed to change that, since the extra profit margin by way of inflated spreads would more than make up for any short-term losses suffered by the brokers. A couple of years back, during one particularly nasty NFP release, a prominent retail broker stuck to their guaranteed execution policy even as prices jumped 300 pips, and quick-fingered speculators took them for a cool $5 million in the process. Needless to say, after that day the guarantees soon went the way of the Dodo.

There may not be any more guarantees, but the reasons for the broker's losses still exist, and you can take advantage of that weakness. As we saw in the Big Figure Trade, on-line FX brokers need to make a market for their customers, even in illiquid times. Ordinarily, the price they quote you is a synthetic rate created by taking the bid/ask of the quotes they receive from their counterparties, and although their pricing engines are all fully computerized and calculate at blazing speed, their quotes are still not *quite* as fast as the quotes they receive. Thus, there is a small price lag between their prices and the actual interbank market, which is referred to as price latency. To the smart trader, this is the equivalent of a time machine.

Imagine if your brokerage firm let you trade off the 15 min delayed quotes from your TV while you were looking at live prices. That would be a money-making proposition to say the least.

After performing a brief review of several retail forex platforms (there are now dozens), one can immediately notice a discrepancy in pricing. When compared to a live EBS feed, some prices are relatively fast, others are slow. This lag can become a big inconvenience if you are trying to get out of a profitable position (since their price will be slow to catch up or, worse, never even trade there), but it can become a big advantage when entering a position.

In normal trading the price lag is nothing to get excited about, since the price may be a pip or two away from the actual interbank price. In times of high volatility, however, the discrepancies can become large and inviting for the cunning arbitrageur. In volatile markets the retail pricing engines have a tough time creating a price since liquidity is thin and their inputs (the prices they get) may be all over the place, making it impossible for them to create a proper price. In times like these, true interbank dealers simply widen their spreads to limit their exposure, but retail brokers stuck with fixed spreads resort to either freezing their prices or switching to manual (dealer-controlled) execution.

After a couple of seconds or minutes the flows smooth out and pricing returns to normal, but by that time you may have already walked away with a handful of risk-free pips. In theory everyone should be able to do this very easily and consistently, although it does take a degree of patience and diligence that may not be everyone's cup of tea.

Here is how it works:

Step 1. Identify a Faster Price Feed Than Your Own

This can easily be done by placing different platforms (demo or real) side by side and comparing their performance during news events and generally volatile times. You can also choose to receive a direct Reuters or EBS feed (through Bloomberg), but that is usually not cost-effective for the small trader.

Step 2. Place the Fast Feed Alongside Your Slower Tradable Feed

If you find that your own platform is the fastest, then you might want to consider switching to one of the slower ones to take advantage of this situation. I have found that UK-based forex brokers tend to quote faster prices than their US rivals, since they often use a modified Reuters feed for their pricing engines.

Step 3. Pick the Hell out of Them

I tested this strategy by opening an account with one of the NY-based forex retail platforms and traded alongside a Reuters feed. In one week of trading I managed to collect more than 200 risk-free pips. No princely sum, but there is no reason not to take it if the market is giving it away.

Obviously the brokers are aware of this situation, and they are constantly trying to upgrade and speed up their price engines. Often they are forced to take pro-active measures when faced with volatile trading, and the first thing they do is anticipate volatile, and possibly hazardous, times. This means that at 08.30 NY time they switch to manual prices, and if 'important' numbers are due they may protect themselves by simply rejecting all incoming trades. Trading becomes impossible in times like these. This is another dirty trick played on FX traders by retail brokers.

Is this legal? Of course it is!

FEED 1	FEED 2 10:00:00	FEED 3
EUR/USD 1.27 74/78	EUR/USD 1.27 72/76	EUR/USD 1.27 71/74
GBP/USD 1.89 89/91	GBP/USD 1.89 91/96 BID/ASK	GBP/USD 1.89 85/90

FEED 1	FEED 2 10:00:04	FEED 3
EUR/USD 1.27 81/82	EUR/USD 1.27 82/85	EUR/USD 1.27 72/75
GBP/USD 1.89 96/98	GBP/USD 1.89 97/02 BID/ASK	GBP/USD 1.89 85/90

Side-by-side comparison of three tradable price feeds before economic news hit the wire. You can see the arbitrage opportunities created by a slow feed, which lets you buy euros nearly 10 pips below market price immediately following the news release.

If your broker is quoting you delayed prices it is *their* problem, not yours. Do not think twice about taking some risk-free money from the brokers, since with their inflated spreads, stop hunting, and generally unfair attitude they are robbing the average trader blind. Consider this to be payback time for all of those stops that were needlessly run and the horrible fills you received. Although you may get pegged as a "picker" after a while, why not make a few bucks in the short run?

What a difference a pip makes!

Spreads are often overlooked by individual traders as simply "the price you pay to play", but even a one pip difference in a spread can have a big impact on an active trader's returns.

Calculating the cost of trading:

Active trader trades 5 times a day
250 trading days/year
Each position is opened and closed (x2)
Account size is $50000
Position size is $200000 (leverage 4)

This trader's annual turnover is thus: 5 * 250 * 2 * 200000 = $500 million

Now let's calculate what your broker pockets
(annual turnover * spread)/2 = spread cost

3 pip spread	**2 pip spread**
(500M * 0.0003)/2 = $75000	(500M * 0.0002)/2 = $50000

The cost of trading with a 3 pip spread vs. a 2 pip spread is $25000, or 50% of the account equity! Transaction costs are the number one reason why active traders typically fail in the long run (in any market). An active trader would have to generate $75000 in profits (150% return) simply to break even. Meanwhile, traders are convinced by their FCM that FX trading features no "commissions" and the cost of trading is minimal.

Source: OANDA. *FX Trader's Bill of Rights*. 2000

KEYS TO THE TRADE

- Be on the lookout for news events that are not "obvious" and time-defined, such as Fed speakers, consumer confidence numbers (generally come out in a 15 min time window), and second-tier economic news like the Beige Book, etc. One can also take advantage of their slower prices during normal market moves, which are sometimes quick and brutal.
- Try targeting more exotic pairs, which are not monitored as closely by the dealers. Most big houses have a euro desk and a Sterling desk, but few houses have a Kiwi desk, for example. Price discrepancies in exotics are less easily noticed by dealers, and may last for a while until they are corrected. (I once caught my broker sleeping and was able to buy GBPJPY 30 pips below the actual market price!)

- To enter the trade, look for the discrepancy to be large enough to at least cover the spread, giving you a risk-free trade. Normally, all trades should be closed out rather quickly, but on the rare event that you jump on to a big move take some profit and place a stop at entry for the rest and see how far it goes!
- Remember to take a screenshot of your open trade just in case your broker decides to "take back" the trade.

VI

THE FUTURE

25 The End of the Beginning

From a big-picture perspective, the two great problems facing the FX market are liquidity and correlation. Although your trading platform's marketing may paint a rosy picture of increasing volumes, limitless liquidity, and countless counterparties, the reality is a little harsher. Liquidity is not increasing in the markets; it is either staying the same or more likely is declining. There is simply a finite amount of liquidity to go around, and although the methods of accessing this pool have increased, the actual amounts available to trade have essentially stayed the same. All of the new electronic prime brokerages and dealing services are now tapping the same well that has long been controlled by a few of the largest banks. With more and more platforms now granting access to this fixed amount, it may create the illusion of increased liquidity (you now have three price providers instead of one), but in fact they are simply slicing up the pie into smaller and smaller pieces.

This never seems to be an issue in good times and overall positive sentiment, but in times of turmoil it can prove deadly as moves tend to get magnified. News events that once failed to inspire traders are now turning into market-moving events that dry up liquidity and produce sharp intra-day swings, creating ever-more choppy trading conditions. Although the volatility may prove momentary, a sleepy market is often the most dangerous one for traders, and at the time of this writing the forex market has been sleeping for a bit too long.

The new millennium has so far been characterized by a framework of low volatility in which some currencies remain essentially pegged to the US dollar (most notably the Chinese renminbi), which some are calling Bretton Woods II. In an effort to dampen exchange rate volatility and spur global growth, central banks have so far mostly coordinated their policy moves and moved together hand-in-hand. For them, this low volatility has had the added benefit of driving many speculators out of the FX market, since in theory if all countries successfully target 3 % inflation they will all end up with the same interest rates (effectively killing currency speculation). This level of cooperation and low volatility is not very likely to last in the long run, however, and the dramatic trade imbalances we see today should sooner or later translate into a rocky period. BWII will be severely tested when these imbalances are eventually corrected and the liquidity issue will once again jump to the forefront of trader's minds.

In our increasingly interconnected financial world, when markets drop traders now say that "the only thing to go up is correlation", and in a time when traders across the globe can instantly sell whole portfolios (i.e. emerging markets) at the hint of a problem, it is no wonder that all eyes are now on China. Their mountain of dollars has essentially become a leveraged play on the US consumer, and if the outcome of this game leads to the death of the US dollar then a series of events are likely to take place that could prove harmful to the FX industry.

Instead of actually addressing the core problems facing the country, politicians will predictably choose to take the easy way out and vilify you, the trader, and implement over-the-top regulation. Currency speculators be warned!

All of this is far from certain, of course, but if currency fluctuations do indeed become more extreme then it is not hard to imagine some sort of exchange controls being implemented in the US that would limit the average person's ability to move and exchange dollars freely. This would prove to be a sad state of affairs, but politicians tend to reach for the closest scapegoat, and FX speculators will at some point in the future fall into this role. It is for this reason that I urge all readers to open and fund an overseas bank account. It is completely legal (you must report it to the IRS) and it will offer you a way to diversify your savings and tap the world's markets even if exchange controls are implemented down the line. The honeymoon period for retail FX is coming to an end, and traders should prepare themselves in advance of any future legislation.

Currency trading should not be the realm of mega-banks and billionaires; everyday people should also actively participate in the market. I would even argue that most people simply do not have a choice. In our interconnected global world, you are going to be affected by exchange rate moves whether you like it or not, so you may as well play a pro-active role in securing your future. Whether spot trading on a margin basis is the right way to go about it is debatable, but all investors should find some way to hedge or speculate on currencies, either through a foreign bank account, ETF, or an FX trading account. In the end, the way you choose to participate is up to you and should reflect your needs and goals.

IT IS UP TO YOU

Where will the dollar be a year from now? Frankly, nobody knows. Although there is plenty of money to be made in forex trading, it is definitely not in currency forecasting. In order to reach this pot of gold you have to be able to find an approach that accurately trades market corrections rather than predicts them, since technical and fundamental analysis are simply not enough to beat the crowd.

The secret to success is actually not such a big secret. Everyone knows that with proper money management and a half-decent strategy you can make money. Yet most still find themselves failing.

To become truly successful, if you are a beginning trader you should immerse yourself completely (and I mean completely) in the subject in order to find your edge. If you are already a winning trader, then you had better make sure that you understand exactly what your edge is. What is it that sets you apart from the other 90 % of traders? Is it sheer luck or something different? Knowing what keeps you in the game is the only way to find your way back during tough times. In the end, no one can ever hope to master the FX market; but for those that manage to set the dollar signs apart and focus on the intellectual enjoyment trading provides them, a fortune usually lies along the way!

a

TRADING HOW TO'S

How to Set Up Your Trading

With decent money management rules and some form of trading strategy in your pocket you are ready to begin conquering the FX market. Yet regardless of whether you are trading systematically or discretionary, before you begin trading for the day you must first feel confident in your trading environment. If the FX market is a battlefield, then you are the general and your positions are your troops, and you want to make sure that you have a firm grasp of the terrain before sending any of them in to fight. Having a set game plan enables you to not only react quickly in fast-moving markets, but it also helps take some of the decision making out of the equation by pre-planning the moves ahead of time.

There are a few, simple things that every trader should do in order to stay in complete control of their trading environment.

UNDERSTAND THE BIG PICTURE

The best way to start your trading day is to begin by looking at charts from a big time frame to small. Start with the dailies, then zoom into the 4 hr, 1 hr, 15 min, etc. If you don't know where you've been, then you can't possibly know where you're going. FX trading is as much about reading the past as it is about interpreting the future, so make sure to ask yourself: are we in a ranging or trending market? Have any significant long-term patterns developed (see chart A.1)?

Only a cursory look is needed at the daily charts, but sometimes overnight moves will have created significant developments (broken trendlines, Fibonacci retracements, etc.) that will be missed if your attention is squarely focused on the short-term charts. The following steps should be taken to get a proper feel for the market:

1. Establish the general direction

Figuring out the general direction should be rather easy. Candlestick analysis and moving average ribbons (chart A.2) are elegant ways of identifying long-term patterns, reversals, or meaningful set-ups.

Chart A.1 The break of long-term patterns (1-trendline, 2- previous top, Fibonacci) would be missed by concentrating entirely on short-term charts.

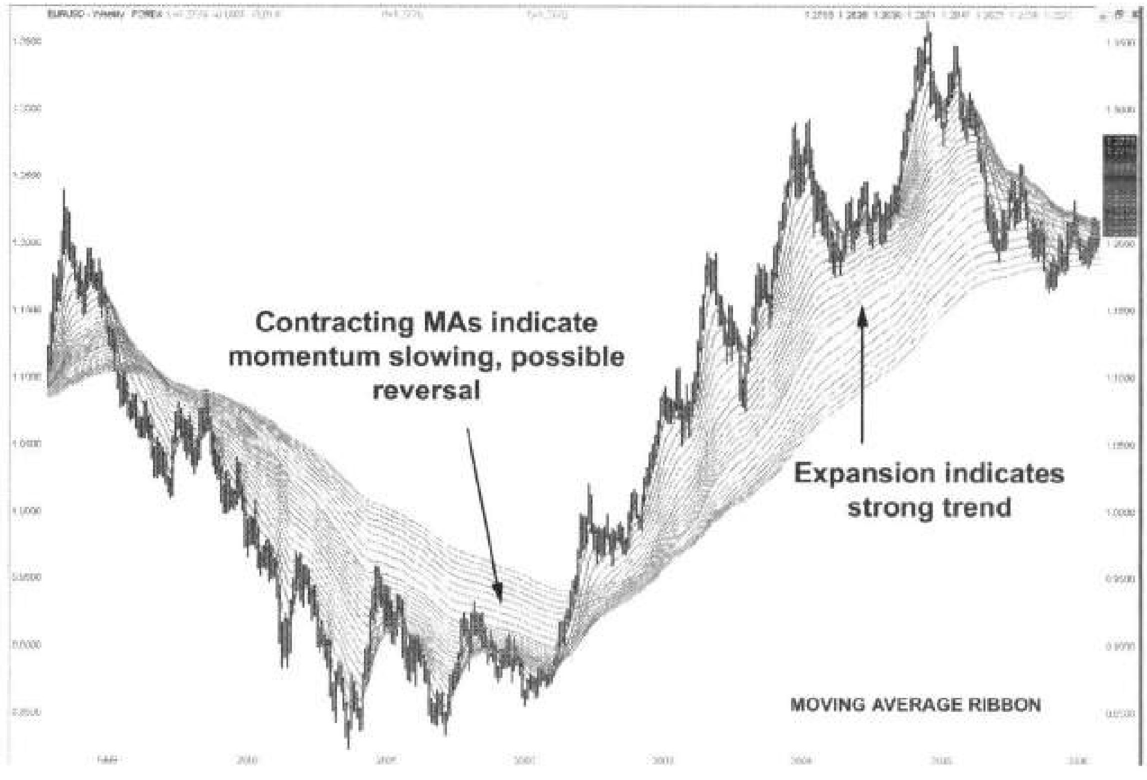


Chart A.2 A moving average ribbon can instantly tell you if the market is trending strongly (MAs spread apart), or consolidating in preparation for the next large breakout (contracting MAs).

2. Figure out the daily trading range

A good daily trading range shows you where the vast majority of the moves are expected happen, and any moves outside of the range should be viewed as short-term abnormalities that can be faded.

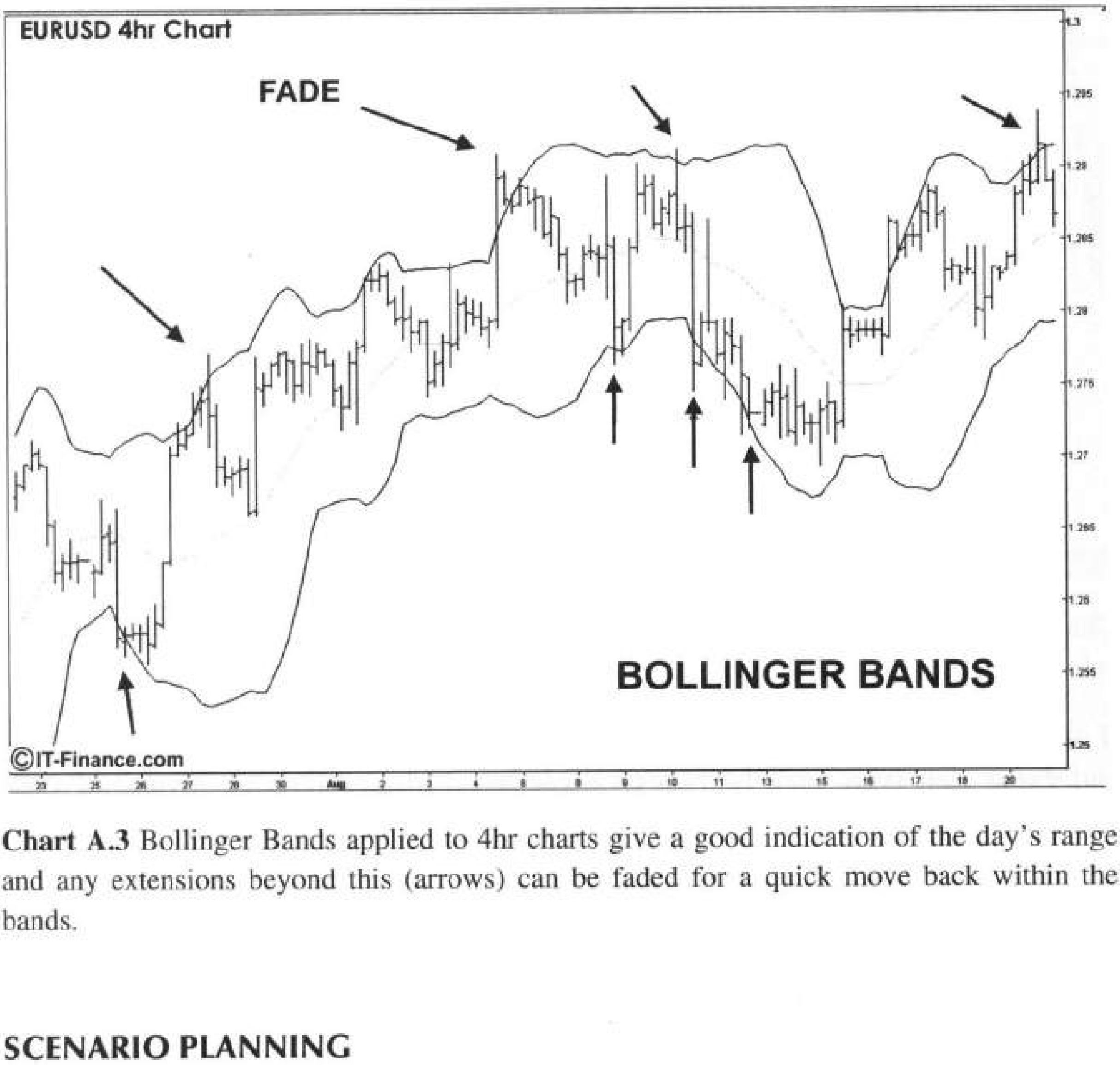


Chart A.3 Bollinger Bands applied to 4hr charts give a good indication of the day's range and any extensions beyond this (arrows) can be faded for a quick move back within the bands.

SCENARIO PLANNING

Once you have a general overview of the market, you can begin planning your trading responses to a number of different scenarios that may take place during the day. Not only does this exercise your mind, but asking yourself "what will happen if the Euro breaches 1.3560?" or "what will be the market reaction to a weak retail sales number?" also helps make your trading reaction to these events automatic.

Make sure that you know ahead of time what news is scheduled to be released, the market expectations, since all too often traders forget that there is more news out there than just the 08.30 NY releases, so keep an eye out for market moving events from Asia and Europe that may have a big impact on prices.

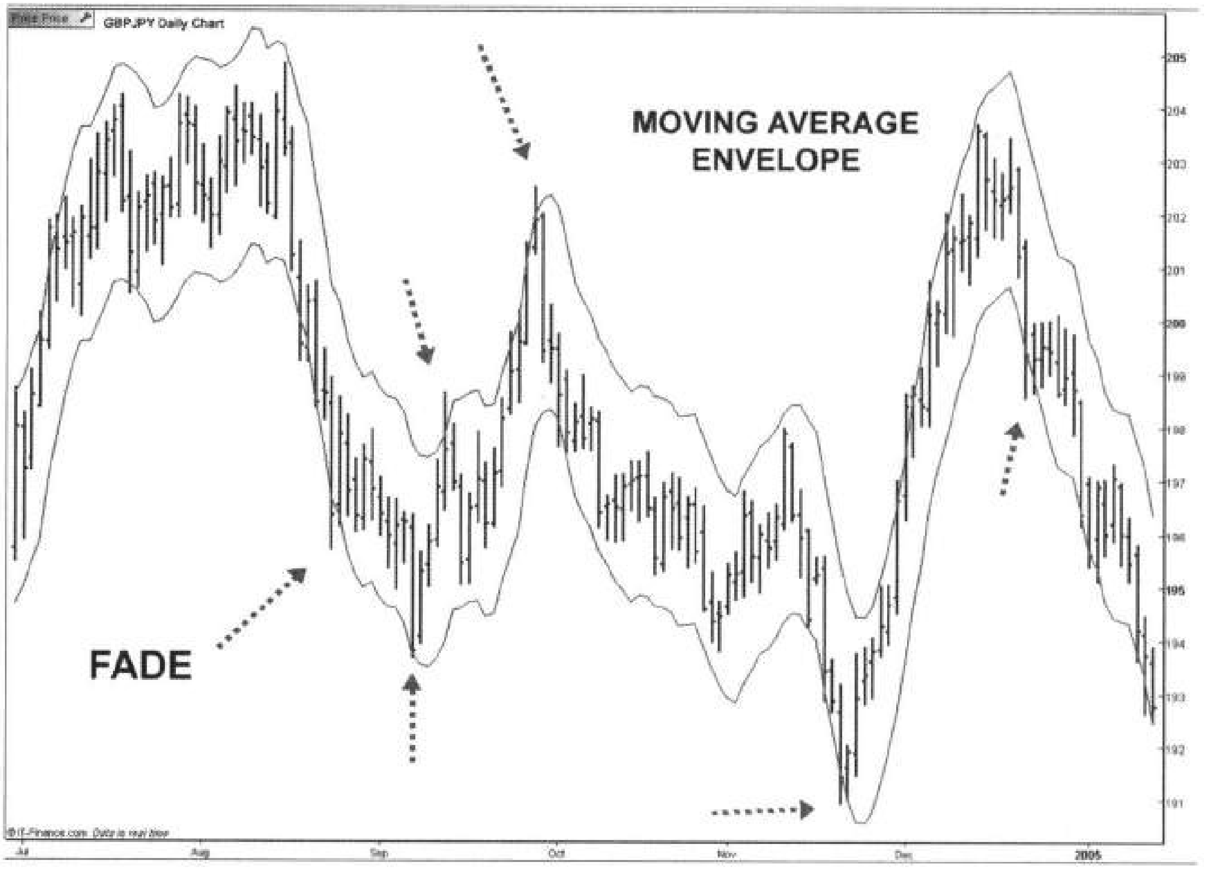


Chart A.4 A moving average envelope contains most of the daily moves for even notoriously volatile pairs such as the sterling/yen.

If after all of this preparation the price action does not correspond to your scenario and game plan (you were bearish on cable but it blasted through several of your resistance levels) then you should take this as a red flag and probably sit on your hands until you can re-evaluate the day's events.

STAY FOCUSED

Understanding the big picture does not mean understanding the *whole* picture. Since you cannot trade everything, focus on your favorite pairs and get to know them well. It takes a lifetime to understand a currency's behavior, how it reacts to things like oil prices, interest rates, etc., so concentrate on learning a few pairs very well instead of following everything half-hearted.

ALWAYS TAKE NOTES

Although it may seem like a thankless task, keeping a trading journal is the best way to reap the benefits of the analysis you have just done above. After all, if you don't keep a written record how are you going to know if your thoughts were on the money, or if your tactics proved to be wrong? Keeping a record will keep you from repeating costly mistakes ("I've been in this situation before, what did I do in that case?") since it may be hard to remember your motivations for entering a trade post-fact. At the end of the day you are your best teacher, and before going home for the day you should make sure to write down your feelings on the majors and set some targets for the overnight market. This will create a continuity of thought and help you jump back into the market the following morning. You can also use this to fine-tune your forecasting and technical abilities.

How to Trade Price Action

The sharp moves often seen in the FX markets can be difficult to trade and properly adjust to, even for advanced traders, but learning to read and interpret the price action in situations like these gives us a big leg-up. In a steep decline, for example, one must be careful to measure the reaction of the longs to know if the move has a chance to turn into a rout. By looking at the reaction of the longs as soon as the rate begins to extend south, you may be able to determine if the market is sitting on a large number of long positions or not.

Usually, if a spike lower is followed by a sharp V-shaped recovery, then you should be wary of shorting the pair. Masses of buyers entering the market at lower levels tells you that the market is not particularly long, and the lower prices represent "bargain" levels for those wishing to accumulate long positions.

On the other hand, if after the initial move lower any uptick is sold into, you can be fairly sure that the market is caught long and wrong. The longs realize that they hold bad trades, and are eagerly awaiting any uptick to offload some of their positions. This is when smart traders and dealers smell blood and go in for the kill.

Take a look at chart A.5 to see how the market reacts during sharp moves.

1. Sellers come into the market for whatever reason (news, etc.) and overwhelm any bids, driving the pair lower. When the pair slows down and consolidates the move, the reaction of the market here is critical.
2. No sharp recovery is seen, indicating that the nobody considers this correction to be a "cheap" buying level, and more likely than not some trapped longs are feeling the heat. The pair moves in a steady fashion as shorts take profit, reload, and short again. The pair will continue to move lower as long as there are more sellers than buyers, and it falls until some sort of equilibrium point is reached.
3. Normally the rate would rebound a bit from this area as shorts buy back their positions, but seeing the attractive round number nearby, stop hunters and retail "chasers" join the short selling party. The pair briefly breaches the round number, takes out any remaining stops and rebounds as dealers buy back their shorts. The longs have now either been stopped out or cut their losses.

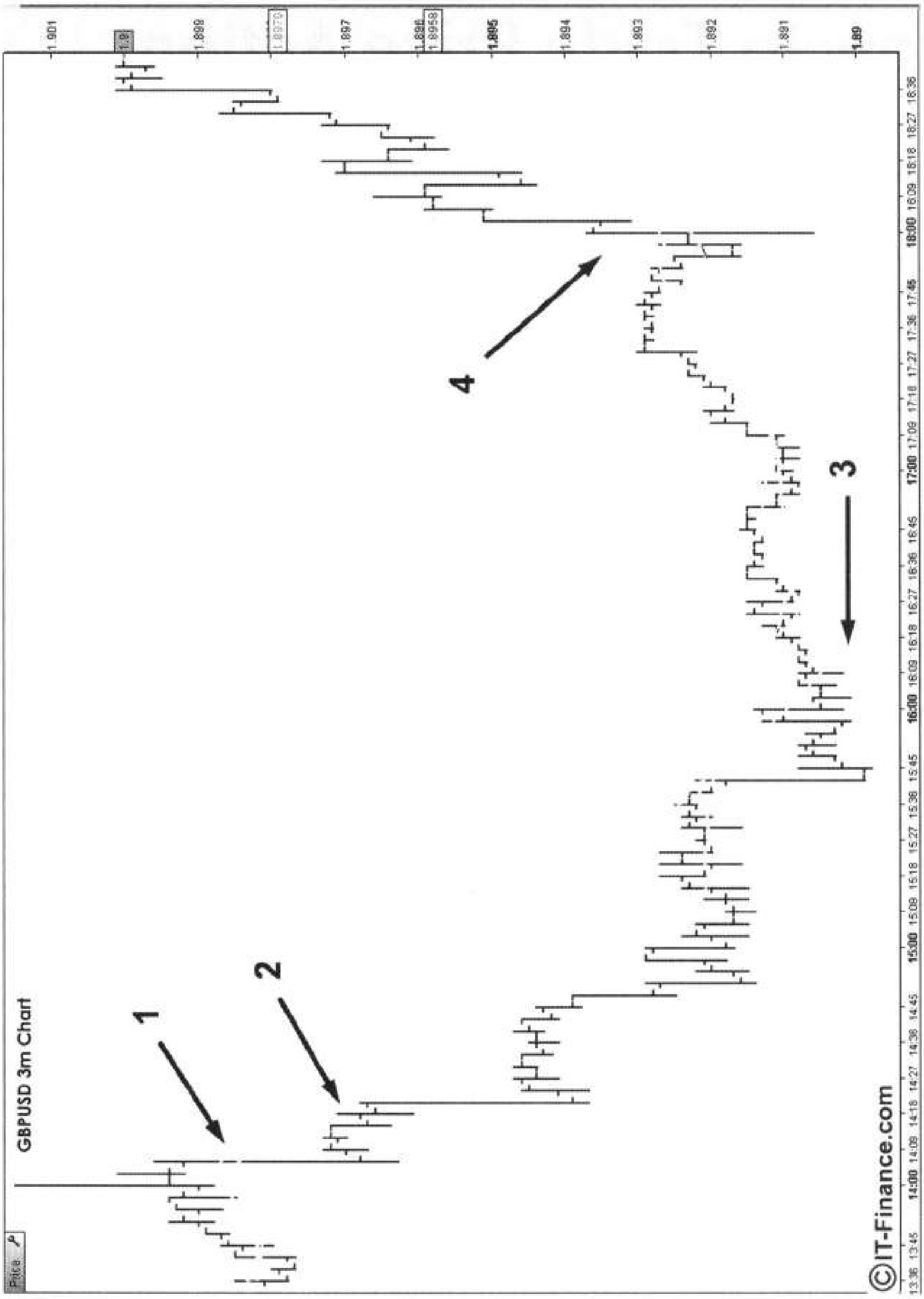

GBPUSD 3m Chart
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Chart A.5

After the last flurry of selling, the market is left leaning on the short side, with no fresh supply hitting the market. This imbalance in turn creates the perfect "short squeeze" set up. Since the market tends to follow the 'maximum pain' theory, it will now probably head north to try and cause some pain to the other side of the market. As soon as the dealers understand that the selling pressure has ended and the original longs have long been shaken out (remember, they have access to order flow), they slowly start to bid up the pair.

4. Expecting a continuation of the move, new shorts (chasers) are taken on a final move lower. The market at this point is oversaturated with shorts and a sharp V-shaped recovery takes place. Like dominos toppling over, the shorts are easily squeezed by the dealers. Squeezes tend to be sharp and vicious, reflecting the panic the shorts are in. Never underestimate the results of disorderly forced buying/selling, and never fade a squeeze; lest you end up getting "squeezed".

In this case, the original orderly down-move took approximately 2 hours to unfold while the short squeeze retraced the entire move in a mere 30 minutes. Simply comparing the two halves of the chart reveals the difference between orderly market moves and forced buying/selling (stops). A testament to the power of fear.

Moves like these are typical of a purely speculative market where "hot money" is out chasing prices and no real money or long-term fundamentally inspired bets are being placed. Basically the day to day chop of the FX markets.

So how does one trade these choppy markets?

TECHNICAL HELP

Moving averages are one of the oldest tried-and-true indicators, but since they are lagging indicators to the short term trader they seem to be of little use. As with all price-driven indicators there are trade-offs, and one has to look at the MA itself to find good uses for such a tool.

The most widely looked at MAs are the 50, 100, and 200 day MA which are a simple, yet efficient ways to gauge trends, their strengths (measured as a % away for the MA), and reasonable support levels. All day-traders should know where these levels sit on the daily charts, because as widely followed indicators they attract stop hunters and should therefore be avoided.

Since moving averages essentially relate the past price action, they can also be used effectively intra-day for entering and exiting positions in one-way markets. During sharp moves, it can be difficult for a trader to properly enter a position since retracements are far and few, and the "it can't go higher/lower" mentality may set in.

For example, even though you were bearish on cable, at the end of the day you find yourself on the sidelines looking at a 200 point drop, or worse, caught trying to pick a bottom.

In this scenario, the MAs can be used as dynamic resistance levels to trade off of, with much better results than the stop-happy static support/resistance levels known to the whole market. Using the 10 and 20 you can effectively choose when to open and close your position based on price action, not just an arbitrary number. Refer to chart A.6.

Chart A.6 Using moving averages during sharp moves.

1. The market breaks lower and you miss the initial short, but after a bearish cross you have the opportunity to enter a position once the price tests the 10d ma. This is the first dynamic resistance and should be sold into (a second can be sold at the 20). In this instance you have numerous chances to enter shorts. Notice how this beats simply selling the next break lower.
2. Once in a trade, choose to exit 1/2; of the position when the 10 is breached (closed bar), and the other half when the 20 gives way (3). After the 20 gives way the price action is telling you that there are more buyers than sellers out there, and the dynamics of the move have changed.

The advantages of using MAs in this manner is that it gives you dynamic levels to trade off and gauge price action, rather than agreeing on arbitrary levels or your 'gut' to tell you when you should take profit. By taking these decisions off of your shoulders and turning them into a systematic ones, you are less prone to take profits too early and it has the added benefit of placing less strain on your psyche. Take a look back at chart A.5 to see how effective the MAs were in protecting profits.

How to Build a Position

Formulating good trading strategies and views on the market is all well and good, but if you don't have a proper way of entering your positions in an orderly manner then you may find your trade in the red the minute you enter the market.

SCALING

It is common knowledge that the ideal way to trade is to gradually enter a position, and then gradually exit as your targets are met. In theory this approach is beautiful; in reality most traders will find it very hard to accomplish. It is hard to add an increasing amount to your position when it looks worst, and hard not to take profits once it moves into the black. The psychological aspect is often times too great and lucky are the few that can sit still while the market gyrations make your P/L swing like a kite in the wind.

One way to get around these considerations is to take small chunks out of the market instead of going for the entire move. Taking profit in a trade is very important not only for the balance sheet, but also for your psyche. Profit taking breeds a positive mentality that all traders need, and in case the position turns around and you end up with a loss, at least you put some pips away to soften the blow.

BUILDING A POSITION

Trying to time the perfect entry/exit is a fruitless exercise engaged by traders that serves only to hinder your trading. Professional traders know that they are not likely to enter at the "exact" top or bottom, so instead they focus on figuring out the price range for their entry.

Let's take a look at a real-world example using the loonie (USDCAD):

Because of our technical analysis and interpretation of the price action, we think the loonie is poised to fall and enter a short position (chart A.7).

According to our money-management guidelines, our risk should be no more than $200 on a $10K account (2%). We have two options:

- One 100K lot with a 20 pip stop.
- Multiple mini lots with varied stops.

Chart A.7

You can immediately see the flexibility you give yourself by trading smaller lots, which is exactly the reason most retail traders should trade mini accounts. Your *total* risk should be what's important to you, not nailing the exact entry point. Most FX platforms these days calculate your average cost automatically, so figuring out the risk on multiple positions is fairly easy to accomplish.

Let's say we decide to trade 5 mini lots (leveraging 5 times). If we where to trade them all at once, then we would need to set a 40 pip stop. We are risking the same amount ($200) but at a lower risk profile. The more experienced you get with your trading, the more comfortable you will be in varying your entries and stops.

Of course, before we are even close to entering the trade we will already have charted out the day's trading levels which we can use to enter and exit the trade. With five lots to trade, we begin to enter incrementally higher amounts once our entry price is reached.

Chart A.8

1. **First sell order executed @ 1.1330**
   Just getting our feet wet, making sure we have an "interest" in the market.

Now, one of two things can happen. The more common one is to see the price shoot up as soon as we enter our short. This is when most traders scream "this always happens to me!", but in our case we are just happy to see better selling levels. On the other hand, if the pair proceeds to immediately plummet, then our position would already be in the black. Not a bad place to be. Starting small means putting yourself in a win-win situation.

2. **The loonie moves higher and we sell 2 more @ 1.1345**
   We are now short 3, and we have two more bullets remaining.

After a few minutes, the pair continues to move higher and is sitting at 1.1355, 25 pips above our original entry. If the rate continues to climb higher, we still have 2 more lots to better our cost, or if we feel uncomfortable with the trade we can choose to exit with a meager loss. Using the one-lot strategy, we would have already been stopped out.

3. **The pair finally begins to come off and gains downside momentum. We enter our final two shorts @ 1.1333**
We are now short 5 avg. cost 37.

Note that this is not "averaging down," which is a desperation move. This is building a position. We were able to get a better cost for our short (37 compared to the initial 30) and managed to ride the blip higher that stopped out many of your fellow traders.

Once the topside stops are taken out, the trade now has room to move on the downside. We exit according to our support levels, taking out 2/3 and leaving the rest with a stop at entry looking for lower levels.

Big traders rarely trade with fixed orders in the market (for fear of revealing their intentions), and enter and exit positions according to price action. This type of trading is probably best suited for experienced traders with established trading styles, while new traders are better-off trading with multiple fixed orders in the market which lets them focus on tweaking their analysis instead.

Building a position means establishing ranges for you to trade off of, rather than trying to define absolute values for the perfect entry. In the FX market there is so much intra-day noise that trying to find the perfect entry and exit of any trade is practically impossible; so why bother? Instead of thinking "at what price should I enter," you should be thinking "what is a good 10-15 pip range to enter/exit my positions?" As long as your analysis is correct most of the time, you should be able to make money most of the time as well.

TRADE YOUR TIMEFRAME

Once in the trade, a crucial mistake some traders make is to trade out of their time frame. Once in a trade, it can be tempting to scour different charts in order to find some glimmer of hope that may turn that losing trade into a winner. A trade opened according to the 3 minute chart will turn sour, but a stubborn trader will not let go and turn to the 15 min or 30 min charts where the trade looks better. As you may have guessed, this never works and only opens the door to larger losses and more pain for the trader.

Learn to cut your losses short. If you opened your trade according to a signal from the 3 min chart, get out as soon as the 3 min chart tells you the trade is no good. It's no use to flip time frames until you find a chart that suits your needs; remember that you are following the price action, not the other way around.

The only time it's appropriate to switch time frame is when the trade is deep in-the-money. If the signal came from the 3 minute chart but extended farther than you thought, it may be reasonable to think that the move has further to go. Switching to a longer time frame may show you the market rolling over and confirming the signal. In this case it is wise to take some profit and let the rest run, but a good rule to follow is to get out according to the time frame you used to enter the trade. If your original analysis was incorrect, then you can't to turn a loser into a winner; no matter what fancy indicators or software you may use. Trash in . . . .trash out, as they say.

How to Trade Out of a Losing Position

One of the most important lessons any trader needs to learn is how to effectively trade out of a losing position. Although this is usually the realm of money management techniques, at some point in their careers traders may find themselves with a trade that is deep underwater and that has the potential to wipe out their account.

Although it would be easy to note that if proper money management rules are followed this situation should never arise, in the real world traders do sometimes find themselves in these positions because of a slip in judgment, technical problem, or simply stubborn behavior. In any case, most traders do at some point find themselves with a run-away position, and what they do in such a scenario determines their longevity in the market.

When holding onto a big loser, most traders have two choices: cut the position immediately for a huge loss, or try to average down and hope for a turn around. Neither approach is particularly attractive, seeing as how you take a big monetary hit with one, or place all of your chips on the table and hope for the best with the other.

There is a third way: trading yourself out of the market. Great traders simply refuse to take an outright loss by way of a stop, and instead once they realize that the market has proven them wrong they begin to "lighten up" by slowly trading their way out of a losing position.

Once you realize your position is dead in the water, your mission then becomes to better your average cost *without* adding to the position. Adding to the position (averaging down) only creates more pain, and can quickly take away your flexibility as the loss grows and becomes unmanageable. So instead of adding, we need to cut part of it on a dip in order to gain more breathing room and be able to trade out of the rest.

Chart A.9 The key to this strategy is flexibility.

Take a look at the chart at left to better illustrate this technique. Assume that you are short against the trend and you want to get out. You are faced with these options:

- Get out of everything and take a substantial loss.
- Hold onto it and hope the pair will collapse before you run out of margin.
- Cut part of the position on any reasonable dip.

The benefit of cutting part of your position on a dip is two-fold. First, although you are forced to take an initial loss, you free up liquidity and give yourself more flexibility to react to future price moves. Any move now is a good move. If the USDJPY bounces higher, you can re-load at better selling levels to improve your average cost. On the other hand, if it immediately collapses then great, it's moving in your direction.

The other great thing about cutting part of your position is that you instantly take some of the stress away. Keep in mind that one of the most stressful aspects of trading is the psychological impact a running loss may have on your trading. Faced with big losses, most traders are keen to stop the pain immediately, and thus take needless hits.

Once you have cut part of your position, you then proceed to make small trades and slowly better your average cost. Using intra-day volatility, you make small trades to effectively trade out of your position.

THE RUN-AWAY TRADE

To better illustrate this technique, let's look at an example of the same USDJPY move that surely caused a lot of pain to many traders not following a flexible trading strategy (refer to chart A.10).

1. Around the beginning of October, we believe that USDJPY is overbought and in the process of topping out. We think the rate may fail near the 113.70 resistance level, so we take an initial short at 113.50. Our plan is to scale into the position and this is our first shot – always stay flexible.

In this swing trade, we are looking for a move back down to the 109 support level in the coming weeks. We are willing to risk 150 pips total, for a very reasonable 1:3 risk/reward ratio (risking 150, looking for around 450pips,). We realize that the market may overshoot the previous top (searching for stops), so we remain flexible and are prepared to add two more shorts higher.

2. After initially failing at the 113.70 resistance, the dollar rallies and takes out stops to print a new high of 114.20. So far it's no surprise, we knew this could happen and we take advantage of the higher levels to set our second short @ 114.10.

We are now short 2 at an average of 113.80 (113.50+114.10). Stop is 75 pips away (150 pips divided by 2 lots). Always keep an eye on your *total* exposure, since that is what is most important.

3. The dollar begins to sink as planned and the trade is now in the black. We are looking to add a third short if it breaks below the figure (113.00), since that will be an indication that momentum is picking up steam to the downside. Unfortunately the pair does not break the figure, but instead rebounds and is soon testing the highs once again.
4. During this rebound we can choose to either cut the trade at cost, or stick with it. Our gut is telling us that something is not right, but we believe the pair is still ripe for a reversal so we stick with the trade. The move might be taking longer than we thought, but techs still point to a decline and there seems to be some good supply near the previous highs. We decide to take our third (and final) short @ 114.40. We are now short 3 lots average 114.00, (113.50+114.10+114.40). Stops are set 50 pips away (150 pips divided by 3).
5. The dollar proceeds to tank, taking out stops and quickly jumping another big figure. At this point you decide to disregard your money management rules and remove your stops – *it's already up almost 600 pips, it can't go higher! The pair is so overbought that it has to correct, and I will cut my position when it does.*

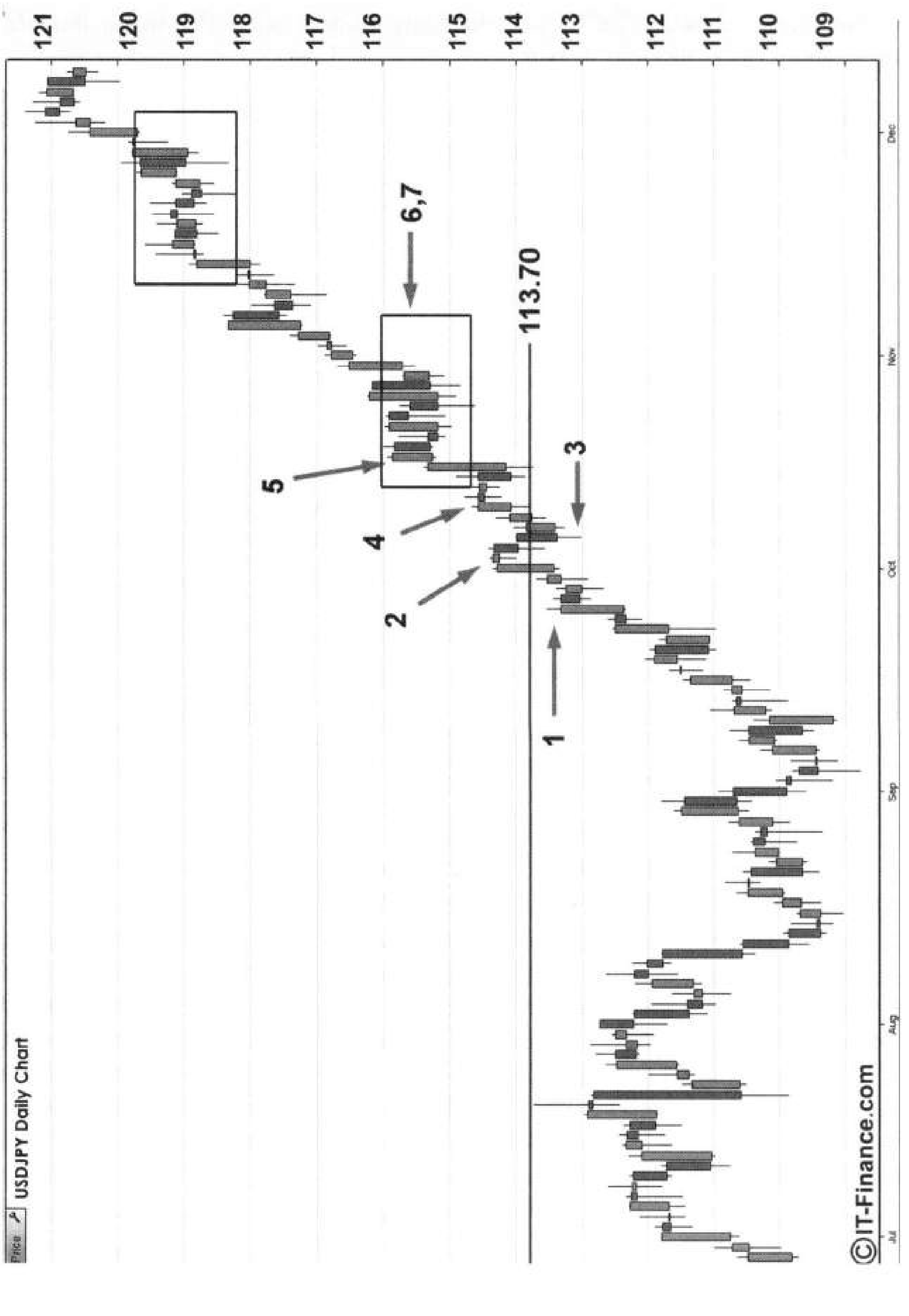
USDJPY Daily Chart
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Chart A.10

Trying to out-think the market is never a bright idea, since the market doesn't *have* to do anything. Whenever the market is faced with something it *can't* do, it quickly proceeds to do that exact thing. This is because the traders hoping for a reversal are all sitting on the same trade, and vulnerable.

We know we are in trouble. We are short average 114.00, and with dollar-yen printing 115.50 we have an unrealized 450 pip (150 × 3) loss ... well above the initial 150 that we were willing to risk. This simple trade is now looking like it may very well take a large chunk out of our account, and the stress level increases. We are tempted to simply stop the pain, get rid of it all and regroup. Stubborn traders may be tempted to double up and bet on a decline.

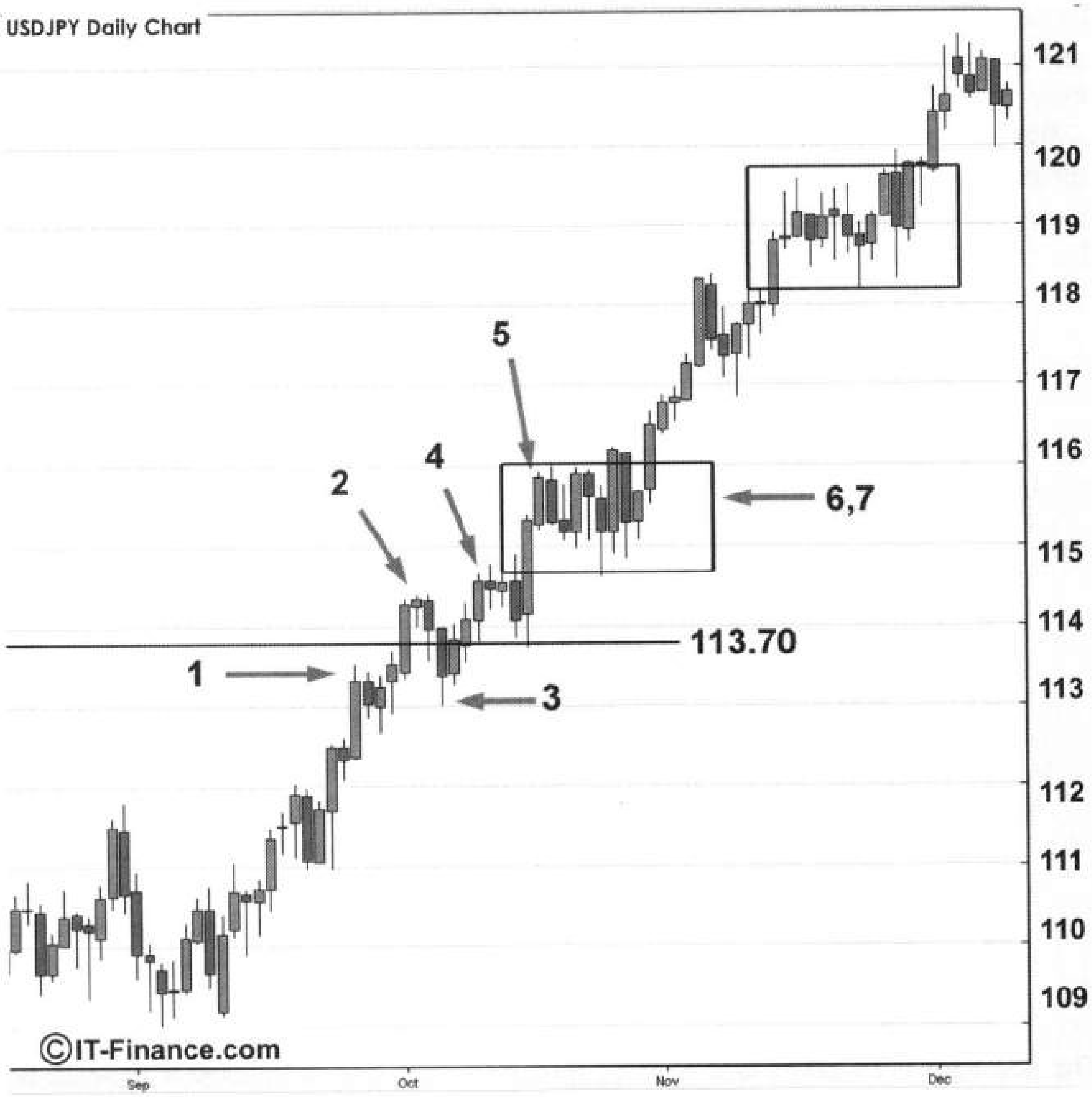

Chart A.11

Shrewd traders do neither. After getting over the initial shock of the situation we take a deep breath, some aspirin, and decide to take control of the situation; we're going to fight tooth and nail until we come out of this trade alive.

We re-analyze the situation from an objective point of view and realize that the market has effectively proven us wrong. Pride has no place in FX trading; the market proved us wrong and we move forward. The USDJPY is not going to reverse lower to 109, and if anything, it looks like it wants to go higher.

The one thing that saves us during these bad trades is the same thing that saves dealers, namely the fact that that currencies do not move straight up (or down), but rather have a tendency to make a move, consolidate, then continue. This stair-case pattern is evident in most financial instruments, and simply indicates the accumulation/distribution stages of a move. Longs may take some profit and shorts may get stopped out, and both need time to set new positions. You should consider these consolidation periods as your window of opportunity (box 6-7).

With our new understanding of the situation we look for a dip to free up part of our position. This soon happens and the pair dips to test the 115 level.

6. We get rid of one lot at 115.10. We take a realized loss of 160pips (first in, first out). Now we are short 2 lots avg. 114.25, with an unrealized loss of 170 pips. Taking the loss hurts, but we have now given ourselves more flexibility (and margin).

The flexibility we have given ourselves means that whatever the yen may do at this point, we can handle.

7. We wait for a range to develop. This soon takes place as a rough 100 point range develops and trades for almost 10 straight days. We recognize that a range has developed and begin to actively trade the third lot that we freed up. Shorting near 116, we buy it back near 115. This technique proves effective and we are nimble enough with intra-day trades to quickly pocket a good amount of pips to offset some of the loss. With some quick range-trading we have put on 7 trades averaging 30 pips each which wipes out our realized loss and brings our unrealized loss to a much more manageable 120 pips. Depending on our outlook, we can then choose to either cut the whole position (in accordance to our original 150 pip stop) or continue to trade this way until a good amount of pips have been pocketed to offset the loss.

The key here is to never *add* to your total exposure, but to manage it instead. By pocketing all of those small amounts, you are effectively bringing up your average cost and making it easier for you to get out with a reasonable loss. Getting out with a small loss when originally faced with a position deep in the red often feels better than taking a profit, since you know that you fought in a market that was against you; and survived. Further satisfaction comes from the fact that you know retail traders are getting wiped out as the pair moves higher!

Remember these simple steps to trading out of a bad position

- Unload part of your position on a dip
- Wait for a consolidation to take place and a range to form
- Trade the range with multiple quick ins-and-outs
- Minimize your loss and get out. Don't try to turn a losing trade into a winner!

WHEN TO CUT AND RUN

Although you may be able to trade yourself out of most positions, there are times when you should take a loss and simply get out. If a sharp move happens for some unexpected reason (9/11, political event, etc.) then it's best to get flat as soon as possible. No one has time to evaluate the ramifications of such an event, so it is better to get out and re-evaluate later.

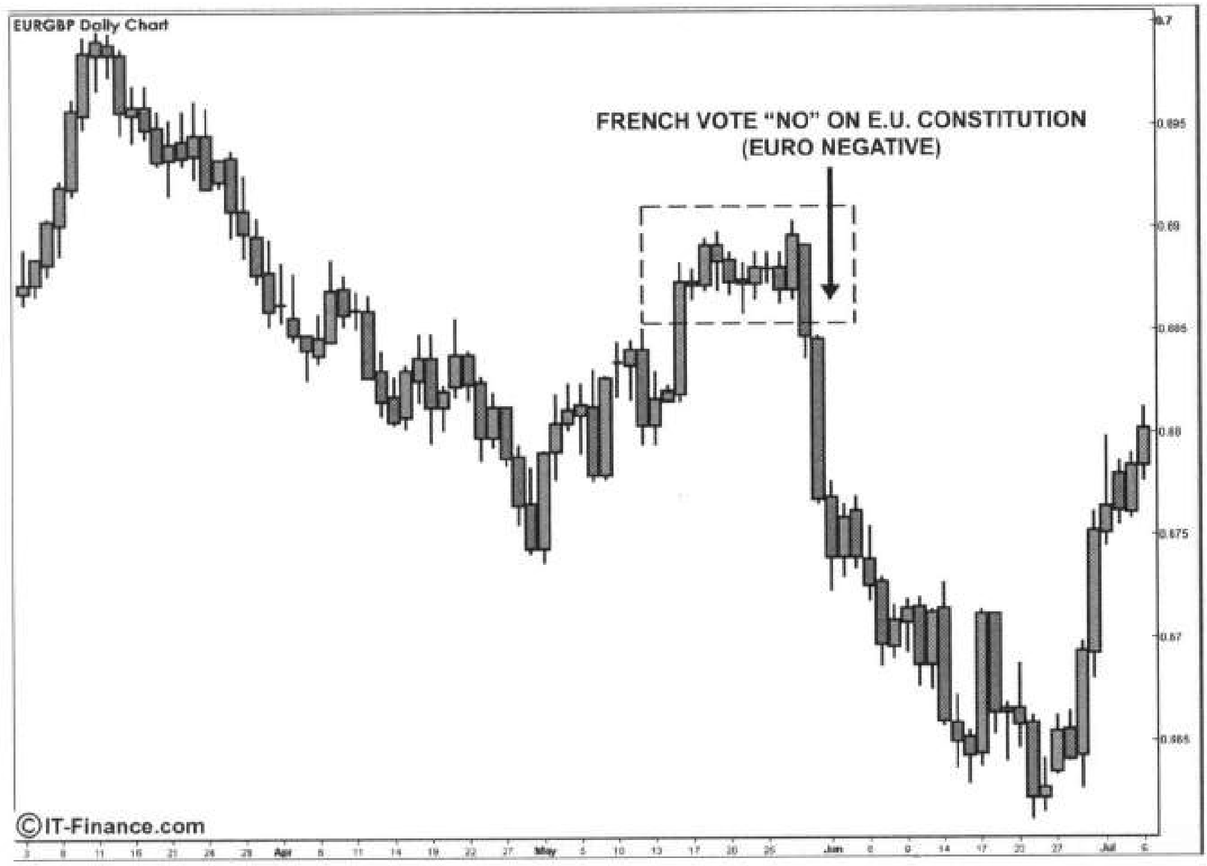

Chart A.12 Political decisions can have long-lasting effects on a currency and should not be faded.

In general, if a trade feels off at some point, then you should think about getting out. It will probably save you much heartache in the long-run. The "gut" simply represents your subconscious mind, which is constantly processing and storing information that you may not be aware of. The longer you trade, the more reliable your gut reaction will be, since it will have accumulated a vast knowledge base of charts and patterns over all those years. You've probably seen similar set-ups before but cannot remember them, and your gut feeling is your subconscious flashing warning signs. This information should not be taken lightly and good traders learn to trust their instincts.

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NOTES

Speaking Like a Dealer

To new participants in the FX market, some of the terminology and parlance may at first be a bit confusing because of the nature of the market. By definition every spot transaction is made up of two transactions, making all moves relative to one another. One must be especially careful when talking about the "strength" or "weakness" of a currency, since it may be easily misconstrued by others.

For example, you are going long USDJPY but are unsure so you decide to phone up a dealer friend to ask for his opinion. He may tell you that in his opinion 'the yen is going to rise". Is he talking about USDJPY going up or the Yen increasing in value (USDJPY declining)? For this reason professionals have long given nicknames to the major currency pairs in order to clear up what they are discussing:

Euro (EURUSD); Cable (GBPUSD);[1] Loonie (USDCAD); Swissy (USDCHF)
Dollar–Yen (USDJPY)

If you ask someone their opinion on the Loonie, it is the USDCAD rate you are asking about, not the Canadian dollar itself. Things get even more complicated for FX operators when discussing bid and offered prices, since they only make sense when you know who is doing the bidding and the offering (a dealer's bid and offer are the opposite of a client's). However, thankfully this does not affect the average trader.

To communicate effectively with other FX professionals, a new trader should make sure that he is well-versed in all of these terms, or risk costly misunderstandings. Also interesting is the way FX professionals interact over the phone when dealing. Traditionally, a trader may say "mine" when buying and "yours" when selling. A conversation in a fast-moving market may go something like this:

Trader: *Hi Frank, what's your price on 10 (million) Euro (EURUSD)?*
Dealer: 55/56

[1]The sterling/dollar nickname comes from the trans-Atlantic cable that was used for a long time to transmit prices, and the USDCAD nickname actually comes from the Canadian Loon (a bird) pictured on the side of the one-dollar Canadian coin.

Trader: *Mine!*
Dealer: Done 10 at 56
Trader: *How do you stand?*
Dealer: 56/58
Trade: *Mine!*
Dealer: Done 10 at 58
Trader: *How do you stand?*
Dealer: 60/65
Trader: *Yours! Etc.*

FX Glossary

Appreciation Describes a currency strengthening in response to market demand rather than by official action.

Ask Price Ask is the lowest price acceptable to the buyer.

Back Office Settlement and related processes.

Bank Rate The rate at which a central bank is prepared to lend money to its domestic banking system.

Base Currency The currency in which the operating results of the bank or institution are reported.

Base Rate A term used in the UK for the rate used by banks to calculate the interest rate to borrowers. Top quality borrowers will pay a small amount over base.

Basis Point One per cent of one per cent.

Bear A person who believes that prices will decline.

Bid Price Bid is the highest price that the seller is offering for the particular currency at a particular moment; the difference between the ask and the bid price is the spread. Together, the two prices constitute a quotation. The bid–ask spread is stated as a percentage cost of transacting in the foreign.

Big Figure Refers normally to the first three digits of an exchange rate that dealers treat as understood in quoting. For example, a quote of "30/40" on dollar mark could indicate a price of 1.2530/40.

BIS Bank of International Settlement.

Bretton Woods The site of the conference that in 1944 led to the establishment of the post-war foreign exchange system that remained intact until the early 1970s. The conference resulted in the formation of the IMF. The system fixed currencies in a fixed exchange rate system with 1 % fluctuations of the currency to gold or the dollar.

Broker An agent who executes orders to buy and sell currencies and related instruments either for a commission or on a spread. Brokers are agents working on commission and not principals or agents acting on their own account. In the foreign exchange market brokers tend to act as intermediaries between banks bringing buyers and sellers together for a commission paid by the initiator or by both parties. There are four or five major global brokers operating through subsidiaries, affiliates, and partners in many countries.

Bull A person who believes that prices will rise.

Bull Market A market characterized by rising prices.

Cable A term used in the foreign exchange market for the US dollar/British pound rate.

Central Bank A central bank provides financial and banking services for a country's government and commercial banks. It implements the government's monetary policy as well, by changing interest rates. The Reserve Bank of India is the central bank of India, which performs the role of maintaining orderly conditions in the forex market by intervention through various instruments like cash reserve ratio, bank rate, open market operations, and moralization.

Confirmation A memorandum to the other party describing all the relevant details of the transaction.

Contract An agreement to buy or sell a specified amount of a particular currency or option for a specified month in the future.

Correspondent Bank A foreign bank's representative who regularly performs services for the bank, which has no branch in the relevant centre, e.g. to facilitate the transfer of funds. In the US this often occurs domestically due to interstate banking restrictions.

Counterparty The customer or bank with which a foreign exchange deal is executed.

Cross Rate An exchange rate between two currencies, usually constructed from the individual exchange rates of the two currencies, as most currencies are quoted against the dollar.

Currency The type of money that a country uses. It can be traded for other currencies on the foreign exchange market, so each currency has a value relative to another.

Currency Basket Various weightings of other currencies grouped together in relation to a basket currency (e.g. ECU or SDR). Sometimes used by currencies to fix their rate, often on a trade-weighted basket.

Deal Date The date on which a transaction is agreed upon.

Deal Ticket The primary method of recording the basic information relating to a transaction.

Dealer An individual or firm acting as a principal, rather than as an agent, in the purchase and/or sale of securities. Dealers trade for their own account and risk. This is in contrast to brokers who trade only on behalf of their clients.

Deficit Shortfall in the balance of trade, balance of payments, or government budgets.

Delivery The settlement of a transaction by receipt or tender of a financial instrument or currency.

Delivery Date The date of maturity of a contract, when the final settlement of a transaction is made by exchanging the currencies. This date is more commonly known as the value date.

Details All the information required to finalize a foreign exchange transaction, i.e. name, rate, dates, and point of delivery.

Discount Less than the spot price example: forward discount.

EFT Electronic Fund Transfer.

EMS European Monetary System.

European Union The group formerly known as the European Community.

Exchange Rate Risk The potential loss that could be incurred from an adverse movement in exchange rates.

Exotic A less broadly traded currency.

Expiry Date The last day on which the holder of an option can exercise his right to buy or sell the underlying security.

Fed The United States Federal Reserve. Federal Deposit Insurance Corporation Membership is compulsory for Federal Reserve members. The corporation had deep involvement in the Savings and Loans crisis of the late 1980s.

Fixed Exchange Rate Official rate set by monetary authorities for one or more currencies. In practice, even fixed exchange rates are allowed to fluctuate between definite upper and lower bands, leading to intervention by the central bank.

Flat/Square Where a client has not traded in that currency or where an earlier deal is reversed, thereby creating a neutral (flat) position.

FOMC Federal Open Market Committee, the committee that sets money supply targets in the US, which tend to be implemented through Fed Fund interest rates, etc.

Foreign Exchange The purchase or sale of a currency against the sale or purchase of another.

Forex An abbreviation of foreign exchange.

Forward Contract Sometimes used as synonym for "forward deal" or "future". More specifically, for arrangements with the same effect as a forward deal between a bank and a customer.

Forward Points The interest rate differential between two currencies expressed in exchange rate points. The forward points are added to or subtracted from the spot rate to give the forward or outright rate (depending on whether the currency is at a forward premium or discount).

Forward Rate The rate at which a foreign exchange contract is struck today for settlement at a specified future date that is decided at the time of entering into the contract. The decision to subtract or add points is determined by the differential between the deposit rates for both currencies concerned in the transaction. The base currency with the higher interest rate is said to be at a discount to the lower interest rate quoted currency in the forward market. Therefore the forward points are subtracted from the spot rate. Similarly, the lower interest rate base currency is said to be at a premium, and the forward points are added to the spot rate to obtain the forward rate.

Front Office The activities carried out by the dealer, normal trading activities.

Fundamental Analysis Analysis based on economic and political factors.

FX Foreign exchange.

GTC ("Good Till Cancelled") An order left with a dealer to buy or sell at a fixed price. The order remains in place until it is cancelled by the client.

Indicative Quote A market-maker's price that is not firm.

Inflation Continued rise in the general price level in conjunction with a related drop in purchasing power. Sometimes referred to as an excessive movement in such price levels.

Info Quote Rate given for information purposes only.

Interbank Rates The foreign exchange rates large international banks quote to other large international banks. Normally the public and other businesses do not have access to these rates.

Interest Rate Risk The potential for losses arising from changes in interest rates.

Intervention Action by a central bank to effect the value of its currency by entering the market. In India the intervention by the Reserve Bank of India is confined to the events of extreme volatility.

Kiwi Dealer slang for the New Zealand dollar.

Leading Indicators Statistics that are considered to precede changes in economic growth rates and total business activity, e.g. factory orders.

Liability In terms of foreign exchange, the obligation to deliver to a counterparty an amount of currency either in respect of a balance sheet holding at a specified future date or in respect of an unmatured forward or spot transaction.

LIBOR (London Inter Bank Offer Rate) British Bankers' Association average of interbank offered rates for dollar deposits in the London market based on quotations at 16 major banks. Effective rate for contracts entered into two days from the date appearing.

Limit Order An order to perform a deal at a superior rate to the current market level. Can be removed on completion (filled) or cancelled at any time (pulled).

Margin The required initial deposit of collateral to enter into a position or foreign exchange trade. This is held as a deposit on any running contract.

Margin Call A demand for additional funds to cover positions.

Market Value Market value of a foreign exchange position at any time is the amount of the domestic currency that could be purchased at the then market rate in exchange for the amount of foreign currency to be delivered under the foreign exchange contract.

Maturity Date for settlement of the transaction, which is decided at the time of entering into the contract.

Offer The rate at which a dealer is willing to sell the base currency.

One Cancels Other Order The execution of one order automatically cancels a previous order; also referred to as OCO or "one cancels the other".

Open Position Any deal that has not been settled by physical payment or reversed by an equal and opposite deal for the same value date. It can be termed as a high-risk, high- return proposition.

Outright Forward Foreign exchange transaction involving either the purchase or the sale of a currency for settlement at a future date.

Over The Counter (OTC) A market conducted directly between dealers and principals via a telephone and computer network rather than a regulated exchange trading floor. These markets have not been very popular because of the risks both the parties face in case the other party fails to honor the contract. They were never part of the stock exchange since they were seen as "unofficial".

Pip Also see "point". The term used in the currency market to represent the smallest incremental move an exchange rate can make. Depending on context, normally one basis point (0.0001 in the case of EUR/USD, GBD/USD, USD/CHF and 0.01 in the case of USD/JPY).

Point (1) 100th part of a percent, normally 10 000 of any spot rate. Movement of exchange rates are usually in terms of points. (2) One percent on an interest rate, e.g. from 8 to 9 %. (3) Minimum fluctuation or smallest increment of price movement.

Position The netted total exposure in a given currency. A position can be either flat or square (no exposure), long (more currency bought than sold), or short (more currency sold than bought).

Range The difference between the highest and lowest price of a future recorded during a given trading session.

Rate The price of one currency in terms of another.

Reserve Currency A currency held by a central bank on a permanent basis as a store of international liquidity; these are normally the dollar , euro, and sterling.

Resistance A price level at which the selling is expected to take place.

Revaluation Increase in the exchange rate of a currency as a result of official action.

Rollover Where the settlement of a deal is carried forward to another value date based on the interest rate differential of the two currencies. Example: next day.

Selling Rate Rate at which a bank is willing to sell foreign currency.

Settlement Actual physical exchange of one currency for another.

Settlement Date It means the business day specified for delivery of the currencies bought and sold under a foreign exchange contract.

Short A market position where the client has sold a currency they do not already own. Usually expressed in base currency terms.

Slippage The difference between the price a trader expects to be filled at and the price they are actually filled at.

Spot (1) The most common foreign exchange transaction. (2) Spot refers to the buying and selling of the currency where the settlement date is two business days forward.

Spot Price/Rate The price at which the currency is currently trading in the spot market.

Spread The difference between the bid and ask price of a currency.

Stable Market An active market that can absorb large sales or purchases of currency without having any major impact on the interest rates.

Sterling British pound.

Stop Loss Order Order given to ensure that should your trade lose a certain percentage, the position will be covered even though this involves taking a loss. Profit orders are less common.

Support Levels A price level at which the buying is expected to take place.

Swap The simultaneous purchase and sale of the same amount of a given currency for two different dates, against the sale and purchase of another. A swap can be a swap against a forward. In essence, swapping is somewhat similar to borrowing one currency and lending another for the same period. However, any rate of return or cost of funds is expressed in the price differential between the two sides of the transaction.

SWIFT Society for Worldwide Inter-bank Financial Telecommunication is a clearing system for international trading.

Swissy Market slang for Swiss franc rate.

Technical Analysis The study of the price that reflects the supply and demand factors of a currency. Common methods are flags, trend lines, spikes, bottoms, tops, pennants, patterns, and gaps.

Technical Correction An adjustment to price not based on market sentiment but technical factors such as volume and charting.

Tick A minimum change in price, up or down.

Trade Date The date on which a trade occurs.

Transaction Date The date on which a trade occurs.

Value Date Settlement date of a spot or forward contract. Also known as maturity date.

Value Spot Normally settlement for two working days from the date the contract is entered into.

Value Today Transaction Transaction executed for same day settlement; sometimes also referred to as "cash transaction".

Volatility A measure of the amount by which an asset price is expected to fluctuate over a given period. Normally measured by the annual standard deviation of daily price changes (historic). Can also be implied from futures pricing, which is referred to as implied volatility.

Whipsaw Dealer slang for a condition of a highly volatile market where a sharp price movement is quickly followed by a sharp reversal.

Working day A day on which the banks in a currency's principal financial centre are open for business. For foreign exchange transactions, a working day only occurs if the bank in both money centers are open for business.

Yard Dealer slang for a billion dollars.

Trading Maxims

12-01-1900, NEW YORK TIMES, p. 8: If the Wall Street proverb, to the effect that "nothing is so timid as a million dollars, except two millions," is true, the timidity of fifty or seventy-five millions may be assumed to represent abject terror of any innovations involving expense and presenting unknown difficulties. ***The bigger you become, the harder it is to trade.***

12-27-1913, NEW YORK TIMES, p. 8: The subject being strictly sordid and mundane, it may be permissible to quote the Wall Street maxim that "everything is in the price". ***Everything is priced-in by the market.***

03-14-1931, NEW YORK TIMES, p. 43: "Good times, good fellowship – hard times, hard faces" is a proverb brought to the Wall Street mind recurrently these days ... ***A trader's life....***

07-18-1959, NEW YORK TIMES, pg. 19: Lorillard introduced its long-heralded menthol filter cigarette and fell 1 3/8 on the Wall Street maxim to "sell on the news". ***News are anticipated and usually already priced-in by professionals, thus there is no reason to take the price higher.***

11-08-1969, NEW YORK TIMES, p. 47: The pyrotechnics in telephone and in the glamour-laden computer issues came from heavy buying by mutual funds, other institutions and market traders following that old adage, "Don't fight the tape". ***Trade the price action. If the price is going up then demand must outstrip supply, irrespective of any outside news or backdrop. Always trade in the prevailing direction.***

03-05-1985, NEW YORK TIMES, p. C5: As they say in the corporate corridors, nobody ever got fired for buying IBM. ***Money managers protect their jobs above all else, even at the expense of performance.***

6-17-1998, NIGHTLY BUSINESS REPORT: There's an old Wall Street saying that cash is trash. ***The search for yield is constant.***

8-2-1998, FORBES MAGAZINE, p. 265: What's been going on with Amazon stock is best explained by an old Wall Street maxim: "A stock and a company are not always the same thing". ***When emotions enter the markets, irrational things happen***.

8-6-1998, CHRISTIAN SCIENCE MONITOR, p. 1: There is an old Wall Street saying that the stock market has anticipated eight of the last three recessions. ***Analysts are wrong more than they are right***.

8-12-1998, WALL STREET JOURNAL EUROPE, p. UK7B: Mr Manley recalls an old Wall Street saying: "If you are going to panic, panic early". ***When in doubt, get out!***

9-21-1998, BUSINESS WEEK, p. 114: Grant, the newsletter editor, likes to quote a play-it-safe Wall Street maxim: "Never meet a margin call". ***Never let a losing position run away from you. Cut your losses short***.

10-12-1998, RICHMOND TIMES-DISPATCH: Guy Chance, director of marketing strategy at Scott & Stringfellow Inc., recalled an old Wall Street maxim during a recent selling spree: "This is when money returns to its rightful owners". ***The "smart money" always ends up on top***.

4-11-1999, SOUTH CHINA MORNING POST, p. 3: It proves an old Wall Street saying – when you rob a whorehouse, take the piano player too, because no one is entirely innocent. ***Money attracts sharks***.

10-4-1999, SEATTLE POST_INTELLIGENCER, p. C3: As the Wall Street proverb says: "You can't eat relative performance". ***You can't be satisfied with beating your peers, you have to learn to make money in down times***.

3-29-2000, YOMIURI SHIMBUN/DAILY YOMIURI: There is a Wall Street maxim that says a bullish market is born amid pessimism, grows up under skepticism, matures with optimism, and dies with euphoria. ***Most of the people are wrong most of the time***.

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