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5 Reasons for the Importance...

# 5 Reasons for the Importance of Currency Pair Correlation in Trading

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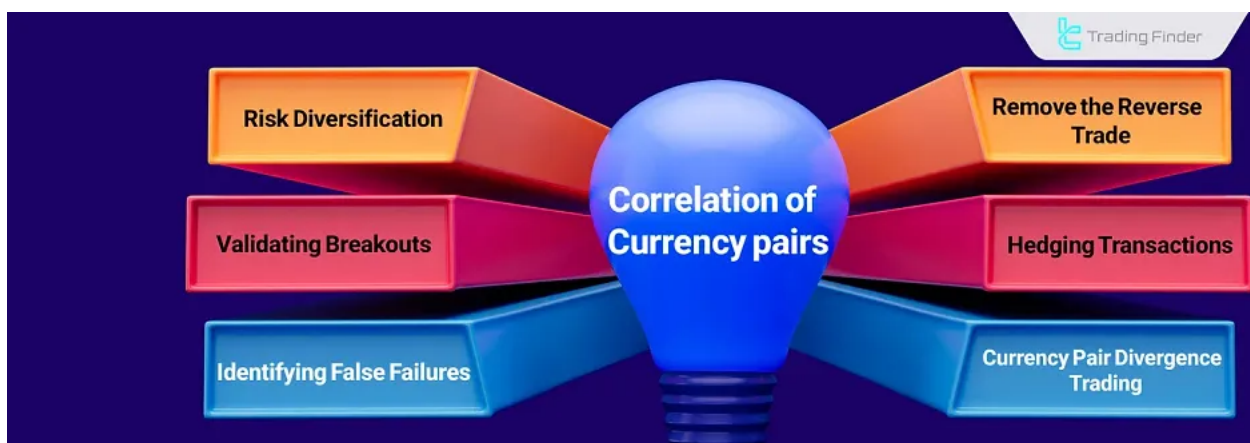
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In **currency pairs** with similar or completely opposite characteristics, a strong negative or positive correlation is formed; the **correlation between currencies in Forex** can be used to eliminate reverse trades and implement **risk management** techniques to prevent severe or unintended losses.







The similar trend and correlation of AUD and NZD against the USD are evident

## 2- Profiting from Temporary Divergences

Occasionally, highly correlated pairs diverge due to **political, geopolitical,** or **economic** factors. Traders can capitalize on the expected **reversion to correlation** by entering positions aligned with the anticipated price reversal.

### Example of Profiting from Divergence

During **political uncertainty in Germany**, EUR/USD weakens while GBP/USD remains stable or strengthens. Post-election, EUR/USD is likely reverts to its correlation with GBP/USD. A trader could profit by going **long in EUR/USD**.

## 3- Hedging Positions

**Understanding the nature of assets and currency pair correlations is crucial for hedging and risk control.**

For example, when **market sentiment** is risk-averse due to war, a trader may

open **long positions on gold** and a **safe-haven currency (such as the Swiss Franc)**.

However, since **geopolitical risks are unpredictable** and there is a possibility of a peace agreement, the trader also enters a **long position in line with market risk appetite (Risk On assets)**.

**In this scenario:**

⚡ **If the war continues**, the **Risk On position** will hit its stop-loss, but this loss will be offset by the **gold and Franc positions reaching their profit targets**;

⚡ **Conversely, if the war risk suddenly dissipates**, the **gold and Franc positions** will hit their stop-loss, but the **hedging Risk On position** will reach its target, compensating for part of the loss.

## 4- Testing Breakouts and Technical Confirmation

Comparing correlated pairs helps validate breakouts at key **support/resistance levels**.

For example, the **NZD/USD** currency pair has a positive correlation with **AUD/USD** and a strong negative correlation with **USD/CAD** and **USD/CHF**; Now, the NZD/USD currency pair has **broken a significant technical support**. In this case, there are two scenarios:

### Confirmed Breakout in Scenario 1

Other correlated pairs (e.g., AUD/USD, USD/CAD) also break their respective key levels, confirming the trend.

### False Breakout in Scenario 2

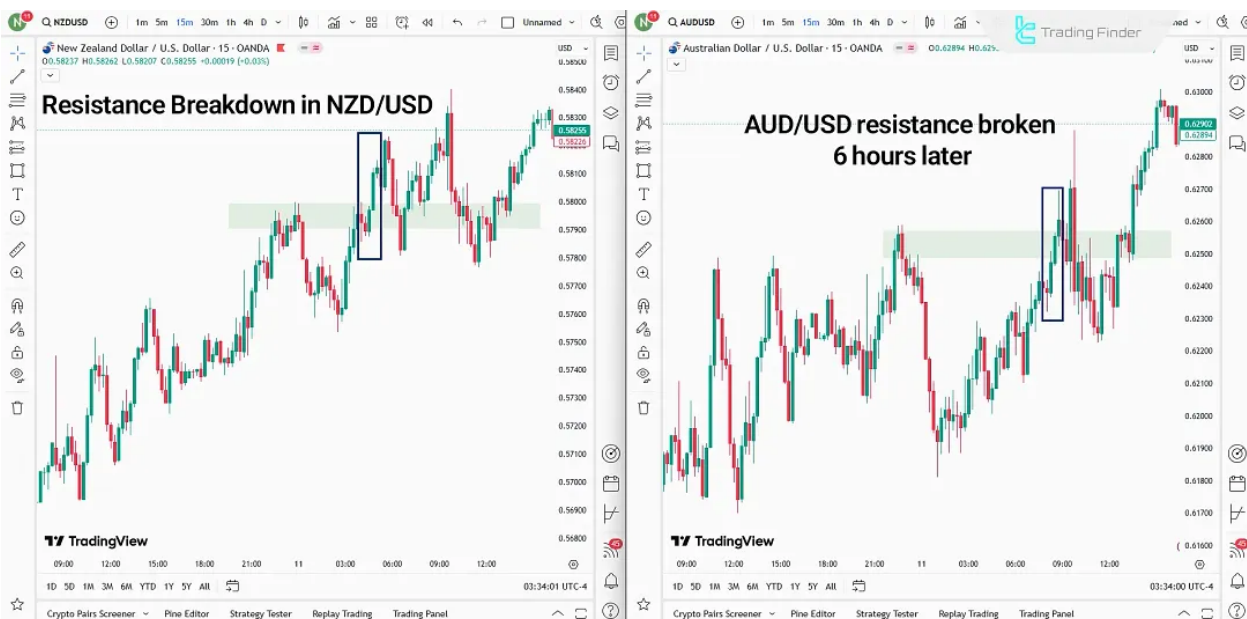
Other pairs **do not weaken** against the USD, suggesting NZD's weakness is

due to **local economic/political factors**.

You can use the TradingFinder tool to identify fake breakouts:

- ⚡ **False Breakout Indicator for MT4**
- ⚡ **False Breakout Indicator for MT5**
- ⚡ [False Breakout Indicator for TradingView](#)

For example, in the image below, the similar fluctuations of the **AUD/USD** pair with the **NZD/USD** pair are highlighted; in the NZD/USD pair, a **resistance level was broken**, and three hours later, the AUD/USD pair also broke through a **similar resistance level**.



Breaking a similar resistance level in AUD/USD and NZD/USD

## 5- Risk Diversification

With highly correlated currency pairs, risk can be diversified.

For example, a trader has a bearish bias on the Dollar and intends to open a **short position** on **EUR/USD** with a 0.5% risk; To diversify the risk, they can short EUR/USD with a 0.25% risk and short GBP/USD with the remaining 0.25% risk.

In fact, if an **unforeseen risk** occurs with the euro, only 0.25% of the account will be affected.

## Conclusion

Currency correlation is an effective tool for traders, helping to **reduce unwanted losses** and **avoid unnecessary trades** by **eliminating countertrades**, taking advantage of temporary divergences, and implementing smart hedging strategies.

Considering the correlation between currencies, a trader can distribute their trading risk across two currency pairs that have a **positive correlation**.





## FAQs

Why is currency correlation important in trading?

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Why are counter trades ineffective? 

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How to profit from temporary divergences? 



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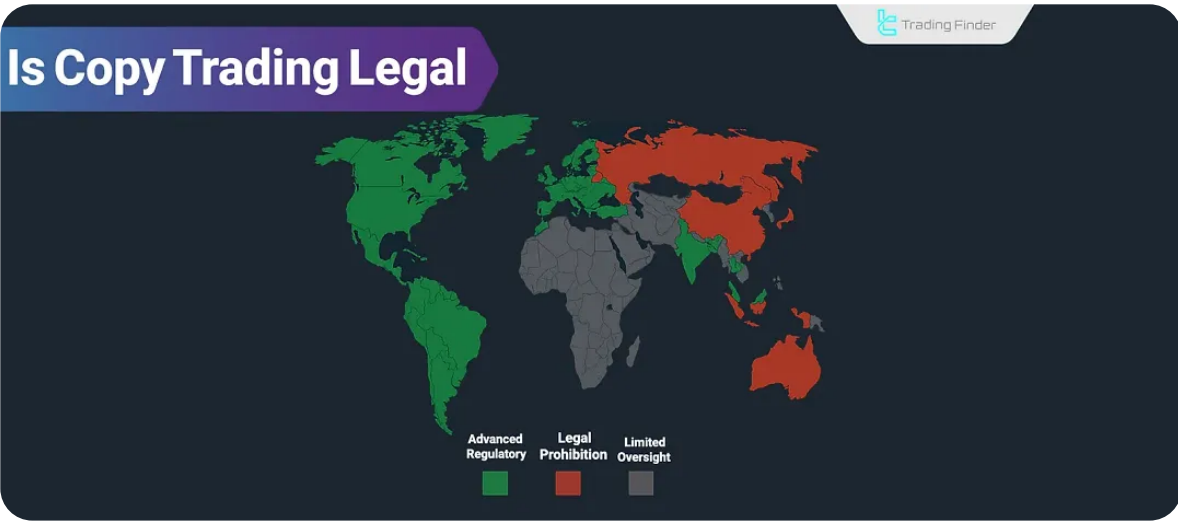
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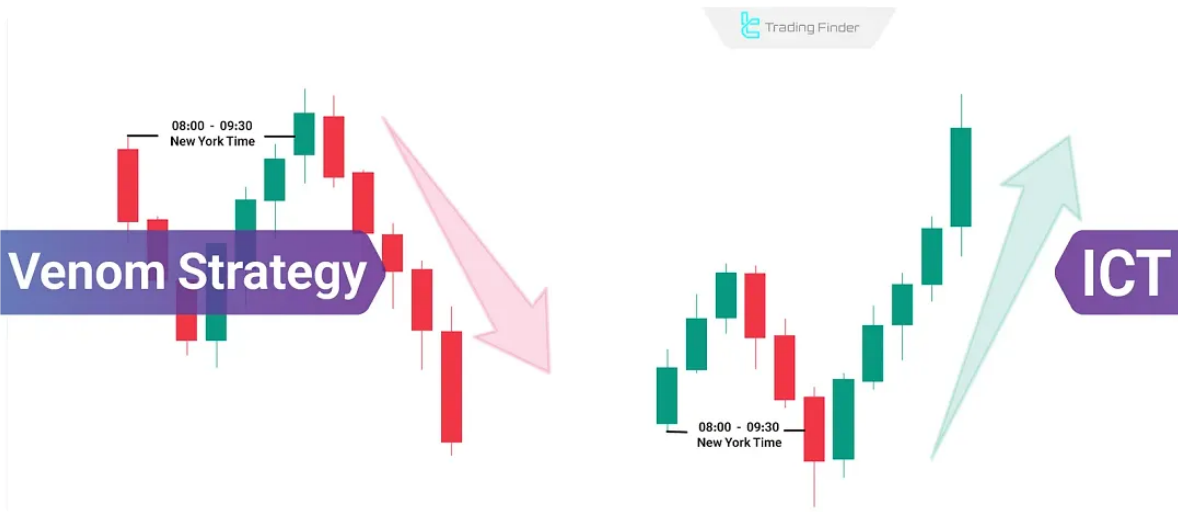
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